Updated April 2021

EVERY TEXAN

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

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

by Eva DeLuna Castro & Dick Lavine

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?

The Economic Stabilization Fund (ESF) was created by an amendment to the State Constitution in 1988, which requires that a portion of oil and natural gas production taxes go into the fund and also provides for transfers or withdrawals from the Fund. Many states have a similar cash reserve, and Texas has one of the largest in the country. The Texas Constitution allows the Comptroller to temporarily transfer money 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 in fiscal 2015, the remainder of that 75 percent goes to the State Highway Fund. Before 2015, the Fund received all of the transfer.

If left unused by the 2021 Legislature, the Fund is projected to have a balance of $8.9 billion by the end of fiscal 2021, and nearly $11.6 billion by 2023. Natural gas tax deposits were a major source of revenue for the Fund from 2002 to 2010, and oil severance taxes became much more important starting in 2012.

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.

Transfers to the 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 (described below). The Legislature can also appropriate money to the Fund, but it 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 certain General Revenues deposited in the prior 2-year period, excluding interest, investment income, and some special funds borrowing. The cap is $18.8 billion for the 2020-2021 budget cycle.

State law had recently required a joint legislative committee to establish a sufficient balance for the Fund each biennium. If the Legislature authorizes spending levels that put the ESF below that amount, 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, a new state law sets the sufficient balance at 7 percent of General Revenue spending for that biennium.

The sufficient 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 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 three-fifths or two-thirds vote in the House and Senate is required to spend money from the Fund. The lower threshold applies when the Fund is used to eliminate a current-year revenue shortfall, such as the $3.2 billion appropriation made in 2011 for that fiscal year, but even that use was approved by the higher vote.

Previous Legislatures have 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;
- and 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.