

## LEGISLATIVE BUDGET BOARD

Austin, Texas

### 84TH LEGISLATIVE REGULAR SESSION

April 13<sup>th</sup>, 2015

## TAX REDUCTION COMPARISON

As requested, the Legislative Budget Board has prepared the requested analysis of the effects of four alternate tax reduction proposals. This dynamic economic analysis estimates the effects of the tax reductions on employment, personal income, GSP, and various other economic variables in Texas using the REMI Tax-PI Model, a dynamic forecasting and policy analysis tool that applies a combination of econometric, input-output, general equilibrium, and economic geography methodologies to forecast the resulting changes in the Texas economy from the tax reductions. Each of the scenarios analyzed in the model are described below, followed by a results section where the scenarios are compared to each other.

### Baseline Scenario

The baseline scenario assumes no changes in current law governing tax and revenue collections. Total net revenue collections in fiscal year 2015 through 2017 are assumed to equal amounts forecasted in the Comptroller of Public Accounts (CPA) January 2015 *Biennial Revenue Estimate* (BRE). In subsequent years revenue collections are forecasted within the REMI model by linking individual tax and non-tax revenue streams to associated economic variables in the model.

Texas state government spending is assumed to equal appropriation levels set in the Committee Substitute to House Bill 1 (CSHB 1) and House Bill 2 (CSHB 2) through the end of fiscal year 2017. Similar to revenue, in future years, government spending is predicted within the REMI model by linking demand for various government services to correlated economic variables. No spending from the Economic Stabilization Fund is assumed; however it is assumed that General Revenue Dedicated balances would be used to certify the budget in the out years. This amount is limited to \$3 billion, which is consistent with the level that has been discussed as the maximum to be used for the 2016-17 biennium.

General Revenue (GR) appropriations of \$104.6 billion in 2016-17 are \$0.8 billion less than 2016-17 recurring revenue of \$105.4 billion (2016-17 BRE revenue less amounts set-aside for transfer to the ESF and Highway Fund). In addition, the BRE estimated a \$3.1 billion GR ending balance from the 2014-15 biennium (as noted above, the General Revenue Dedicated Account balances that are not appropriated in CSHB1 are excluded from this analysis since it is assumed they remain un-appropriated). Subtracting the \$0.3 billion appropriated in CSHB 2 and combining with 2016-17 unspent revenue yields a predicted balance of \$3.6 billion in 2016-17. After fiscal year 2017 the model assumes that the budget will be balanced in every year. Beginning with fiscal year 2018, in years that predicted expenditures exceed predicted revenue plus any remaining balances, it is assumed that expenditures will be cut

proportionally across all spending categories. Conversely, expenditures will be increased proportionally across all spending categories in years that forecasted revenue and any remaining balances exceed forecasted expenditures. The dynamic economic effects described below will differ should expenditures that are changed to match available revenue not be changed proportionally. The distribution of expenditure reductions will be the decision of future Legislatures, and are thus unknown. However, because of the assumption of the continued reliance on GR-D account balances described above, it is not necessary to make any assumption on the allocation of expenditure reductions because the GR-D balances were enough to offset the revenue losses in each year, so no expenditure reductions were necessary.

### **Sales Tax Reduction Scenario**

In this scenario the state sales tax rate is reduced from a current law value of 6.25% to 5.95% beginning on January 1, 2016. The rate change results in an estimated partial year revenue loss of \$840 million in fiscal year 2016, a full year loss of \$1,470 million in fiscal year 2017, and similarly growing amounts in future fiscal years.

### **Franchise Tax Reduction Scenario**

In this scenario the franchise tax rate is reduced from current law values of 0.5% (for businesses engaged in wholesale or retail trade) and 1% (for all other businesses) to 0.375% and 0.75%, respectively, beginning with reports due in fiscal year 2016. In addition, the total revenue threshold that taxable entities are eligible to elect the EZ calculation as a method of determining tax liability is raised from \$10 million to \$20 million and the EZ tax rate is lowered from 0.575% to 0.331%. These changes result in an estimated revenue loss of \$1,268 million in fiscal year 2016, \$1,291 million in fiscal year 2017, and similarly growing amounts in future fiscal years.

### **School District Homestead Exemption Increase Scenario 1**

In this scenario the state mandated school district homestead exemption is increased from a current law value of \$15,000 to a level such that the revenue loss resulting from the increased exemption would exactly equal the revenue loss under the Sales Tax reduction scenario. It assumed that state expenditures for the Foundation School Program would increase by an amount necessary to hold the school districts harmless from the revenue loss incurred from the increased exemption.

