Center for Public Policy Priorities

March 30, 2011

The Honorable Jim Pitts
Chair, House Appropriations Committee
P.O. Box 2910
Austin, TX 78768

The Honorable Sylvester Turner
Vice Chair, House Appropriations Committee
P.O. Box 2910
Austin, TX 78768

Dear Chairman Pitts and Vice Chairman Turner:

Yesterday, Dale Craymer of the Texas Taxpayers and Research Association wrote Chairman Pitts criticizing the Legislative Budget Board's dynamic impact statement for CSHB 1, suggesting that it is not a useful tool for evaluating the proposed budget. In fact, the dynamic impact statement is a very useful tool and suggests that an alternative that takes a balanced approach using rainy day dollars and adding new revenue is preferable to CSHB 1.

As we explain briefly in this letter, spending rainy day dollars from the Economic Stabilization Fund to avoid cuts in state spending is a way to increase revenue without a tax increase, and there are other ways to increase revenue that are better for the economy than cutting state spending.

The LBB estimates that there would be 272,000 fewer jobs in Texas in 2012, and 335,000 fewer in 2013, than if CSHB 1 merely maintained the current level of state spending. Nearly 45 percent of these jobs would be in the private sector. Personal income in Texas would be $12.6 billion lower in 2012, and $17.2 billion less in 2013, than if state expenditures were to remain constant. Mr. Craymer seems to agree that the LBB correctly modeled these consequences.

What he says, though, is that the consequences would flow not from CSHB 1, but from the economic recession, which reduced available revenue. In reality, the consequences would <u>not</u> come from the recession, but from how the Legislature <u>responded</u> to the recession. If it is raining, but you refuse to open your umbrella, you get soaked not because of the weather, but because you refused to open your umbrella.

Of course the recession left the state with less revenue, but Texas has a $9.4 billion umbrella called the Economic Stabilization Fund that can be used to protect Texans from getting soaked. Spending these rainy day dollars to avoid cuts in state spending can be done with no offsetting consequences from raising taxes. We need to use the Economic Stabilization Fund. Our economy will recover. With its dedicated revenue stream, the fund will automatically replenish. But if we don't open our umbrella, we can't blame the weather for soaking us.

The state also needs new revenue in some combination of fees and taxes, including eliminating unwarranted tax exemptions. While it is folk wisdom in Texas that raising taxes always hurt the economy, the truth is a good deal more complicated. In fact, state spending reductions can hurt the economy more than certain tax measures. This is true for several reasons. When a state reduces spending, it largely reduces spending on goods and services purchased in Texas—from Texas businesses employing Texans. When a state increases taxes, however, a significant amount of the money may come from out-of-state taxpayers, having much less effect on the Texas economy or Texas jobs. For instance, according to the Comptroller, 47 percent of the

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natural gas tax is exported to out-of-state consumers or shareholders. And the high-cost natural gas exemption costs the state close to $2 billion a biennium.

Additionally, reducing spending reduces the consumption supporting our economy dollar for dollar, while a tax increase does not take money out of the economy dollar for dollar. When the state reduces spending a dollar, the Texas economy loses a dollar. When the state increases taxes a dollar, the Texas economy doesn't lose a full dollar because some portion of the tax is paid from money that would otherwise be idle. There are ways to raise revenue that are better for the economy than cutting spending.

Of course, it is also folk wisdom that Texas must keep taxes low to attract business. But low taxes are a relative thing. Whether you measure taxes per resident or as a percentage of the economy, Texans—including Texas businesses—pay less than those in other states. Texas has ample room to raise some new revenue and still be a low-tax state.

Moreover, being a low-tax state doesn't mean you win the business competition. Businesses care about more than taxes. Law and order, roads and bridges, emergency preparedness and disaster response, teaching, research, job training, economic development, and health and human services are all critically important to business.

Think about 1987, the last time Texas faced a revenue crisis of the present magnitude. Governor Bill Clements hoped he could deal with the problem without new taxes but ended up signing a large tax increase. During the following decade, Texas prospered. Our state did well because smart investment from careful taxation strengthens, not weakens, an economy.

And that raises an important point. We have to worry about our future economy as well as our present economy. For example, investment in public and higher education may cost us today, but yield a significant return in the future. And, we must keep in mind our obligation to our children and our elderly. Everything isn't about making money.

Certainly we join Mr. Craymer in calling for deeper thinking about tax and budget choices. But the LBB dynamic economic impact statement is a step forward and a useful tool in assessing CSHB 1, not against an imaginary alternative, as Mr. Craymer suggests, but against a real alternative—a balanced approach that uses rainy day dollars, adds some new revenue, and minimizes damaging cuts to critical state services.

Sincerely yours,

F. Scott McCown

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Executive Director