INTERIM REPORT

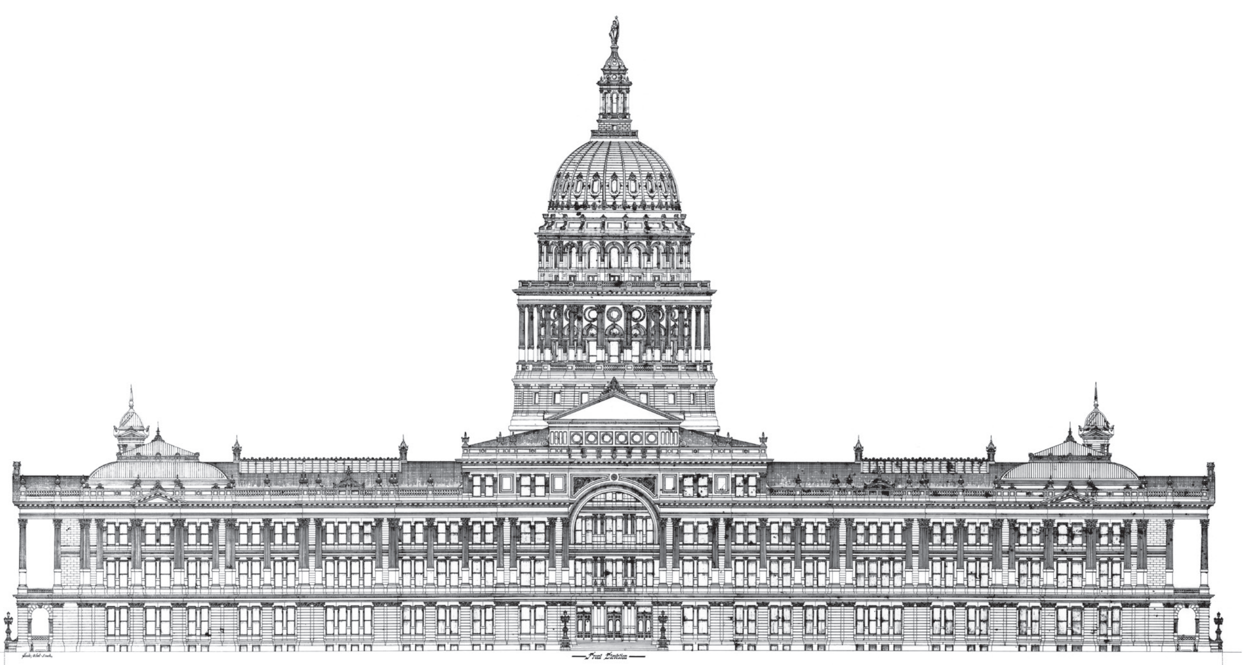
TO THE

82ND TEXAS LEGISLATURE

House Select Committee on

FISCAL STABILITY

December 2010



HOUSE SELECT COMMITTEE ON FISCAL STABILITY
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2010

A REPORT TO THE
HOUSE OF REPRESENTATIVES
82ND TEXAS LEGISLATURE

JOHN OTTO
CHAIRMAN

COMMITTEE CLERK
NIKKI DAWSON COBB

Select Committee On Fiscal Stability
November 30, 2010

John Otto
Chairman

P.O. Box 2910
Austin, Texas 78768-2910

The Honorable Joe Straus
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The Select Committee on Fiscal Stability of the Eighty-first Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Eighty-second Legislature.

Respectfully submitted,

John Otto

John Otto, Chair

Sylvester Turner

Sylvester Turner, Vice-Chair

Marisa Marquez

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Angie Chen Button

Angie Chen Button

René O Oliveira

Rene Oliveira

Gary Elkins

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INTRODUCTION

On January 12, 2010, the Honorable Joe Straus, Speaker of the Texas House of Representatives, appointed 15 members to the Select Committee on Fiscal Stability: John Otto, Chair; Sylvester Turner, Vice Chair; Angie Chen Button; Gary Elkins; Kirk England; Jim Keffer; Phil King; Eddie Lucio III; Marisa Marquez; Rene Oliveira; Tan Parker; Ken Paxton; Jim Pitts; Marc Veasey and Mike Villarreal. The charges to the Select Committee on Fiscal Stability (SCFS) are as follows:

- Assess the state's ability to meet its current and future budget obligations;
- Determine whether the past and anticipated budget shortfalls are due primarily to the current economic recession or a more systemic problem.

