To Increase, or Not To Increase, That Is The Question

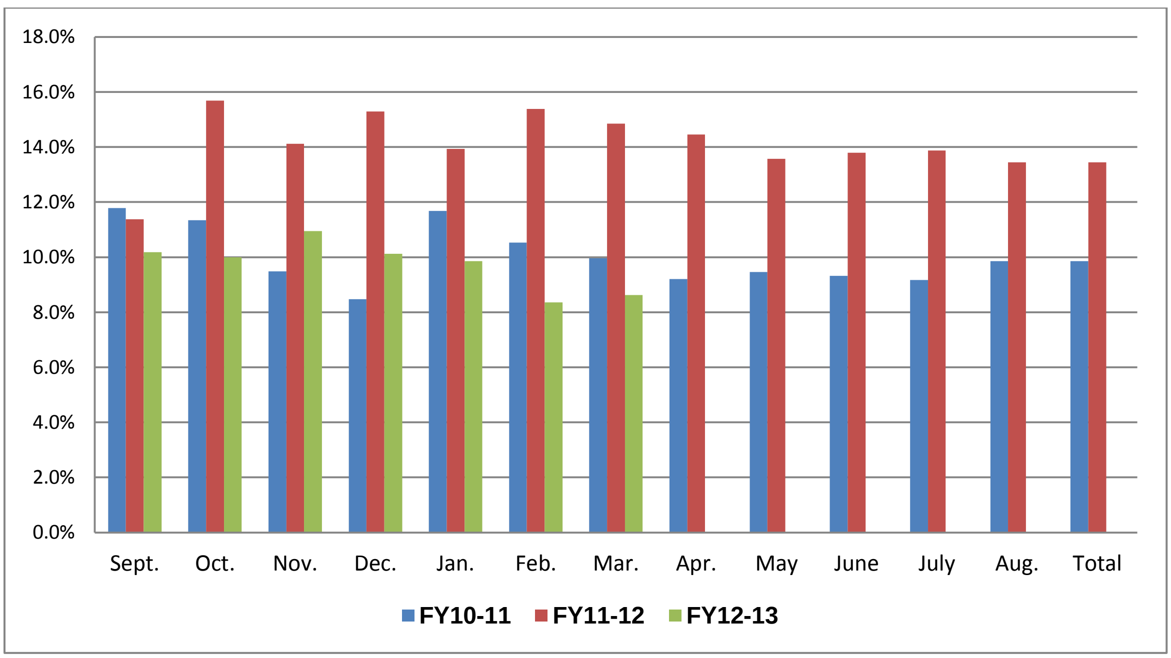
by Stuart Greenfield, Ph.D.

With the release of revenue and expenditure data for March, Texas is now more than halfway through fiscal 2013 (FY13) and the Legislature is in its home stretch,

The Legislature adjourns sine die, Monday, May 27 and both the Senate and House have passed appropriations bills A conference committee will now decide how the state will spend and what their priorities will be. Having the most up-to-date information on state revenue should be help legislators set those priorities and allow the rest of us to look over their shoulders.

Tax revenue collections, through March, is important not only for this fiscal year (FY13), but also influences estimated revenue for the coming biennium While growth in tax collections is no longer at double digit rates (Figure 1 below), the rate of increase (8.6 percent) in year-to-date tax collections is 60 percent higher than the

Figure 1: Cumulative YTD Growth in Tax Collections, various fiscal years



rate (5.4 percent) in the Biennial Revenue Estimate (BRE).

The growth in total net revenue is 0.7 percent, a rate considerably less than the 8.3 percent increase in the BRE (Table 2). State expenditures continue to decline, with the rate of decline increasing from -4.3 percent through February to -5.1 percent through March (Table 3).

Total tax collections through March continue to increase at a rate greater than forecast in the BRE. However, this increase has declined from a double digit rate in FY12. Compared to the estimate for FY12, the

Table 1: All Funds Tax Collections by Major Tax (in millions dollars), YTD (through March) FY12 and FY13

