

HOUSE OF REPRESENTATIVES



Jim Dunnam
Chairman

Myra Crownover
Vice Chairman

Garnet F. Coleman
Drew Darby
A. Craig Eiland
Carol Kent
Solomon P. Ortiz, Jr.
Jim Pitts
Vicki Truitt

Texas Capitol Room E2.202

Post Office Box 2910
Austin, Texas 78768-2910
(512) 463-0240

Leslie Lemon
Executive Director

Zachariah T. Evans
Deputy Director

Chelsea Reilly
Valerie Pizana
Committee Clerks

SELECT COMMITTEE ON FEDERAL ECONOMIC STABILIZATION FUNDING

PRELIMINARY MID-SESSION REPORT

April 14, 2009

**Contact: Leslie Lemon
or Zachariah Evans
(512) 463-0240**

EXECUTIVE SUMMARY

Texas is expected to receive \$16 billion in American Recovery and Reinvestment Act (Recovery Act) funding that will be administered by state government. State agencies are beginning to receive, obligate and expend significant amounts of Recovery Act money now and will continue to receive and expend funds throughout the 2010-2011 biennium.

For example, the Texas Health and Human Services Commission has already received \$670 million in additional Recovery Act funds to pay for a greater Federal share of total Medicaid expenditures that the State has incurred since October 1, 2008. Also, the Texas Department of Transportation moved quickly after passage of the Recovery Act to obligate at least \$1.7 billion or 75 percent of over \$2.25 billion in new transportation spending from stimulus funds. Much of the remaining funds will go to local MPOs.

In the next few days or weeks, the Texas Education Agency will receive as much as 67 percent of the \$3.9 billion allocated for education under the State Fiscal Stabilization Fund (SFSF) provisions. This also includes 67 percent of the \$700 million of flexible SFSF funding that the Governor may use for public safety or other government services, including funding for elementary, secondary and higher education. TEA also will receive 50 percent of nearly \$2 billion in Title I and IDEA funds that will be distributed directly to local school districts sometime in April.

By late May 2009, the State Energy Conservation Office (SECO) must submit its plan for using around \$250 million in additional energy conservation funds and must allocate the funds sometime in June 2009.

In summary, a large portion of the stimulus funds will be received, obligated and potentially expended in FY 2009. This fact is significant when attempting to assure transparency and accountability for these funds.

The timing of the receipt of these funds, while the 81st Legislature is in session, enables the Legislative Branch to deliberate the appropriate use of the funds, establish state priorities, and allocate the stimulus funds accordingly—for the remainder of FY 2009 and for the 2010-2011 biennium. Funding decisions of this magnitude should not be left to the sole discretion of the Executive Branch, or any one branch of government.

Complicating matters, the final rules and regulations for all stimulus funding included in the Recovery Act may not be in place by the end of the regular session, and actual Federal funding levels may be more or less than anticipated. In fact, if the economy does not recover in the near-term, there may be additional stimulus legislation providing more Federal funds to Texas. Therefore, the Legislature should ensure that a process is quickly put in place that allows both the purpose and level of appropriations to be adjusted and to assure they are in compliance with Federal laws and guidelines and legislatively designated State priorities.

The Legislature has a duty to invest the Federal stimulus funds wisely, provide taxpayers with the greatest possible return on their investment, and ensure the highest level of accountability and transparency. The overall goals of the Recovery Act, ranging from long term economic stimulus to rapid job creation, should be considered in relation to all spending decisions. If Texas simply uses the one-time funds to replace existing state expenditures, as opposed to investing in programs that will maximize job creation and stimulate the economy, then a unique opportunity may be lost.

Concerns have been expressed that Federal stimulus funds could create a huge demand on General Revenue in the future after the Federal funds expire—that only “one time,” non-recurring expenditures should be made from these funds. While this is an important consideration, it is important to note that House Bill 1 and Senate Bill 1, introduced prior to the passage of the Recovery Act, assumed spending up to \$3 billion from the State Economic Stabilization (or "Rainy Day") Fund to cover proposed spending for 2010-2011. Those bills did not include money to pay for school textbooks nor the per student technology allotment, estimated to cost over \$1 billion.

For the first time, the Legislative Budget Board has publicly warned lawmakers that Texas has a biennial "structural deficit" of around \$8 billion. A structural deficit is, by definition, one that economic growth cannot cure. A structural deficit can only be corrected by making changes in core tax and/or spending policies. These conditions existed prior to the passage of the Recovery Act, and this \$8 billion structural deficit cannot be blamed on the acceptance of temporary, Federal stimulus funds.

After more than 20 meetings thus far, including two public hearings outside of Austin, the Select Committee has received broad input from state agencies, interest groups, service providers, recipients of services, and interested citizens.

The Select Committee specifically asked each state agency if the need exists for the additional Federal funds. The uniform response was “yes.” In many cases, agency directors answered that the state’s needs are still far greater than the additional Federal funds will cover. This important

fact means the Recovery Act funds can be used to meet real needs of Texans. The Select Committee specifically asked if the agencies could put a process in place to ramp up and then ramp back down when the Federal funds run out. Again, the uniform response was “yes.” The Select Committee encouraged the agencies to use all available means to inform recipients, employees, and the general public that the additional funds are temporary to avoid creating unrealistic expectations for continued future funding. The Select Committee likewise obtained assurances that it would be promptly advised of any changes or needs related to the Recovery Act within each agency.

Virtually all activity of the Select Committee is discoverable at www.txstimulusfund.com, the Select Committee website. All documents, hearing schedules and hearing video/audio can be accessed on the website, as well as links to other useful information.

The following recommendations reflect the broad input received over the course of the Select Committee's hearings. The Committee will continue to monitor Federal guidelines, updates and stimulus allocations, and will endeavor to distribute this information to the Legislature as it becomes available.

CORE RECOMMENDATIONS

1. Appropriate all Federal stimulus funds estimated to be received by the state during FY 2009 in the Supplemental Appropriations Act so the Legislature can establish priorities for spending, identify and account for the funds, add reporting requirements and performance measures, and amend existing riders to ensure maximum legislative authority over the Federal stimulus funds.

Explanation: Agencies currently are receiving, obligating and expending significant amounts of Federal stimulus money in FY 2009 while the Legislature is concentrating on budgeting for 2010-2011. Riders that govern the use of Federal funds in the current appropriations bill did not contemplate the receipt of billions of dollars in new Federal funds. These riders need to be modified and strengthened in the supplemental bill so they will be in place for the remainder of the 2008-2009 biennium.

2. The Supplemental Appropriations Act for 2008-2009 and the General Appropriations Act for 2010-2011 should itemize every dollar of Federal stimulus money appropriated in a separate “Article” of the bill where any legislator or citizen can see the amounts appropriated, the specific purposes for which the funds are appropriated, performance measures tied to each expenditure of funds, the number of FTEs authorized, and a list of all capital items to be purchased with the stimulus funds. This itemization should also include the same information for General Revenue that is freed-up as a result of the availability of Federal stimulus funds.

