Center for Public Policy Priorities
POLICY PAGE
900 Lydia Street Austin,Texas 78702 PH: 512.320.0222/FAX: 512.320.0227 www.cppp.org

Feb. 16, 2006 More Information: Eva DeLuna Castro, deluna.castro@cppp.org No. 258

TEXAS HAS NO SURPLUS!

Using $4.3 billion in "available" state funds to cut local school property taxes would be irresponsible

With a special session on school finance looming, some are interested in buying down local school property taxes using part or all of the $4.3 billion that the Comptroller has said is "available," thus reducing the need to increase state taxes. This *Policy Page* explains why the $4.3 billion estimated to be available to fund the 2006-07 budget is not surplus money, and why it would be a bad idea to use any of the $4.3 billion to buy down school property taxes.

Sources of the $4.3 billion

The comptroller's February 8 announcement that "$4.3 billion in General Revenue-related funds are available to be appropriated or re-appropriated" came as a surprise to many. However, those who had been following budget issues closely knew that the comptroller had previously announced in Fall 2005 that legislators had approved spending $4.0 billion less in General Revenue (GR)-related funds than the state was expected to collect by August 2007, the end of the current budget cycle. The comptroller made this announcement as part of her constitutional duty to certify appropriations bills.

Of the $4.0 billion, $1.8 billion would have been appropriated for schools during the first special session if school finance and property tax reduction bills had passed. Another $473 million was General Revenue that the Governor vetoed from legislative appropriations (excluding Texas Education Agency/K-12 vetoed spending that was later restored). This $473 million is available for budget execution or re-appropriation.

The February 8 announcement by the comptroller accompanied the release of the certification revenue estimate, detailing additional (compared to the January 2005 revenue estimate) sources of unappropriated funds:

Fiscal 2005 Revenues: For fiscal year 2005 (which ended in August 2005), the state collected $1.335 billion (or 4 percent) more in General Revenue than legislators originally anticipated. Revenue sources that did better than expected compared to January 2005 include the franchise tax ($360 million more), sales tax ($258 million), motor vehicle sales/rental ($135 million), natural gas tax ($122 million), and oil production/regulation taxes ($90 million). Also, licenses, fees, fines, and penalties generated $93 million more by the end of fiscal 2005 than originally expected.

Not all revenue sources outperformed the January 2005 estimate: motor fuels taxes raised $26 million less in General Revenue, for example, and the lottery yielded $20 million less.

Revenues Expected in 2006 and 2007: For 2006-07, the February 2006 revenue estimate forecasts an additional $761 million (1.2 percent more) in sales tax General Revenue, above and beyond the amount estimated in January 2005; the franchise tax will yield an additional $187 million. Licenses/fees/fines/penalties will produce $654 million more for the GR fund than was estimated in January 2005; $400 million of this is due to legislators' extending the Telecommunications Infrastructure Fund (TIF) assessment until September 1, 2011, and counting TIF as General Revenue.

Another $255 million in GR that was not part of the January 2005 estimate is a transfer from the Texas Mobility Fund of drivers' license and driver records fee revenue. After January 2008, these transfers will stop; the money will remain in the Mobility Fund to pay for state highways.

The performance of the sales tax is especially critical because it generates about half of all General Revenue, or one-fourth of total revenue. Actual sales tax collections from September 2005 to January 2006 suggest that sales tax revenue may turn out to be almost 6 percent higher than estimated by the time fiscal 2006 ends. If this trend continues, the state would have another $900 million in unappropriated sales tax revenue by August 2006.

Using $4.3 billion collected over three years to cut school property taxes for one year, only works once

It takes about $1.2 billion a year to buy down school property taxes by ten cents. Roughly, $4.3 billion would lower school taxes from $1.50 per $100 of property value to $1.15 for the 2006-07 school year.

The problem, of course, is how to continue funding the property tax cut for the 2007-08 school year and beyond. The $4.3 billion is an estimate of unappropriated funds that will have built up over three years (2005 to 2007). Legislators could very well have to wait another three years before a similar amount is generated by the state's antiquated tax system. The alternative—taking $4.3 billion from somewhere else in the state budget to continue funding the school property tax cut—would require devastatingly large reductions in higher education spending, prisons and public safety programs, health and human services, and general government. Programs and services in these critical areas are still reeling from 2003 budget cuts, many of which have not been restored.

Budget restorations are still needed, not continued cuts

The $4.3 billion available to be appropriated is a product of both a slightly improved revenue estimate and significant budget cuts made by legislators in 2003 and 2005. In 2003 alone, over $7.5 billion in General Revenue spending was cut from the 2004-05 budget, from critical spending areas such as textbooks and grants for pre-K and kindergarten; teachers' and other public employees' health insurance; and Medicaid and CHIP.

During 2006-07, even with the state's improved revenue picture, General Revenue spending will continue to fall once population growth and inflation are taken into account. Estimates in the Legislative Budget Board's (LBB) new *Fiscal Size Up* indicate that inflation-adjusted, per capita GR spending will decrease 5.2 percent in fiscal 2007, more than canceling out the increase of 4.7 percent in 2006. This comes after a 4.3 percent drop in GR spending in 2003; 5.7 percent in 2004; and 2.8 percent in 2005. All-Funds state spending, adjusted for population and inflation, will drop 4.7 percent by 2007, less than was spent in 2002.

Budget execution items: Further evidence that the 2006-07 budget is inadequate

As mentioned earlier, about $473 million of available General Revenue is funds vetoed by the Governor from the state budget. Language in the state budget allows these vetoed funds to be allocated through budget execution if legislators are not in session.

