TEXAS TAXPAYERS
TTARA
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The 2020-21 Texas Budget: The Miracle Continues

It was the best of times, it was the *very* best of times.

For a session many initially thought would be fraught with fiscal peril, lawmakers returned to Austin this past January facing a much healthier state treasury than anticipated. As a result, they were able to craft a 2020-21 state budget that not only met much (but not all) of the state's basic needs, they also added a whopping $11.6 billion to state funding for public education, roughly half of which would be used to lower school property tax rates.

In this, the third and final installment of three reports on the 86th Legislature, TTARA evaluates the budget as passed and takes a look into the crystal ball for lawmakers when they return to Austin in 2021.

A Brighter Bulb in the Revenue Socket

When lawmakers left town in 2017 they had balanced the state's upcoming budget even though money was fairly tight. To make the numbers work, they had tapped some one-time revenue sources and deferred certain obligations. Many, including TTARA, were concerned that the 2019 session would see those chickens come home to roost and lawmakers could face a massive structural gap. But, as is common in Texas, a funny thing happened on the way to the next fiscal crisis – oil prices rose and state revenues popped. State Comptroller Glenn Hegar even took the unusual mid-term step of revising his revenue estimate upward – adding almost $6.4 billion to his estimate of tax collections alone. That eased the reliance on one-time measures, generated a $4.2 billion surplus, and gave lawmakers a much higher revenue base from which to build the next state budget.

The Comptroller added to those numbers in his official biennial revenue estimate presented to the 86th Legislature to use in crafting the 2020-21 state budget (Figure 1). Solid revenue growth of nearly $9.5 billion ensured that the budget committees would have a much easier session.

The revenue pot grew even bigger as the Legislature enacted new enforcement tools to collect sales tax from remote sellers (HB 1525 by Burrows; see TTARA's *Wrap-Up for the 86th Legislature: Tax and Fiscal Policy*, July 2019), tapped excess balances in dedicated accounts, and received a $500 million upward revision to the revenue numbers by the Comptroller toward the end of session.

All of this combined would set the stage for the most massive public education reform bill in years.

Overall Budget

The General Appropriations Act for 2020-21 – House Bill 1 by Zerwas – budgets a total of $248.3 billion, an increase of $8.5 billion over the 2018-19 budget, or 3.6 percent. Much of these moneys are dedicated for specific purposes, and not subject to substantial legislative discretion.

Spending from the state's more discretionary general revenue fund[1] tallies $122.7 billion, $10.3 billion more than what was budgeted for 2018-19, though $5.0 billion of that increase pays for school property tax relief rather than a net increase in government spending. The great majority of the state's general revenue spending – roughly 84% – goes to Education and Health and Human Services. While the fastest growing part of the state budget is traditionally Health and Human Services – in particular the state's Medicaid program – this legislative session, Public Education took center stage.

[1] In this analysis, TTARA includes the Property Tax Relief Fund as a "general revenue fund," because the state's general revenue spending for schools automatically adjusts to offset any revenue differences in the Property Tax Relief Fund.

Figure 1
Projected State Revenues, 2018-2021

Item	2018-19 Biennium	2020-21 Biennium Total	2020-21 Biennium Dollar Change	2020-21 Biennium Percent Change
Balances and GRD[1] Adjustments				
Beginning Balances	$883.4	$4,182.8	$3,299.4	373.5%
GR Dedicated Funds & Adjustments	$1,056.2	$0.0	($1,056.2)	-100.0%
Plus: Current Revenues				
Sales Tax*	$65,501.5	$71,260.7	$5,759.2	8.8%
Motor Vehicle Sales Tax*	$9,846.8	$9,889.6	$42.8	0.4%
Severance Taxes	$9,686.5	$10,716.9	$1,030.3	10.6%
Franchise Tax	$7,588.6	$8,192.7	$604.0	8.0%
Alcohol & Tobacco Taxes	$5,392.9	$5,609.0	$216.1	4.0%
Hotel Tax	$1,215.1	$1,307.0	$91.9	7.6%
Other	$8,478.9	$9,146.0	$667.1	7.9%
Total Tax Revenue	$107,710.4	$116,121.8	$8,411.4	7.8%
Non-Tax Revenue	$14,553.5	$14,163.4	($390.1)	-2.7%
Total	$122,263.9	$130,285.2	$8,021.3	6.6%
Minus: Transfers				
Sales Tax Highway Transfer	($5,000.0)	($5,000.0)	$0.0	0.0%
Severance Tax Hwy Transfer	($2,783.7)	($3,170.1)	($386.4)	13.9%
Economic Stabilization Fund	($2,783.7)	($3,170.1)	($386.4)	13.9%
Total Transfers	($10,567.4)	($11,340.2)	($772.7)	7.3%
Equals: Certification Revenue				
Total, Revenues for Certification	$113,636.1	$123,127.9	$9,491.8	8.4%

Notes: [1] GRD funds, or general revenue dedicated funds, hold balances that can be used for general purpose spending. Sales and motor vehicle sales tax include funds dedicated for highways.

