HOUSE RESEARCH ORGANIZATION
Texas House of Representatives

State Finance Report

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WRITING THE STATE BUDGET

79th Legislature

Index to key concepts

This report summarizes the steps in the state budget process and the constitutional, statutory, and procedural requirements guiding the Legislature as it considers state spending needs. It also briefly reviews the filed version of the general appropriations bill for fiscal 2006-07, the governor's budget proposal, the comptroller's revenue estimate, the constitutional limits on state spending growth, and other recent budget figures.

The budget cycle in brief

Writing a two-year budget is one of the main tasks the Texas Legislature performs. During the 2005 regular session, the 79th Legislature will consider a budget for fiscal 2006-07, the two-year period ("biennium") from September 1, 2005, through August 31, 2007.

Although Texas law designates the governor as the state's chief budget officer, the Legislature traditionally has dominated the budget process. The Legislative Budget Board (LBB) is charged with preparing the budget and evaluating agencies' financial performance. Both the LBB and the governor develop budget recommendations and must submit budget proposals to the Legislature. The Legislature develops and adopts the budget.

Since the early 1990s, the state has developed biennial budgets through a form of performance budgeting based on strategic planning. The governor initiates this process by outlining government's mission, goals, and priorities. Each state agency then develops strategies for accomplishing its goals and submits a budget request to implement its strategic plan. The Legislature determines the agency's biennial funding after considering various performance measures to gauge the agency's success in meeting its goals.

In recent sessions, the Legislature has adjusted each agency's funding in comparison to its current funding levels. Last session, in response to tight budget conditions, state leaders adopted an approach known as zero-based budgeting, a modified form of which was used during the 1970s and 1980s. Budget deliberations for each agency began at zero rather than the current funding level, and agencies were asked to identify and justify funding for essential services. The final budget represented an accumulation of essential service "building blocks," up to an identified spending limit based on available general revenue at that time. The 79th Legislature will return to the practice of adjusting funding based on current funding levels.

The general appropriations bills for fiscal 2006-07, SB 1 by Ogden and HB 1 by Pitts, reflect an estimate of the level of funding needed to continue most current services at 95 percent of current funding levels, with certain exceptions such as public education and federally mandated programs. The House and Senate will hold committee hearings at which agencies may justify their spending priorities and others may express their views.

Before each regular legislative session, the comptroller of public accounts issues a constitutionally required estimate of revenue available for spending. On January 10, 2005, Comptroller Carole Keeton Strayhorn estimated that the state will have available about $130.5 billion from all revenue sources during fiscal 2006-07. The estimate includes $64.7 billion in general revenue-related funds available for general-purpose spending, following a projected $2.3 billion positive balance at the end of fiscal 2005.

For an appropriations bill to be valid, the comptroller must certify that the state will have enough revenue to cover the approved spending. The bill also must comply with certain constitutional spending limits.

The governor may veto any appropriations bill and may veto specific spending provisions, called line items, within the general appropriations bill. If the Legislature is still in session, it may override the governor's line-item veto by a two-thirds majority of members present in each house.

Texas is one of 21 states that use a two-year rather than a one-year budget cycle. Between sessions, LBB and the Governor's Office monitor budget implementation and evaluate agencies' success at attaining their goals. The governor and LBB may adjust appropriations under certain circumstances by using budget execution authority. Other agencies, such as the State Auditor's Office and the Comptroller's Office, and legislative committees also may review the financial performance, effectiveness, and efficiency of state agencies or programs.

The general appropriations bill

The general appropriations bills for fiscal 2006-07, HB 1 by Pitts and SB 1 by Ogden, are the starting points for legislative action to prescribe agency spending and to alter state accounting, performance measures, and other budgetary provisions. The bills set a baseline for each state agency and each category of spending.

For the current biennium, LBB estimates the amount of all funds spent or budgeted at $126.6 billion, including expected demands for supplemental appropriations by the 79th Legislature. The total includes about $65.5 billion in general revenue-related funds.

On January 17, 2005, LBB issued a "current services" baseline budget estimate, reflecting a continuation of current levels of government services, but holding funding for many state agencies to 95 percent of the fiscal 2004-05 level. Compared to the current biennium, this plan would increase state spending from all sources by 6.1 percent, to $134.4 billion, and would increase general revenue-related spending by about 6 percent, to $69.6 billion. Much of the increase would pay to cover student enrollment growth and school financing equity requirements in public education, restore teacher health insurance passthrough funds, fund higher caseloads in the state-federal Medicaid program and replace one-time federal fiscal relief funds, and other funding obligations. According to the LBB, this level of spending is within both the comptrollers' biennial revenue estimate and the limitation on the growth of appropriations established by the LBB. (See LBB's *Summary of Legislative Budget Estimates*, January 2005, for more details.)

Budget format. The appropriations bills as filed reflect the LBB current services budget proposal. Art. 3, sec. 35 of the Texas Constitution limits bills to one subject, except for general appropriations bills, which can include various subjects and accounts. However, this provision has been interpreted as prohibiting the general appropriations bill from changing substantive law. House Rule 8, sec. 4 reflects this interpretation and explicitly prohibits changes in general law in an appropriations bill. In other words, appropriations bills deal only with spending.

Articles. For fiscal 2006-07, HB 1 and SB 1 as filed retain the basic structure of previous budget acts, with 10 articles for agency budgets.

Articles 1 through 8 cover state agency budgets by functional category. For example, Article 3 covers agencies of public and higher education. Article 9 contains general provisions and directions to state agencies, the state salary classification schedule, and contingency appropriations and reductions. Article 10 contains appropriations for the Legislature.

The appropriations bill that is voted out of committee will likely include three additional articles. Article 11 in previous sessions' general appropriations bills listed agencies' exceptional items or "wish lists." Article 13 is the savings clause, stating that if any part of the act is held invalid, the remaining portions of the act will not be affected. Article 14 contains an emergency clause stating that the bill takes effect upon enactment.

