The Economic Stabilization Fund: *Designed for Texas to Use*

Many states have state savings accounts, but Texas has one of the largest in the nation. ***Here's how we think it should be used.***

by Eva DeLuna Castro & Dick Lavine

Key Takeaways

- The Economic Stabilization Fund should be used as originally intended: to prevent sudden, massive cuts to schools, health care, higher education, and other services that rely on General Revenue.
- The Legislature could also consider one-time appropriations from the Fund to reduce future liabilities, such as those of state retirement systems.
- The Legislature should rethink the Fund's arbitrary sufficient balance requirement and its impact on highway funding.

Everyone fortunate enough to have a savings account knows it's a blessing during hard times. Texas is fortunate to have a large savings account in its Economic Stabilization Fund -- often called the Rainy Day Fund -- created to prevent or reduce sudden massive cuts to schools, health care and other state services.

What is the Rainy Day Fund?

Since 1989, the State Constitution has required that a portion of oil and gas production taxes go into the Economic Stabilization Fund (ESF). Many states have a cash reserve; Texas has the second largest in the country. The Texas Constitution allows the Comptroller to make temporary transfers out of the Fund to maintain cash flow during a budget cycle. With a supermajority vote, the Legislature can use the Fund as General Revenue in the current or next budget cycle.

How does money get into the Fund?

The Fund receives a transfer of at least one-half of 75 percent of the prior year's oil and gas severance tax collections that exceed what each of those taxes generated in 1987. Starting with fiscal 2015, the remainder of that 75 percent goes to the State Highway Fund. Before 2015 the Fund received all of the transfer.

The Fund balance is projected to reach $8.5 billion by the end of fiscal 2021. Natural gas tax deposits were a major source of revenue for the Fund from 2002 to 2010; oil severance taxes became much more important starting in 2012.

Transfers to the Rainy Day Fund are required when any uncommitted General Revenue remains at the end of a biennium. That has happened twice: $20 million in 1992 and $1.8 billion in 2008. Interest generated by the balance stays in the Fund as long as doing so doesn't put the Fund over its cap. The Legislature can also appropriate money to the Fund but has never done so.

Maximum and Minimum Balances

The Constitution limits how big the Economic Stabilization Fund can become. The cap is 10 percent of revenues deposited in General Revenue in the prior 2-year period, excluding interest and investment income and fund transfers but including some federal revenue. The cap is $18.8 billion for the 2020-2021 budget cycle.

State law has recently required the Legislature to establish a minimum balance for the Fund each biennium; if the Legislature authorizes spending levels that put the ESF below that minimum, transfers to the Highway Fund are suspended until the minimum is reached again. The "sufficient balance" is $7.5 billion for 2020-2021. Starting with fiscal 2022, the minimum is 7 percent of General Revenue spending for that biennium. The balance requirement was created in 2014 in response to fears that too small a fund would hurt the state's credit rating. But in the early 2000s, before the sufficient balance requirement existed, the Fund balance dropped to almost zero, with no harm done to the state's credit ratings. As the State Comptroller has said, "An ESF balance provides a flexible alternative, in addition to budgetary and revenue tools, to manage through challenging economic cycles. An ESF balance demonstrates fiscal strength and flexibility, but balances are not the only factor rating agencies consider."

When Does it Make Sense to Use the Fund?

Though use of the Fund has sometimes been a point of contention, the Legislature has used the Fund frequently, both for one-time and ongoing budget items. Legislative approval by a two-thirds vote in the House and Senate is required to spend money from the Fund in most circumstances.

In the past, the Legislature has spent the Fund on existing, ongoing costs -- everything from public schools to criminal justice to Medicaid and the Children's Health Insurance Program. The Fund has also been used for new budget items such as the State Water Plan, the Texas Enterprise Fund, and flood prevention and planning.

The following are common-sense situations when legislators should consider using the Fund:

- when needed to prevent state service cuts that further destabilize the economy and prolong a recession, such as teacher layoffs or nursing home closures
- when one-time uses could prevent larger costs in the future, like unfunded state pensions
- when, like a household, dipping into savings will help the state get through a temporary shortfall

The Economic Stabilization Fund is not designed to correct chronic underfunding of state services. If something needs additional funding in general then the Legislature should devise a way to provide permanent, additional funding.

When revenue falls short, the Economic Stabilization Fund is here to help.

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