

## Lessons from 2003

by The Honorable Talmadge Heflin & The Honorable Arlene Wohlgemuth

In 2003, the Texas Legislature did something unprecedented. Faced with a record \$10 billion budget shortfall, lawmakers balanced the budget without raising taxes and cut general revenue spending for the first time since World War II. This achievement did much to lay the foundation for the period of extraordinary economic growth and prosperity we are currently experiencing in Texas.

Now, with the state facing another large budget shortfall, Talmadge Heflin, former chairman of the House Appropriations Committee, and Arlene Wohlgemuth, former chairman of the Appropriations Subcommittee on Health and Human Services, offer their insight on the most important lessons they learned from 2003 to help inform the decisions of today's policymakers.

### Lesson #1: Build the Budget from Zero

One of the most effective ways of managing the growth of state government spending is via zero-based budgeting.

In essence, zero-based budgeting is an approach to public finance based on the idea that no costs or activities should be automatically carried over from one budget to the next. Instead, every agency's budget is built from the ground up, requiring that each expense be justified.

Though zero-based budgeting is not normally employed by the state's budget writers—as it requires a great deal of time, energy, and cooperation—when it is used, it helps to produce a quality product. There is no better example of this than the events of 2003.

During the 2003 legislative session, lawmakers were faced with a \$10 billion budget shortfall. Working closely with agency heads and directors, we started from scratch, examining the funding and expenditures of each of the state's 200-plus agencies first on the basis of any constitutional mandates, then according to statutory requirements, and finally by determining whether they were actually needed—at current funding levels or at all. By building the budget in this manner, we were able to

get a detailed picture of each agency's spending habits and root out unnecessary items. In the end, we were able to overcome the state's multi-billion budget shortfall without raising taxes and actually reduce general revenue spending.

Today's lawmakers have an opportunity to take zero-based budgeting one step further and not only use this approach to help balance the budget but also achieve greater government transparency. Zero-based budgeting helps to expose the flaws in the current performance-based budgeting methodology which obscures specific programs and makes it impossible for the public and most legislators to identify unnecessary or low priority programs being funded. With zero-based budgeting every expense is identified and scrutinized—something which is critical in keeping the budget under control.

All of this is to say that if zero-based budgeting is pursued diligently by lawmakers in the 82nd Texas Legislature, it could prove to be a powerful tool in the hands of those looking to overcome another multi-billion dollar budget shortfall, without raising taxes.

### Lesson #2: Safeguard the Rainy Day Fund

To paraphrase a recent saying about the Rainy Day Fund: It's not that we should be concerned with how much we are going to spend this session, but we should be concerned with how much of the Rainy Day Fund we have on hand for the next session.

Spending the Rainy Day Fund (RDF) to alleviate some of the fiscal pressures from the upcoming biennium is an approach that is gaining traction this session, but it is a course of action that has potentially dire consequences for the legislative session in 2013.

It is one thing to use the RDF to cover a deficit in the current biennium, as we've seen with the recent proposal to spend up to \$3.2 billion in rainy day funds for 2010-11. But should the Legislature tap the state's RDF to pay for ongoing expenses as some in the Legislature are advocating now, lawmakers will

only dig a deeper hole for 2013. That is because using one-time funds to pay for recurring expenses is poor public policy. Consider all the trouble the state's use of one-time stimulus funds in 2009 has created this session.

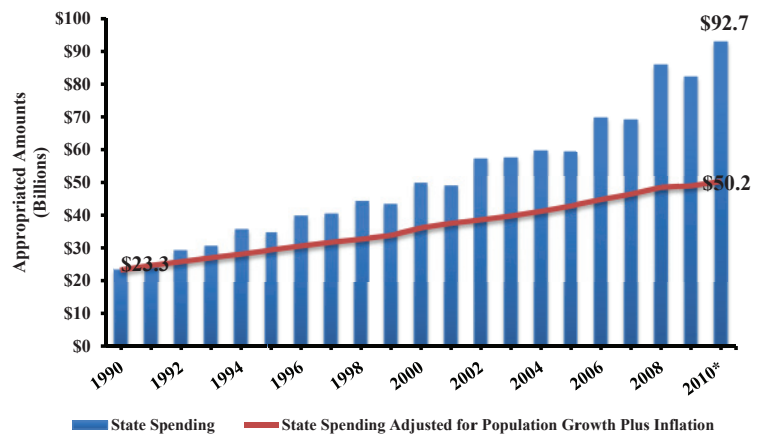
For those who would point to the Legislature's use of RDF monies in 2003, there is one big difference between now and then. When the Legislature met then, the economy was beginning an upswing from a recession that was neither as deep nor as long lasting as the present one. Replenishing the RDF was feasible in those conditions. That's not likely to be true now. Additionally, projections for economic recovery over the next two years do not bode well for significant growth in available revenue for the 83rd Legislature in 2013. Higher spending this session based on the use of the RDF may well put Texas in a situation of another revenue shortfall in 2013 with only a depleted RDF as a backup.

Most significantly, in 2003, Congress had let it be known that additional money for Medicaid was on its way to the states. This year, nearly the reverse is happening. Not only is the Congress not sending additional money, but Texas' federal match (FMAP) has dropped (cut \$1.2 billion for 2012-13), and is likely to continue dropping. The additional FMAP Congress sent in 2009 just left Texas with a bigger hole to fill this session when it is no longer available—exactly what using the Stabilization Fund would do for 2013.

Furthermore, the new federal health care law will require an estimated \$14 billion in additional general revenue to pay the state's share for Medicaid. Without real reform, Medicaid alone is projected to consume 46.6 percent of the 2014-15 All Funds Budget. Without the Stabilization Fund available in 2013, even heftier tax increases or even deeper cuts in spending may be required, neither of which is palatable.

### Lesson #3: Avoid the Gimmicks

There is a temptation among some in the Legislature to use smoke and mirrors to help balance the state's two-year budget; but by relying too heavily on accounting gimmicks to bridge the gap, lawmakers shift and potentially intensify the consequences of the current budget shortfall down the road.



Source: Texas Public Policy Foundation, "Trends in Texas Government: State Government Spending"

Over the short-term, gimmicks, such as delaying payments by one day to shift the cost into the next biennium, can help to ease the pressure of writing this session's budget. But by shifting the budgetary pressure to next session, lawmakers are assured of a much tougher budget writing session in 2013—one that is already expected to begin with a \$10 billion budget shortfall.

Over the long-term, employing these kinds of tricks masks a much larger problem in state government—excess spending. Consider that from FY 1990 to FY 2010, Texas state government spending increased by a total of nearly 300 percent, while the sum of population growth plus inflation grew by only 116 percent. Expenditure growth of this kind is simply not supportable in the long-run.

At some point, state budget writers will be forced to confront and overcome the fiscal challenge that has been kicked down the road; and the longer the problem has been avoided, the tougher it will be to overcome. While we used some accounting gimmicks in 2003, as noted above the state faces a much more uncertain fiscal future today than we did back then. Any use of one-time revenue simply pushes the current problem off to the future, and with the prospect of reduced future revenue and increased future costs, now is not the time to resort to one-time budget gimmicks. ★

