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Fiscal 2012-13

State Budget: Background on the Issues

This report provides background information on many of the competing demands for funding in the fiscal 2012-13 state budget. It also provides an overview of the revenue streams, budget drivers, and many of the major policy issues for each budget article.

Budget Overview

The Legislature's budget-writing committees are considering spending proposals for fiscal 2012-13. The House and the Senate versions of initial "base budget" spending recommendations made by the Legislative Budget Board (LBB) are serving as a starting point for budget deliberations. As required by the Texas Constitution, all state spending decisions ultimately must be reconciled with the comptroller's estimates of available revenue.

This report provides background information on the funding available to the state and on selected state agency budget issues. It outlines each of the eight principal articles of the state budget, identifies some of the factors that drive spending in the articles and the revenue streams unique to each article, and examines competing demands for spending and major budget issues for the state agencies.

HRO State Finance Report, Number 82-1, *Writing the State Budget*, February 3, 2011, summarizes the steps in the budget process and the constitutional, statutory, and procedural requirements guiding the Legislature when it considers state spending. When the House Appropriations Committee reports CSHB 1, its version of the proposed budget for fiscal 2012-13, the HRO will publish another State Finance Report focusing on the major policy issues in the budget that will be considered by the House.

Proposed budgets

The House's and the Senate's introduced versions of the fiscal 2012-13 general appropriations act, HB 1 by Pitts and SB 1 by Ogden, both keep state spending within the state's available revenue. The proposed funding increases and decreases in the House and the Senate base budgets are made from each agency's fiscal 2010-11 spending levels adjusted to reflect about $1.4 billion in reductions approved during the interim by the governor, the lieutenant governor, and the speaker of the House.

Both proposed budgets would reduce the state's general revenue and general revenue-dedicated spending overall by about 10 percent compared to fiscal 2010-11 spending. Neither the House's nor the Senate's proposed budget assumes any spending from the state's Economic Stabilization ("rainy day") Fund, and neither includes funds for growth in some populations served by the state, including public school children and those eligible for Medicaid.

The House's base budget would spend $156.4 billion in all funds, a decrease of about 16.6 percent, or $31.1 billion, from the amount of all funds spent and appropriated for fiscal 2010-11. Of this, $79.3 billion would be general revenue and general revenue-dedicated funds, which is about 10.4 percent, or $9.2 billion, less than fiscal 2010-11.

The Senate's base budget would spend $158.7 billion in all funds, about $2.3 billion more than the House base budget. The Senate proposal would spend $79.7 billion in general revenue and general-revenue dedicated funds, about $438 million more than the House base budget. When compared with fiscal 2010-11 spending, the Senate's proposed budget would spend about 15.4 percent, or $28.8 billion, less in all funds and $8.8 billion, or 9.9 percent, less in general revenue and general revenue-dedicated funds.

The Senate's higher spending recommendations are partially due to spending more on public and higher education. The Senate proposal also uses a different assumption for the federal matching rate for Medicaid, which would lower its general revenue spending on Medicaid by $1 billion compared with the House proposal.

HB 1 and SB 1, as filed, include about $145.8 million in revenue gains across state agencies, mainly from fees. The Senate proposal includes an additional fee on commercial shipping and passenger vessels docked at Texas ports, which would raise about $10 million.

Gov. Perry's fiscal 2012-13 budget proposal adopts for each state agency the lowest amount of general revenue and general revenue-dedicated funds that would be appropriated in either the House or the Senate base budgets. Overall, the governor proposes base spending of $79.4 billion in general revenue and general revenue-dedicated funds and $155.9 billion in all funds.

The governor's proposal would add to the agency base funding levels about $219.2 million in spending on certain priorities and initiatives. These initiatives include $82.0 million for science, technology, engineering, and math education and $15.0 million for the Emerging Technology Fund. The governor's initiatives also include $155.0 million in tax reductions and incentives.

The governor's proposal includes $468.5 million for "savings and sources of revenue." About $341.1 million of that total would come from the collection of debts owed to the state and the sale of state land. Another $56.4 million in savings would come from suspending

Comparison of House and Senate proposed budgets, by article (in millions)

	Fiscal 2010-11		Fiscal 2012-13 proposed			
			HB 1		SB 1	
	All Funds	*GR/GRD*	*All Funds*	*GR/GRD*	*All Funds*	*GR/GRD*
Total	$ 187,498.1	$ 88,525.6	$ 156,383.6	$ 79,294.6	$ 158,653.4	$ 79,733.0
Article 1	4,807.9	3,063.8	3,665.7	2,608.6	4,359.9	2,702.8
Article 2	65,477.6	22,664.3	49,352.8	20,922.7	49,370.4	19,940.4
Article 3	76,441.5	49,362.4	67,672.1	44,316.8	69,819.9	45,633.7
Pub Ed	*53,701.5*	*33,784.0*	*46,663.6*	*30,720.3*	*48,278.4*	*31,504.3*
Higher Ed	*22,740.0*	*15,578.4*	*21,008.5*	*13,596.5*	*21,541.5*	*14,129.4*
Article 4	673.9	489.9	604.2	429.1	604.2	429.1
Article 5	12,073.9	8,695.8	10,534.6	7,626.5	10,743.5	7,831.5
Article 6	3,649.0	2,169.9	3,071.0	1,581.8	3,079.9	1,590.6
Article 7	23,202.8	968.1	19,888.7	822.5	19,888.7	822.5
Article 8	798.7	739.2	686.8	657.1	522.1	492.4
Article 9	0.0	0.0	572.1	(5.5)	(70.9)	(44.8)
Article 10	372.8	372.2	335.5	335.0	335.5	335.0

GR/GRD - general revenue/general revenue-dedicated

Source: Legislative Budget Board, Legislative Budget Estimates Summaries funding for four agencies, including the Texas Historical Commission and the Commission on the Arts, and from consolidating several state agencies and commissions. The rest would come from selling state land used for a prison that is anticipated to close under both the House and the Senate base bills, cutting funding for prison health care, and instituting a charge for health insurance coverage for the spouses of state employees who have access to health insurance elsewhere.

Agency budget cuts for fiscal 2010-11

State leaders have taken two steps to reduce state spending in fiscal 2010-11 in light of estimates of insufficient revenue to cover general revenue spending in the general appropriations act enacted in 2009. The comptroller has estimated that state revenue will be short by $4.3 billion by the end of fiscal 2010-11, taking into account reductions made to fiscal 2010 budgets but not any reductions made to fiscal 2011 appropriations.

In January 2010, state leaders required all state agencies to identify a 5 percent reduction to their general revenue and general revenue-dedicated funds for fiscal 2010-11. Agencies were told that they should not reduce benefits or client eligibility levels in the Medicaid entitlement, Children's Health Insurance Program (CHIP), or foster care programs and that there should be no reductions to staff who determine eligibility for health and human services programs. Also exempt from the cuts were:

- the Foundation School Program;
- Social Security contributions;
- contributions to the Teacher and Employees Retirement Systems' retirement programs;
- contributions to the Higher Education Fund; and
- debt service for previously issued bonds.

Agencies identified $1.8 billion in possible reductions. The governor, the lieutenant governor, and the speaker reviewed the proposed reductions and agreed to about $1.3 billion in cuts to total agency spending. The reductions represented about 1.4 percent of total fiscal 2010-11 general revenue and general revenue-dedicated appropriations of about $87.1 billion. Agencies implemented these budget cuts by spending less than their appropriations on the items approved for reduction.

In December 2010, agencies were told by state leaders to cut another 2.5 percent from their original general revenue and general-revenue dedicated

The General Revenue Fund

general revenue funds

The non-dedicated portion of the General Revenue Fund that is available for general purpose spending, as well as three education funds:

-- Available School Fund

-- State Textbook Fund

-- Foundation School Fund

general revenue-dedicated funds

All other constitutionally or statutorily dedicated funds held within the General Revenue Fund. Examples of dedicated funds:

-- State Parks Account

-- System Benefit Fund

-- Department of Insurance Operating Account appropriations for fiscal 2011. The governor, the lieutenant governor, and the speaker told agencies to exempt from the cuts the same items that were exempt from the 5 percent reductions in January 2010. The letter sent to agencies said that these savings will be formalized in a supplemental appropriations bill for fiscal 2011 to be adopted by the 82nd Legislature. These reductions are estimated to total about $438 million for all state agencies.

Agency requests for fiscal 2012-13

State agency budget requests for fiscal 2012-13 were submitted in August 2010 and were required to meet certain spending reduction requirements. Under the instructions given to state agencies, baseline spending requests for general revenue and general-revenue dedicated funds had to be 5 percent less than the sum of the amount expended in fiscal 2010 plus the amount budgeted in fiscal 2011. In addition, as part of their fiscal 2012-13 appropriations request, agencies had to submit a plan showing potential general revenue and general revenue-dedicated spending cuts of another 10 percent.

The exceptions to the baseline request limits were amounts necessary to:

- maintain funding for the Foundation School Program;
- satisfy debt service requirements for bond authorizations;
- maintain benefits and eligibility in Medicaid entitlement programs, CHIP, and the foster care program;
- maintain health and human services eligibility staffing; and
- satisfy employer contribution requirements for state pension systems and employee group benefits, though modifications in group benefits such as health insurance could be considered.

State agencies' proposed 10 percent reductions, not including formula funding for higher education, totaled about $2.5 billion for fiscal 2012-13. An estimated $500 million reduction for higher education formula funding, which is tallied separately due to the formulas used in the funding, brought the total to $3 billion.

Funding available for fiscal 2012-13

On January 10, 2011, the comptroller released her *Biennial Revenue Estimate* (BRE) for fiscal 2012-13, which estimated that the state will have $177.8 billion in total revenue for the fiscal 2012-13 biennium. Of that, $100.5 billion is dedicated revenue that the state is obligated to spend in specific ways, leaving $77.3 billion in general revenue-related funds.

In the comptroller's calculation, about $866 million of the general revenue collection is set aside for the rainy day fund, and $4.3 billion must be used to offset a projected negative ending balance for fiscal 2010-11. Offsets to general revenue left a net total of $72.2 billion available for general-purpose spending for fiscal 2012-13.

The Legislature cannot carry forward a negative balance from one fiscal biennium to the next. If revenue is insufficient to cover spending in fiscal 2010-11, the shortfall must be subtracted from available revenue in the next biennium for the comptroller to certify the fiscal 2012-13 budget as balanced.

Budget writers have assumed that some additional funds beyond those included in the BRE will be available for fiscal 2012-13 spending. These include about $945 million in spending reductions that state agencies made to their fiscal 2010 budgets and $438 million in cuts that state agencies are scheduled to make to their fiscal 2011 spending. An additional $300 million will come from a transfer from the General Land Fund to the Permanent School Fund that was approved by the School Land Board in early January 2011.

Supplemental appropriations may be made by the 82nd Legislature for additional agency spending in fiscal 2011 and to formalize agency reductions to fiscal 2011 appropriations. At the end of January, the LBB identified $415 million in supplemental needs for public education. If this supplemental spending adds to any shortfall for fiscal 2010-11, it will reduce the amount of revenue available for spending in fiscal 2012-13 due to the requirement that any shortfall for the previous biennium be subtracted from available revenue for the next biennium.

Federal stimulus funds

For fiscal 2010-11, the Legislature appropriated $12.1 billion in federal Recovery Act funds. No new federal stimulus funds are expected to be available to appropriate in fiscal 2012-13.

For fiscal 2010-11, the Legislature appropriated $6.4 billion of the Recovery Act funds for FMAP Medicaid matching funds, Texas Education Agency (TEA) programs, and higher education to make available general revenue funds for a variety of purposes. The Legislature appropriated the remaining $5.7 billion in federal Recovery Act funds through existing funding streams for numerous state agencies and programs, including TEA; the Texas Department of Transportation (TxDOT); workforce and child care development; home weatherization assistance for low-income households; and the State Energy Program. Some agencies have yet to spend all the federal Recovery Act funds appropriated for fiscal 2010-11, and some additional federal stimulus funds became available after the Legislature approved the fiscal 2010-11 appropriations act.

Tax revenue

Texas will collect more tax revenue in fiscal 2012-13 than in fiscal 2010-11, but less than it collected in fiscal 2008-09, according to the comptroller's *Biennial Revenue Estimate*. In fiscal 2012-13, the state is expected to collect $67.3 billion in taxes, an increase of 7.4 percent over the $62.7 billion that the state is expected to collect in fiscal 2010-11. Collections in fiscal 2008-09 were $79.2 billion.

Tax revenue is expected to be less than what was collected prior to the recession as taxes, especially those related to construction, personal consumption, and oil and gas, have yet to fully recover to pre-recession levels.

The sales tax accounts for slightly more than 50 percent of all state revenue and 64 percent of state tax revenue, and it is expected to generate about 8 percent more in fiscal 2012-13 than it did in fiscal 2010-11. For fiscal 2012-13, it should bring in $42.9 billion, while it is expected to bring in $39.8 billion in fiscal 2010-11.

The Texas business margins tax underperformed during the recession and has yet to generate the levels of revenue anticipated when it was created in 2006. Initially, it was estimated that the margins tax would produce $5.9 billion in fiscal 2008, $6 billion in fiscal 2009, and $6.4 billion in fiscal 2010. The tax underperformed when compared to these projections, generating $4.5 billion in fiscal 2008, $4.3 billion in fiscal 2009, and $2.6 billion in fiscal 2010.

The comptroller estimates the business margins tax will generate $2.7 billion in fiscal 2011, $2.9 billion in fiscal 2012, and $2.9 billion in fiscal 2013. According to the comptroller's Business Tax Advisory Committee, the margins tax is raising less than predicted because of the extended recession and greater utilization by businesses of certain exemptions than was anticipated and because of HB 4765 by Oliveria, enacted in 2009, which raised the small business exemption from the tax base from $300,000 to $1 million.

Local property taxes also are expected to decline in fiscal 2012-13. Total taxable property value in Texas in fiscal 2009 was $1.7 trillion. The comptroller expects that value to drop by 2.0 percent in fiscal 2010, and expects a drop in fiscal 2011 of another 3.5 percent. The values are expected to rise by 0.7 percent in fiscal 2012. A decline in local property tax revenue increases education costs to the state. While local property taxes do not provide revenue directly to the state, under the school finance formulas, their decline obligates the Legislature to increase certain payments to school districts under the Foundation School Program.

Motor fuels taxes are expected to generate $1.7 billion during fiscal 2012-13, compared with an expected $1.6 billion during fiscal 2010-11.

While most state tax revenues are expected to increase, expected revenue from cigarette and tobacco taxes and from oil production and severance taxes is expected to fall between the current and the next biennium. For fiscal 2010-11, Texas expects to collect $1.2 billion from cigarette and tobacco taxes. In fiscal 2012-13, the comptroller estimates that tax collections will fall to $1.1 billion, a 5 percent decrease. Oil production and severance revenue is expected to decrease as crude oil prices settle at around $80 a barrel, according to long-term projections. Oil tax revenue is expected to decrease by 4.1 percent, from $2 billion in fiscal 2010-11 to $1.9 billion in fiscal 2012-13.

Ongoing cost of property tax relief

The Property Tax Relief Fund exists to help compensate local school districts for tax revenue that was lost when their tax rates were compressed by one-third by the 79th Legislature in its third called session in 2006. The fund receives dedicated revenue from the business margins tax, the motor vehicles tax, and certain tobacco taxes.

From the beginning, the state revenue sources dedicated to paying school districts for the cost of lower property taxes did not cover this cost, requiring the state to use general revenue to make up the difference. This shortfall has grown larger as the dedicated revenue sources have generated even less due to the recession and lower than anticipated returns.

Also, the state will be paying more to cover the cost of property-tax relief in fiscal 2012-13 because local property values are expected to decline. The LBB expects that state aid to school districts will increase by $315 million in fiscal 2012 and $555 million in fiscal 2013 to make up for decreases in local property-tax revenue stemming from declines in local property values.

Dedicated fund balances

The 82nd Legislature is expected to have balances in the state's general revenue-dedicated accounts available for spending in fiscal 2012-13. General revenue-dedicated funds are those funds, such as the State Parks Account and the System Benefit Fund, within the General Revenue Fund reserved for specific purposes by the Texas Constitution or specific statutes. The comptroller, in her *Biennial Revenue Estimate*, projected the total unspent account balances from general revenue-dedicated funds to be about $6.0 billion for fiscal 2012-13.