Although Texas has weathered the national recession better than other states, the state faces a multi-billion shortfall, with estimates ranging from $11 to 21 billion when the 82nd Legislature convenes. While the current economic climate has contributed to this deficit, there are other factors which must be taken into account.

The SCFS studied aspects of the state's financial stability, such as growth in population; increases in sales tax revenues from 2005-07; the dedication of funds in General Revenue; the expansion of the health and human services sector; and the constitutional debt limit.

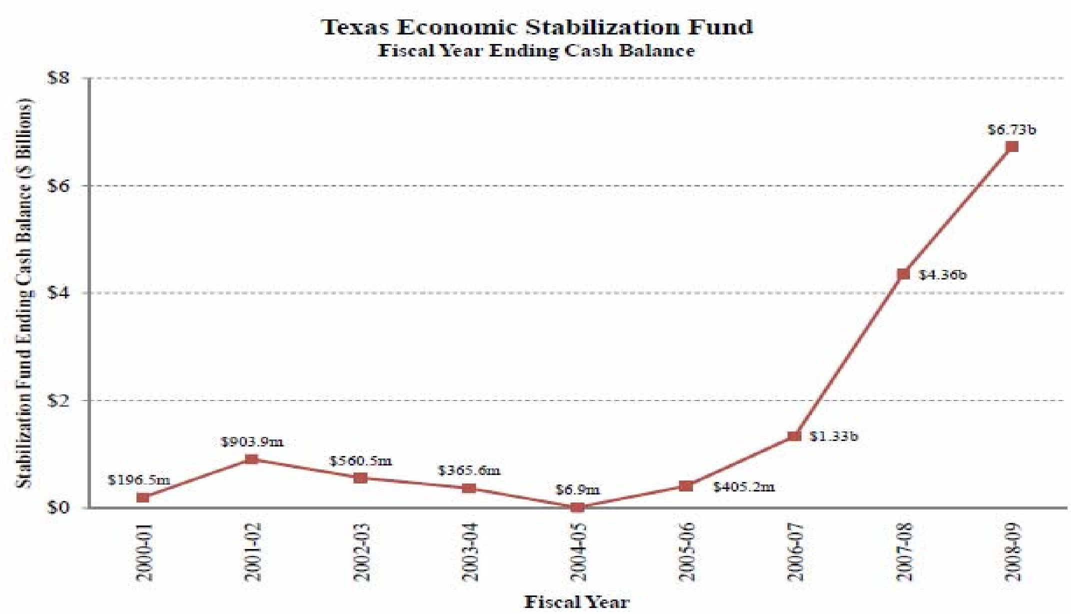
The Select Committee on Fiscal Stability has completed its hearings, and has adopted the following report.

ECONOMIC STABILIZATION FUND:

