



## *LIFT Perspective*

*Limited Government Series*

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### **Strengthening Taxpayer Protection: The Imperative for Budget Reforms**

#### **The Spending Explosion**

Total annual state spending grew from \$47.7 billion to \$64.7 billion between 2000 and 2005 – an increase of more than 30%. The increase is most marked in two areas: health and human services spending jumped from \$16.3 billion in 2000 to \$24.3 billion in 2005, and education spending grew from \$19.1 billion to \$21.8 billion.<sup>1</sup> The 79<sup>th</sup> Legislature left taxpayers with a \$139.4 billion biennial budget to fund. This represented a 19% increase over the budget enacted just two years previously, and outstripped the growth in personal income over the same period.<sup>2</sup>

While it is often suggested that population increases fuel the need for budget growth, general revenue spending has far exceeded growth in population, inflation, or gross state product (GSP). Except during the 78<sup>th</sup> Session, the Legislature has not had the will to restrain spending when there was extra money available to the state. What is often characterized as a revenue problem is actually a *spending* problem. The exhaustion of more than \$19 billion in total budget surpluses since 1994-95<sup>3</sup> best illustrates the problem at the heart of the need for passing new mechanisms to restrain the growth in spending.

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<sup>1</sup> Comptroller of Public Accounts, "Texas Expenditure by Function, 1978-2005."

<sup>2</sup> "Budget Bloated by 'Good Causes'", Michael Quinn Sullivan, Texas Public Policy Foundation, June 2005.

<sup>3</sup> "Choosing a New Path – Using the Projected Budget Surplus for Property Tax Reduction," TCCRI, March 2006.

In response, Governor Perry proposed five budget reforms that he argues will “restrain spending, open the state government checkbook to the public, and end the disingenuous money-shifting shell games that allow funds to be spent on priorities other than what was promised.”<sup>4</sup>

### **Budgetary Reforms**

Gov. Perry’s five budget reforms are:

- Amend the constitutional spending limit so that it includes more areas of the budget to be a meaningful restraint on state expenditure ;
- Establish a process for returning dedicated funds to taxpayers if they are not used as intended;
- Increase the Governor’s ability to restrict spending by requiring more detailed budget line-items;
- Require all state agencies to publish their expenditures online; and,
- Amend the Constitution so that surplus revenue can be returned to taxpayers.<sup>5</sup>

While these reforms would undoubtedly bring additional efficiency and fiscal accountability to the state budget process, there is a more fundamental debate over fiscal policy that must take place.

The issue of whether government spending should be increased or decreased runs to the heart of the philosophical divide between conservatives and liberals. There are fundamental differences between the liberal philosophy of more spending and ever larger government, and the conservative philosophy which believes in the primacy of the family, importance of individual responsibility, and that government cannot solve every problem or meet every need.

This point is underscored by the reaction of several left-leaning policy and labor organizations to the Comptroller’s recent projection of a \$4.3 billion budget surplus when the biennial budget cycle ends in August. The *Fort Worth Star-Telegram*, reporting that the surplus can be attributed to higher than expected sales tax collections, describes how Anne Dunkelberg, Associate Director of the Center for Public Policy Priorities, called for the surplus to be spent on state programs:

“The state has enormous pent-up demand for services...We still have not restored the rolls of the Children’s Health Insurance Program and Medicaid back to their levels before the deep cuts in 2003.”<sup>6</sup>

Additionally, the Texas State Teachers Association has called for a portion of the surplus to be used to increase education funding and to give teachers a further pay raise on top of the \$2,000 across-the-board increase enacted during the most recent special session.

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<sup>4</sup> “Perry Outline Budget Reforms,” September 27, 2006; <http://www.rickperry.org/news/article/303>

<sup>5</sup> Governor Perry’s Budget Reform Initiative; <http://www.rickperry.org/pdf/BudgetReformProposal.pdf>

<sup>6</sup> “Surplus Likely to Be \$4.3 Billion,” *Fort Worth Star-Telegram*, October 4, 2006.

Laying its claim to a portion of the surplus, Environment Texas, an environmental advocacy organization, demanded that the Texas Department of Parks and Wildlife (TPWD) should receive additional funding to help maintain state parks; this neglects the fact that TPWD already receives a dedicated revenue stream for this purpose from the sales tax levied on sporting goods.

These responses to the announcement of a projected budget surplus emphasize the need for meaningful spending restraints to be enacted. Surpluses, by definition, represent an over-collection of taxes relative to budgeted spending, and should therefore be returned to taxpayers.

