

Take a Balanced Approach to Balancing the Budget

by Dick Lavine

Every balance sheet has two columns -- one for income and one for expenses. To balance a budget you have to look at both sides.

Texas faces a budget shortfall of up to \$16 billion. That's how much more money is needed just to keep up the current level of state services. This adds the cost of new students, population growth, and inflation to the comptroller's estimate of \$9.9 billion.

We've been in this type of predicament before. Our current legislators should turn to how their predecessors dealt with severe shortfalls.

Back in January 1986, oil prices collapsed from \$30 a barrel down to just \$10. The price collapse left a huge hole in the state budget, which had relied on oil and gas taxes for one-quarter of all tax revenue.

The Legislature back then didn't just blindly slash services to fit the amount of revenue generated by our crippled tax system. They also looked at the income column, expanding taxes as necessary to keep the state afloat. Over the next five years they reshaped the state tax system, creating the foundation that has supported the state up to now.

The Legislature of the late 1980s was controlled by conservative, business-oriented Democrats, and the governor for much of the period was a Republican oilman, Bill Clements. This was no crowd of free-spending liberals, yet they did what was necessary to avoid drastic reductions in services.

Between 1986 and 1991, the Legislature raised the state sales tax from 4 1/8% to the current 6 1/4%, doubled gasoline and cigarette taxes, and rewrote the corporate franchise tax. They also balanced three budgets, maintained essential public services, and put the state on the path to a prosperous decade.

Our new Legislature needs to take a similar balanced approach.

The way to start, of course, is to scrub the budget. Texas spends too little on public services to waste even one dollar.

But in the end, it's still going to take more money.

The first place to look for money is the state's Rainy Day Fund, established to deal with difficult financial situations. The fund will have \$1.3 billion available to support the next budget. The balance would be automatically replenished in the future under existing constitutional provisions.

Then find money by closing loopholes in current tax laws. Too many Texas companies avoid the corporate franchise tax by shifting profits made in Texas to subsidiaries in Delaware, a dodge known as the “Delaware Sub.” Plugging this hole could raise another \$500 million.

Next, we could make the property tax function better. The property tax is a local tax, not a state tax, but higher school property tax revenue would reduce the need for state aid to school districts, freeing up money for other parts of the budget.

Businesses are supposed to report (“render”) equipment and inventory to local appraisal districts. But there’s no penalty for failure to render, so some businesses don’t—and don’t pay that tax. Establishing penalties to enforce existing law could flush out \$36 billion of now-unreported business property and generate \$1 billion in school property taxes. In addition, requiring that real estate sales prices be reported to local appraisers would improve the accuracy and fairness of the property tax.

Many states have raised cigarette taxes to help reduce budget shortfalls. Texas now charges 41 cents a pack, about the national average. A one-dollar increase could generate \$1.5 billion over the next two years

Finally, the state needs to modernize the sales tax, which brings in more than half of all state tax revenue. When the tax was adopted 40 years ago, the economy mainly involved buying and selling goods. The economy now increasingly involves buying and selling services. The state could generate up to \$7.5 billion for the next budget by expanding the sales tax to cover services that aren’t taxed—and still exempt medical and dental services.

The budget shortfall presents a difficult problem. The Legislature needs to use all the tools at its disposal – on both the spending and revenue sides of the equation – to arrive at a balanced solution. The future of Texas depends on it.

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