Background

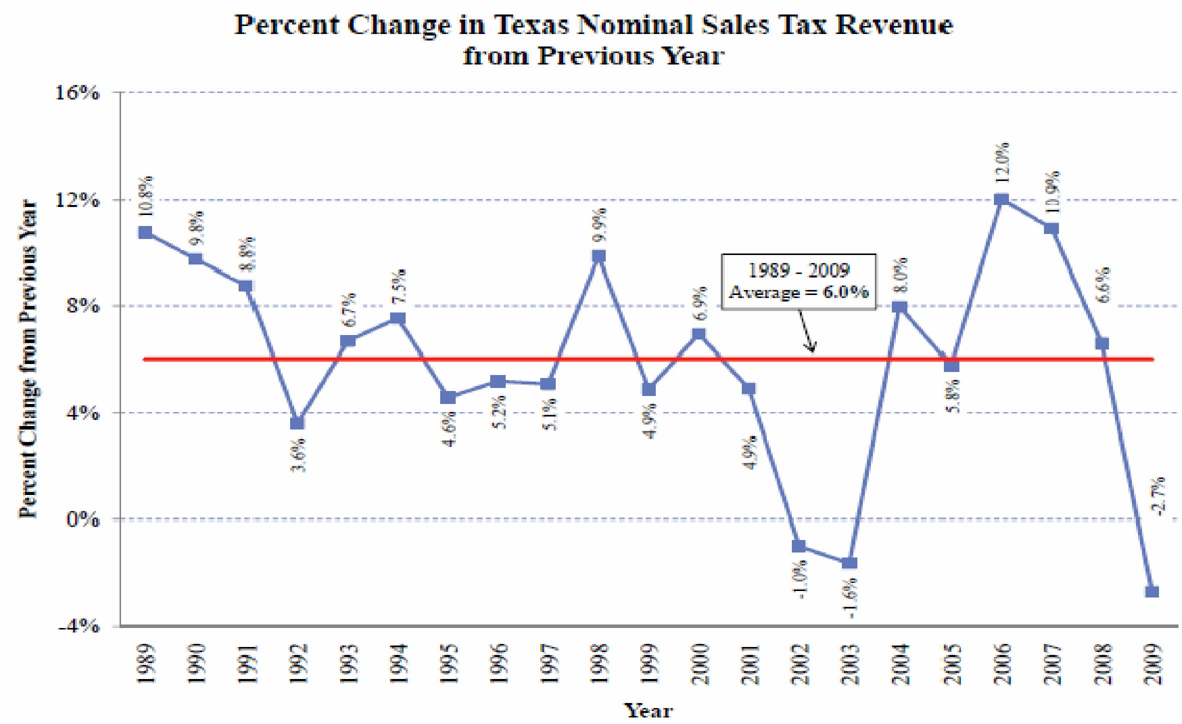
Following the decline in oil revenues and banking troubles of the 1980s, Texas established the Economic Stabilization Fund (Rainy Day Fund) to be used in times of financial hardship. Currently, it is funded by oil and gas severance tax revenue that exceeds a certain benchmark established 1987, the same year it went into effect. The fund is capped at ten percent of General Revenue fund deposits during the preceding biennium.

After significant economic growth in the 1990s, the state's economy began to cool in the early 2000s in response to the national recession and the bust of the technology sector. Ultimately, these factors contributed to significant drops in the state's revenue collections and resulted in a $10 billion budget shortfall for the 2004-2005 biennial budget. Consequently, the legislature appropriated $1.3 billion from the Rainy Day Fund to assist with balancing the budget.



Source: Texas Comptroller of Public Accounts.
Analysis prepared by TLC, Research Division.

In the years following the 2003 shortfall, Texas realized extraordinary growth in sales and use tax revenues due to a combination of events: growth in new construction; oil and gas exploration and development; and increased consumer spending due to expanded access to capital through home equity borrowing. These three activities created a perfect storm of unprecedented growth in sales tax revenues, which grew between nine and twelve percent during that time period, in comparison to the six percent average annual growth in sales tax revenues over a twenty year period (Percent Change in Texas Sales Tax Revenue from Previous Year, 2010).



Source: Texas Comptroller of Public Accounts.
Analysis prepared by TLC, Research Division.

Over the last two biennia, the Legislature relied on this above normal level of revenue growth as a baseline when crafting the budget. In doing so, expectations were created that revenue would continue at or above this level. In reality, this extraordinary level of growth was an anomaly as revenues declined to historic lows.

Scholars tout the importance of "rainy day" funds in battling recessions, noting "[t]here are only two possible ways a state may ease the fiscal stress it faces during recessions: (1) reduce the cyclical variability of its revenue stream; or (2) build savings during the booms to inject during recessions (create and *properly* use a rainy day fund)."[1] Currently all but two states have a type of economic stabilization fund. Of those, six draw revenue from General Funds through formulas and caps.[2] However, it has become evident that additional streams of revenue must be deposited into the funds in order for them to adequately assist states when necessary.