Explanation: For the most part, the \$16 billion in Federal stimulus funds flow through existing programs included in existing strategies within the current state budget structure. The additional Federal funds should be appropriated together with the existing funds to

show the total funding for that same program or strategy. However, in order to provide complete transparency, the stimulus funds should be itemized elsewhere in the bill so that the State's use of those funds can be easily identified. The amount and use of General Revenue that is freed-up as a result also must be clearly identified.

3. Provide a temporary increase in the number of FTEs for additional agency employees to handle increased funding capacity, contract management and monitoring, performance reporting, transparency requirements, enhanced accountability and auditing, etc. Clarify that the additional employees are temporary positions that will expire with the expiration of the Federal funds.

Explanation: The Recovery Act authorizes a portion of the Federal funds to be used to meet the additional demand created by the funding, to expedite the disbursement of the funds, and to comply with the new reporting, accountability and transparency requirements.

4. The Supplemental and General Appropriations Acts should, at a minimum, include riders that:
 - a. Require all state agencies and institutions of higher education to file all documents and information pertaining to the receipt and expenditure of Federal stimulus money with a single entity, such as the Legislative Reference Library, including but not limited to correspondence, notice of availability of funding and awarding of grants or contracts, signed contracts, project description, progress toward project completion, audit reports, etc.
 - b. Require all inspectors general, internal auditors, external contracted auditors, and all other personnel at state agencies and institutions of higher education to cooperate with any and all requests by the State Auditor's Office pertaining to Federal stimulus funding.
 - c. Require all state agencies and institutions of higher education to post in a prominent position on the home page of the agency's website all information pertaining to Federal stimulus funding received or disbursed by the agency or institution, including but not limited to notices of the availability of stimulus funding, the process for applying for or obtaining a grant or contract, and a contact address and phone number to receive more information, file a complaint, etc.
 - d. Designate specific state agencies to serve as the lead agency to coordinate and maximize the state's efforts to apply for and obtain funding in areas where states and/or other entities must apply for and/or compete for funding, such as broadband expansion and mapping; renewable energy, health information technology, etc.

- e. In the event that the Texas Government Accountability and Transparency Act of 2009 or similar legislation is not enacted, a rider should be added to the Supplemental and General Appropriations Acts to: a) require each agency to provide 30-day written notice to each member of the legislature prior to obligating or expending federal stimulus funds that exceed the amount appropriated in those acts; b) require the notice to be posted on the agency's website and in the Texas Register; c) require each agency to hold a public hearing on the intended use of the additional funds; and d) require the written approval of the Legislative Budget Board in advance of obligating or expending the funds.
5. Use Federal stimulus money to maximize funds, create jobs, and stimulate the Texas economy. These are one-time funds, the purpose of which is to create jobs and stimulate the Texas economy. Decision-makers should always ask, for each spending alternative, does it comply with the intent of the Recovery Act and is it the best and highest use of the funds. Examples include:
- a. Investing in higher education results in a return of approximately \$7 for each dollar invested, and the Recovery Act specifically encourages states to use funds to mitigate tuition costs. The Legislature should appropriate additional funds to institutions of higher education to mitigate the last six years of dramatic increases in tuition and distribute the additional funds to public colleges and universities through formula funding.
 - b. Supplementing public school funding provided by the state lessens the tax burden on local property taxpayers. Adding this one-time money to funds previously set aside for public education will also enable the state to meet Recovery Act goals such as increasing teacher effectiveness, expanding pre-K, and improving college and career readiness.
 - c. Investing in certain health and human services programs will draw down significant Federal matching funds. The Recovery Act temporarily increases the percentage the Federal government will pay for services covered under the state's Medicaid program, commonly known as the FMAP or Federal Medical Assistance Percentage. This is a unique opportunity to reinvest Recovery Act money to draw down additional Federal funds that can be used to provide health care for Texas children or improve the quality of life for mentally disabled Texans living in state schools. Also, Texas can qualify for an additional \$200 million in Federal Temporary Assistance for Needy Families (TANF) funds by increasing the "back to school" payment and the stipend for grandparents taking care of TANF grandchildren, which are non-recurring expenditures that will stimulate the economy.
 - d. Providing a 13th check to retired state employees and retired teachers will stimulate the economy.
 - e. Designating a pool of stimulus funds for infrastructure needs of county and municipal governments would create jobs and would distribute them across the state.

- f. Modernizing unemployment insurance eligibility will draw down \$555 million in additional Federal funds and will reduce or avert a higher tax increase on employers and provide additional relief to unemployed Texans.
6. Require agencies to clearly identify all programs, projects, services and other items funded by the Recovery Act by placing the official Recovery Act emblem that is available electronically free of charge on all documents, including but not limited to contracts, public announcements, notices and correspondence.

RESPONSE TO QUESTIONS FROM THE OFFICE OF THE SPEAKER

The Speaker's Office asked the Select Committee a number of specific questions regarding the Federal stimulus funding. Below are the Select Committee's preliminary responses.

1. Where do we get the most use of the stimulus funds in the budget—where can we maximize freed-up General Revenue and/or pay for one-time items?

The state gets the most “use” of the stimulus funds in the health and human services programs that receive the newly increased Federal match for every dollar of general revenue expended. Not only is there a Federal match obtainable by spending new Federal dollars (a rather unique opportunity), the multiplier effect of health care spending is high and will result in lower local tax burdens and maximum economic stimulus effect.

We can maximize freed-up General Revenue by reinvesting those funds in programs that draw down significant Federal matching funds, e.g., providing 12-month continuous eligibility for children enrolled in Medicaid; restoring the Medically Needy program for adults; and repairing the dysfunctional eligibility system that unnecessarily delays and denies legitimate applicants for Medicaid, CHIP and 100% federally-funded Food Stamps. Freed-up General Revenue draws the highest federal match when used to provide Medicaid services (60-67%); CHIP coverage (over 70%); vocational rehabilitation (80%); and also for family planning services (90%).

The Legislature can assure that these are “one-time” funding items by including a sunset provision. (Unlike the unemployment law changes, changes in Medicaid *can be sunset*). Also, a future Legislature can simply choose not to provide funding in the General Appropriations Act for 2012-2013 when the federal stimulus funds are no longer available or it can decide to terminate the services by changing the law, as it did in 2003.

2. How do we avoid expanding existing programs with one-time Federal funds?

Most expansions can be guaranteed for only one biennium by using sunset provisions. As mentioned above, the Legislature can terminate services and programs funded with Federal stimulus funding by statute or, in most cases, simply by reducing the level of appropriations in the 2012-2013 budget. Avoiding expansion of existing programs

simply to avoid tough decisions later can result in failure to maximize the use of Federal funds and the failure to generate the greatest return on the state's investment in terms of job creation and retention and economic growth.