If the liberal approach results in increased taxation and spending, the conservative approach must not be simply to *maintain* pre-existing level of spending or merely slow the growth, but rather to find ways in which spending can be *reduced* through improved efficiency, elimination of wasteful and unnecessary expenditures, and ensuring that families and individuals take responsibility for their well-being to the greatest extent possible.

In its State Finance Task Force Report to the 78<sup>th</sup> Legislature, “A Roadmap to Responsible Reform, published in January 2003, the Texas Conservative Coalition Research Institute (TCCRI) advocated many of the budgetary reforms that Governor Perry has recently proposed.

### **Constitutional Spending Limits**

*The Austin American-Statesman* (September 28, 2006) reported that in the coming fiscal year, Texas is likely to break the constitutional limit for the first time. In reality, however, the constitutional spending limit has been broken for years both because it is fundamentally flawed.

Since the passage of the constitutional spending limit under the Texas Tax Relief Act of 1978, the state has witnessed spending grow by 723%, while personal income has grown by only 583% over the same period, and GSP by only 431%.<sup>7</sup>

Furthermore, state appropriations over the last thirty years have *more than doubled* every ten years, even though population has not doubled, and personal income and GSP have continued to improve. In other words, state government is taxing more and spending more despite the fact that the citizens of Texas are better off financially and generally better educated:

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<sup>7</sup> State spending data taken from the Comptroller of Public Accounts, “Texas Expenditure by Function, 1978-2005.” Personal income growth calculated from figures provided by Federal Reserve Bank of Dallas Regional Data. Data from Comptroller of Public Accounts used to calculate growth in Gross State Product.

<u>Year</u>	<u>Appropriation</u>
1975	9,704,608,115
1985	30,920,827,659
1995	70,115,933,212
2005	137,500,000,000*

Source: Legislative Budget Board

\*SBI as voted on by House 4/6/05

Governor Perry’s proposal suggests that the constitutional spending limit should be simplified:

“Amend Article VIII, Section 22 of the constitution to simplify what spending is limited. The constitution could be amended to make all state spending (everything other than federal funds) subject to the spending limit.”<sup>8</sup>

This is an important reform because the current constitutional provision only limits appropriations from state tax revenues that are not constitutionally dedicated. Article VIII, Section 22(a) of the Texas Constitution declares that:

“In no biennium shall the rate of growth of appropriations from state tax revenues *not dedicated by this constitution* [emphasis added] exceed the estimated rate of growth of the state’s economy.”

As the number of constitutionally dedicated appropriations continues to grow, the portion of the budget which is exempt from the constitutional restraints stood at more than \$5.6 billion in 2006-07<sup>9</sup>. This underscores the need for the constitutional spending limit to be extended to cover both dedicated and undedicated appropriations. With spending set to rise again, proposals that reform the constitutional spending limit into a meaningful restriction on the growth of state spending are both timely and necessary.

The “rate of growth of the state’s economy” as mentioned in Article VIII, Section 22(a) of the Texas Constitution is calculated by the Legislative Budget Board by “dividing the estimated Texas total personal income for the next biennium by the estimated Texas total personal income for the current biennium.”<sup>10</sup> However, economic growth is usually calculated by measuring increases in output (i.e. Gross Domestic Product [GDP] or gross state product [GSP]), rather than measuring increases in personal income. The U.S. Department of Commerce, for example, uses GSP to measure economic growth in each state<sup>11</sup>. Rather than personal income, using growth of Texas’ GSP to determine state

<sup>8</sup> Governor Perry’s Budget Reform Initiative; <http://www.rickperry.org/pdf/BudgetReformProposal.pdf>

<sup>9</sup> Legislative Budget Board, Fiscal Size-Up, Fund Sources Detail by Article, 79<sup>th</sup> Regular Session.

<sup>10</sup> “Tax Relief Amendment Implementation Limit on Growth of Certain State Appropriations,” Legislative Budget Board; [www.lbb.state.tx.us/Notice/Technical\\_Memo.pdf](http://www.lbb.state.tx.us/Notice/Technical_Memo.pdf).

<sup>11</sup> Bureau of Economic Analysis, Department of Commerce; <http://bea.gov/bea/newsrel/gspnewsrelease.htm>

economic growth is an important reform that should be enacted to ensure that the constitutional spending limit is based on an authentic measure of economic growth. With GSP having increased by 431% since 1978, compared to the 583% growth of personal income over the same period, it is clear that had the GSP measure been used, spending growth would have been slowed.