At the 2010 Southern Legislative Conference, Chairman of the Federal Reserve Ben Bernanke stated:

> Tools exist to help mitigate the effects of the business cycle on state budgets. Many states deal with revenue fluctuations by building up reserve--or "rainy day"--funds during good economic times…These high reserve-fund balances were helpful in lessening the severity of spending cuts or tax increases in many states. Nevertheless, given the depth of the recent recession, even these historically high reserve-fund balances proved insufficient to buffer fully the budgets of most states. Thus, state governments may wish to revisit their criteria for accumulating fiscal reserves. Building a rainy-day fund during good times may not be politically popular, but it can pay off during the bad times.[3]

Recommendation

To assist the state in meeting its future budget obligations, it is our recommendation that legislation be passed to provide a deposit to the Rainy Day Fund from sales tax revenues that exceed the twenty year moving average. This would effectively smooth the volatility in the peaks and valleys in sales tax revenue growth.

To the extent sales tax revenue growth exceeded the twenty year average after the post 2003 recovery, it would have been prudent to set aside part of the funds in excess of the average growth in sales tax revenues for the future periods when sales tax growth would become level or actually decline.

CONSTITUTIONAL DEBT LIMIT:

Background

Currently the state is authorized to issue the following two types of bonds:

1. *General Obligation bonds* are backed by the full faith and credit of the state and must be approved by two-thirds of both chambers of the Legislature and by a majority of voters. These bonds are traditionally used for repair and construction projects, veterans housing, parks, transportation construction, grants and loans.
2. *Revenue bonds* are authorized by the Legislature and secured by a specific source of revenue and do not require voter approval. These types of bond are traditionally used for lease revenue bonds and the Master Lease Purchase Program administered by the Texas Public Finance Authority.

General obligation bonds and revenue bonds can be classified as self-supporting or non self-supporting. The former is debt that is to be repaid with revenues other than General Revenue, whereas the latter is debt that is expected to be paid by General Revenue.

Presently 4.09 percent of the five percent cap is considered to be comprised of "authorized but unissued debt." Approximately $11.2 billion is considered not self-supporting GO bond authority and consists primarily of the following 2007 authorizations:

- $5.0 billion for highway improvement projects;
- $3.0 billion primarily for cancer prevention and research grants;
- $1.0 billion for maintenance, repair or construction projects

Article III, Section 49(j) of the Texas Constitution limits the Legislature from issuing additional state debt if the percentage of debt service payable by general revenue in any fiscal year exceeds five percent of the average of unrestricted general revenue for the past three years. The Constitutional Debt Limit (CDL) can be negatively affected should any of the following circumstances change: increase in authority of not self-supporting GO or Revenue Bond debt; reduction in the amount of unrestricted General Revenue; and increased interest rates on issued debt and in the assumptions used for authorized by unissued debt.

TEXAS DEBT OUTSTANDING ($ billions)	8/31/2005	8/31/2006	8/31/2007	8/31/2008	8/31/2009	2/28/2010	Remainder 2010 (Projected)
General Obligation Debt							
Self-Supporting	4.48	5.18	7.36	8.44	9.82	9.93	10.57
Not Self-Supporting	2.51	2.36	2.23	2.34	2.63	2.70	3.56
Total General Obligation Debt	**6.99**	**7.54**	**9.59**	**10.78**	**12.45**	**12.63**	**14.13**
Non-General Obligation Debt							
Self-Supporting	13.75	15.16	16.26	19.74	21.19	22.34	25.50
Not Self-Supporting	0.63	0.62	0.52	0.51	0.44	0.40	0.40
Total Non-General Obligation Debt	**14.38**	**15.78**	**16.78**	**20.25**	**21.63**	**22.74**	**25.90**
Total Debt Outstanding	**21.37**	**23.32**	**26.37**	**31.03**	**34.08**	**35.37**	**40.03**