	FY2012 YTD	***FY2013 YTD***	Actual Percent Change	Estimated BRE Percent Change
Sales Tax	13,611.9	14,733.4	8.2%	8.0%
Motor Vehicle Sales and Rental Taxes	1,977.1	2,194.0	11.0%	5.2%
Motor Fuel Taxes	1,814.6	1,837.4	1.3%	3.9%
Franchise Tax	90.9	61.5	-32.3%	2.5%
Insurance Taxes	860.4	1,063.0	23.5%	5.7%
Natural Gas Production Tax	1,031.9	821.0	-20.4%	-30.8%
Cigarette and Tobacco Taxes	770.6	855.1	11.0%	9.1%
Alcoholic Beverages Taxes	522.5	552.0	5.7%	6.1%
Oil Production and Regulation Taxes	1,122.8	1,613.8	43.7%	10.5%
Inheritance Tax	(0.2)	(10)		
Utility Taxes	219.5	204.5	-6.8%	-1.6%
Hotel Occupancy Tax	210.2	231.7	10.3%	5.2%
Other Taxes	102.6	102.9	0.3%	-8.2%
Total Tax Collections	**22,334.6**	**24,260.0**	**8.6%**	**5.4%**

Source: Comptroller of Public Accounts

estimate for this fiscal year should be considered spot-on. The $1.9 billion increase in tax collections is primarily due to the increase in sales tax ($1.1 billion) and in the oil production tax ($491 million). With the substantial increase in the oil production tax and reduced decline in the natural gas tax, the transfer to the Economic Stabilization Fund (the Rainy Day Fund or ESF) is likely to be around $2.3 billion. This is almost $650 million more than in the estimate.

Were the estimate to follow the historical relationship between the state's economy and state revenue one should expect the "estimated ending certification balance" for FY15 to be $110 billion, an increase of almost $9 billion from the current estimate. The transfer to the Rainy Day Fund should be $1.7 billion more, resulting in a balance of over $13 billion in FY15.

Table 2 shows that All Funds Total Net Revenue through March of FY13 is $374 million more than collected in FY12. The primary reason that the increase in total revenue is less than the increase in tax collections is that many of the non-tax revenue sources have declined. The largest decline is in federal income, $1 billion from FY12. It is expected that with enactment of HB 10, the Medicaid supplement, federal income will increase by $6.6 billion.

Table 2: All Funds Revenue by Receipt Type (in millions dollars), YTD (through March) FY12 and FY13

	FY2012 YTD	***FY2013 YTD***	Actual Percent Change	Estimated BRE Percent Change
Tax Collections	22,334.6	24,260.0	8.6%	5.4%
Federal Income	19,268.1	18,253.5	-5.3%	14.8%
Interest and Investment Income	4,332.0	3,997.1	-7.7%	16.4%
Licenses, fees, permits, penalties	815.4	787.5	-3.4%	1.8%
Contributions to Employee Benefits	1,022.6	1,082.8	5.9%	-5.0%
Sales of Goods and Services	242.2	128.1	-47.1%	4.6%
Land Income	537.7	488.1	-9.2%	-3.9%
Lottery Proceeds	956.7	673.1	-29.6%	-19.7%
Settlement of Claims	0.1	0.1	-31.7%	-6.7%
Other Revenue Sources	2,493.3	2,706.0	8.5%	-5.9%
TOTAL Net Revenue	**52,002..6**	**52,376.2**	**0.7%**	**8.3%**

Source: Comptroller of Public Accounts

The BRE projects that all funds tax collections will increase by $2.3 billion in FY13. With the improved economy and resulting growth in tax collections, the increase in tax collections should exceed the estimate by over $1.3 billion. About 45 percent of this increase is accounted for by improved severance tax collections.

The BRE forecasts an increase of almost $8 billion in total net revenue, if the current growth rate continues; the state could expect total revenue to increase by an additional $700 million. Underlying this increase is that the two major revenue sources, taxes and federal income (with enactment of HB 10), are increasing at a rate higher than estimated in the BRE.

While total revenue year-to-date increased by 0.7 percent ($374 million), total expenditures declined by 5.1percent ($2.9 billion). As shown in Table 3, two items, public assistance payments (35.4 percent), and public education payments (27.0 percent) accounted for almost two-thirds of state expenditures. However, there was no growth in either public assistance payments or public education payments were through March.

Table 3: All Funds Expenditures by Category (in millions dollars), through March, FY2012 and FY2013

CATEGORY	**FY2012**	**FY2013**	**Percent Change**	**Proportion Expenditure 2013**
Employee Compensation	9,100.1	9,248.4	1.6%	17.1%
Public Assistance Payments	20,458.1	19,104.6	-6.6%	35.4%
Public Education Payments	16,411.2	14,596.3	-11.1%	27.0%
Intergovernmental Payments	2,282.9	2,369.3	3.8%	4.4%
Other Expenditures	8,655.9	8,682.6	0.3%	16.1%
TOTAL EXPENDITURES	**56,908.2**	**54,001.2**	**-5.1%**	**100.0%**

Source: Comptroller of Public Accounts

Almost 60 percent of the decrease in state expenditures was due to the reduction in public education payments ($1.8 billion). With the substantial decline in public education expenditures, the proportion of the state budget devoted to public education declined from 28.8 percent in FY12 to 27.0 percent this fiscal year. Had public education expenditures maintained its FY12 proportion, expenditures would be $1 billion more. Items (employee compensation, intergovernmental payments, and other expenditures) accounting for 37.6 percent of expenditures had minimal increases.