### **School District Homestead Exemption Increase Scenario 2**

In this scenario the state mandated school district homestead exemption is increased from a current law value of \$15,000 to a level such that the revenue loss resulting from the increased exemption would exactly equal the revenue loss under the Franchise Tax reduction scenario. It assumed that state expenditures for the Foundation School Program would increase by an amount necessary to hold the school districts harmless from the revenue loss incurred from the increased exemption.

### **Results and Discussion**

Table 1 (Sales) and 3 (Franchise) show the estimated changes of several economic variables from the two tax reduction plans relative to the baseline scenario. Table 2 and 4 displays the difference in

changes of the same variables compared under the Sales Tax and Franchise Tax, relative to the corresponding Homestead Exemption scenario. In each fiscal year of the forecast period, the total tax reduction in either scenario equals 0.1 to 0.2 percent of Texas State GSP; thus the resulting estimated changes in economic statistics are relatively small.

As shown in the bottom of Table 1 and 3 the dynamic estimate of tax revenue loss is less than the static estimate in fiscal year 2017 by approximately 12.1 percent in the Sales Tax scenario and 8.2 percent in the Franchise Tax scenario. The reduction of the revenue loss estimate attributed to the dynamic economic effects is greatest for the consumer portion of the sales tax and smallest for the franchise tax and business portion of sales tax. The reduction in consumer prices from the sales tax reduction as a percentage of consumer spending on taxable goods and services is larger than the percent reduction in business production costs from the sales tax and franchise tax reduction as a percentage of business production spending; therefore the induced spending from lower prices is larger for consumers than businesses.

As shown in Table 2 and 4 estimated employment levels are higher, relative to the corresponding Homestead Exemption increase, in both the Sales Tax and Franchise Tax scenario by an average of 0.11 percent and 0.08 percent, respectively, over the five year forecast period. In addition, Texas Gross State Product and Personal Income under the Sales Tax and Franchise Tax scenarios are estimated to exceed estimates in the Homestead Exemption increase scenarios (by 0.13 and 0.12 percent respectively for GSP and 0.08 and 0.06 percent respectively for PI). Much of this difference can be attributed to higher levels of consumer and business spending in the first two scenarios (increases in personal consumption expenditures are more than double those in the Homestead Exemption scenario). In the Homestead Exemption scenario, relatively more of the consumer tax reduction is allocated towards both savings and spending on debt repayment (primarily mortgage debt), which have less of an economic stimulus effect than other consumer spending.

**Table 1 - \$2.31 billion Biennial Sales Tax Reduction  
Compared to Baseline Scenario - Differences**

<b>ECONOMIC RESULTS</b>						
Category	Units	2016	2017	2018	2019	2020
Total Employment	Thousands (Jobs)	15.03	28.07	32.94	36.70	39.53
	<i>% change</i>	<i>0.09%</i>	<i>0.17%</i>	<i>0.19%</i>	<i>0.21%</i>	<i>0.22%</i>
Private Non-Farm Employment	Thousands (Jobs)	13.99	26.07	30.53	33.98	36.58
	<i>% change</i>	<i>0.10%</i>	<i>0.18%</i>	<i>0.20%</i>	<i>0.22%</i>	<i>0.24%</i>
Total Government Employment	Thousands (Jobs)	1.04	2.01	2.42	2.72	2.95
	<i>% change</i>	<i>0.05%</i>	<i>0.10%</i>	<i>0.12%</i>	<i>0.13%</i>	<i>0.14%</i>
Gross Domestic Product	Billions of Fixed (2009) \$	1.05	2.03	2.46	2.78	3.02
	<i>% change</i>	<i>0.07%</i>	<i>0.12%</i>	<i>0.14%</i>	<i>0.15%</i>	<i>0.16%</i>
Personal Income	Billions of Current \$	0.75	1.56	2.02	2.40	2.73
	<i>% change</i>	<i>0.06%</i>	<i>0.11%</i>	<i>0.13%</i>	<i>0.15%</i>	<i>0.16%</i>
Disposable Personal Income	Billions of Current \$	0.65	1.34	1.74	2.07	2.36
	<i>% change</i>	<i>0.05%</i>	<i>0.10%</i>	<i>0.13%</i>	<i>0.14%</i>	<i>0.15%</i>
PCE-Price Index	2009=100 (Nation)	(0.07)	(0.11)	(0.10)	(0.10)	(0.10)
	<i>% change</i>	<i>-0.07%</i>	<i>-0.10%</i>	<i>-0.10%</i>	<i>-0.09%</i>	<i>-0.09%</i>
Personal Consumption Expenditures	Billions of Fixed (2009) \$	1.09	1.97	2.18	2.36	2.52
	<i>% change</i>	<i>0.12%</i>	<i>0.20%</i>	<i>0.22%</i>	<i>0.23%</i>	<i>0.24%</i>
Population	Thousands	5.9	15.2	24.2	32.8	41.0
	<i>% change</i>	<i>0.02%</i>	<i>0.05%</i>	<i>0.09%</i>	<i>0.11%</i>	<i>0.14%</i>
<b>BUDGET RESULTS</b>						
Static Sales Tax Reduction	Thousands of Current \$	(840,000)	(1,470,000)	(1,536,150)	(1,605,277)	(1,677,514)
Dynamic Sales Tax Reduction	Thousands of Current \$	(794,064)	(1,383,580)	(1,436,516)	(1,494,714)	(1,557,669)
Dynamic All Other Revenue Gain	Thousands of Current \$	44,044	92,413	122,466	150,136	175,970
<b>Net Revenue Change: Dynamic vs. Static</b>	Thousands of Current \$	89,980	178,833	222,100	260,699	295,815

