

NCPA

National Center for Policy Analysis

CENTER FOR
TEXAS STUDIES

POLICY REPORT
NO. TS-101
AUGUST 31, 1989

IS THE TEXAS STATE BUDGET BALANCED?

By

Bill Cobb*

The next budget for the state of Texas -- the 1990-91 budget -- contains a hidden deficit of at least \$958 million. This deficit exists because the Texas Legislature has authorized spending increases over the next two years which total almost one billion dollars more than expected revenues. Unwilling to raise taxes to cover this additional spending, the legislators instead passed a bill to allow the State Comptroller to engage in a one-day switch of funds in an attempt to formally satisfy the constitutional requirement for a balanced budget. The one-day accounting switch works like this:

- On the last day of the 1990-91 fiscal period (August 31, 1991) the State Comptroller will remove \$958 million from more than 200 special funds, including federal matching funds, welfare funds, health care funds, building funds and the Unemployment Compensation fund.
- This money will be placed for one day in the state's general fund, which is used to pay for general program operating expenses.
- Based on this one-day injection of new money into the state's general fund, the State Comptroller has declared the 1990-91 biennial budget "balanced" -- certifying that the state can pay for the general spending programs the legislature has authorized.
- The following day (September 1, 1991), the State Comptroller will reverse the process and put the \$958 million back in the special funds.

* Bill Cobb served for six years as Budget Director in the Governor's office during the administration of John Connally. From 1951-1961, he served as Chief Examiner for the Texas Legislative Budget Board.

This one-day trick with smoke and mirrors does not change the fact that Texas is entering the 1990-91 fiscal period with a projected deficit of almost \$1 billion. Because of this deficit, Texas taxpayers face an almost certain increase in taxes in the next biennium, including the possibility of an income tax.

THE CONSTITUTIONAL REQUIREMENT FOR A BALANCED BUDGET

The Constitution of Texas requires that the government of the state maintain a balanced budget.¹ This provision was added by amendment to the state constitution during the 1930s when Texas voters wanted to force state government to operate on a pay-as-you-go basis and avoid deficit spending. What follows is a brief explanation of what the "balanced budget" requirement means.

Initial Certification by the State Comptroller. Because the state of Texas operates on a two-year cycle, the Texas Legislature must approve a two-year budget prior to the beginning of a new budget period. The current 1988-89 fiscal period ends on August 31, 1989. The next 1990-91 fiscal period begins on September 1, 1989. In order to satisfy the balanced budget requirement, the Texas Comptroller of Public Accounts,² as the chief accounting officer of the state, must certify that expected revenues will be sufficient to pay for the spending which the Legislature has authorized in the new budget.

The Distinction Between the General Fund and Special Funds. In addition to general revenues and general spending programs, the state of Texas operates about 450 special funds. Often, the revenue for these funds is specifically related to an industry or activity and spending from the funds is directed toward that industry or activity. For example, road-use taxes (three fourths of the gasoline taxes, all motor vehicle registration fees, etc.) go into the highway fund, and unemployment compensation taxes go into the unemployment compensation fund. As Table 1 shows, about 40 percent of all state government spending is from these special, or dedicated, funds. But, since spending from these funds is automatically limited by the revenue they receive, the requirement that a balanced budget be certified is really a restriction on the general-revenue-related funds.

The Meaning of a Balanced Budget after the Fiscal Period Begins. What happens if, contrary to expectations, revenues fall short of expenditures during a budget period? One option is for the state treasurer to issue short-term notes to finance the temporary deficit.³ In other words, the state can borrow money to cover short-term deficits provided the notes are paid off by the end of the fiscal year. Long-term borrowing is prohibited unless specifically approved by the voters.

What happens if there is a Permanent Revenue Shortfall? If the Legislature is in session, it must either raise taxes or cut spending. If the Legislature is not in session, the Governor must call a special session to balance the budget. Texas is notorious for the number of special sessions called to achieve a balanced budget.

¹Section 49a, Article III of the Texas State Constitution.

