

**TEXAS
BUDGET**

HIGHLIGHTS

Fiscal 2006-07

This report highlights many of the major spending issues considered by the 79th Legislature in its regular session and in two called sessions in 2005. A summary of SB 1 by Ogden, the general appropriations act, appears in the May 2005 Legislative Budget Board (LBB) report, *Summary of the Conference Committee Report on Senate Bill 1*, and final spending figures for fiscal 2004-05 are found in the LBB's *Fiscal Size-Up 2006-07 Biennium*, January 2006. For information on the rules, laws, and constitutional provisions governing the budget process, see House Research Organization State Finance Report Number 79-1, *Writing the State Budget*, February 4, 2005. For more information on specific budget issues, see HRO State Finance Report Number 79-2, *CSSB 1: The House Appropriations Committee's Proposed Budget for Fiscal 2006-07*, April 4, 2005.

Overview of the Fiscal 2006-07 Budget

For fiscal 2006-07, which began September 1, 2005, the 79th Texas Legislature has budgeted total expenditures of \$138.2 billion in all funds, an increase of \$11.5 billion (9 percent) over the amount spent in fiscal 2004-05, according to the LBB. The general revenue-related (general revenue plus general revenue-dedicated) portion is \$69.7 billion, an increase of \$4.8 billion (7.3 percent) over the amount spent in fiscal 2004-05 and \$5.2 billion (8.1 percent) over the amount originally budgeted. The variation in the amount spent in fiscal 2004-05 versus the amount originally budgeted takes into account supplemental appropriations and adjustments.

On January 10, 2005, the Comptroller's Office estimated total revenue available for spending during fiscal 2006-07 at \$130.5 billion and estimated the amount of general revenue-related funds available for certification at \$64.7 billion, an increase of 19.6 percent over fiscal 2004-05. According to the Comptroller's Office, the approximate surplus at the end of fiscal 2005 was \$1.3 billion.

LBB's *Legislative Budget Estimates*, published in January 2005, presented LBB's baseline budget estimate. This estimate reflected the cost of continuing spending in fiscal 2006-07 at 95 percent of the previous biennial spending level, and also accounting for public and higher education enrollment growth, public school equity, population growth in the correctional system, Medicaid and Children's Health Insurance Program (CHIP) caseload growth, growth in foster care and adoption subsidies, cost increases for state employee benefits, and existing debt service. The baseline budget estimate totaled \$134.4 billion from all funding sources, a 6.1 percent increase from the fiscal 2004-05 budget, and \$69.5 billion in general revenue-related spending, also a 6.1 percent increase.

The House-approved version of SB 1 would have authorized total spending of \$137.5 billion for fiscal 2006-07, an increase of 8.6 percent from the amount spent in the previous biennium. General revenue-related spending would have increased \$6 billion, or 9.1 percent, to \$71.5 billion. The Senate-approved version of SB 1 proposed a total increase of 10 percent, \$139.3 billion in all funds, including an increase of 10.3 percent in general revenue-related spending to \$72.2 billion.

In HB 10 by Pitts, the supplemental appropriations bill, the Legislature appropriated additional funds for fiscal 2005 and fiscal 2006-07. To pay for shortfalls in fiscal 2005, HB 10 appropriated \$2.7 billion in all funds, including \$1.1 billion from the rainy day fund, for health and human services (HHS), education, criminal justice, and other needs. The bill also appropriates \$872 million from the rainy day fund in fiscal 2006-07 for child protective services and public education.

The spending provisions in SB 1 were modified by the governor's vetoes of certain line items, most significantly the line-item veto of public education spending, and by the provisions of other bills enacted by the 79th Legislature. The governor used line-item vetoes to reduce the budget by \$23.4 billion in general revenue and \$35.3 billion in all funds, of which \$33.8 billion in all funds had been appropriated to the Texas Education Agency (TEA) and would be restored during the first called session. Other line-item vetoes included an allocation of \$444 million in all funds for payment of the state's share of certain Medicare prescription drug benefits to the federal government and an appropriation of \$19.9 million in all funds for contracted prison bed capacity in fiscal 2006. The governor also vetoed contingency appropriations related to bills that did not pass during the regular session, including judicial pay raises and tuition revenue bonds for institutions of higher education.

