POLICY PAGE

Center for Public Policy Priorities | 900 Lydia Street Austin,Texas 78702 PH: 512.320.0222/FAX: 512.320.0227 www.cppp.org

January 17, 2007 More Information: Dick Lavine, lavine@cppp.org No. 278

WHERE DID THE "SURPLUS" COME FROM?

$14.3 BILLION IN "NEW MONEY TO SPEND" IS MAINLY CARRY-OVER FROM PAST SHRUNKEN BUDGETS, NOT REVENUE GROWTH

The Comptroller has announced that the Legislature will have "$14.3 billion in new money to spend in the 2008-09 state budget." This figure is a comparison between the amount of general revenue expected to be available for the coming biennium and the amount being spent in the current biennium. This is not the same as estimating that the state will take in $14.3 billion more in 2008-09 than in 2006-07. In fact, total net revenue to general-revenue-related funds in the next biennium is projected to increase by only $3.2 billion over the current level.

Sales tax accounts for almost all of tax revenue growth

General-revenue-related tax collections are expected to increase by $4.12 billion – from $63.56 billion in 2006-07 to $67.68 billion in 2008-09. Almost all of this growth comes from the state sales tax, which is expected to take in $3.82 billion more in the coming biennium than in the current biennium.

Other major contributors are the motor-vehicle sales tax ($552 million increase) and the franchise tax ($413 million increase). The franchise tax number is a calculation of how much revenue would have been collected from the former tax, before it was reformed in last year's special session. The increase in franchise tax collections due to the special-session changes is dedicated to funding property tax cuts, so is not included in general-revenue-related funds.

Offsetting this growth in tax revenue are anticipated decreases in the natural gas tax ($625 million decrease), oil production tax ($223 million decrease), and utility taxes ($113 million decrease). On the other hand, the amount of oil and gas revenues that must be set aside for the Rainy Day Fund will also decrease.

The sales tax is estimated to provide 61% of total GR-related tax collections in 2008-09, up from 59% in 2006-07.

Non-tax collections are expected to fall

Collections from non-tax sources are expected to fall from $10.75 billion in 2006-07 to $9.81 billion in 2008-09 – a drop of $942 million. Interest and investment income, which is primarily from Permanent School Fund investments, is projected to fall by $350 million. Other contributors to the decline are licenses, fees, fines and penalties ($227 million drop), and "other revenue sources" ($369 million decrease).

Total net general revenue will increase slowly

Total net general revenue, which includes both tax and non-tax sources, is estimated to increase by only $3.18 billion, from $74.31 billion in 2006-07 to $77.49 billion in 2008-09. This is an increase of only 4.3%, compared to a growth rate of 17.3% from 2004-05 to 2006-07 and a rate of 11.0% from 2002-03 to 2004-05.

Carry-over balances account for most of the increase in available funds

The General Revenue Fund is expected to begin the 2008-09 biennium with a balance of $6.99 billion – an increase of $3.30 billion over its balance at the beginning of the current biennium.

<u>This jump in the initial GR balance accounts for 44% of the total increase in funds available for certification.</u>

A primary cause of this large carry-over balance is the budget cuts made in the 2003 session. Many of these services have not been restored, despite ongoing unmet needs. Although the state's revenue system has recovered, the state's budget has not, leaving $7 billion unspent at the end of the current budget.

Another $1.23 billion increase in available balances is due to a drop in the amount that must be set aside for constitutionally required transfers to the Rainy Day Fund (officially known as the Economic Stabilization Fund), because of declining oil and gas revenue. This is somewhat like increasing your disposable income by reducing your 401(k) contribution.

These two fund balances contribute $4.53 billion to the increase in funds available for certification – 60% of the total increase of $7.50 billion.