Even when sunset provisions are impracticable, there are ways to structure programs to ensure that the expenditures are non-recurring. For example, the TEXAS Grants program could be structured to provide every eligible junior and senior enrolled in a public college or university with the maximum assistance without obligating future expenditures.

Providing TANF recipients with a one-time supplemental payment is another example of a non-recurring expense that uses additional Federal TANF funds in the Recovery Act to put money directly in the hands of needy families who will immediately put it back in the Texas economy without expanding an existing program. This investment also will allow Texas to qualify for over \$200 million in additional TANF funds.

Public schools, public libraries, community colleges and universities have significant backlogs of building renovations and repairs, equipment and technology upgrades, and numerous energy-savings that would be classified as one-time expenditures that could also yield long-term energy savings if these funds are used as intended with “green” building concepts.

Expanding existing programs may be unavoidable unless we are willing to turn back Federal funds that can then be redirected to other states. To expedite the infusion of Federal funds into the Texas economy, the Act often uses existing program structures to deliver the expanded services. A good example is the \$214 million increase in child care services. There is a huge demand for child care services for low-income working Texans and recently unemployed Texans who are seeking jobs. These child care funds are desperately needed in Texas and should be available here to help Texans seek and maintain employment. Otherwise, many Texas children could remain in unsupervised homes while their parents are at work or are searching for work, or those unemployed parents might not search for work at all.

3. How can the UI provisions be implemented to comply with Federal requirements but avoid long-term costs to the trust fund?

An important point to consider is that Texas can defer implementation for up to one year and still receive the \$555 million immediately. Therefore, on October 1, when the Texas Workforce Commission takes the snapshot of the Unemployment Insurance Trust Fund which will determine the amount of the tax increase on Texas businesses, the deficit in the fund will be smaller and will trigger a smaller increase. If we were to accept the \$555 million and transfer the existing balances from the Governor’s Enterprise Fund, which is funded by a tax on employers, right now before he obligates any additional money, the deficit would be drastically reduced, and a deficit tax for calendar year 2010 might be avoided entirely.

The estimated annual cost of enacting the modernizations is \$75 million. The \$555 million in federal incentive funds will cover the cost for approximately 7.5 years (10 years if the time-value of the money is factored in). During difficult economic times, Texas businesses cannot afford to pay higher tax rates that could be avoided. Texas should be taking every measure possible to ameliorate any tax increases on business until the economic outlook is much improved.

Importantly, the U.S. Department of Labor has acknowledged in writing that, while provisions cannot be subject to automatic sunset, they can be repealed by a future Legislature, without having to return any of the \$555 million.

In the meantime, a special committee could be established, with small and large businesses represented on the committee, to monitor the changes and the overall health of the fund and make recommendations to the 82nd Legislature on whether the costs of modernization are less than or greater than estimated and whether they should be continued or discontinued.

4. How can we ensure that state agencies will maximize use of the funds and get them out the door as quickly as possible?

Agencies are receiving funds right now and the Legislature has yet to establish any reporting, accountability or transparency requirements. The Legislature should quickly pass legislation establishing specific requirements in law. In addition, the Supplemental Appropriations and General Appropriations Acts should establish clear performance measures for job creation, job retention, economic growth, and delivery of specific services to additional numbers of Texans, for example.

Agencies, community and technical colleges and other institutions of higher education should be directed to work cooperatively on areas where new funds will create a demand for new job skills such as those necessary to perform "green collar" jobs.

Some Federal funds are available only on a competitive or grant basis and lead agencies/universities must be designated to coordinate and maximize the state's effort to apply and compete for these funds. There are significant funds available for broadband expansion and mapping, but it appears no state agency has assumed a leadership role for bringing all entities, public and private, together to ensure Texas receives its fair share of these funds.

Agencies also should be permitted within limits to provide public announcements, advertise, and distribute educational materials to notify the public, particularly local units of government, of the availability of these new funds so that there are plenty of applicants. This method also should be used to inform the public and potential recipients that the funds are temporary and are subject to termination.

5. What sort of federal accountability requirements can we expect we'll have to deal with? Regular audits from the OMB? Extensive reporting requirements?

Texas was selected as one of 16 states the U.S Government Accountability Office will monitor and audit regularly. The GAO will submit bi-monthly reports on what they are finding in these 16 states. Therefore, Texas will be under the microscope in our use of the \$16 billion in federal stimulus fund. Passage of the Texas Government Accountability and Transparency Act of 2009 would provide a strong oversight structure to ensure that Texas is in full compliance.

More importantly, the Federal government's accountability guidance currently only covers prime contractors and states, and does not extend to local governments that receive funding through the state and other sub-contractors. This is an area where the state will need to exercise greater diligence in requiring transparency and accountability.

6. If agencies or locals (e.g. school districts) spend the funds on things that require on-going costs, what is the best way to ensure this won't come back to the state with the complaint that we either "must fund or it is an unfunded mandate."

The best way to ensure this won't come back to the state with a complaint that we "must fund" its continuation is to clearly state upfront that an entity that "ramps up" spending with federal stimulus funds must also have a plan in place to "ramp down" once the federal funds expire. Entities should be encouraged to inform new employees and recipients of grants or contracts that the funds are temporary and will expire at the end of the designated funding period.

SUMMARIES OF AGENCY TESTIMONY BEFORE THE SELECT COMMITTEE

Texas Department of Housing and Community Affairs

The Texas Department of Housing and Community Affairs (TDHCA) will receive \$565 million in stimulus money under the Recovery Act. The funds will be directed almost entirely to existing programs within the agency, such as homelessness prevention (\$42M), weatherization (\$327M), community services grants (\$48M) and the HOME Investment Partnerships Program (\$148M).

The homelessness prevention program is designed to assist people who are homeless, or at risk of becoming homeless (whether due to foreclosure or other reasons), and assists those people in locating housing. The service also provides rent assistance, credit repair counseling, security and/or utility deposits and help with moving costs. Funding for this program will increase approximately 10-fold (from \$4.85M annually to \$41M in supplemental funding) under the Recovery Act.

Another large portion of TDHCA funding will be dedicated to weatherization funding. This program will see a 25-fold increase in funding (from \$13M annually to \$327M in supplemental funding). Texans who are living under 200 percent of poverty level will be eligible to receive up to \$6,500 (up from \$5,000) for weatherization improvements on their homes. (For 2009, the

Federal poverty level for a family of four is \$22,050.) TDHCA submitted an initial application to the US Department of Energy (DOE) to receive Recovery Act weatherization funds on March 19, 2009; a comprehensive plan is due by May 12, 2009.

