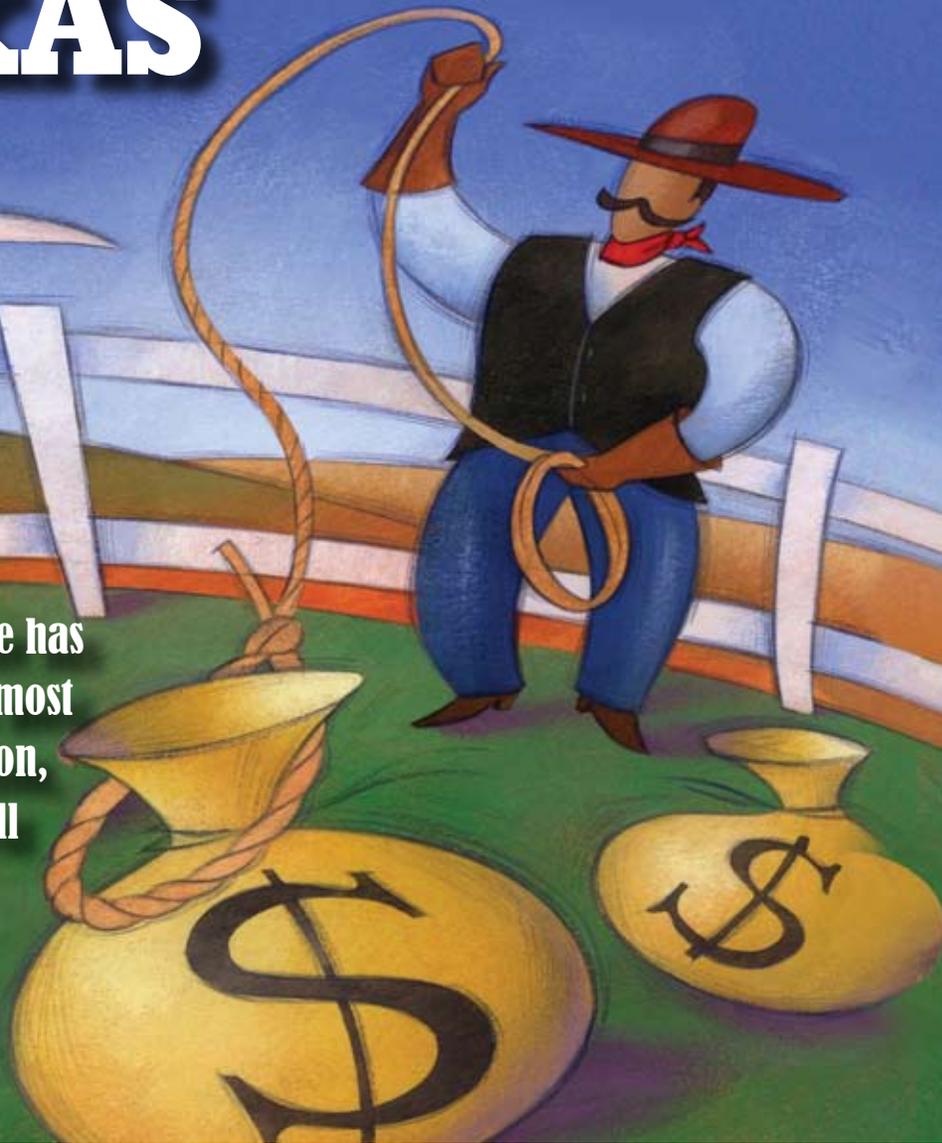


Economy Still Blossoming in TEXAS

The Lone Star State has fared better than most during the recession, but lawmakers will face fiscal woes next year.



BY JOHN MORITZ

As the nation's economy continues to struggle and many states face the daunting task of closing multi-billion budget gaps, some national news magazines have portrayed Texas as a verdant oasis standing against a parched economic desert.

Unemployment in Texas ranks well below the national average. State lawmakers left Austin last June after passing a two-year, \$182 billion budget that not only was bal-

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Editor's note: This is one in an occasional series of in-depth state fiscal profiles as legislatures grapple with deep budget shortfalls and painful decisions on how to cut spending and increase revenue.

anced, but also left a projected \$9 billion in reserve in the state's rainy day fund. Texas continues to far outpace the rest of the nation in attracting new residents and new businesses to the state.

A closer examination of conditions in the state, however, shows more than a little wilt on the Texas rose, and even some suggestion that the image of the state as a welcoming

oasis could be fading into a gauzy mirage.