In addition to applying the constitutional spending limit to the *total* state budget (not just dedicated funds) and adjusting the measurement of Texas' economic growth, the constitutional spending limit should be strengthened by requiring a supermajority in the legislature to bypass the limit. Currently, a simple majority can bypass the limit by declaring an emergency, which is an insufficient requirement if the constitutional spending limit is to be a meaningful control.

### **Use of Dedicated Funds**

The appropriations process is the Legislature's balancing act, with the legislation on one hand and the dollars in the other. The Legislature is responsible for determining the state's priorities and funding them accordingly.

Examples of dedicated funds that are diverted to other areas of the budget include:

- The Telecommunications Infrastructure Fund tax (\$200 million per year);
- An additional tax levied on electricity bills since 1999 (\$239 million in 2005);
- The 50 cent monthly fee paid by phone customers to help pay for 911 services (the fund now has a balance of more than \$80 million, while many rural counties have still not upgraded their 911 technology)<sup>12</sup>; and,
- \$147 million appropriated from the State Highway Fund by the 79<sup>th</sup> Legislature to fund salary increases for state employees, construction of a ferry system by the Department of Transportation, and to allow the Health and Human Services Commission to increase funding for Children and Medically Needy programs<sup>13</sup>.

To address this problem, Governor Perry's proposed budgetary reforms include ensuring that dedicated funds are used for the purpose for which they were collected, so that:

“Taxes or fees collected for certain purposes either should be used for those purposes or discontinued. Spending authority should be granted on the basis of demonstrated results, not simply because dedicated funding is available.”<sup>14</sup>

Allowing dedicated funds to be spent in other areas of the budget creates tremendous opportunities for unchecked and wasteful spending that allows an agency or program to deviate from focus on its core mission.

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<sup>12</sup> “Funds for Parks, Other Efforts Often Raided or Left Unspent,” *San Antonio Express-News*, August 145, 2006.

<sup>13</sup> “Two Steps to Long-Lasting Property Tax Relief,” TCCRI Report, April 17, 2006.

<sup>14</sup> Governor Perry's Budget Reform Initiative; <http://www.rickperry.org/pdf/BudgetReformProposal.pdf>

## **Line-Item Veto**

Reflecting the important role that the Governor's line-item veto plays in limiting increases in state spending, Governor Perry's proposals include a requirement that the state budget should be more detailed, and specifically that it should contain more line-items so that the Governor can use his veto authority more effectively. In particular, Governor Perry's proposal stresses that:

“[A]ppropriating money in huge sums, often in billions or hundreds of millions of dollars, significantly restricts a Governor's ability to exercise his constitutional duty to review the appropriation bill and veto expenditures which do not meet with the Governor's approval.”<sup>15</sup>

The Governor has the authority granted by the Constitution to use the line-item veto in any spending bill containing more than one item of appropriation, but generally may not veto a rider in an appropriations bill unless it is in itself an item containing a specific appropriation of money. Governors in 43 states have the authority to reduce state spending through the use of the line-item veto, and ten of these states grant governors the use of the item-reduction veto. This item-reduction allows governors to reduce spending without striking the entire amount of a given appropriation.

The Governor, as the statewide elected executive of the state, is held the most accountable for the fiscal health of the state. Just as the Governor vetoes and signs individual legislation, the Governor also should have the opportunity to approve or veto any or all parts of any appropriations bill. The Governor should also be able to strike or amend “riders” in appropriations bill. Riders direct agencies to spend certain funds on specific programs, and effectively protect this spending from the Governor's veto pen.

The Governor should have the tools to restrain legislative spending without being forced to choose between the complete elimination or approval of a given appropriation, and should be allowed the full authority to veto any or all of an agency's budget, or even to write in a new amount.

## **Returning Surplus Revenue to Taxpayers**

Building on current policy, Governor Perry's proposals include amending the Texas Constitution so that the state is authorized to return surplus revenue to taxpayers:

“Rather than changing any existing provisions, a new amendment should be added which authorizes the return of surplus revenue under a certain set of conditions notwithstanding any existing provisions to the contrary.”<sup>16</sup>

House Bill 2 (79S3) dedicated revenue from the franchise tax, motor vehicle sales and use tax, and taxes on tobacco products to providing school district property tax relief.

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<sup>15</sup> Governor Perry's Budget Reform Initiative; <http://www.rickperry.org/pdf/BudgetReformProposal.pdf>

<sup>16</sup> Ibid.

This was an important first step towards reducing the burden on property taxpayers, which should be built on by constitutionally dedicating current and future budget surpluses to a further reduction, and eventual elimination, of school property taxes. To be clear, a surplus is an overpayment of taxes which should be returned to taxpayers.

