

Preserve Texas' Rainy Day Fund in These Uncertain Economic Times

by The Honorable
 Chuck DeVore

Key Points

- The ESF is projected to receive \$1.91 billion of oil and gas-derived revenue during the 2012-13 biennium, increasing the total balance to \$7.3 billion by the end of the biennium.
- Oil and gas severance tax revenues are highly sensitive to the global economy, which is showing signs of weakening.
- With added pressure for greater spending on Medicaid, education and other programs, lawmakers need to resist the temptation to bolster baseline spending using an ESF balance that could be soon depleted in a poor economy.
- It is important that lawmakers maintain a balance of at least 5% of general revenue and general revenue-dedicated funds, or approximately \$4.5 billion for the current cycle.
- The ESF should only be spent on one-time emergency items or tax relief. The fund should not be spent to support ongoing expenses.

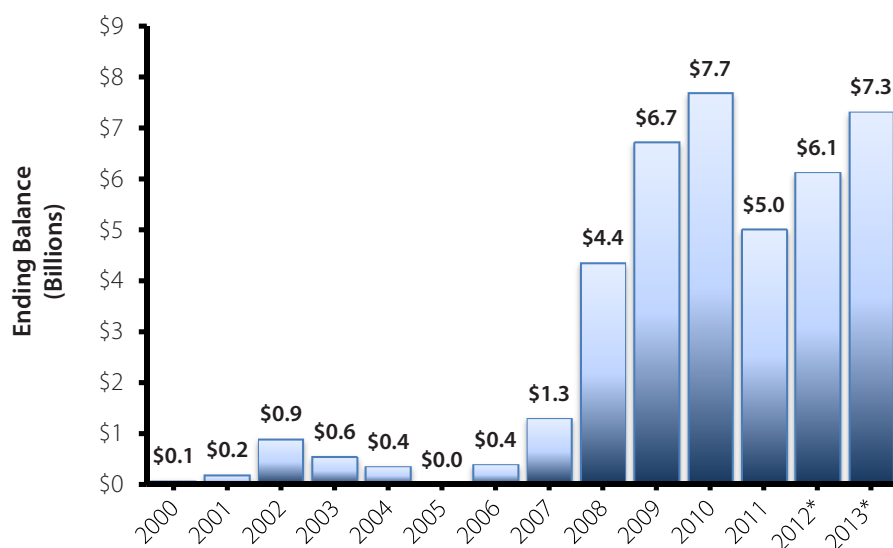
The Economic Stabilization Fund (ESF), or “rainy day” fund, was established in the Texas state constitution in 1988 when voters approved the Legislature’s recommended creation of the fund.* It is filled per a fairly simple formula: when oil and gas production (severance) taxes exceeds the amount received in 1987, then 75 percent of that amount goes into the ESF, with the other 25 percent being made available to the general fund.¹ Severance taxes equal 7.5 percent of the market value of gas produced and 4.6 percent of the market value of oil and condensate produced.² Thus, when a combination of oil and gas prices, production, and tax rates generate more revenue for Texas, three-quarters

of that additional revenue flows into the ESF. While it has not done so yet, the Legislature may also appropriate additional funds into the ESF. Further, the fund receives half of any unspent general revenue at the end of each biennium as well as interest earnings—estimated at near \$105 million for the current biennium.

The ESF is capped at 10 percent of the preceding biennium’s general revenue, excluding investment and interest income and money borrowed from special funds. For the current 2012-13 biennium, this cap is estimated at \$7.9 billion.

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Economic Stabilization Fund: Ending Balances



*Estimates from the Texas Comptroller’s 2012-13 Certification Revenue Estimate
 Source: Legislative Budget Board

*The constitutional amendment establishing Texas’ Economic Stabilization Fund was House Joint Resolution No. 2, passed during the 70th Regular Session and approved by voters on November 8, 1988.

The ESF's revenue source is volatile, thus, the temptation to use it to meet recurring budget needs should be resisted.

It was not until recently that the state's emergency reserves have grown into anything of significance. Throughout the early 2000s, the net cash balance in the ESF remained low. However, beginning in fiscal 2007, the fund's balance exceeded \$1 billion and it has grown steadily ever since, reaching an all-time high of \$7.7 billion in fiscal 2010. After being reduced as the Legislature chose to spend \$3.2 billion of it in 2011, the ESF is expected to reach \$7.3 billion by the end of fiscal 2013.³

To spend money in the ESF, certain vote requirements must be met. The Legislature may, by a three-fifths vote of the members present in each house, appropriate funds in two instances: 1) to cover a deficit (certified to exist by the comptroller) in a current budget, and 2) to make up for a decline in revenue (projected by the comptroller) in the upcoming biennium relative to the current biennium. Additionally, the Legislature can appropriate funds from the ESF "at any time and for any purpose" by a two-thirds vote of the members present in each house.⁴ Even with these voting requirements in place, the ESF has been tapped many times over the past, with the three most recent instances occurring in fiscal years 2003, 2005 and 2011.⁵

The ESF's revenue source is volatile, thus, the temptation to use it to meet recurring budget needs should be resisted. For instance, Texas' Medicaid program is expected to need from \$10 billion to \$15.6 billion in additional state funds in the upcoming budget cycle⁶—the higher range being about double the entire projected 2013 ESF balance.