During the 79th Legislature's first and second called sessions, lawmakers enacted bills that appropriated additional funds and reauthorized funds vetoed by the governor. During the first called session, the Legislature approved an education spending bill, HB 1 by Pitts, that restored \$33.2 billion in all funds to the TEA for fiscal 2006-07. That allocation was separate from other education-related spending contemplated during the special sessions, such as funding for certain textbooks, pay raises for teachers and other professionals, and school property tax reduction.

In HB 11 by Hartnett, second called session, the 79th Legislature approved an appropriation of \$41 million, including \$6.7 million in general revenue, for an increase in pay and retirement benefits for members of the judiciary and certain other professionals whose salaries and benefits are pegged to those of judges. The bill also established

new court fees that are expected to generate \$41 million, the amount appropriated for the pay raise (see *Employee compensation and judicial pay raises*, page 6).

Budget execution authority. Government Code, ch. 317 allows the governor and the LBB, acting jointly, to make certain spending changes regarding funds the Legislature already has appropriated, including funds that the governor line-item vetoed in the budget. Budget execution authority can be used only when the Legislature is not in regular or special session to approve budget revisions. On August 22, 2005, shortly after adjournment of the second called session of the 79th Legislature, Gov. Perry issued a budget execution proposal that would have shifted more than \$700 million within the budget, including \$294.5 million for textbook purchases, \$200 million for increased payments to nursing homes, and transfers for various other purposes such as a higher personal needs allowance for low-income nursing home residents, trauma care, and higher education. The governor's budget execution

proposal expired when the LBB did not take action within the required 31 days after its official publication.

Spending by Function

Overall spending patterns

The total appropriation of \$138.2 billion for fiscal 2006-07 includes \$69.7 billion in general revenue-related funds, including \$64.1 billion of undedicated or "pure" general revenue. Spending from general revenue-related funds is scheduled to increase by \$4.8 billion over the amount actually spent in fiscal 2004-05 and \$5.2 billion over the amount originally budgeted by the 78th Legislature. Total spending also includes \$48.3 billion in federal funds and \$20.1 billion in other funds, which include the State Highway Fund, the Texas Mobility Fund, bond proceeds, trust funds, and other sources of revenue.

Table 1
State Spending by Government Function
(All funds in millions)

	Budgeted Fiscal 2004-05	Spent Fiscal 2004-05	Budgeted Fiscal 2006-07	Biennial change*	Percent change*
Art. 1 General Government	\$2,759	\$3,478	\$3,252	\$(226)	(6.5)%
Art. 2 Health and Human Services	39,763	43,788	48,241	4,453	10.2
Art. 3 Education	49,938	51,779	54,672	2,893	5.6
Art. 4 Judiciary	425	429	524	95	22.1
Art. 5 Public Safety/Criminal Justice	7,971	8,212	8,529	316	3.8
Art. 6 Natural Resources	2,012	2,348	2,320	(28)	(1.2)
Art. 7 Business/Economic Development	14,373	15,681	18,663	2,982	19.0
Art. 8 Regulatory	769	670	535	(135)	(20.2)
Art. 9 General Provisions	(79)	0	1,111	1,111	n.a.
Art. 10 Legislature	269	325	317	(8)	(2.4)
TOTAL	\$118,200	\$126,710	\$138,162	\$11,452	9.0%

*compares *Spent Fiscal 2004-05* with *Budgeted Fiscal 2006-07*

Notes: Amounts have been adjusted to reflect the governor's vetoes and appropriations bills enacted during called sessions of the 79th Legislature. Totals may not add because of rounding.

Source: *Legislative Budget Board*

The fiscal 2006-07 budget meets all spending limits imposed by the Texas Constitution and state law. Art. 3, sec. 49a of the Constitution limits spending to the amount of revenue that the comptroller estimates will be available during the two-year budget period. On June 10, 2005, the comptroller certified that enough revenue would be available to cover budgeted spending, including amounts in SB 1 and HB 10. Also, under Art. 8, sec. 22, the growth of spending from revenue not dedicated by the Constitution to a particular purpose may not exceed the growth rate of the Texas economy. The LBB estimates that budgeted spending for fiscal 2006-07 is about \$2.6 billion below this cap.

