

# TARA

Texas Taxpayers and Research Association

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## The 2014-15 Texas State Budget: Assessing the Numbers

*This is the third and final installment of a series on the fiscal actions of the 83<sup>rd</sup> Legislature. The first, published in June of 2013, summarized the various changes to public education law. The second, published in July 2013, summarized various tax law changes.*

Rags turned to riches for the 83<sup>rd</sup> Legislature. Two years earlier lawmakers had faced the biggest potential deficit in the state's history. They balanced the budget for 2012-13 without raising taxes—bucking the trend of most states during the recession—making deep budget cuts, but also deferring some bills and adopting some temporary accounting shifts. That meant there would be unfinished business for the 2013 legislature to address.

When the legislature did convene in 2013, the economy had roared back, filling state coffers with a massive surplus. Lawmakers tackled three tasks on the fiscal front:

1. finish work on the 2013 budget, putting state finances on a solid foundation,
2. craft a balanced budget for the upcoming 2014-15 Biennium, and
3. bolster the economy with a pro-growth package of tax and fee cuts.

Lawmakers went three for three. Not only were bills deferred from the previous session paid in full, lawmakers also repealed the now-unnecessary accounting shifts. They put in place

a balanced budget for 2014-15 that grows less than the combined rate of population and inflation. They provided almost \$1.4 billion in tax and fee relief—targeting new investment and jobs. Texas state finances are now on a solid foundation for the future.

And the good times are far from over. At the time the lawmakers put their finishing touches on the budget, the Comptroller advised them that \$683 million in state general revenues remained unspent. Within a few weeks, she added \$225 million to that, based on better-than-expected oil and gas severance tax collections. And in December, in her formal “certification” estimate she raised her estimate of surplus funds to \$2.6 billion. Current trends suggest even that figure may be low by several billion dollars.

**Texas’ conservative fiscal and regulatory policies are clearly paying dividends.**

### **Task One: Balance the Current State Budget**

The first task facing lawmakers in 2013 was to bring the budget from the previous session into balance. Two years earlier, faced with what would have been the biggest deficit in history, legislators made deep budget cuts, deferred the timing of state aid payments to local schools, moved the due date of certain taxes forward, and explored a variety of options to restructure the state’s Medicaid program—including seeking

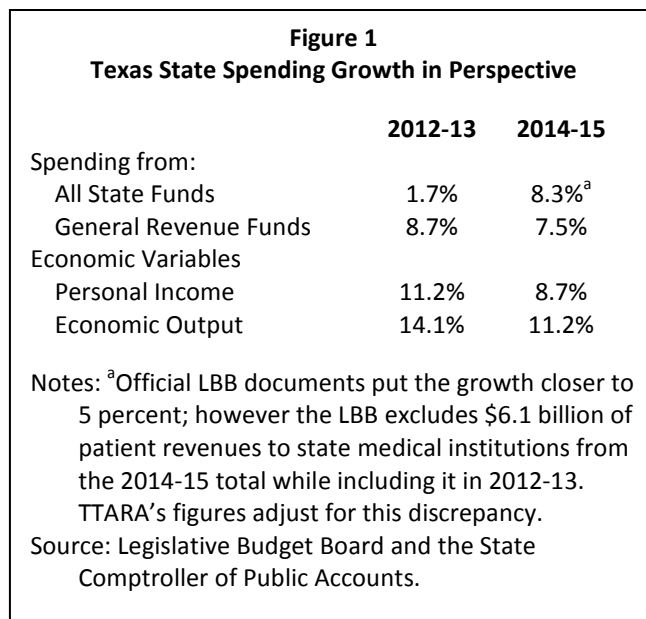
a federal block grant. Absent federal approval for such restructuring, though, the budgeted amount for Medicaid would fall short by several billion dollars. Ultimately the federal government provided no help, and lawmakers of the 83<sup>rd</sup> Legislature were faced with an unpaid Medicaid bill north of \$4.5 billion (as well as a \$630 million shortfall in public school formula aid and a handful of other items, including funds related to fighting the Bastrop fire). In House Bill 10, House Bill 1025, and Senate Bill 559 lawmakers paid these bills, and undid a number of accounting shifts adopted during the previous session—the largest of which would have delayed a \$1.75 billion payment to local schools. The scheduled tax speed-ups never took effect.

