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Budget Cutting Through the Sales Tax Reduction (STaR) Fund

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Key Points

- Texas' government budget is up an excessive 11.8 percent above increases in compounded population growth plus inflation since the 2004-05 budget.
- Some legislators are frustrated with the budget process because the money saved by cutting spending in one area is often reallocated elsewhere resulting in no reduction in the overall budget.
- To resolve this problem while relieving taxpayers from the burden of paying higher taxes, we recommend creating the Sales Tax Reduction (STaR) Fund.

Introduction

The efforts of Texas legislators seeking to reduce state government spending have been frustrated by an appropriations process designed to increase spending. Specifically, tax dollars saved from cutting appropriations in one area of the budget are often reallocated somewhere else resulting in no reduction in the overall budget. Reallocation of taxpayer dollars promotes continued budget increases for agencies that then have little to no incentive to operate economically.

The appropriations process has often contributed to increases in the budget by more than the rate of population growth plus inflation. While the 84th Legislature passed a 2016-17 budget of $209.1 billion that increased by less than this rate, Heflin et al. (1-2) note longer-term trends reveal that is not always the case. In fact, the state's budget is up 11.8 percent above compounded population growth plus inflation since the 2004-05 budget. This excess spending translates into an average family of four paying about $1,600 per year more in taxes than if the Legislature had held budget increases to no more than this rate per period.

Rather than continue spending potential budget cuts on ineffective programs and surplus tax dollars that raises the tax burden on Texans, it is time that these dollars remain in taxpayers' pocket to satisfy their desires. To accomplish this, we recommend that the Legislature create a budget-cutting mechanism called the Sales Tax Reduction (STaR) Fund.

STaR Fund Basics

The STaR Fund would be a special fund where tax dollars cut from one area of the budget and other surplus tax dollars, such as taxes above appropriations and above the Economic Stabilization Fund's (ESF) cap, could be transferred. Dollars in this fund would accumulate until the appropriations bill is adopted. At the end of that fiscal period, the Texas Comptroller would calculate the amount in the fund and then determine a temporary period to reduce the state sales tax rate, which is the broadest based and easiest to administer state tax, based on the previous fiscal year's sales tax collected until the fund is effectively depleted. After the determined period of state sales tax reduction, the sales tax rate would automatically revert to its original rate. The Legislature could create the STaR Fund in one session and have it available in the following session.

STaR Fund Sources

To maximize the amount of budget cuts and sales tax reduction, the STaR Fund could be funded by the following sources:

- Budget cuts of state programs,
- Surplus funds in excess of appropriations, and
- Surplus funds in excess of the Economic Stabilization Fund's (ESF) cap.

STaR Fund in Practice and an Example

Given the amount that accumulates in the STaR Fund from these sources, the Texas Comptroller would decrease the 6.25 percent state sales tax rate over a given period based on the previous year's state sales tax collected. Reductions in these tax collections from reducing the tax rate will be covered by transferring dollars from the STaR Fund into the state's general revenue (GR) fund. When the fund is depleted, the state sales tax rate will automatically revert to the original rate of 6.25 percent.

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As an example, consider that tax revenue from the state sales tax was $28.2 billion in fiscal year 2016—the fiscal year before the regular legislative session (Texas Comptroller). At the current sales tax rate of 6.25 percent, each cent of the sales tax collects, on average, $4.5 billion in tax revenue. By this metric, if the STaR Fund was in place and accumulated $4.5 billion from the three sources above during the appropriations process, the comptroller could lower the state sales tax rate by 1 percentage point for one fiscal year or by 0.5 percentage point for 24 months. Similarly, if the Fund accumulated $1.13 billion, the comptroller could reduce the rate by 0.25 percentage points for a fiscal year or by 0.125 percentage points for two years. While these sales tax rate reductions may not seem substantial, every dollar not funding ineffective government programs or in surplus is another dollar that remains in the productive private sector.

STaR Fund Boost from ESF Reform

Seventy-five percent of severance taxes collected from oil and natural gas production have historically flowed directly to Texas' Economic Stabilization Fund (ESF)—also known as the rainy day fund. The ESF was primarily created to cover unforeseen budget shortfalls. However, half of this allocation has been redirected to the State Highway Fund for transportation projects since passage of Proposition 1 in November 2014 but will fully return to the ESF in 2025 should current law hold.

Even with the funding redirection and the oil and natural gas slowdown in recent years, the money allocated to the ESF increased by more than $1 billion in FY 2016 and could reach $10.3 billion at the end of FY 2017. As severance taxes continue to roll in, this amount continues to grow closer to the constitutional cap of 10 percent of certain biennial GR-related funds, which is $16.2 billion for the 2016-17 budget period (Costello et al.). If the ESF were to reach its cap, additional severance taxes collected would remain in GR; however, when the STaR Fund is in place, those surplus dollars would flow into it so they would not be frivolously spent but rather returned to taxpayers through a reduction of the state sales tax rate. Ginn et al. provide a recommendation that would speed up this process by decreasing the ESF's cap from 10 percent to 7 percent, which would currently be $11.3 billion. More dollars in the STaR Fund would contribute to larger, longer state sales tax reductions instead of simply increasing spending.

Conclusion

The broadest, most visible, and easiest way to administer surplus state tax revenue back to taxpayers is through the Sales Tax Reduction (STaR) Fund. The prominent organization ALEC passed similar model legislation in 2015 so Texas would be wise to adopt it first before other states gain a competitive advantage.

By creating the STaR Fund, legislators would have a mechanism to use excess taxpayer dollars to reduce the bottom line of the budget and taxpayers would be able to keep more of their money. The Fund would receive money from multiple sources, including budget cuts in ineffective government programs, surplus dollars above expenditures, and severance tax dollars above the ESF cap. Ultimately, the STaR Fund will help tackle the disease of excessive government spending so that the symptoms of overly burdensome taxation and less economic growth can be cured. These fiscal reforms will support economic success so that Texas can be a model for other states and Washington, D.C. to follow. ★

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About the Authors

The Honorable Talmadge Heflin is the Director of the Foundation's Center for Fiscal Policy. Prior to joining the Foundation, Heflin served the people of Harris County as a state representative for 11 terms. Well regarded as a legislative leader on budget and tax issues by Democratic and Republican speakers alike, he for several terms was the only House member to serve on both the Ways and Means and Appropriations committees. In the 78th Session, Heflin served as chairman of the House Committee on Appropriations. He navigated a $10 billion state budget shortfall through targeted spending cuts that allowed Texans to avoid a tax increase.

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