SPECIAL EDITION

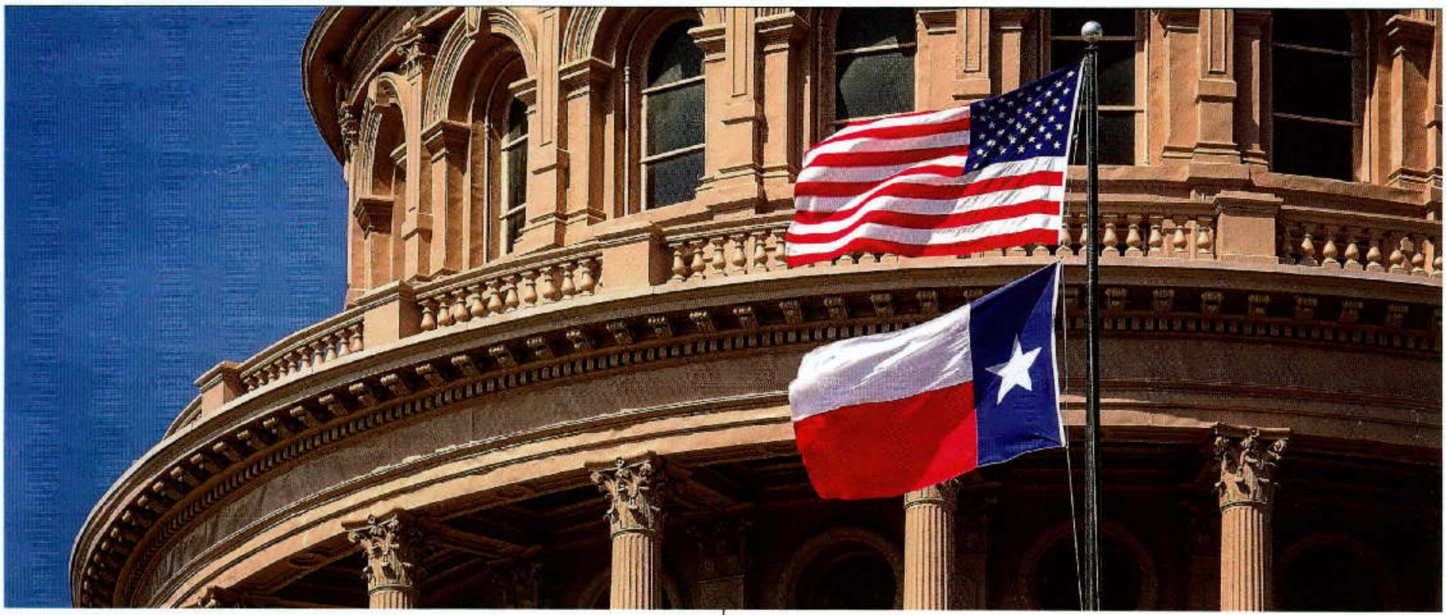
NOVEMBER 2018

FISCAL NOTES

AN EXAMINATION OF THE MAJOR COMPONENTS OF THE TEXAS STATE BUDGET.

A REVIEW OF THE TEXAS ECONOMY FROM THE OFFICE OF **GLENN HEGAR**, TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

BUDGET DRIVERS
THE FORCES DRIVING STATE SPENDING



Every regular session of the Texas Legislature considers thousands of pieces of legislation. But regardless of what happens to this mountain of bills, there's one that always gets attention — the General Appropriations Act (GAA), which outlines the state budget. The GAA, as thick as a Victorian novel, addresses every aspect of state government funding, from roads and prisons to immunizations and scientific research.

Most of the budget is driven by mandates in state law and the Texas Constitution and matching requirements for federal aid. Less than a fifth is available for "discretionary" spending, and lawmakers prioritize this spending as Texas' needs change. Deciding how to spend that crucial fifth requires hundreds of hours of debate and negotiation in every session.

But a majority of state spending goes to just three purposes: education, health care and transportation. In this report, we examine what's driving the steady increase in their costs.

CLASSIFYING STATE REVENUE

Texas state government derives its revenue from taxes, licenses, fees, interest and investment income, net lottery proceeds, federal aid and other, minor sources.

These revenues can be classified into four categories:

- **General Revenue funds** are revenues that are not restricted by state law and include the nondedicated portion of the General Revenue Fund, the state's primary operating fund.
- **General Revenue dedicated funds (GR-D)** include revenue in more than 200 accounts within the General Revenue Fund that state law dedicates for specific purposes.

CONTINUED ON PAGE 3

A Message from the Comptroller

Texas state government is a complex and expensive undertaking. In our 2018 and 2019 fiscal years, we'll spend more than \$216 billion to provide vital services for Texans, money that will be spent to support hundreds of programs. And more than four-fifths of that spending is locked in, driven by the state's laws and constitution and the matching requirements of federal aid. The remainder left for "discretionary spending" is the subject of long and sometimes bitter debate in each legislative session.

But the dizzying variety of state and state-federal programs tends to obscure an important fact. Most of the state's spending — nearly 90 percent of it — goes to support just three things: education, health care and transportation. To understand the state's budget, we need to examine the forces driving costs in these three areas.

In this special report, we examine these forces in detail. We hope to provide a valuable overview of these issues before lawmakers begin preparing the next state budget in 2019.

We look at the tension between state and local education spending, and the way in which the steady climb in Texas property values has shifted the burden toward property owners. We examine higher education costs and the rapid increase in tuition and fees at public universities. We'll explain the way in which our state's management of Medicaid eligibility has helped contain rapidly rising costs and caseloads. And we look at major recent commitments for transportation funding.

We also consider some of the tools the Legislature has used to make ends meet when revenues won't stretch quite far enough, such as deferred Medicaid payments, the use of dedicated fund balances and the persistent underfunding of obligations such as employee pensions. Some call these "budget tricks," but these tools have helped make the budget work when needed. Whether they'll continue to do so for the foreseeable future is another matter entirely.