²The current Comptroller is Bob Bullock.

³For example, in August 1989 the state issued \$450 million in cash management notes to cover a short-term deficit.

TABLE I

THE BUDGET OF THE STATE OF TEXAS

(\$ Billions)

| | <u>1990-91</u> | <u>Increase Over Prior Period</u> |
|---------------|----------------|---------------------------------------|
| General fund | \$28.0 | 16.2% |
| Special funds | <u>\$19.4</u> | <u>10.3%</u> |
| Total | \$47.4 | 12.0% |

Source: Comptroller of Public Accounts

NEW INCREASES IN GOVERNMENT SPENDING

Running the government of Texas is the biggest business in the state. Excluding the federal budget, the Texas state budget is the fourth largest spender of taxpayer dollars in the United States. Only California, New York, and New York City have larger budgets. The Lone Star State not only spends more on government programs than do 47 other states, it also spends considerably more than most of the industrialized and non-industrialized nations of the world.

Although we are often reminded by politicians in Austin that Texas has one of the most economical governments in the country,

- Government spending authorized by the 71st Texas Legislature for the next fiscal period will increase almost three times as fast as the incomes of Texas taxpayers.
- Although the per capita income in Texas is increasing at a rate of 5.4 percent per year,⁴ government spending in Texas is increasing at a rate of 16.2 percent.⁵

⁴Estimate of the Bureau of Economic Analysis.

⁵Fiscal Notes. June 1989, p.1.

It would be one thing if this new spending were absolutely necessary. Yet evidence indicates millions of dollars of waste in the state budget.⁶ Moreover, much of the *increase* in state spending appears far from essential. As Table II shows,

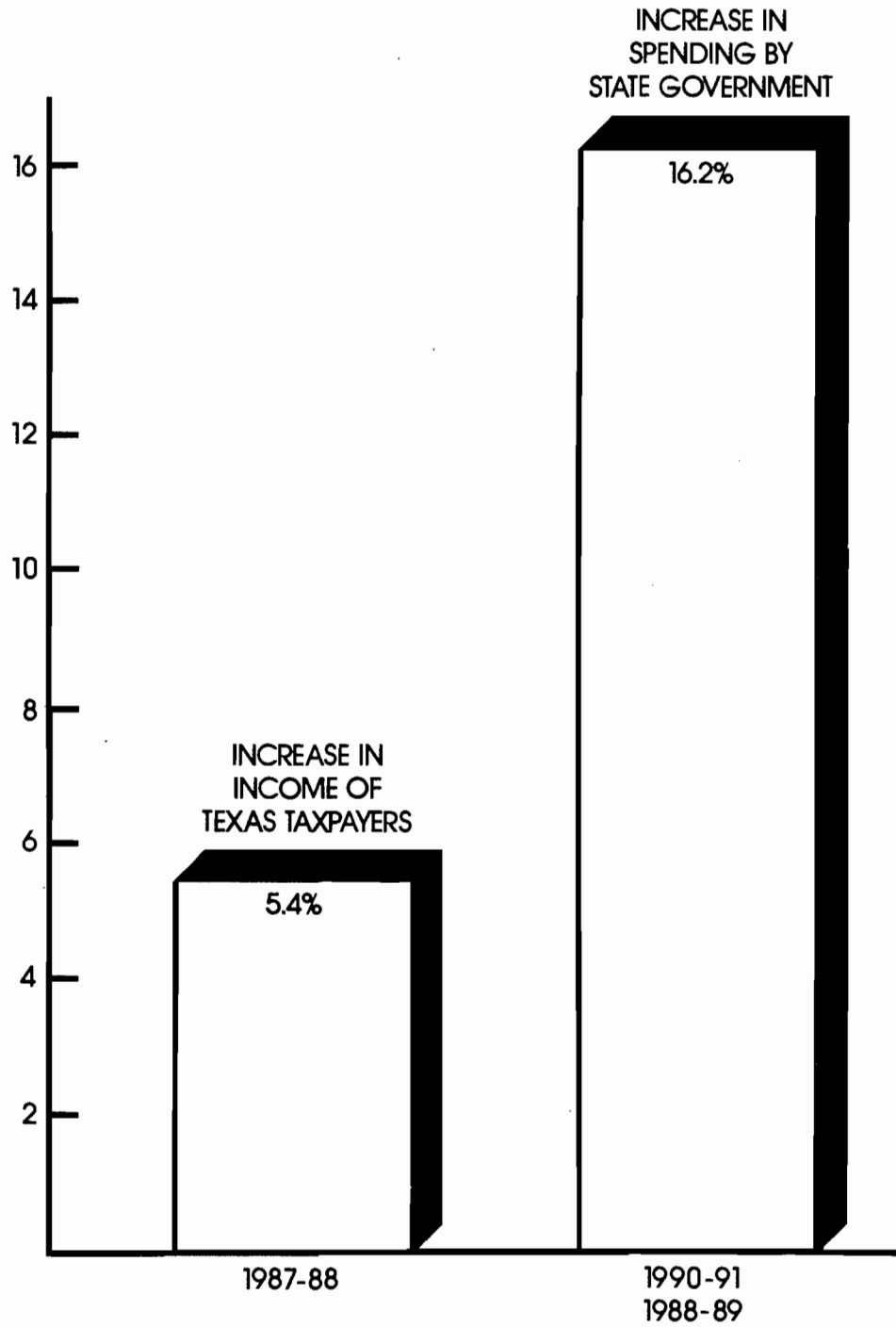
- The new budget contains larger increases for wages and fringe benefits for state employees than it does for education.⁷
- Although the state plans substantial increases for Health and Human Services and Criminal Justice -- primarily in response to court-ordered reforms -- the largest increase of all is for general government, including \$155 million to renovate the capitol.

