Modeling a Comparison of Texas Sales, Franchise, and Property Tax Reduction Proposals with REMI Tax-PI

September 2015
Fiscal Background

- Texas bi-annual budget: Legislature meets January – May of odd numbered years to establish appropriations for following 2 years.

- January 2015: Beginning of 84th Legislative Session
  - State Revenue Collections > Forecast for 4 consecutive fiscal years, 2011-2014
  - 2014-15 Estimated Ending Certification Balance = $7.5 billion (~7.2% of estimated biennial General Revenue collections)
  - Numerous proposals for various tax reductions
Texas Government Code:

“The (LBB) shall prepare a dynamic fiscal impact statement (DFIS) for each bill… that raises or lowers the rate or amount of a tax or fee… (by) at least $75 million annually.”

“The DFIS must, based on dynamic scoring principles, project for (a) five-year period… the estimated fiscal and economic impacts of raising or lowering the rate or amount of the tax or fee…”
REMI Tax PI
# REMI Budget Calibration

### Options
- **Start of Fiscal Year**: September
- **Expenditures Determined By**: Revenues, Demand

### Policy Variable
- Select a policy variable to associate with the budget item. When a policy variable change is made to this budget item, the associated model variable will automatically be changed. Select a variable that best represents how the budget category works. For example, a sales tax on consumer goods would be well represented by the Consumer Price policy variable.

### Revenues
- **Display Years**: 2014 to 2017

#### Revenue Details
- **Sales Taxes - Consumer**
  - **Policy Variable**: Consumer Price
  - **Details**:
    - Production Cost (amount)
    - Capital Cost (amount)
    - Personal Taxes (amount)
    - State Taxes with Federal Offset (amount)
    - State Taxes with Marginal Propensity to Consume (amount)
    - State Taxes with Federal Offset and Marginal Propensity to Consume (amount)
    - Electricity (Commercial Sector) Fuel Cost (amount)
    - Furniture and furnishings
    - Household appliances
    - Glasses, bathtubs, and household utensils
    - Tools and equipment for house and garden
    - Video, audio, photographic, and information processing equipment and media
    - Sporting equipment, supplies, guns, and ammunition
    - Sports and recreational vehicles
    - Musical instruments
    - Safety and watches
    - Therapeutic appliances and equipment
    - Books, educational and recreational
    - Luggage and similar personal items
    - Telephone and facsimile equipment
    - Food and nonalcoholic beverages purchased for off-premises consumption
    - Alcoholic beverages purchased for off-premises consumption
    - Food produced and consumed in farms
    - Men's and women's clothing
    - Women's and girl's clothing
    - Children's and infants' clothing
    - Other clothing items and footwear
    - Motor vehicles, fuel, lubricant, and fluids
    - Fuel oil and other fuels
    - Pharmaceutical and other medical products
    - Recreational items
    - Household services

### Settings
- **Inflation Factor**: CPI All Items
- **Discount Rate**: 3%

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**SEPTEMBER 2015**

**LEGISLATIVE BUDGET BOARD**

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## REMI Budget Calibration

### Expenditures

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<thead>
<tr>
<th>Expenditure Name</th>
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<th>FY2015</th>
<th>FY2016</th>
<th>FY2017</th>
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### Expenditure Details

#### K-12 Education Instruction

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### Options

- Start of Fiscal Year: September
- Units: Nominal & (2008)
Tax Reduction Proposals

Compare equal revenue loss ($2 billion per year) for 4 proposals:

- Increase resident homestead exemption for School District Property Taxes
  - No state Property Tax
  - State reimburses School Districts for lost revenue
- Decrease Franchise Tax rate
- Increase Franchise Tax total revenue exclusion
- Decrease Sales Tax rate
Issue #1: Structural vs Cyclical Surplus

- REMI economic forecast and budget calibration: August 2014
  - 2014 Annualized Q3 Texas GSP ↑ 10.6%
  - Annualized Employment Growth ↑ 3%
  - Oil Prices ≈ $100 bbl; Texas YoY Oil Production ↑ ≈ 600 Mb/d
  - Tax PI predicts Structural Surplus
- Model Runs on Tax Reductions: February 2015
  - Oil Prices ↓ 50%, Oil Production still growing, but slower pace
  - Effects on Texas economy highly uncertain? Surplus structural or cyclical?
- Solution:
  - National Simulation w/ Output declines in Mining Sector and Consumer/Business Price declines for Petroleum related products
  - Create “Cyclical Surplus” revenue variable
Issue #2: Balanced Budget Requirement

- Texas has “Pay as You Go” balanced budget requirement
  - Legislature cannot appropriate more General Revenue Related funds than Comptroller of Public Accounts forecasts will be available.

- Not the same as requiring Expenditures ≤ Revenue
  - Legislature can appropriate $ amount of fund balances in Dedicated accounts within GR Fund without appropriating the actual fund balances
  - 58% of predicted $7.5 billion ending balance = dedicated account balances

- Tax PI balanced budget feature does not take balances into account.

- Solution:
  - Create “GR-D Balance” revenue variable (similar to Surplus variable)
  - Allows some level of tax cuts w/o forced spending cuts by Tax PI balanced budget feature.
Issue # 3: State/Local Budget Interaction

- No Local Govt. spending/revenue variables in model.
- Property Tax Reductions:
  - State mandates school districts reduce property taxes
  - State reimburses school districts through school funding formulas
- Local reimbursement = ↑ State Expenditure
  - However, ∆ Total Education Spending = 0
- Solution:
  - Create spending variable w/ no link to economic indicators or policy variables
  - ↓ Consumer Spending on Imputed rent of owner-occupied housing
  - ↑ Consumer Reallocation by equal amount (some saved, some spent in other consumption categories)
Issue #4: Alternate Distribution of Benefits

- Requested comparison: Equal amount of revenue loss for 2 different franchise tax reduction proposals.

- Tax benefits of 2 proposals have different distribution across industries, across size of firms, and across types of firms (in-state vs. out-of-state and corporations vs partnerships vs sole props).
  - Increase “no tax due” threshold from $1 million total revenue
    - All of $ tax benefit to small, mostly in-state taxpayers
  - Decrease franchise tax rate
    - Most of $ tax benefit to large multi-state firms
- Tax PI: no ability to model alternate distributions of a tax reduction.

- Solution:
  - Create sales and franchise revenue variables for each NAICS industry
  - Use distribution of franchise tax paid by industry size to proportionally allocate tax benefits
Contact

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