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LESSONS FROM THE 2003 SESSION: A BALANCED APPROACH TO BALANCING THE STATE BUDGET

Many are looking to how legislators dealt with the 2003 budget shortfall for guidance in approaching a similar problem in 2011. For history to be helpful, though, we must accurately remember what happened. The budget shortfall in 2003 was almost $16 billion, not $10 billion,[1] and it was closed with a balanced approach of both cutting spending and increasing revenue.[2] The Legislature should also take a balanced approach in 2011. A balanced approach that includes new revenue is the better choice for Texas. Relying solely on budget cuts leaves critical public structures and systems, such as education and health care underfunded.[3]

Background

The primary challenge facing state budget writers in 2003 was a drastic drop in the amount of General Revenue that the state expected to receive in 2004-05. The comptroller's revenue estimate, released in January 2003, projected a $7.4 billion biennial revenue drop—about 12 percent less than the $61.5 billion in General Revenue spending budgeted at the time for 2002-03.

The main cause of the forecast for lower revenue in the subsequent biennium was the national economic recession then hitting the U.S. In addition, tax collections in 2002-03 had fallen below prior forecasts after the events of September 11, 2001.

The 2003 Legislature also had to deal with a $1.8 billion General Revenue shortfall in fiscal 2003, caused mostly by higher-than-budgeted spending needs in Medicaid and the Children's Health Insurance Program.

An additional problem facing the Legislature was that the 2002-03 budget had been funded with a one-time carryover of $2.9 billion in general revenue from the 2000-01 biennium, as well as $1 billion in other general revenue that would not recur in the 2004-05 biennium.

In sum, legislators in 2003 faced a situation likely to face them again in 2011—inadequate revenue because of an economic slowdown, plus a lack of one-time funds that supported the prior budget.

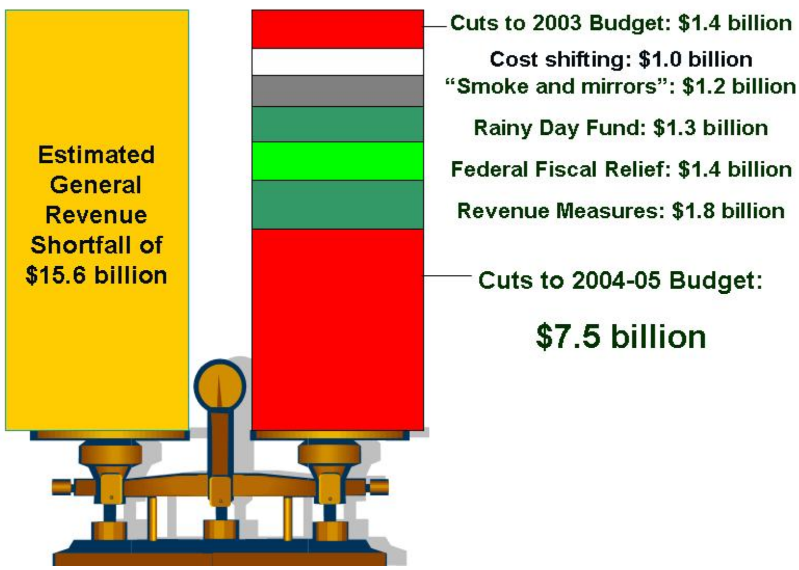
Budget cuts

Many state officials initially insisted that the budget could be written entirely within the $54.1 billion in General Revenue that was originally estimated as available for 2004-05. But in the end, the magnitude of cuts that would have been required was too drastic. The Legislature cut at least $7.5 billion in General Revenue spending out of the state budget, based on CPPP's estimate of "current services" needs and population and inflation-driven growth for 2004-05.

The Legislature also cut spending for the rest of fiscal 2003 by $1.4 billion in General Revenue and GR-Dedicated funds. Only the Foundation School Program, Medicaid acute care services, and the Children's Health Insurance Program were exempt from these cuts.

In the end, the functions receiving the largest General Revenue cuts were higher education; public education; public safety and criminal justice; and health and human services.

How the 2004-05 State Budget was "Balanced"



Rainy Day Fund

The 2003 Legislature appropriated $1.26 billion from the Rainy Day Fund—almost all that legislators expected it to contain through 2005. One-third ($450 million) was for Children's Health Insurance Program (CHIP) and Medicaid shortfalls for the then-current fiscal 2003. The Legislature appropriated the remaining $811 million for 2004-05 to fund retired teachers' health care and to create the governor's Texas Enterprise Fund for economic development incentives ($295 million).[4]

Federal fiscal relief

In May 2003, after the state budget had been almost completed, Congress passed the Jobs and Growth Tax Reconciliation Act of 2003, which included federal fiscal relief through higher Medicaid match rates (a 2.95 percent boost, in effect from April 2003 to June 2004) and flexible grants to state governments. Of Texas' $1.3 billion share, about $840 million was used to balance the budget and to restore HHS funding (primarily to HHS provider rates and to community care).

