

SUBJECT: Supplemental appropriations and reductions for fiscal 2003

COMMITTEE: Appropriations — committee substitute recommended

VOTE: 21 ayes — Heflin, Berman, Branch, F. Brown, Crownover, J. Davis, Deshotel, Dukes, Gutierrez, Hamric, Hope, Hupp, Kolkhorst, McClendon, Menendez, Pickett, Pitts, Raymond, Truitt, Turner, Wohlgemuth

0 nays

8 absent — Luna, B. Brown, Eiland, Ellis, Isett, E. Jones, Solis, Stick

WITNESSES: None

BACKGROUND: The Economic Stabilization Fund or “rainy day fund,” established by a constitutional amendment in 1988, is appropriated half of any unencumbered revenue at the end of a biennium and 75 percent of any oil or natural-gas production tax revenue that exceeds the amount collected in fiscal 1987. No transfers of unencumbered revenue have occurred since 1991, as the state’s budgets have left no such revenue at the end of fiscal biennia. However, the rainy day fund has received about \$1 billion from excess natural-gas production tax revenues since 1997. The fund may not exceed an amount equal to 10 percent of the general revenue (minus certain types of income and funds) received during the previous biennium. The fund balance projected at the end of the current biennium, \$1.2 billion, would represent about 2 percent of general revenue appropriated for fiscal 2002-03.

Generally, money in the rainy day fund may be spent only as approved by at least three-fifths of the members present in each house. Spending from the fund generally may not exceed the amount of any unanticipated deficit or revenue shortfall. However, any amount from the fund may be spent for any purpose if at least two-thirds of the members present in each house approve it. The Legislature authorized transfers from the rainy fund for the foundation school program in 1989 and for criminal justice programs in 1993.

The 74th Legislature created the Telecommunications Infrastructure Fund (TIF) as part of the Public Utility Regulatory Act of 1995. With revenue

generated by an assessment on telecommunications providers' receipts that is passed on to consumers through a charge on telephone bills, the TIF was intended to receive \$1.5 billion over 10 years to provide telecommunications access for public schools, not-for-profit hospitals, public libraries, and higher education institutions. The fund is expected to reach its statutory limit during the third quarter of fiscal 2004, at which point the assessment will end.

DIGEST:

CSHB 7 would reduce fiscal 2003 appropriations for state agencies and higher education institutions by nearly \$1.7 billion and would transfer about \$789 million from the rainy day fund and \$142 million from the TIF. From the rainy day fund, the bill would appropriate \$494 million to state medical assistance programs and \$295 million to a Texas Enterprise Fund, contingent on creation of such a fund by the 78th Legislature.

Reductions. The bill would reduce appropriations for individual agencies and institutions made by the 77th Legislature's general appropriations act for fiscal 2002-03. Reductions of unencumbered general revenue from agencies, including from junior and community colleges, would total slightly more than \$1 million. The bill also would sweep \$645 million in unencumbered balances from dedicated funds and accounts at various agencies.

Each agency would have to identify the strategies and objectives for which funding would be reduced. The House speaker and lieutenant governor would have to determine reductions for legislative agencies. Four agencies would receive exceptions to spending required by the fiscal 2002-03 general appropriations act, allowing the agencies to tap into funds that otherwise would be protected by statute: Project RIO at the Texas Workforce Commission, unclaimed lottery funds through the Texas Department of Health (TDH), appropriations for new-generation medications and long-term care waivers through the Texas Department of Mental Health and Mental Retardation, and the State History Museum through the State Preservation Board.

Rainy day fund appropriations. The bill would appropriate \$460.3 million from the rainy day fund to the Health and Human Services Commission (HHSC) for Medicaid acute care in fiscal 2003 if program expenditures exceeded available funds because of changes in caseloads or costs or because of a lower federal match rate. HHSC also would receive \$26.4 million for

CHIP in fiscal 2003 from the rainy day fund. TDH would receive \$6.9 million for Medicaid Texas Health Steps and the Medical Transportation program from the rainy day fund.