After all the dust had settled, the state closed the books on the 2012-13 budget having spent \$190.8 billion from all state funds and \$93.6 billion for the more discretionary general revenue purposes—well below the state’s economic growth of 14.1 percent (Figure 1).

More importantly, they had put the state on a solid foundation for future growth. **Even after righting the fiscal ship of state, Texas closed the books on 2013 with a whopping \$5.5 billion surplus.**

**Task Two: Craft a Balanced Budget for the 2014-15 Biennium**

The resurgent economy and the associated revenue growth enabled lawmakers to build from the very conservative budget base in place. Some funding priorities were clear—lawmakers were able to substantially restore previous funds cut from the public education budget in conjunction with a massive revamping of the state’s curriculum (although not enough for local school groups to put aside their court challenge to the school finance system). Tax cuts were a part of the mix, too. Legislators not only cut the state’s unpopular franchise tax, they also



targeted tax relief for new investments in research and development, telecommunications infrastructure, and data centers.

**The overall state budget for 2014-15 totals \$200.4 billion, with the more discretionary general revenue affected dollars tallying \$100.6 billion.** <sup>1</sup> The budget passed by a 27 to 2 vote in the Senate and a 118 to 29 vote in the House, with a majority of both Democrats and Republicans in support. **Compared to the previous budget, general revenue spending will grow by \$7.0 billion or 7.5 percent.** Lawmakers made judicious use of the Rainy Day Fund, using it to pay one-time bills as well as allowing voters the choice of using a portion for new water and transportation infrastructure.

<sup>1</sup>In this budget analysis, TTARA focuses on the more discretionary general revenue-affected funds (see “Just How Much Budget Discretion Does the Legislature Really Have?” on page 6). This includes the state’s general revenue fund plus all other funds that interact with general revenue in a manner in which surpluses or deficits in those funds directly impact general revenue: the Available School Fund 2, the Instructional Materials Fund 3, the Foundation School Fund 193, and the Property Tax Relief Fund 304. In addition, we include any expenditure from the Economic Stabilization Fund that directly supplants or augments general revenue.

## 26 Percent Budget Growth? 100 Percent Wrong

After lawmakers forwarded the 2014-15 budget to Governor Perry, a number of conservative groups sent a letter to Governor Perry lamenting a “\$22 billion” or “26 percent” increase in state spending—a claim that was later picked up by an editorial writer for the Wall Street Journal in an incendiary piece titled “Texas Goes Sacramento.” The groups implied that the budget was irresponsibly high, but offered no proposals of specific budget cuts they would endorse nor identified any items the Governor should veto. Instead they called for using the Rainy Day Fund to pay for a reduction in the sales tax—an action that ironically would have no impact on the budgeted level of state spending.

While additional tax cuts would have been a clear positive for the Texas economy, the claim of a 26 percent spending increase was simply wrong, and TTARA noted such in a June 12 letter to the Wall Street Journal. *PolitiFact Texas* also determined that the 2014-15 Budget grew less than the rate of growth of population and inflation combined. The “26 percent” budget figure misleads rather than informs. Basic accounting principles were sacrificed as spending and revenue numbers were mixed across fiscal years, with certain items either included or excluded depending on whether they supported a predetermined conclusion. After such severe mathematical torture, the numbers were ready to confess to anything. But the numbers are wrong and here is why.

**First, of that \$22 billion, \$7 billion was to cover the bills deferred by the prior legislature and bring the previous state budget into balance.** The implication is that it would somehow have been more fiscally responsible for the state to default, an action which could have resulted in costly federal sanctions as well as the possible closure of hundreds of hospitals across the state, hitting rural areas the hardest. That’s a little like congratulating someone for their frugality when they fail to pay their electric bill, and condemning them as profligate when they finally pay the bill late.

**Second, \$2 billion of the “spending” was not for general purposes but was for loans to local governments to alleviate the state’s water crisis—and took effect only with the overwhelming approval of Texas voters.** This amendment authorized using money from the state’s rainy day fund to purchase local water bonds. In fact, investing in local bonds will keep the money in the state treasury and allow it to earn a greater return than it would sitting in the state’s rainy day fund. Equating that to general purpose spending is false. It is no more “spending” than one’s investment in an individual retirement account is considered “spending.”