We hope you'll find this special report on Texas budget drivers both timely and useful.

GLENN HEGAR
Texas Comptroller of Public Accounts

Note: This report contains estimates and projections that are based on available information, assumptions and estimates as of the date of the forecasts upon which they are based. Assumptions involve judgments about future economic and market conditions and events that are difficult to predict. Actual results could differ from those predicted, and the difference could be material.

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Together, General Revenue and General Revenue-dedicated fund balances are called **General Revenue-related funds (GRR).** *GRR represents a little more than half of all state spending.*

- **Federal funds** include grants, allocations and payments or reimbursements received from the federal government by state agencies and institutions.
- **Other funds** consist of any funds not included in general revenue, whether dedicated or not, such as the state revenue included in the State Highway Fund, the Texas Mobility Fund, the Property Tax Relief Fund and the Economic Stabilization Fund (or "Rainy Day Fund").

The sum of all these revenue sources is called **All Funds.**

SPENDING BY ARTICLE

The GAA is organized into 10 major "articles" based on type of government function (**Exhibit 1**). Article VI, for example, includes agencies that deal with natural resources such as the Texas Parks and Wildlife Department, the Department of Agriculture and the Railroad Commission.

LIMITS ON STATE SPENDING

State laws and the Texas Constitution place certain limits on legislative appropriations to maintain the state's fiscal health.

Article VIII, Section 22 of the Texas Constitution states that:

> ...in no biennium shall the rate of growth of appropriations from state tax revenues not dedicated by this constitution exceed the estimated rate of growth of the state's economy.

Government Code Chapter 316 defines the "rate of growth of the state economy" as the rate of growth of Texas personal income. Since the 1996-97 biennium, Texas personal income has risen by an average 5.4 percent annually, compared to 4.3 percent for GRR appropriations and 4.6 percent for All-Funds appropriations (**Exhibit 2**).

EXHIBIT 1

ARTICLES OF THE GENERAL APPROPRIATIONS ACT	
Article I	**General government**, including agencies providing services such as the management of state finances and the administration of employee benefits
Article II	**Health and human services**, including Medicaid, foster care and public health programs
Article III	**Education**, including public K-12 schools and higher education institutions and research
Article IV	**The judiciary**, including appeals courts and judicial commissions
Article V	**Public safety and criminal justice agencies** and Texas' **military department**, which includes the Texas Army National Guard, the Texas Air National Guard and the Texas State Guard
Article VI	**Natural resources**, including agencies related to agriculture, energy, parks and environmental protection
Article VII	**Business and economic development**, including transportation, workforce and housing
Article VIII	**Regulatory functions** for utilities, professions, medical licenses, securities and racing
Article IX	**General provisions**, providing job titles, salary schedules and other provisions related to appropriation authority
Article X	The **Legislature**, including the Senate, House of Representatives and other legislative entities such as the Legislative Budget Board

Source: Texas Legislature

Note on the data in this report

Appropriation amounts cited in this report may not match those reported in previous GAAs. Amounts have been adjusted by reallocating certain unusual or one-time appropriations such as Foundation School Program payments deferred between biennia. Appropriations for fiscal 2010 and 2011 related to the American Recovery and Reinvestment Act have been attributed to the applicable article. Furthermore, funding for programs and functions that moved among agencies in the periods under review, including supplemental appropriations, has been reallocated to the agency currently carrying the responsibility. Appropriations from the Property Tax Relief Fund (PTRF) are combined with GRR to portray education funding. PTRF is a special fund in the state Treasury categorized as "Other Funds" but its revenue is directed toward public education.

Throughout the report, average annual growth is defined in terms of *compound annual growth rate (CAGR)*, calculated as:

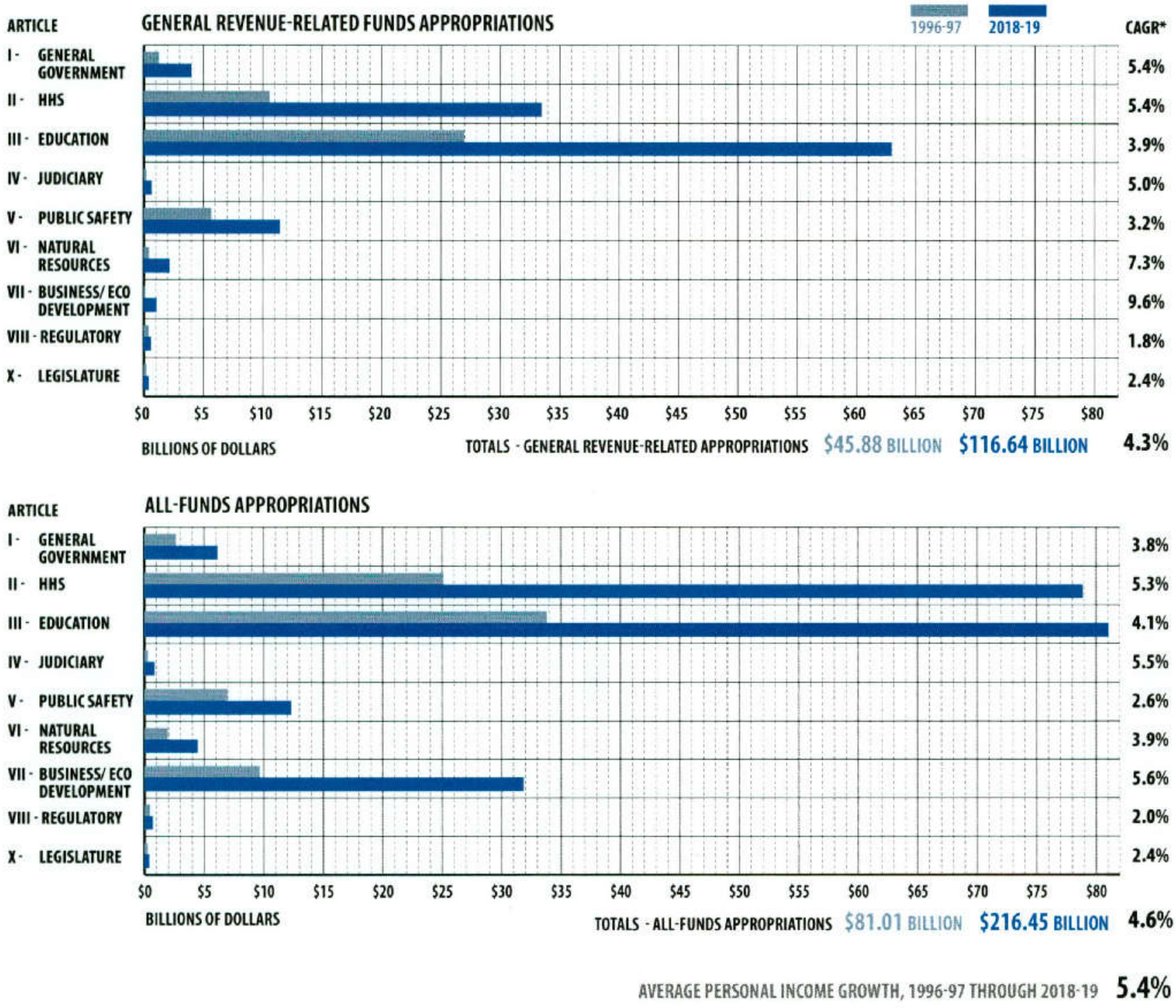
$$(\text{End Period Value}/\ \text{Beginning Period Value})^{(1/\#\ \text{years})} - 1$$