Source: Bond Review Board

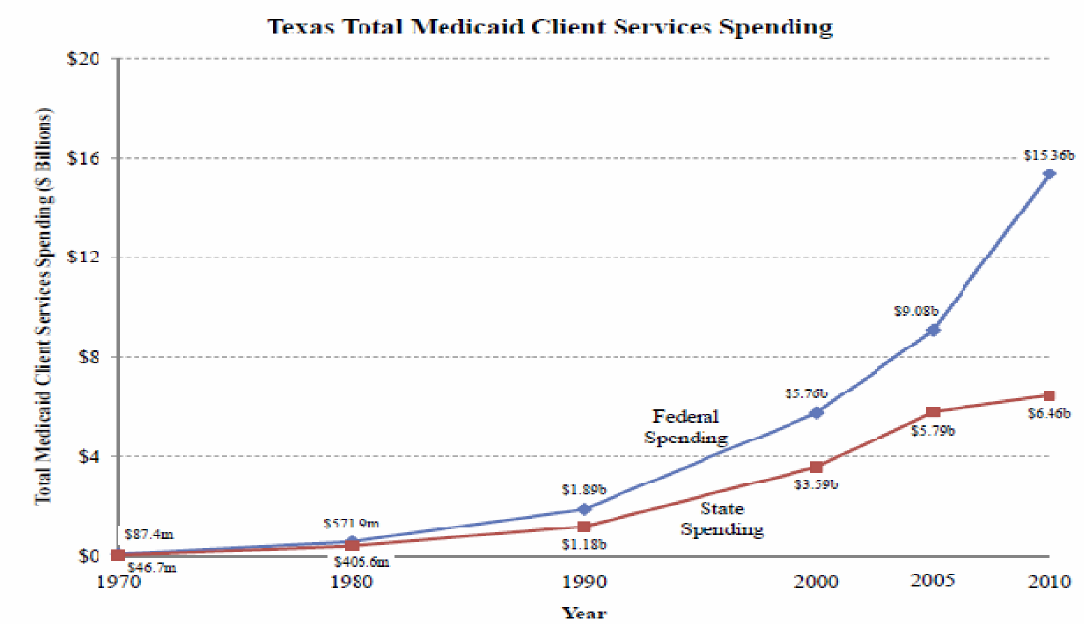
Recommendation

The economic downturn has caused the state to experience a significant drop in sales tax collections, which has caused a drop in the amount of unrestricted General Revenue. Consequently, the state is at risk of diminished capacity within the CDL without actually having authorized more debt. As a result, the Legislature must be prudent in authorizing further debt and in considering the impact on the CDL.

HEALTHCARE:

Background

Specific policy investigations and recommendations on this matter were delegated to other committees, however, it merits noting in this report due to its large fiscal impact on future state budgets. Over the past years, Article II, the Health and Human Services portion of the state budget, has significantly grown. (Texas Total Medicaid Client Services Spending, 2010). Factors



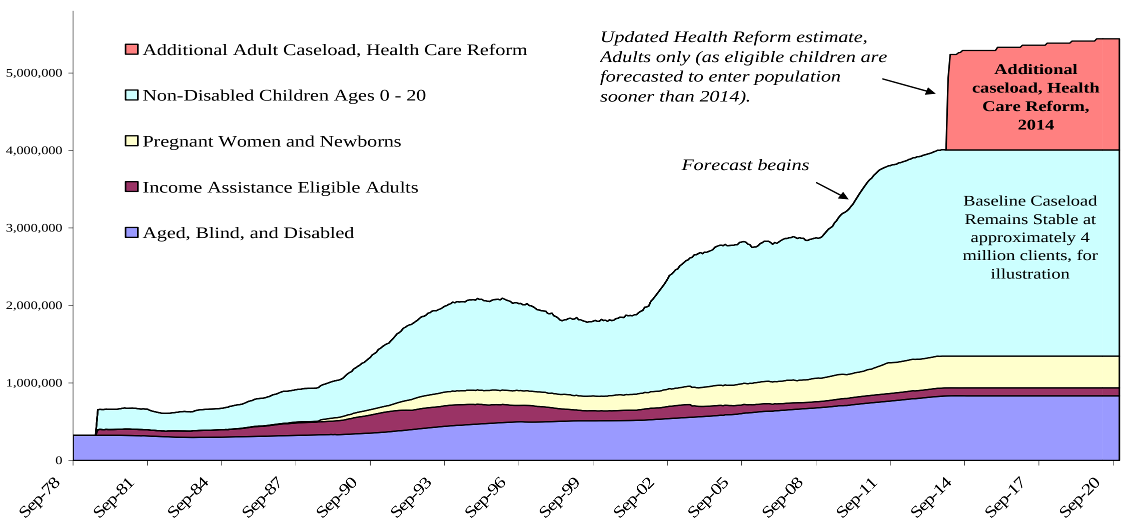
Source: Texas Health and Human Services Commission.
Analysis prepared by TLC, Research Division.

