

Fiscal Picture in Focus: The 2020-21 Snapshot Looks Very Good

The 86th Legislature has been gavelled to order. Comptroller Hegar has laid out his official revenue estimate and the House and Senate budgets have been unveiled. The 2019 legislative budget games are about to begin!

The numbers are healthy, giving lawmakers a variety of options on which to work. Governor Abbott, Lt. Governor Patrick (the presiding officer of the Texas Senate), and House Speaker Dennis Bonnen have narrowed the field by agreeing that public school finance and property tax reform will be the top priorities of the session. While all are in sync at session start, the real battle may come down to who can be the biggest champion of public education, and cutting the property taxes that fund so much of the program.

A Pleasant Surprise from the Comptroller

The Texas Constitution makes Comptroller Glenn Hegar the numbers referee. He provides lawmakers with an estimate of available revenues at the start of the legislative session—the biennial revenue estimate, or BRE. Except under extraordinary circumstances, they may not spend a penny more than he certifies as being available, ensuring that they pass a budget that is balanced.¹

In 2017, lawmakers had relied on a number of one-time measures to bring the budget into balance, such as deferring a transfer of sales tax revenues dedicated to the State Highway Fund, underfunding Medicaid, tapping unused fund balances, etc. All totaled, the measures used to balance the 2018-19 budget amounted to near \$8 billion, sug-

gesting that the next budget would be very tight. However, in July of 2018, with the economy and oil prices strong, Comptroller Hegar raised his estimate of current revenues by roughly \$7 billion, eliminating much of the impending structural gap.

But that was then, and this now. The big question on the minds of lawmakers in 2019 was how much revenue the Comptroller would say was available to write the upcoming 2020-21 state budget. With concerns over a number of factors that could slow the economy—weakening oil prices, unresolved trade wars, fissures in the European Union, and a maturing national recovery—they had anticipated bad news. Comptroller Hegar acknowledged those risks, but also saw the underlying Texas economy as healthy. Looking forward, the Comptroller projected legislators will have a total of \$122.9 billion in general revenues and property tax relief fund² revenues to spend this legislative session—up a healthy \$9 billion (Table 1). That money will be used to write the 2020-21 Budget, but will also be used to pay for the state’s supplemental needs to bring the 2019 fiscal year to a close.

Included with the Comptroller’s biennial revenue estimate is a forecast of the revenues and balances of the state’s Economic Stabilization Fund (ESF), commonly referred to as the “Rainy Day Fund.” Absent any withdrawals, the fund balance is expected to hit a record \$15.4 billion in 2021—roughly 25% of one year’s general revenue spending. Approved as an amendment to the Constitution in 1988 by Texas voters, the ESF was created as a cash cush-

¹Technically, the Legislature can “override” the Comptroller’s failure to certify the appropriations bill, but it takes a record 4/5 vote, which has never happened.

²While the Comptroller provides the Legislature with a forecast of all state fund revenues, only appropriations from the general revenue fund are subject to his certification, as the general revenue fund is the only state fund that can go into a deficit. General revenue related funds, and the property tax relief fund, interact with the general revenue fund’s bottom line. For example, the greater the revenue to the state’s property tax relief fund, the lesser the draw is from the general revenue fund. Consequently, though it is not counted as such, as a practical matter the Property Tax Relief Fund is a general revenue related fund.

Table 1
Evolving 2018-19 Revenues and the Outlook for 2020-21
General Revenue Related Funds, Including the Property Tax Relief Fund
(\$ billions)

	2018-19			2020-21	
	Certification Revenue Estimate	July 2018 CRE Revision	Biennial Revenue Estimate ^a	Biennial Revenue Estimate	Increase from 2018-19 ^b
Net Beginning Balance	\$2.1	\$2.1	\$1.9	\$4.0 ^c	\$2.0
Current Revenues					
Sales Tax ^d	\$62.3	\$65.0	\$65.5	\$71.3	\$5.8
Motor Vehicle Sales Tax	\$9.9	\$9.9	\$9.8	\$9.9	\$0.0
Severance Taxes	\$6.8	\$10.2	\$9.7	\$10.7	\$1.0
Franchise Tax	\$7.4	\$7.5	\$7.6	\$8.2	\$0.6
Alcohol & Tobacco Taxes	\$5.5	\$5.4	\$5.4	\$5.6	\$0.2
Other Taxes	\$9.5	\$9.7	\$9.7	\$10.5	\$0.8
Non Tax Revenue	<u>\$13.8</u>	<u>\$14.4</u>	<u>\$14.6</u>	<u>\$14.2</u>	<u>(\$0.4)</u>
Gross Current Revenues	\$115.1	\$122.0	\$122.3	\$130.1	\$7.8
Less Dedicated Transfers					
Highway Fund Transfers ^d	(\$3.2)	(\$7.7)	(\$7.8)	(\$8.2)	(\$0.4)
ESF Transfers	<u>(\$1.7)</u>	<u>(\$3.0)</u>	<u>(\$2.8)</u>	<u>(\$3.2)</u>	<u>(\$0.4)</u>
Net Total Revenue	\$112.3	\$113.5	\$113.7	\$122.9	\$9.3