In 2011, some groups that traditionally advocate for more spending and higher taxes urged using *all* of the ESF balance plus expected 2012-13 ESF revenues for a total of \$9.4 billion to avoid making difficult budget reductions in the biennium. During the last Regular legislative session,

the Center for Public Policies Priorities (CPPPP) wrote:

"...if we don't use all of the Rainy Day Fund now to help maintain vital public services, the damage in 2012-13 is certain and great. Cuts would imperil our economic recovery. In the short run, Texas would lose 250,000 public and private jobs just because of the cuts to public education... If revenue doesn't recover, we can always cut *later*; we have no reason to cut so deeply *now*."⁷ (emphasis in the original)

Examining the jobs record from June 2011 to June 2012 will help evaluate this claim. During this period, government jobs in Texas declined by 51,100—but private sector job expansion swamped this reduction, growing by 282,900 for a net increase of 231,800 jobs.^{8*} Further, had the entire \$9.4 billion balance been spent from the ESF, as CPPPP advocated, the rainy day fund would have only had about \$1 billion going into 2013, instead of \$7.3 billion. More importantly, under this scenario, state spending would have been at a much higher, unsustainable clip and the ESF's ability to mitigate any deficit would have been greatly hampered.

As a Matter of Policy

Using the ESF to fill a hole in a chronically overdrawn budget creates the danger that higher levels of state spending will deplete the rainy day account, which, by design, is not reliant on a stable revenue source. So, if the ESF should not be tapped to sustain ongoing expenditures, such as for education or entitlements, what should it be used for, if at all?

Ideally, only for one-time emergency items or tax relief.

More specifically, responsible targets for these one-time ESF appropriations could include: expenditures resulting from natural catastrophes; the early repayment of debt; prioritizing higher interest bonds; or providing temporary cash flow to begin the conversion of government retiree pensions and health insurance benefits to a defined contribution system, rather than continue sustaining an unsustainable defined benefit system.[†] In better times, the Legislature could even consider returning a portion of the ESF back to taxpayers in the form of a temporarily reduced sales tax rate or property tax reduction.

* Texas Workforce Commission press release, July 20, 2012, "Texas Employers Add 12,900 Jobs in June, Texas Civilian Labor Force at an all-time high."

† Payments to meet the unfunded liabilities without attendant reordering of a pension system would be tantamount to spending one-time funds to sustain ongoing obligations.

If the Legislature decides to appropriate funds from the account in the next legislative session on any of the above items, the amount appropriated should ideally not exceed \$2.8 billion so that the fund can maintain a minimum balance of about \$4.5 billion or at least 5 percent of general revenue and general revenue-dedicated funds in 2013. Various government bond rating agencies have cited this 5 percent threshold as the minimum required to maintain the highest bond ratings, and thus keep public borrowing costs as low as possible.

In the interest of the state's future financial security and to keep state spending from growing faster than is wise, however, the Foundation recommends that the fund be used as sparingly as possible in the upcoming legislative session. ★

Endnotes

¹ Texas Constitution Article 3 Sec. 49-g.

² Texas Comptroller of Public Accounts, "Texas Taxes and Tax Rates: Natural Gas Production Tax" (5 Sept. 2012).

³ Texas Comptroller of Public Accounts, "The 2012-13 Certification Revenue Estimate" (12 Dec. 2011).

⁴ Texas Constitution Art. 3, Sec. 49-g.

⁵ Texas Legislative Reference Library, "FAQs about the Economic Stabilization ('Rainy Day') Fund" (accessed 5 Sept. 2012).

⁶ "Statement on use of the Economic Stabilization Fund in the FY 2011 state budget," Texas Public Policy Foundation (5 Sept. 2012).

⁷ "Using the Rainy Day Fund to Ensure our Recovery and Prosperity," Center for Public Policy Priorities (accessed 9 Aug. 2012).

⁸ Texas Workforce Commission press release, July 20, 2012, "Texas Employers Add 12,900 Jobs in June, Texas Civilian Labor Force at an all-time high" (accessed 10 Aug. 2012).

About the Author

The Honorable Chuck DeVore is Vice President of Communications and Senior Fellow for Fiscal Policy at the Texas Public Policy Foundation. From 2004 to 2010, DeVore represented almost 500,000 people in the California State Assembly. He was the Vice Chairman of the Assembly Committee on Revenue and Taxation and served on the Budget Committee as well. DeVore worked in the aerospace industry for 13 years as an executive. DeVore served as a Reagan White House appointee in the Pentagon from 1986 to 1988 as Special Assistant for Foreign Affairs. DeVore is a Lieutenant Colonel in the U.S. Army (retired) Reserve where he serves as an intelligence officer.

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