Like the fiscal 2004-05 appropriations act, SB 1 groups state agency budgets into 10 articles or functional categories. Table 1 (page 3) shows the changes in state spending by major functional area from fiscal 2004-05 to 2006-07. Major changes include:

- a \$6 billion (13.6 percent) increase in federal and state funds for HHS under Article 2, primarily to cover higher caseloads and costs in the Medicaid program and Children's Health Insurance Program and to pay for child protective services reform;

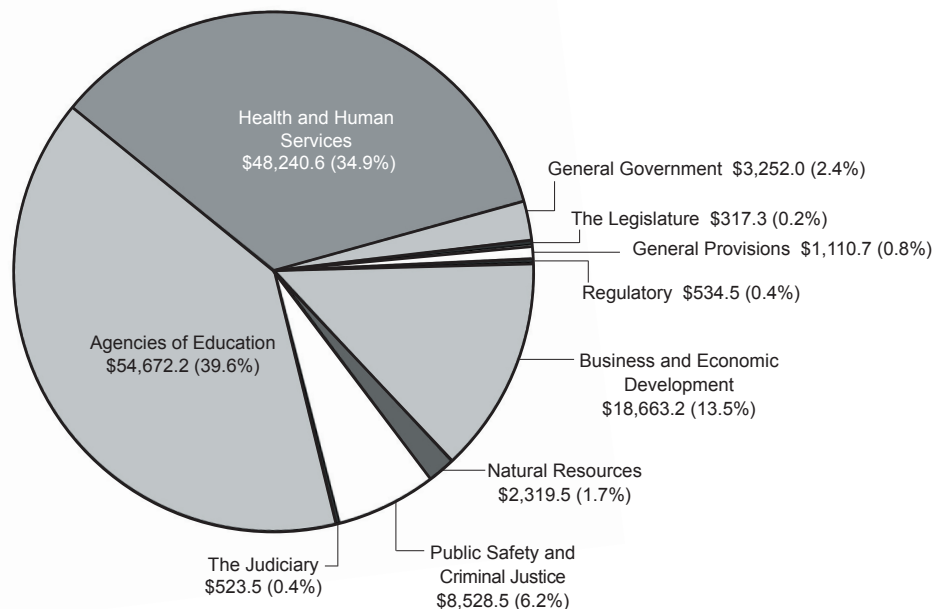
- a \$2.3 billion (7.5 percent) increase in all-funds spending for public education, primarily to meet projected enrollment growth, and;
- a \$3 billion (18.9 percent) increase in business and economic development spending, primarily due to growth in federal and other funds appropriated to the Texas Department of Transportation and higher state bond debt-service payments.

Approximately three-quarters of all spending in the fiscal 2006-07 budget is concentrated in education and HHS (see Figure 1, page 4). Business and economic development programs, primarily highway construction and maintenance, account for 14 percent of all spending, and public safety and criminal justice make up approximately 6 percent. Natural resource regulation and other functions together represent nearly 6 percent of the all-funds budget. Debt-service payments on general obligation and revenue bonds will total \$1.3 billion, 30 percent more than in fiscal 2004-05 when only interest was paid as a cost-saving measure.

The distribution of general revenue-related funds by function differs from the all-funds distribution because federal money plays a relatively large role in funding HHS

Figure 1
All Funds Appropriations by Function, Fiscal 2006-07
(in millions)

Total = \$138,161.9 million



Source: Legislative Budget Board

and business and economic development programs (Figure 2, below). About 55 percent of general revenue-related funds go toward education, 25 percent toward HHS, and 10 percent toward public safety and criminal justice.

Health and Human Services

The HHS agencies in Article 2 constitute Texas’ second-largest budget function after public and higher education, accounting for about 35 percent of the total budget for fiscal 2006-07 and 25 percent of general revenue-related spending. These agencies receive funding from multiple federal, state, and local sources and vary widely in size, mission, and funding mix. Much of the increase in Article 2 spending is driven by long-term trends in the Medicaid program. Caseloads are projected to grow through fiscal 2006-07, as they have done for the past two biennia, and the client population mix is expected to continue trending toward those with greater health care needs and a continued increase in costs.