General revenue-dedicated account balances that exceed the appropriations from those accounts are included in the comptroller's biennial certification that total appropriations are within projected revenue for the biennium. The $77.7 billion that the comptroller certified would be available for general-purpose spending in fiscal 2010-11 included about $3.7 billion in anticipated general revenue-dedicated account balances.

Three large general revenue-dedicated funds alone comprised over $1.5 billion of the fund balances used to certify the fiscal 2010-11 budget. The largest was the System Benefit Fund, a general revenue-dedicated account containing an assessment collected from electric ratepayers to assist low-income utility customers and fund education programs, which the comptroller certified had a balance of $670.7 million. Appropriations from the System Benefit Fund for fiscal 2010-11 totaled about $258.9 million, much less than the total funds available for appropriation. Two other funds with large balances at the time of certification were the Texas Emissions Reduction Plan, with a balance of $515.3 million, and the Designated Trauma Facility and EMS fund, with a balance of $331.3 million.

The practice of retaining general revenue-dedicated account balances to certify the budget as balanced has been the subject of debate. Some argue that the Legislature is obligated to spend dedicated account balances for the purposes for which they were collected. Others have questioned the desirability of eliminating the use of unspent balances that allow more general revenue to be made available for other state priorities, such as education, health care, and public safety.

One-time accounting measures

The Legislature may consider one-time accounting measures that would shift spending from one biennium to the next. Moving a payment date from the last month of one biennium to the beginning of the first month of the next biennium would mean the state would make 23, instead of 24, payments over the course of fiscal 2012-13. Delaying payments or transfers from general revenue to other funds could mean one-time savings of $2.5 billion to $5 billion, depending on which payments were delayed. For example, delaying the monthly payment from the Foundation School Program to local school districts could save the state about $1.4 billion, according to the Comptroller's Office. Delaying payments to employee and teacher retirement funds, Medicaid payments, and transfers of gasoline taxes from the general-revenue fund into the state-highway fund also could shift millions of dollars to the next biennium. Extending the shift to future biennia would avoid a large spending increase solely in fiscal 2014-15, while allowing a large one-time reduction in fiscal 2012-13.

The Legislature has delayed various payments several times, most recently in 2003 when it delayed Foundation School Program payments to local school districts. In 2007, the 80th Legislature used a revenue surplus to restore the regular payment schedule by adding a 25th payment from the Foundation School Program to local school districts. This reversed the previous payment delay and allowed future legislatures to adopt similar payment delays in the future if needed.

Rainy day fund

As of August 31, 2010, the state's Economic Stabilization Fund, also known as the "rainy day fund," had a net cash balance of $7.7 billion. The balance in the fund is expected to be $9.4 billion at the end of fiscal 2013, according to the comptroller.

Money in the rainy day fund may be spent only with legislative approval. Generally, spending may not exceed the amount of any unanticipated deficit or revenue shortfall. Under these circumstances, subject to various limitations, spending must be approved by at least three-fifths of the members present in each house. 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.

Transfers to the fund are required by statute and by Art. 3, sec. 49-g of the Constitution. By the 90th day of each biennium, the comptroller must transfer to the rainy day fund "one-half of any unencumbered positive balance of general revenues on the last day of the preceding biennium." Unencumbered revenue has no constitutional or statutory restrictions and has not been obligated to be spent in the future. Most biennia have concluded with no unencumbered general revenue balance. The comptroller has transferred unencumbered funds only twice since the rainy day fund was established in 1987.

Most of the growth in the rainy day fund in recent years has come from increased collections of oil and natural gas production taxes. Art. 3, sec. 49-g of the Constitution requires that the fund receive 75 percent of any oil or natural gas production tax revenue that exceeds the amount collected in fiscal 1987. The remaining 25 percent of excess revenue goes to general revenue. Transfers of excess natural gas and oil production taxes to the rainy day fund are projected to be $369 million in fiscal 2011.

The Legislature has appropriated money from the rainy day fund during four legislative sessions. In 2005, the 79th Legislature enacted HB 10 by Pitts, the supplemental appropriations act, appropriating a total of $1.93 billion from the rainy day fund, including funding for public schools and textbooks, Child Protective Services, Medicaid, CHIP, and the Emerging

Technology Fund. In 2003, the 78th Legislature appropriated a total of $1.26 billion from the fund, mostly for Medicaid, teacher health insurance, and the Texas Enterprise Fund, through a supplemental appropriations act, HB 7 by Heflin. In 1993, the 73rd Legislature appropriated a total of $198 million from the rainy day fund for criminal justice programs, including establishing the state jail system. In 1991, the 71st Legislature appropriated $29 million, the entire balance of the fund, to the Foundation School Fund.

General Government

The 21 agencies within Article 1 perform some of the core operations of state government. They include:

- offices of the governor, secretary of state, attorney general, and comptroller;
- agencies charged with general operations of state office buildings and bond issues;
- agencies that support and coordinate statewide and federal priorities; and
- agencies that administer state employee benefits, pensions, and workers' compensation payments.

The budgets for the Legislature and legislative agencies appear in Article 10.

The House base budget for fiscal 2012-13 would appropriate $3.7 billion in all funds for Article 1, and the Senate base budget would appropriate $4.3 billion. The Senate base budget would include an additional $600 million in general obligation bond proceeds for the Cancer Prevention and Research Institute.

Fiscal 2010-11 spending levels for Article 1 were $4.8 billion in all funds. In early 2010, Article 1 agencies identified a total of $193 million in potential reductions that would decrease their fiscal 2010-11 spending by 5 percent, and $157 million of these potential cuts were approved. The State Office of Risk Management, workers' compensation payments, and the comptroller's fiscal programs were not required to make the 5 percent cuts. The additional 2.5 percent cuts total $47.5 million, with the Employees Retirement System (ERS) of Texas being required to make the largest cut, $19.6 million.

Both the House and the Senate base budgets for fiscal 2012-13 would assume $82.8 million in revenue gains for Article 1 agencies. Of this, $23 million in general revenue funds would come from a new $25 annual fee on most child support cases to be collected by the Attorney General's Office; $20 million in general revenue from repealing the tax credit for examination fees and assessment that insurance companies may use when they are examined by the Texas Department of Insurance; and $14.9 million in other funds from a new charge to certain libraries for access to some of the Library and Archives Commission databases. The House and the Senate base budgets also would transfer $10 million from the Historical Commission's Preservation Trust Fund, used for the preservation of historic properties and archeological sites, to the General Revenue Fund.

Selected budget issues

Cuts to economic development and other programs. The trusteed programs of the Governor's Office are funds intended to promote economic development, crime prevention, disaster preparedness, and federal-state relations. The Governor's Office awards grants from these funds. The fiscal 2010-11 spending level for these programs was $870.1 million in all funds. For fiscal 2012-13, the House base budget would appropriate $362.3 million in all funds to these programs, and the Senate base budget would appropriate $442 million in all funds.

Neither the House nor the Senate base budgets would make new appropriations to the Texas Enterprise Fund or the Emerging Technology Fund, the governor's two main economic development funds. Each would allow the funds to roll over their unexpended balances from fiscal 2010-11 for use in fiscal 2012-13. The Texas Enterprise Fund would receive $151.3 million in general-revenue dedicated funds, and the Emerging Technology Fund would receive $21.3 million in general-revenue dedicated funds. The Senate base budget differs from the House base budget in that it would transfer $50 million from the Texas Enterprise Fund to other state agencies for workforce training. The governor's budget proposal would appropriate an additional $15 million beyond the $21.3 million in all funds to the Emerging Technology Fund.

The House base budget would appropriate about $306,000 in general revenue to the governor's Disaster Recovery Grant Fund for ongoing remediation projects. This fund received $96.8 million in all funds in fiscal 2010-11, almost all of it general revenue. The Senate base budget would reduce the appropriation to $50 million in all funds. The governor's budget proposal would appropriate $25 million in all funds for disaster recovery grants. Both the House and the Senate base budgets would make further cuts to the governor's film and marketing, criminal justice, and economic development and tourism programs.

State employee health benefits. State employee health benefits are administered by ERS. For fiscal 2012-13, ERS has requested a total of $2.5 billion in baseline funding to provide group health benefits to state employees and retirees, an increase of $37 million from fiscal 2010-11 spending levels. For fiscal 2012-13, the House and the Senate base budgets both would appropriate $2.5 billion in all funds to provide group health insurance benefits for state employees, retirees, and their dependents.

Facing a shortfall for fiscal 2011 state employee health benefits, the ERS board in May 2010 shifted $143 million in costs to state employees and their dependents by increasing co-payments for prescription drugs and doctor visits. ERS expects large increases in its contribution requirements for the group benefits plan in the upcoming biennium, due to the cost of replacing funds spent from its contingency fund, increased costs from the federal Affordable Care Act of 2010, and general increases in the cost of health care services. To cover these expenses, ERS has requested exceptional items of $576 million in all funds for fiscal 2012-13 to maintain existing plan benefits, as well as $311 million in all funds to replenish its contingency reserve fund.

State employee retirement. Fiscal 2010-11 spending for ERS for defined benefit state employee retirement programs totaled $806.5 million in all funds. The House base budget for fiscal 2012-13 would appropriate $699.8 million in all funds for state employee retirement benefits. This would reflect a lowering of the state contribution rate to employee retirement accounts from 6.5 percent to 6 percent, the minimum percentage contribution allowed by the Texas Constitution. The Senate base budget also would lower the state contribution rate to 6 percent but would appropriate $695.6 million. The House base budget would include $4.2 million more than the Senate base budget because it assumes a 0.5 percent annual payroll growth for state employees, while the Senate base budget does not.

The summer 2010 valuation of ERS' assets and liabilities showed that the state employee retirement fund has 83 cents for each dollar it will pay toward the benefits earned by current active and retired beneficiaries. To make the fund actuarially sound, the combined state and employee contribution rate would need to be 17.07 percent of payroll. As an exceptional item, ERS had requested an increase in the state contribution rate to the employee retirement system of 3.05 percent or $362.5 million in all funds in order to help make the fund actuarially sound. This would increase the state contribution rate to its constitutionally set maximum of 10 percent of payroll. To make the fund fully actuarially sound, employee contribution also would have to be raised by 0.57 percent, to 7.07 percent of payroll, an increase of $67 million in all funds from the previous biennium.

Health and Human Services

Article 2 covers the state's health and human services (HHS) system, which includes five agencies. The Health and Human Services Commission (HHSC) oversees the agencies and performs administrative duties. HHSC also is in charge of the Texas Medicaid program, administering most Medicaid acute care services, including the pharmacy (vendor drug) program, and overseeing Medicaid policies in the other four agencies. It also determines eligibility for many HHS programs, including Medicaid, the Children's Health Insurance Program (CHIP), Supplemental Nutrition Assistance Program (SNAP, formerly known as food stamps) and Temporary Assistance for Needy Families (TANF), which offers cash and other assistance for low-income families and individuals. The four other HHS agencies are:

- *Department of Aging and Disability Services (DADS).* DADS operates state-supported living centers (formerly state schools), offers guardianship services for adults, and administers programs that provide facility-based and community-based care for the aged and for people with developmental and physical disabilities. These services and facilities include nursing homes, assisted living facilities, and home health and personal attendant services.

- *Department of State Health Services (DSHS).* DSHS oversees mental health programs, including state hospitals; health services, such as prevention, epidemiology, and disaster response; vital health statistics record-keeping and reporting; substance abuse services; and regulation of health, food, and drug-related industries and professions.

- *Department of Family and Protective Services (DFPS)*. DFPS administers child and adult protective services, including responding to reported incidents of abuse and neglect, early intervention and prevention services, and child-care regulation.

- *Department of Assistive and Rehabilitative Services* (DARS). DARS implements rehabilitation services, early childhood intervention, and services for autistic children and for the blind and the deaf.

The HHS programs under Article 2 constitute Texas' second-largest source of spending after education. HHS spending in the House base budget for fiscal 2012-13 would be almost 32 percent of the state budget and 26.4 percent of general revenue and general revenue-dedicated expenditures. In the Senate base budget, the percentages would be 31 percent and 25 percent. For fiscal 2012-13, both the House and the Senate proposals would appropriate $49.4 billion in all funds, a decrease of 24.6 percent from fiscal 2010-11. The House base budget would appropriate $20.9 billion in general revenue and general revenue-dedicated funds, a decrease of 7.7 percent. The Senate base budget, which assumes a higher federal Medicaid match rate, would appropriate $19.9 billion in general revenue and general revenue-dedicated funds. The major reductions in Article 2 spending stem from the loss of one-time federal stimulus funding used to support HHS programs in fiscal 2010-11, from provider rate cuts of 10 percent, and from not fully funding caseload growth or rising medical and other costs.

Fiscal 2010-11 reductions. In early 2010, in response to the state leadership's request for agencies to trim their budgets, HHS agencies presented a unified plan to reduce general revenue spending across the HHS enterprise by 5 percent. With Medicaid entitlement, CHIP, foster care programs, and eligibility staffing exempt from reductions, HHS agencies identified $278 million in potential reductions. About $205 million in reductions were approved, bringing the overall decrease to 3.7 percent. Most of the $205 million reduction was achieved with a hiring freeze and other administrative savings, by identifying programs with lower-than-anticipated caseloads, and by identifying projects with delayed start dates. Provider rates were lowered by 1 percent effective September 1, 2010, for all HHS programs except Medicaid community care, foster care, and adoption subsidies. HHSC Medicaid managed care rates also were reduced 1 percent.

In response to a request for agencies to reduce spending another 2.5 percent, HHS agencies implemented $85 million in general revenue funds reductions. About half of the reductions, $42 million, will come from further provider rate reductions effective February 1, 2011, bringing the cumulative rate reduction for acute care services, including managed care, to 2 percent, and for nursing facilities and Intermediate Care Facilities for the Mentally Retarded (ICFs-MR) to 3 percent. Other major reductions come from administrative savings, continued freezes on hiring and on merit increases, and discontinuing enrollment of clients in various programs, such as new waiver service slots that were intended to expand the number of people who could receive services in the community rather than in institutional care.

Revenue streams

HHS agencies receive funding from federal, state, and local sources, with federal funds being especially significant. The state often must fund part of a program in order to receive matching federal dollars. In both the House and the Senate base budgets, federal funds constitute more than half of Article 2 spending. In the House base budget, they are 56.6 percent or almost $28 billion. In the Senate base budget, they are 58.7 percent, or about $29 billion. These amounts are about one-third less than the expected federal funds spending for fiscal 2010-11. Some federal funding programs include:

Recovery Act. In fiscal 2009-11, the federal American Recovery and Reinvestment Act helped support a range of programs in all Article 2 agencies, including nutrition programs, immunizations, child care, health information technology, and vocational rehabilitation. It also temporarily increased federal matching rates for Medicaid, bringing in more federal dollars without increasing state spending. For fiscal 2010-11, Article 2 agencies received more than $4.3 billion in Recovery Act funds, 6.6 percent of the Article 2 all-funds budget, which "freed up" general revenue funds that otherwise would have been spent to support state programs. Recovery Act funding is not available for fiscal 2012-13, and the House and the Senate base budgets would not replace stimulus funding with state revenue.

Medicaid. Medicaid, the federal-state health insurance program for the poor, elderly, and disabled, is the largest source of federal funds in the state budget. The LBB projects Medicaid federal funds spending for fiscal 2010-11 of $33.4 billion. The House base budget for fiscal 2012-13 would spend $20.3 billion in federal funds on Medicaid, a decrease from fiscal 2010-11 of 39.2 percent, and would spend $14.6 billion in general revenue funds. The House base budget would appropriate $35.2 billion in all funds to the Medicaid program, a decrease in all-funds spending of 28.8 percent from fiscal 2010-2011.

The LBB Budget Estimates Summary says House base budget reductions are largely from:

- a 10 percent provider rate reduction ($1.6 billion in general revenue; $2.2 billion in federal funds);
- not replacing an estimated $4.3 billion in federal stimulus funds, mostly associated with a higher FMAP (decreasing federal funding by $5.7 billion);
- no funding for caseload or cost growth ($1.7 billion in general revenue; $2.5 billion in federal funds); and
- assumed expansion of Medicaid managed care (about $367 million in general revenue; almost $600 million in federal funds).

