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# TEL It Like It Is:
## *Why Texas Needs Spending Limit Reform*

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### Key Points

- Although Texas has done better economically and in many ways fiscally than most states during much of the past two decades, consistently limiting the state's budget needs improvement.
- The 2016-17 all funds budget of $209.4 billion is up 8.8 percent above population growth plus inflation since 2004, costing a family of four $1,251 more per year.
- A primary factor driving excessive budget growth is the state's weak tax and expenditure limit (TEL).
- Legislators can strengthen the TEL by capping the total budget, basing the growth on the lowest of three metrics, and requiring a supermajority vote to exceed it.
- If these reforms would have been in place since 2003, Texans could have $17 billion more in their pockets while covering the needs of the state.

Although Texas has done better economically and in many ways fiscally than most states during much of the past two decades (Ginn 2015, 14), one area that needs improvement is consistently controlling the state's budget growth. Since spending is taxation, especially in Texas as spending must be paid for by taxpayer dollars given the state's balanced budget amendment, limiting budget growth is essential for keeping the economy competitive to support prosperity.

Texas' budget of $209.4 billion in fiscal years 2016-17 (Legislative Budget Board (LBB) 2015, 3) is an increase of 69 percent over the $124 billion spent in 2004-05, according to Heflin, et al. (2015, 1). It is important to compare this increase with the state's population growth plus inflation. This key metric provides a measuring stick for fiscal responsibility by accounting for potential changes in demand for government services and in the cost of providing them.

Using actual data and projections in each budget period,* we estimate that population growth plus inflation has increased by a compounded 55 percent since 2004-05. Adjusting for this, Texas' budget is up 8.8 percent above the pace of population growth plus inflation since 2004, amounting to excess spending of $16.9 billion in 2016-17. This excess spending has put heavy burdens on Texans costing a family of four $1,251 per year and on the economy contributing to slower economic growth from higher taxes and fees than otherwise, as has been the case in high versus low-taxing states (Moore, et al. 2015, 8-9).

Legislators have recently practiced some budget constraint, particularly during the 2003, 2011, and 2015 legislative sessions when they passed budgets that increased by less than population growth plus inflation. However, in 2005 and again in 2013 the subsequent budget adopted by the Legislature increased by significantly more than this key metric, erasing most of the gains from the previous sessions (Heflin, et al. 2015, 1). While the Foundation will be working with legislators to keep the 2018-19 budget within population growth plus inflation, a better path forward to keep this cycle from repeating would be to put this limit into law.

Growth in the budget above population and inflation during much of the last decade has expanded the size and scope of government indicating potential weaknesses in the state's tax and expenditure limit, otherwise known as a TEL. A TEL is simply an institutionalized restriction on the growth of tax revenue and/or government spending with a goal of restraining budget growth to a level that can fund essential government services without over-burdening taxpayers with paying high taxes and fees.

The Texas Legislature passed legislation in 1978 that initially put a constitutional amendment to implement a TEL (HJR 1, 1-8). After subsequent changes, Article VIII Section 22(a) of the Texas Constitution (2015) defines the limit as the following: "In no biennium shall the rate of growth of appropriations from state tax revenues not dedicated by this constitution exceed the estimated rate of growth of the state's economy." Since spending growth in every biennium is controlled by, and roughly equivalent to, appropriations, this explicit growth cap on a portion of state appropriations limits state spending, which is why it is often called a "spending limit." Subsequently, legislators added Texas Government Code (2015) in Section 316.001 that directed the LBB to estimate

** Quarterly Texas population data are actual and projections from Moody's Analytics provided by the LBB in November 2014. Quarterly U.S. consumer price index (CPI) data are actual from the Federal Reserve (2015) and projections from Moody's Analytics provided by the LBB in November 2014.*

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the state's economic growth by total personal income for the upcoming two-year fiscal period and Section 316.006 requires a majority vote to exceed the growth limit.