So after sorting through the math, and comparing apples to apples, the 83<sup>rd</sup> Legislature:

- made good on billions of dollars unpaid obligations from the previous legislature,
- provided \$1.4 billion in tax and fee cuts,
- reduced diversions of dedicated funds,
- left, at a minimum, \$2.6 billion available for future tax cuts or budget needs,
- stayed well within the Constitutional limit that restricts growth in state spending to no more than the rate of growth of the Texas economy,
- set aside funds voters could approve to meet the state’s water needs, and
- increased general revenue spending by \$7.0 billion, or 7.5 percent.

**Figure 2**  
**The Texas Budget by the Numbers**  
**Billions of General Revenue Affected<sup>3</sup> Dollars**

Item	2012-13	2014-15	Dollar Change	Percent Change
<b>Beginning Balance</b>	<b>\$1.1</b>	<b>\$5.5</b>	<b>\$4.4</b>	
<b>Revenues</b>				
Sales Taxes (incl.Auto)	\$57.4	\$62.6	\$5.2	9.1%
Severance Taxes	\$8.1	\$9.5	\$1.4	16.9%
Franchise Tax	\$9.4	\$9.3	(\$0.1)	-0.7%
Alcohol/Tobacco	\$4.9	\$4.9	\$0.0	0.6%
Other Taxes	\$7.0	\$7.3	\$0.3	4.2%
Non Tax Revenues	<u>\$12.4</u>	<u>\$11.2</u>	<u>(\$1.2)</u>	-9.5%
<b>Total Current Revenues</b>	<b>\$99.1</b>	<b>\$104.7</b>	<b>\$5.7</b>	<b>5.7%</b>
<b>Certification Adjustments</b>				
Change in Dedicated Account Balances	\$0.7	(\$0.6)	(\$1.3)	-190.8%
Less: ESF Reserve	(\$4.4)	(\$5.4)	(\$1.0)	23.4%
Plus: Rainy Day Funds Appropriated	\$1.9	\$0.0	(\$1.9)	-100.0%
Other Certification Adjustments	<u>\$0.7</u>	<u>(\$1.0)</u>	<u>(\$1.7)</u>	-240.7%
<b>Total Certification Adjustments</b>	<b>(\$1.1)</b>	<b>(\$7.0)</b>	<b>(\$6.0)</b>	
<b>Spending</b>				
Public Education	\$34.7	\$37.6	\$2.9	8.4%
Higher Education	\$12.6	\$13.1	\$0.6	4.4%
Health & Human Svcs	\$27.5	\$29.7	\$2.1	7.7%
Public Safety/Corrections	\$8.4	\$9.1	\$0.7	8.8%
Other	<u>\$10.4</u>	<u>\$11.1</u>	<u>\$0.7</u>	6.6%
<b>Total Spending</b>	<b>\$93.6</b>	<b>\$100.6</b>	<b>\$7.0</b>	<b>7.5%</b>
<b>Net Surplus</b>	<b>\$5.5</b>	<b>\$2.6</b>	<b>(\$2.9)</b>	

Note: <sup>3</sup>Figures include General Revenue Fund 1, Available School Fund 2, Instructional Materials Fund 3, Foundation School Fund 193, Property Tax Relief Fund 304 and those appropriations from the Economic Stabilization Fund appropriations directly augmenting or supplanting state general revenues.

**Public Education.** The state's public schools are financed through a complicated set of mathematical formulas written into state law. State aid is distributed to local school districts in a manner to mitigate the disparities in local property tax bases. School districts with little property value per student receive more in state aid than districts with higher levels of property wealth per student (very property-rich districts are even subject to recapture, so that their wealth is "shared" with other districts—a system

designed to comply with court equity mandates). Under the formulas, as property wealth grows, state aid diminishes. Aid formulas were rewritten for the 2012-13 Budget to reduce the demands on state aid by \$4 billion, but in the 2014-15 Budget excess money allowed lawmakers to restore \$3.2 billion of the previous cuts. The budget also increased funding for textbooks as well as providing additional funds to protect the fiscal health of the teacher retirement system.

**Higher Education.** Formula funding and special items for institutions of higher education were increased by more than \$550 million, and student grants were increased by \$135 million.

**Health and Human Services.** About 85 percent of the state’s health and human services funding is for Medicaid—a health insurance entitlement program for low-income Texans. As an entitlement program required to meet certain federal minimum standards, state discretion is limited, though the budget did incorporate \$400 million of savings from new cost-containment initiatives. Overall, general revenue funding for Health and Human Services was increased by \$2.1 billion, based on conservative assumptions about caseload growth. It is not unlikely, nor would it be uncommon, for supplemental funding to be necessary for the program to remain in compliance with federal law before the books are closed on the 2014-15 Budget. Additional funding was also provided for Child Protective Services, foster care, substance abuse and mental health services.