Historical data for this analysis begin with fiscal 1996 due to changes in state revenue accounting that prevent comparisons with earlier years.

Fiscal 2018 and 2019 measures of population, inflation, property values and personal income are estimated.

EXHIBIT 2

AVERAGE ANNUAL GROWTH OF GENERAL REVENUE-RELATED AND ALL-FUNDS APPROPRIATIONS, BY ARTICLE, 1996-97 VS. 2018-19 BIENNIA



Note: Article IX consists of general provisions such as state employee salary schedules and does not involve costs.
* Compound annual growth rates (CAGRs) based on annual averages within the 1996-97 and 2018-19 biennia.
Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, IHS Markit, Legislative Budget Board, Texas Comptroller of Public Accounts and Texas Education Agency

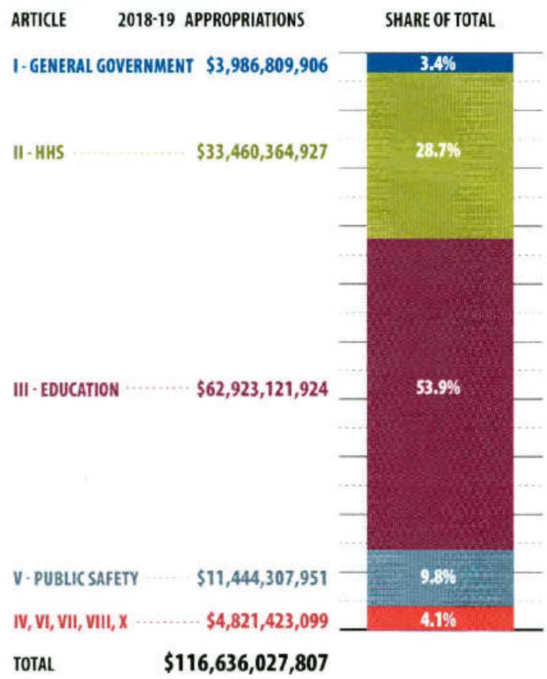
State spending in Texas also cannot exceed available revenue. Article III, Section 49a of the Texas Constitution restricts state spending to the amount of revenue the Texas Comptroller estimates will be available in a given biennium. In other words, the Texas Legislature cannot pass a budget in deficit, except in "the case of emergency and imperative public necessity" and with a four-fifths vote from each house of the Texas Legislature — a very high hurdle.

SPENDING BY ARTICLE: GRR

Texas appropriates very different amounts to each of the articles in the budget (**Exhibit 3**), spending the vast majority of all GRR resources on just two articles. Article III, which includes public and higher education, accounts for nearly 54 percent of general revenue-related funds appropriated for the 2018-19 biennium. Article II, health and human services, comes in second at nearly 29 percent.

EXHIBIT 3

GRR APPROPRIATIONS FOR THE 2018-19 BIENNIUM, BY ARTICLE



Note: Article IX consists of general provisions such as state employee salary schedules and does not involve costs. Totals may not add due to rounding.
Sources: Legislative Budget Board and Texas Comptroller of Public Accounts

The relative shares of funding devoted to each article have changed over time (**Exhibit 4**). Since the 1996-97 budget, health and human services have taken an increasing share of GRR, while education's share has fallen. Health and human services appropriations rose by 217 percent during this period, while those for education rose by less than 134 percent, well below the increase in total GRR spending.

SPENDING BY ARTICLE: ALL FUNDS

For All Funds, the spending picture is different (**Exhibit 5**). For 2018-19, education's share is substantially lower than for GRR (37.4 percent), while health care's is a bit higher, as health care receives more federal dollars. Article VII, a negligible portion of GRR funding, accounts for nearly 15 percent of All-Funds spending, due largely to substantial amounts of federal and "other" funding for transportation.

As with GRR appropriations, health and human services have claimed a growing share of All-Funds spending in the last two decades, while education's share has declined (**Exhibit 6**).