The remaining \$295 million of appropriations from the rainy day fund would be transferred to the Texas Enterprise Fund for the governor's use during the two-year period following the creation of the fund. If the 78th Legislature also created an Other Events trust fund for the governor's use, \$10 million of the \$295 million would be appropriated to that new fund.

Transfers from the rainy day fund would take effect only if CSHB 7 was finally passed by a two-thirds record vote of the members present in each house.

TIF appropriations. CSHB 7 would appropriate \$26.4 million from the TIF to the Texas Department of Human Services in fiscal 2003 for the Texas Integrated Eligibility Redesign System. It also would appropriate \$116 million to the Texas Education Agency (TEA) to fund the \$30-per-student technology allotment for fiscal 2003, if enabling legislation is enacted. If the enabling legislation is not enacted, CSHB 7 would appropriate the same amount from the State Textbook Fund instead.

The bill would take immediate effect, as provided for a general appropriations act under Texas Constitution, Art. 3, sec. 39.

**SUPPORTERS
SAY:**

CSHB 7 would take a measured approach to reducing appropriations for fiscal 2003 as needed because of revenue shortfalls and would leave in agency hands most of the decision-making about where and how to make spending reductions. In January 2003, the governor, lieutenant governor, and House speaker directed agencies to reduce their fiscal 2003 budgets by 7 percent, excluding the Foundation School Program (FSP), acute care Medicaid, and the Children's Health Insurance Program (CHIP). Most agencies plan to achieve their reductions by freezing hiring, reducing travel, delaying capital projects, and returning unexpended balances.

The bill would shelter some programs, ensuring that funding would not be reduced for the state's priorities in education and health care for the poorest and youngest Texans. Exempting the FSP, Medicaid, and CHIP from across-

the-board reductions would ensure that any reductions for those programs would not be imposed by an arbitrary percentage, but evaluated through the regular appropriations process.

The House Appropriations Committee evaluated all the proposed reductions in agency budgets and adjusted some. Asking agencies to propose reductions by 7 percent was a starting point, but all agencies had an opportunity to explain how they would make those reductions and what size of reduction would be feasible given the agency's level of efficiency.

In January, the comptroller projected that fiscal 2002-03 will end with a negative balance of \$1.8 billion. Under Texas Constitution, Art. 3, sec. 49a, this negative balance must be eliminated by the end of fiscal 2004-05 in order for the comptroller to certify a balanced budget, requiring either spending reductions or increased revenues. With spending already tight in the upcoming biennium due to falling revenues and increased needs, eliminating an additional \$1.8 billion would make it even more difficult to meet essential priorities. By eliminating a substantial portion of the general revenue deficit through spending reductions in fiscal 2003, CSHB 7 would allow the next biennial budget to start in or near the black.

Use of the rainy day fund. It would be appropriate to use the rainy day fund to address budget shortfalls and economic stimulus, as proposed by CSHB 7. Never before has Texas seen back-to-back years of declining sales-tax revenue, but the state is facing a second year of decline after nine months of consecutive monthly sales-tax declines. Few bright spots are evident on the economic horizon, so now is the right time to tap into the rainy day fund.

CSHB 7 would not draw down the entire rainy day fund. After the bill's appropriations, the fund balance would be roughly \$400 million, enough to provide a cushion in case of a catastrophe. The rainy day fund balance has grown substantially in recent years because of higher natural-gas prices, and it is reasonable to expect that oil and gas tax revenues will remain high enough to contribute additional revenue to the fund in the future.

CSHB 7 would put the rainy day fund to good use by preventing cuts in essential services and stimulating growth in the Texas economy. The fund

should not be used as a one-time patch for ongoing state expenses, and the bill would not use it in that manner.

Economic development programs would be a wise use of the rainy day fund because the state can generate \$13 for each dollar it invests in these programs. State-funded incentives would pay for themselves through increased state tax revenue in the near future. This return would be felt quickly, with an average payback period of two and one-half years. Economic development programs would stimulate job creation and benefit Texas citizens.