The reformed franchise tax will increase revenue by less than expected

Last year's special session dedicated all new revenue raised by bills passed during the session to partially fund school property tax cuts. The fiscal notes to the revenue bills forecast that the three bills would produce $8.34 billion in additional revenue in 2008-09 – $6.83 billion in increased revenue from reforms in the franchise tax (now popularly known as the "margins tax"); $1.42 billion from the increase in the cigarette tax; and $85 million from changes in the tax on used car sales. This money would be set aside in a new Property Tax Relief Fund and dedicated to reducing school property taxes.

The comptroller's forecast shows that the fund will take in only $7.52 billion in tax revenue in 2008-09 – $818 million less than expected. The difference between the amount available in the fund and the cost of cutting school property taxes by one-third would have to be made up by appropriations from general revenue.

Almost all of this shortfall from the original fiscal note estimate is because the new margins tax is now estimated to increase revenue by only $6.09 billion in 2008-09, compared to the revenue that would have been generated by the old franchise tax. This is $744 million less than the fiscal note estimate from April 2006.

High natural gas prices will replenish the Rainy Day Fund

The Rainy Day Fund is expected to end the current fiscal year with a balance of $1.22 billion, after appropriations for $792 million in 2007 to fund child protective services, education, and other items.

By the end of the 2008-09 biennium, the fund's balance is expected to grow to $4.27 billion, primarily because of a transfer of $1.81 billion in natural gas taxes, plus smaller amounts in oil production taxes ($339 million), and interest earned on the balance ($302 million). In addition, one-half of the unencumbered 2007 general revenue ending balance is projected to be transferred to the fund, adding another $597 million.

Experts recommend a reserve fund of 8 percent of general-fund spending to tide states over through budget years in which economic recessions or slowdowns cause state revenues to stagnate or fall, as they did in 2003.

Adding the school property tax cuts to a "bare bones" estimate of potential current services demands for General Revenue yields a biennial total of around $91 billion. Eight percent of $91 billion is $7.3 billion -- $3 billion more than the expected balance in the Rainy Day fund at the end of the coming biennium.

Total revenue from all sources will increase

The comptroller also estimates "all funds" revenue, which includes state tax revenue that is dedicated to certain purposes and revenue from the federal government. Revenue from all funds is expected to increase by $11.62 billion – from $145.15 billion in 2006-07 to $156.77 billion in 2008-09 – an increase of 8.0%. In comparison, "all funds" revenue grew by 13.5% from 2004-05 to 2006-07.

The primary reason that "all funds" revenue is expected to increase by more than general-revenue-related funds is that the increase in revenue due to reforms in the franchise tax – $6.1 billion – is included in "all funds." This increase is excluded from general-revenue-related funds, since it is dedicated to help fund property tax cuts.

Compared to needs, there is no surplus

If "surplus" means "more than we need," then, we do not have a surplus at all; we are actually billions of dollars short. See: *Prudent Stewardship of the State's Budget,* http://www.cppp.org/research.php?aid=589. Indeed, economic growth is masking a serious budget hole—the difference between the ongoing cost of local school property tax cuts enacted in the special session and the new state revenue to be raised. Prudent stewardship and conservative budget principles require more than a two-year view. Texas needs to meet vital needs, use dedicated funds properly, and set aside an appropriate reserve, as well as fund the tax swap made in the special session.

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	2006-07	2008-09	Change
GENERAL-REVENUE-RELATED FUNDS			
Tax collections	$63.56	$67.68	$4.12
Non-tax revenue	10.75	9.81	-0.94
Total GR-related revenue	$74.31	$77.49	**$3.18**
GR fund balance	3.69	6.99	3.30
Rainy Day Fund reserve	-3.24	-2.01	1.23
Other	.21	.00	-.21
GR-related funds available for certification	$74.97	$82.47	**$7.50**
ALL FUNDS			
Tax Collections	$68.80	$80.15	$11.35
Federal Income	48.34	48.88	0.53
Other sources of revenue	28.01	27.75	-.26
Total All Funds revenue	$145.15	$156.77	**$11.62**

Source: Comptroller, *Biennial Revenue Estimate 2008-09* (Jan. 8, 2007)
All numbers in billions of dollars