In 2004, Governor Perry recommended returning budget surpluses to taxpayers in the form of a “buy-down” of school property tax rates. Governor Perry advocated “constitutionally dedicating one-third of future state budget surpluses to buying down school property tax rates.”<sup>17</sup>

Following the Governor’s recommendation, House and Senate leaders filed legislation that included constitutional dedication of surplus revenue. Senator Florence Shapiro, Chairman of the Senate Education Committee, filed Senate Joint Resolution 1 (784S) which constitutionally dedicated future surpluses generated by an increase in the sales and use tax. Similarly, Representative Kent Grusendorf, Chairman of the House Public Education Committee, filed House Joint Resolution 1 (78S4) which constitutionally dedicated one-third of all future surpluses to property tax relief.

Article III, Section 51 of the Constitution currently prohibits public money being granted to individuals except in conditions of public disaster. Governor Perry’s proposal would create a mechanism by which taxpayers could have surplus revenue returned directly to them. TCCRI recommended a similar refund of surplus revenue to property tax payers in March 2006:

“A permanent solution [to public school funding] will be found in consistently returning surplus revenue to the people and businesses that generated them in the form of lower property taxes.”<sup>18</sup>

The fundamental reform of education funding during the 3<sup>rd</sup> Special Session of the 79<sup>th</sup> Legislature was enshrined in House Bill 1 (79S3), and will reduce school district property tax rates by as much as 66.67% by 2008<sup>19</sup>. This process should be continued by returning the anticipated \$4.3 billion surplus to taxpayers in the form of lower property tax rates. Returning revenues to taxpayers is clearly an appropriate response in times of surplus, and if taxpayers have the potential to have surplus tax revenue returned to them, the incentive to demand efficient and limited government is greatly increased. Conversely, if surplus revenue is not returned to taxpayers with the aim of eliminating the M&O tax, it will inevitably be put toward inflating spending, thereby greatly increasing the budget in subsequent biennia.

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<sup>17</sup> Press Release from the Office of the Governor, April 8, 2004.

<sup>18</sup> “Choosing a New Path: Using the Projected Budget Surplus for Property Tax Reduction,” TCCRI, March 2006.

<sup>19</sup> Legislative Budget Board Fiscal Note, House Bill 1 (79S3).

## **Conclusion**

Governor Perry's proposed budget reforms represent an important first step in delivering meaningful taxpayer protections in Texas. TCCRI recommended many similar reforms in the run up to the 78<sup>th</sup> Legislative session, and concluded that reining in the growing budget requires an evaluation of not only where revenue is spent, but also of the entire budgeting process. Improving the state's budget structure is at the heart of improving the way the state spends money.<sup>20</sup>

Conservative lawmakers must now reestablish their commitment to fiscal responsibility and responsible reform by setting spending priorities to serve as a guideline for governing the state of Texas. At the heart of this document is the acknowledgement that government cannot and should not do everything. As former Governor Bush wrote: "Government cannot solve every problem or meet every need. State government should do a few things and do them well."<sup>21</sup>

Government should focus solely on the things that only it can do. A government that expands to meet every "need" not only loses sight of its priorities and becomes unwieldy to manage, but also ensures that it will not do the basics very well. It also guarantees that government will inevitably pass more tax and fee increases to fuel that growth. Restoring the limited role of government as a way to improve government efficiency and to control the growth in government spending is one of the primary goals of conservative lawmakers.

In some respects, the state is in the best position to establish a coherent vision for the basic activities of the state and allow private enterprise or citizen groups to handle the rest. There have been a few very modest attempts at privatization, more for outsourcing, and more consideration must be given to citizen empowerment and engagement in social services. The state's spending priorities should focus only on what the government, and the government alone, can and must do. Agencies must justify their requests based upon the success of a program. Inefficient and ineffective programs must be eliminated or restructured. Areas of the government that are better handled by the private sector or at the local level should be turned over to those entities.

Additionally, the state must have a commitment to truth in budgeting, making the process as transparent and honest as possible in order to establish clear accountability to the taxpayer. One-time accounting gimmicks are always a temptation, but they avoid the inevitable and necessary changes to government that would make service delivery more effective while minimizing the tax burden.

The responsibility of the 80th Legislature must be to start the arduous though necessary task of reforming the appropriations process to control growth of state spending.

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<sup>20</sup> "A Roadmap to Responsible Reform", TCCRI Report to the 78<sup>th</sup> Legislature, January 2003.

<sup>21</sup> Vision Texas, Office of the Governor, February 2000.