Listed at the end of each article are summary appropriations for employee retirement contributions, group health benefits, social security and benefit replacement pay, tobacco settlement funds and lease payments for buildings financed through the Texas Public Finance Authority. Also shown are recapitulations ("recaps") of total spending by article and by type of fund.

Agency budget configuration. Each agency's budget is described in components that link funding to the agency's strategic plan.

- *Agency goals* are general statements of the agency's long-range purposes.
- *Outcome measures* derived from an agency's objectives assess the actual impact or results of the agency's actions on the public.
- *Strategies* state how an agency intends to achieve its goals and objectives. The agency may need more than one strategy to accomplish each objective. Strategies, sometimes called line items, are the bases for appropriating money to an agency, and the appropriation may support more than one division or program in the agency.
- *Output measures* gauge the quantity of a service provided or a good produced.
- *Efficiency measures* gauge the cost or time taken per unit of output.

The example on page 5 illustrates the format for a portion of the fiscal 2004-05 appropriation for the Commission on the Arts.

COMMISSION ON THE ARTS

	For the Years Ending	
	August 31, 2004	August 31, 2005
A. Goal: SECURE RESOURCES Secure from public and private sectors the appropriate and necessary resources for the purpose of funding the Commission on the Arts and to equitably distribute such resources.		
A.1.1. Strategy: CULTURAL ENDOWMENT FUND Promote the Texas Cultural Endowment Fund to secure stabilized public and private funding.	$ 350,000	$ 350,000
B. Goal: ARTS EDUCATION Continue to ensure that arts education is recognized and utilized as a major contributor to increase literacy and strengthen basic learning skills in Texas schools and communities.		
B.1.1. Strategy: ARTS EDUCATION Provide and support arts education opportunities.	$ 851,340	$ 826,340
Efficiencies:		
Average Grant Amount Awarded for Arts Education Programs	3,422	3,422
C. Goal: ARTS ACCESS Ensure that Texas citizens and visitors are aware of the value of the arts and have equitable access to quality arts programs and services.		
Outcome (Results/Impact):		
Percentage of Total Assistance Dollars Provided to Applications from Minority Organizations	22%	22%
Percentage of Total Assistance Dollars Provided to Applications from Rural and Geographically Isolated Communities	29%	30%
C.1.1. Strategy: DISTRIBUTE DIRECT GRANTS	$ 3,452,808	$ 3,435,808 & UB
Output (Volume):		
Number of Funded Applications from Rural and Geographically Isolated Communities	550	550
Number of Funded Applications from Minority Organizations	300	300
C.1.2. Strategy: PROMOTION & PARTICIPATION Improve statewide participation in arts programs, enhance the public's understanding of the arts' contribution and value, and encourage and promote cultural tourism.	$ 684,535	$ 584,535
Output (Volume):		
Number of Marketing and Public Relations Activities, Conferences, and Seminars Which Promote Tourism.	75	75
Total, Goal C: ARTS ACCESS	$ 4,137,343	$ 4,020,343

A *rider* sets conditions on an appropriation. Riders often express detailed instructions for agency operations. For example, the Texas Parks and Wildlife Department's fiscal 2004-05 budget includes Rider 14, which directs the agency to use part of the appropriation for a specific strategy, Local Parks, to fund local grants to develop indoor recreation facilities. Riders also are used to set out an agency's capital budget, listing all capital expenditures and their method of finance.

Some riders contain *contingent appropriations*, measures that would appropriate money only if the Legislature enacts other specific bills. These riders are added to reflect other legislation moving through the legislative process. For example, provisions for agencies going through "sunset" review usually include a rider making all appropriations contingent on the enactment of sunset legislation to continue the agency.

The budget may report an agency's *administrative appropriations* as:

- part of a strategy's funding. Administrative costs such as salaries and capital expenditures that are related directly to implementing a strategy are allocated to the strategy's funding level.

- a budget goal called *Indirect Administration*. Agencies receive *direct* appropriations of Indirect Administration funds to cover general overhead costs, such as for computers, administration, and support services, that cannot be attributed to specific programs. Indirect administrative budgets are itemized as the last goal in an agency's budget pattern and usually are found in the budgets of medium-sized and large agencies. Agencies without an Indirect Administration goal have indirect costs allocated to each strategy's funding.

- an informational item at the end of the budget called *Other Direct and Indirect Costs Appropriated Elsewhere in this Act*. This item identifies expenditures that are costs in performing agency operations but are not appropriated directly to the agency. For example, employee health-benefit contributions are appropriated to the state Employees Retirement System, not through the individual agency budgets. The amount reported for this item is *in addition* to the amount budgeted for the agency as reported in the grand total. Usually this item appears in the budgets of agencies that are required to support all their operations through revenues they collect.

- a rider called *Appropriations Limited to Revenue Collections*. This contingent rider requires an agency to pay for specific programs or costs, including administrative costs, with specific revenues such as fees or fines. It also authorizes LBB to direct the comptroller to reduce appropriations to the amount of revenue expected to be available in the event that actual revenue collections are insufficient to cover the specific costs.

Some agencies' budgets contain only one or two of the above. Others, such as the Texas Alcoholic Beverage Commission's budget, contain all four. Also, at the end of each article is a recapitulation of appropriations for employee benefits.

Each agency's budget describes the *method of financing* or mix of revenue sources that finance the agency's appropriation, including interagency contracts. For most agencies, this appears as an informational item after the line showing the grand total. For agencies funded from one revenue source only, usually small agencies such as the Credit Union Department, the method of financing is shown at the beginning of the agency's budget format.

Each agency's budget lists the number of full-time equivalent (FTE) *employee positions* authorized by the Legislature and sets out a schedule of exempt positions, specifying the salaries of certain employees not covered by the state employee salary classification schedule. FTE authorizations serve as a cap on agency staffing.