Medicaid eligibility. Medicaid is an entitlement program, meaning all who meet eligibility requirements are entitled to receive services. The state cannot cap participation by limiting funding. Eligibility requirements vary by age, income, and disability status, and some are federally mandated. All categories of Medicaid eligibility require that a client's income not exceed a certain percentage of the federal poverty level (FPL). In 2011, 100 percent of the FPL is $10,890 for a single adult and $22,350 for a family of four.

Federal Medical Assistance Percentage (FMAP). Medicaid expenditures are split between the federal government and the states according to each state's average per-capita income relative to the national average, which is adjusted annually. The House base budget would assume an FMAP of 58.4 percent for fiscal 2012 and 57.4 percent for fiscal 2013. This means that for every dollar Texas spent on the Medicaid program, the federal government would subsidize about 57 to 58 cents. This also means that for every dollar of general revenue cut in Medicaid, the state will forego about $1.35 to $1.40 in federal assistance.

The Senate base budget assumes the federal government would set Texas' FMAP at an unspecified higher rate, which would increase federal funding and reduce the need for state general revenue spending by $1 billion (see SB 1, HHSC budget, rider 62). In fiscal 2010-11, the federal Recovery Act increased Texas' FMAP to a high of 70.94 percent. The enhanced funding level, originally set to expire December 2010, has been extended and will be phased out by June 2011. With the extension, the average fiscal 2011 Medicaid FMAP rate is 67.33 percent. Without the extension, it would have been 64.02 percent.

Special hospital funding. The Disproportionate Share Hospital (DSH) Program is another source of reimbursement to state-operated and local hospitals that serve a disproportionately large number of Medicaid and indigent patients. An Upper Payment Limit (UPL) is a mechanism through which local hospitals can receive additional reimbursement in certain cases when Medicaid rates are lower than Medicare hospital rates. State expenditures are matched by federal funds, and the state uses general revenue funds appropriated to state-owned hospitals and local tax funds from nine public hospital districts to draw down the federal match. Both DSH and UPL payments were financed in part by federal Recovery Act funds in fiscal 2010-11.

Study to eliminate Medicaid. In December 2010, HHSC and the Texas Department of Insurance jointly issued a report in response to a mandate by HB 497 by Zerwas, enacted by the 81st Legislature in 2009, to study the impact of abolishing Medicaid. The report said that if Texas opted out of Medicaid, the state would lose billions of dollars in federal matching funds and up to 2.6 million Texans could become uninsured, while Texas residents and businesses continued to pay federal taxes to support other states' Medicaid spending. It also said hospitals still would be required by federal law to treat medical emergencies of uninsured former Medicaid and CHIP clients, potentially adding billions of dollars to their annual uncompensated care costs. It said that while the state could continue its share of funding for health benefits and target spending as it sees fit, it would be difficult to cover costs without shifting responsibility to county governments and public hospitals. It concluded that to chart a sustainable future, federal Medicaid policy would have to change to give states more flexibility in handling program costs.

CHIP. The Children's Health Insurance Program (CHIP) is the sixth-largest source of federal funds in the state budget and the second-largest source in Article 2. CHIP provides primary and preventive health care to low-income, uninsured children whose family income or assets are too high for them to qualify for Medicaid. Subject to certain family asset restrictions, 12 months of CHIP eligibility is granted to children under age 19 whose net family income, excluding Medicaid-allowable child care expenses, is at or below 200 percent of the FPL. CHIP federal funding requires a matching amount from the state. The House and the Senate base budgets would spend about $1.5 billion in federal funds, 3.7 percent less than in fiscal 2010-11, for CHIP due to an almost 10 percent proposed reduction in state general revenue spending for the program. Total funding for CHIP, including the state match, would be $2.1 billion for fiscal 2012-13.

State-federal funding match. CHIP appropriations are paid through a state-federal match based on an enhanced FMAP (EFMAP), a percentage of the state Medicaid FMAP. The House and the Senate base budgets assume an EFMAP of 70.9 percent for fiscal 2012 and 70.2 percent for fiscal 2013. This means the federal government would fund more than 70 cents of every dollar spent in Texas on CHIP in the next biennium.

TANF. Temporary Assistance for Needy Families (TANF) block grant funds are the 10th-largest source of federal funds to Texas and the fourth-largest in Article 2. TANF funds Article 2 initiatives such as foster care, youth dropout and delinquency prevention, and child care regulation. It also provides temporary cash assistance grants to needy families who meet income criteria. The monthly cash amount is based on family size, income, and needs. Both the House and the Senate base budgets would spend $247.8 million in all funds on TANF cash assistance grants, about 9 percent less than fiscal 2010-11 spending. The House base budget would spend $111.7 million in federal funds, and the Senate base budget, $106.7 million. TANF cash assistance caseloads are projected to increase from 122,386 in fiscal 2011 to 128,985 in fiscal 2013. HHSC estimates the level of funding in the base budgets would decrease monthly assistance for standard program recipients by about 16 percent, from $72.52 to $60.67 per month, and by about 50 percent for two-parent TANF families, from $69.18 to $34.49 per month.

Budget drivers

Changes in age, ethnicity, and health composition of the population, poverty rates, and overall economic trends drive much of the demand for HHS services. Neither the House nor the Senate base budget for fiscal 2012-13 would include funding to serve the number of clients projected to be eligible for HHS services or to cover anticipated cost increases due to medical inflation, increased acuity (greater seriousness and complexity of the recipients' conditions), or higher use of services, which for the Medicaid program alone would cost an estimated $4.2 billion in all funds.

CHIP and Medicaid caseloads. CHIP and acute-care Medicaid caseloads are two of the biggest drivers in the Article 2 budget. The average monthly Medicaid caseload grew between fiscal 2001 and fiscal 2009 from 1.87 million to a little more than 3 million. In 2001, CHIP had an average monthly caseload of 251,476. Caseloads peaked at 529,211 in May 2002, fell to 308,762 in 2006, and gradually increased thereafter to 503,186 by fiscal 2010.

The average CHIP monthly caseload budgeted for fiscal 2011 is estimated to be 573,769, and both the House and the Senate base budgets project this number will increase by 7 percent, to 613,263, by fiscal 2013. In both bills, the average acute-care Medicaid monthly caseload expected for fiscal 2011 is 3,517,959. It is projected to increase by more than 5 percent, to 3,709,990, in fiscal 2013. CHIP and Medicaid caseload increases are expected to result from population growth and the effect of the economy on family incomes and health coverage.

Economy. As economic conditions and incomes decline, demand for health and social services typically increases. In addition, employers also may reduce or eliminate health benefit coverage for employees. Eligibility criteria for most HHS programs measure personal income as compared to the federal poverty level. According to the U.S. Census Bureau, in 2009, 4.2 million Texans, or 17.2 percent of the state population, lived below the federal poverty level, which was $22,050 for a family of four and $10,830 for a single adult. People without adequate health coverage are more likely to defer needed treatment, which can make their health condition worse or more complex. They then may seek care in more costly settings, such as emergency rooms, incurring costs they are unable to pay. Unpaid medical bills for the indigent must be covered by the providers or local taxes (in the case of many public hospitals) or may be used by providers to increase charges to private health plans, shifting the costs to employers and the insured.

Demographic changes. In January 2011, the Office of the State Demographer estimated that in the last decade the Texas population grew more than 20 percent, surpassing 25 million, the fastest growth rate in the nation. The demographer attributed this in part to high birth rates and lower death rates relative to other states. More than a quarter of Texas' population is under age 18. High birth rates and a relatively young population, combined with economic distress, can increase caseloads for programs like Medicaid and CHIP. According to the HHSC, in 2009, children ages 0 to 5 made up about 35 percent of the Medicaid program and those under 21, about 77 percent. Nondisabled children accounted for 66 percent of the Medicaid caseload but 32 percent of program expenditures. According to the HHSC, more than half of all births in Texas are covered by the Medicaid program.

Texas' elderly population also is growing rapidly. This can lead to increased need for medical and nursing services and other supports from families, friends, and communities. According to DADS, in 2010, the population of Texans aged 60 years and older is projected to be 3.7 million or 14 percent of the population. By 2040, the projection is 10 million or 22 percent of the population. According to the state demographer, the population aged 65 years and older will increase by about 181 percent between 2010 and 2040. Aging and disabled clients accounted for 25 percent of the total Medicaid population but 58 percent of Medicaid costs in fiscal 2010, according to HHSC.

Health status. The overall health of Texans also affects the demand for HHS services. Ongoing concerns include diabetes, obesity, and tobacco use. In a 2009 report, the state demographer said about 29 percent of Texas adults are obese and that this could climb to about 43 percent by 2040. Obesity rates are highest among Latinos and the elderly, the fastest-growing populations in the state. Obesity can lead to a spectrum of chronic health problems, including diabetes, heart disease, high blood pressure, high cholesterol, and respiratory ailments. Obesity cost Texas businesses $9.5 billion in 2009, according to a recent comptroller's report, and could cost them $32.5 billion annually by 2030. The state demographer also reported that Texas has one of the highest incidence rates for diabetes in the United States, with age-adjusted rates tripling to 11.1 per 1,000 persons from 1997 to 2007. Diabetes, currently the sixth-leading cause of death in Texas, can cause other health problems, such as cardiovascular disease, chronic renal failure, and retinal damage. Tobacco use is linked with cancer, respiratory ailments, and other health issues. According to 2008 DSHS data, tobacco use among Texans is 19.3 percent. While overall youth tobacco use fell from 24.7 percent to 20 percent from 2006 to 2008, more than a quarter of Texas high school students continue to use tobacco products.

Medical cost growth. Health care costs rise each year due to inflation and other factors, such as technological advancements and increased prevalence of chronic diseases. Neither the House nor the Senate base budget would include funding for increased costs. HHSC estimated in its exceptional-item request that cost growth from fiscal 2011 levels would be 5.2 percent for fiscal 2012 and 10.9 percent for fiscal 2013. The total exceptional-item request to cover HHSC projections of Medicaid cost growth and utilization increases was $1.3 billion in general revenue funds and $3.3 billion in all funds.

Selected budget issues

Provider rates. The general revenue reductions in Article 2, in both the House and the Senate base budgets, are largely due to Medicaid provider rate reductions of 10 percent. This would be a reduction of $1.6 billion in general revenue funds and $3.8 billion in all funds from fiscal 2010-11 levels. The rate cuts would affect most health care providers that provide Medicaid services, including physicians, dentists, pharmacists, hospitals, and nursing homes. Non-Medicaid providers, such as foster care providers, also would be subject to rate reductions in varying amounts in the House and the Senate base budgets.

Services for the aged and disabled. DADS delivers services to many aged, physically disabled, and developmentally disabled people who live in homes or community-based settings instead of nursing homes and institutions. These services can include home-delivered meals, adult day care, and personal attendant care. Medicaid funds most of these services. Others are funded with general revenue. All Medicaid recipients who meet relevant medical and developmental criteria are entitled to receive care in a nursing facility or ICF-MR, but waiver programs allow them to use Medicaid funds for community care. Some community care programs are "entitlement" programs, meaning every individual who meets the financial and functional need criteria is served (no caps or waiting lists), while others are nonentitlement programs and are capped. The consolidated HHS budget issued in 2010 forecasted caseload growth for all community care services to 170,552 in fiscal 2013 from a projected 167,439 in fiscal 2011.

Both the House and the Senate base budgets would reduce by 44 percent from fiscal 2010-11 general revenue funding for non-Medicaid-funded community services, which would cut services to almost 12,000 Texans. Both bills also would maintain Medicaid waiver caseloads at 2011 levels. In 2009, the 81st Legislature approved a $208 million general revenue increase to expand the number of people served by community waiver programs, reduce the waiting lists for those programs, and reduce the number of people in state-supported living centers.

Both base budgets would reduce funding for DARS programs that serve disabled children by about 20 percent from fiscal 2010-11 levels. The House base budget would eliminate funding for the autism program, which serves children aged 3 to 8, reducing the budget by $6.7 million in all funds. The Senate base budget would reduce the autism program by $3.3 million in all funds. Both bills would reduce client services in the blind children's program, which provides support for people until age 22, and for early childhood intervention, which serves disabled or developmentally delayed children aged 3 and under, by neither funding caseload increases nor replacing federal Recovery Act funding.

Last session, the Legislature appropriated $32.7 million in general revenue to improve the conditions at the 13 state-supported living centers that care for about 4,200 developmentally disabled Texans. The House base budget would continue to fund construction and renovation of facilities at the state-supported living centers with unissued general obligation bond proceeds that were appropriated last session and carried forward in the base budget.

A January 2011 LBB report said that keeping all state institutions in operation is not cost effective due to declining numbers of residents and increased demand for community-based care. The report said Texas should close at least one of 13 state-supported living centers by May 31, 2013, and direct DADS to continuously review their necessity. The report found Texas to have more people with disabilities living in institutions than any other state and to have a disproportionate amount of the U.S. total (12 percent). In the next biennium, closing one facility could save between $4 million and $15 million, it said.

Mental health services. Both the House and the Senate base budgets would cut mental health services in Article 2, reversing a trend in the past two sessions to increase funding. DSHS delivers outpatient and inpatient mental health and substance abuse services via contracts with 39 local mental health authorities and the Dallas-area Medicaid managed care program NorthSTAR. DSHS also operates 10 state mental health hospitals for those with severe mental illness and helps support three community mental health hospitals.

Both base budgets would reduce community mental health services by reducing general revenue funding by $74.9 million ($170.5 million in all funds). Both would reduce federal substance abuse grant funding by $19.7 million. Both also would reduce inpatient mental health services and staffing by cutting state and community hospital spending from fiscal 2010-11 levels by $33.9 million in all funds, mostly in general revenue. Both budget proposals contain a rider to the DSHS budget directing the agency to begin the process of privatizing one mental health hospital by September 2012. Effects on program caseloads and services for fiscal 2012-13 would include:

- decreasing the average daily number of patients in state mental health hospitals by 130 from fiscal 2011 levels (to 2,347 patients per day);
- providing community mental health services to 3,779 fewer adults and 751 fewer children from the number served in fiscal 2011; and
- maintaining the number served in substance abuse treatment programs at fiscal 2011 levels (5,360 adults and 750 children).

Children's prevention, early intervention programs. Both the House and the Senate base budgets propose a 9.3 percent reduction in all funds to the Department of Family and Protective Services (DFPS) and do not include funding to meet caseload increases. According to DFPS, because the agency must continue to respond to an expected increase in reports of abuse and neglect of children and adults, unfunded foster care and adoption caseload growth would mean the agency must cut in other areas, such as by reducing by 7 percent the rates paid to foster homes in addition to the 5 percent cut already made. DFPS also could not fund new adoptions. DFPS said the funding also would require cutting direct delivery Child Protective Services and Adult Protective Services staff. For Prevention and Early Intervention (PEI) programs, designed to prevent juvenile delinquency and child abuse and neglect, the Senate base budget would decrease general revenue spending by $12.7 million ($35 million in all funds), and the House base budget would reduce it by $15 million in general revenue ($40 million in all funds). This level of PEI funding would be 40 to 45 percent lower than fiscal 2010-11 spending levels, reducing participation by at least 9,100 clients per month.

Managed care expansion. The House and the Senate base budgets assume expansion of Medicaid managed care programs statewide, expecting a net savings of $367 million in general revenue. Medicaid managed care in Texas includes the client having a primary care provider who generally provides preventive and primary health services and refers the patient for specialty care as appropriate. A specialist may agree to serve as a primary care provider for those with special health care needs.

A capitated managed care program pays a contracting managed care organization (MCO) a fixed monthly amount per recipient enrolled in the MCO's plan to pay for all covered services. STAR (for acute care) and STAR+PLUS (integrating both acute and long-term care) are capitated Medicaid managed care programs. STAR currently is available in nine primarily urban areas and their surrounding counties: Bexar, Dallas, El Paso, Harris, Nueces, Jefferson, Lubbock, Tarrant, and Travis. As of August 1, 2010, STAR+PLUS MCOs served 169,873 members in the Bexar, Harris, Nueces, and Travis County service areas. STAR+PLUS will begin operations in the Dallas and Tarrant service areas in February 2011. Primary Care Case Management (PCCM) is a noncapitated Medicaid managed care alternative that pays primary care physicians for each rendered service but adds a $5-per-month per-recipient payment to cover their costs in coordinating that patient's care. All non-STAR counties (primarily rural) are covered by PCCM. Total PCCM enrollment was 840,172 as of August 1, 2010. CHIP also operates capitated managed care programs statewide.

