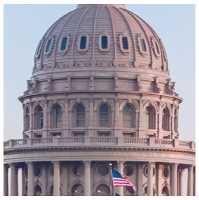

TEXAS PUBLIC POLICY FOUNDATION
Testimony

April 3, 2019
Center for Economic Prosperity

HJR 10 & HB 20
Let People Prosper by not Growing Government
Testimony Before the Texas House Committee on Appropriations—S/C on IRI

by Vance Ginn, Ph.D., Director

Chairman Capriglione and Members of the Committee:

My name is Dr. Vance Ginn, and I am a senior economist and the director of the Center for Economic Prosperity at the Texas Public Policy Foundation. I am testifying today ***against*** House Joint Resolution 10 and its enabling legislation House Bill 20 because it would create a new Texas legacy fund with some dollars in the Economic Stabilization Fund (ESF) used to attempt to gain a higher return on taxpayer money and allocate the returns to unnecessarily grow government.

Purpose of the Economic Stabilization Fund (ESF). Production of crude oil and natural gas has historically fluctuated based on a number of market-driven and geopolitical factors. Because the Texas Legislature collects severance taxes from this volatile production to primarily fund the state's ESF, broadly considered the state's "rainy day fund," the purpose for and use of the ESF must be worthy. Texas voters approved the ESF with passage of a constitutional amendment in 1988 after an uncertain state revenue period when oil and gas comprised a large share of economic output and was highly volatile in the 1970s and 1980s. The ballot language that Texans approved was *"the constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue."* The Texas Constitution requires a three-fifths vote in each house to close a revenue shortfall and a two-thirds vote in each house to use it for other reasons.

ESF is for covering unforeseen revenue shortfalls. The ballot language sold to Texas is clear that this money is to fill unexpected revenue declines. However, only 27.4 percent, or $3.2 billion, of the $11.6 billion spent from the ESF since inception has been for general deficit reduction. In 2013, $4 billion of ESF dollars were appropriated to fund expenditures for education and Medicaid above what was appropriated in 2011. Texans approved amendments in 2013 to take $2 billion from the ESF to pay for water projects and in 2014 to direct a portion of severance taxes to the State Highway Fund (SHF) instead of the ESF. In 2017, the Legislature appropriated $1 billion from the ESF primarily for state facilities ($778 million) but also for disaster relief and one-time grants to local entities. Clearly, a more stringent use of the fund outside of its intended purpose is warranted.

Growing ESF account. Despite the use of severance taxes for one-time and ongoing expenditures, the ESF's balance is expected to be $15.4 billion at the end of the 2020-21 budget cycle. Given the ESF's constitutional limit of 10 percent of general revenue (GR)-related funds excluding interest and investment income in the previous budget cycle, the cap this period is $18.6 billion. Excluding any spending of the ESF this session, much of which is likely to be spent, the amount could rise to the highest cap share yet of 83 percent.

Need to lower the ESF cap. These funds are a one-time resource to the state. The cap of 10 percent on biennial GR-related funds is really a 20 percent annual cap. Every dollar not in the private sector without a clear purpose is wasting potential productivity that could help Texans prosper, so these dollars should be used wisely and not be excessively collected. Moreover, the state's economy and therefore tax revenue is much less reliant on oil and gas activity than previously. Research shows that Texas could have a biennial cap closer to 7 percent, or annually 14 percent, to cover the most severe fiscal downturns, which should primarily be solved with spending restraint. Alternatively, if this money is spent each session, the ESF will quickly dwindle, and the state's credit rating could be at risk.

ESF is not for ongoing spending. Using one-time funds to pay for ongoing expenditures only delays needed difficult decisions that should be made with general revenue funds and depletes one-time funds available for revenue shortfalls, future emergencies, or tax relief. In addition, using ESF funds for investment purposes that could support a higher rate of return

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to fund unfunded state liabilities without structural reforms to pensions and reductions to debt first is not recommended because it kicks the day of reckoning for taxpayers and beneficiaries down the road. The state should use precious taxpayer dollars to spend within its budget and not tap one-time funds for reasons never approved by Texans.

Sound fiscal policy. Based on sound fiscal policy, taxpayers should feel the burden of government spending so that they remain part of the political process. Considering that high taxes and debt are always and everywhere a spending problem, taking money deposited into the ESF and using it to attempt to achieve higher returns on savings is problematic. This not only cuts the tie between government spending and taxation, but it also puts taxpayer dollars at a higher risk of loss and uses potential returns of savings to unnecessarily grow government without making needed structural reforms.

Recommendations to reform Texas' rainy day fund. Our recommendations include:

- Raising the threshold to use ESF money "at any time and for any purpose" from the current two-thirds of members present to four-fifths of all members in each chamber;
- Lowering the constitutional cap from 10 percent to 7 percent of biennial GR-related funds in the previous biennium, which could essentially be done by removing federal funds from the cap's base.
- Using excess state revenue above the ESF cap, or from budget restraint, for tax relief instead of spending or saving it in riskier assets and removing growing government from the burden of taxation.

Details of HJR 10 and HB 20. This legislation would:

- Put the sufficient ESF fund balance at 7 percent of the biennially certified general revenue-related appropriations in statute;
- Create the Texas legacy fund and the Texas legacy distribution; and
- Use returns of savings from the Texas legacy fund to distribute to state debt, pension obligations, and other long-term debts.

We oppose HJR 10 and HB 20. We agree that the ESF cap should be lowered to a level that does not overtax Texans, specifically the oil and gas sector. While this legislation is well-intentioned to deal with long-term debt obligations with some money above the designated sufficient ESF fund balance, the use of the Texas legacy fund is counter to sound fiscal policy. The problem is that it would use taxpayer money to grow government by spending instead of providing tax relief or structurally reforming long-term debt obligations, which would reduce the cost to taxpayers and secure the beneficiaries' returns. This includes moving from defined-benefit pension plans to defined-contribution plans, stopping the issue of state bonds, and using general revenue to fund infrastructure.

By appropriately allowing more money to remain in the productive private sector instead of saving it in riskier assets and growing government, Texas can remain the economic powerhouse of America—and the world.

Thank you for your time and the work you do, and I look forward to continued discussion on this topic.

ABOUT THE AUTHOR

Vance Ginn, Ph.D., is a senior economist and director of the Center for Economic Prosperity at the Texas Public Policy Foundation, a 501(c)(3) non-profit, non-partisan free market think tank based in Austin. He is a former college lecturer, and an expert on economic and fiscal issues with research to let people prosper by removing government barriers in Texas, D.C., and beyond.