HOUSE RESEARCH ORGANIZATION bill analysis	5/1/2007	HB 2786 Paxton (CSHB 2786 by Bonnen)

SUBJECT: Requiring a dynamic fiscal impact statement from the LBB on certain bills

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 8 ayes — Keffer, Ritter, Otto, Bonnen, Y. Davis, Flores, Peña, Pitts

0 nays

1 absent — Paxton

WITNESSES: For — Talmadge Heflin, Texas Public Policy Foundation (*Registered, but did not testify*: Tom Aldred, Texas Conservative Coalition; Richard Lawson, Verizon Southwest; Richard Sookiasian, Texas Association of Mexican American Chambers of Commerce)

Against — Dick Lavine, Center for Public Policy Priorities

On — Scott Mackey

BACKGROUND: Government Code sec. 314.001 requires the Legislative Budget Board (LBB) to prepare a fiscal note estimating the cost of a bill or resolution that would authorize the expenditure of state funds for a purpose other than one provided for in the general appropriations bill. Sec. 314.003 requires the fiscal note to be attached to the bill or resolution and remain with the bill throughout the legislative process, including submission to the governor.

DIGEST: CSHB 2786 would require the Legislative Budget Board to prepare a "dynamic fiscal impact statement" for each bill or joint resolution:

- that would raise or lower the rate or amount of a tax or fee or propose an amendment to the Texas Constitution that would raise or lower the rate or amount of a tax or fee; and
- for which the bill or resolution's fiscal note indicated a positive or negative impact on revenue would be at least $100 million during a period of no more than five years.

Each dynamic fiscal impact statement would be based on "dynamic scoring principles" and would be attached to the bill or resolution immediately following the fiscal note.

The bill would define "dynamic scoring principles" as a means for estimating the pace of economic growth or the change in the aggregate level of economic output and income in response to a change in the rate of a tax or fee. The methods used in these principles would have to take into account:

- the impact on fee receipts and program costs;
- the effect on incentives to work, save, invest, and conduct economic affairs;
- the resulting change in the overall level of economic activity;
- the impact of a change in the level of economic activity on tax or fee receipts and program costs;
- the impact on the unified budget.

For the five-year period beginning on the effective date of the bill or joint resolution, the statement would project the fiscal and economic impacts of the proposal. This would include the impact on:

- tax or fee receipts; and
- the costs of any program the tax or fee was designed to support.

The bill would take effect September 1, 2007.

SUPPORTERS SAY:

By directing the LBB to provide a dynamic fiscal impact statement on tax legislation, CSHB 2786 would apply the principles of dynamic scoring in order to provide legislators with a more balanced and complete picture of the effect that proposed fiscal changes could have on state government revenue and the Texas economy. Dynamic scoring would estimate the impact that higher or lower economic activity resulting from a given policy change would have on program costs and tax receipts. Dynamic fiscal impact statements would help Texas lawmakers take better account of the effect of fiscal policy on the state's overall economy.

CSHB 2786 particularly would be helpful to obtain a more complete picture that the effect of a tax cut or increase on the Texas economy and on state government receipts. It is a well-understood economic principle that tax policy influences individual behavior and that tax cuts in particular stimulate consumption and economic activity. However, static fiscal analysis of the kind employed for a fiscal note only takes into account the negative impact of a tax cut on the state's treasury. A static fiscal note fails to recognize that if a reduction in taxation led to an expansion of Texas' gross state product, the base on which that tax was applied could expand. Alternately, any tax increase might be shown to generate less than expected if the tax increase diminished economic activity in the state. A dynamic fiscal analysis would take these types of effects into account, likely predicting a more realistic impact on state revenue than generated from static analyses.

Legislators have benefited in the past from the type of information that would be included in the dynamic fiscal impact statement required under CSHB 2786. For example, when the Legislature considered revising the franchise tax under HB 3 by Keffer during the 79th Legislature's 2005 regular session, the Comptroller's Office prepared a supplemental dynamic fiscal analysis indicating that the net effect of the legislation would have led to a $5.9 billion increase in personal income and an increase in overall employment of more than 88,000 jobs. CSHB 2786 would ensure that similar analyses would accompany all significant tax legislation, so that legislators fully understood the long-term economic effects that legislation likely would have.

CSHB 2786 simply would add another tool to the toolbox of legislators as they tried to determine the pros and cons of complex tax legislation. The dynamic fiscal impact required under CSHB 2786 would not supplant the static fiscal note, which would continue to be included with every bill. CSHB 2786 simply would allow legislators to have additional information to consider when voting on large tax bills.

It is unlikely that the inclusion of a dynamic fiscal impact statement with a bill would slow down legislative process. In order to perform the type of analysis required under CSHB 2786, it is likely that the LBB and Comptroller's Office would develop an economic forecasting model into which information from a tax proposal could be entered. In fact, several such models currently exist and are used in states across the country, including Massachusetts, Minnesota, Oregon, and New Mexico.

OPPONENTS SAY:

A dynamic fiscal impact statement by its very nature would be speculative and very likely less accurate than the projections currently produced for a bill's fiscal note. It is easy for the LBB to predict the cost to the state of a tax cut. Further, it is relatively straightforward to estimate the marginal decline in tax revenue associated with a fee increase for a commodity for which the elasticity of demand is known, such as gasoline or cigarettes. Such predictability allows these effects to be factored into the analysis included in a fiscal note. Further, such estimates are represented in the Comptroller's Biennial Revenue Estimate and budget certification at the beginning and end of each legislative session. The cascading economic effects that would be considered in a dynamic fiscal note almost certainly would be less accurate. Inclusion of this analysis along with a fiscal note could lead lawmakers to invest more confidence in such a report than should be given, possibly leading lawmakers to base long-term fiscal policy on an unacceptably shaky foundation.

Although dynamic scoring often is promoted by those who favor lower taxes, the simple fact is that tax cuts do not pay for themselves. Often, the economic impact of tax legislation only represents two to three percent of the overall cost of a tax bill. Further, because the Texas Constitution requires a balanced budget, tax cuts inevitably have costs associated with them. A dynamic fiscal impact statement for a tax cut bill might show a positive impact for the economy only because the negative economic consequences associated with cutting government services to pay for that tax cut were not included.

In order to be accurate and useful, a dynamic scoring model would have to allow for multiple variables and be based on extensive research. For this reason, it is possible that inclusion of a dynamic fiscal impact statement could delay the consideration of some bills by the Legislature. Given the challenging deadlines that the LBB and the Comptroller’s Office already must operate under when analyzing tax legislation, it is possible that this additional report could slow the consideration of tax legislation by the Legislature.

OTHER OPPONENTS SAY:

Tax legislation certainly has economic impacts, but other activities of government produce positive and negative economic effects as well. If dynamic scoring were to be applied to tax legislation, it only would be appropriate to apply similar methodologies to the analysis of legislation making expenditures. For example, additional funds dedicated by the state to public and higher education, highway and infrastructure projects, job training programs, and many other priorities likely would show a positive and substantial impact on the state's economy and future tax receipts. For this reason, dynamic fiscal impact statements should be applied to any policy proposal likely to have a significant impact to Texas' economy.

NOTES: In the bill as filed, a dynamic fiscal impact statement would have had to have been prepared for every bill or joint resolution that raised or lowered a tax or fee, rather than only when the fiscal note indicated a positive or negative impact of at least $100 million, which was added by the substitute.