Should Texas increase spending on state employees by 19.2 percent when state per capita income is increasing by only 5.4 percent? Should the state spend \$155 million to renovate its Capitol while many Texans are struggling with severe economic difficulties? These questions have not been seriously debated because of the widespread perception that the Legislature accomplished its spending goals without creating new burdens for Texas taxpayers. This perception is wrong.

⁶See Morgan Reynolds, *How Much Government Does Texas Need?* (Dallas, Texas: National Center for Policy Analysis, 1989).

⁷This includes an across-the-board (regardless of merit) 5 percent pay raise for all state employees, expanded health benefits, and increased retirement and Social Security contributions.

NEW BURDENS FOR TEXAS TAXPAYERS



INCREASES IN STATE SPENDING (1990-91)

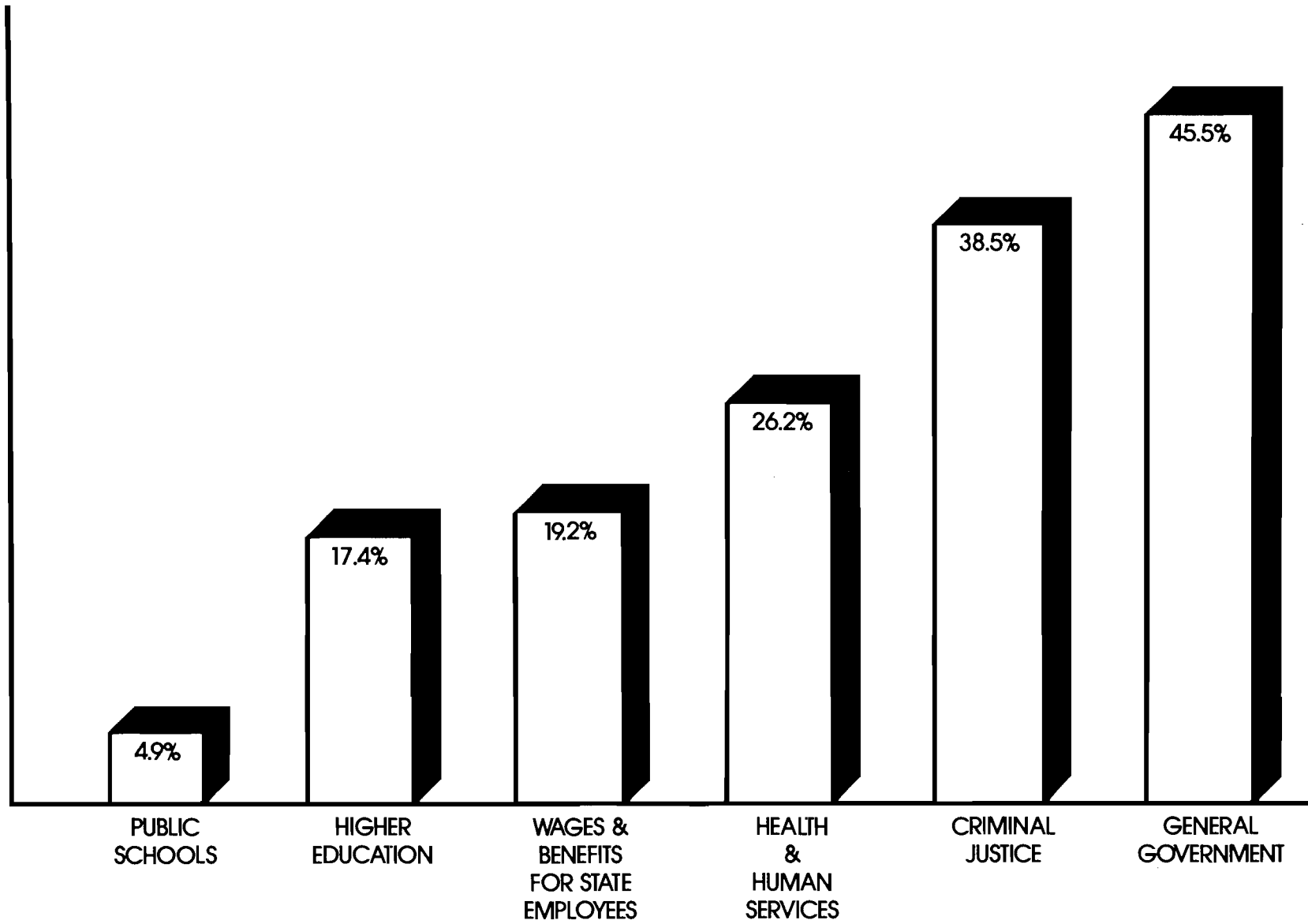


TABLE II

INCREASE IN GENERAL SPENDING IN THE 1990-91 BUDGET

| <u>Program</u> | <u>Amount (\$ billions)</u> | <u>Percent Increase Over Prior Period</u> |
|--------------------------------|---------------------------------|-------------------------------------------------------|
| General Government | \$1.6 | + 45.5% |
| Criminal Justice | \$1.8 | + 38.5% |
| Health and Human Services | \$5.3 | + 26.2% |
| Employee Wages and Benefits | \$3.1 | + 19.2% |
| Higher Education | \$5.4 | + 17.4% |
| Public Schools | \$10.8 | + 4.9% |

Source: Comptroller of Public Accounts

THE COMPTROLLER'S BALANCING ACT

While the legislature adjourned this past June with the self-congratulatory announcement that it had solved most of Texas' fiscal problems without new taxes (with the exception of workers' compensation insurance), the facts are otherwise.

When the 71st Legislature began in January 1989, the Comptroller of Public Accounts, as required by law, issued a forecast that general revenue and related funds revenue forecast for 1990-91 would total \$25.5 billion. This was not enough to satisfy the Legislature's insatiable appetite for spending. The Governor pleaded with the legislators not to exceed the Comptroller's forecast, and threatened to veto any higher spending bill. Since Texas Legislatures had already strapped state taxpayers with new and expanded taxes of more than \$10 billion, some legislators agreed that the \$25.5 billion spending level was adequate. But lobbyists persuaded most lawmakers that a \$28 billion general fund budget was the necessary minimum.