MEASURING GROWTH WITH INDICES

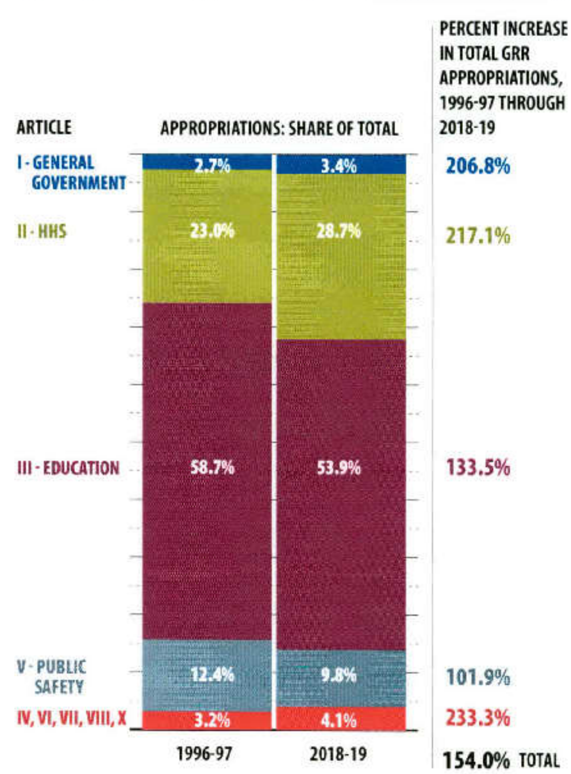
Comparisons made in this report examine growth since 1996. To highlight and compare the relative change in appropriations, revenues, population and personal income in this analysis, the relevant numbers have been *indexed*. That is, we assume the value 100 for the base year or biennium, with values in subsequent years or biennia showing change from this base. For example, assuming a base of 100 for fiscal 1996, an index of 255.5 for fiscal 2019 appropriations would mean 2.555 times as much spending as in the base year.

In addition to indices for appropriations, the following are used:

- a **general cost index**, which reflects growth in the price of goods and services as the product of population and the consumer price index, or CPI;
- an **education cost index**, which shows growth in the cost of education as the product of weighted average daily attendance and the federally

EXHIBIT 4

CHANGE IN GRR APPROPRIATION SHARES BY ARTICLE, 1996-97 VS. 2018-19 BIENNIA

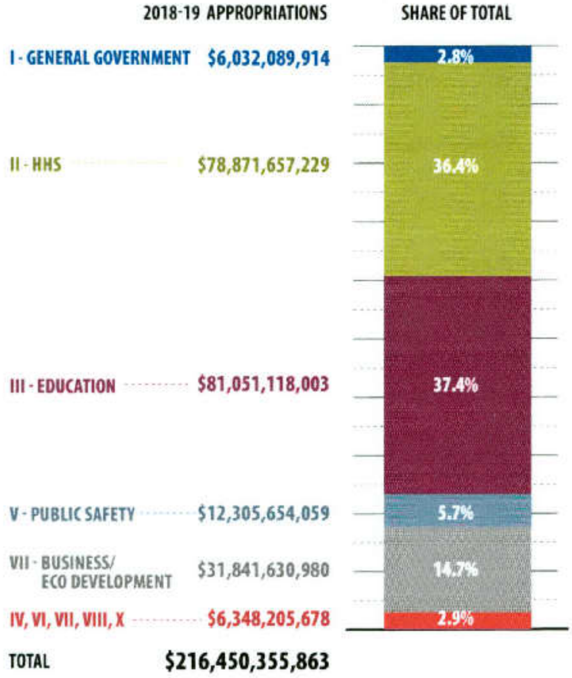


Note: Article IX consists of general provisions such as state employee salary schedules and does not involve costs. Totals may not add due to rounding.
Sources: Legislative Budget Board and Texas Comptroller of Public Accounts

Budget Drivers: The Forces Driving State Spending

EXHIBIT 5

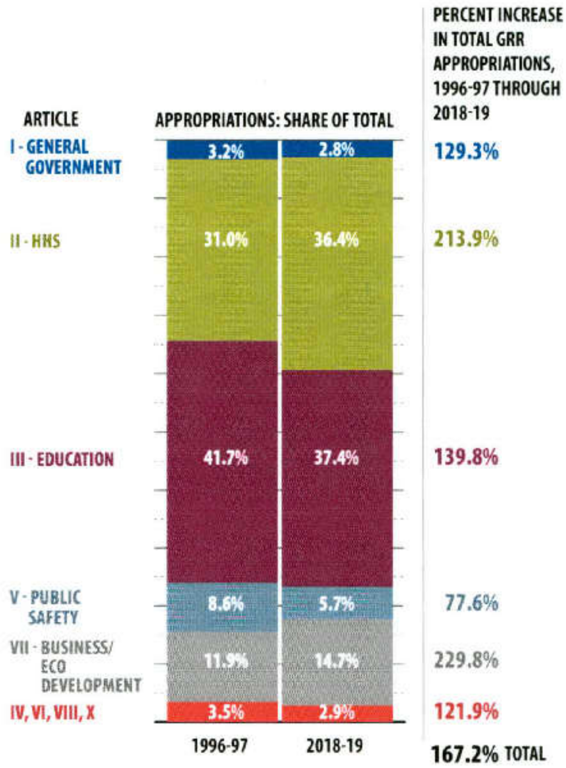
ALL-FUNDS APPROPRIATIONS FOR THE 2018-19 BIENNIUM, BY ARTICLE



Note: Article IX consists of general provisions such as state employee salary schedules and does not involve costs. Totals may not add due to rounding.
Sources: Legislative Budget Board and Texas Comptroller of Public Accounts

EXHIBIT 6

CHANGE IN ALL-FUNDS APPROPRIATIONS BY ARTICLE, 1996-97 VS. 2018-19 BIENNIA



Note: Article IX consists of general provisions such as state employee salary schedules and does not involve costs. Totals may not add due to rounding.
Sources: Legislative Budget Board and Texas Comptroller of Public Accounts

determined State and Local Government Purchases deflator, a measure of price inflation in goods that governments typically buy;

- a **higher education cost index**, reflecting the growth in higher education costs as the product of total credit hours and the CPI;
- a **net tuition and fees index**, which shows the growth in average tuition and fees per student at Texas public institutions from the base year of fiscal 1996;
- a **highway construction cost index**, which reflects growth in the cost of building and maintaining roads as the product of total vehicle miles traveled on Texas roads and the federally maintained price index for state and local investment in highways and streets;
- a **medical cost index** for Medicaid expenditures, which shows growth in the cost of health care as the product of the Medicaid caseload and the federally determined Medical Services Consumer Price Index;
- a **personal income index**, which shows growth in Texas personal income from the base year of fiscal 1996; and
- a **taxable property values index**, which shows growth in the total taxable value of Texas property from the base year of fiscal 1996.