Amounts shown are for state general revenue funds including the Property Tax Relief Fund. Figures shown are as of the start of the Legislative session and do not include the fiscal effects of any legislation passed, including supplemental appropriations, which will reduce the 2019 ending/2020 beginning balance.

Public Education

The 86th Legislature was able to accomplish something that alluded lawmakers for many years: pass major school finance reform without a court mandate. The passage of House Bill 3 by Huberty, not only overhauled the various weights and allotments for calculating per-student funding, it increased direct funding to schools by $6.5 billion, while providing another $5.1 billion for schools across the state to cut their property tax rates. Within those amounts is a $3.6 billion (47%) reduction in recapture (often called "Robin Hood"), which is the practice of property wealthy school districts providing property tax dollars to the state in order to equalize funding with property poor districts.

School finance in Texas is a shared responsibility of the state and local school districts. The state guarantees districts a set amount of funding per student. Districts levy a local school property tax. If the local tax doesn't generate enough revenue to meet the state's guarantee, the state and recapture dollars make up the difference. This is a highly equalized system of funding across districts. Over time, however, as local property values rise through normal economic growth, even the poorest districts become "wealthier" and they qualify for lower amounts of state aid. In 2019, the state's share of public education spending was a mere 37.8% – down from 45.1% in 2014[2]. This growing reliance on property tax revenues, and in particular on recapture, was a major target of the school finance discussion. For an in-depth look at the changes made through the passage of House Bill 3, please see TTARA's research report entitled *HB 3 by Huberty, A True School Finance Overhaul*, June 2019.

[2] http://www.lbb.state.tx.us/Documents/SFC_Summary_Recs/86R/Agency_703.pdf

The Teacher Retirement System (TRS), the state's pension and health insurance program for teachers and retired teachers, also received much needed attention by the Legislature. TRS is not actuarially sound, meaning the fund's balance and income is not enough to pay future liabilities. Senate Bill 12 by Huffman, which cost $1.1 billion, will make TRS actuarially sound by 2020 and provides retired teachers with a "13th check," a one-time supplemental payment to retired teachers of up to $2,000.

School safety was a priority this session, with the Legislature investing $343.5 milion in items such as $100 million from the Economic Stabilization Fund for school "hardening" (i.e., doors, metal detectors), $100 million in general revenue for a new school safety allotment as part of the school finance formula, and $99 million for the Children's Mental Health Consortium, a new program designed to improve effectiveness and access to behavioral health care for children.

Another large cost to this budget was special education. In November 2018, the U.S. Court of Appeals for the Fifth Circuit declared that students with disabilities in Texas did not receive an adequate level of state spending for their special education services. The court found that Texas had an arbitrary target for enrolling students with special needs. The US Department of Education also found that Texas had not been keeping up with the federal maintenance of effort spending for special education, meaning Texas was not spending at least the same amount each biennium that they had previously, as the federal requirement mandates. In response to both findings, lawmakers increased special education funding by roughly $1 billion over the previous budget.

Higher Education

Higher Education funding increased over $1 billion general revenue, a majority of which was for financial aid for students and formula funding at the state colleges, universities, and community colleges. The Legislature gave extra attention to the Texas State Technical College System (TSTC) and the state's health related institutions. TSTCs are funded on a "returned value" formula based on the return on investment the state receives from TSTC graduates making more than minimum wage 5 years after graduating. Several of Texas' health related institutions (i.e., medical schools) received additional funding to launch new outcomes-based funding formulas. House Bill 1 also provided $20 million for a new University of Houston Medical School and $13 million in additional funding for a new Texas Tech School of Veterinary Medicine.

Health and Human Services

The bulk of funding for Health and Human Services is for Medicaid, a state-federal shared health insurance program for low income individuals and families. Of the $84.3 billion in total funding for Health and Human Services in HB 1, $66.5 billion was for Medicaid services.[3] Medicaid's federal share is calculated using a mathematical formula called the Federal Medical Assistance Percentage (FMAP). This match rate fluctuates yearly based on Texas' per capita personal income compared to the national average. Texas' federal match rate is 60.89% for 2020 (which means the state pays the remaining 39.11%)[4] and 61.96% for 2021 (estimated). The FMAP rate for the 2020-21 biennium is substantially higher than it has been in the past, saving the state $1.9 billion in general revenue.

