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Prioritizing Texas Budget Reductions Amid Deficits Due to the COVID-19-Induced Recession

Key Points

- Texas usually ranks high in economic prosperity and must maintain a balanced budget, but the COVID-19-induced recession has put pressure on taxpayers to fund the tax receipts needed to cover the state's budget.
- Texas must prioritize fiscal restraint by finding responsible budget reductions to deal with any potential budget shortfall.
- Statewide elected officials have appropriately begun the process of prioritizing budget cuts by directing some state agencies to identify 5% reductions in their existing 2020-2021 budgets, but additional cuts may be necessary.
- As with past shortfalls, the Legislature should work with state agencies and adopt zero-based budgeting to prioritize program spending and identify responsible spending cuts.

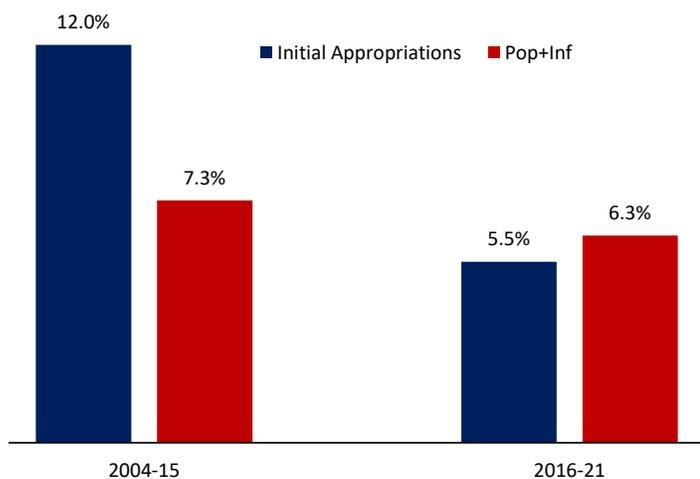
Background

The COVID-19-induced recession in 2020 strained the ability of many Texans to pay taxes that fund state expenditures, contributing to a potential budget shortfall of an estimated \$4.6 billion at the end of the current 2020-21 biennium ([Texas Comptroller, 2020](#)). Of course, there remains much uncertainty in the economy and the direction of the COVID-19 pandemic, which means that this budget shortfall could be much higher, lower, or possibly turn into a surplus by the time this fiscal biennium ends in August 2021. Regardless, this situation requires that the Texas Legislature exercise fiscal restraint by not only limiting future budget increases but also by cutting expenditures that do not support a limited government. As with past budget shortfalls, there will be a temptation to raise taxes and fees to recoup lower tax receipts. But that temptation should be avoided so as not to put additional strain on Texans who are already struggling financially and to not weaken the economy thereby further reducing tax receipts, making a bad fiscal situation worse.

The Texas budget has already increased substantially since the 2004-05 budget, exceeding Texans' ability to pay for it—as measured by the compounded rate

Figure 1

Texas's Budget Growth Has Slowed Since the Creation of the CTB in 2015



Note. Data from *Fiscal Size-Up*, Legislative Budget Board (<https://www.lbb.state.tx.us/FSU.aspx>) and authors' calculations of average biennial figures.

of population growth plus inflation. The Conservative Texas Budget (CTB), a maximum growth threshold of initial appropriations created by the Texas Public Policy Foundation in 2015, has successfully helped to constrain some of this growth during the last three budgets ([Ginn et al., 2020a](#)). Specifically, **Figure 1** shows how the CTB, since its inception, helped limit the growth of appropriations. Prior to the CTB, the average growth rate of the five biennial budgets from 2004 to 2015 was 12%—well above the average biennial growth of population growth plus inflation. The three biennial budgets since the creation of the CTB have had an average growth rate of just 5.5%, which was less than half that for the earlier period and well below the average growth rate of population growth plus inflation.

Even with the CTB, overall state appropriations have continued to grow, though at more reasonable levels. However, the budget growth rate in the earlier period, which grew faster than population plus inflation, has compounded over time to excessively burden Texans with higher taxes than otherwise. In fact, since the 2004-05 budget, the state budget has grown by an estimated 18.9% more than if each budget had followed this key metric ([Ginn et al., 2020a](#)).

While state legislatures have held the budget's growth more in line with this threshold in the last three budgets, whether considering the growth in appropriations or expenditures ([Ginn et al., 2020b](#)), the longer-term growth trend shows excesses are putting a higher burden on taxpayers. Given this higher historical fiscal burden and the potential budget shortfall due to the COVID-19-induced recession, it is time for the Legislature to prioritize budget reductions to adequately meet the needs of Texans without raising taxes or fees. This means that cuts both to complete the ongoing 2020-21 budget and possibly to the 2022-23 budget to be written during the upcoming 2021 legislative session ought to be considered. These efforts will help the budget not only grow by no more than the CTB—a 5% growth rate to a new maximum of \$246.8 billion, excluding items explicitly for COVID-19 that should not go in the ongoing baseline budget—but also get back on track and remain within taxpayers' ability to pay ([Ginn et al., 2020a](#)).