In mid-August 2005, Governor Perry proposed the use of budget execution authority to fund almost $660 million worth of items not already in the 2006-07 budget:

- $295 million for K-12 textbooks,
- $200 million for a nursing home rate increase;
- $13 million to restore the personal needs allowance for nursing home residents (one of the cuts made by legislators in 2003);
- $76 million for trauma centers;
- $48 million to operate the new pharmacy school in Kingsville and medical school in El Paso;
- $20 million for other higher education items, and
- $5.8 million for other budget needs.

An LBB meeting scheduled for September 21 to act on the governor's budget proposals never took place. With Hurricane Rita approaching the Gulf Coast and Hurricane Katrina's costs to Texas not yet known, state officials said that it was too soon to commit state revenue to other needs. (More recently, on February 10, Governor Perry informed Washington officials that Texas still needed $2 billion in aid to deal with damage done by Hurricane Rita.) Because the governor's proposal was not acted upon within 31 days, it has expired and would have to be re-issued before another meeting could be scheduled.

Supplemental appropriations for 2006-07 may also be needed

For the past few sessions, legislators have made emergency appropriations to key areas of the budget (usually health care, education, public safety, and costs to the state due to natural disasters) when initial assumptions about caseloads, enrollment, federal aid, or costs turned out to be too optimistic. In Medicaid especially, even a slight percentage increase in clients, utilization, or the share of costs paid for by the state can result in the need for hundreds of millions more in General Revenue funding.

The legislature that meets in 2007 will probably see similar supplemental needs. In Medicaid alone, for instance, the estimated shortfall for the biennium is $558 million in General Revenue as of November 2005. The main cause of the Medicaid shortfall so far is not caseload growth—which is actually a little lower than what the state budgeted for—but higher utilization costs, a less favorable match rate for fiscal 2007, and the unresolved issue of the Medicare prescription drug "clawback" payments.

Medicare clawback: In the general appropriations act for 2006-07, legislators budgeted $444 million in GR for the clawback payments, which federal law requires from states to offset savings produced when certain Medicaid-eligible recipients of prescription drugs become covered by the new Medicare benefit. The entire amount was vetoed by the governor and constitutes more than 90 percent of the spending vetoes by the governor. Texas and several other states are considering a lawsuit to resolve the issue in the U.S. Supreme Court. Until it is resolved, the Health and Human Services Commission is counting the $444 million as part of the $558 million GR Medicaid shortfall.

Using dedicated funds now creates problems for future state budgets

A considerable part of the $4.3 billion is due to increases in the balances of General Revenue-dedicated accounts. These accounts helped balance the budget for purposes of certification, but actually spending these revenues in 2006-07 for other purposes (such as property tax cuts) will only worsen future budget problems.

A case in point: the GR-Dedicated System Benefit Fund will generate $268 million in 2006-07. However, only $7.2 million of this will be spent because the legislature did not appropriate any money at all for LITE-UP, a discount program that helps low-income households with high electricity bills. (LITE-UP received $150 million in 2003 alone, before budget cuts made by legislators in response to a massive revenue shortfall.) If System Benefit Fund revenue actually gets spent during 2006 or 2007 for general purposes, it will have to be replaced at some point with other General Revenue; otherwise, System Benefit Fund revenue will not be available to restore LITE-UP in 2008 and beyond.

Another example: a GR-Dedicated Trauma Facility/EMS account will generate $143 million in the 2006-07 biennium. However, legislators appropriated only $64 million for trauma programs in 2006-07. On paper, this leaves $80 million unused and "available" to balance the GR-related budget. But just as in the case of the System Benefit Fund, any use of this $80 million in the current budget would not be sustainable if at some point legislators insist that the revenue be used only for the originally intended purpose.

Rainy Day Fund needs replenishing

In writing the 2006-07 budget and dealing with 2005 budget shortfalls, legislators spent $1.9 billion from the Economic Stabilization Fund, also called the "Rainy Day" fund. This will shrink the fund to $196 million by the end of the budget cycle—enough to cover GR spending for only two days. While the rainy day fund will eventually grow because of constitutionally and statutorily required transfers of certain oil and natural gas production tax revenues, it will be unable anytime soon to cover large budget needs that may arise.

Before the 2001 recession, the national rule of thumb for state rainy day funds was that they should equal 5 percent of General Revenue spending to help offset the cyclical pattern of revenue booms and busts. However, 5 percent turned out to be totally inadequate for most states to weather the multiyear revenue shortfalls seen after 2001, resulting in huge budget cuts in Texas and most other states and cost-shifting to local governments. Now, many state budget experts think that 5 percent is a bare minimum for a contingency fund and 10 percent should be a goal. For Texas, 5 percent of biennial GR spending is $3.2 billion; 10 percent would be $6.4 billion. The available balance of $4.3 billion is less than 7 percent of GR spending.

Conclusion

Even if the $4.3 billion amount grows by the time legislators meet for a special session, no responsible person would think of it as "surplus." These funds are only "available" because of years and years of devastating cuts to state spending that was already the lowest in the nation, combined with a refusal to acknowledge immediate budget needs and an almost nonexistent rainy day fund.

Instead of seeking a quick-fix for school finance that will cost billions to continue, legislators need to begin a serious discussion about long-term, structural tax reforms needed to allow for the kinds of public investments that will make Texas truly competitive in the long run. For more information, visit http://www.cppp.org/research.php?aid=482

To make a donation, sign up for free E-Mail Updates, or see more of our work, visit www.cppp.org.