As described on its website, HHSC proposes to:

- expand Medicaid managed care to counties contiguous to existing service areas starting September 2011;
- newly implement Medicaid managed care (STAR) in the 10-county Hidalgo Service Area by March 2012 (state law currently prohibits Medicaid HMOs in Hidalgo, Cameron, and Maverick counties);
- expand STAR+PLUS to El Paso, Hidalgo and Lubbock by March 2012;
- fold inpatient hospital benefits into STAR+PLUS;
- convert the PCCM areas to STAR by March 2012;
- fold pharmacy benefits, which now are delivered via a fee-for-service method, into Medicaid and CHIP managed care by March 2012; and
- create a statewide dental managed care program for Medicaid by March 2012.

About 72 percent of Texas Medicaid clients were in some form of managed care as of February 2011. The remaining 28 percent of Medicaid clients receive services through a traditional fee-for-service model under which health care providers receive a specified reimbursement for each service rendered.

Federal health care reform. Although federal health care reform legislation, commonly referred to as the Affordable Care Act of 2010, will not have a significant impact on Article 2 spending in fiscal 2012-13, its requirement to increase Medicaid eligibility starting in 2014 has been one of the reasons some have called for eliminating or restructuring Texas Medicaid or taking federal actions to repeal, reform, or transform the Medicaid program.

Starting in 2014, Texas must expand its Medicaid eligibility up to 133 percent of the federal poverty level for individuals under age 65. New client populations in Texas will include:

- parents and caretakers, 14 percent to 133 percent of the federal poverty level;
- childless adults, up to 133 percent of the federal poverty level;

- children in foster care through age 25; and
- children ages 6 to 18, between 100 percent and 133 percent of the federal poverty level (currently CHIP eligible)

In November 2010**,** HHSC had estimated that this would mean another 1.2 million Medicaid recipients in 2014, both from newly eligible individuals and those currently eligible but not enrolled. The Affordable Care Act commits the federal government to paying 100 percent of the cost of newly eligible recipients through 2016 and 95 percent through 2017, gradually decreasing its share until 2020, stabilizing at 90 percent. This is part of a package of requirements to ensure most citizens are covered by health insurance in 2014 and beyond. Other requirements toward this goal include requiring most citizens to have health coverage, new requirements for certain businesses in providing employee health coverage, new requirements creating health insurance exchanges, and subsidies to help individuals, families, and businesses buy health coverage.

Other Affordable Care Act provisions cover CHIP funding and state requirements, the education and availability of doctors and other health care professionals, wellness programs for at-risk communities, cross-provider care organizations, bundling provider claims, establishing value-based purchasing, and revisions to Medicare Part D (drug benefits). Affordable Care Act provisions already in effect include:

- prohibiting use of pre-existing condition exclusions for children;
- prohibiting the dropping of sick individuals or lifetime caps on benefits;
- allowing children up to age 26 to stay on their parents' coverage;
- phasing out co-payments and deductibles for preventive care;
- closing the "doughnut hole" in Medicare prescription cost-sharing;
- eliminating out-of-pocket spending for Medicare annual check-ups and other preventive tests;
- assistance to help pay for local, state, and private business retiree health benefits; and
- new requirements that insurance companies spend at least 80 to 85 percent of premium dollars on health care and justify rate increases.

The Affordable Care Act is under legal challenge. Texas Attorney General Greg Abbott has signed onto a federal lawsuit urging the rollback of the law. Two federal judges have upheld the constitutionality of the federal health care law and two have declared it unconstitutional, mostly hinging on the requirement that most citizens have health insurance coverage.

Public Education

Public education is the largest single function funded by the state. Nearly all public education funding is appropriated to the Texas Education Agency (TEA). Article 3 public education funding also is appropriated to the State Board for Educator Certification, the Texas School for the Deaf, the Texas School for the Blind and Visually Impaired, and the Teacher Retirement System.

The House base budget for fiscal 2012-13 would appropriate $46.7 billion in all funds to agencies of public education for fiscal 2012-13, a decrease of 13.1 percent from fiscal 2010-11 spending. The Senate base budget would appropriate $48.3 billion in all funds, a 10.1 percent decrease.

TEA administers the Foundation School Program (FSP), the primary source of state funding for Texas school districts. In fiscal 2010-11, $49.2 billion in all funds was appropriated to TEA, including $36.9 billion to the FSP. The House base budget for fiscal 2012-13 would appropriate $43.3 billion in all funds to TEA, including $32.8 billion to the FSP. The Senate base budget would appropriate $45.1 billion in all funds to TEA, including $33.3 billion to the FSP. The House appropriation to the FSP is estimated to be $9.8 billion below the state's statutory funding obligations and the Senate appropriation, $9.3 billion below.

The House base budget would appropriate $3.7 billion in all funds to the Teacher Retirement System (TRS), a decrease of $343.6 million from fiscal 2010-11 spending. The Senate base budget would appropriate $3.5 billion, a decrease of $509.3 million. Both base budgets would decrease the state and employee contribution rates to TRS from 6.64 percent in fiscal 2010-11 to 6.0 percent for fiscal 2012-13.

The House and the Senate base budgets each would appropriate $38.3 million in all funds to the Texas School for the Blind and Visually Impaired, a 59.1 percent decrease from fiscal 2010-11. Both would appropriate $49.1 million in all funds to the Texas School for the Deaf, an 8.3 percent decrease.

The House base budget would make no appropriations for any public education programs or initiatives not funded through the FSP. It would reduce general revenue for public education outside the FSP by $1.8 billion, a 67.1 percent decrease from fiscal 2010-11. The House base budget would not provide funds to school districts to offset the cost of disciplinary alternative education programs. Other programs that would not receive appropriations in the House base budget include the Student Success Initiative, a grant program that provides funding to schools whose students are unlikely to meet state assessment benchmarks, and the Texas High School Completion and Success Initiative, which provides instructional support and professional development for teachers with students at risk of dropping out of school. Other major programs and initiatives that would not be funded in the House base budget include:

- incentive pay for teachers;
- teacher mentor programs;
- the technology allotment;
- prekindergarten and early childhood program grants;
- the extended school day and extended school year programs;
- life skills classes for teen parents;
- initiatives to increase student interest and performance in math and science;
- science labs;
- communities in schools and other dropout prevention programs;
- the Virtual Schools Network;
- background checks for school personnel;
- the arts education grant; and
- random steroid testing for high school athletes.

The Senate base budget would reduce general revenue for public education outside the FSP by $1.4 billion, a 51.6 percent decrease from fiscal 2010-11. The Senate base budget would eliminate funding for nearly all programs and initiatives not included in the FSP. It would appropriate $1.8 million to the steroid testing program and $400 million to create Grants for Effective Public Education to improve high school completion and college readiness; prekindergarten and early childhood education; intervention strategies for struggling students, campuses, and districts; and teacher effectiveness. The bill specifies that at least $100 million of the $400 million must be allocated in each year of the biennium to improve teacher effectiveness.

Revenue streams for public education

Public education in Texas is funded by both state appropriations and local property tax revenue. Four major sources provide state funding to public education — the Foundation School Program (FSP), the Permanent School Fund (PSF), the Available School Fund (ASF), and the State Textbook Fund. Most state funding — including money for maintenance, operations, technology, and textbooks — is distributed to school districts through the FSP.

Foundation School Program. Through the FSP, school districts receive part of their total state appropriation — their target revenue hold-harmless amount, which guarantees a school district an amount equal to its 2009-10 school year appropriation, or the amount the district would receive using the school finance formulas, whichever is higher. The formulas distribute funds among school districts using weights and adjustments based on student and district characteristics to account for the varying costs of educating different types of students and for school district property wealth. The state's statutory financial obligation is determined by the sum of the amounts to which each school district is entitled.

Permanent School Fund. The PSF is a trust that holds state lands and mineral rights. Its investment returns are constitutionally dedicated to the benefit of Texas public schools, and if the fund's investment performance permits, a percentage of the fund's value is transferred to the ASF. The distribution rate is adopted by the State Board of Education (SBOE) prior to each legislative session. The Legislature appropriates money transferred to the ASF to the State Textbook Fund, which funds textbooks for local school districts. Remaining funds go to school districts on a per student basis.

The PSF is expected to transfer $1.9 billion to the ASF for fiscal 2012-13. The SBOE voted in January 2011 to allow 4.2 percent of the value of the PSF to be transferred to the ASF in fiscal 2012-13, an increase from the 3.5 percent distribution rate adopted for fiscal 2010-11. While an increase in distributions to the ASF does not increase the total amount appropriated to public schools, more ASF dollars reduce the amount of general revenue lawmakers must use for the state's existing school finance obligations.

The ASF consists of distributions from the PSF and revenue from one-fourth of motor fuels taxes and one-fourth of occupations taxes. To preserve the principal of the PSF, Article 7, sec. 5 of the Texas Constitution caps the percentage of PSF investment returns that may be distributed to the ASF and prohibits any distribution in years when the PSF value falls below a certain level.

Before the 2009 regular session of the 81st Legislature, the comptroller's biennial revenue estimate indicated that the ASF likely would not receive a distribution from the PSF during fiscal 2010-11 because the PSF had experienced a significant decrease in the value of its assets. The Legislature used federal Recovery Act funds to compensate for the loss of the distribution amount. During fiscal 2010-11, the PSF experienced increased returns, allowing an estimated $1.14 billion distribution to the ASF. This amount was added to the per-student distribution, which reduced the need for general revenue appropriations to the FSP in fiscal 2010-11.

Facilities funding. Most new school facilities are financed by bonds approved by local school district voters and paid with local property-tax revenue. The PSF may guarantee payment of bonds issued by school districts for maintenance and construction of instructional facilities, allowing school districts to obtain lower interest rates for repayment of the bonds. The state provides facilities funding through the Instructional Facilities Allotment and the Existing Debt Allotment.

Other general revenue appropriations. The Teacher Retirement System is funded with investment returns from the corpus of the fund and with general revenue contributions from the state and employees through a percentage of employee payroll determined by the Legislature. The payroll percentage contribution cannot be less than 6 percent under Texas Constitution, Art. 16, sec. 67(b)(3).The School for the Deaf and the School for the Blind and Visually Impaired are funded with general revenue funds.

Additional federal funds. The state has applied for $830 million in federal funds to hire and retain teachers. A federal law enacted in August 2010 appropriated $10 billion to states to fund teacher salaries, with funds distributed to states through existing statutory formulas. Each state must apply to the U.S. Department of Education to receive its portion of the funds. A provision of the bill that applies only to Texas requires the state to include in its application a guarantee to maintain the same level of state appropriations to public education from the time the money is received through 2013 in order to receive the federal funds. Gov. Perry has said compliance with the guarantee would violate the Texas Constitution by requiring the governor to dedicate funds on behalf of future legislatures.

The U.S. Department of Education in September 2010 denied the state's application to receive the funds, citing the absence of a guarantee to maintain funding levels through 2013. Later that month, the state of Texas sued the U.S. Department of Education, seeking to overturn the agency's rejection of the state's application. Texas has until September 2011 to reapply and provide the guarantee. Members of Congress are seeking to remove the provision requiring the guarantee. The Senate base budget would appropriate these funds to local school districts should the state receive the $830 million.

Budget drivers

A decrease or increase in local property tax revenue will increase or decrease the state's financial obligation to public education under the school finance formulas. In addition, every biennium, the state's basic financial obligation to the public education system increases to account for the number of new students enrolling in Texas schools. TEA expects higher-than-average student enrollment growth in fiscal 2012-13, with 170,000 new students projected to enroll, for a total enrollment of almost 5 million students.

Spending on TRS is determined by the number of current employees and the total amount of payroll for those employees, as well as by the state's contribution rate. The current state contribution rate is 6.64 percent of TRS active members' payroll, and the current member contribution rate is 6.44 percent of payroll.

Selected budget issues

Decreased funding for Foundation School Program. The House base budget for fiscal 2012-13 would appropriate $32.8 billion in all funds to the FSP. Of this, $26.7 billion would be general revenue and general revenue-dedicated funds, a reduction of $953 million from fiscal 2010-11. The Senate base budget would appropriate $33.3 billion in all funds. Of this, $27.2 billion would be general revenue and general revenue-dedicated funds, a reduction of $453 million.

The state's statutory financial obligation to school districts is determined by the sum of the amounts to which each district is entitled. The LBB has estimated the state's financial obligation to be $42.6 billion, which takes into account increased student enrollment and decreased local property tax revenue. The House base budget appropriation to the FSP for fiscal 2012-13 is estimated to be $9.8 billion below statutory funding obligations, and the Senate base budget appropriation would be $9.3 billion below. Neither base budget accounts for student enrollment growth, nor would either supplement the projected decrease in local revenue resulting from decreased property values. Because the school finance system is set by statute, the Legislature would have to amend the Education Code to permit a state appropriation to the FSP below the statutory financial obligation.

Funding for prekindergarten. Prekindergarten is a program for 3- or 4-year-old children to prepare them developmentally, academically, and emotionally for kindergarten. In the 2009-10 school year, 1,024 school districts offered state-supported half-day prekindergarten, and Texas public schools served a total of 214,694 prekindergarten students. Of these students, about 84 percent were minorities and about 89 percent were classified as economically disadvantaged. In the 2009-10 school year, 10,170 prekindergarten teachers were employed in Texas.

Prekindergarten in Texas is funded through tuition and through state and federal grants and appropriations. The state spent $703 million from the FSP for prekindergarten in the 2009-10 school year, an average of $3,650 per student, per year for half-day prekindergarten. The state has two grant programs through which school districts can receive additional state funds for pre-kindergarten. The early start grant awards funds to expand existing half-day programs to a full day or to start new programs at campuses without them. It served 95,352 students in the 2009-10 school year. For fiscal 2010-11, $208.6 million in general revenue funds were appropriated to the early start grant. Texas School Ready, an early childhood school readiness program, is a competitive grant for prekindergarten programs that serve at least 75 percent low-income children. In the 2009-10 school year, 40,986 students in 1,863 classrooms participated in the program. In the current school year, 1,942 schools or centers are participating. The Legislature appropriated $15 million in general revenue funds to the early childhood school readiness program for fiscal 2010-11.

Under the House and the Senate base budgets, school districts would receive funding for half-day prekindergarten programs through the FSP. The House base budget would not appropriate any funds outside of FSP payments for prekindergarten or early childhood education grant programs. The Senate base budget would appropriate $200 million for a grant with which school districts could choose to fund prekindergarten and early childhood education.

Funding for teacher incentive pay programs. The District Awards for Teacher Excellence (DATE) program is a non-competitive grant for which all district and charter schools may apply to reward certain classroom teachers with salary supplements. DATE was appropriated $395.6 million in general revenue funds for fiscal 2010-11. The House base budget for fiscal 2012-13 would not fund this program. The Senate base budget would instead appropriate $200 million directly for teacher incentive pay.

All district and charter schools currently are eligible for DATE funding and must provide a 15 percent match in funds. At least 60 percent of the funds must be awarded to classroom teachers who improve student achievement. The remainder may be used for stipends for mentors or to provide incentives to teachers certified in subjects they teach, especially in critical areas such as math and science, and those holding advanced degrees. According to the LBB, about 213 school districts and charter schools, serving a little less than half the state's students, participated in the program in 2008-09, with district awards ranging from about $4,000 to more than $13 million, with an average grant of about $700,000.

Instructional materials. The House and the Senate base budgets each would appropriate $308 million in all funds for fiscal 2012-13 to fund continuing contracts for textbooks and other instructional materials, a 30 percent decrease in general revenue from fiscal 2010-11 spending. Neither base budget would fund textbooks and instructional materials under Proclamation 2011, which includes English, language arts, and reading materials, and neither would fund supplemental science materials scheduled to be purchased in fiscal 2012-13. Neither would appropriate the total of the amount distributed from the PSF to the

ASF for textbooks and other instructional materials; both would appropriate remaining funds to the FSP.

TRS pension trust fund. The House base budget would appropriate $3.3 billion in all funds to the TRS pension fund, and the Senate base budget would appropriate $3.1 billion. Each proposal would reflect a decrease in the state contribution from 6.64 percent to 6.0 percent. Because state law sets the employee contribution rate at 6.4 percent and prohibits the state from contributing a smaller percentage than the employee contribution, the statute would have to be amended to reduce the employee contribution percentage and to allow a 6 percent contribution by the state. The fund's 2009 actuarial valuation found that a state contribution rate of 7.72 percent is needed to amortize the fund, assuming the member contribution rate remains 6.4 percent of payroll. To maintain the current benefit structure would require a state contribution rate greater than 7.7 percent in future biennia.