The DOE allows states and sub-recipients to use up to 5 percent of their share of weatherization money for administration. DOE also allows states to set aside 17 percent for Training and Technical Assistance (T&TA). TDHCA testified that they will reserve only 10 percent for T&TA. (After receiving clarification, TDHCA said the agency will likely not have the flexibility to use these funds for such things as grants or scholarships for people who wish to receive technical training in order to obtain certification in fields related to environmental construction and maintenance.) After all training and administrative set asides, TDHCA will distribute \$280 million for direct weatherization services. \$140 million will go directly to cities that currently have weatherization programs of their own. The other \$140 million will be allocated through existing contracts with regional non-profits, known in some areas as community action agencies. Community action agencies exist in many areas where a municipality does not provide weatherization services, and they are responsible for letting contracts to local contractors who will actually perform the weatherization improvements. TDHCA reported that they have received hundreds of calls from companies wanting to participate in the program, and slowdowns in new construction mean that local contractors should be able to meet the demand for qualified people to conduct weatherization work.

The Select Committee is providing each House member with information on the appropriate local contacts for local contractors. Contracts will be let locally through existing regional non-profits by competitive bid.

The Community Services Section awards Federal funds to assist local agencies that provide services to needy Texas residents. During FY 2008, Community Services programs assisted 539,436 poor and/or homeless individuals. New funding for the program will be \$48.2M on top of the current \$31M annual allocation. The community grants portion of Recovery Act funding will be available to Texans at or below 200 percent of poverty level.

The HOME Investment Partnerships Program (HOME) provides grants and loans to help local governments, nonprofit agencies, for-profit entities, and public housing agencies provide safe, decent, affordable housing to extremely low-, very low- and low-income families. HOME allocates funds through four basic activities: Homebuyer Assistance, Rental Housing Development, Owner-Occupied Housing Assistance, and Tenant-Based Rental Assistance. Under the Recovery Act, new funding for HOME will be \$148M above the current \$42M. Seventy-five percent of that \$150M must be committed to recipients within 1 year of enactment of the Recovery Act, and recipients must expend 75 percent of those funds within two years and 100 percent in three years.

TDHCA officials made clear there exists more than enough need and demand, and the increases the agency is receiving in all areas will not actually satisfy all need and demand in the state for services.

The agency also assured that they have sufficient personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

Texas Department of Transportation

The Texas Department of Transportation (TxDOT) is estimated to receive \$2.25 billion in stimulus funding. Of that \$2.25 billion, \$1.68 billion will go to TxDOT, \$500 million will go to metropolitan planning organizations (MPOs), \$175 million to rural areas and \$67.5 million to transportation enhancement projects.

TxDOT began anticipating stimulus funds prior to December 2008 and assembled a list of approximately \$6 billion in projects. This list was later updated in late January 2009 to over \$13 billion in projects, using input from local MPOs. TxDOT narrowed the \$13 billion list to a \$2.25 billion list on February 23, 2009, and narrowed it again a few days later to \$1.2 billion in new construction and \$500 million in maintenance projects.

The Recovery Act requires states to “obligate” 50 percent of the funds within 120 days or by June 17, 2009. The remaining 50 percent must be obligated by February 17, 2010. Initially TxDOT stated an intention to obligate all funds from the Recovery Act by February 26, 2009. As a result of the Select Committee’s concerns, TxDOT officials delayed its non-maintenance decisions for one week.

TxDOT approved the \$500 million in maintenance projects on February 26, 2009, and approved 100% of all remaining highway funds on March 5, 2009.

Seventy percent (\$841 million) of the final \$1.2 billion in new construction is for tollway-related projects. Only 27 percent of new construction funds are in "economically distressed" areas. In a letter from U.S. House Transportation Chairman Oberstar, TxDOT and the Select Committee were advised that the Federal Highway Administration will ensure that TxDOT has complied with the Recovery Act requirement that "economically distressed" areas being given priority for projects prior to approving projects.

On March 26, 2009, TxDOT met and obligated all of the \$67.5 million in Recovery Act funding for transportation enhancement projects.

On April 6, 2009, TxDOT testified that bidding for approximately \$450 million worth of its stimulus funds will begin toward the end of April.

Texas Health and Human Services Commission

The Texas Health and Human Services Commission (HHSC) estimates that it will receive an additional \$4.7 billion in stimulus money as a result of the temporary change in the Federal contribution or "match" rate known as the Federal Medical Assistance Percentage (FMAP) for Medicaid-related programs.

The Legislative Budget Board's estimate is approximately \$600 million less than the agency's. The primary reason for the difference is the HHSC believes that Texas will qualify for an even higher Federal match rate under the provision in the Recovery Act that provides additional relief for states that are experiencing higher unemployment rates.

Prior to passage of the Recovery Act, for every dollar Texas spent on Medicaid, the Federal government paid almost 60 cents (a 59.44 percent FMAP for FY 2009). Under the Recovery Act, the FMAP for Texas will increase by 6.2 percentage points, retroactive to October 2008. At this rate, Texas will receive a total of \$1.66 billion in stimulus funds in FY 2009 and another \$2.5 billion in 2010-2011. If the HHSC estimates are correct and Texas unemployment rates remain at 6.8 percent or higher for three consecutive months, Texas will receive another \$600 million.

In order to receive the FMAP increase, the Act specifies that states may not enact more stringent eligibility standards, methodologies or procedures than those in effect as of July 1, 2008. As long as Texas makes no negative changes in its current program, the additional funding will be received. The Commission reported that it is monitoring legislation closely for proposals that could disqualify Texas from receiving the \$4.1 to \$4.7 billion in Federal FMAP funding.

The Recovery Act contains a specific provision that the increased FMAP cannot be received "if any amounts attributed (directly or indirectly) to such increase are deposited or credited into any reserve or rainy day fund of the State." In short, the \$4.1 to \$4.7 billion in general revenue expected to be freed-up from the FMAP increase cannot be used to increase the Texas Economic Stabilization (Rainy Day) Fund or otherwise be reserved. Clarification is still needed on this issue in light of hold over funds in the budget. However, the plain wording of the Recovery Act would appear to prohibit non-appropriation of General Revenue and also possibly require the expenditure of Rainy Day Funds that exceed the constitutional cap.

Approximately 180 Disproportionate Share Hospitals (DSH) that serve significant populations of indigent patients will receive an additional \$23 million in FY 2009 and \$47 million in FY 2010.

The Supplemental Nutrition Assistance Program (SNAP), formerly known as "Food Stamps," the monthly benefit that helps low-income families purchase food, was increased by 13.6 percent. SNAP benefits are 100 percent Federally-funded, and the cost of administering the program is shared 50/50 by the state and Federal government. In January 2009, there were 1,130,535 SNAP cases in Texas.