Initial budget development

The Governor's Office and LBB work jointly in issuing instructions to state agencies for strategic planning and appropriations and in holding pre-session budget hearings. Government Code, ch. 2056 governs state strategic planning.

LBB is a 10-member joint House and Senate committee established in 1949 (Government Code, ch. 322). The lieutenant governor and the House speaker serve as co-chairs. Other members include the chairs of the House

Appropriations and Ways and Means committees and the Senate Finance committee. The speaker appoints two additional members from the House and the lieutenant governor appoints three from the Senate for terms expiring when the next regular session of the Legislature convenes.

Pre-session budget instructions and hearings. In June 2004, LBB and state leaders directed state agencies to submit budget requests for fiscal 2006-07 containing two components: a "baseline" request to fund ongoing operations and a list of "exceptional" items above the baseline level. While agencies had received similar instructions during the previous four budget cycles, in this cycle they were asked to limit the baseline request to 95 percent of fiscal 2004-05 levels.

Agencies were instructed to request funding in their baseline requests sufficient to:

- maintain a constitutional school finance system and meet the requirements of current law;
- satisfy debt-service requirements for existing bond authorizations; and
- maintain caseloads for federally mandated services.

Agencies could request funding above 95 percent of the fiscal 2004-05 baseline level for exceptional items, which could include current services that would require funding above the 95 percent level or new programs and services. In previous sessions, these items formed the basis of agency "wish lists" and were a primary subject of consideration during the legislative budget process.

Deadlines for receipt of agencies' budget requests, known as Legislative Appropriations Requests (LARs), were set for August 2004. The LBB and governor's budget staffs held joint hearings during August, September, and October for agencies to explain their requests, provide supporting data, and answer questions not addressed in the LARs.

State law requires the governor to hold budget hearings with opportunity for testimony by agencies and the public (Government Code, secs. 401.043 and 401.044). Such hearings are optional for LBB (Government Code, sec. 322.010). The governor and LBB may cooperate, exchange information, and hold joint public budget hearings. These hearings are the first opportunity for public testimony regarding future agency and program funding.

LBB budget submission. Government Code, sec. 322.008 requires LBB to send copies of an estimated state budget to the governor and each member of the Legislature within the first five days of a regular session. This document, called *Legislative Budget Estimates*, includes agency-by-agency figures for spending in previous years, the budget amounts requested by each agency, the amount estimated by LBB, and methods of financing. The document also indicates the number of FTE positions targeted for each agency and a schedule of salaries for exempt positions. LBB also must submit a budget in the form of a bill within seven days of the beginning of the regular session. For the 79th legislative session, LBB issued *Legislative Budget Estimates* and a draft of the budget on January 17, 2005, four days after the session began. (See page 4.)

LBB must submit to the Legislature by the third Tuesday of the regular session a report evaluating the performance and efficiency of agency programs (Government Code, sec. 322.011). Recommendations cited in LBB's *Staff Performance Report* often are incorporated into funding proposals. LBB issued its *Staff Performance Report* for the 79th Legislature on January 18, 2005.

Governor's budget proposal. The governor must submit a budget before giving the State of the State address (Government Code, sec. 401.046) and may prepare a general appropriations bill by the 30th day of the session, or by the 20th day following inauguration if newly inaugurated (Government Code, sec. 316.009). Governors once traditionally submitted their own detailed budget proposals, but in recent years, they have tended to submit either general outlines or no separate budget at all.

On January 26, 2005, Gov. Perry released his fiscal 2006-07 budget proposal in a document called *A New Era of Possibility*. The governor's budget proposal would spend $1 billion more in all funds, and $593 million more in general revenue, than the LBB recommendations. The largest spending priorities in the governor's budget include reforming child and adult protective services, funding a Texas Tech Health Sciences Center in El Paso, and combining and enhancing funding for financial aid programs for higher education. The governor also recommended the creation of an emerging technology fund from the rainy day fund.

Growth rate adopted. Art. 8, sec. 22 of the Constitution caps spending of state tax revenue not dedicated by the Constitution to a particular purpose. The growth of spending from nondedicated tax revenue from one biennium to the next may not exceed LBB's official estimate of the state's economic growth rate, defined as the growth in statewide personal income. A majority of the members in each house may vote to override this limit.

On November 17, 2004, LBB adopted an estimated growth rate of 11.34 percent from fiscal 2004-05 to fiscal 2006-07. This means that appropriations from state tax revenue not dedicated by the Constitution may total no more than $52.146 billion in fiscal 2006-07, based on the estimated fiscal 2004-05 appropriation of $46.835 billion of nondedicated tax revenue. The spending cap is derived by multiplying the spending of nondedicated tax revenue in the current biennium by the projected growth rate:

$46.835 billion x 1.1134 = $52.146 billion

The constitutional spending limit for fiscal 2006-07 appears to exceed by about $300 million the amount of nondedicated tax revenue projected in the comptroller's biennial revenue estimate. However, if the 79th Legislature approves emergency appropriations for fiscal 2005, the base for calculating the growth-rate limit will change.

LBB adopted the comptroller's growth-rate estimate from among five forecast sources that offered estimates ranging from 11.34 percent to 13.16 percent. This is the lowest growth rate adopted since the 11.12 percent rate adopted in 1986. The highest growth rate, 33 percent, was adopted in 1980, after the spending limit first was enacted. In fiscal 2004-05 the growth rate was 11.83 percent.

Comptroller reports. Art. 3, sec. 49a of the Constitution requires the comptroller to submit before a regular session statements disclosing the financial condition of the state at the close of the last fiscal period, an estimate of the revenues and expenditures for the current fiscal year, and an estimate of anticipated revenue for the upcoming biennium.