In order to cover any budget shortfalls, the Legislative Budget Board (LBB) and the Legislature can best achieve budget cuts by employing tools used successfully in the past, such as directing state agencies to identify responsible cuts and to use zero-based budgeting to prioritize spending ([Ginn et al., 2020b](#)). They should consider directing agencies to prioritize programs in their existing budget and identify expenditures that may be reduced or eliminated with the least impact on programs that are necessary, effective, and that support a limited government. These

identified cuts should be in incremental amounts of at least 10%, 15%, and 20% of their overall budget. Other cuts could be derived from specific identifiable program areas of the budget, like eliminating or postponing certain capital expenditures, vehicle purchases or leases, out-of-state travel, and outside contracts. Finally, recommendations by the [Sunset Advisory Commission](#) and the Legislative Budget Board's ([LBB, 2020a](#)) *Strategic Fiscal Review* for agency consolidation and the elimination or streamlining of certain programs and activities should be adopted.

2020-2021 Budget

The current 2020-2021 budget, initially approved by the 86th Legislature in 2019, was a projection of expenditures and was necessarily based on projected tax receipts and program costs over almost 3 years. The initial appropriations were \$235.0 billion, excluding items that should not go in the ongoing baseline budget—\$13.3 billion toward property tax relief and Hurricane Harvey recovery efforts ([Ginn et al., 2020a](#)). As the end of that budget period approaches, it is common for the Legislature to address budget shortfalls or changes in those projections. Many of these changes are simply “true-ups” of shortfalls, which, arguably, could have been more accurately projected, such as expenditure needs based on funding formulas related to Medicaid and government schools.

Other discrepancies in the budget projections are more difficult, if not impossible, to predict, such as the economic downturn due to the COVID-19 pandemic and shutdowns by state and local governments. Tax receipts available at the end of the budget cycle are projected to be substantially lower than originally estimated due to this downturn ([Texas Comptroller, 2020](#)). As the economy rebounds, much of those tax receipts will likely be restored, but the damage for those months of downturn will necessitate adjustments to the budget.

In May 2020, a statewide elected officials' letter directed some state agencies to identify savings of at least 5% in their budget, which could amount to \$1 billion ([Office of the Texas Governor, 2020](#)). Due to the state's response to COVID-19, the letter communicating that direction excluded the following:

- Appropriations to the Texas Division of Emergency Management, the Texas Department of State Health Services, the Texas Workforce Commission, the Texas Military Department, and the Texas Department of Public Safety;
- Funding for debt service requirements and bond authorizations;

- Current law requirements for the Foundation School Program and school safety;
- Funding for Child Protective Services;
- Benefits and eligibility levels in Medicaid programs, the Children’s Health Insurance Program, the foster care program, the adoption subsidies program, the permanency care assistance program, and services for individuals with intellectual or developmental disabilities;
- Funding for behavioral health service programs;
- Appropriations for Correctional Security Operations and Correctional Managed Health Care at the Texas Department of Criminal Justice;
- Appropriations to Health Related Institutions and Community Colleges; and
- Employer Contributions to the Teacher Retirement System and Employees Retirement System funds and to Social Security.

While the 5% in cuts to some state agencies are warranted, they may be insufficient to address a potential budget deficit. This is acknowledged in the letter from the Office of the Texas Governor (2020) by specifying that every state agency and institution “should prepare to submit reduced budget requests” (p. 2) for the 2022-23 budget “as well as strategies to achieve further savings. Furthermore, when the state revenue picture becomes clearer in the coming months, it may become necessary to make additional budget adjustments” (p. 2).

2022-2023 Budget

Every budget process begins with a Legislative Appropriations Request (LAR) from each state agency for future expenditure needs in the upcoming biennium. In the next budget cycle, state agencies are submitting their LAR for fiscal years 2022-23 pursuant to instructions issued by the LBB (2020b). In 2020, these instructions were issued in August and directed agencies to submit their LAR with a base funding amount equal to their adjusted (5% reduction) 2020-21 base, in alignment with the governor’s instructions submitted in May (Office of the Texas Governor, 2020). Some agencies that were exempted from the 5% reduction in the 2020-21 appropriations will nonetheless be provided adjusted baseline numbers for their 2022-23 LAR. Any request above that base level, including a restoration of reductions, is to be included as an exceptional item, and therefore treated as a request for additional appropriations.

In short, the discussion about the 2022-23 state budget will likely begin with a 5% reduction in its base from those cuts in the 2020-21 budget. However, given there may be greater need for budget cuts in either the 2020-21 budget or

the 2022-23 budget depending on the economic and fiscal situations, the 5% in cuts could be only the first step toward finding appropriate budget savings.