Notes: Numbers may not add due to rounding. ^aFrom the 2020-21 Biennial Revenue Estimate. ^bCompares to the 2018-19 estimates included as a part of the 2020-21 Biennial Revenue Estimate. ^cThe Comptroller deducts \$0.2 billion as a constitutionally-required expense of general revenue funds to cover a pending shortfall in the Texas Tomorrow Fund, the state's prepaid tuition program. ^dIncludes sales tax revenues dedicated to the State Highway Fund.

ion to smooth over volatile state revenues.³ The fund largely consists of oil and gas severance tax revenues in excess of the amount the state collected in 1987.⁴

The Supplemental Bill and the 2019 Balance

Lawmakers passed a 2018-19 budget last session that barely balanced within available revenues at the time. One way to make the numbers work was to underfund the state's Medicaid program. Medicaid is an "entitlement" program—individuals are entitled to the benefits of the program based on their income, age and other factors. The state's Medicaid appropriation is essentially a forecast of costs, rather than a hard dollar cap. Underfunding Medicaid is a common budget tool of recent years. Tight money keeps pressure on the Health and Human Services Commission to continually strive for cost savings. Plus, the Legislature counts on the Comptroller's revenue estimate being conservative, with the expectation that more

final numbers will be higher, providing the money to make Medicaid whole through a supplemental appropriation by budget's end. That gamble often pays off, and will in 2019 with the Comptroller predicting an ending 2019 cash balance of \$4 billion. Currently estimates are that Medicaid will require an additional \$2.1 billion to close 2019's books—an amount provided from general revenue in the supplemental appropriations bill filed in the Senate, SB 500 by Nelson (Table 2). SB 500 also appropriates \$160 million of general revenue to address a shortfall in the managed health care for inmates of the Department of Corrections, \$90 million for foster and relative care payments, and \$6 million for the state's crime lab. SB 500 also reduces certain appropriations by \$700 million; however, some of these items may have already been counted by the Comptroller in his revenue estimate.

A big part of the Legislature's supplemental appropriations bill will address costs associated with the damages

³See TTARA's research report: *The Economic Stabilization Fund: Origins and Historical Use*, available at www.ttara.org under the "Reports and Briefs" tab.

⁴The balance of the ESF is capped at an amount equal to 10% of the revenue deposited into the general revenue fund during the previous biennium excluding interest and investment income, and amounts borrowed from special funds. General revenue fund deposits are substantially higher than the amount of net general revenues available for certification.

Table 2
2019 Supplemental Appropriations in SB 500,
(\$ billions)

Budget Area	General Revenue Fund	Economic Stabilization Fund
Medicaid	\$2.2	
Correctional Managed Care	\$0.2	
Foster Care Payments & Crime Lab	\$0.1	
Hurricane Harvey		\$1.2
Wildfires		\$0.1
Pensions		\$0.6
School Safety		\$0.1
Texas Tomorrow Fund		\$0.2
State Hospital Facilities		\$0.3
Total	\$2.4	\$2.5

caused by Hurricane Harvey. SB 500 appropriates \$1.2 billion from the Economic Stabilization Fund for costs associated with the disaster, with additional blanks yet to be filled in. The bill also taps the ESF to address actuarial shortfalls in the state’s pension systems and the state’s prepaid tuition program; wildfires, state hospital facilities, and school safety.

The 2020-21 Budget Bills

The task of preparing the initial budget bill(s) falls to the staff of the Legislative Budget Board. The 10 member board is co-chaired by the Lieutenant Governor and the Speaker of the House. For many years both the Senate and House filed identical bills at start of session. In recent years the House and Senate have had LBB staff prepare separate bills for introduction reflecting the priorities of each house.

Though the Senate and House bill structures and many line items are largely the same, among the differences are a few key items between the House and the Senate totaling billions of dollars at the session starting line (Table 3.)

Public Education. The most striking difference between the House and Senate bills ironically reflects an area of agreement between the two: additional dollars should be invested in public education.

Public school finance in Texas is a shared responsibility between the state and local school districts. School districts levy a property tax with the state guaranteeing a certain amount of revenue per penny of tax effort. If the school district’s property tax raises less than what the state guarantees, the difference is made up with state aid. If the school district’s property tax raises more than what the state guarantees, the excess may be subject to “recapture” and is shared with other school districts. Texas’ system of school finance is highly equitable. However, over time property values rise and the property tax takes on a much larger share of financing public schools, while the demands on state aid diminish. On occasion, as funds permit, the Legislature will revamp the school finance formulas and commit additional state money, as they are expected to do in 2019.