On January 10, 2005, Comptroller Strayhorn estimated total revenue available for spending during fiscal 2006-07 at $130.5 billion and estimated the amount of general revenue-related funds available for certification at $64.7 billion. This includes a positive balance of $2.3 billion at the end of fiscal 2005, after setting aside $746 million in natural gas production tax revenues for the "rainy day" fund, as required by the Constitution (see page 14). See the comptroller's *Biennial Revenue Estimate, 2006-07* for a more complete description of the revenue estimates and projected economic outlook.

Government Code, sec. 403.013 requires the comptroller to report to the governor by the first Monday of each November the funds, revenues, and expenditures of the state. These end-of-year financial descriptions appear in the comptroller's *Annual Cash Report* and cover revenues and expenditures for funds held by the state treasury. The comptroller also must issue by the last day of February of each year an audited financial report of all state agencies, called the *Comprehensive Annual Financial Report* (CAFR). Unlike the cash report, the CAFR is prepared using generally accepted accounting principles and includes information on funds outside the state treasury, fixed assets, and additional statistical and economic data.

Legislative action

The House and the Senate usually take turns originating the general appropriations bill and chairing the budget conference committee. This session, the Senate will go first. Both houses work on the budget and hold hearings simultaneously.

During the 78th Legislature, the House Appropriations Committee reported HB 1 by Heflin, the general appropriations bill for fiscal 2004-05, on April 7, 2003. After the bill passed the House on third reading on April 17, it was received by the Senate and referred to the Senate Finance committee, which reported a substitute version on April 25. The Senate passed the bill as amended on April 29, a conference committee was appointed on May 2, and both houses adopted the committee report during the first week of June. Gov. Perry signed HB 1 on June 22.

House action. The House Appropriations Committee (HAC) leads House action on appropriations bills. For the 2005 session, the HAC includes a chair, a vice-chair, and 27 members representing substantive House committees, all named by House Speaker Tom Craddick. The speaker designated a member of each of the 27 substantive committees as chair for budget and oversight. This method for appointing the HAC is similar to that used under Speaker Gib Lewis from 1983 to 1993. Under Speaker Pete Laney (1993-2003), up to one-half of the HAC membership was determined by seniority, as in determining the membership of other substantive committees.

Chairman Jim Pitts has divided the HAC into five subcommittees: education, health and human services, criminal justice, regulatory, and general government. In addition, HAC will have a subcommittee on government efficiency and operations composed of members from the other subcommittees. Each subcommittee will hold public hearings and make recommendations on budget proposals for agencies under its jurisdiction, but the full committee will make the final budget decisions during "mark-up." The HAC began agency budget hearings on January 31, 2005.

Time constraints. House Rule 8, sec. 21(g) requires the HAC to report the general appropriations bill to the House by the 90th day of the session, which for the 2005 session will be April 10. The HAC has met the 90th-day deadline in each of the past six sessions.

The general appropriations bill has priority over other bills that would appropriate money. Under House Rule 8, sec. 21(a), during the first 118 days of the session the speaker may not lay before the House any bill appropriating money unless the general appropriations bill already has been enacted and the comptroller has certified it. The speaker is to withhold his signature from such bills until the general appropriations bill has been enacted and sent to the comptroller for certification. If the HAC does not meet its 90th-day reporting deadline, this rule is suspended. The 118th day of the 2005 session will be May 8.

House Rule 8, sec. 21(b) and (f) further restricts consideration of specific appropriation bills. To ensure compliance with the constitutional limit on spending from state tax revenue not dedicated by the Constitution, no bill that appropriates such revenues may be considered before final approval of the general appropriations bill, and no bills may be considered that, when added to amounts previously appropriated, would exceed the limit.

Bills reducing taxes or providing payment for legislative expenses, judgments against the state, and emergency matters are not subject to the House appropriations restraints (House Rule 8, sec. 21(e)).

Distribution of the bill. A printed copy of the general appropriations bill reported by the HAC must be placed in the mailbox of each House member at least 168 hours (seven days) before it may be considered on second reading during a regular session. During a special session, 72 hours advance notice is required (House Rule 8, sec. 14(a)). Most other types of bills must be in members' boxes at least 36 hours before second-reading consideration in a regular session, 24 hours in a special session.

Limit on amendments. The House Calendars Committee usually adopts a special rule limiting floor amendments to the appropriations bill to changes that do not affect the "bottom line." The rule has required that any amendment adding or increasing an appropriation item must contain an equal or greater reduction in one or more other appropriation items. For a special rule proposed by the Calendars Committee to take effect, House members must adopt it by a majority vote. A proposed rule cannot be amended.

The House limited floor amendments last session when considering the general appropriations bill for fiscal 2004-05. The Calendars Committee rule also required members to file any second-reading amendments at least two days before the House considered the bill. As usual, the House considered many floor amendments before approving its version of the general appropriations bill.

Senate action. The Senate Finance Committee develops the Senate budget proposal. Like all standing committees, the Finance Committee is appointed by the lieutenant governor, who also names the chair and vice chair. Sen. Steve Ogden, chairman of the Finance Committee, began agency budget hearings in September 2004 and started budget hearings on SB 1 on January 31, 2005. Budget hearings usually are conducted before the entire committee, although four workgroups will hear testimony on specific areas of the budget.

Unlike in the House, Senate action on the general appropriations bill tends to follow the same rules that apply to all other legislation before the Senate. Bills are placed on the daily calendar in the order in which the Senate receives the committee reports. Approval by two-thirds of the members present is required to suspend the regular order and bring the general appropriations bill to floor consideration. Also unlike in the House, in the past four sessions the Senate Finance Committee version of the budget has passed the full Senate without floor amendments.

Conference committee action. After the House and the Senate adopt their versions of the general appropriations bill, the speaker appoints five House members and the lieutenant governor appoints five senators to a conference committee. The committee usually includes the chairs of the House Appropriations and Senate Finance committees and four other members of each committee.