The governor, lieutenant governor, and speaker of the House in August (Abbott et al., 2020) quoted the Texas Comptroller in their letter as saying that the current economic outlook “carries an unprecedented amount of uncertainty” (p. 1). While the letter indicated the need and commitment for “fiscal restraint,” it also reiterated multiple expenditure items excepted from the 5% reduction. These include exceptions to the baseline request limitation necessary to:

- *maintain funding for the Foundation School Program under current law;*
- *satisfy debt service requirements for bond authorizations;*
- *maintain funding at fiscal year 2021 budgeted levels plus amounts necessary to cover the impact of payroll growth for state pension systems and employee group benefits (not including payroll contributions made by state agencies and institutions of higher education for retirement and group health insurance), though group benefit modifications may be considered;*
- *maintain current benefits and eligibility in Medicaid programs, the Children’s Health Insurance Program, foster care programs, the adoption subsidies programs, and the permanency care assistance program (baseline requests for these programs should include amounts sufficient for projected caseload growth);*
- *maintain funding for programs serving individuals with intellectual or developmental disabilities;*
- *maintain funding for Child Protective Services; and*
- *maintain funding for the Department of Public Safety. (p. 2)*

If these exceptions are maintained, a large percentage of agency budget requests may increase substantially. This means the Legislature should be prepared to look for more budget cuts. Given this potential requested increase in some areas of the budget, there will need to be an emphasis on not growing the rest of the 2022-23 initial appropriations so that the total budget stays within the Conservative Texas Budget or is cut given the struggle many Texans currently face (Ginn et al., 2020a).

Methods for Reducing the Budget

Statewide elected officials have already provided direction to state agencies and must now provide oversight and make decisions on how to reduce the budget. This ongoing task is best performed with the cooperation and assistance of the various boards and directors of state agencies. These agency heads have the expertise necessary to know how to prioritize expenditures and cuts within their own budgets and it is their job to do so within the appropriations provided by the Legislature. These agencies should be directed to further identify the most effective budget savings while being responsible for determining how best to allocate resources to maximize benefits at the least cost to Texans. In other words, agency heads should be directed but also empowered to do as much or more with less. This may entail options such as flexibility on fund transfers between programs and postponing certain purchases, such as large capital items and the start of new programs and initiatives.

A larger percentage of the budget should be targeted for reductions in order to achieve meaningful savings to fill any budget shortfall at the end of this budget cycle and possibly in the upcoming one. Given statewide elected officials have already directed some agencies to find 5% in savings, a meaningful target for those agencies and others, if not all, should range from 10% to 20% savings to cover an uncertain deficit.

There is some precedent for this recommendation. In 2003, the Legislature faced a \$10 billion shortfall and practiced zero-based budgeting. Budgets started essentially at zero dollars, and the Legislature worked with state agencies to prioritize programs and to determine which programs were most effective at achieving their intended goals and which were less effective. These efforts helped identify significant cuts sufficient to cover the projected shortfall without raising taxes on already struggling families ([Heflin, 2020](#)). In addition, the agencies were able to help the Legislature identify solutions to save money, like consolidating 12 health and human services agencies into five.

These are the types of solutions that are needed again, and they can best be achieved through cooperation and partnership with the agencies and institutions of state government.

Recommendations

Statewide elected officials and the Legislature should consider the following to prioritize budget reductions to fill any budget shortfall while continuing to correct past excessive state budgets:

- Direct all state agencies to prioritize program areas in their budgets;
- Direct all state agencies to identify budget cuts in increments of 10%, 15%, and 20%;
- Establish priorities starting with constitutional requirements, then statutory requirements, then identified priority needs;
- Utilize zero-based budgeting to prioritize funding for programs that effectively meet their intended goals and consider eliminating or reducing those that do not;
- Eliminate or postpone unnecessary capital expenditures and new projects;
- Eliminate or postpone unnecessary outside contracts;
- Eliminate unnecessary out-of-state travel;
- Freeze unnecessary hiring; and
- Consolidate small state agencies and programs such as those identified in the current Sunset Advisory Commission's and LBB's recommendations.

Texas can regain its standing as an economic leader after the economic downturn due to COVID-19 and shutdowns by state and local governments, but that must be done by reducing government barriers to many struggling businesses and individuals. Texans do not need to have additional uncertainty brought about by potential hikes in taxes or fees, and they do not need excessive government spending that burdens them just the same. Texas government has risen to similar challenges before and can do so again by following the recommendations outlined here. The time, the circumstances, and the taxpayers demand it. ★

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The Honorable Talmadge Heflin

The Honorable Talmadge Heflin is a distinguished senior fellow for the Conservative Texas Budget at Texas Public Policy Foundation. Prior to joining the Foundation, Heflin served the people of Harris County as a state representative for 11 terms. Well regarded as a legislative leader on budget and tax issues by Democratic and Republican speakers alike, he for several terms was the only House member to serve on both the Ways and Means and Appropriations committees.

In the 78th Legislature, Heflin served as chairman of the House Committee on Appropriations. He navigated a \$10 billion state budget shortfall through targeted spending cuts that allowed Texans to avoid a tax increase.

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