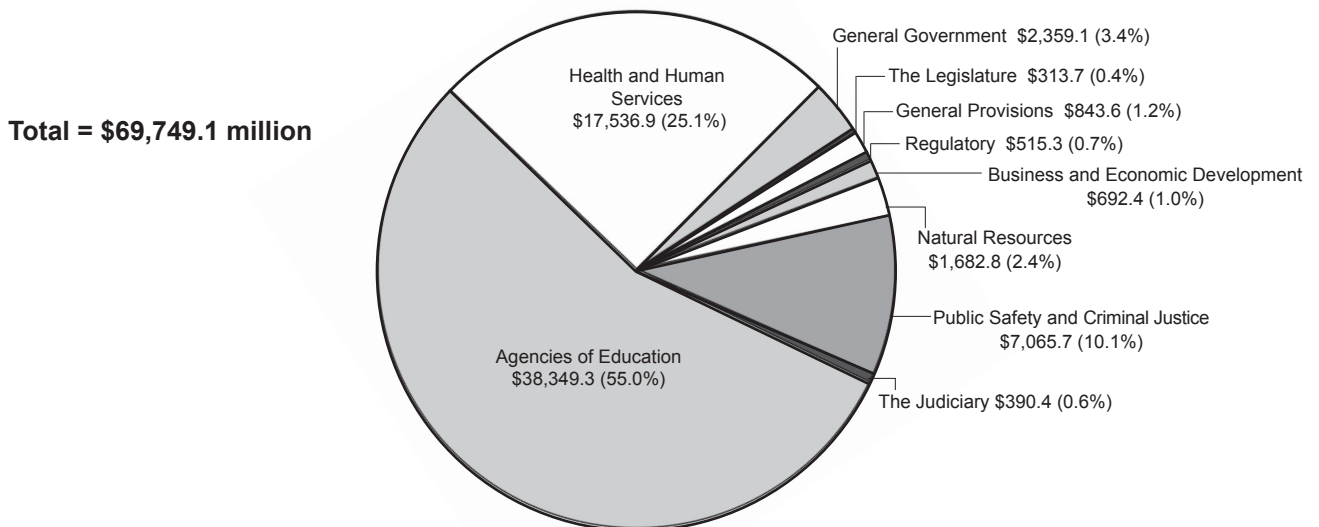
The general appropriations act allocates \$37.9 billion to Medicaid, (\$14.2 billion in general revenue-related funds). The growth in Medicaid – \$3.4 billion in all funds

– is attributable to higher caseloads, restoring long-term care provider rates to at least fiscal 2003 levels, restoring coverage that was cut in 2003, and the creation of a program by which people with disabilities can buy in to the program. It did not include a rate increase for acute care providers.

CHIP is allocated \$1.4 billion (\$444 million in general revenue-related funds). In addition to funding caseload and cost growth, the increased appropriation – \$111.7 million in general revenue-related funds – will pay for restoration of benefits that were cut in 2003, including vision, dental, and mental health services. Other policies enacted in 2003 would not change, including six-month continuous eligibility, 90-day waiting period, income disregards, and asset tests.

Protective services for both children and adults are administered through the Department of Family and Protective Services (DFPS). Reports of systemic failure to protect children and adults from abusive or neglectful situations prompted calls for reform and additional funding. The budget includes a total of \$259.9 million in additional funds for DFPS, including \$213.6 million in general revenue funds. The new funding will provide 2,613 new full-time employees, most of whom will be case workers.

Figure 2
General Revenue-Related Appropriations by Function,
Fiscal 2006-07
 (in millions)



Source: Legislative Budget Board

Public Education

Public education accounts for 27 percent of all-funds spending and 36 percent of general revenue-related spending appropriated for fiscal 2006-07. The current budget increases total funding for K-12 public education by \$2.3 billion, or 7.5 percent, over fiscal 2004-05 expenditures. Federal funds for public education are expected to rise to approximately \$8.1 billion, an increase of \$638 million. Most of this increase is for Title I grants for low-income students under the federal No Child Left Behind Act and special education funding.

Education funding issues addressed by the 79th Legislature included continuation of the health insurance “passthrough,” which supplements funding for teacher health insurance. The Legislature also appropriated money for school facilities funding and to pay for certain textbooks.

In 2003, the 78th Legislature reduced the health insurance passthrough to all active school employees from \$1,000 to \$500 per year for full-time employees and \$250 for part-time employees and eliminated it altogether for administrative staff. This funding level was not changed by the 79th Legislature, which appropriated \$548 million to fund the passthrough.