**Public Safety and Corrections.** Little growth is expected in the state’s prison population, but operational appropriations are increased for prisoner health care costs and correctional officer salary increases.

**Other.** Other key items included in the budget are a 1 percent state employee salary increase in 2014 followed by a 2 percent increase in 2015 (with a slightly better increase for selected employee groups), as well as increases in state employee pension contributions.

**Task Three: Tax and Fee Cuts**

The budget package offers almost \$1.4 billion in tax and fee relief (For a more detailed discussion of these and other changes in tax law, see TTARA’s Tax Wrap-Up for the 83<sup>rd</sup>, published in July 2013). House Bill 500 cut the franchise tax

<u>Bill</u>	<u>Savings</u>
HB 500: Franchise Tax Cuts	\$482.0
HB 500: 2015 Franchise Tax Rate Cut	\$232.0
HB 7: Elimination of System Benefit Fees	\$245.5
HB 7: Fee Reductions	\$33.6
HB 800: Research & Development Tax Cuts	\$239.2
HB 800: Early Implementation of HB800	\$40.0
HB 1333: Telecommunications Infrastructure Tax Refund	\$100.0
HB 1223: Tax Cuts on Data Centers	<u>\$14.6</u>
<b>Total Tax and Fee Reductions</b>	<b>\$1,386.9</b>

rate by 2.5 percent in 2014 and by 5 percent in 2015, along with a number of more targeted measures. House Bill 7 repealed the system benefit fee levied on utility bills (as well as rebating the balances of the fund to reduce electric rates—an amount not included in the numbers in Figure 3). To promote jobs creation and new investment, lawmakers approved a package of bills to incentivize new investments in research and development, telecommunications infrastructure and data centers—all investments in which Texas has historically been at a disadvantage relative to other states.

**A Glimpse at the 2016-17 Budget**

The 84<sup>th</sup> Legislature will convene next January to write the state budget for 2016-17. Lawmakers will inherit a multi-billion surplus, probably higher than the \$2.6 billion currently projected. Adding to this should be continuing revenue growth matched with traditional fiscal frugality. The state should have more than sufficient funds to maintain the current level of state services, inviting a discussion of additional funds for transportation and public education, and/or another round of tax cuts.

### **Just How Much Discretion Do State Budget Writers Really Have?**

Budget-writing is always a challenge, whether money is plentiful or not. The budget is very much a political document, for it must represent a consensus of a majority of representatives elected from diverse areas across the state. But in truth, it can only partially reflect the priorities of lawmakers because of certain constraints placed by the state constitution and federal law.

The Texas state budget for 2014-15 spends an estimated \$200.4 billion dollars; however, \$68.7 billion of that is money from the federal government that is restricted for specific programs. Constitutional and other dedications limit another \$31 billion. That leaves only half of the state's money—\$100.6 billion—as “general revenue-affected” funding, but even this is not truly discretionary.

For example, the single biggest program in the state's overall budget is Medicaid—a health insurance program for those with low incomes. Medicaid is a shared program between the state and the federal government. While the federal government covers more than half the program's costs, that federal money comes with strings attached. The program's general parameters are dictated by federal law, while other parts are constrained by court orders and settlements. Over the past several decades Medicaid spending has grown by nearly 12 percent annually—driven not so much by the decisions of Texas lawmakers, but by federal mandates. Now with the Affordable Care Act in law, states have even less Medicaid budget flexibility. So even if Medicaid is not a lawmaker's priority, their hands are largely tied by Washington, as Medicaid takes precedence over most other items in the Texas budget. For example, lawmakers attempted to make deep cuts in Medicaid in 2011, but most ultimately were precluded by federal law, and the first order of business for the 2013 Legislature was to make the program whole, or face federal sanctions. In the 2014-15 Budget the state will put up \$22.8 billion from general revenues for Medicaid (and draw \$34.6 billion in federal funds).