House Rule 13, sec. 9(b) and Senate Rule 12.04 allow conferees to reconcile only points on which the House and Senate bills differ. They may not alter figures that are identical in both bills. If both bills include a spending item but differ on the amount, the conferees may not set the amount lower than the smaller amount in the two bills nor increase it above the larger amount. If an item appears in only one bill, the conferees may include or delete it. If they include it, they may reduce but not increase the amount originally included in the bill.

The conferees may include no item in the conference committee bill that does not appear in either the House or the Senate bill, with two exceptions. House Rule 13, sec. 9(b)(5) and Senate Rule 12.04(5) allow the conference committee to include money "for purposes or programs authorized by bills that have been passed and sent to the governor" and "contingent appropriations for purposes or programs authorized by bills that have been passed by at least one house."

The conference committee also may seek permission from the House and Senate to make changes otherwise prohibited by the rules – "outside the bounds" – by means of a resolution specifying the changes. Adoption of the resolution requires a majority vote in each house (House Rule 13, sec. 9(f) and Senate Rule 12.08). In 2003, the House and Senate each adopted such resolutions (HR 1861 by Heflin and SR 1040 by Bivins) shortly before adopting the conference committee report. The House and Senate resolutions were identical and listed each exception to conference committee rules and the reason for the suspension.

House Rule 13, sec. 10 requires that the conference committee report on any bill be distributed to members at least 24 hours before it may be considered, with no special provision for the general appropriations bill. Senate Rule 12.09(a) requires that the conference committee report be laid out for 48 hours before being considered in a regular session, 24 hours in a special session.

Action after final passage

Certification. After an appropriations bill is approved by each house and signed by the speaker and the lieutenant governor, it goes to the comptroller. Under Art. 3, sec. 49a of the Constitution, no appropriations bill may be considered enacted or be sent to the governor for consideration until the comptroller certifies that the state will have enough revenue to cover the approved spending. Government Code, sec. 403.0131(a), added in 2003, requires the comptroller to complete certification of the appropriations act not later than the 10th day, excluding Sundays, after the date the act is reported enrolled by the house where it originated.

Art. 3, sec. 49a allows appropriations in excess of anticipated revenues in cases of "emergency and imperative public necessity" with approval of four-fifths of the total membership of each house. Generally, however, the Legislature does not approve an appropriations bill unless the revenue necessary to pay for it is available.

A bill not certified is treated as if it never passed and is returned to the house from which it originated. If the Legislature is still in session when the comptroller returns the bill, the bill can be amended to conform with the comptroller's revenue estimate.

Governor's veto powers. Art. 4, sec. 14 of the Constitution authorizes the governor to veto line items in any spending bill that contains more than one item of appropriation. Gov. Perry vetoed about $81 million in certified appropriations from strategies and riders in the fiscal 2004-05 budget act, plus another $200 million in appropriations that were eliminated from HB 2425 by McCall, and HB 3175 by Pitts, both revising the comptroller's administrative and financial procedures.

While the Legislature is in session, the governor has 10 days (not counting Sundays) after receiving the appropriations bill to make line-item vetoes. If the governor fails to act within the 10 days, the bill becomes law. If the Legislature is still in session when the governor vetoes a line item, the bill is returned to the Legislature, which may override the veto if two-thirds of the members present in each house approve. The house where the bill originated votes first.

If the appropriations bill goes to the governor later than the 10th day (not counting Sundays) before the session ends, the governor has 20 days (counting Sundays) after the session ends to act. In this case, if the 79th Legislature's regular session lasts its full 140 days and ends on May 30, 2005, the veto deadline will be Sunday, June 19.

The Legislature must take all actions on a bill during the same session. Because the general appropriations bill usually receives final approval during the last few days of a session, the Legislature typically forfeits the chance to override any line-item vetoes. If the Legislature happens to be meeting in a subsequent special session when the governor vetoes line items from a bill approved during the regular session, the Legislature cannot override the vetoes during the special session.

Veto-proof riders. Texas Constitution, Art. 4, sec. 14 states: "If any bill presented to the Governor contains several items of appropriations he may object to one or more of such items, and approve the other portion of the bill." But in a 1911 court case (*Fulmore v. Lane*, 140 S.W. 405), the Texas Supreme Court held that the governor generally may not veto a rider. A 1951 attorney general's opinion (V-1196) stated that the governor has no authority to veto a rider in an appropriations bill "unless it is in itself an 'item,' that is, a provision containing a specific appropriation of money." In a 1975 case (*Jessen Associates, Inc. v. Bullock*, 531 S.W.2d 593), the Texas Supreme Court sustained this view. If a rider is not an item of appropriation, the veto "is of no effect," but "if the language is intended to set aside funds for a specified purpose, it is an 'item of appropriation' and is therefore subject to veto by the Governor."

An example of an expenditure authorized by rider that is not technically an "item of appropriation" – and thus is presumably veto-proof – appears on page V-25 of the general appropriations act for fiscal 2004-05. Rider 67 to the budget for the Texas Department of Criminal Justice (TDCJ) states: "Out of funds appropriated above in Strategy A.1.2, Diversion Programs, $6,500,000 in fiscal year 2004 and $6,500,000 in fiscal year 2005 in discretionary grants shall be made to the Harris County Community Supervision and Corrections Department for the continued operations of the Harris County Community Corrections Facility." The rider language does not appropriate money; it merely stipulates how some of the money appropriated to TDCJ for diversion programs is to be spent. Thus, if the governor had wanted to veto the $13 million for the boot camp, he would have had to veto the entire $122.6 million for the biennium for TDCJ's Diversion Programs strategy.

Lump-sum appropriations. In the five previous state budgets, each institution of higher education was funded through a single line item, or lump-sum appropriation, instead of through multiple-line appropriations for separate strategies. A breakdown of each institution's funding by goals, objectives, strategies, and other budget components was listed in the first rider, called "Informational Listing of Appropriated Funds."