SPENDING: THE BIG THREE

While Texas appropriates money for a wide range of programs, in the last two decades three areas — health care, education and transportation — have framed virtually every budget debate. This is hardly surprising, given that the three articles dominated by these purposes, as seen in **Exhibit 4**, account for nearly 90 percent of all state spending.

Relentless growth in *health care* spending in particular, spurred by rising costs and caseloads, has taken an increasing share of available revenue.

Education spending has risen consistently as well, due to average student enrollment increases of nearly

73,000 or 1.6 percent annually, but local property taxes account for a growing share of this spending, reducing state appropriations under the state's funding formulas. Widespread taxpayer discontent with rising property taxes prompted school finance reform in 2006 that put more state money into the school system and reduced property tax rates. Since then, however, Texas property values have continued to climb, driving up property tax collections and reducing the state's share of total funding by about 2.1 percentage points annually since 2008. Twelve years later, lawmakers once again are grappling with ideas for lowering property taxes.

Finally, in recent years Texas has dedicated more state revenue to *transportation*, sending significant portions of severance and sales tax collections to the State Highway Fund and thus reducing revenue available for other programs.

ARTICLE II: HEALTH AND HUMAN SERVICES

Cost drivers — Rising population, caseloads and medical costs

For the 2018-19 biennium, Article II received \$33.5 billion in GRR appropriations and \$43.8 billion in federal funding; total All-Funds appropriations were \$78.9 billion, including about \$1.6 billion in other revenue from interagency contracts, rebates and other payments. The state's Health and Human Services Commission, which administers Medicaid in Texas, received the largest share of both GRR appropriations (\$28.7 billion or 86 percent) and federal funds (\$40.9 billion or 93 percent) for the 2018-19 biennium.

Medicaid is the costliest Article II program by far, receiving \$61.8 billion in All Funds for the biennium, or 78 percent of the total.

From fiscal 1996 through 2019, both GRR and All-Funds appropriations for Article II more than tripled, rising at an average annual growth rate of 5.2 percent (**Exhibit 7**). The rise reflects both the growth and the aging of the Texas population, the rising cost of prescription drugs and the prevalence of chronic disease such as diabetes, cancer and Alzheimer's disease.

Note, however, that appropriations rose more slowly than either the medical cost index (5.9 percent annually) or personal income (5.5 percent annually). This indicates that Texas' Medicaid program may be comparatively cost-efficient due to relatively tight eligibility requirements, low reimbursement rates and the state's increased use of managed-care service models.

ARTICLE III: EDUCATION

Cost drivers — enrollment, tuition and property values

Article III appropriations support public schools and state colleges and universities.

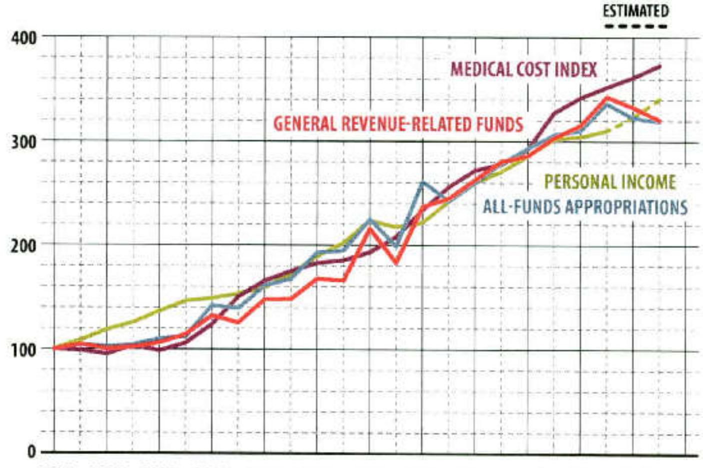
For this analysis, GRR funding for Article III is combined with revenue from the Property Tax Relief Fund (PTRF), created in 2006 to boost state aid for public education and ease the burden on property taxpayers. This led to the growth in appropriations seen in **Exhibit 8** during fiscal 2008 and 2009. Then, during the 2009 session, the Legislature used federal funds from the American Recovery and Reinvestment Act to fund part of the state's obligations under the school finance system. This resulted in the declining state appropriations seen in 2010.

In all, the Legislature appropriated \$62.9 billion in combined GRR and PTRF revenue for Article III in the 2018-19 biennium; All-Funds appropriations totaled \$81.1 billion, including \$10.8 billion in federal funds and \$7.4 billion in other funds.

Increases in Article III appropriations are driven primarily by the number of Texas children enrolled in

EXHIBIT 7

ARTICLE II APPROPRIATIONS VS. MEDICAL COST INDEX AND PERSONAL INCOME, FISCAL 1996-2019 (1996=100)



Sources: Bureau of Labor Statistics, IHS Markit, Legislative Budget Board and Texas Comptroller of Public Accounts school districts and charter schools and the number of credits taken by students enrolled in Texas public colleges and universities. In the last 23 years, the state has supplied a decreasing share of funding for both public and higher education.

Exhibit 8 compares appropriations for Article III against the general cost index and personal income growth. Since 1996, adjusted GRR+PTRF and All-Funds appropriations have risen less than the general cost index and much less than personal income.