The Recovery Act also provides an additional \$52.7 million in Temporary Assistance for Needy Families (TANF) funding. TANF provides cash benefits to very low income families with children. However, Texas uses the majority of this block grant to pay for a wide range of other services, such as Communities in Schools, early childhood programs, employment and training and child care. These grants were set to expire at the end of FY 2009; the Recovery Act will extend them through FY 2010.

Texas could draw down \$200 million more in Federal TANF funds by spending approximately \$60 million more in Federal TANF funds on non-recurring grants of assistance such as

increasing the \$30/child back-to-school payments or the stipend for grandparents taking care of TANF grandchildren.

There is \$20 billion available nationally for Health Information Technology. HHSC said it is awaiting further guidance from the Federal government, but indicated the agency might be able to draw down some of these funds for electronic health records.

In response to the Select Committee's specific questions, HHSC answered that the amount of General Revenue for health and human services agencies in the Committee Substitute for Senate Bill 1 as adopted by the House Appropriations Committee is \$1.98 Billion less than the amount of General Revenue in House Bill 1 as introduced. Although most of the General Revenue reduction was made possible by the enhanced FMAP for Medicaid-related programs, the proposed state budget also used other funds in the Recovery Act to free-up General Revenue, including the Child Care Development Block, TANF, and IDEA Part C.

Texas Workforce Commission

The Texas Workforce Commission has identified around \$1 billion in potential economic stimulus funding that Texas is eligible to receive for unemployment insurance, child care services and job training programs.

Approximately \$418 million will be received “automatically” in increases to funding for existing employment and child care programs. Another \$39 million will be received “automatically” to help cover the increases in handling unemployment claims. No changes in state law are required to receive these funds and no increase in state match is required.

Child care services received the largest increase--\$215 million, which is almost 50 percent more than the current Federal allocation of \$470 million. Agency administrators testified that the additional funds are needed to help meet the existing demand for child care services but there will still be unmet need even with this significant increase. TWC also approximated that \$214 million would provide daycare services to about 25,000 children.

Youth employment services will receive \$82 million, a 100 percent increase; employment services for adults will receive \$35 million, nearly a 50 percent increase; services for dislocated workers whose plants have shut down, for example, will receive an additional \$54 million, a 100 percent increase; and the Wagner-Peyser Employment Grant that provides various services to help match employers and job seekers with the current demands of the labor market will receive \$27 million, around a 40 percent increase. The smallest increase, but not an insignificant one, is a \$1.3 million or 20 percent increase for the Community Service for Older Americans program which provides employment opportunities for seniors in community settings such as public libraries.

Texas also is eligible to receive approximately \$555 million in funds to pay for unemployment benefits, but only if the 81st Legislature makes certain changes to current unemployment laws.

In order to receive these funds Texas must take two steps:

1. Change the existing base period for calculating benefits; and
2. Meet two of four other unemployment insurance modernization “incentives”

If Texas changes its existing base period for calculating benefits to consider the most recent quarter of wages before becoming unemployed, termed an Alternative Base Period (ABP), the state will receive \$185 million in additional Federal unemployment funds. TWC said their estimate for this change is approximately \$83 million for FY 2010-2011 (\$212m over 5 years).

Unless the above change is made, the state is not eligible to receive a remaining \$370 million. If the Alternative Base Period *is* adopted, Texas must meet another two of the following four criteria to receive the additional \$370 million:

1. Allow people seeking part-time work to receive unemployment benefits. TWC does not have a cost estimate for this change at the present time
2. Allow benefits for people who leave work for compelling family reasons (Texas already does most of this requirement, and the remaining provisions are not considered significant in terms of increasing demand on the state. (TWC cost estimate: \$4.6m/year)
3. Allow up to 26 additional weeks of benefits for people in job training (basically, any employee who has received the maximum of 26 weeks would be eligible to receive up to 26 more weeks as long as they were attending an approved job training course, and only for that length of time). (TWC cost estimate: \$32m/year)
4. Provide additional benefits of least \$15/dependent/week for eligible workers. (TWC cost estimate: \$283m/year)

Under the Recovery Act, Texas could delay implementation of the changes for up to a year and still receive the incentive money (\$555 million) immediately. Furthermore, although states are not allowed to automatically “sunset” the modernization provisions, the Department of Labor issued an advisory letter on March 25, 2009, which states unequivocally that future legislatures can repeal the modernization changes without having to pay back any of the incentive funds. At the present, it appears that if Texas enacted the necessary changes, its Unemployment Trust Fund could receive \$555 million at a cost of approximately \$75 million over FY 2010-2011 (a net gain of around \$480 million to the Trust Fund).

TWC has reported a rising unemployment rate for the last several months. In November 2008 the rate was 5.7 percent; December was 6.0; January 2009 was 6.4; February was 6.5. If Texas unemployment rate reaches 6.8 percent for three consecutive months, the state will receive an estimated \$600 million in additional fiscal relief under the Medicaid program. (The jobs report for March is expected to be available on April 17, 2009.)

Consistent with rising unemployment rates, TWC has reported large increases in weekly unemployment insurance payments. In January, the State's total weekly payout was approximately \$45 million; in February it was \$57 million; in late March it was \$64 million; and by the first week of April it was \$74 million per week.

TWC also reported it estimates the Unemployment Trust Fund will have a balance of approximately \$19 million on October 1, 2009, which is \$839 million below the statutory "floor." In March 2009, TWC projected that the Trust Fund would have an \$812 million shortfall; in January 2009, that projection was \$447 million. Any Unemployment Trust Fund balance below the floor will trigger a "Deficit Tax" on employers. This could be temporarily addressed by issuing bonds or borrowing from the Federal government.

It is significant to note that the current Unemployment Trust Fund balance projection is based on the Comptroller's estimate that Texas will lose 111,000 jobs in the first quarter of 2009. Texas lost over 100,000 jobs in January and February of 2009 alone. The Dallas Federal Reserve estimates that Texas could lose closer to 300,000 jobs in 2009. With a revised jobs estimate being used, the projected Fund balance would be significantly lower, and a "zero balance" is an almost certainty. The Dallas Federal Reserve also said "that the current [economic] slowdown will persist for at least the next few quarters."

TWC also reported that the Texas Enterprise Fund received \$52.3 million from the unemployment tax funds on September 2008 (\$120 million total in FY 2008-2009). The Skills Development Fund received \$40 million total over the current biennium.

The agency indicated that proposed changes would not create an administrative problem.

The agency also assured that they have proper personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

State Energy Conservation Office

Texas usually receives between \$1.8 million to \$2.5 million per year in Federal funding for the State Energy Plan (SEP) which may be used for energy efficiency and renewable energy projects. Under the Recovery Act, Texas will receive an additional \$218.8 million in Recovery Act funding for the SEP. To receive the SEP money, SECO must submit a comprehensive application to DOE by May 12, 2009.