**Table 2 - \$2.31 Billion Biennial Sales Tax Reduction  
Compared to \$2.31 Billion Biennial Homestead Exemption Increase - Differences**

<b>ECONOMIC RESULTS</b>						
Category	Units	2016	2017	2018	2019	2020
Total Employment	Thousands (Jobs)	9.83	18.65	21.34	22.63	23.10
	<i>% change</i>	<i>0.06%</i>	<i>0.11%</i>	<i>0.12%</i>	<i>0.13%</i>	<i>0.13%</i>
Private Non-Farm Employment	Thousands (Jobs)	8.74	16.60	19.01	20.12	20.48
	<i>% change</i>	<i>0.06%</i>	<i>0.11%</i>	<i>0.13%</i>	<i>0.13%</i>	<i>0.13%</i>
Total Government Employment	Thousands (Jobs)	1.10	2.05	2.34	2.51	2.62
	<i>% change</i>	<i>0.05%</i>	<i>0.10%</i>	<i>0.11%</i>	<i>0.12%</i>	<i>0.13%</i>
Gross Domestic Product	Billions of Fixed (2009) \$	1.18	2.22	2.52	2.71	2.84
	<i>% change</i>	<i>0.07%</i>	<i>0.13%</i>	<i>0.15%</i>	<i>0.15%</i>	<i>0.15%</i>
Personal Income	Billions of Current \$	0.49	1.05	1.35	1.57	1.72
	<i>% change</i>	<i>0.04%</i>	<i>0.07%</i>	<i>0.09%</i>	<i>0.10%</i>	<i>0.10%</i>
Disposable Personal Income	Billions of Current \$	0.42	0.91	1.17	1.36	1.50
	<i>% change</i>	<i>0.03%</i>	<i>0.07%</i>	<i>0.09%</i>	<i>0.09%</i>	<i>0.10%</i>
PCE-Price Index	2009=100 (Nation)	(0.07)	(0.11)	(0.11)	(0.11)	(0.11)
	<i>% change</i>	<i>-0.07%</i>	<i>-0.11%</i>	<i>-0.10%</i>	<i>-0.10%</i>	<i>-0.10%</i>
Personal Consumption Expenditures	Billions of Fixed (2009) \$	1.15	2.06	2.23	2.35	2.45
	<i>% change</i>	<i>0.12%</i>	<i>0.21%</i>	<i>0.23%</i>	<i>0.23%</i>	<i>0.23%</i>
Population	Thousands	4.91	12.76	20.07	26.73	32.84
	<i>% change</i>	<i>0.02%</i>	<i>0.05%</i>	<i>0.07%</i>	<i>0.09%</i>	<i>0.11%</i>