Higher Education

State appropriations for higher education provide funding for instruction, student services, and administration at 35 general academic teaching institutions (with three new institutions opening in 2011), nine health-related institutions, 50 community and junior college districts, three lower-division state colleges, the state technical colleges, and the Texas Higher Education Coordinating Board (THECB).

State appropriations also fund higher education employee benefits and the Higher Education Fund (HEF), a constitutionally authorized fund for new construction and excellence programs for public universities that are not eligible for Permanent University Fund (PUF) proceeds. State appropriations also go to Texas A&M University System agencies that provide research, extension, and service, such as the Texas Forest Service and the Texas AgriLife Extension Service. Tuition revenue bond debt service also is funded with state appropriations.

Fiscal 2010-11 spending for higher education agencies totaled $22.7 billion in all funds, of which $15.6 billion was general revenue and general revenue-dedicated funds. The federal Recovery Act provided $326.9 million for higher education for fiscal 2010-11, which included $227 million for formula and incentive funding and $99.9 million for new initiatives.

In early 2010, all sectors of higher education identified a total of $574 million in potential reductions to decrease their fiscal 2010-11 general revenue and general revenue-dedicated funds spending by 5 percent. Certain programs were partially exempted, bringing actual reductions for higher education agencies to $518.4 million, more than 41 percent of the 5 percent reduction among all state agencies. THECB was required to reduce its budget by $23.1 million. It also was directed not to spend $24 million for certain financial aid programs until final budget reductions are determined by the 82nd Legislature. No sectors of higher education were exempt from the additional 2.5 percent reductions to fiscal 2011 spending required of state agencies, and proposed cuts will total $142.6 million.

The House base budget for fiscal 2012-13 would appropriate $21.1 billion in all funds to support higher education, and the Senate base budget would appropriate $21.6 billion. The House base budget would appropriate $13.6 billion in general revenue and general revenue-dedicated funds, a decrease of about $1.9 billion, or 12.7 percent, from fiscal 2010-11 spending. The Senate base budget would appropriate $14.1 billion in general revenue and general revenue-dedicated funds, a decrease of $1.4 billion, or 9.3 percent.

Both base budgets propose reductions in funding to student financial aid programs, but the Senate base budget contains a $50 million contingency rider for financial aid. Both base budgets also would reduce formula funding for general academic institutions and most of the health-related institutions, higher education group insurance, and special items. The House base budget would eliminate funding for four community colleges, the Texas Research Incentive Program (TRIP), and the Professional Nursing Shortage Reduction Program. It would eliminate or reduce numerous other programs administered by THECB. The Senate base budget does not propose closing any community colleges but instead would decrease formula funding by 5 percent. The Senate base budget also would eliminate or reduce by 25 percent the funding for several programs at THECB. Neither base budget anticipates funding for enrollment growth at any higher education institution.

Gov. Perry's base budget would spend slightly less than the House base budget for higher education and would shift about $1.3 billion among certain items. The governor would eliminate tuition waivers (except for those for the military), reduce special-item funding, and require institutions to realize savings through increased faculty productivity. The funds from these reductions would be used to increase and combine TEXAS Grant and Tuition Equalization Grant funding, increase system discretionary funding, and restore formula funding for general academic, health-related, and two-year institutions.

Revenue streams

Public higher education institutions and agencies are funded from various sources, but the major sources for core instruction and operations are tuition, fees, and state appropriations. Institutions receive appropriations in lump sums. Unlike most state agencies, they do not have to spend the money within specified funding strategies. State appropriations include:

- direct appropriations through funding formulas and through non-formula appropriations for special items for a particular institution's area of expertise or special need;
- indirect appropriations, or those not made directly to each institution, that are used to pay for staff health insurance, retirement benefits, and Social Security; and
- distributions from the Available University Fund (AUF) and the Higher Education Fund (HEF).

In addition, funds are "trusteed" to THECB for distribution to institutions, mostly to support student financial aid. Most of the remaining trusteed funds provide incentive funding for general academic institutions and the Texas Research Incentive Program, as well as funding for enrollment growth at two-year institutions, grants from the Advanced Research Program, and support for Baylor College of Medicine. State appropriations benefiting private institutions include financial aid programs for Texas residents who attend those institutions.

General academic institutions. General academic institutions receive direct appropriations through both funding formulas and non-formula appropriations. Formula funding is based primarily on an institution's enrollment numbers and the types of courses it offers.

Formula funding. Formula funding calculations include statutory tuition revenue. The statutory tuition rate, which is set by the Legislature, is $50 per semester credit hour for Texas residents. For budgeting purposes, revenue from statutory tuition is estimated. Universities may spend the amount that is collected, even if it exceeds the estimate. About 68 percent of the total appropriation for general academic institutions in fiscal 2010-11 was appropriated for formula funding. For fiscal 2010-11, a portion of the formula was financed with federal Recovery Act funds.

*Non-formula funding***.** A significant portion of funding does not flow through the formulas. About 32 percent of direct funding for institutions and university system office operations for fiscal 2010-11 was non-formula funding. This includes appropriations for "institutional enhancement" and special items, which are projects that are specific either to an institution's area of expertise or a special purpose, such as the McDonald Observatory near Fort Davis operated by the University of Texas at Austin. Special items also can be used to support new programs or to address disparities and other inequities among institutions. A large portion of special item appropriations is institutional enhancement, which can be used for day-to-day operations, such as for hiring faculty.

Non-formula funding also supports debt service for tuition revenue bonds, higher education group insurance, research development funding, excellence funding that supports most general academic institutions, and distributions from constitutional funds. Constitutional funds include the Available University Fund (AUF), which supports the University of Texas and Texas A&M systems, and the Higher Education Fund (HEF), which supports institutions that are not eligible for the AUF. The HEF is funded with general revenue.

Other non-formula funding includes higher education performance incentive initiative funding. The 81st Legislature in 2009 appropriated $80 million in federal Recovery Act funds to THECB for incentive funding for general academic institutions that increase the number of degrees awarded, especially in critical fields, and that increase degree recipients who are at-risk students. The 81st Legislature also enacted HB 51 by Branch, which established TRIP. The program matches certain gifts and endowments at emerging research universities, and lawmakers in 2009 allocated $50 million in general revenue for this purpose.

In addition, HB 51 rededicated the corpus of the Permanent Higher Education Fund (PHEF) endowment, which is separate from the annual HEF allocations of general revenue funds, to a new purpose. The PHEF originally was intended to become a permanent endowment to support PUF ineligible institutions. The estimated market value of the endowment at the end of September 2010 was almost $558.3 million. The corpus was rededicated with voter approval of Proposition 4, which amended the Texas Constitution to establish the National Research University Fund (NRUF). The NRUF is intended to provide funding to enable emerging research universities in Texas to achieve national prominence as major research universities if they reach certain benchmarks.

Institutions also have access to funds generated outside the state appropriations process. Examples include board-authorized tuition, also known as designated tuition, as well as fees, auxiliary income, indirect cost recovery income from research grants and contracts, and gifts.

Health-related institutions. Most health-related institutions offer undergraduate medical, nursing, pharmacy, allied health, and dental programs. They also provide residency training and graduate medical education to new physicians.

Health-related institutions receive direct state appropriations through formula funding. They also receive non-formula funds from revenue generated by patient care, special-item funding, funding for employee benefits and tuition revenue bond debt service, and interest earnings from tobacco settlement funds. For budgeting purposes, income from patient care is estimated, and institutions may spend whatever amount is collected. A portion of formula funding for fiscal 2010-11 was financed with federal Recovery Act funds.

Health-related institutions also have access to funds outside the appropriations process, including certain tuition revenue, indirect cost recovery, grants, and gifts. Special-item funding supports residency programs, academic outreach, public service, research, and other items. Health-related institutions are eligible for constitutional funding from the AUF and the HEF, just like general academic institutions.

Texas A&M System agencies. In the Texas A&M System, agencies focus on research, extension, or services, such as emergency response, training, and educational programs. They do not receive contact-hour, formula-based funding and do not generate tuition and fees like other institutions, although some may charge fees for their services. They are eligible to receive funds from the PUF. Their staff benefits, including employee group health insurance, are paid for in the same way as other higher education institutions.

Community colleges. Community colleges are funded with state general revenue funds through formula funding primarily based on student contact (classroom) hours. They also are supported by local property tax revenue and by tuition and fees. Community colleges are not eligible for HEF or AUF allocations or for state tuition revenue bonds. Certain institutions receive appropriations for special items. Community colleges also have access to funds trusteed to THECB for enrollment growth for institutions that meet specific growth criteria, funds for institutions that increase adult basic education, and new campus funding.

State appropriations must be used exclusively to pay salaries of instructional and administrative employees and to buy supplies and materials for instruction. For fiscal 2010-11, a portion of the formula was financed with $15 million of federal Recovery Act funds. No state funding is provided for physical plant operations or maintenance of facilities. Those costs are borne by the institutions and usually funded by local property taxes. Tuition and fees also provide revenue for community colleges, along with state funding for employee health and retirement benefits.

Selected budget issues

Reduced funding for universities. The House base budget would decrease general revenue funds for general academic institutions and system office operations by $562.8 million from current spending levels. This would include a 10 percent decrease of $312.7 million in formula funding. The Senate base budget would decrease funding to general academic institutions and system operations by $398.8 million from current levels. It would decrease formula funding by $158.2 million, or 5 percent. Both base budgets propose a 25 percent reduction in special-item funding for all higher education institutions. Neither of the base budgets contains funding for enrollment growth.

Many institutions have said any additional reductions in state appropriations beyond those already made could lead to increased tuition and staff layoffs, as well as faculty buyouts and unpaid furloughs. For example, at UT-Austin, roughly 65 percent to 70 percent of the academic budget is attributed to the cost of employing people, and officials have said proposed reductions in the House and the Senate base budgets would result in the loss of hundreds of jobs, as well as larger classes, fewer courses, and enrollment caps. Others have said that reduced state appropriations, zero funding for enrollment growth, and reductions in student financial aid funding would negatively affect the affordability and quality of higher education.

Decreased appropriations to health-related institutions as proposed in the House and Senate base budgets could lead to faculty and staff layoffs and reductions in services to students and patients. Other results could include reduced research, enrollment caps, and fewer health care graduates, according to university leaders.

Student financial aid. Student financial aid programs trusteed to THECB include the TEXAS Grant program, the state's primary grant program, which provides grants to financially needy students at public institutions; the Texas Educational Opportunity Grants program (TEOG), which awards grants to students attending public community, technical, or state colleges, with the highest priority given to needy students; the Tuition Equalization Grant (TEG) program, which provides grant aid to students attending private, independent institutions; Texas Work Study, which allows students to earn money to pay for part of their educational expenses by working at certain types of jobs; and the B-on-Time Loan program, which provides no-interest, forgivable loans to students who graduate from college under certain conditions.

The House base budget would decrease general revenue funds to THECB by $675.8 million, and the Senate base budget decrease would be $513.5 million. The decreases would result primarily from $431.2 million in reductions to funding for student financial aid programs. The base budgets recommend funding grants only for students already receiving financial aid from certain programs. Some university officials say they will try to redirect other grants to students who would otherwise receive a TEXAS Grant and try to put more loan money into their financial aid packages.

TEXAS Grants. TEXAS Grants would be funded at $365.7 million, which is $256 million below fiscal 2010-11 funding levels, a 41 percent decrease. This program will serve about 111,400 students in fiscal 2010-11. The projected number of students that would be served in fiscal 2012-13 is 50,900. THECB had requested an additional $421 million, which would serve all renewal students plus 80,000 new students.

TEOG. Texas Education Opportunity Grants would be funded at $6.9 million, $17.2 million below 2010-11 funding levels, a 71 percent decrease. This program will serve about 12,000 students in fiscal 2010-11. The projected number of students that would be served in fiscal 2012-13 is 3,600. THECB has requested an additional $27 million for this program, which would serve all renewal students plus 12,800 new students.

Community college funding. Texas community colleges enroll more than 50 percent of the students in public higher education in the state. THECB has projected enrollment growth of 19 percent for fiscal

2012-13, but it could be as high as 22.6 percent, according to the Texas Association of Community Colleges (TACC).

The House base budget would decrease general revenue funding to public community colleges by $38.0 million, mostly by eliminating funding for four community colleges: Ranger, Odessa, Brazosport, and Frank Phillips. These colleges have reported contact hour decreases since 1990-91 and were recommended for zero funding because of the decline in educational activity. Community college officials say that ending state support of the four community colleges as proposed in the House base budget would effectively end these colleges as viable institutions in their respective communities. The Senate base bill would reduce funding to community colleges by $88.4 million, mostly through a 5 percent reduction in formula funding.

The House base budget also would reduce state contributions to higher education group insurance for community colleges by $253.8 million, an 81.4 percent decrease from fiscal 2010-11 spending. The contribution rate would be $75 per eligible employee, the same as for independent school districts. The Senate base budget would reduce state contributions for higher education group insurance by $113.5 million, resulting in a state contribution rate that was 50 percent of other state employee premium rates.

State appropriations for community college health insurance benefits for fiscal 2010-11 totaled $328.2 million. This amount included funds for insurance benefits for local community college district employees working in positions eligible to be paid with state general revenue funds, regardless of whether their salaries actually were paid with state funds, as directed through the general appropriations act. Community colleges are required to provide health insurance through ERS, and if state support declines, those costs would have to be borne by the local colleges. Some colleges say they would have to increase tuition and taxes to pay for it.

Many colleges have said that to make up for reductions in formula funding, they will have to increase tuition. Other options would be reducing access to classes and advisers, eliminating programs, not purchasing new technology, or reducing staff. Community college officials say that the goals of closing the gaps in higher education could not be met with the funding levels proposed in the base budgets.

Incentive funding. General academic institutions receive incentive funds based on the number of degrees awarded. Additional funding is awarded if the degree is in a critical field or the recipient is an at-risk student. The 81st Legislature in 2009 allocated $80 million in one-time federal Recovery Act funding to this initiative. Neither the House nor the Senate base budget for fiscal 2012-13 proposes any federal funding for this initiative. THECB had requested $80 million to continue it.

The Texas Research Incentive Program (TRIP), established by HB 51 in 2009, provided $50 million in matching funds and incentives to support emerging public research universities. The House base budget would eliminate TRIP funding, and the Senate would decrease TRIP funding by 25 percent, to $35.6 million for fiscal 2012-13. University officials say that cuts beyond the initial 5 percent reduction taken in 2011 could hinder the state's seven emerging research institutions' efforts toward attaining tier-one research status.

Judiciary

Article 4 covers the judicial system of Texas — two high courts, 14 intermediate appellate courts, 454 state district courts, and 2,243 county, municipal, and justice-of-the-peace courts. The state pays for almost all functions of the Texas Supreme Court and the Court of Criminal Appeals, as well as most functions of the 14 state courts of appeal. The state also pays:

- the base salaries of all 552 appellate and district judges;
- some of the travel expenses for district judges with jurisdiction in more than one county;
- salary supplements for constitutional county, statutory county, and statutory probate judges;
- salaries for child support and child protection court associate judges; and
- salaries and expenses for prosecutors.

Some of the appellate courts receive funding from the counties in which they are located. Counties cover the cost for most county and justice-of-the-peace court personnel, and cities pay for municipal court personnel, as well as those courts' capital and operating expenses.

Other state-funded judiciary functions include the Office of Court Administration (OCA), the State Law Library, the Office of the State Prosecuting Attorney, the State Commission on Judicial Conduct, the Court Reporter's Certification Board, the Judiciary Section of the Comptroller's Office, and the Public Integrity Unit.

Total funding for the judiciary in fiscal 2010-11 was \$673.9 million. The LBB calculated an adjusted 5 percent reduction for Article 4 agencies for fiscal 2010-11 of \$4.3 million in all funds. The additional 2.5 percent cuts will total \$4.6 million, with the OCA making the largest cut of about \$985,000.