"We're certainly not immune from the downturn that has hit all of the other states," says Dale Craymer, president of the non-partisan Texas Taxpayers and Research Association, an Austin think tank. "Other states may have experienced more severe difficulties than we have. But looking ahead to next January, I think we are looking at one of the toughest legislative sessions in our history from a budget standpoint."

Start with the state's 6.25 percent sales tax that is levied on almost all retail transactions except groceries and medicine. Because Texas is among the few states with no personal income tax, the sales tax has long pro-

vided state lawmakers with the largest and most reliable single source of general revenue. But after years of near uninterrupted growth, sales tax collections began plunging in February 2009 and have remained in a downward spiral ever since.

Receipts for FY 2009, which ended Aug. 31, were down 2.7 percent from the year before. Collections for November 2009 were down more than 13 percent. In December 2009, which included the Christmas shopping season, revenue plunged nearly 12 percent from the previous December. And motor vehicle sales tax collections were down 22.5 percent for FY 2009.

Another fault line appeared in Texas' all-important oil and gas sector. The deep plunge in prices of both crude oil and natural gas beginning in late 2008 led to a cor-

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responding drop in energy production tax receipts to the state. After nearly doubling from 2007 to 2008, tax revenues plummeted by some 25 percent last year, and the decline was even sharper for the first three months of FY 2010.

And even as the trend lines on the revenue side of the ledger show a downward spike, the expenditure side is pointing up. In January, the Texas House Ways and Means Committee heard testimony that the Medicaid rolls—a key driver of the state budget—were on pace to rise between 8 percent and 10 percent this year.

A RECKONING IN 2011

When lawmakers return to work for the 2011 legislative session—the Texas Legislature meets only every other year in regular session—experts are predicting they’ll face a budget shortfall ranging somewhere between \$11 billion and \$19 billion.

But one of the Legislature’s leading Republicans brushed aside suggestions the Texas sky is about to fall.

“I just don’t think it’s as bleak as everyone

is saying it might be,” says Representative Phil King, a 12-year veteran of the House who serves on the revenue-raising Ways & Means Committee. “When you look at the total size of the state budget, a \$15 billion shortfall is not as big as it sounds. You’ll find that there is a lot of room to make cuts, and I think that’s the route we’re going to go.”

A top House Democrat disagreed.

“There is no doubt that we’re going to be looking at a deep hole in our budget in 2011,” says Representative Jim Dunnam, who is the head of the Texas House Democratic Caucus and arguably one of the most influential Democrats in a state government that has been solidly under Republican control for more than a decade. “And from the looks of it, the hole is only going to get bigger.”

Dunnam’s bleak assessment was underscored by the Texas economic outlook published by Comptroller Susan Combs in late January. Texas started the year with an unemployment rate of 8.3 percent, up from 8 percent at the beginning of November, she reported. Job losses in the state were nearly 276,000 in 2009 and industrial production fell by 3.6 percent.

Coupled with the jobless numbers in Combs’ report were equally sobering statistics from the housing sector. Building permits for single-family homes fell by 20 percent in 2009 and permits for multifamily homes dropped by a staggering 65 percent. Home foreclosures in the state, meanwhile, shot up by more than 54 percent.

The continued decline in the energy production taxes, which are pumped into the state’s rainy day fund, prompted Combs in November to revise her forecast. Instead of \$9 billion in the account at the end of the current biennium, the state will more likely see a balance of around \$8 billion, she said.

STILL AHEAD OF THE NATION

The upside for Texas, which has not gone unnoticed by such publications as *Forbes* magazine and *The Economist*, is that despite



REPRESENTATIVE
PHIL KING
TEXAS



REPRESENTATIVE
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TEXAS

BY THE NUMBERS: THE TEXAS ECONOMY

8.3%

The Texas unemployment rate for December, which has been at or below the national rate for 36 consecutive months.

15%

The decrease in building permits for single-family homes December 2009 compared to a year earlier.

1-in-785

The mortgage foreclosure rate in Texas in January 2010. This compares to Nevada’s 1-in-95 and Arizona’s 1-in-129.

42%

Increase in tax collections for natural gas in FY 2008 compared to FY 2007.

48%

Decrease in tax collections for natural gas in FY 2009 compared to FY 2008.

72%

Increase in tax collections for oil in FY 2008 compared to FY 2007.

39%

Decrease in tax collections for oil in FY 2009 compared to FY 2008

Source: Texas Comptroller

these challenges, the state is faring far better than most, and better than the nation as a whole.