K-12 EDUCATION

Cost drivers — enrollment and property values

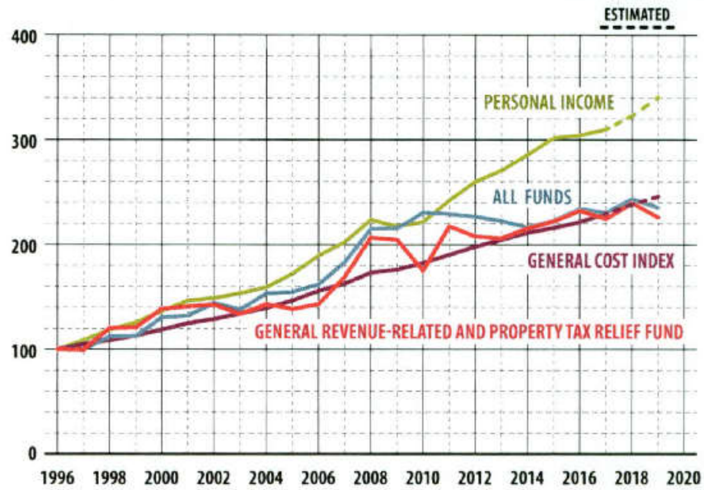
The Texas Education Agency (TEA), which oversees the state's public education system, is the largest single recipient of Article III funding, at $40.2 billion in GRR and PTRF and $55.4 billion in All Funds for the 2018-19 biennium, or about 63.9 percent and 68.3 percent of the Article III total, respectively.

Due to the nature of the Texas school finance system, the primary cost drivers for state appropriations to TEA are public school enrollment and local property values. As more students enroll in public schools, the need for state appropriations rises; as local property values and tax collections increase, the state's funding formulas supply less state money. The data indicate that the latter factor has been more important since 1996 (**Exhibit 9**).

Since 1996, GRR and PTRF appropriations have risen by an annual average 3.5 percent, while All-Funds appropriations have risen by 4.1 percent annually — both considerably less than the growth in personal income and the education cost index. This is primarily because taxable property values have risen by an estimated 6.1 percent annually since 1996.

EXHIBIT 8

ARTICLE III APPROPRIATIONS VS. GENERAL COST INDEX AND PERSONAL INCOME, FISCAL 1996-2019 (1996=100)



Sources: U.S. Bureau of Labor Statistics, IHS Markit, Legislative Budget Board, Texas Comptroller of Public Accounts and Texas Education Agency

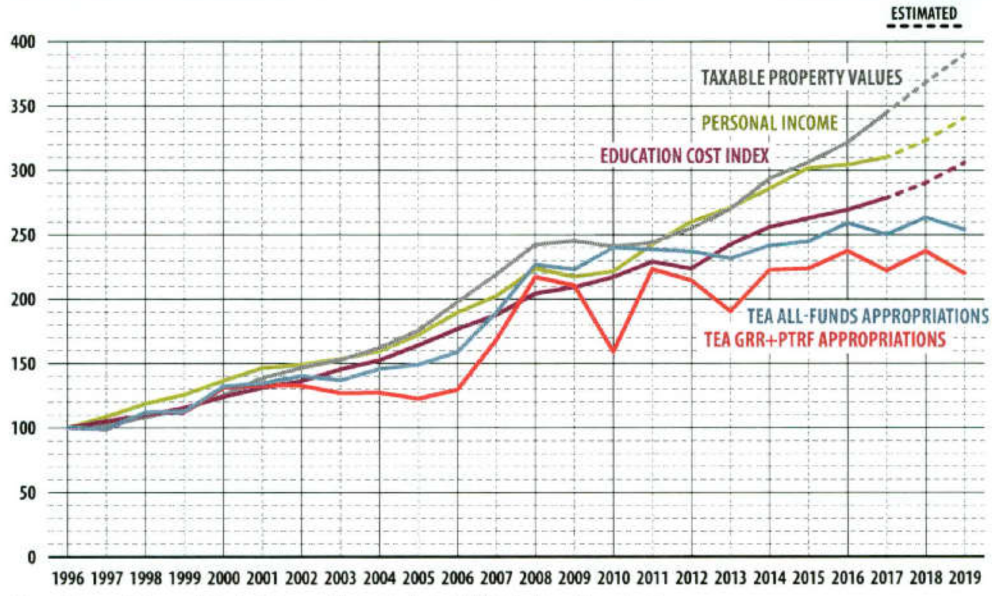
HIGHER EDUCATION

Cost drivers — credit hours taken and tuition

Texas public higher education institutions receive a little more than a third of the amount devoted to K-12 education: $20.1 billion in All Funds for the

EXHIBIT 9

TEA APPROPRIATIONS VS. EDUCATION COST INDEX, PROPERTY VALUES AND PERSONAL INCOME, FISCAL 1996-2019 (1996=100)



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, IHS Markit, Texas Education Agency

2018-19 biennium, of which GRR represented about \$17.5 billion or 87 percent. The largest share of Texas' higher education spending goes to "general academic institutions," or four-year public universities.

Since 1996, state funding for these institutions has risen by an average 3.6 percent annually; in fiscal 2017, they received \$4.3 billion (**Exhibit 10** is based on data from the Texas Higher Education Coordinating Board and 2018-19 figures are not yet available).

The growth of this funding, however, has not kept pace with inflation or the rapid increase in enrollment, leading to a decline in per-student state contributions. Consequently, net tuition and fees rose by an average annual 9.3 percent in the study period. Interestingly, net tuition and fees rose faster before tuition deregulation than after (11.4 percent annually from 1996 to 2003 and 8.2 annually thereafter).