Revenue measures

The Legislature took several steps to generate new revenue. For instance, the 2003 Legislature extended the Telecommunications Infrastructure Fund (TIF) to raise an additional $250 million. The TIF, which was scheduled to expire once it had raised $1.5 billion, was originally created to provide grants and loans to K-12 schools, institutions of higher education, libraries and hospitals to improve distance learning, Internet connectivity, and other related technology. The Legislature extended the TIF and changed its allowable uses so that it could fund the $30-per-student technology allotment to school districts for the purchase of electronic textbooks and other electronic instructional materials.

The Legislature also created a tax amnesty program that raised $50 million; entered a multi-state lottery (Mega-Millions) that was projected to bring in $102 million; and established a quality assurance fee (QAF), paid by facilities for people with developmental disabilities, to raise $54 million.

Related measures included changing the investment and distribution policy of the Permanent School Fund to increase payments to school districts by $275 million in 2004-05; hiring additional enforcement officers and auditors at the comptroller's office, estimated to increase tax collections by $122 million; and limiting the amount of tax refunds paid without express legislative authorization, saving $120 million in the biennium.

Accounting Adjustments

The Legislature can create the appearance of more money available to certify a state budget by accounting adjustments such as delaying payments from the last month of one biennium into the first month of the next, reducing the amount apparently needed in the first period without actually reducing spending on that program. Steps such as these, commonly called "smoke and mirrors," can be responsible steps to take in a fiscal crisis to avoid harmful budget cuts. In 2003 the Legislature shifted a Foundation School Program payment of $800 million into the next (2006-07) budget cycle; deferred payments to the Employees Retirement System and Teacher Retirement

System (TRS); converted Medicaid acute care services to a cash method of accounting; and deferred for one month payments to community centers serving Texans with developmental disabilities.

Cost-shifting

The 2004-05 budget was reduced by shifting the cost of services from the state to program beneficiaries or to other levels of government. For instance, people covered by state-subsidized health insurance—mainly state employees and teachers—faced $790 million in new co-pays, premiums, and other out-of-pocket costs, while local school districts had to shoulder an additional $203 million in payments to TRS for retiree health insurance. Tuition at state universities was "deregulated," shifting some of the cost of supporting higher education from the state to students and their families, who had to pay higher tuition and fees. Counties were no longer permitted to retain a portion of motor vehicle registration fees, but were instead reimbursed from motor vehicle sales taxes, reducing county revenue by $136 million in 2004-05.

Other revenue changes

The Legislature authorized the Texas Transportation Commission to issue up to $3 billion in revenue bonds supported by the State Highway Fund. The bonds were, in part, supported by moving existing revenue from motor vehicle inspection driver's license fees from General Revenue to the Texas Mobility Fund. In addition, traffic-law violators were assessed numerous new fees, including charges of $1,000 a year for three years for a first conviction for driving while intoxicated.

A balanced approach in 1986

In 1986 the Legislature also took a balanced approach. Two special sessions were required to balance the budget in the face of a drop in state revenue caused by a sudden fall in oil prices. The Legislature used a balanced approach that relied on revenue measures more than budget cuts to close the projected shortfall. General revenue appropriations for 1987, the second year of the then-current biennium, were cut by 4.65 percent, reducing services by $582.2 million. But the Legislature also increased the state sales tax rate from 4.125 percent to 5.25 percent to generate $582.4 million—the same amount as the budget cuts.

In addition, the motor-fuels tax rate was raised from 10 cents per gallon to 15 cents per gallon, creating $292.8 million in additional revenue, and certain statutory dedications to the Highway Fund were suspended, to allow $136.5 million to be retained in the General Revenue Fund. Also, cities not within a transit authority were permitted to levy a 0.5 percent local sales tax, on top of the existing optional 1 percent local sales tax.

Creation of the Rainy Day Fund

After the experience of 1986, the Legislature sent to the voters a constitutional amendment to create the Rainy Day Fund (technically, the Economic Stabilization Fund, see Texas Constitution, Article 3, Section 49-g). The fund is intended to be a forced savings account, filled by excess natural gas and oil tax revenue, which can fill in budget holes caused by unexpected economic slowdowns. The fund is expected to have $9.6 billion available for appropriation for the 2012-13 budget.[5]

Conclusion

The lessons of 2003 and 1986 can be useful as the Legislature approaches 2011, but only if we remember accurately what was done. The key is taking a balanced approach that recognizes the importance of maintaining state investments in critical public structures and systems to ensure both our short-term and long-term prosperity.

[1] For an explanation of the 2003 shortfall, see Release of 2004-2005 Revenue Estimate Reveals Budget Gap of Almost $16 Billion (Jan. 2010).

[2] For a graphic presentation of the combination of budget cuts and new revenue see Slide 3 in All About the Money: The State Budget (Sept. 2004).

[3] To learn more about the devastating 2003 cuts, see Truth and Consequences: The State Budget for 2004-2005 and Its Impact on Texans (July 2004).

[4] For more information on the Rainy Day Fund, see Use All of the Rainy Day Fund: a Balanced Approach to Balancing the State Budget (Apr. 2010).

[5] Ibid.