contributing to this growth include increased caseload and rising costs of care and services. In addition to a rise in population, Congressional passage of the Patient Protection and Affordable Care Act (PPACA) will greatly affect the state's budget in the future. The most significant costs from the PPACA will come into effect in 2014, which will include Medicaid eligibility expansions, health insurance exchanges and employer insurance mandates. The Health and Human Services Commission estimates that the state can expect an estimated $15-16 billion increase in General Revenue funding from 2014-2019 to account for these changes (Medicaid Eligibility: Caseload September 1977 - June 2010, 2010).

Recommendation

Unless states are given flexibility to manage the growth in caseloads and utilization of services, then all states will be facing a funding challenge in the years to come. This committee recommends flexibility in caseload management and utilization of the system, possibly through co-pays for services and medications or other methods. This would aid in addressing the financial costs to Texas.

Medicaid Caseload by Group: September 1978 to June 2010, with Caseload Forecast to December 2013 and Health Care Reform Caseload, 2014 to 2020



Source: Texas Health and Human Services Commission

FISCAL NOTES:

Background

In 1985, the 69th Legislature required the Legislative Budget Board (LBB) to establish a system of fiscal notes identifying the probable costs of each bill or resolution that authorizes or requires the expenditure or diversion of state funds. The LBB projects cost estimates for a five-year period that begins on the effective date of the bill or resolution and must state whether or not the costs or diversions will be involved after that period. However, the drafting of legislation can be done in such a way to move the majority of a measure's cost outside the five-year period and effectively hide the true cost of the proposal. Given the impact a fiscal note can have on the chances of legislation passing, there is an incentive to minimize the immediate costs of a particular legislative proposal.

Recommendation

It is the recommendation of the committee that the LBB identify legislation that increases the projected cost estimate to a period of time longer than five years. This would allow legislators to be better informed as to what the future costs of a measure would be, and whether such costs are appropriate and justifiable.

GENERAL REVENUE-DEDICATED ACCOUNTS:

Background

General Revenue-Dedicated accounts are accounts within General Revenue that are statutorily dedicated to specific purposes. Balances that are not appropriated count towards certification of the budget, which results in fund consolidation. In 1991, the 72nd Legislature passed the first funds consolidation bill, which did not technically eliminate dedicated general revenue accounts. Instead, 278 special funds were transferred into General Revenue which created temporary General Revenue-Dedicated accounts. The accounts were scheduled to be dissolved into General Revenue the following biennium on August 31, 1995. However, the Comptroller cited technical difficulties with immediate dissolution. The following Legislature allowed all but 104 of the temporary General Revenue-Dedicated accounts to be dissolved on August 31, 1995 as scheduled. The remaining accounts became permanent General Revenue-Dedicated accounts. Presently, there are 265 General Revenue-Dedicated Accounts totaling $3.6 billion or 4.5% of all General Revenue expenditures (General Revenue Dedicated Account Balances Available for Certification, 2010).