Another program area of SECO is Local Government Energy Efficiency Block Grants (EEBG). DOE has allocated \$163 million directly to large Texas cities and counties, but they must still apply in order to actually receive their respective allocations. SECO will receive \$45 million, of which 60 percent (\$27 million) must be used to help small, non-HUD entitlement local governments reduce energy use and fossil fuel emissions, and improve energy efficiency. Small is defined as cities with populations less than 35,000 and counties with less than 200,000; in Texas, there are about 233 counties and 1130 cities that will be eligible. SECO will have discretion under the Act to use the remaining 40 percent (\$18 million) for other energy efficiency and conservation projects. In order to receive EEBG money, states must submit their applications to DOE by May 26, 2009. Direct allocation cities and counties must submit their applications by June 25, 2009.

The agency also assured that they have proper personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

Federal guidelines issued recently will require SECO to submit plans for allocating the funds by late May 2009 and obligating the funds by late June 2009.

Comptroller of Public Accounts

Officials from the Texas Comptroller of Public Accounts presented a detailed spreadsheet which attempts to identify all of the funds in the economic stimulus bill that will potentially benefit Texas, not just the portion of funding that the state is expected to receive. The agency continues to expand and refine the information as more information becomes available.

Public Utility Commission

The Public Utility Commission testified before the committee in regard to broadband and energy provisions in the Recovery Act. The agency representative indicated that they would not receive any funds directly. The U.S. Assistant Secretary of Commerce for Communications & Information will administer competitive grants intended for various aspects of broadband build-out. Several other grants are available that will help expand computer center capacity in public libraries, for example, and telemedicine and distance learning for rural areas. Another grant will help develop and maintain a comprehensive broadband inventory map.

Under energy programs, Texas will be eligible to receive a portion of the grants designed to improve energy efficiency in buildings and transportation; weatherization assistance; development and implementation of the state energy conservation plan; manufacturing of advanced batteries and components; and, research on advanced and innovative energy technologies that reduce fossil fuel emissions.

The agency assured they have proper personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

Office of Rural and Community Affairs

The Recovery Act included an increase of \$19.5 million in Community Development Block Grant (CDBG) funds that will be allocated to the Office of Rural and Community Affairs under an existing formula. These funds will be distributed to small cities or “non-entitlement” communities in Texas. A non-entitlement area under this program is defined as a city under 50,000 or a county under 200,000. This \$19.5 million is on top of the current allocation of approximately \$70 million.

The agency informed the committee that the timing of these new Federal funds coincided with their annual application process for CDBG funds and the agency is prepared to distribute the

funds to local communities very quickly. The agency received between \$120-\$140 million in applications, so even with the supplemental Federal funding, the new Recovery Act funding will not meet the actual need. The funds are very flexible but generally are to be used for affordable housing, job creation and retention, and to address a serious and immediate threat to the health and safety of a community for which there are no other funds available. All other cities and counties in Texas will receive their CDBG funding directly from the Federal government.

The agency assured that they have proper personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

Texas Water Development Board

The Texas Water Development Board (TWDB) provided the committee with a complete list of \$4.9 billion in potential economic recovery “Clean Water” projects and another \$4.9 billion in “Drinking Water” projects. Most of these projects are shovel ready, illustrating that the need far exceeds the available funding levels.

The state’s allocation from the \$4 billion appropriated for the Clean Water State Revolving Fund (CWSRF) is \$181 million. This fund provides grants to states to capitalize their revolving loan funds for wastewater infrastructure improvements. Our allocation from the \$2 billion appropriated for the Drinking Water State Revolving Fund (DWSRF) is approximately \$160.5 million. This fund provides grants to states to capitalize their revolving loan funds for drinking water infrastructure. The agency suggested that the demand in Texas for funding from these two programs has been heightened by the difficulty in getting good rates right now in a troubled bond market.

The Recovery Act directs that states must allocate that 20 percent of CWSRF and DWSRF recovery funds to projects that improve water use efficiency and reduce water consumption, known as the Green Project Reserve. Guidance has been issued by the Environmental Protection Agency (EPA) on aspects that should be considered when evaluating whether a project qualifies for the Green Project Reserve designation. TWDB testified that they are in the process of rating and ranking projects on its approved Intended Use Plan (IUP) lists for consideration under the Green Project Reserve, and that they expect to have those evaluations complete around mid-April. TWDB plans to hold public hearings on its final rankings and IUPs in May 2009, and adopt final IUPs in the same month.

The agency also assured they have proper personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

Texas Commission on Environmental Quality

The Texas Commission on Environmental Quality (TCEQ) has identified six different potential sources of funding in the economic stimulus package that may help benefit environmental programs TCEQ administers.

TCEQ expects to receive \$1.7 million in a non-competitive, formula allocation for state grants under the Diesel Emissions Reduction program. The agency mentioned that these funds could be used for the clean school bus program for public schools. Another \$300 million is available nationally for diesel emissions reduction with \$90 million specifically designated for additional non-competitive state grants and the remaining \$210 million to be distributed among the states on a competitive basis.

There is \$200 million available nationally for the Leaking Underground Storage Tank program (LUST). There is no state match required. Around 200 sites in Texas would meet the criteria for the program.

TCEQ will receive approximately \$1.8 million in additional funds for allocation to local planning groups under the Water Quality Management Program. There is no match required for these funds. Under the Drinking Water State Revolving Fund (which will be managed by the Texas Water Development Board), TCEQ will receive a percentage allocation to provide technical assistance. The agency did not specify what amount they expect to receive.

There is \$100 million available nationally that will be distributed on a competitive basis under the “Brownfields” program. This program is intended to assess, cleanup and reclaim previously unusable property.

The Recovery Act increased funding for the Hazardous Substance Superfund by \$600 million. According to TCEQ, the funding can only be used for sites that are on the “National Priority List” or (NPL). Although Texas has 47 sites that are “shovel ready,” they are not on the national list and will not qualify for the funding.

The agency also assured that they have proper personnel and systems in place to assure rapid distribution of funds while not sacrificing transparency and accountability.

Texas Education Agency and Texas Higher Education Coordinating Board

Public Education – Direct to local schools (over \$2.6 billion)

Local school districts in Texas should receive \$944 million in Title I funds (formula funding for the economically disadvantaged). Districts will also receive \$285 million in Title I funds for School Improvement Grants (early childhood, middle through high school focus).

Texas schools also will receive \$970 million in direct funding under IDEA (formula funding for Individuals with Disabilities Education Act); \$59 million in Title II, D (Education Technology Grants), and \$3.4 million in Title VII (Homeless Assistance funds).