A dilemma existed, and a stalemate was in the offing. The Comptroller then stated that he thought he could accommodate lawmakers by tapping for one day the balances in some 450 special funds the state maintains for specific purposes. Consequently, the Comptroller's "bookkeeping" bill⁸ was introduced and passed, making available a whopping \$958 million held in several hundred special fund balances. This will allow the Comptroller to transfer these balances to general revenue on the last day of the 1990-91 budget period and then move the money back to the special funds on the following day. In other words, on August 31, 1991, the close of the fiscal year, the general revenue fund will have funds in its account for certification to make the budget balance that day. The next day the money will be moved back to the special funds from which it originally came leaving the general revenue fund in deficit.

TABLE III

SOME EXAMPLES OF SPECIAL FUND BALANCES THAT WILL BE DEPLETED FOR ONE DAY IN ORDER TO BALANCE THE GENERAL BUDGET

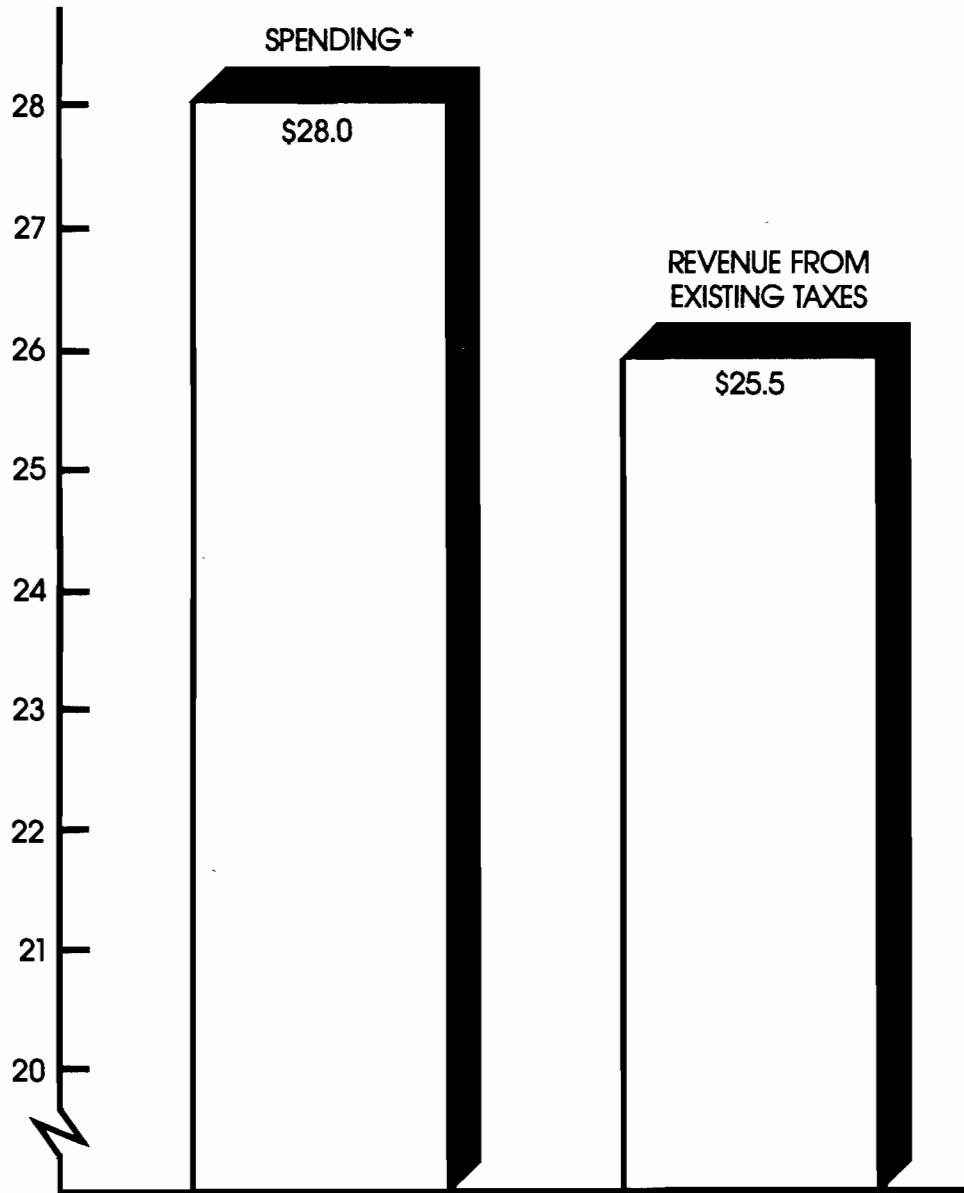
(\$ Millions)