SB 1 appropriates more than \$1.5 billion in facilities funding to assist school districts in paying bond debt associated with the cost of expanding and upgrading local facilities. The Existing Debt Allotment (EDA), an equalized funding program that helps school districts pay “old” debt, was “rolled forward” to cover two more years of debt, at an estimated cost of \$150 million for the biennium. The Legislature appropriated \$50 million for new grants for the Instructional Facilities Allotment (IFA). While this is an increase over the \$20 million for new grants in fiscal 2004-

Employee compensation and judicial pay raises

As of September 1, 2006, the state will employ approximately 219,555 full-time employees with payroll expenses, including benefits, of \$4.2 billion in fiscal 2006-07. The fiscal 2006-07 budget includes a pay raise for all state employees at a cost of more than \$585 million during the biennium. Beginning September 1, 2005, all employees received a 4 percent pay increase with a minimum increase of \$100 per month. They also will receive a 3 percent increase with a monthly minimum of \$50, beginning September 1, 2006. In addition, longevity and hazardous duty pay increased for state employees. Under the new system, longevity pay is set at the rate of \$20 per month for each two years, rather than each three years, of service and hazardous duty pay at the rate of \$10 per month for each year of service.

Peace officers. SB 1 also included a targeted pay raise for peace officers at the Department of Public Safety, Department of Criminal Justice, Parks and Wildlife Department, and the Alcoholic Beverage Commission. The raise is in the form of a stipend for certain skill or certification levels, including \$50 per month for an associate’s degree, \$100 per month for a bachelor’s degree, and \$150 per month for a master’s degree. Other certifications and bilingual capabilities also could make officers eligible for an additional stipend.

Judicial pay. HB 11 by Hartnett, second called session, increases judges’ salaries and bases them on the salary of a district judge, instead of a Supreme Court justice. District court judges’ minimum annual state salaries increased from \$101,700 to \$125,000. Appellate court justices, other than chief justices, have minimum annual state salaries of 110 percent of district judges, meaning that their minimum salaries rose from \$107,350 to \$137,500. Supreme Court justices have minimum annual state salaries of 120 percent of district judges, meaning that their minimum state salaries rose from \$113,000 to \$150,000. District judges and courts of appeal justices can receive county supplements up to the caps in HB 11.

To pay for these increases, HB 11 raises fees in civil and criminal cases. A person convicted of any offense, other than a pedestrian or parking offense, pays an additional \$4 in court costs. Sixty cents of this fee goes to the general fund of the municipality or county to promote the efficient operation of municipal courts and the investigation, prosecution, and enforcement of municipal and state offenses. The other \$3.40 is deposited in the state judicial fund. The bill also adds a \$37 civil case filing fee in district courts, statutory county courts, and county courts, to be deposited in the judicial fund.

05, it is significantly less than the amounts appropriated in the early years of the program, which was established in 1995.

In response to funding cuts in 2003, the State Board of Education adopted but delayed acquisition of about \$145 million in textbooks for the 2004-05 school year. SB 1 provided \$327 million in general-revenue related funds for the purchase of these textbooks but did not provide funding for textbooks scheduled for purchase in 2006. The governor and legislative leaders since have authorized TEA to spend \$295 million for this purpose.

Total funding for the Teacher Retirement System (TRS) is \$3.4 billion in all funds for fiscal 2006-07. For the retirement fund, the state's contribution will continue to be 6 percent of payroll at a cost of \$2.9 billion, an increase of \$217 million to cover payroll growth. Appropriations for TRS-Care, the health insurance program for public school retirees, total \$506 million, a decrease of \$203 million. According to LBB, this decrease is the result of higher-than-expected savings associated with changes to the network, increases in the contribution rate for school districts and active members, and savings anticipated as a result of implementation of the federal Medicare Part D Prescription Drug Benefit in calendar year 2006.

Higher Education

The fiscal 2006-07 budget allocates \$13 billion in general revenue-related funds for higher education, a 4 percent increase over the previous biennium. This includes funding for 35 universities, 50 community and junior college districts, the technical college system with four campuses, and three lower-division state colleges. Nine health-related institutions, seven service agencies, the Texas Higher Education Coordinating Board, and two constitutionally authorized funds also receive funding.