The state has generated significant growth in the past by investing in economic development. In 1988, the state and the University of Texas invested \$57 million in site acquisition, retrofitting, equipment, and other incentives for Sematech, a consortium of semiconductor companies. This investment brought the consortium to Central Texas and became a magnet for the microelectronics industry.

The governor should have the flexibility to determine how economic development funds are spent. Gov. Perry has called for creating the Texas Enterprise Fund, which would include a deal-closing fund, a technology and biotechnology fund, additional funding for Sematech, funding for health institutions in the Texas-Mexico border region, and disaster relief.

The deal-closing fund would enable the governor to act decisively when negotiating with companies. Businesses expect the governor to have the authority to close deals. The state now is discussing arrangements with 22 businesses that would result in almost 9,000 new jobs. By giving the governor access to the resources to close those deals, CSHB 7 would ensure that nothing hinders the state in attracting new business.

The technology and biotechnology fund projects would include establishing a Nobel Laureate Center and other initiatives to bring rapid-growth industries to the state. The Sematech fund would be used to attract building of additional microelectronic facilities in Texas. Border health institutions fund projects would include a Regional Academic Health Center and a Border Health Institute in El Paso. The disaster relief fund would be used to cover the state's share of Tropical Storm Allison damage.

The Legislature could ensure that money taken from the rainy day fund would be returned in a timely manner. HB 3207 by Heflin would require that any appropriation from the fund for use in fiscal 2003 be repaid from general revenue during fiscal 2004. Also, HJR 2 by Heflin would set a permanent repayment requirement if enacted and approved by voters. This proposed constitutional amendment would require that any amount appropriated from the rainy day fund during a biennium be repaid from general revenue the following biennium. This provision would apply to transfers made for fiscal 2004-05, even if the actual transfer was made before the constitutional amendment was approved by voters.

The state's bond rating is unlikely to fall because of appropriations from the rainy day fund. A recent Standard & Poor's publication says: "Drawing down reserve funds is not a credit weakness on its own....A balanced approach to utilizing reserves in combination with recurring revenue or spending measures is optimal from a credit standpoint." The measures proposed in CSHB 7 would reflect this balanced approach.

TIF appropriation. Allocating TIF funds to TEA would achieve the purpose envisioned when the TIF was created: supporting the use of technology in public schools. The TIF board already has allocated more than \$1 billion to building the technology infrastructure across the state.

**OPPONENTS
SAY:**

The Legislature should not reduce agency budgets across the board. That approach reflects an assumption that all agencies are equally inefficient, which they are not. Oversight reports by the comptroller, state auditor, and Sunset Advisory Commission show that some state agencies operate more efficiently than others. Asking those that operate more efficiently to reduce their budgets by the same amount could require them to cut the very resources that ensure efficient operations. CSHB 7 would penalize well-run agencies for their frugality.

The state has priorities in addition to those that the governor exempted from budget cuts. The reductions proposed by CSHB 7 would force TEA and health and human services (HHS) agencies to operate with greatly reduced resources, impairing the administration of sheltered programs. Essential services such as TDH's Children with Special Health Care Needs program would have to return some funds that could have been used to help gravely ill

children. Furthermore, any program that escaped reduction in fiscal 2003 would be reduced under the funding proposals in CSHB 1 by Heflin, general appropriations bill for fiscal 2004-05.

An emergency appropriations bill should be enacted only to fund emergency shortfalls in agency appropriations, not to reduce the entire state budget. The reductions this bill would enact have no connection with agency shortfalls. If HHS agencies' fiscal 2003 funding were not reduced, the state would have sufficient funds to cover the shortfalls at HHSC and TDH.