GENERAL REVENUE DEDICATED ACCOUNT BALANCES AVAILABLE FOR CERTIFICATION
AMOUNTS IN $ MILLIONS

FUND #	ACCOUNT TITLE	81st Leg 2010-11	80th Leg 2008-09	79th Leg 2006-07	78th Leg 2004-05	77th Leg 2002-03	76th Leg 2000-01	75th Leg 1998-99	74th Leg 1996-97	73rd Leg 1994-95
5100	GR Account - System Benefit	670.7	561.3	42.1	-	-	-	-	-	-
5071	GR Account - Emissions Reduction Plan	515.3	522.9	259.1	-	-	-	-	-	-
5111	GR Account - Designated Trauma Facility and EMS	331.3	199.1	5.0	-	-	-	-	-	-
0655	GR Account - Petroleum Storage Tank Remediation	186.6	91.3	159.3	172.4	129.6	212.7	89.1	1.0	9.1
5028	GR Account - Fugitive Apprehension	157.8	115.9	34.0	4.2	41.5	-	-	-	-
5050	GR Account - 9-1-1 Service Fees	151.6	105.3	75.5	61.5	32.2	-	-	-	-
0036	GR Account - Texas Department of Insurance Operating	98.8	92.3	44.3	46.5	37.3	43.2	42.6	36.5	24.1
5000	GR Account - Solid Waste Disposal Fees	97.2	76.8	47.6	37.5	23.3	23.6	14.4	-	-
0099	GR Account - Operators and Chauffeurs License	91.2	126.2	41.8	4.6	3.2	5.7	37.7	17.9	6.4
0151	GR Account - Clean Air	67.2	111.7	69.5	55.2	27.0	34.6	56.3	25.3	18.4
5101	GR Account - Subsequent Injury	60.4	52.4	42.7	-	-	-	-	-	-
0550	GR Account - Hazardous and Solid Waste Remediation	47.6	44.2	68.4	84.1	76.2	61.9	66.6	86.9	31.9
5064	GR Account - Volunteer Fire Department Assistance	45.9	23.0	22.9	15.0	-	-	-	-	-
0467	GR Account - Texas Recreation and Parks	42.3	26.6	58.6	53.5	51.2	55.4	54.8	50.2	38.3
0255	GR Account - Texas Tech University	32.8	16.5	20.4	0.4	10.2	9.1	17.6	16.1	11.4
0165	GR Account - Unemployment Compensation Special A	32.0	26.9	20.2	28.7	23.8	20.9	11.1	4.4	2.4
0245	GR Account - Prairie View A&M University	31.9	15.8	5.0	-	2.4	0.4	2.1	5.8	1.7
5085	GR Account - Child Abuse Neglect and Prevention Trus	31.0	29.0	32.2	32.1	-	-	-	-	-
5010	GR Account - Sexual Assault Program	30.7	0.2	1.6	1.4	0.8	0.4			
0549	GR Account - Waste Management	30.5	24.1	51.7	42.6	28.4	10.9	15.1	9.4	8.9
0242	GR Account - Texas A&M University Current	30.4	36.4	28.7	19.5	29.5	14.2	16.8	6.2	10.3
0009	GR Account - Game, Fish, and Water Safety	29.2	80.6	24.9	47.8	43.2	49.1	8.3	13.3	12.5
5128	GR Account - Employment and Training Investment Hol	29.0	76.4	-	-	-	-	-	-	-
0027	GR Account - Coastal Protection	27.3	14.9	21.7	24.9	10.4	25.2	21.6	4.6	15.4
0222	GR Account - Department of Public Safety Federal	26.1	3.1	12.2	8.1	10.6	21.5	15.0	-	5.5
	All Other GR Dedicated Certification Accounts	770.7	731.3	1,562.9	1,457.5	1,036.3	750.7	667.9	1,031.8	743.9
	Total Estimated GR-Dedicated Certification Balance	3,665.6	3,213.0	2,751.9	2,197.4	1,624.9	1,339.4	1,137.1	1,309.5	940.1

	81st Leg 2010-11	80th Leg 2008-09	79th Leg 2006-07	78th Leg 2004-05	77th Leg 2002-03	76th Leg 2000-01	75th Leg 1998-99	74th Leg 1996-97	73rd Leg 1994-95
General Revenue Expenditures	80,614.2	81,639.0	67,208.1	58,955.7	59,917.7	55,647.6	48,889.9	44,685.9	39,959.1
Total Balance as a Percentage of GR Expenditures	4.5%	3.9%	4.1%	3.7%	2.7%	2.4%	2.3%	2.9%	2.4%

Source: Legislative Budget Board

Recommendation

The committee recommends thorough consideration of the necessity of continuing each fund. Should consideration determine that an account be continued, then the Legislature should specify an amount to be collected per biennium and dedicated to the account. Any excess revenues collected should be transferred into General Revenue.