Higher Education

Additional Pell Grants – \$523 million (this represents an over 50% increase from FY 2008)

Additional College Work Study - \$10.7 million (this represents a 20% increase)

Competitive Grants

Teacher Quality Enhancement - \$100 million nationally

Statewide Data Systems - \$250 million nationally

Combined Public and Higher Education

\$3.973 billion in the "State Fiscal Stabilization Fund" will be available for Texas.

Of the above amount, \$700 million of the total amount is available for "public safety and other governmental services," including public and higher education.

The remaining \$3.273 billion is available for education only. The Recovery Act requires that any shortfalls in current fund levels for public education be addressed first. Next, shortfalls in higher education must be addressed. Remaining funds should flow through Title I formulas for public education. Clarification on flexibility in these decisions is still being sought by TEA and the Select Committee.

The Higher Education Coordinating Board has suggested that 1/3 of the total funds (\$1.325 billion) be set aside for higher education, with the remaining 2/3 used for public education.

No funds can be used for new construction, only maintenance and repairs, with emphasis on "green" technology.

The core question that remains to be answered is whether a shortfall exists in the general formulas for public and higher education. Arguments have been advanced in many directions. Since the Rainy Day Fund was anticipated to be sufficient to cover all shortfalls in the LBB budgets, it can be argued that no shortfalls exist, requiring all funds to flow through Title I formulas to public schools. Likewise, it can be argued that the filed budgets had \$4 billion shortfalls, and that a portion of that shortfall logically was in existence in the education formulas. The status of the Available School Fund may also be a factor.

Whether Recovery Act funds can be used to "supplant" general revenue and free up discretionary general revenue, or whether they must be used to "supplement" general revenue is all still somewhat unclear. Whether the Legislature can "create" a shortfall artificially and then divert education funds to other programs is likewise unclear; although clarification is being sought from the Federal authorities.

On April 7, 2009, the Texas Education Agency (TEA) released additional information on how No Child Left Behind (NCLB), Title I and Individuals with Disabilities Education Act (IDEA) money will be allocated to Texas school districts. They also published guidance on the use of

those funds. Details on this information is available to the public at <http://www.tea.state.tx.us/arrastimulus/>.

TEA testified that Federal officials provided guidance that allows the State use some of the stimulus education funds for new school construction. Previously, there was some question over whether that was even an option. He also said that Texas schools will qualify for approximately \$535 million in low- to no-interest loans for school building construction.

Governor's Criminal Justice Division

The Criminal Justice Division of the Governor's Office (CJD) is designated as the administering agency in Texas for several federal criminal justice grant programs. The Recovery Act will increase funding for at least three of these federal funding streams: 1) Byrne Justice Assistance Grants (JAG); 2) Victims of Crime Act Grants (VOCA); and 3) S.T.O.P. Violence Against Women Act Grants (VAWA).

Texas will receive an additional \$147.5 million in Byrne Justice Assistance Grants—40 percent or \$57.3 will go directly to local entities and 60 percent or \$90.3 million will be received by the state and will be distributed through the Governor's Criminal Justice Division. The Governor's office must distribute 60 percent of the \$90.3 million in grants to local law enforcement and the remaining 40 percent can be used for other local or state level law enforcement purposes. According to the Director of the CJD, the 40 percent may be awarded through grants at the Governor's discretion. These funds must be obligated by September 30, 2010, and no matching funds are required. Byrne grants can be used for a broad range of criminal justice activities such as prevention and education; community corrections; drug treatment and enforcement; planning, evaluation and technology; and crime victim and witness programs (other than compensation).

The CJD Director stated that additional, temporary personnel may be needed to handle the increase in awarding and accounting for the new grant money. He also stated that he believed the CJD has an extremely strong auditing and contracting section. While these funds are administered by the Governor's Office, the legislature could choose to designate specific uses for some of the additional revenue.

There is \$4.2 million in the Recovery Act for non-monetary services to Texas crime victims. The Governor's office will provide grants to local law enforcement programs, and these funds will require a 20% match.

The State also will receive an additional \$16.1 million in Violence Against Women Act (VAWA) funds; \$9 million will be allocated by formula to the Governor's office to provide grants to local law enforcement and \$7 million will be allocated to the Attorney General's office for crime victims compensation. The CJD must distribute the \$9 million according to specific percentages set aside for specific crime victims services.

Office of the Attorney General

The Attorney General's Office estimates it will receive federal stimulus funds through the Recovery Act for the Child Support Enforcement Program, the Crime Victims Compensation Program, and the Internet Crimes Against Children Task Force.

With respect to funding for child support enforcement, the Recovery Act reversed a previous change in federal law that required the 80th Texas Legislature to appropriate an additional \$25 million and \$28.6 million in General Revenue for FY 2008 and FY 2009 respectively to draw down federal funds. This reversal would enable Texas to use federal incentive funds as a match to draw down federal child support funds and free-up approximately \$54.6 million in general revenue. Texas' share of stimulus funding for Child Support could be as much as \$161 million.

The Attorney General's Office and the Governor's Office will each receive a portion of the \$100 million in Victims of Crime Act funding available nationally. Guidelines have not been issued on the use and allocation of these funds, but the Attorney General's Office estimated that the AG's office could receive approximately \$7.8 million for compensation payments to victims based on previous federal grant data.

An additional \$2.3 million in Internet Crimes Against Children funds will be allocated to Texas. There are two task forces eligible for these funds: the Dallas Police Department and the Office of the Attorney General.

ERCOT

There is \$4.5 billion available nationally in the Recovery Act for modernization of the electric grid. According to the Comptroller's Office, the Department of Energy has not determined the amount of funding for each grid operator, which is ERCOT in Texas. ERCOT noted that since it is regulated by the Texas Public Utility Commission and not by the Federal Energy Reliability Commission (FERC), this could be an issue with eligibility for the Federal funds.

There also is \$6 billion available nationally for an "Innovative Technology Loan Guarantee Program" which is a loan program for electric grid operators. The Comptroller's Office identified ERCOT as the entity that would receive loans in Texas, and ratepayers would pay back the loans with monthly charges on their electric bills.

Texas Department of Agriculture

Commissioner Todd Staples provided an overview of the federal stimulus funds the Texas Department of Agriculture is expected to receive. Approximately \$11.5 million is expected to be available for grants to public schools for the equipment under the National School Lunch Program.

Commissioner Staples indicated that his agency would receive \$8.2 from the Commodity Assistance Program for emergency food assistance to food pantries, soup kitchens, senior centers, etc. He said there is enormous need right now and the food banks are outstanding partners with his agency. An additional \$2.1 million in 2010 will be received to cover administrative costs.

Also, there is \$50 million available nationally for assistance to aquaculture producers who experienced high feed costs in 2008. It is not known at this time how much Texas might receive from the \$50 million allocation.