Three key design flaws with the TEL contribute to excess budget growth:

1. **Less than half of the budget is under the limit.** In Article VIII, Section 22(a) of the Texas Constitution (2015), the only appropriations subject to the spending limit are those derived from "state tax revenues not dedicated by this constitution," which is about 45 percent of the 2016-17 budget (LBB, 23-24). The rest are funds appropriated from federal funds, fees, and constitutionally-dedicated funds. This incentivizes legislators to constitutionally dedicate funds and find other ways to keep the budget growth below the spending limit while avoiding total budget constraint, which is the full measure of the footprint of government.
2. **The measure establishing the budget limit's growth rate.** The Texas Constitution (2015) requires that the limit be based on growth in the state's economy, which the statute says must be measured by personal income. Research shows this tends to be a poor measure as it does not effectively limit spending, costing taxpayers more over time (Heflin and Ginn 2015, 3-4).
3. **Texas currently projects economic growth for almost three years.** Since estimates of personal income growth are submitted to the LBB (2014, 11) by several groups in November before a regular legislative session for the next two fiscal years (i.e. each fiscal year is from September 1 to August 31), the projections are for about 33 months. It is difficult to predict the next week's price of gasoline much less the growth rate of a dynamic economy of $1.3 trillion in personal income for multiple years, leading to large discrepancies between actual and projected growth rates, as illustrated by Heflin and Ginn (2015, 5).

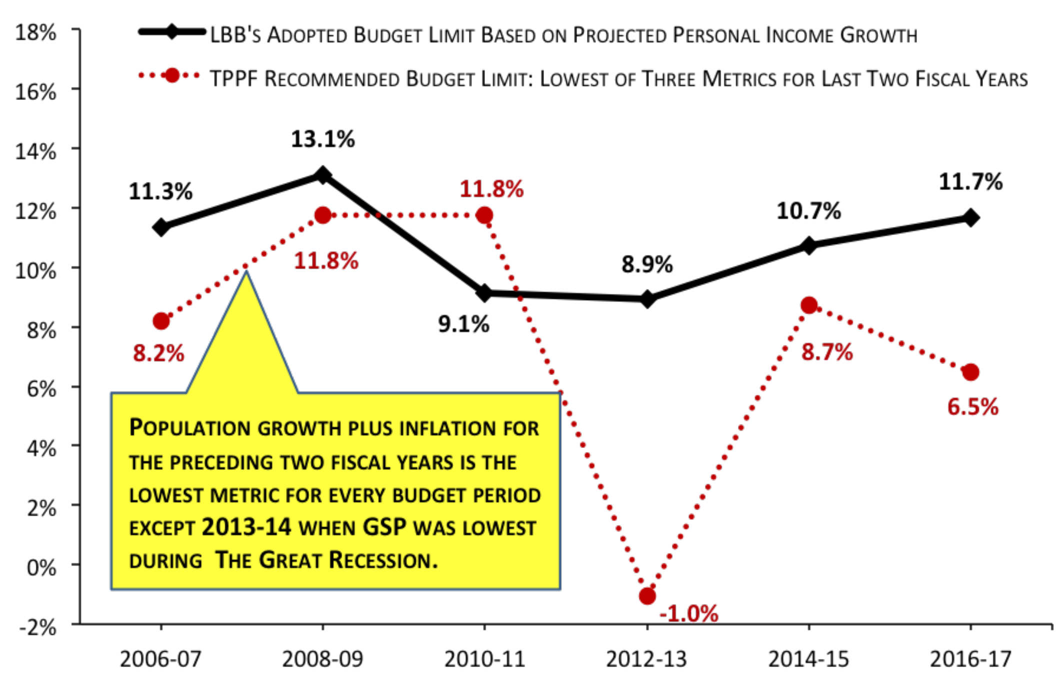
These flaws highlight why Texas' spending limit does not work as intended, but it can be strengthened with modest changes.

## Recommendations

To slow the growth of the total budget and limit the state government's growing burden on Texans, we recommend that legislators make the following reforms to the Constitution or in statute (see SB 361, 1-6) to improve the state's TEL:

- Apply the TEL to the total budget and to all state funds;
- Base the limit on the growth rate of population plus inflation, personal income, or gross state product (GSP), whichever is *less*, for the two years immediately preceding the regular legislative session when the budget is adopted; and
- Require a supermajority vote of each chamber to exceed its limit rather than just the simple majority vote in statute today.