The House and the Senate base budgets for fiscal 2012-13 would appropriate to Article 4 about \$604.2 million in all funds, of which \$429.1 million would be general revenue and general revenue-dedicated funds. This would be an overall decrease to Article 4 of \$69.7 million or 10.3 percent from fiscal 2010-11 spending. Among the major cuts found in both base budgets are the elimination of funding for the State Law Library, the folding of the Office of the State Prosecuting Attorney into the OCA, and the elimination of funds appropriated in fiscal 2010-11 to pay for civil legal aid services.

Budget drivers

Court budgets are determined largely by salaries for judges and staff. Statistics on the number of cases resolved compared to the number filed, both per court and per judge, help to gauge staffing needs and determine where more courts might be needed. In general, the number of cases filed increases every year, with criminal case filings increasing faster than civil case filings in most parts of the state. The Supreme Court and the Court of Criminal Appeals have some discretion over which cases they hear, but the intermediate appellate courts must dispose of every case filed. As the number of filed cases has increased relative to the number of judges, the appellate courts have relied on staff increases and on visiting judges to help avoid a backlog.

Selected budget issues

Judicial staffing. Staff salaries make up 90 to 95 percent of the budgets of Texas appellate courts. Both the House and the Senate base budgets would fund core judicial functions at 98 percent of fiscal 2010-2011 spending. They would fully fund the salaries of all 456 district court judges. Both base budgets would reduce by 15 percent certain "ancillary" court functions, such as grants for judicial education and indigent defense grants to counties. Judicial education grants would be reduced from \$20 million in fiscal 2010-11 to \$17.1 million for fiscal 2012-13. Appropriations for indigent defense would be reduced from \$63.4 million in fiscal 2010-11 to \$54.7 million for fiscal 2012-13, a 13.7 percent decrease.

Texas State Law Library. Both the House and the Senate base budgets would eliminate funding for the Texas State Law Library, and its holdings would be transferred to the library of the University of Texas School of Law. The Texas State Law Library is a public library that also serves the Supreme Court of Texas, the Court of Criminal Appeals, the Office of the Attorney General, and other state agencies. It received $2.1 million in fiscal 2010-11 and had 13 FTEs (full-time equivalent positions).

Legal aid funding shortfall. Civil legal aid provides emergency legal services to Texans who fall below 125 percent of the poverty line. Family law issues make up about half of the legal aid caseload. A recent high-profile legal aid case involved the state's removal of more than 200 children from a ranch operated by a polygamist group in Schleicher County in West Texas.

Since the mid-1980s, attorneys in Texas have taken the short-term interest on funds held on behalf of clients and turned it over to the Texas Access to Justice Foundation, which is overseen by the Supreme Court of Texas. The foundation's function is to disperse grants to legal aid groups throughout Texas. Funding has declined because of the extended economic recession. As part of its efforts at economic recovery, the Federal Reserve has lowered the benchmark interest rate to historic lows of zero to 0.25 percent, affecting the Interest on Lawyers' Trust Accounts (IOLTA). The drop in interest rates diminished funding for the IOLTA program from $20 million in 2007 to $5.5 million for 2010. These funds are generated and administered outside of the state appropriations process.

The 81st Legislature appropriated $20 million to the Supreme Court for fiscal 2010-11 to make up for the IOLTA shortfall. Neither the House nor the Senate base budget for fiscal 2012-13 would appropriate funds for civil legal aid to make up for the IOLTA shortfall.

Criminal Justice

Article 5 covers state agencies responsible for criminal justice and public safety. The largest is the Texas Department of Criminal Justice (TDCJ), which operates the adult correctional system. TDCJ receives about two-thirds of the general revenue and general revenue-dedicated funds in Article 5. Together, the Texas Youth Commission (TYC) and the Texas Juvenile Probation Commission (TJPC), which are responsible for juvenile offenders, receive about 8 percent of Article 5's general revenue and general revenue-dedicated funding. Other Article 5 agencies include the Department of Public Safety (DPS), Texas Alcoholic Beverage Commission (TABC), Commission on Jail Standards, Adjutant General's Department, Military Facilities Commission, and two boards that license and regulate criminal-justice professionals.

General revenue and general revenue-dedicated funds make up about three-quarters of Article 5 spending, and most agencies are funded primarily with these funds. One exception is DPS, which before reductions made for fiscal 2010, received about 30 percent of its fiscal 2010-11 funding from State Highway Fund 6. Fund 6 receives revenue from federal reimbursements, state motor fuels taxes, motor vehicle registrations, and various fees.

In early 2010, Article 5 agencies identified $351.1 million in potential reductions that would decrease their fiscal 2010-11 spending by 5 percent. Of the potential cuts, $102.9 million in reductions was approved, bringing the overall decrease in spending for Article 5 to 1.2 percent. The TDCJ was the agency with the largest adjustment made to its potential reductions, with final cuts of $55.0 million, rather than $294.3 million, being required.

No Article 5 agencies are exempt from the additional 2.5 percent reductions to fiscal 2011 general revenue and general revenue-dedicated spending being required of state agencies. These cuts will total $88.4 million for Article 5 agencies, with TDCJ being required to make the largest cut at $75 million.

The House base budget would appropriate $7.6 billion in general revenue and general revenue-dedicated funds for Article 5 in fiscal 2012-13, a decrease from fiscal 2010-11 spending levels of $1.1 billion, or 12.3 percent. The Senate base budget would appropriate slightly more, $7.8 billion in general revenue and general revenue-dedicated funds for Article 5. This would be a decrease of $864.4 million, or 9.9 percent, from fiscal 2010-11.

Both the House and the Senate base budget proposals would reduce funding about the same amount for health care for incarcerated adults and for the closing of one prison unit. Both would reduce funding that supports prison operations, but the House reduction would be larger. Other cuts, in both bills but for different amounts, include funds to contract for beds in private correctional facilities and for inmate treatment and transition services.

Both the House and the Senate base budgets assume $1.1 million in revenue gains relating to Article 5 agencies. About one-half of the revenue would come from requiring the Commission on Jail Standards to expand its inspection fees program to include all jails, instead of the limited number of jails that it currently charges for inspections. The rest would come from a new $50 fee for distance learning exams administered by the Texas Commission on Law Enforcement Officer Standards.

Budget drivers for adult criminal justice

Spending on adult criminal justice is driven mainly by trends in the number of adult offenders incarcerated by the state and the number on parole and probation. Operating state prisons accounts for the bulk of spending on adult criminal justice. Since July 2005, Texas periodically has leased beds from counties when it needed additional space.

In January 2011, the LBB released population projections for adult and juvenile criminal offenders. The projections are based on current laws, statutes, policies, and practices, and changes to these factors could change the projections.

Prison population and state capacity. At the end of 2010, TDCJ had an operational capacity of 156,673 beds, with no temporary contract beds from the counties. The "operational capacity" of TDCJ is calculated as 96 percent of bed capacity to account for the need to house inmates appropriately and for flexibility in moving inmates. Under Government Code, sec. 499.121, the state has a 45-day deadline for moving prisoners from county jails to state facilities once they have been sentenced to a state facility and all processing for the transfer has been completed.

While the adult incarcerated population is expected to be about 0.3 percent below the state's capacity in fiscal 2011, the population will grow to slightly more than capacity annually for each year of fiscal 2012-13, according to estimates released by the LBB in January 2011. In fiscal 2012, the population is estimated to be 0.2 percent above the state's capacity and in fiscal 2013 it is estimated to be 0.7 percent above capacity. This translates to the offender population exceeding prison capacity by 313 at the end of fiscal 2012 and by 1,121 by the end of fiscal 2013.

The number of offenders sent to Texas prisons during the next biennium could be influenced by funding for the diversion and treatment programs and beds first authorized in 2007 and fully funded in fiscal 2010-11 by the 81st Legislature.

Parole population. The LBB projects the number of adults being supervised by the state parole system to increase annually through fiscal 2013, according to its January 2011 report. The population is growing more slowly than previously predicted due to a slight decrease in parole approval rates and a continued decrease in parole revocation rates, according to the LBB's January 2011 report. The end-of-month yearly average is projected to be 81,545 parolees in fiscal 2011; 81,663 parolees in fiscal 2012; and 82,280 parolees in fiscal 2013.

Probation population. The number of offenders on probation (community supervision) for committing felony offenses began an annual increase in fiscal 2006 that is projected to continue through fiscal 2016, according to the LBB. The end-of-month yearly average for probationers under direct supervision for felony offenses is estimated to be 173,099 in fiscal 2011; 173,558 in fiscal 2012; and 173,810 in fiscal 2013.

The number of offenders placed on probation for committing misdemeanor offenses is projected to decrease slightly each year, according to the LBB's January 2011 report. It is expected to be 109,651 in fiscal 2011, drop to 107,601 in fiscal 2012, and drop again to 105,551 in fiscal 2013. These numbers reflect those actually placed on supervision, not an end-of-month yearly average.

Budget issues for adult criminal justice

Prison, parole staffing. A large portion of the budget of TDCJ goes to prison operations, such as food, fuel, and utilities, and to staffing for both correctional officers and personnel who support prisons, such as those in food and laundry services, agricultural operations, and transportation.

The House base budget would reduce TDCJ's appropriation for operating prisons and other lock-ups, which would result in the elimination of about 1,500 positions involving unit support staff. The Senate base budget would apply a smaller reduction, resulting in a cut of about 800 positions.

TDCJ currently has funding for about 96 percent of its 26,350 correctional officer positions. Both the House and the Senate base budget proposals would eliminate the 250 correctional jobs at the one prison unit that would close under both proposals.

Salary freeze, cuts. The House proposal also would freeze the salaries of correctional officers, prison food service and laundry managers, and parole officers at their August 2011 amount, meaning that scheduled career-ladder salary increases could not be made.

Neither the House nor the Senate base budgets would continue funding for a salary increase approved by the 81st Legislature for specific positions. Under the fiscal 2010-11 general appropriations act, correctional and unit-based staff, parole officers, probation officers, and other probation staff received raises of 3.5 percent each year of fiscal 2010-11. TDCJ says that it would need statutory authority to roll back the raises or else would cut staff and use the resulting funds to retain the higher current salaries for remaining staff.

Parole. The House proposal would reduce general revenue funds going toward parole processing, supervision, and services by about $27.6 million, and the Senate proposal would reduce this funding about $9.7 million. These reductions would result in about 90 positions being eliminated under the House proposal and about three positions being eliminated under the Senate proposal.

Neither the House nor the Senate proposal would fund the projected increases in the number of persons supervised on parole. The Senate proposal would maintain total supervision funding at the fiscal 2010-11 level. The parole population is expected to reach 82,280 in fiscal 2013, an increase of 735 over the number in fiscal 2011. Reductions in parole officers and increases in the number of parolees would result in higher caseloads for parole officers, according to TDCJ.

Continuing funding for treatment and diversion programs. In 2007, the 80th Legislature responded to a growing offender population and a projected need for additional prison beds by expanding the agency's diversion and treatment programs and beds, including 1,500 substance-abuse felony punishment (SAFP) beds, 1,400 intermediate-sanction facility (ISF) beds for offenders who violate their parole or probation, 500 beds for offenders convicted of driving-while-intoxicated, and 300 new halfway-house beds. In fiscal 2010-11, TDCJ received full funding for these programs.

The House and the Senate base budget proposals would cut TDCJ's funds for inmate treatment programs. The House base budget would cut funds for substance abuse treatment programs included in the 80th Legislature's treatment and diversion initiative by $32.8 million, and the Senate base budget would cut these funds by $18.1 million. These general revenue cuts would represent reductions from the fiscal 2010-11 spending on these programs of about 19 percent for the House base budget and about 11 percent for the Senate base budget.

Funding for local probation departments. TDCJ sends funds to the 121 local community corrections and supervision departments for the supervision of probationers, diversion of offenders from state prisons, and treatment programs. The state provides about two-thirds of the funding for local probation departments. The agency gives local departments about $1.52 per day for each person on probation for a felony offense and 70 cents per day for each person on probation for a misdemeanor offense, for up to 182 days.

Both the House and the Senate base budgets would eliminate the $27 million that TDCJ sends to local departments for supervising offenders on probation for misdemeanor offenses. The House base budget would reduce the per diem rate for felony probation from $1.52 per day to $1.37 per day, while the Senate base budget would not reduce the rate. Both bills would provide funding for the projected 2012-13 felony probation populations, but at the different per diem rates.

Closing prison units and private correctional beds. Both the House and Senate base budgets would reduce the state's correctional capacity by requiring TDCJ to close the Central Prison Unit in Sugar Land and by reducing the number of private correctional beds. The LBB's projections show that, under current laws, policies, and practices, the number of offenders incarcerated by the state will be just under the state's capacity in fiscal 2011 but then rise slightly each year of fiscal 2012-13.

Under both the House and the Senate base budgets, the Central Unit, which houses about 1,060 offenders, would have to be closed by September 1, 2011. Both proposals would reduce TDCJ's funding by $31.1

million for closing the unit. Proposals have been made for the state to sell or lease the land that the unit occupies, potentially producing more revenue on a one-time basis. The governor's budget proposal estimates a $30 million gain from the sale of the Central Unit's property.

The House base budget would cut by $50.9 million the funds that TDCJ spends on privately operated correctional beds in prisons, state jails, and residential pre-parole facilities. The agency would decide where to make the specific cuts, which would total about 2,000 beds based on fiscal 2010-11 spending. The Senate base budget would cut spending for private beds by $20.6 million, which would translate into about 900 fewer beds.

Other proposals have been made to use changes in sentencing policies or parole policies to reduce the number of offenders sent to state prisons and thereby allow the closure of prison units. Under these proposals, some of the funding for closed prisons would be shifted to supervising offenders in the community.

Budget drivers for inmate health care

The system used to deliver health care to prison inmates is based on a managed care model. It is operated by the Correctional Managed Health Care Committee (CMHCC), which the Legislature created in 1993. The CMHCC's appropriation is within TDCJ's budget. TDCJ contracts through the committee with the University of Texas Medical Branch (UTMB) at Galveston and the Texas Tech University Health Sciences Center (TTUHSC) to provide the statewide managed care network, which is similar to health maintenance organizations that operate in the open market and offer a full range of medical, dental, and psychiatric services to inmates. UTMB's contract covers about 120,200 of the state's about 150,000 inmates, and TTUHSC's contract covers the rest.

The state's costs for inmate health care are driven by the size of the prison population, the age and health needs of inmates, health care costs, and a need to provide a constitutional prison health care system. Fiscal 2010-11 spending for inmate health care will be about $929.8 million, an increase of about $40.6 million for these items from fiscal 2008-09. In the last quarter of fiscal 2010, the cost per offender per day for health care services was $9.88.

Budget issues for inmate health care

Funding for inmate health care. Both the House and the Senate base budgets would reduce funding for managed health care for inmates by $226.6 million in all funds and $222.7 million in general revenue. This total includes reductions realized by limiting payments to certain health care providers to a specific state Medicaid rate and reductions for unit, psychiatric, and pharmacy care and for indirect charges not specified in the provider contract.

The reduced funding in the base budgets contrasts with an increase in funding requested by the Correctional Managed Health Care Committee (CMHCC) in its legislative appropriations request. CMHCC has requested $263.6 million beyond its 95 percent base request, with about 72 percent of the increase going for costs that have been incurred providing services. Another $41.9 million of the request would recover the 5 percent reduction in funds required for agency budget submissions. The CMHCC says these funds would be used to maintain operations and deliver the level of services required by minimum standards. The request for additional funds also would cover hospital and specialty care, pharmacy and drug cost increases, and updated equipment.

In late November 2010, the universities that provide the health care identified expenses that they said will result in a supplemental appropriations request of $67.8 million for fiscal 2010-11 to cover the costs of providing inmate care.

In February 2011, the State Auditor's Office released an audit of correctional managed health care at UTMB.

The auditor examined UTMB's reported funding deficit in fiscal years 2009 and 2010. The auditor concluded that the deficit was caused by UTMB:

- charging reimbursement rates that exceeded standard Medicare, Medicaid, and a major private insurer's amounts;
- authorizing salary increases in fiscal 2008 through 2010;
- charging costs to its correctional managed care division that were not directly related to offender care;
- charging for costs specifically prohibited by the contract or by the state; and
- establishing an organizational structure that resulted in limited independent review and approval of its correctional managed care division and in a lack of coordination with the state's CMHCC.