The general appropriations act for fiscal 1992-93, the last budget to use the old budget format, appropriated money to 160 agencies in lump sums. Gov. Ann Richards, in her 1991 veto proclamation, complained that this "special protection .... effectively prevents the Governor from exercising the authority granted in Art. 4, sec. 14 of the Texas Constitution to veto individual items of appropriation." For the "lump sum" agencies, the governor would have had to veto the agency's entire budget if she objected to a particular item.

Advocates of lump-sum budgets maintain that they protect agency budgets from veto cuts, allow more flexibility for agencies to operate, and eliminate the need for the Legislature to "micromanage" or to anticipate many months in advance how much funding individual programs will require.

Effective date. A general appropriations bill may take effect immediately. Art. 3, sec. 39 of the Constitution says that other bills must be approved by at least two-thirds of the membership of each house in order to take effect sooner than 90 days after adjournment of the session in which they are enacted. A general appropriations bill takes effect when the governor signs it or allows it to become law without signing it (Art. 4, sec. 14).

Other appropriations and adjustments

Supplemental appropriations. The Legislature may change the state budget after it has been approved. Because the regular session begins in January, with eight months remaining in the two-year budget period, agencies sometimes ask for supplemental appropriations to tide them over until the new budget period begins.

The 79th Legislature is expected to enact emergency appropriations for fiscal 2005 to cover expenditures that will exceed the budgeted amounts. The projected shortfall of between $1.2 billion and $1.4 billion is attributed to higher-than-budgeted expenditures in Medicaid and CHIP, lower cost savings by the Health and Human Services Commission, higher-than-projected growth in public school enrollment, and the need for textbook funds. Other elements of the shortfall are attributed to the TDCJ, juvenile probation, the Office of the Secretary of State, elements of the child protective services proposed reforms, and lower than expected revenue from the sale of state land. The governor's budget proposal recommends spending $657 million from the state Economic Stabilization Fund, the so-called "rainy day" fund, to address the estimated fiscal 2005 Medicaid and CHIP shortfall. Last session, lawmakers approved HB 7 by Heflin, which appropriated from the rainy day fund, the HHS Quality Assurance Fund, and the Telecommunications Infrastructure Fund about $1.1 billion on an emergency basis for fiscal 2003 and another $295 million for the Texas Enterprise Fund.

Appropriation reductions and adjustments. The Legislature may reduce appropriations during a two-year budget period. For example, appropriations made by the 71st Legislature for fiscal 1990-91 were reduced by the 72nd Legislature in January 1991.

The Legislature also may adjust the budget in special sessions called by the governor. During the 78th Legislature's first and third called sessions, lawmakers enacted bills that appropriated $405.1 million in additional funds. According to LBB, because of additional revenue and savings included in the bills that were enacted, the total appropriation of general revenue only increased by $74.1 million.

Budget execution authority. Government Code, ch. 317 allows the governor and LBB, acting jointly, to use budget execution authority to make certain changes in appropriations when the Legislature is not in regular or special session.

A budget execution order may prohibit an agency from spending funds, change the purpose for an appropriation, change the time that an appropriation is distributed to an agency, or transfer an appropriation from one agency to another. An order may not withhold for more than 180 days money appropriated to any agency, reduce the salary of an elected state official or a board member appointed by the governor, or reduce appropriations to the Legislature or legislative agencies. An order may not extend beyond a two-year budget period. An order may be superseded by legislative action.

Either the governor or LBB may propose a budget execution order. The entity receiving the proposal may ratify, reject, or recommend changes in the proposal. If a proposal is adopted without change, it takes effect upon adoption. If the receiving entity changes a proposal by adopting a "contingent order," the proposing entity may approve or reject the changes.

Two budget orders were executed during the interim between the 78th and 79th Legislatures. The first was adopted by the board on February 9, 2004, and approved by the governor effective March 12, 2004. That order transferred funds to the UT Health Science Center at San Antonio for operating expenses and to the Texas Tech University Health Sciences Center for start-up funds for a new medical school in El Paso. It also authorized the transfer of funds to the Texas Cooperative Extension for wildlife management and to the Secretary of State for election operations. The second order was adopted by the board on August 23, 2004, and signed by the governor on September 21, 2004. It transferred funds to the Texas School for the Blind and Visually Impaired for classroom instruction and support services, to health-related institutions for operating costs, and to the Texas Excellence Fund and University Research Fund for allocations to academic institutions.

Spending limits

Constitutional limits. Five major constitutional limits bear on the appropriations process.

Appropriation requirement. Under Art. 8, sec. 6 of the Constitution, no money may be drawn from the state treasury unless it has been appropriated by law. No appropriation may be made for longer than two years.

Budget growth limit. Art. 8, sec. 22 caps spending of state tax revenue not dedicated by the Constitution to a particular purpose. An example of dedicated revenue is motor-fuels tax revenue, dedicated to highway and public education expenditures. Appropriations from that revenue source do not count toward the spending limit.

The growth of spending from undedicated tax revenue may not exceed LBB's official estimate of the growth rate of the state's economy. A majority vote of the members of each house may override this spending limit. Government Code, ch. 316, subch. A, specifies the procedure by which LBB adopts the growth rate and defines undedicated tax revenue. (See page 7 for a review of the most recent growth rate.)

If LBB does not adopt a spending limit, the growth rate must be treated as zero, and the appropriation of undedicated tax revenue may not increase from the current level (Government Code, sec. 316.002(e)).

Prohibition against deficit spending. Art. 3, sec. 49a limits spending to the amount of revenue that the comptroller estimates will be available during the two-year budget period. The comptroller must certify that the state will have enough revenue to pay for the approved spending. The Legislature may override the provision if at least four-fifths of the members of each house approve.