**Table 3 - \$2.56 Billion Biennial Franchise Tax Reduction  
Compared to Baseline Scenario - Differences**

<b>ECONOMIC RESULTS</b>						
Category	Units	2016	2017	2018	2019	2020
Total Employment	Thousands (Jobs)	15.42	21.63	25.99	29.80	32.79
	<i>% change</i>	<i>0.09%</i>	<i>0.13%</i>	<i>0.15%</i>	<i>0.17%</i>	<i>0.18%</i>
Private Non-Farm Employment	Thousands (Jobs)	14.28	19.99	24.01	27.53	30.29
	<i>% change</i>	<i>0.10%</i>	<i>0.14%</i>	<i>0.16%</i>	<i>0.18%</i>	<i>0.20%</i>
Total Government Employment	Thousands (Jobs)	1.14	1.63	1.99	2.27	2.50
	<i>% change</i>	<i>0.06%</i>	<i>0.08%</i>	<i>0.10%</i>	<i>0.11%</i>	<i>0.12%</i>
Gross Domestic Product	Billions of Fixed (2009) \$	1.23	1.76	2.16	2.49	2.75
	<i>% change</i>	<i>0.08%</i>	<i>0.10%</i>	<i>0.12%</i>	<i>0.14%</i>	<i>0.15%</i>
Personal Income	Billions of Current \$	0.83	1.28	1.66	2.01	2.32
	<i>% change</i>	<i>0.06%</i>	<i>0.09%</i>	<i>0.11%</i>	<i>0.12%</i>	<i>0.13%</i>
Disposable Personal Income	Billions of Current \$	0.72	1.11	1.44	1.74	2.00
	<i>% change</i>	<i>0.06%</i>	<i>0.09%</i>	<i>0.10%</i>	<i>0.12%</i>	<i>0.13%</i>
PCE-Price Index	2009=100 (Nation)	(0.06)	(0.06)	(0.05)	(0.05)	(0.04)
	<i>% change</i>	<i>-0.06%</i>	<i>-0.05%</i>	<i>-0.05%</i>	<i>-0.04%</i>	<i>-0.04%</i>
Personal Consumption Expenditures	Billions of Fixed (2009) \$	1.12	1.34	1.50	1.65	1.78
	<i>% change</i>	<i>0.12%</i>	<i>0.14%</i>	<i>0.15%</i>	<i>0.16%</i>	<i>0.17%</i>
Population	Thousands	5.4	10.9	16.4	21.9	27.3
	<i>% change</i>	<i>0.02%</i>	<i>0.04%</i>	<i>0.06%</i>	<i>0.08%</i>	<i>0.09%</i>
<b>BUDGET RESULTS</b>						
Static Franchise Tax Reduction	Thousands of Current \$	(1,268,483)	(1,291,384)	(1,285,736)	(1,312,405)	(1,332,960)
Dynamic Franchise Tax Reduction	Thousands of Current \$	(1,256,842)	(1,277,241)	(1,269,807)	(1,294,690)	(1,313,735)
Dynamic All Other Revenue Gain	Thousands of Current \$	57,586	91,739	121,398	149,771	176,146
<b>Net Revenue Change: Dynamic vs. Static</b>	Thousands of Current \$	69,228	105,882	137,326	167,486	195,371

**Table 4 - \$2.56 Billion Biennial Franchise Tax Reduction  
Compared \$2.56 Billion Biennial Homestead Exemption Increase**

<b>ECONOMIC RESULTS</b>						
Category	Units	2016	2017	2018	2019	2020
Total Employment	Thousands (Jobs)	8.64	12.74	15.21	16.69	17.45
	<i>% change</i>	<i>0.05%</i>	<i>0.07%</i>	<i>0.09%</i>	<i>0.09%</i>	<i>0.10%</i>
Private Non-Farm Employment	Thousands (Jobs)	7.37	11.10	13.35	14.67	15.33
	<i>% change</i>	<i>0.05%</i>	<i>0.08%</i>	<i>0.09%</i>	<i>0.10%</i>	<i>0.10%</i>
Total Government Employment	Thousands (Jobs)	1.27	1.64	1.86	2.02	2.12
	<i>% change</i>	<i>0.06%</i>	<i>0.08%</i>	<i>0.09%</i>	<i>0.10%</i>	<i>0.10%</i>
Gross Domestic Product	Billions of Fixed (2009) \$	1.48	1.89	2.15	2.35	2.48
	<i>% change</i>	<i>0.09%</i>	<i>0.11%</i>	<i>0.12%</i>	<i>0.13%</i>	<i>0.13%</i>
Personal Income	Billions of Current \$	0.47	0.80	1.05	1.25	1.41
	<i>% change</i>	<i>0.03%</i>	<i>0.05%</i>	<i>0.07%</i>	<i>0.08%</i>	<i>0.08%</i>
Disposable Personal Income	Billions of Current \$	0.41	0.69	0.91	1.08	1.22
	<i>% change</i>	<i>0.03%</i>	<i>0.05%</i>	<i>0.07%</i>	<i>0.07%</i>	<i>0.08%</i>
PCE-Price Index	2009=100 (Nation)	(0.06)	(0.06)	(0.05)	(0.05)	(0.05)
	<i>% change</i>	<i>-0.06%</i>	<i>-0.06%</i>	<i>-0.05%</i>	<i>-0.05%</i>	<i>-0.04%</i>
Personal Consumption Expenditures	Billions of Fixed (2009) \$	1.24	1.41	1.51	1.60	1.66
	<i>% change</i>	<i>0.13%</i>	<i>0.15%</i>	<i>0.15%</i>	<i>0.16%</i>	<i>0.16%</i>
Population	Thousands	4.11	8.30	12.28	16.03	19.49
	<i>% change</i>	<i>0.01%</i>	<i>0.03%</i>	<i>0.04%</i>	<i>0.06%</i>	<i>0.07%</i>