ARTICLE VII

Cost drivers — highway construction and maintenance

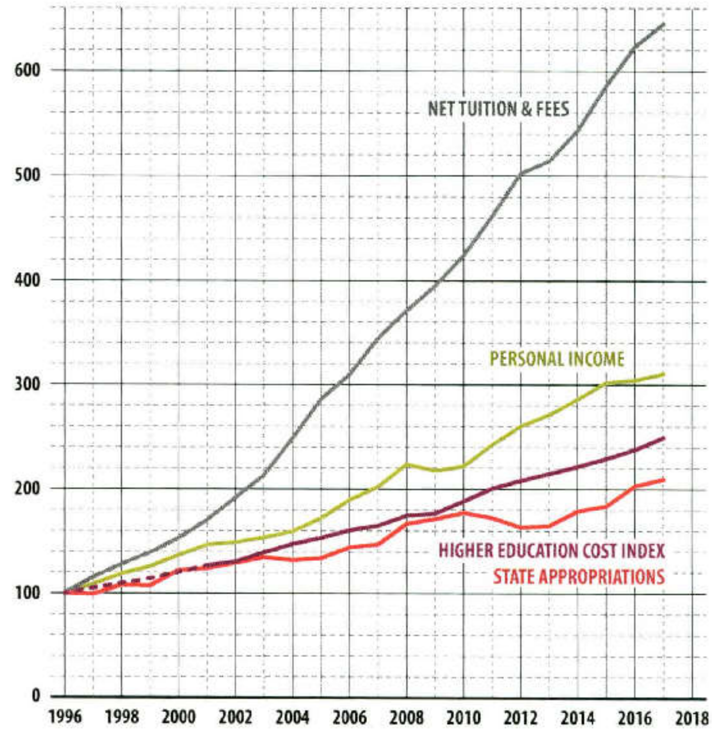
Appropriations for Article VII are driven mostly by road maintenance and construction and, like health care and education, squeeze the rest of the discretionary budget. The Texas Department of Transportation (TxDOT) is the primary recipient of Article VII All-Funds appropriations, receiving \$26.6 billion or 83.5 percent of the total \$31.8 billion for the 2018-19 biennium. Of TxDOT's share, GRR represented less than 3.7 percent of the total.

Federal and "other" funds (mostly State Highway Fund appropriations) accounted for about 95 percent of annual Article VII appropriations from fiscal 1996 through 2019, rising at 4.6 percent and 6.2 percent annually, respectively (**Exhibit 11**). Total All-Funds appropriations for Article VII rose by an average 5.5 percent annually. The highway construction cost index rose by 6.2 percent annually, mirroring All-Funds appropriations and exceeding growth in personal income (5.5 percent).

In recent years, lawmakers and Texas voters have amended the state constitution to substantially boost the amount of state revenue dedicated to highway funding. Starting in fiscal 2013, a portion of revenue from oil and natural gas production taxes was dedicated to the State Highway Fund. Then, beginning in fiscal 2018, up to \$2.5 billion in annual state sales tax revenue has been dedicated to the

EXHIBIT 10

GENERAL ACADEMIC INSTITUTION FUNDING VS. TUITION, THE HIGHER EDUCATION COST INDEX AND PERSONAL INCOME, FISCAL 1996-2017* (1996=100)

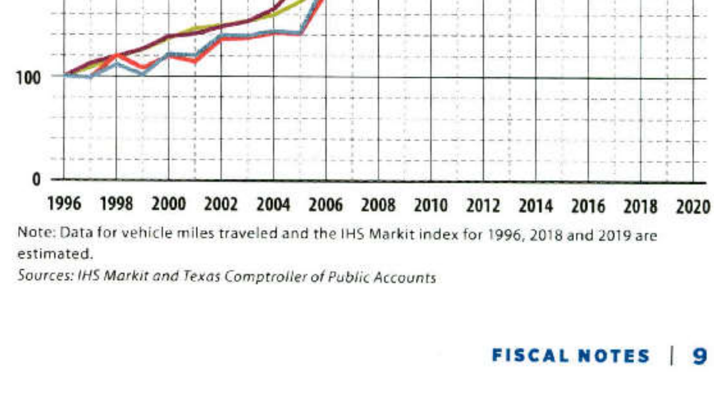


* General academic institution credit hours for 1996-2001 are estimated. 2018 and 2019 estimates of tuition and credit hours were unavailable.

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, IHS Markit, Legislative Budget Board, Texas Comptroller of Public Accounts and the Texas Higher Education Coordinating Board

EXHIBIT 11

ARTICLE VII APPROPRIATIONS VS. HIGHWAY COST CONSTRUCTION INDEX AND PERSONAL INCOME, 1996-2019 (1996=100)



Note: Data for vehicle miles traveled and the IHS Markit index for 1996, 2018 and 2019 are estimated.

Sources: IHS Markit and Texas Comptroller of Public Accounts

State Highway Fund; starting in fiscal 2020, some motor vehicle sales tax revenue also will be added to the fund. Because these sales tax funds used to be GRR, they will reduce discretionary funding for the rest of the budget.

BALANCING STATE BUDGETS

Since 1996, the Texas population has grown faster than that of the U.S., increasing the demand for state services, especially in health care, education and transportation. Rising Medicaid caseloads and costs have placed substantial pressure on the state budget. The state's public school student population also ballooned in the last two decades, while enrollment in our higher education institutions continues to climb.

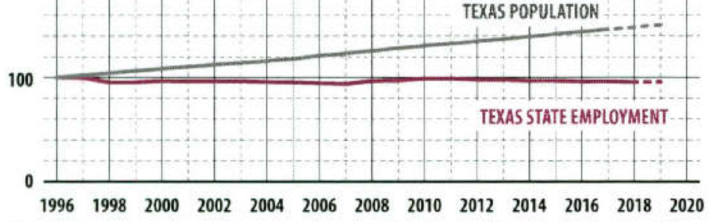
Nonetheless, state appropriations have risen more slowly than state personal income. The Legislature has succeeded in repeatedly balancing budgets even when revenue growth was expected to fall short of anticipated spending needs.

The relatively slow growth of state spending is due to a number of factors. For example, the state has tried to restrain growth by improving the efficiency of agency spending.