Before the regular session begins in January, the comptroller must provide the Legislature with an estimate of the amount of state revenue projected to be available for spending during the next two-year budget period. A supplemental estimate is required before any special session. (For the latest revenue estimate, see page 8.)

The comptroller is not bound by the initial revenue estimate and may revise it at any time. The only revenue estimate that counts in determining if the state budget has a deficit is the one made when the comptroller certifies the general appropriations bill. Once the comptroller certifies a general appropriations bill, that certification stands, even if the comptroller subsequently determines that revenues will not cover expenditures after all.

The state may end a fiscal biennium with an unanticipated deficit, but it must eliminate the deficit in the subsequent budget. There must be sufficient revenue for the upcoming biennium to cover both spending in the general appropriations bill and any deficit left over from the previous biennium. (See Attorney General Opinion JM-666, April 1, 1987.)

Limits on state debt. Art. 3, sec. 49 prohibits state borrowing except to "supply casual deficiencies of revenue," repel invasion, suppress insurrection, defend the state in war, or pay existing debt. Texas voters have amended this provision more than 20 times to authorize the issuance of general-obligation bonds backed by the state's full faith and credit. Most recently, in September 2003 voters approved an additional $250 billion in general-obligation bonds for military enhancement projects and authorized the Texas Department of Transportation to issue general-obligation bonds to be repaid out of the state highway fund (Fund 6).

Voters amended Art. 3, sec. 49 in November 1991 to allow creation of state debt through ballot propositions submitted to the voters by a two-thirds vote of each house of the Legislature without amending the Constitution itself for each new bond proposal. This provision has never been used.

Art. 3, sec. 49-j, approved by voters in November 1997, sets a limit on state debt. The Legislature may not authorize general-obligation or revenue bonds or large lease-purchase agreements designed to be repaid from general revenue if the resulting annual debt service from general revenue would exceed 5 percent of the average amount of general revenue (excluding funds dedicated by the Constitution) over the preceding three fiscal years. The limitation does not include bonds backed by the full faith and credit of the state that are reasonably expected to be paid from other revenue sources and not draw on general revenue, unless repayment from general revenue actually is required.

At the end of fiscal 2004, debt service on outstanding debt equaled about 1.5 percent of unrestricted general revenue, according to the Bond Review Board. The ratio of total authorized debt service (issued and unissued) to unrestricted general revenue was 2.3 percent. In connection with its budget estimates for fiscal 2006-07, LBB estimated the ratio of debt service on outstanding debt to unrestricted general revenue at 1.5 percent for fiscal 2005.

Limit on child welfare spending. Art. 3, sec. 51-a limits state spending on assistance to needy children to no more than 1 percent of the total state budget. Federal matching funds and administrative expenses are not included under the spending cap.

According to LBB, the welfare spending limit for fiscal 2004-05 is about $1.2 billion. The current budget allocates $178 million for grants for Temporary Assistance for Needy Families, about $1 billion below the constitutional limit.

Dedicated revenues and funds. Legislative spending discretion also is restricted by constitutional or statutory dedications that earmark certain revenue sources for special purposes or by state compliance with court orders and federal requirements. According to LBB's *Fiscal Size-Up, 2004-05 Biennium*, only about 18 percent of the general revenue-related funds appropriated for fiscal 2004-05 reflected totally discretionary spending by the Legislature.

Constitutional or statutory dedications consumed about 49 percent of all general revenue-related appropriations in fiscal 2004-05. For example, the Constitution dedicates three-fourths of all motor-fuels taxes to highway-related spending. The other fourth goes to the available school fund for distribution to public schools. About 21 percent of general revenue-related spending was influenced or directed by federal laws, regulations, and court decisions, and about 13 percent was influenced by statutorily imposed funding formulas, according to LBB.

In addition to general revenue restrictions, the state's $118.2 billion total appropriation for fiscal 2004-05 included about $39.2 billion in federal fund expenditures. Federal funds generally are granted for specific purposes or with restrictions on how states may spend these funds. In May 2003, Congress enacted and President Bush signed the Jobs and Growth Tax Relief Reconciliation Act, which included $20 billion in fiscal relief for states. Texas received nearly $1.3 billion in total, including $709 million for general purposes and $553 million in Medicaid matching funds.

Fund consolidation. Since 1991, the Legislature has phased out restrictions on many dedicated revenue funds and has changed the methods of fund accounting. In the past, most dedicated revenue was held in separate "special funds," severely limiting the amount of general revenue available for general-purpose spending. The Legislature has phased in the consolidation of many dedicated funds into general revenue and has contained the growth of newly created dedicated accounts. The general revenue fund now contains about 200 dedicated accounts.

Since 1997, fund consolidation changes also have included annual accounting "sweeps." On August 31, cash balances in dedicated revenue accounts that exceed amounts appropriated or encumbered are transferred into the general revenue fund for one day to be counted as available general revenue by the comptroller. Accounts exempt from this provision include accounts created by a court or the Constitution, trust funds, federally required funds, and funds outside the treasury.

Economic stabilization fund. A portion of any balance remaining in the general revenue fund at the end of a biennium is transferred to the economic stabilization fund, also known as the "rainy day" fund. The transfer is required both by statute and by Art. 3, sec. 49-g of the Constitution, approved by voters in 1988.

As of January 10, 2005, the fund had a net cash balance of about $829 million. The fund is held outside of general revenue, and its revenues and expenditures are summarized in the comptroller's *Annual Cash Report*.

By the 90th day of each fiscal 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 restriction and has not been obligated to be spent in the future. No such transfer has occurred since November 1991 because no unencumbered general revenue balance has remained at the end of any fiscal year.

The rainy day fund has grown rapidly in recent years, however, because of increased collections of natural gas production taxes. Art. 3, sec. 49-g 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 the excess revenue goes to general revenue. Transfers of excess natural gas tax collections to the rainy day fund are $594.5 million in fiscal 2005. After appropriations from the fund are calculated, the fund balance is projected to settle at $715 million for fiscal 2005, according to the comptroller.