Republican Governor Rick Perry seldom passes up an opportunity to note that Texas’ unemployment rate even in these down times has consistently been 2 percentage points below that of the nation as a whole, and that 70 percent of all jobs created in the United

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States in 2008 were in the Lone Star State. It continues to be the fastest-growing state in the nation, adding some 150,000 new residents a year for the past half decade or so.

Perry also seems to take great delight in comparing the Texas balanced budget and rainy day surplus with most other states, especially the only one that can boast a larger population—California. The Golden State this year was battling a \$20 billion budget deficit. Speaking at a conference of Texas medical professionals in January, Perry jokingly lamented that his fellow governors—and especially California’s Arnold Schwarzenegger—have grown weary of his boasts about his home state.

“Arnold hates to see me show up [in California] for two reasons,” Perry deadpanned. “No. 1, he knows I’m going to brag about the Texas economy. And secondly, he knows I’m out there trying to retrieve another business out of California.”

Finding examples to back up the claims that Texas is faring better than most has been comparatively easy.

“For the exasperated job-seeker to whom employment opportunities seem bleaker than ever, salvation may lie in the Lone Star State,” Forbes reported in its September issue. “Texas, home to dozens of energy heavyweights and nearly as many innovative small companies, has three of the best cities to earn a living: Dallas, Houston and Austin.

“When taking into account the cost of living, strength of industry, economists’ predictions for the future state of employment and, of course, salary, these are some of the best U.S. cities in which to take home a paycheck.”

In a July 9 piece contrasting the economic climate of Texas with that of California, The Economist clearly came down on the side of the Lone Star State.

“Texas also clearly offers a different model,

based on small government,” the magazine said in the article that Perry reprinted on his government website. “It has no state capital-gains or income tax, and a business-friendly and immigrant-tolerant attitude. It is home to more Fortune 500 companies than any other state—64 compared with California’s 51 and New York’s 56.”

END OF STIMULUS MONEY

Favorable comparisons to California notwithstanding, many observers point out that Texas’ upcoming budget outlook might be more similar to the Golden State’s than immediately meets the eye.

Yes, Texas did balance its books and leave a comfortable cushion when it crafted its 2010-11 budget last year. But that task was made so much easier thanks to upward of \$20 billion in federal stimulus funds. Because the Texas Constitution forbids borrowing money to finance day-to-day government operations, deep program cuts or additional state revenue would have been required without the stimulus money.

Top state leaders are already laying the groundwork to put the brakes on spending. Early this year, Perry and the presiding officers of both houses of the Legislature directed state agencies to identify ways to trim their budgets by at least 5 percent.

The directive was reminiscent of 2003, when Texas was facing a \$9.9 billion shortfall and Perry and legislative leaders were adamant about bridging the gap without raising taxes. They largely succeeded, but some fees, like college tuition, increased and some state payments were deferred to the next budget cycle to balance the books.

And there will likely be pressure to impose deep and across-the-board spending cuts, as was done in 2003, and to tap into the rainy day fund, which requires a two-thirds vote of both houses, before state leaders put any revenue-raising options on the table.

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Straus says of the effort to bridge the looming revenue shortfall. The rainy day fund, he acknowledges, will be a tempting target for lawmakers.

“I’m not in favor of draining the rainy day for fund any purpose. But it is there for difficult times, and we are in difficult times.”

Combs, the state comptroller who has the responsibility of telling lawmakers exactly how much they have to spend each budget cycle, said she expects the Texas economy to pick up and grow in the 2.5 percent range before the year is out, which could arrest the yearlong slide in revenues.

“It is expected the double-digit declines in tax collections seen over the last half-year will first moderate with collections returning to growth during the first or second quarter of 2010,” Combs says.

Craymer, the head of the taxpayers and research association, was a little more cautious in his optimism. Yes, there are signs that the downturn has bottomed out in Texas, he said, but the recovery appears less robust than the state has experienced after the recessions of the early 1990s and the one that caused the 2003 budget shortfall.

“Even though we are starting to see some growth, employers are still reluctant to rebuild their payrolls because of the lingering uncertainty,” says Craymer, a former chief revenue estimator for the state. “And we’re still not yet seeing a return to the free flow of credit, which businesses need if they are going to expand. Remember that half of our sales tax is paid by businesses, and if they’re not spending sales tax collections will continue to be a major concern going forward.”

CHECK OUT NCSL’s latest “State Budget Update” to learn more about the fiscal condition of the states and read previous in-depth fiscal profiles of Michigan, California, Arizona, New York and Rhode Island at www.ncsl.org/magazine.