As an entitlement program, the state has little discretion over Medicaid funding – if the individual meets the eligibility criteria set for the program, they are "entitled" to the full array of benefits the program provides. That means the Medicaid appropriation is essentially a forecast based on certain assumptions over the program's various moving parts. For example, the Legislature has to estimate the second year of the biennium's FMAP rate. Additionally, there are variables such as caseload growth (i.e., number of participants) and cost growth. HB 1 increased spending to account for caseload growth but did not provide for any cost increases over 2019 rates. Ultimately, the Legislature will have to appropriate additional funds to cover any program shortfalls, presumably through a supplemental appropriation when they come back for the 87th Legislative Session in January of 2021. The 86th Legislature had to provide a supplemental appropriation of $2 billion for Medicaid, and the 87th Legislature may have to do the same.

Beyond uncertainty in estimating at the state level, there is also uncertainty as to the future of federal aid Texas has relied upon. The federal Medicaid program allows for states to apply for waivers from certain federal requirements. Texas has the Healthcare Transformation and Quality Improvement Program, also known as the 1115 waiver. This waiver has allowed Texas to draw down federal funds using local funds and to employ managed care as a cost containment tool. It is important to note that while state dollars fund Medicaid, for the 1115 waiver, "local" funds are those of counties and local hospital districts that provide the funds needed to attract federal dollars. Texas was originally granted the waiver in 2011 for uncompensated care (UC) and the Delivery System

[3] http://www.lbb.state.tx.us/Documents/Appropriations_Bills/86/Conference_Bills/5872_S12_Bill_Summary.pdf
[4] http://www.lbb.state.tx.us/Documents/SFC_Summary_Recs/86R/Agency_529.pdf

Figure 2
The General Revenue Budget By Category
2020-21 and 2018-19 Biennia ($ millions)

Item	General Revenue 2018-19 Biennium	General Revenue 2020-21 Biennium	General Revenue Increase	All Funds 2018-19 Biennium	All Funds 2020-21 Biennium	All Funds Increase
General Government	$3,338.7	$4,028.6	$689.9	$7,778.2	$7,452.6	($325.6)
Health & Human Services	$34,750.7	$33,643.3	($1,107.4)	$83,816.2	$84,303.9	$487.7
Education	$59,575.9	$69,516.6	$9,940.7	$82,214.8	$95,901.9	$13,687.1
Public Education (GR)	*$44,622.2*	*$53,540.5*	*$8,918.3*	*$61,315.4*	*$70,415.8*	*$9,100.4*
Higher Education	*$14,953.7*	*$15,976.1*	*$1,022.4*	*$20,899.4*	*$25,486.1*	*$4,586.7*
Judiciary	$491.7	$545.7	$54.0	$858.0	$933.7	$75.7
Public Safety & Corrections	$11,545.0	$12,072.3	$527.3	$18,850.3	$12,549.0	($6,301.3)
Natural Resources	$910.7	$1,011.7	$101.0	$8,474.7	$9,012.3	$537.6
Business/Economic Dev.	$496.6	$525.9	$29.3	$36,730.4	$37,061.1	$330.7
Regulatory	$351.4	$379.2	$27.8	$677.8	$707.1	$29.3
Legislature	$392.7	$392.0	($0.7)	$392.8	$392.2	($0.6)
Total Appropriations/Expenditures	$111,853.5	$122,115.3	$10,261.8	$239,793.2	$248,313.7	$8,520.5
HB 3 Property Tax Rate Cut		($4,980.0)	($4,980.0)		($4,980.0)	($4,980.0)
Total State Spending	$111,853.5	$117,135.3	$5,281.8	$239,793.2	$243,333.7	$3,540.5

Notes: General Revenue amounts include those from the Property Tax Relief Fund. Figures are based on revised Legislative Budget Board (LBB) estimates.

Reform Incentive Payment Program (DSRIP). The UC portion of the waiver is scheduled to incrementally drop from $3.1 billion in 2019 until it expires in 2022. Funding for DSRIP is $3.1 billion in 2019, and is set to expire on September 30, 2021. Without further extension of these waiver expiration dates or some alternative, hospitals face major funding uncertainty, and may look to the state for assistance.