Public education is another area of the budget influenced by factors beyond lawmakers' control. The Texas constitution requires that the legislature provide an “efficient system of public free schools”—language that plaintiffs contend requires not just equitable funding across districts but also the level of state appropriations. Lawmakers can rewrite those formulas to spend less, as they did in 2011, but those budget cuts immediately resulted in school districts filing suit against the state. An Austin trial court judge ruled in favor of the plaintiffs, and while the case is currently under further review, a final decision could place additional demands on state appropriations, limiting lawmakers' budget flexibility even more. Lawmakers appropriated \$40 billion in general revenue affected funds in 2014-15 for public schools.

So in total, dedications, restrictions, Medicaid and Public Education cover over 80 percent of the Texas budget, leaving the remainder to fund all other executive agencies, the courts, and the legislature—not much to work with if the state is going to continue to operate.

That limited discretion, though, illustrates just what an incredible accomplishment it was in 2011 for the Governor and lawmakers to balance the state budget without relying on tax increases—a boast two-thirds of the states cannot make.

## Understanding “General Revenue” Funds

The Comptroller is charged with determining if sufficient revenues will be available to cover the appropriation made by the legislature, but in fact, many of the appropriations in the General Appropriations Bill automatically adjust to the amount of revenue the state receives, regardless of the Comptroller’s estimates. For example, if the budget appropriates \$1 billion in federal funds to an agency for a program, but the agency only receives \$500 million, it can only spend the \$500 million and not a penny more. The Comptroller’s revenue estimate does not control the appropriation, the actual amount of revenue received does.

The General Revenue Fund is different in that appropriations are guaranteed. If an agency receives a general appropriation from the fund, it can spend the money whether there is money in the fund or not (the exception to this being an appropriation from a specific revenue source within general revenue, such as an agency fee). Because the general revenue fund is the only state fund that is authorized to incur a deficit, the Comptroller’s “certification” focuses on the general revenue fund and those few funds that directly impact it—essentially those involved in financing public schools. Texas has a number of revenue sources dedicated for the support of public schools, but the overall amount of state revenue for schools is determined by formulas in state law. **Because the revenues dedicated for public education fall far short of the formula amounts, state general revenues make up the difference.** Consequently, the Comptroller’s forecast of these revenues directly impacts state’s general revenue obligations. These funds, in combination with the general revenue fund, are sometimes referred to as “certification” or “general revenue-related” funds, or sometimes simply referred to as “general revenue.”

- **Available School Fund 2:** In accordance with dedications established in the Texas Constitution, Fund 2 receives investment income from the Permanent School Fund as well as 25 percent of state motor fuels tax collections. The revenue is distributed to public schools but counts against the state’s school funding formulas. Because the amount in the fund falls far short of what the formulas require for schools, revenue in the available school fund essentially only acts to reduce the amount of general revenue spent on schools. If the state overestimates the amount of revenue to the Available School Fund, the general revenue fund must make up the difference.
- **Instructional Materials Fund 3:** The sum-certain amount necessary to cover the state’s appropriation for textbooks is transferred to the instructional materials fund from the Available School Fund. This reduces revenue to the Available School Fund which is offset, as outlined above, by the general revenue fund.
- **Foundation School Fund 193:** The Foundation School Fund is a “clearinghouse” fund used to process the state’s appropriations to local schools. It receives certain dedicated revenues plus the amount from general revenue necessary to fully fund the state formula-based appropriation of state aid to public schools.
- **Property Tax Relief Fund 304:** The property tax relief fund was established as a part of the 2006 initiative to reduce local school taxes for maintenance and operations and replace it with state money—a portion of which was to be

paid for by increases in the state's cigarette and franchise taxes. Should the amount of revenues fall short, the difference is offset by increased general revenues, and vice-versa. While the Property Tax Relief Fund interacts with the general revenue fund in the exact same manner that the above school funds do, the Comptroller and the Legislative Budget Office typically exclude it from their total of general revenue funds.

- **Economic Stabilization Fund 599.** The economic stabilization fund, most commonly referred to as the "Rainy Day Fund," has no automatic link to the

state's general revenue funds, but mostly the fund has been tapped to replace or augment appropriations typically made from general revenues. The exception to this is the recent voter authorization of \$2 billion to invest in local water bonds. Otherwise, most appropriations from the stabilization or "Rainy Day Fund" for all intents and purposes have been associated with items normally funded by general revenues. The Rainy Day Fund can only be accessed through appropriation by the Legislature, and whether the appropriation serves a "general revenue" purpose can only be determined on a case-by case basis.