| <u>Special Purpose Fund</u> | <u>Estimated Balance</u> |
|------------------------------------------------------|---------------------------------|
| Welfare Administration Operation Fund | \$120 |
| State Board of Insurance Operating Fund | 23 |
| Criminal Justice Planning Fund | 12 |
| Hazardous Waste Disposal Fund | 14 |
| Texas Local Parks and Recreation Fund | 37 |
| Unemployment Compensation Administration Fund | 9 |
| Federal Public Welfare Administration Fund | 41 |
| Federal Health, Education and Welfare Fund | 17 |
| Operators and Chauffeurs License Fund | 6 |
| State Park Fund | 17 |
| Indigent Health Care Assistance Fund | 10 |
| Over 200 Other Special Funds | <u>652</u> |
| Total | \$958 |

⁸HB 1279, Acts of the 71st Legislature.

THE COMING SHORTFALL IN THE 1990-91 BUDGET

(\$ BILLIONS)



*GENERAL FUND.

It is important to note that the \$958 million that will be moved to the general fund for one day cannot actually be used to finance general fund expenditures. In some cases it would be illegal to spend this money on general programs. Table III gives some examples of estimated special fund balances that will be used to "balance" the general fund budget for one day. With respect to these examples:

- The Hazardous Waste Disposal Fund, the Federal Public Welfare Administration Fund and the Federal Health, Education and Welfare Fund contain federal money that is restricted to special purposes by federal law.
- Even though the Unemployment Compensation Administration Fund contains money collected in Texas, it would violate federal law to use this money for general purposes.
- Even though the Indigent Health Care Assistance Fund could be depleted, that would leave no funds to pay for the recently passed indigent health care reform.
- Depleting the Welfare Administration Operating Fund would leave no money to pay for the state's welfare programs.

OTHER ACCOUNTING GIMMICKRY

The one-day bookkeeping transfer is not the only questionable procedure by which the Texas budget is being balanced. Some 1990-91 financial commitments are being moved to the next budget period, and will be spent in 1992. Some tax revenues that would ordinarily be paid in 1992 will actually be collected in 1991. Through these and other one-time revenue increases, more than \$1 billion in additional revenue will be available in 1990-91, but not in future budget periods.

- About \$190 million that should go into employee retirement funds in 1990-91 will be delayed until 1992.
- About \$25 million in cigarette tax stamp money that would ordinarily be collected in 1992 will be collected at the end of 1991 through "speed-up payment" techniques.
- Overall, about \$1.1 billion in revenue will be collected through one-time "fixes" -- techniques that can be used in the next budget period, but not in succeeding periods.

What this means is that the Legislature's biennial appetite for spending has grown by \$1.1 billion, but biennial revenues have not. When these one-time fixes are added to the \$958 million shortfall described above, Texans will face a potential future tax increase of about \$2 billion.

