

The Rainy Day Fund:

A RESOURCE DESIGNED FOR TEXAS TO USE

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, created to prevent or reduce sudden massive cuts to schools, health care and other state services. Short-sighted tax cuts and diversions in recent legislative sessions mean that lawmakers have reduced General Revenue available to write the two-year state budget by at least \$10 billion — independent of revenue changes due to oil and gas prices. But ideological arguments for not spending any of the Fund should not prevent state leaders from tapping the account when needed to maintain state services.

CPPP RECOMMENDS

- The Rainy Day 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.
- The Legislature could use at least \$4.3 billion of the ESF before reaching the “sufficient balance” and affecting the transfer to the State Highway Fund.
- Since it is largely short-sighted tax cuts and diversions that have prompted concerns about the Texas budget, lawmakers should resist calls for further tax cuts or revenue diversions.

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, but Texas has the second largest in the country. The Texas Constitution authorizes the Comptroller to make temporary transfers out of the Fund to make up for a General Revenue deficit. 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 year 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 be almost \$12 billion by the end of Fiscal 2019. Natural gas tax deposits were a major source of revenue for the Fund from 2002 to 2010; oil severance taxes were more important from 2012 to 2018.

Transfers to the Rainy Day Fund are required when any uncommitted General Revenue remains at the end of

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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 Rainy Day 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 current cap is \$16.9 billion.

State law requires the Legislature to establish a minimum balance for the Fund each biennium. This "sufficient balance" is set at \$7.5 billion for 2020-21. The balance requirement was created 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 says, "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 recently become a point of contention, the Legislature has used the Fund frequently, for both 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 everything from public schools to criminal justice to closing shortfalls in Medicaid and the Children's Health Insurance Program. The Fund has been used for new budget items such as the State Water Plan or the Enterprise Fund.

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

- when needed to prevent state services from being cut in ways that further destabilize the economy, 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 Rainy Day 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 Rainy Day Fund is Here to Help



CPPP is an independent public policy organization that uses research, analysis and advocacy to promote solutions that enable Texans of all backgrounds to reach their full potential. Learn more at CPPP.org. For more information, please contact Oliver Bernstein at bernstein@cppp.org or call 512.823.2875.