Appropriations issues related to higher education included financial aid, tuition revenue bonds, and new health-related institutions. The general appropriations act includes \$371.4 million in general revenue-related funding (a 5 percent increase) for four programs – Texas Grants, Texas Educational Opportunity Grants, College Work Study, and B-On-Time – that were combined into a single financial aid strategy. SB 1 would have appropriated funds for tuition revenue bond (TRB) debt service for 2006-07, but the enabling legislation was not enacted, and the governor

vetoed the funds. In August 2005, Gov. Perry through budget execution authority proposed spending \$38 million for the Texas Tech University medical school in El Paso and \$10 million for the Texas A&M-Kingsville Irma Rangel College of Pharmacy for those entities to become fully operational, along with other higher education spending proposals. The governor's proposal expired when the LBB took no action on it.

Public Safety and Criminal Justice

For fiscal 2006-07, SB 1 increases spending on criminal justice and public safety by about 3.8 percent over fiscal 2004-05 levels to \$8.5 billion in all funds. General revenue-related spending for Article 5 agencies is \$7.1 billion, a 6.5 percent increase over the previous biennium. Art. 5 spending is driven mainly by trends in the number of adult offenders incarcerated in state facilities. From 1989 to 1999, adult correctional capacity (mainly in prisons, state jails, and transfer facilities) more than tripled. In the spring of 2005, when the Legislature was crafting the fiscal 2006-07 budget, the Texas prison system was operating at near capacity after about two years of being able to house all offenders sentenced to state facilities without having to procure beds in county or private facilities. However, the LBB projected that the state would run out of space in its adult correctional facilities during fiscal 2006-07, and the appropriation to Article 5 addressed this by including funds for TDCJ to contract for beds during the biennium.

Also related to capacity, SB 1 appropriated new money for probation and parole. Budget writers added \$55 million in new money to fund outpatient programs and residential beds for substance abuse treatment as well as new probation officers to reduce caseloads for medium- and high-risk offenders. SB 1 appropriates to TDCJ's parole supervision strategies \$4.6 million in new funds to handle a projected increase in the number of parolees.

Inmate health care, specifically correctional managed health care and psychiatric care for adult offenders in state custody, will receive a total of \$747.5 million in fiscal 2006-07, which is an increase of \$34.8 million in general revenue-related funds above the actual amounts received in fiscal 2004-05. The new funds will be used to increase base operational funding and to pay for additional needs, including expansion of a secure medical facility in Lubbock and hepatitis C treatment.

Special Funds

Rainy day fund. The Texas Constitution and state law require that half of any unencumbered balance remaining in general revenue at the end of a fiscal biennium and 75 percent of any oil or natural gas production tax revenue that exceeds the amount collected in fiscal 1987 be transferred to the economic stabilization or “rainy day” fund.

HB 10 appropriated \$973 million from the rainy day fund to HHS, education, criminal justice, and other needs in fiscal 2005. It also appropriated \$941 million from the rainy day fund for education and child protective services in fiscal 2006-07. Including these expenditures and more recent fund balance estimates, the rainy day fund is projected to contain \$196.4 million at the end of fiscal 2006-07.

Texas Enterprise Fund. In 2003, the 78th Legislature created the Texas Enterprise Fund (TEF) as a “deal-closing” fund within the Governor’s Office to entice businesses to expand in or relocate to Texas. The fund, which received an initial appropriation in fiscal 2004-05 of \$285 million from the rainy day fund, provides cash grants for a wide variety of economic stimulus programs. Money may be awarded by the governor only with the approval of the lieutenant governor and the speaker of the House, and contracts contain “clawback” provisions that require

an enterprise to repay some or all of the grant if it fails to create the promised number of jobs or to invest a minimum amount in the state. To date, about \$212.4 million in grants have been awarded to 18 entities, primarily for business incentives.

The fiscal 2006-07 budget included \$182.3 million of general revenue-related funds for the TEF, \$102.8 million less than the amount appropriated from the rainy day fund to the TEF last biennium. The budget also includes a \$200 million appropriation for a new emerging technology fund within the Governor’s Office earmarked for investments in scientific research and enterprise.

Tobacco settlement funds. In 1998, Texas finalized a settlement of its lawsuit against major tobacco companies that awarded the state \$17.3 billion over 25 years, subject to adjustments. In 1999, the 76th Legislature established 21 health-related permanent trust funds and higher education endowments and designated the first money left over from the permanent funds and endowments to support CHIP. For fiscal 2006-07, SB 1 appropriated about \$1.1 billion in tobacco-settlement funds for various health-related programs, primarily CHIP. The funds include payments from the tobacco companies, interest earnings from the trust funds and endowments, and a carry forward of some unspent balances.

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