TABLE IV

SUMMARY OF TECHNIQUES USED
TO BALANCE THE 1990-91 BUDGET

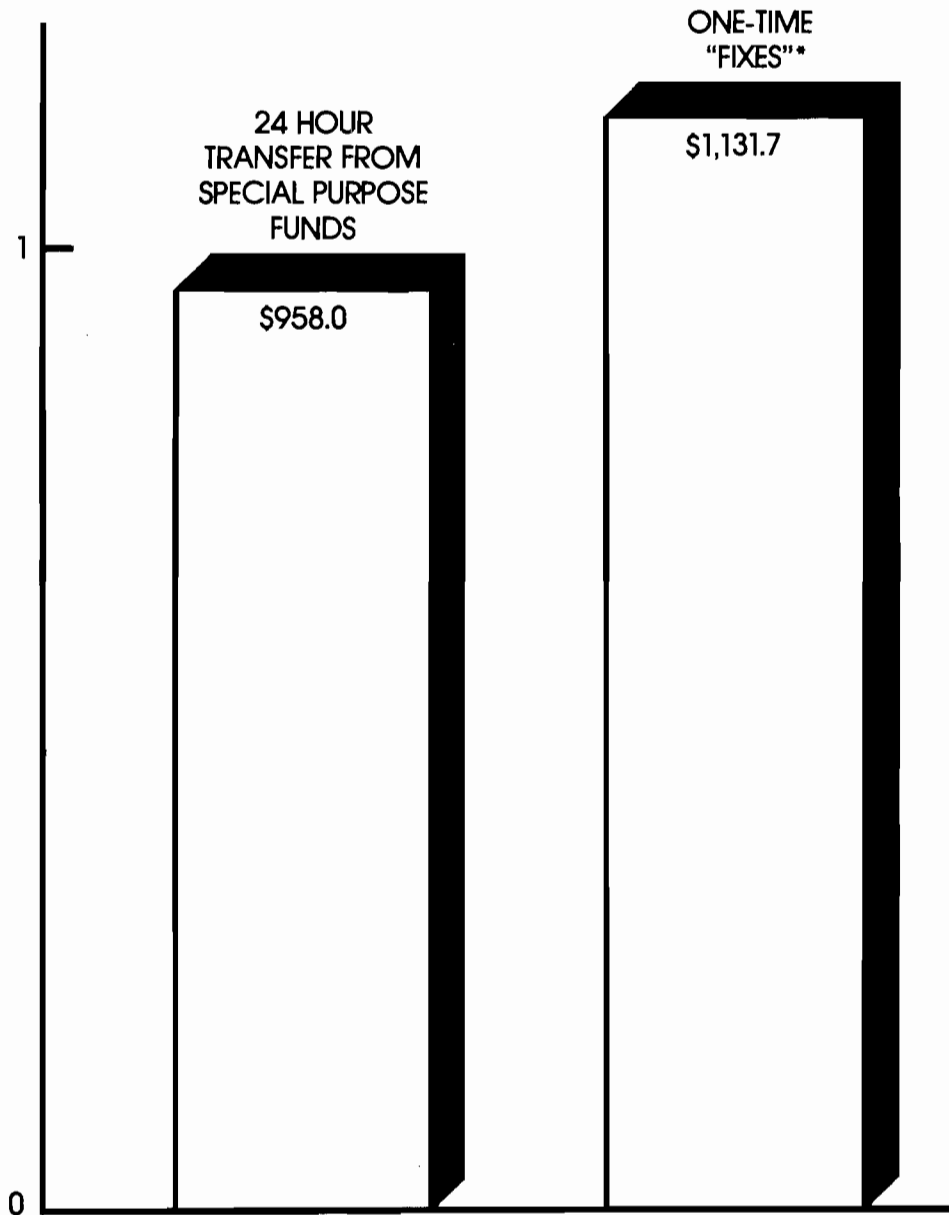
(\$ Millions)

| <u>Technique</u> | <u>Amount</u> |
|------------------------------------------|-------------------|
| Initial revenue estimate | \$25,552.7 |
| January 1989 sales tax forecast revision | 150.0 |
| April 1989 economic forecast revision | 209.8 |
| One-day "bookkeeping" transfers | 958.0 |
| Property/casualty insurance fix | 246.4 |
| Life insurance fix | 467.8 |
| Franchise tax repair | 289.8 |
| Gas utility refund limit fix | 125.7 |
| Motor fuels enforcement | 31.0 |
| Cigarette tax stamp speed-up | 25.0 |
| Commercial drivers' license fee | 20.0 |
| Bingo transfer | 15.0 |
| Other | 75.4 |
| Less: 1989 emergency appropriations | <u>-164.4</u> |
| Total | \$28,002.2 |