The budget bill filed in the Senate, SB 1 by Nelson, provides an additional \$6 billion for public education over current formula requirements. Of this, \$3.7 billion provides a \$5,000 pay raise for all teachers in the state. The remaining \$2.3 billion is set aside for tax relief. HB 1 by Zerwas provides an additional \$9 billion for public education with amounts yet to be determined split between educational enhancements and tax relief. Given Texas’ high property taxes, any amount dedicated for tax relief is certainly a blessing; however, school property taxes are expected to rise by some \$7 billion over the next biennium. At best, any amount set aside for tax relief will provide some protection against rising tax bills, but won’t be enough for taxpayers to actually see reductions in their tax bills.

Higher Education. House and Senate budget totals are generally similar for higher education, although the Senate provides \$100 million for a new Texas mental health care consortium to expand health care services, but is lower on a number of items throughout the bill.

Health and Human Services. Both the House and Senate budgets spend \$33.6 billion of general revenue for health and human service agencies, the bulk of which is for the state’s share of funding the Medicaid program. As mentioned earlier, the cost of the Medicaid program is shared between the state and the federal government. The federal government pays a percentage of the program’s costs using a state-specific calculation based on per capita income. In the current state budget the federal government pays approximately 57 cents of every dollar the program spends with state general revenues comprising the bulk of the state’s 43 cent obligation. Ironically, in spite of the healthy Texas economy of recent years, the rest of the

Table 3

The House and Senate Budgets for the 2020-21 Biennium
 General Revenue-Related Funds and the Property Tax Relief Fund
 (\$ billions)

Budget Area	House	Senate	Comments
Public Education	\$52.3	\$49.4	House provides additional \$9 billion to be split between property tax relief and increased funding; Senate adds \$6 billion with \$3.7 billion for a proposed \$5,000 teacher salary increase and \$2.3 billion for tax relief
Higher Education	\$15.1	\$15.2	Senate provides \$100 million for Texas Mental Healthcare Consortium
Health and Human Services	\$33.6	\$33.6	GR requirements are reduced because of a 4 percentage point increase in the federal match (roughly 10%); neither side funds increases for inflation, utilization, or acuity
Public Safety & Corrections	\$11.8	\$11.9	
Other Agencies	\$6.2	\$5.7	House provides \$200 million to improve drivers' license offices; House uses \$200 million in GR for prepaid tuition shortfall while the Senate draws from the ESF in 2019
Total Spending	\$119.0	\$115.8	

Notes: The House Appropriations bill is HB 1 by Zerwas; the Senate Appropriations bill is SB 1 by Nelson.

nation has benefited from delayed “catch-up” growth after the great recession. At the same time, Texas population growth has continued to outpace the nation as a whole. Since 2014, Texas per capita income has actually fallen relative to the rest of the United States. This surprising economic fact will produce a windfall for the state as the federal government will now cover 61 cents of every Texas Medicaid dollar. That results in a roughly 10% reduction in Texas’ Medicaid share—a savings to state general revenues in excess of \$3 billion in 2020-21, but one which may be short-lived.

Other Key Budget Differences. The House budget includes an additional \$200 million to improve customer service at the state’s driver’s license offices, an amount not in the Senate bill. The House budget also includes \$200 million to address a shortfall in the Texas Tomorrow Fund (an amount already deducted by the Comptroller in the BRE). The Senate covers the shortfall with a \$200 million appropriation from the ESF in their supplemental appropriations bill.

Net Money Remaining

All totaled, after making the appropriate adjustments for the set-aside for the Texas Tomorrow Fund, both the Senate and House budgets are well within the Comptroller’s BRE—the House by approximately \$1.5 billion, the Senate by \$4.9 billion (Table 4.)

Conclusion

An old axiom at the Texas Capitol is that legislative sessions with no money are easier than those with money. If little money is available, legislators can simply say “no” to every request. Those sessions in which there is extra money can be the toughest. Lawmakers have to pick and choose among competing constituencies, saying “yes” to some, and “no” to others—a process that can result in bruised egos and disappointments.

This year lawmakers have some extra money. It’s going to be a tough session.

Table 4

Money and the Budgets: What’s Still Available?
 (\$ billions General Revenue-Related Funds and the
 Property Tax Relief Fund)

2020-21	House	Senate
Comptroller’s BRE	\$122.9	\$122.9
Less: SB 500 2019 Supplemental Appropriations	\$2.4	\$2.4
Less: 2020-21 Appropriations (bills as filed)	\$119.0	\$115.8
Net Funds Remaining^a	\$1.7	\$4.9

Notes: ^aTotal includes an additional \$200 million over the above calculation to adjust for a double count of the state’s prepaid tuition shortfall.