This is perhaps best demonstrated by shrinking state government employment (**Exhibit 12**). From 1996 to 2019, the Texas population rose by more than 50 percent, from 19.3 million to an estimated 29.1 million. In the same period, state full-time equivalent (FTE) jobs funded by state appropriations *fell* by about 4 percent, from 225,500 in 1996 to an estimated 215,700 in 2019.

EXHIBIT 12

TEXAS STATE GOVERNMENT EMPLOYMENT, 1996-2019 (1996=100)



Note: State government employment numbers do not include health-related institution staff funded by patient fees and other sources not appropriated by the state.
Sources: IHS Markit and Legislative Budget Board

As with the private sector, state government has relied on technology to deliver more services with fewer employees. Consolidation of agencies, outsourcing to private providers and changes in the delivery of state services also helped restrain rising costs.

COST SHIFTING

Another factor constraining state spending has been cost shifting, which occurs when changing funding patterns impose greater financial responsibility on other levels of government or end users.

Public school funding provides a good example. Despite a substantial commitment of new state funding for public schools with the passage of the 2006 school finance legislation, rising local property values have reduced state formula assistance. Local property tax revenue has risen significantly faster than state funding and accounts for a growing share of all Texas funding for public schools.

An example of shifting costs to users is higher education funding; state funding has grown more slowly than population and inflation, while tuition and fees have surged by more than 545 percent since 1996.

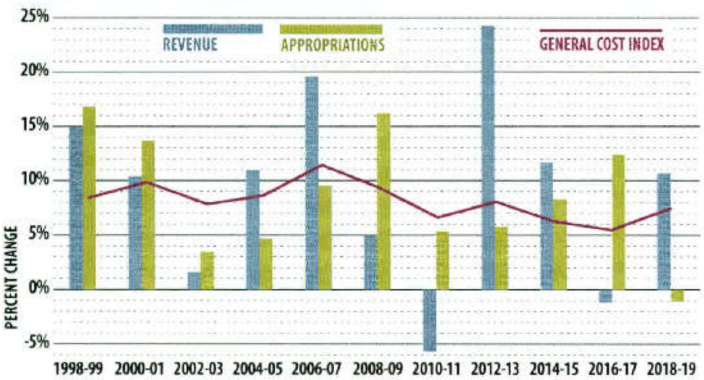
REVENUE VOLATILITY

Despite a relatively robust economy, Texas' economic growth is not always steady and can fluctuate substantially from year to year (**Exhibit 13**). Sometimes, expected revenues fall short of meeting budget needs.

The Legislature has a number of tools at its disposal to make ends meet in such situations. One option employed in many legislative sessions is to underfund the state's Medicaid program and then pass supplemental appropriations in the next session to cover the shortfall for the remainder of the biennium. Similarly, the Legislature can delay some payments from one biennium to the next; by the time the Legislature returns, the economy and revenue collections often have rebounded, allowing lawmakers to make up any delayed payments.

EXHIBIT 13

CHANGE IN GRR REVENUE AND APPROPRIATIONS FROM PREVIOUS BIENNIUM, 1998-99 TO 2018-19*



Notes: Changes in state revenue accounting in 1996 prevent comparisons with the 1994-95 biennium. 2018-19 appropriations do not include supplemental appropriations as none have been made at this writing; 2019 revenue is estimated.
Sources: Legislative Budget Board and Texas Comptroller of Public Accounts

Another tactic is to speed up revenue collections by moving tax due dates forward a month, pulling the revenue collection from one biennium forward into the next. Such moves often are reversed in subsequent legislative sessions.

The Legislature also has relied on growing balances in dedicated accounts within general revenue to help balance the budget. Typically created to fund specific programs, these dedicated accounts often have balances because legislators have not appropriated all the revenue in them. Legislation passed in each session identifies which of these balances can be counted to certify the budget. After reducing reliance on these balances in recent sessions, in 2017 the Legislature expanded the number of GR-D accounts whose balances could be counted toward budget certification.

And, as noted in our recent report on long-term liabilities, the Legislature has consistently underfunded state employee pensions, allowing it to reduce spending in the short term but increasing the need for future funding. Similarly, Texas' original prepaid college tuition plan, the now-closed Texas Tomorrow Fund, has long forecast an eventual cash shortfall. Actuarial projections now show that the program will run short of money in the 2020-21 biennium, resulting in a draw on general revenue.

Texas has been fortunate in that the economy and state revenues haven't experienced prolonged downturns or stagnant periods. The economy's resilience has allowed the Legislature to continue using short-term strategies to balance budgets in difficult times, later covering costs that were delayed. In recent years, the state has kept a lid on long-term budget growth by limiting expenditure growth to match that of the state's population and inflation.

LOOKING AHEAD

Texas' revenue needs for education, health care and transportation have driven the budget for years and are likely to continue doing so. At present, state revenues are growing, meaning that the short-term fixes used to keep the state budget in balance can continue to be useful.

It is unlikely, however, that Texas' rates of economic and revenue growth will continue to match those of the last two decades. While Texas is expected to continue outpacing national economic growth, structural factors such as an aging population will limit growth to some extent — and the state's economy is always cyclical. Thus, it's possible that sooner or later the state's economy and revenue system will fail to come to the rescue after a budget relying on delayed payments and other short-term strategies.

Some of the factors that have helped keep spending in check also may falter. State spending on public education, for example, has been relieved by growing property tax revenue. But that growth has created significant political pressure to reduce property taxes. Doing so would require more state funding or changes to the Texas school finance system.

Furthermore, as this agency has pointed out repeatedly, significant and growing long-term obligations, such as public employee pensions, will require shoring up.

The state will continue to grow and the need for spending on infrastructure, education, health care and other state services will grow along with it. Fortunately, the Texas economy and state revenues are growing as well. But the Legislature will continue to face difficult decisions to balance the budget and ensure the state's continued fiscal health. **FN**

FISCAL NOTES

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