Source: Comptroller of Public Accounts

HOW THE STATE OF TEXAS WILL COVER THE 1990-91 BUDGET SHORTFALL

(\$ BILLIONS)



* FUNDS NOT AVAILABLE IN FUTURE BUDGET PERIODS

SPEND NOW, PAY LATER

Another technique used by the Legislature to avoid raising taxes is approving more long-term debt.⁹ Although there is an economic argument for spreading the cost of capital construction over the period during which the benefits will be enjoyed, the ability to issue debt allows politicians to provide benefits now, without worrying about how those benefits will be paid for later. It is precisely the danger inherent in this political temptation that led Texas voters to approve a balanced budget amendment to the Texas Constitution sixty years ago.

During the spring of 1989, for example, the Legislature turned to borrowing options with abandon -- approving about \$1.4 billion in new long term debt.¹⁰ Of this total, about \$270 million will have to be approved by the voters on November 7, 1989.

AUTHORIZE NOW -- PAY LATER

Although not a new innovation, another practice employed by the legislature is authorizing certain spending plans, major new programs, and the expansion of state-supported institutions but not funding these facilities in the current budget. Why do they do this? It makes the bill easier to pass in both houses if it does not carry an immediate price tag. Seldom do legislators worry what the price tag will be two or three bienniums in the future. They may not even be in the legislature and will therefore not be bothered with the problem. Here are a few concrete examples:

- The new Central Texas College at Killeen was created, subject to approval of the State Coordinating Board, but not funded.¹¹
- The expansion of the University of Texas at Dallas to a four-year university was passed but not funded.
- Under the so-called "South Texas Initiative," Corpus Christi State University will become a four-year institution, Laredo may get a four-year college, and a law school may be created at Texas A & I in Kingsville. (All of these institutions will now go under the jurisdiction of the Texas A & M System.)
- Pan-American Colleges at Edinburg and Brownsville will be upgraded and become a part of the University of Texas System.

⁹As noted above, this debt must be directly approved by the voters.

¹⁰The Legislature authorized \$142 million in borrowing for prison construction, \$100 million for water and sewer facilities along the Texas-Mexico border, and \$750 million to make low-interest loans to local school districts for capital projects. To be approved by the voters is an additional \$400 million for additional prison construction and renovations at Mental Health and Mental Retardation and Texas Youth Commission facilities.

¹¹This is in the district of the powerful chairman of the Calendars Committee.

Texas already has about 20 more colleges and universities than it needs, yet the Legislature decided to authorize more. Future legislatures will have to decide whether to fund these already authorized programs and institutions or repeal them. Imagine how popular future politicians will be if they try to repeal programs and institutions that have already been authorized!

CONCLUSION

During the upcoming biennium, government spending in Texas will increase by more than 16 percent. This growth in state spending is occurring although the Texas economy has shown little or no growth during the past few years and is just now showing some life in certain economic areas. In the private sector we have witnessed plant closings, job layoffs, and pay reductions. In the public sector we are witnessing continued growth. As a result, Texas voters can expect the following:

1. Because the 71st Legislature authorized programs without raising taxes to pay for them, expect a significant state deficit to appear in 1990 and 1991.
2. Unless the Texas economy takes a dramatic upturn (which is not anticipated, even in high-tech fields), expect major deficits to continue through the 1990s.
3. Plan on lawmakers finding themselves at loggerheads over how to finance big spending programs and ultimately proposing tax increases.

NOTE: Nothing written here is to be construed as necessarily reflecting the views of the National Center for Policy Analysis or as an attempt to aid or hinder passage of any bill before the State Legislature.