In its response, UTMB disagreed with most of the auditor's conclusions and said it believes it conforms with generally accepted accounting principles and health care industry practices. The state's CMHCC agreed with an auditor's recommendation that it coordinate with the LBB and UTMB to create transparency and independence for decision making about reimbursement amounts, salaries, and allowable costs. The State Auditor's Office also examined Texas Tech University's provision of inmate health care and found issues that were similar to those identified in its audit of the UTMB, according to the audit report. TTUHSC disagreed with the recommendations in the audit report.

Provision of inmate health care. Funding for CMHCC would be eliminated in both the House and the Senate base budgets. The responsibility for contracting with providers of the managed health care system would be transferred to TDCJ.

In November 2010, UTMB proposed changing its arrangement with the state so that it no longer would operate in-prison medical clinics but would continue its current responsibility to treat inmates at the UTMB hospital in Galveston. UTMB proposed contracting directly with TDCJ, instead of using the CMHCC as an intermediary, and cited a desire to avoid interim budget shortfalls, which have occurred in the past.

Options for providing inmate health care if the current arrangement with UTMB does not continue include the state's providing the care directly or contracting with private medical companies to operate the in-prison clinics. The governor's budget proposal includes $30 million in savings for the state that would be realized by early cancellation of contracts for inmate health care and by exploring private sector delivery of health care or by instructing health care providers to give care according to the constitutional minimum level of care.

Budget drivers for juvenile justice

TYC and TJPC together are responsible for juvenile offenders and receive about 8 percent of general revenue and general revenue-dedicated funds in Article 5.

Several decisions made by recent legislatures have reduced the population of youths in TYC. In 2007, the 80th Legislature made several changes to the TYC in the wake of sexual abuse and other problems in TYC facilities. Changes included prohibiting youths from being sent to TYC for misdemeanor offenses and lowering the maximum age for those in TYC from 21 to 19. In 2009, the 81st Legislature appropriated $45.7 million to TJPC for local programs to divert youths from TYC.

The TYC population at the end of fiscal 2011, according to a January 2011 LBB report, is projected to be 1,689, down from a high of near 5,000 at the end of fiscal 2006. The TYC population is projected to remain relatively stable through fiscal 2016, reports the LBB. Under the projections, the populations of youths will be 1,694 at the end of fiscal 2012-13 and 1,700 at the end of fiscal 2014-15. State-funded capacity during these years, absent any changes to current laws and policies, will be 2,118.

Budget issues for juvenile justice

Closing Texas Youth Commission facilities. Both the House and the Senate base budgets would limit TYC to a maximum of 1,600 beds beginning January 1, 2012, but this limit would not include halfway houses. TYC would be authorized to close up to three TYC facilities. The agency would be required to report by October 1, 2011, a detailed plan to reduce capacity. In both proposals, the agency's budget would be reduced by $54.3 million in general revenue funds and 503 job positions would be cut, primarily due to the proposed reduction in capacity and population, according to the LBB.

Currently, TYC operates 10 institutional facilities and nine halfway houses and contracts with 12 private providers and one county for residential services. The TYC population will be about 400 below state capacity in fiscal 2012 and 2013, according to the projections released by the LBB in January 2011.

Legislators may consider a proposal that would downsize TYC significantly by sending funds to counties to handle juvenile offenders and funding a small number of state-run facilities for the most violent youths. The Sunset Advisory Commission has recommended that TYC and TJPC be merged into a new state agency, the Texas Juvenile Justice Department.

Funding to TJPC to divert youths from TYC. For fiscal 2010-11, the 81st Legislature added a new appropriation to TJPC for local programs to divert youths from TYC. Commitments of youths to TYC have dropped from 1,589 in fiscal 2009 to 1,119 in fiscal 2010. Both the House and the Senate base budgets would fund this item at the fiscal 2011-12 spending level with about $39 million in general revenue funds, but whether to continue this funding and at what level may be debated.

Budget issues for public safety

Department of Public Safety border security operations. The House base budget would give the DPS $59.6 million for border security operations, while the Senate base budget would fund DPS border security of $64.4 million. DPS' border security funding in the Senate base budget would be the same as it was in fiscal 2010-11, while the House proposal would exclude funding for requested capital expenditures.

The House base budget would appropriate $19.5 million from Highway Fund 6 for border security, and the Senate base budget would appropriate $23.4 million from Fund 6. The money would be spent on salaries, training, operations, and equipment for highway patrol, criminal investigation, Texas Rangers, and aircraft operations.

The remaining funds, about $40.0 million from both the House and the Senate base budgets, would come from the general revenue-dedicated Operators and Chauffeurs License Account 99 and would be spent on local border security, including for DPS troopers along the border; Texas Ranger positions; increased patrol and investigation costs for DPS and local peace officers; operations of the Texas Military Forces; operations of the Border Operations Center and the Joint Operations and Intelligence Centers; and operations of the Rio Grande Valley Border Security and Technology Training Center.

Border security operations for DPS also would be funded in both the House and the Senate base budget proposals with a $13.0 million appropriation from the general revenue-dedicated Operators and Chauffeurs License Account 99 to the Trusteed Programs in the Governor's Office. In addition to those funds, the Senate base budget would appropriate $30.0 million for border security to the governor's trusteed programs and would require that it be transferred to DPS for local border security.

Natural Resources

Natural resources agencies in Article 6 are entrusted with protecting, managing, and developing the state's agricultural, wildlife, environmental, water, and oil and gas resources, as well as state parks and lands. These agencies include the Texas Commission on Environmental Quality (TCEQ), Texas Parks and Wildlife Department (TPWD), General Land Office (GLO), Texas Water Development Board (TWDB), Texas Railroad Commission (RRC), Texas Department of Agriculture (TDA), Texas Animal Health Commission (TAHC), Texas State Soil and Water Conservation Board (TSSWCB), and river compact commissions.

Fiscal 2010-11 spending levels for natural resources agencies totaled about $3.6 billion in all funds, of which $2.2 billion was general revenue and general revenue-dedicated funds. In early 2010, Article 6 agencies identified $89.7 million in potential reductions to decrease their fiscal 2010-11 spending by 5 percent. Of that amount, $83.7 million in reduced spending was approved, bringing the overall decrease in spending for Article 6 to 3.8 percent. Within Article 6, amounts necessary to satisfy debt service requirements for bond authorizations at the TWDB were exempted from a request to propose 10 percent reductions.

Both the House and the Senate base budgets for fiscal 2012-13 would appropriate about $3.1 billion in all funds to Article 6 agencies. The House base budget would decrease funding by $578 million, or 15.8 percent, from fiscal 2010-11 spending levels, while the Senate base budget would decrease funding by $569.1 million, or 15.6 percent.

Both base budgets would appropriate about $1.6 billion in general revenue and general revenue-dedicated funds for fiscal 2012-13. The House base budget would decrease funding by $588.1 million, or 27.1 percent, from fiscal 2010-11 spending levels, and the Senate base budget by $579.4 million, or 26.7 percent.

Both the House and the Senate base budgets would reduce funding for the Texas Emissions Reduction Plan (TERP) by 50 percent and eliminate funding for the Low Income Repair Assistance Program (LIRAP) at TCEQ. Both the House and the Senate base budgets would eliminate funding for grants to develop and acquire new local parks at TPWD and for flood control dam repair and maintenance grants at TSSWCB. Both bills would cut funding and defer payments for certain construction projects in progress at TPWD and would cut funding for state-managed clean-ups of oilfield sites and inspections of oil and gas fields.

The House base budget would include $34.3 million in new revenue from fees, including $10.5 million for coastal erosion from a new commercial landing fee on commercial shipping and passenger vessels docked at Texas port facilities; $8.8 million from various animal disease testing, inspection, and export fees; and $8.6 million from fees imposed on those receiving Department of Agriculture marketing services. The Senate base budget does not include the proposed commercial landing fee for coastal erosion.

Natural resource agencies are funded largely by general revenue and general revenue-dedicated funds. Some, such as TCEQ, are funded mainly by fees, while others, such as the Department of Agriculture, are supported mainly by federal funds.

Selected budget issues

Air quality. Texas must comply with federal Environmental Protection Agency (EPA) air quality standards to reduce ground-ozone, sulfur dioxide (SO2), nitrogen dioxide (NO2), and lead in areas designated by EPA as nonattainment or near nonattainment. EPA is expected to decide by 2012 on proposed revised standards for SO2, NO2, and lead and a lowering of the national ambient air quality standard (NAAQS) for ozone emissions. New rules likely would change the status of several urban areas from attainment to nonattainment, increasing the number of Texas cities that exceed acceptable standards.

Air quality monitoring. EPA is requiring TCEQ to install additional air quality monitoring to comply with new national ozone, SO2, NO2, and lead standards. The House and the Senate base budgets both would reduce general revenue-dedicated funds for air monitoring equipment by $1.48 million and for air monitoring operations by $1.84 million. An exceptional item request that would have provided more monitors to comply with the new NAAQS requirement would not be funded.

TCEQ has indicated that the reductions would result in missing an EPA regulatory deadline for installing about 20 new ozone, lead, SO2, and NO2 air quality monitoring sites in several areas, including Abilene, Amarillo, Austin, Dallas, El Paso, Fort Worth, Houston, Lubbock, McAllen/Edinburg/Mission, San Angelo, San Antonio, Sherman/Dennison, and Wichita Falls. Without the monitors, additional areas of the state would not be in compliance with federal regulations requiring air monitoring, resulting in potential federal funding reductions and more areas designated as nonattainment. TCEQ says the cuts also could cause a loss of federal grants due to delays in installing other types of required monitors, such as those necessary for upper air meteorological monitoring that measures wind speed and direction in the lower atmosphere (up to 10,000 feet) for air quality modeling.

Reduced funding also would lead to discontinuation of about 60 monitoring sites not required by law but installed in response to local concerns about ozone and air toxins. Potentially affected areas include Austin, Beaumont, Corpus Christi, Dallas, Fort Worth, Houston, Navarro County/Corsicana, and Odessa. All non-emergency-related mobile air monitoring activities would be eliminated, including any special air quality studies requested of TCEQ by external entities, such as local governments or citizens.

Emissions reduction. TCEQ has implemented certain emissions reduction programs in an effort to meet national standards for air quality.

The Texas Emissions Reduction Plan (TERP) provides financial incentives to eligible individuals, businesses, or local governments to reduce emissions from polluting vehicles and equipment. Both the House and the Senate base budgets would decrease general revenue-dedicated funds for TERP by $114.3 million, or 50 percent, for fiscal 2012-13. TCEQ has said reductions to TERP could hinder its ability to reduce emissions, making it difficult to achieve State Implementation Plan (SIP) goals. The SIP establishes how Texas intends to abide by the federal Clean Air Act.

The Low Income Repair Assistance Program (LIRAP) is a financial assistance and incentive program for qualified owners of vehicles that fail to meet state emissions standards or whose vehicles are at least 10 years old. Both the House and the the Senate base budgets would eliminate funding for LIRAP for fiscal 2012-13. LIRAP spending levels for fiscal 2010-11 were $100 million in general revenue-dedicated funds. According to TCEQ, 19,981 vehicles were repaired and/or replaced through LIRAP assistance in 2010.

The LBB has recommended including a $100 fuel inefficiency surcharge on the sale of new vehicles that are considered inefficient in their fuel consumption based on national standards. According to the LBB, the $100 surcharge would generate $115.3 million of general revenue during fiscal 2012-13, which could fund efforts to comply with federal air quality standards and fund state programs to reduce pollution, such as TERP and LIRAP.

The LBB also has recommended eliminating a TERP grant program established to encourage development and commercialization of technologies that reduce pollution. According to the LBB, this would allow more of the funds appropriated to the TERP to be applied to more proven emissions reduction efforts.

Water infrastructure and water project funding. The state does not have a dedicated funding source for water infrastructure to support the anticipated future rise in public demand. As reported in the 2007 State Water Plan, by 2060 the available water supply will fall short of the state's demands by 8.8 million acre-feet of water per year (one acre foot = 325,851 gallons). TWDB provides grants and loans to communities to plan, design, and build water and wastewaterrelated projects through the Development Fund, the Economically Distressed Areas Program (EDAP), the State Participation Program, the Water Infrastructure Fund, the Clean Water State Revolving Fund, and the Drinking Water State Revolving Fund. Neither base budget for fiscal 2012-13 would provide any new funding for water infrastructure projects.

TWDB has requested an exceptional item of $17.6 million in general revenue funds for non-self-supporting debt service to finance a total of $200 million in bonds for the Water Infrastructure Fund to be used to fund state water plan projects. The $200 million would account for most of the remainder of Development Fund bond authority estimated to be available. However, the House and the Senate base budgets would not fund this request.

TWDB also has requested $12.1 million in general revenue funds above the baseline request for non-self-supporting debt service funds to finance about $100 million in bonds to fund 35 economically distressed areas projects in the next biennium. These projects are in the planning phase and without additional funding would not be built. The House and the Senate base budgets would not fund this request.

Dam safety. The House base budget would eliminate $13.4 million in funding for TSSWCB's Flood Control Dam Grant Program for fiscal 2012-13. The program provides grants to operate, maintain, repair, and rehabilitate flood control dams across the state.

Texas has 1,995 flood control dams that initially were built to protect agricultural lands and property, rural roads, and small towns. Recent population growth and urban expansion have resulted in many dams originally built as low-hazard dams having to be reclassified as high-hazard dams as downstream development continues. TSSWCB has said that without funding, a backlog of structural repair work to flood control dams could pose a risk to property and life downstream.

Parks operations, construction, and repairs. An ongoing issue for TPWD is upkeep of existing state parks, wildlife management areas, and fish hatcheries. The fiscal 2010-11 budget included $126.8 million in all funds to TPWD for improvements and major repairs at these facilities. For fiscal 2012-13, both the House and the Senate base budgets would decrease this funding by about $52 million, or 41 percent, in all funds.

The House and the Senate base budgets both would reduce all funds to TPWD by $7.8 million, including 76.3 FTEs, by transferring seven state parks to local governments and closing regional offices in Waco and Bastrop. The parks that would be transferred to local governments include:

- Lake Casa Blanca International State Park;
- Big Spring State Park;
- Blanco State Park;
- Lockhart State Park;
- Daingerfield State Park;
- Sebastopol House State Historic Site; and
- The Wyler Aerial Tramway at Franklin Mountains State Park.

Both bills would eliminate funding for grants to develop and acquire new local parks projects, including boating access, outreach and education grants, and hike and bike trail development. Spending for these grants in fiscal 2010-11 totaled $46.7 million in all funds.

The House and the Senate base budgets also would reduce general revenue-dedicated funds by $2.3 million, including 8.6 FTEs, by deferring minor repair projects in the state park system for six months in 2012. Both base budgets would reduce general revenue and general revenue-dedicated funds by $26.9 million for state park capital development, eliminating new facility development at existing parks and reconstruction efforts at Galveston Island State Park, which was damaged by Hurricane Ike in 2008. The House and the Senate base budgets also call for a 25 percent reduction to specified park programs, such as park business development, cultural and natural resources, and interpretation and exhibits, totaling $4.1 million in all funds.

Reduced funding for oil field remediation. The RRC regulates the exploration, development, and production of oil and gas in Texas, including issues related to environmental protection and public safety. The RRC uses the Oil Field Cleanup (OFCU) Fund, consisting of permitting and production fees paid by Texas oil and gas operators, to finance the plugging and clean-up of abandoned wells, leases, pits, and other oil field sites when the responsible operators fail to do so. As of December 31, 2010, the RRC has used the OFCU Fund to plug 31,722 wells and clean up 4,538 sites.

Both the House and the Senate base budgets would reduce the state-managed programs to plug and clean up abandoned oil and gas wells and sites by 25 percent, including a combined $12.7 million decrease in general revenue and general revenue-dedicated funds and 13.6 FTEs. The reductions are expected to result in an average six-month delay in well-plugging projects and clean-ups of oilfield sites. This would decrease by 390 the number of orphaned wells plugged and by 210 the number of oilfield sites cleaned with use of state funds for the biennium.

Both bills also would reduce field operations and enforcement by 12.5 percent, including a decrease of $3.8 million in general revenue and general revenue-dedicated funds and 35.4 FTEs for fiscal 2012-13. This would result in an average 90-day delay in agency inspection activities.

The RRC is requesting restoration of these funds contingent upon passage of legislation recommended by the Sunset Advisory Commission that would make the agency's oil and gas program self-supporting, resulting in new revenue that would replace the OFCU account.