Use of the rainy day fund. The Legislature should draw down the rainy day fund only to preserve essential services, not to fund the governor's pet projects. Most essential services would be cut in fiscal 2004-05 if CSHB 1 becomes law, because funding levels would not meet the needs identified by agencies. Some essential services would be cut entirely: 55,000 elderly and disabled Texans would lose the help they need to stay in their homes and out of nursing homes; more than 200,000 children in low-income families would lose medical coverage; compensation of teachers and other school employees would be reduced because of lower contributions to their health insurance. Those services should be restored before money is shifted from the rainy day fund to a vaguely defined "enterprise fund."

Economic development would be stimulated better through mechanisms the state has used in the past: primarily job training funded by a surcharge on the unemployment compensation tax. Many studies have shown that one of the most important keys to economic development is a well-educated workforce. The 77th Legislature abolished Smart Jobs, a job-training grant program operated by the Texas Department of Economic Development (TDED), after finding significant problems in the program's administration. Instead of giving the governor money from the rainy day fund, the state should move TDED's functions to the Governor's Office and resurrect Smart Jobs.

The governor should not receive a blank check for economic development programs. Such programs should be evaluated on a project-by-project basis. CSHB 7 would place no restrictions on how the governor could use money from the rainy day fund. The Legislature should ensure that these funds are used wisely by establishing parameters and goals for economic development activities before authorizing the transfer of funds.

Draining the rainy day fund would remove the state's cushion in an emergency. If CSHB 7 were enacted, the remaining balance of \$400 million would be insufficient to cover the costs associated with a hurricane, let alone a terrorist attack or continuing economic decline. Tropical Storm Allison blew through Houston in 2001 and left \$1 billion of damage in its wake. The New York City Comptroller estimated that the September 11 attacks cost the city \$95 billion. The Texas Animal Health Commission has warned that a statewide outbreak of foot-and-mouth disease could cost between \$4 billion and \$5 billion. The state should leave enough money in reserve to cover such emergencies, and \$400 million is not enough.

TIF appropriation. TIF funds were intended to be used to help prevent a "digital divide" by developing a strong technology infrastructure in rural and underserved communities, not to fund general technology expenditures in schools, regardless of how worthy such expenditures may be. If TIF funds were distributed through the technology allotment, rural communities would receive a much smaller portion of the funds, because the allotments are distributed on a per-student basis.

OTHER
OPPONENTS
SAY:

Use of the rainy day fund. The state should build up the rainy day fund, not drain it. Bond credit rating agencies consider the presence of a reserve fund and the relative size of that fund when determining a state's creditworthiness. According to the Comptroller's Office, bond rating agencies favorably regard a reserve fund of 5 percent or greater. Moody's, a major credit rating agency, rates Texas' general obligation debt as "Aa1," the second highest possible rating. If the state could improve its bond rating to the highest level, it could save on debt-service payments for new bond issues.

Using money from the rainy day fund to cover the fiscal 2003 shortfall, rather than using the savings generated by agency reductions, would free up more money for spending in fiscal 2004.

NOTES:

The fiscal note for CSHB 7 estimates a net positive impact on general revenue-related funds of \$1.1 billion in fiscal 2003 and about \$224 million in fiscal 2004. Appropriations to the proposed Texas Enterprise Fund would be made in fiscal 2004, based on the assumption that the fund would be created effective September 1, 2003.

As filed, HB 7 would have appropriated no money from the rainy day fund but would have made smaller supplemental appropriations to HHSC from savings in fiscal 2003. The original bill also would have appropriated no money from the TIF. The committee substitute would revise the proposed reductions and dedicated account transfers for certain agencies.

SB 1860 by Bivins, identical to HB 7 as filed, has been referred to the Senate Finance Committee.

HB 3323 by J. Keffer and SB 1771 by Brimer and would create the Texas Enterprise Fund. HB 3323 was considered by the House Economic Development Committee on April 2 and left pending. SB 1771 has been referred to the Senate Government Organization Committee.

HB 3459 by Pitts and SB 1873 by Bivins would authorize the appropriation of TIF funds to TEA for the technology allotment. These bills have been referred to the House Appropriations Committee and the Senate Finance Committee, respectively.