With the estimated $8.8 billion ending balance for FY13, a number of bills have either passed, e.g., HB 10, or are being considered which will increase appropriations for this fiscal year, e.g., SB 758, which has passed committees in each branch, will shift $1.75 billion in payments to school districts from FY14 to this fiscal year. Other bills are being considered to increase funding for public ed. Even after these changes funding for public education will be around $800 million less than in FY12.

Table 4 shows expenditures by function through March of FY12 and FY13. Total expenditures declined by $2.9 billion, most of it due to the over $2.0 billion reduction in education expenditures. Decreases in general government and health and human services offset the increase in other government functions. Taking into account the supplemental appropriations bills already filed and certain to pass, Texans should expect the Education expenditure for FY13 to be around $1.5 billion less than in FY12, while Health and Human Services expenditures should be around $2.2 billion more than the FY12 expenditure.

Table 4: All Funds Expenditures by Function (in millions dollars), through March, FY2012 and FY2013

EXPENDITURES BY FUNCTION	FY2012	FY2013	Change	Percent Change
General Government	1,557.8	1,557.8	(291.4)	-15.8%
Education	19,436.2	19,436.2	(2,023.4)	-9.4%
Employee Benefits	2,003.4	2,003.4	54.2	2.8%
Health and Human Services	21,284.3	21,284.3	(1,084.1)	-4.8%
Public Safety and Corrections	2,594.2	2,594.2	32.4	1.3%
Transportation	4,024.9	4,024.9	217.6	5.7%
Natural Resources/Recreational Services	1,353.9	1,353.9	107.0	8.6%
Regulatory Services	201.8	201.8	7.3	3.8%
Lottery Winnings Paid	408.8	408.8	60.0	17.2%
Debt Service - Interest	820.6	820.6	(17.2)	-2.1%
Capital Outlay	315.5	315.5	31.0	10.9%
TOTAL EXPENDITURES	**54,001.2**	**54,001.2**	**(2,907.0)**	**-5.1%**

Source: Comptroller of Public Accounts

State tax revenues continue to improve through March of FY13, with tax collections increasing by 8.4 percent compared to FY12. With the growth in state tax collections, FY13 tax collections should be $1.3 billion more than the estimate in the BRE.

While tax collections are increasing substantially, total state revenue has only increased by 0.7 percent, as most of the non-tax sources of revenue have experienced negative growth rates. The negative growth in federal receipts should be reversed with the passage of HB 10, which will increase federal funds by $6.6 billion.

Total state expenditures decreased by 5.1 percent, with the majority of this decrease attributable to the $2 billion reduction in education expenditures. With the supplemental appropriations bills, all funds appropriations for FY13 should increase to $92.7, about $1.5 billion less than the appropriation for FY12.

The state score board continues to read “revenue up, expenditures down.” Let’s hope serious thought is being given to revising not only the estimate for FY13, but especially for the 2014-2015 biennium. Tax collections and total revenue for FY13 should be greater by $1.3 billion and $700 million, respectively. The estimated growth rate in tax collections for FY14, 1.9 percent, has only been experienced 8 times in the last 50 years (4 of these times have been since 2000 due to recessions). The estimated increase in tax receipts for the biennium, 7 percent, is the fourth lowest change in tax collections since the 1960-1961 biennium. In fact, the compound growth in biennium tax revenues has been 16.7 percent, a rate over twice the estimated rate for the 2014-2015 biennium.

When the Comptroller provides legislators the update to the current estimate, I would expect an increase for this fiscal year and a substantial increase for the FY14-15 biennium. Unless there is a recession forecast for FY14, a growth in tax collections of 1.9 percent has only a 1 in 12 chance of happening. While these odds are better than any lottery game, it still is highly unlikely.

Dr. Greenfield holds a Ph.D. in economics from the University of Texas. He worked for three Comptrollers of Public Accounts and other Texas state agencies. Since retiring from the state in 2000, Greenfield has taught economics at ACC and UMUC.