Coastal management and erosion control. The GLO is responsible for managing the 367 miles of Texas coastline from the vegetation line on the beach to 10.3 miles into the Gulf of Mexico, as well as millions of acres of submerged land in the coastal bays. On average, the state loses 235 acres of Gulf shoreline each year from erosion. Erosion is a result of natural processes and has been accelerated by human activities such as navigational dredging practices, ship wakes, and subsidence related to oil and gas development.

The GLO administers the Coastal Erosion Planning and Response Act (CEPRA), a coordinated effort of state, federal, and local entities to address erosion along the Texas Gulf Coast. Under CEPRA, the GLO implements response projects and studies, for which fiscal 2010-11 spending levels were $24 million after 5 percent reductions. Money for the programs is appropriated from sporting goods sales tax receipts and provided to the GLO through an interagency contract with the TPWD. The House base budget would reduce by $12 million, or 50 percent, interagency contracts funding derived from the sporting goods sales tax for these projects. The Senate base budget would reduce this funding by $1.5 million, or 6 percent.

House contingency rider. Contingent upon enactment of legislation, contracts funding for coastal programs in the House base budget would be replaced with funding from new dedicated funding sources recommended by the LBB, including:

- redirecting half of the existing funds from the Outer Continental Shelf Settlement Monies from the General Revenue Fund to the Coastal Erosion Response Account ($4.1 million in general revenue);
- reallocating 25 percent of the Unclaimed Motorboat Fuels Tax Refunds received by the TPWD to the Coastal Erosion Response Account ($10.8 million in general revenue); and
- imposing a $2-per-foot commercial landing fee on commercial shipping and commercial passenger vessels docked at Texas port facilities ($10.5 million).

Approval of this legislation would result in a net decrease of $1.5 million, or 6 percent, from fiscal 2010-11 spending levels for coastal erosion projects.

Economic Development

Article 7 includes agencies charged with supporting business and economic development, transportation, and community development. These agencies include the Texas Department of Transportation (TxDOT), Texas Workforce Commission (TWC), Texas Department of Housing and Community Affairs (TDHCA), Texas Lottery Commission, Texas Department of Rural Affairs (TDRA), and since 2009, Texas Department of Motor Vehicles (TxDMV).

Both the House and the Senate base budgets would appropriate $19.9 billion in all funds for Article 7 agencies for fiscal 2012-13, a 14.3 percent decrease from the $23.2 billion budgeted for fiscal 2010-11. Much of the decrease stems from $2.7 billion in one-time federal Recovery Act funds appropriated to Article 7 agencies in fiscal 2010-11. In the House and the Senate base budgets for fiscal 2012-13, of the funds appropriated to Article 7, TxDOT would receive $15.4 billion, TWC would receive $2.2 billion, TDRA would receive $675.2 million, and TDHCA would receive $379.5 million.

In both base budgets, other funds, such as the state motor fuels tax, would account for more than half of fiscal 2012-13 appropriations for Article 7, with federal funds making up most of the rest. General revenue and general revenue-dedicated funds would make up less than $1 billion of the nearly $20 billion in appropriations for fiscal 2012-13. Both base budgets assume an increase in transportation-related general revenue of $10 million from an increase to the state traffic fine, which currently is $30.

To achieve a 5 percent decrease in fiscal 2010-11 spending, Article 7 agencies identified $42.2 million in reductions, with $6.1 million in reductions approved. The final reduction was less than 1 percent of total general revenue and general revenue-dedicated funds appropriated for Article 7 for fiscal 2010-11. Additional 2.5 percent reductions to fiscal 2011 general revenue and general revenue-dedicated spending total about $5.6 million.

Major reductions to Article 7 agencies in the base budgets include cuts to highway development, automobile theft prevention, housing for low-income and homeless individuals, and workforce training and development programs funded through the TWC.

Revenue streams

Most Article 7 appropriations go to fund transportation. State general revenue makes up a small portion of total appropriations, which come mainly from federal funds and revenue collected through State Highway Fund 6.

For fiscal 2010-11, Article 7 agencies also were appropriated $2.7 billion in one-time federal Recovery Act funds. This included $1.6 billion to TxDOT for highways and bridges, $565.1 million to TDHCA, largely for weatherization and affordable housing, $436.8 million to TWC for various programs, and $19.5 million to TDRA for community development. For fiscal 2012-13, both base budgets would appropriate some federal Recovery Act funds that were obligated to various programs but have yet to be spent.

Transportation. Fund 6 is the state's primary highway funding mechanism. It collects revenue from federal reimbursements, state motor fuels taxes, motor vehicle registrations, toll revenue and concessions payments, and various fees. The Legislature may appropriate money from Fund 6 for highway-related purposes, consistent with constitutionally and statutorily established limits. The House and the Senate base budgets would appropriate to TxDOT about $6 billion from Fund 6 for fiscal 2012-13, not including revenue from bond proceeds and toll project concession payments.

Since 2001, other funding options for transportation have included the authority to issue bonds and enter into comprehensive development agreements (CDAs) to build and maintain toll roads. (For more on highway funding in Texas, see HRO Focus Report 81-5, *Highway Funding in Texas: A Status Report*, February 23, 2009).

Since 2003, the Texas Transportation Commission (TTC) has been authorized to issue bonds secured by revenue in Fund 6. In 2007, the Legislature increased the total Fund 6 bonding authority available to no more than $1.5 billion per year, not to exceed a total of $6 billion issued. To date, TxDOT has issued $4.6 billion in Fund 6 (Proposition 14) bonds, leaving $1.4 billion available. For fiscal 2012-13, both base budgets include spending $1.1 billion of the remaining capacity of Fund 6 revenue bonds.

The Texas Mobility Fund (TMF) is a revolving fund through which the TTC may issue bonds to help fund state highways and publicly owned toll roads. Bonds and debt obligations are secured by funds in the TMF and by the state of Texas. Before more bonds may be issued from the TMF, the comptroller must certify that the fund is projected to have available revenue equal to at least 110 percent of the amount necessary to pay principal and interest due yearly for the term of the proposed bonds. To date, TxDOT has issued more than $6 billion in TMF bonds. Both base budgets include spending $127.2 million of the remaining capacity of TMF bonds for fiscal 2012-13.

Bond funding for highway projects also includes up to $5 billion in general obligation bonds approved by voters through Proposition 12 in November 2007. The 81st Legislature, in its first called session, enacted contingent legislation to appropriate $2 billion in bond proceeds to acquire, build, rebuild, and maintain a highway or right-of-way and $100 million in general revenue to pay for debt service on the issued bonds. The TTC may issue the bonds contingent upon approval from the LBB and the governor. While the LBB and the governor approved issuing $1 billion in general obligation bonds for highway improvements, another $1 billion appropriated to fund the State Infrastructure Bank had not been approved as of February 2011. The House and the Senate base budgets include spending $144.9 million of the remaining general obligation bond proceeds that TxDOT issued in fiscal 2010.

Fiscal 2010-11 appropriations to TxDOT included one-time payments from tolling authorities for the rights to develop and operate toll roads. In fiscal 2008, Fund 6 revenue included a $3.2 billion payment to the state from the North Texas Tollway Authority for State Highway 121 in the Dallas-Fort Worth metropolitan area. It also included other funds paid as part of a private agreement for the development of portions of State Highway 130 in Central Texas. While current state law requires revenue received as part of toll agreements to be spent in the geographic area in which it was collected, the money is deposited into a separate subaccount of Fund 6 and is counted toward the total available revenue. TxDOT has requested appropriations of this money to pay for planned projects in the agency's Dallas district. Both base bills for fiscal 2012-13 include about $1.2 billion in toll revenue and concessions payments.

Budget drivers

Article 7 funding needs are influenced by the state's economic performance and its work force. This may include highway congestion in metropolitan areas, road and bridge conditions, needs for employment services and training, and the availability of affordable housing. Major weather events, such as hurricanes, can affect Article 7 agencies, which have active roles in rebuilding roads, cleaning up debris, and helping relocated residents find housing and jobs.

Selected budget issues

Funding for new highway construction. For fiscal 2012-13, both base budgets would appropriate about $1.2 billion for new highway construction projects. With the current estimated funding levels in the base bills, TxDOT says it would be able to build new roads that already have been planned, but would not be able to plan new projects without decreasing funding for road maintenance or other services. The base budgets would reduce appropriations for planning and designing transportation projects and acquiring rights-of-way by almost $600 million for fiscal 2012-13. They would increase funds for maintenance by $122.1 million.

Because highway construction is a multi-year process, much of TxDOT's current proposed budget is obligated to paying for previously authorized projects. The agency also must pay debt service for previously issued bonds and pay to maintain existing roads. Of TxDOT's total base budget of $15.4 billion, $11.7 billion would be committed to debt service, ongoing projects, road maintenance, or specific geographic areas, with $1.6 billion obligated to pay for debt service.

Highway bonding authority. The House and the Senate base budgets include no additional general obligation bond funding for transportation projects for fiscal 2012-13. TxDOT has requested $3 billion in proceeds from the remaining Proposition 12 general obligation bonds. The agency has proposed using $1 billion of the additional bond proceeds to complete certain highway projects that it already has initiated, another $1 billion for a transportation revolving fund in 2012, and a final $1 billion to improve roadways listed among the top 100 most congested in the state. Every billion dollars issued in the general obligation bonds would require about $110 million to $120 million in debt service to be paid each biennium from general revenue.

TxDOT says that approval to issue at least $1 billion more in general obligation bonds is necessary to continue making payments on highway projects authorized in 2009. A rider in the 2009 general appropriations act authorized the first $1 billion in general obligation bond proceeds appropriated in fiscal 2010-11 to make "progress payments" on no more than $1.85 billion in multi-year highway construction contracts. The agency says that without an additional $1 billion in bond funds, it will have to divert funding from projects that already have been planned in order to make payments on road projects that were initiated with the first $1 billion in general obligation bonds issued in fiscal 2009.

Restoring Fund 6 appropriations to highway construction. The 81st Legislature in 2009 appropriated $1.2 billion of Fund 6 revenue to state agencies other than TxDOT and TxDMV. All but slightly less than $40 million of this amount went to DPS and for pay raises for commissioned peace officers. The remaining funds were appropriated to other agencies for various purposes.

TxDOT's request for appropriations beyond their baseline includes eliminating most of the so-called "diversions" from Fund 6 to agencies and purposes not directly related to highway development and vehicle registration. The request is for about $1.1 billion in current so-called diversions to be used to begin planning and development on unfunded, top-priority highway projects.

Automobile Burglary and Theft Prevention Authority. The House and the Senate base budgets would eliminate $29.1 million in general revenue funds and $2.2 million in other funds for the Automobile Burglary and Theft Prevention Authority (ABTPA). The ABTPA, which provides grants to local enforcement authorities to prevent and reduce automobile theft, traditionally has been funded by a fee on automobile insurance policies of $1 per vehicle per year. In fiscal 2010-11, the ABTPA provided 56 grants totaling $27.5 million to local enforcement entities. The proposed base budgets would retain the fee while redirecting funds collected from the fee to other purposes.

Reduced funding to TWC programs. The Texas Workforce Commission, which administers programs related to employment and workforce development, generally receives more non-dedicated general revenue than other agencies in Article 7. The House base budget would reduce funding for the Skills Development Program to $48.5 million, from $78.5 million in fiscal 2010-11. It also would eliminate funding for the Texas Back to Work Program (TBTW) and the Project Reintegration of Offenders (RIO) program.

The Senate base budget would make the same cuts to Article 7, but would include a rider for the governor's trusteed programs under Article 1 that — if accompanied by necessary legislation — would restore to the TWC $30 million for skills development and $15 million for Texas Back to Work out of funds appropriated to the Texas Enterprise Fund.

TWC says proposed reductions to the Skills Development Fund program, which provides grants to businesses to fund workforce training, would result in about 5,500 fewer trainees per year to participate than would the agency's baseline legislative appropriations request. The agency says eliminating the TBTW program, which provides a $2,000 incentive for businesses that hire first-time unemployment insurance claimants full time for at least four months, would eliminate this option for about 7,000 claimants who might qualify for the program. Project RIO, funded jointly by TWC and the Texas Department of Criminal Justice, provides employment and training services to recently released offenders. Eliminating funding to Project RIO would reduce certain case-managed employment services available to ex-offenders but would not prevent them from seeking other TWC services.

Regulatory Government

Article 8 includes agencies that regulate business professionals and service industries. The agencies vary in size and scope and include the Public Utility Commission (PUC), the Insurance and Banking departments, the Texas Medical Board, the Real Estate Commission, and the Racing Commission. The Department of Licensing and Regulation alone oversees businesses, industries, trades, and occupations, ranging from cosmetologists and barbers to mixed martial-arts fighters and tow truck operators. The State Office of Administrative Hearings provides general administrative support. The agencies under Article 8 regulate specific professions or industries in areas that include general professions and services, health care, financial services, insurance and workers' compensation, and utilities.

Most Article 8 agencies obtain revenue from fees – typically for registration, licensing, and examinations – paid by the professionals and workers they regulate and from fines assessed to violators of agency rules and regulations. A few also derive revenue from sales of goods and services and through interagency contracts. Most Article 8 agencies raise fee revenue that is greater than their biennium budgets, and that excess is swept into general revenue funds for general purpose spending.

For fiscal 2010-11, regulatory agencies received $798.7 million in all funds. General revenue and general revenue-dedicated funds spending for Article 8 agencies totaled $739.2 million. In early 2010, Article 8 agencies identified $35.8 million in potential reductions to decrease their fiscal 2010-11 budgets by 5 percent. Of that amount, $22.2 million in reductions was approved for Article 8 agencies, bringing the overall decrease in spending to 2.5 percent.

The House base budget for fiscal 2012-13 would appropriate $686.8 million in all funds to Article 8, a decrease of $111.9 million, or 14 percent, from fiscal 2010-11. The Senate base budget would appropriate $522.1 million, a decrease of $276.6 million, or 34.6 percent. In general revenue and general revenue-dedicated funds, the House base budget would appropriate $657.1 million, a decrease of $82.1 million, or 11.1 percent, from fiscal 2010-11.The Senate base budget would appropriate $492.4 million, a decrease of $246.8 million, or 33.4 percent.

The major reductions in both base budgets would be to programs paid for by the System Benefit Fund, including the low-income discount program, with the Senate base budget eliminating funding to the program.

The System Benefit Fund. An ongoing budget concern has been excess revenue from licensing and other fees raised by Article 8 agencies being swept into general revenue funds and made available for general purpose spending. Some balances from fees and other special assessments are neither allocated for their original purpose nor appropriated for general spending. These unallocated balances are used by the comptroller to certify that the state budget is balanced. One of the largest of these accounts is the System Benefit Fund, which contains revenue generated by an assessment collected from electricity ratepayers in areas open to competition. It is administered by the PUC to fund the operation of the agency, assist low-income utility customers, and pay for customer education programs.

In 1999, the 76th Legislature created the System Benefit Fund as a special trust fund. It was made a dedicated account in the General Revenue Fund in 2001. For fiscal 2006-07, the Legislature did not allocate System Benefit Fund money to assist low-income electricity customers, but instead held the money for certification of the budget because of projected budget shortfalls. In 2007, the Legislature appropriated $82.9 million for fiscal 2008 and $93.9 million for fiscal 2009 for low-income discounts, consumer education, electricity market oversight contracts, and administration of industry restructuring. In addition, the Legislature appropriated $30 million in a supplemental appropriations bill for low-income discounts to be used in the summer of 2007. In 2009, the Legislature appropriated $122.5 million for fiscal 2010 and $135.2 million for fiscal 2011 for the same purposes and, according to the comptroller, $670.7 million in unspent money in the fund was used to certify the budget for fiscal 2010-11. The ending balance for the System Benefit Fund for fiscal 2010 was $607.8 million.

The House base budget for fiscal 2012-13 would decrease general revenue-dedicated funding for programs paid for with System Benefit Fund money by \$56.4 million. This 25 percent decrease includes \$54.9 million less than fiscal 2010-11 for the low-income discount program, \$400,000 less for customer education, \$600,000 less for electric market oversight contracts, and \$500,000 less for the administration of chapter 39 of the Utilities Code, which governs industry restructuring.

The Senate base budget would eliminate all funding for both the low-income discount program and customer education for fiscal 2012-13, a total decrease of \$221.1 million. This would include reductions of \$219.6 million for the low-income discount program and \$1.5 million for customer education.

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