REVENUE UPDATE TO THE LEGISLATURE:

Background

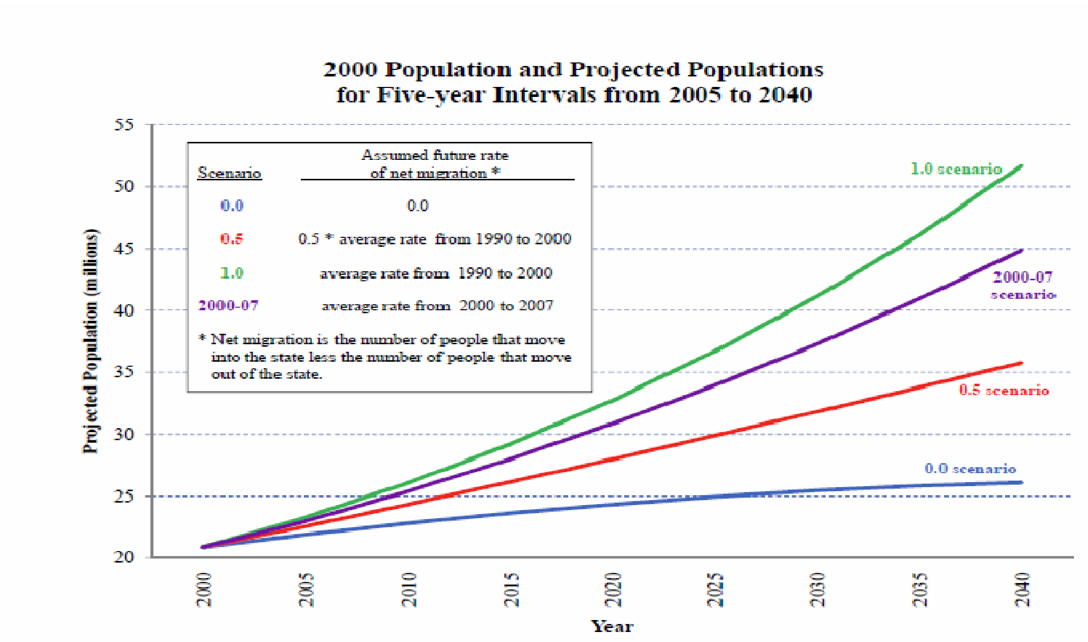
Currently, the Committee on Appropriations receives a revenue update from the LBB as to the state's revenue forecast, fiscal situation, agency appropriation requests, appropriations bill and the supplemental appropriations bill.

Recommendation

It is our recommendation that the entire House membership receive an update and overview from the LBB in order to fully understand the issues and priorities being contemplated before introducing legislation that would increase expenditures to the state.

POPULATION GROWTH

A driving factor in the increase of Texas' budget over the past few decades is its population growth. With an increase in population, the state has had to increase spending to cover services. Growth has been a combination of natural population increase, state-to-state migration and international migration. A presentation given by Dr. Lloyd Potter on behalf of the Texas State Data Center illustrated this continued trend. Projections from the same presentation also indicate that this growth had no inclination of stopping. Lawmakers must take this into consideration when crafting the budget and planning for the state's future.



Source: Texas State Data Center.
Analysis prepared by TLC, Research Division.

ENDNOTES

[1] *"State Fiscal Crises: Causes, Consequences, Solutions,"* held by the Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution, and by Northwestern University's Kellogg School of Management and Institute for Policy Research*;* http://www.urban.org/uploadedPDF/1000614.pdf
[2] *2008 Budget Processes in the States*, National Association of State Budget Officers
[3] *Challenges for the Economy and State Governments,* speech at the Annual Meeting of the Southern LegislativeConference of the Council of State Governments, Charleston, South Carolina; August 2, 2010; http://www.federalreserve.gov/newsevents/speech/bernanke20100802a.htm