Economic Development

Though not a major budget category, state spending for economic development is a critical tool in promoting the prosperity of the state. Lawmakers ensured that Governor Abbott's office received sufficient funds to keep the Texas Miracle moving. For the 2020-21 biennium, the Governor's budget includes $110 million (including unexpended balances) for tourism, $50 million for film and music incentives, $40 million (including unexpended balances) for the Governor's University Research Initiative, and $150 million (including unexpended balances) for the Enterprise Fund. The Enterprise Fund is a deal-closing grant program to encourage businesses to locate projects in Texas. The grants make Texas competitive with other states and can bring significant capital and employment opportunities to boost the Texas economy. Since its inception, this program has created nearly 100,000 jobs in Texas.

The Legislature also passed a key piece of legislation to further economic development. HB 3143 by Murphy, continues one of Texas' key economic development programs, Chapter 312 of the Tax Code. Chapter 312 agreements allow cities and counties to offer temporary tax abatements. This successful program was set to expire in 2019, but was extended through 2029. For more information about tax legislation from the 86th session, see TTARA's research report entitled *Wrap-Up for the 86th Legislature Tax and Fiscal Policy*, July 2019.

Transportation

Transportation funding in HB 1 is roughly $31 billion, of which $27.2 billion is earmarked for highway planning and design, right-of-way acquisition, construction, and maintenance and preservation. Traditionally, funding for Texas roads has come from a few key sources, including federal funds (the bulk of the funding), motor fuels taxes, and vehicle registration fees. However, these funding sources have not kept pace with growing transportation needs. To meet demands, the Legislature has been finding alternative sources of revenue to supplement the traditional funding streams. In 2014, voters approved Proposition 1 (by an 80% margin), which diverts half of the oil and gas severance tax revenue that would normally be deposited into the Economic Stabilization Fund, and instead deposits it into the State Highway Fund. For the 2020-21 biennium, it equates to an additional $3.9 billion (including unexpended balances) to spend on transportation projects. Proposition 1 was set to expire in 2024, but the Legislature extended the program another 10 years, to 2034. In 2015, voters approved Proposition 7 (by an 83% margin) which states that if sales tax revenue is more than $28 billion in a year, then the next $2.5 billion goes to transportation. Both years of the biennium are expected to exceed $28 billion in sales tax revenue, generating an additional $5 billion for the Department of Transportation for the 2020-21 biennium.

An Uncertain Future

Though HB 1 is passed and now law, the final words on the 2020-21 budget will be spoken next session in a supplemental appropriation bill that will close whatever gap remains with Medicaid and any unanticipated needs.

Lawmakers will then have to turn their attention to writing a balanced budget for the 2022-23 biennium. That's a task that could be tremendously difficult, or not, depending on the economy.

For the 2022-23 budget to be an *easy* task, the economy must exceed expectations, allowing the state to accumulate a significant surplus to the *current* budget. That will not only provide lawmakers with some cash to pay for a supplemental bill and carry forward into 2022-23, it will also provide a higher revenue base from which to grow.

If, however, the Comptroller's numbers are on the money (literally), there will be no positive surprises and no surplus. That means the budget would be tight for the 87th Legislature. They might need to either cut the current budget or tap the Economic Stabilization Fund to cover any supplemental needs, while perhaps having little new money going into 2022-23.

And if the economy slides into recession, or if oil prices fall and drilling slows, redistricting won't be the toughest challenge facing the 87th Legislature – it will be the budget.

Spending from the Economic Stabilization Fund: A Tragic Rainy Day and Other Items

Texas is blessed with the largest "Rainy Day Fund" in the nation – the Economic Stabilization Fund – which at the start of the session Comptroller Hegar estimated would end 2021 with a $15.4 billion balance. That balance proved to be fortuitous, as lawmakers were able to address costs associated with Hurricane Harvey as well as a number of other items.

Hurricane Harvey made landfall in August of 2017, and devastated parts of 60 counties in Texas. Governor Abbott declared a state of emergency and provided emergency disaster funds from his own office at the time of the disaster, but no legislative budget actions could be taken until the 86th Legislature met in 2019. The supplemental appropriations bill – HB 500 – appropriated $3.7 billion for direct costs resulting from the hurricane and for future disaster preparation, flood planning, and infrastructure.

HB 500 also appropriated $2.3 billion for a variety of other items, including an additional payment to retired teachers, state hospital construction, and the Texas Tomorrow Fund.

After accounting for these appropriations, current estimates put the balance of the Economic Stabilization Fund at $9.0 billion by the end of 2021.