



SPENDING CAP

Constitutional Spending Limit Must be Adjusted to Account for Replacement of School Property Taxes with State Revenue

The state's commitment to reduce school property taxes by one-third in fiscal 2008 has called into play a little-known restriction on state budgeting—the constitutional limit on spending—which limits the amount of state tax revenue that may be spent. The Legislative Budget Board met on November 27 to consider setting the amount of the cap, as required by statute, but adjourned until January without taking action. This *Policy Page* explains the constitutional cap, the restrictions it imposes on future state budgets, and how it should be applied.

How Does the Spending Limit Work?

Article VIII, Section 22, of the Texas Constitution, which was approved by the voters in 1978, caps spending of state tax revenues that are not constitutionally dedicated. Spending that is supported by federal funds, nontax revenue such as fees, or constitutionally dedicated revenue such as state gasoline taxes does not count against the cap. Spending may not grow faster than the Legislative Budget Board's estimate of the biennial rate of economic growth, which is measured by state personal income—the best indicator of the ability of Texans to support state services. The limit is adopted before each regular legislative session and can be exceeded only by a majority vote of the House and Senate.

What Would Be the Spending Limit for 2008-09?

The Legislative Budget Board, consisting of the Lieutenant Governor and four Senators, plus the Speaker and four Representatives, met on November 27 to consider adoption of the biennial growth limit. Although no action was taken, both leaders indicated their intention to adopt the lowest growth rate of the five estimates presented to them—a rate of 13.11%. (Estimates ranged as high as 17%.)

When applied to a base of 2006-07 appropriations from tax revenue not dedicated by the Constitution, which is currently estimated to be \$55.55 billion, a 13.11% growth rate produces a maximum spending level for the upcoming 2008-09 biennial budget of \$62.83 billion. In other words, appropriations affected by the limit may increase by only \$7.28 billion over the current level before hitting the cap.

How Would the Spending Limit Affect the Property Tax Cuts Adopted in the Special Session?

HB 1, the school-finance bill passed in the recent special session, requires school maintenance-and-operations (M&O) tax rates to be compressed by one-third in fiscal 2008, i.e., from \$1.50 per \$100 in property value to \$1.00. Starting in 2009, the commissioner of education will calculate the compression percentage based on the amount of state funds in the property tax relief fund, which receives the revenue raised by the tax changes made in the special session, "or from another funding source available for school district property tax relief."

The cost of the property tax cuts in HB 1 was estimated at the time of passage to be \$13.4 billion for the 2008-09 biennium. A more

recent estimate by the Speaker's Office shows a cost of \$11.4 billion, apparently based on higher-than-expected property values, which increase local tax revenue, so decrease the need for state matching aid.

So even if state spending were continued only at its current level, without adjustment for enrollment and caseload growth or the increased costs of providing services, the additional cost of replacing local school property taxes with new state revenue would be more than the amount permitted to be spent by the constitutional limit. Of course, there are also many unmet needs that should be funded in the 2008-09 budget. See *Prudent Stewardship of the State's Budget*, <http://www.cppp.org/research.php?aid=589>

What Should the Legislature Do?

The spending cap should be adjusted to accommodate the expanded role of state government in funding public education, accomplished by replacing school property taxes with state tax revenue. This is a large increase in state responsibility, but not actually an increase in the size of government, since state spending would only replace local revenue. The intent of the constitutional cap—to limit the rate of growth in government spending—would be maintained if the cap

Just the cost of cutting school property taxes alone, without any other increase in state spending, would be enough to violate the spending cap.

were re-set to take into account the shift in responsibility from local school districts to the state.

The spending cap may be overridden by a simple majority vote in both chambers. This would permit the 80th Legislature to spend state tax revenue to replace school property taxes, maintain the current level of state services, and make necessary investments in the future of Texas.

Re-setting the Cap Once Solves the Problem

Once a new base is established, the spending cap problem is unlikely to recur any time soon. This is because Texas' current revenue system generally does not grow as fast as the state's economy, so available revenue rarely is greater than the amount permitted by the constitutional limit. For suggestions on how to improve Texas's revenue system, see *The Best Choice for a Prosperous Texas: A Texas-Style Personal Income Tax*, <http://www.cppp.org/research.php?aid=482&cid=7>

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