The fund cannot exceed an amount equal to 10 percent of the general revenue (minus certain types of income and funds) received during the previous biennium. The current cap would be roughly $6 billion, far above the current fund balance.

Money in the fund can be spent only with legislative approval. Subject to various limitations, approval by at least three-fifths of the members present in each house is required for any expenditure from the fund. Spending generally may not exceed the amount of any unanticipated deficit or revenue shortfall. 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. Last session, approximately $447 million was transferred from the fund to health and human services and $295 million to the Texas Enterprise Fund in HB 7 by Heflin, the supplemental appropriations bill. In 1993, a portion of fund was transferred to TDCJ for criminal justice programs. In 1991, the entire balance of the fund was transferred to the foundation school fund.

Budget monitoring

Several state agencies and committees evaluate agency budget performance and major state finance issues.

LBB activities. In addition to assisting with the development and execution of the budget, the LBB staff monitors agency performance measures and expenditures, performs interim assignments directed by the general appropriations act, and responds to special requests from the board, legislators, and agencies.

After a regular session ends, LBB summarizes the state budget and state government functions, activities, and agencies in its *Fiscal Size-Up* report. The report also describes state revenues and major revenue issues and compares Texas with other states in terms of state expenditures, tax rates, personal income, number of government employees, and other factors.

All agencies must submit quarterly or semiannual reports to LBB and the Governor's Office on their progress in meeting performance targets. Data submitted through these reports are verified by the State Auditor's Office (SAO) and serve as the primary tool for monitoring each agency's progress toward reaching its strategic goals and objectives. The LBB staff reports to the board major variances from stated goals.

In March 2004, LBB distributed *Budget and Performance Assessments: State Agencies and Institutions, Fiscal Years 1999-2003*, which provides information on selected agencies' budgets, major contracts, lawsuits, employment levels, and other performance highlights, including a notice of reviews by SAO or the Sunset Advisory Commission, if applicable. LBB publishes periodic summaries of agency performance in reports called *Summary Assessment of Agency Performance*.

LBB staff analyzes how state agencies and programs are financed, organized, and operated and recommends improvements that will streamline operations, eliminate duplication, save the state money, and enhance the delivery of services. In addition to LBB review, the Comptroller's Office formerly assessed agency performance and issued a report recommending changes designed to improve the operation of state government. The comptroller's staff also conducted reviews of individual state agencies, school districts, and other units of local government. Both responsibilities were transferred from the Comptroller's Office to LBB in HB 7 by Swinford, enacted by the 78th Legislature in its third called session. Significant findings and recommendations for improvement in agency performance appear in LBB's biennial Staff Performance Report (see page 7).

State Auditor's Office. SAO acts as an independent auditor of state government management and financial systems and offers audit-related information services for the Legislature. It operates under the direction of the Legislative Audit Committee (LAC), comprising the lieutenant governor, the House speaker, and the chairs of the Senate Finance committee and of the House Appropriations and Ways and Means committees as well as another member of the Senate appointed by the lieutenant governor. SAO assists in strategic planning and budgeting by assessing the use and appropriateness of agency performance measures. The agency also reviews and evaluates state salary classifications.

The state auditor also conducts management control audits and financial audits. Management control audits assess agency or program organization, management information systems, administrative controls, and other factors to determine whether resources are used efficiently and economically. Statewide financial audits are conducted to satisfy federal grant requirements and to determine the accuracy of state financial statements. Audits of individual agencies evaluate financial operations, certify financial statements, and determine compliance with specific laws. Internal auditors at the larger state agencies and universities also monitor the reliability of financial controls, the accuracy of financial information, and the safeguarding of state property.

The state auditor and LAC annually select agencies or programs for audit through a risk-assessment process that considers such factors as budget size, history of program problems, and unmet performance measures. Audits are coordinated with LBB staff and the Sunset Advisory Commission (Government Code, sec. 321.013(c)).

Sunset Advisory Commission. The Texas Sunset Act (Government Code, ch. 325) requires the Legislature to evaluate all state agencies periodically and to abolish or "sunset" inefficient or unnecessary operations. The Sunset Advisory Commission reviews all agencies scheduled by law for termination in a given year, examining each agency's operational efficiency, conformity to its strategic plan and statutory objectives, and any duplication or overlapping jurisdictions with other agencies. In 2005, 30 agencies representing a broad range of governmental activities are scheduled for sunset review.

The Sunset Advisory Commission includes 12 members: five senators and one public member appointed by the lieutenant governor and five House members and one public member appointed by the speaker. The commission completed its recommendations for all 30 agencies in January 2005.

Legislative budget committees. Like other committees, the legislative budget committees receive interim charges to study. During the interim between the 78th and 79th Legislatures, the House Appropriations Committee was charged with studying the structure of the General Appropriations Act, including the transparency of agency bill patterns and the effectiveness of performance measures; monitoring the performance of state agencies and their contracting practices; examining the number of general revenue dedicated accounts held outside the state registry; reviewing the use of debt financing by the state; and evaluating the funding for graduate medical education and parole and community supervision systems.

The Senate Finance Committee was charged with analyzing how health-related caseload and cost estimates are made, monitoring health and human services reorganization, conducting a data review of all health and human services programs in Article 2, monitoring homeland security spending, studying the effect of tuition deregulation, reviewing tuition revenue bond authorizations, developing a profile of the use of local funds by state agencies, studying funding and accountability in higher education, supporting the Joint Select Committee on Public School Finance, monitoring the use of the transportation Fund 6 and the Texas Enterprise Fund, reviewing fees at state regulatory agencies, revisiting the issue of rising health care costs, monitoring adult and juvenile correction population trends, and reviewing general budget and tax issues such as the rainy day fund, the pension fund, the issuance of state bonds, budget pattern, and budget certification.