### Figure 1: TEL Reform Would Better Limit Budget Growth Than Personal Income

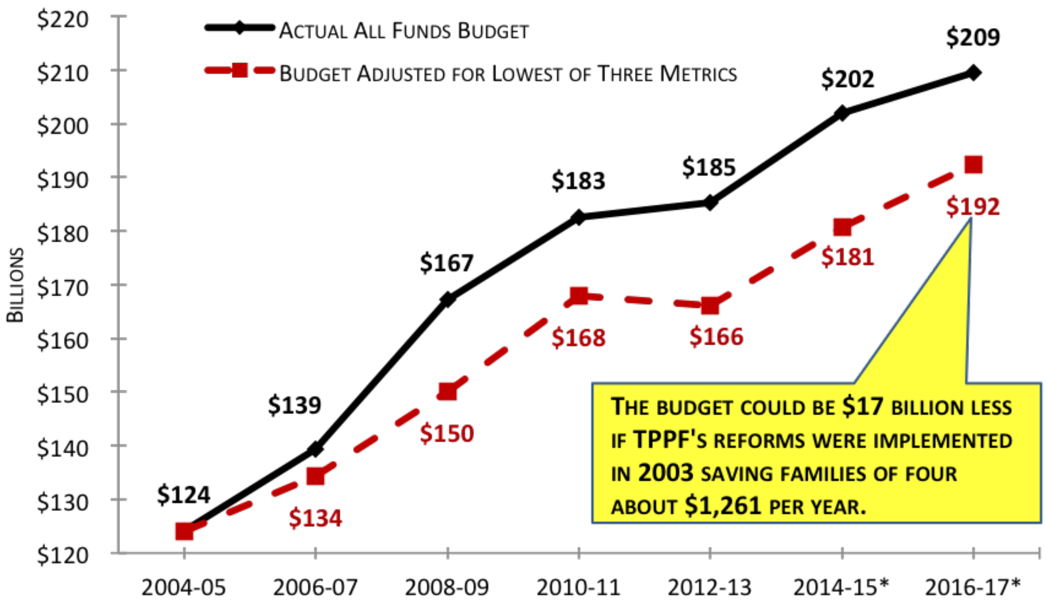



*Source: Legislative Budget Board, Federal Reserve*

**Figure 1** illustrates the growth rate of personal income adopted by the LBB for each two-year budget period and the calculated growth rates according to our recommendations. Our reform based on actual data instead of a moving target of projected personal income would have been lower in every period except for the 2010-11 budget period. The average growth rate as determined by the LBB is 10.8 percent during this period and ours is 7.6 percent.

Of course, these averages do not account for compounded changes over time. Figure 2 presents the budget adjusted for these growth rates to consider what the budget would look like if the Legislature would have implemented our recommended reforms in 2003 and followed it since the 2004-05 budget. This shows that taxpayers would be asked to support a substantially smaller budget of $192 billion, $17 billion less than the current two-year budget.

Figure 2: Texas' Government Budget Growing Faster Than Reformed TEL Since 2004**




*Source: Legislative Budget Board, Federal Reserve*

The 84th Texas Legislature proved that this TEL reform could work by holding the increase in appropriations of the total budget to 3.6 percent, which was below the 6.5 percent limit calculated by the lowest metric, population growth plus inflation, for the preceding two fiscal years. Legislators were good stewards of tax dollars overall by prioritizing the budget increase of $7.3 billion towards education, health care, transportation, border security, and other items that met the needs of the state and more while providing a historic $4 billion in tax relief and leaving money on the table. Though there are reasonable disagreements about how every taxpayer dollar was appropriated, an increase in the total budget of this magnitude is a step in the right direction to reducing the overall footprint of government.

## Conclusion

To fund budget priorities first without expanding the size of government more than Texans' ability to pay, the state's weak spending limit should be reformed to cap the entire budget, change the growth limit calculation, and require a supermajority to exceed the limit. If these reforms would have been made in 2003, Texas families of four could have $1,261 more in their pockets to put food on their table, save for a rainy day, or choose other options that best meets their needs. Although it is encouraging that the 84th Legislature proved it is possible to restrain budget growth to below our recommended limit while meeting the needs of Texans, this restraint must be continued during the next legislative session and beyond, preferably with passage of a stronger TEL so that more money is not diverted from hard-working Texans.

*** Budget data are the latest spending measures from 2004-05 to 2014-15 and appropriations for 2016-17. Adjusted budget estimates are calculated based on TPPF's recommended TEL reform.*

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