Commissioner Staples also mentioned that the State should ensure that Texas businesses and agencies are maximizing the use of the Federal dollars that are available for rural broadband. There is \$2.5 billion available nationally on a competitive basis for grants, loans and loan guarantees for distance learning, telemedicine and rural broadband. There is \$4.7 billion available nationally through the Commerce Department for extending broadband services. Commissioner Staples said Texas can benefit tremendously from this opportunity. He also mentioned that our participation in the \$1.4 billion in rural water loans and grants and the \$515 million for wildfire management would be an excellent stimulant for the economy.

Commissioner Staples said he has created a grants division and has proper accountability protections in place; however, there may be a need in his agency for additional help with internal audit responsibilities.

Texas Railroad Commission

Officials from the Railroad Commission (RRC) testified that there may be funds available to the RRC through the US Environmental Protection Agency (EPA), or the US Department of Energy (DOE).

The Recovery Act provides for \$100 million worth of competitive grants to the EPA Brownfields Program for clean up, revitalization, and sustainable reuse of contaminated properties.

On November 14, 2008, the RRC applied for grants under the Brownfields program, focusing on areas that were affected by Hurricane Ike, which may be "a competitive advantage" in winning those grants. The EPA is expected to award grants by June 2009.

Department of Public Safety

Texas Department of Public Safety (DPS) officials identified several areas where they expect to receive stimulus funding. DPS said Texas will receive \$143 million in funds under the Edward Byrne Memorial Justice Assistance Grant (JAG) Program that will be administered by the Governor's Office. (See Governor's Office Criminal Justice Division) Sixty percent of these funds are awarded to states based on a formula where population and overall crime rate are taken into consideration. The remaining 40 percent is given directly to local governmental entities.

JAG funds can be used for law enforcement, prosecution, crime prevention, corrections and drug treatment programs, among others. The Recovery Act also provides \$225 million in competitive Byrne Grants.

Other areas DPS expects to see funding for include law enforcement in rural areas; law enforcement along the Southern border; Internet Crimes Against Children (ICAC) and Community Oriented Policing Services (COPS).

Texas General Land Office

Commissioner Jerry Patterson appeared before the Select Committee, focusing primarily on coastal restoration projects that the General Land Office (GLO) has identified as being of immediate importance. Commissioner Patterson indicated that the need for several of the projects originated with the damage caused by Hurricane Ike. Outlines for those projects indicate that they are all "shovel ready" and work could begin almost immediately once they are funded.

While the Recovery Act does make certain provisions regarding Hurricanes Katrina and Rita, there is no specific language that refers to Hurricanes Ike or Dolly, which both impacted the Texas coastal region in 2008. If there are stimulus funds available for GLO coastal restoration projects, where they would come from is not clear.

Hurricane Ike

The Select Committee was advised by LBB and Speaker Pro Tem Eiland that \$750-900 million may be needed to address supplemental appropriation needs related to Hurricane Ike. On March 20, 2009, the House Committee on Appropriations voted to spend \$864,672,778 out of the Economic Stabilization (or "Rainy Day") Fund to pay for the damages and disruptions to agencies and institutions caused by natural disasters (CSHB 6 by Eiland).

The Structural Deficit

In testimony before the Select Committee, the Legislative Budget Board Director warned that the State has a "structural deficit" and that it should be considered when evaluating the Recovery Act and the current Texas budget gap. The Chairman of the House Committee on Appropriations also has informed the members of the House of Representatives about the structural deficit in remarks on the House Floor.

A "structural deficit" differs from a "cyclical deficit" in that it exists even when the economy is operating at its full potential. No matter how good the economy gets, the deficit cannot be cured.

A true structural deficit can only be addressed by explicit and direct changes in government policies: reducing spending (including entitlements), increasing the tax base, and/or increasing tax rates. It can be described as more "chronic" or long-term in nature hence needing government

action to remove it. For example, the U.S. Social Security system is sometimes declared to be creating a structural deficit in the Federal budget, as many argue that changes in the structure of the social security system are needed to avoid bankruptcy of that system in 2042.

Currently, the LBB recommended budget for FY 2010-2011 (the introduced version of H.B.1 and S.B.1) anticipates **\$87.5 billion in recurring spending** from general revenue-related funds and the Property Tax Relief Fund.

The LBB budget anticipates **\$79.5 billion in recurring revenue from general revenue-related funds (\$74.5) and revenue that is deposited to the Property Tax Relief Fund (\$5.5 billion).**

Thus, there is an approximate **\$8 billion structural deficit facing the State of Texas** for FY 2010-2011 if you look only at ongoing expenditures and revenues.

However, the 80th Legislature reserved \$3 billion in general revenue balances from the FY 2008-2009 biennium to be used in the future to help pay for the property tax cut authorized in 2006.

The components of the overall numbers reveal that a sizeable portion of the problem is that tax revenues anticipated from the 2006 Property Tax Relief initiative are lower than projected at the time. For FY 2010-2011, the Comptroller estimated that \$9.1 billion in revenue would be collected, and that estimate has now been lowered to the \$5.5 billion mentioned above. However, the original cost estimates of the 2006 Property Tax Relief initiative by LBB have been shown to be prophetic - \$14.2 billion for FY 2010-2011.

This difference	-	\$14.2 billion in cost
		<u>- \$5.5 billion in revenue</u>
		<\$8.7 billion deficit>

In summary, had the 2006 Property Tax Relief Initiative been revenue neutral or not enacted, assuming no other changes in spending, Texas would today have a \$700 million surplus in its recurring budget, rather than an \$8 billion shortfall.

The Economic Stabilization (or “Rainy Day”) Fund

The Comptroller estimates that the Economic Stabilization (or “Rainy Day”) Fund will reach \$9.1 billion by the end of the 2010-2011 biennium. The Texas Constitution places a limit on the amount of funds that can be held in the Rainy Day Fund. This amount is 10% of the previous biennium’s general revenue receipts, less investment and interest income. According to the Comptroller’s Revenue Estimate issued in January 2009, the amount of general revenue collected during the 2008-2009 biennium, less interest and investment income, is around \$79 billion, which would lead one to conclude that the cap on the Rainy Day Fund is \$7.9 billion for FY 2010-2011. The Comptroller’s Office, however, has indicated that they included some federal funds in their calculation to arrive at a cap of \$11 billion.

Once the Rainy Day Fund reaches the cap, no additional transfers may be made to the fund from general revenue.

The Recovery Act also contains at least one specific provision that applies to the Rainy Day Fund or any other reserve account. “A State is not eligible for an increase in its FMAP...if any amounts attributable (directly or indirectly) to such increase are deposited or credited into any reserve or rainy day fund of the State.”

That said, at the present time, additional deposits into the Rainy Day Fund that would be required by the Texas Constitution are likely permitted since the source of funds in the Texas Constitution is arguably not directly or indirectly related to the increased FMAP, provided the total remains below the cap.