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The Economic Stabilization Fund Origins and Historical Use

The Economic Stabilization Fund, commonly known as the "Rainy Day Fund," was created in 1987 as a mechanism to stabilize volatile state revenues with an eye toward ending the state's feast-or-famine budget cycle. The fund has a mixed history—sometimes used too easily, sometimes left fallow too long. The fund may, or may not, be a critical part of lawmakers' budget deliberations in the current legislative session. To better inform the discussion, this analysis delves into the history of the fund—with particular detail given to the stated purposes for which it was created, as well as how the fund has been used in the budget process.

In sum, the Economic Stabilization Fund was created for the purpose its name describes—stabilization. It was not designed specifically to be used for one-time needs or for natural disasters—although either is certainly a legitimate use of the fund. The stated intent of the legislation was to smooth over state revenue fluctuations—as the author's testimony and the ballot language clearly illustrates.

Background. The 1980s saw the Texas economy struggle from a dramatic downturn of what had been a burgeoning oil and gas industry along with a bust in the commercial real estate market. The impacts wreaked continuing havoc on the state treasury.

Legislators first responded in 1983 by moving forward the due dates of several key taxes, allowing the Comptroller to certify an extra month's worth of tax collections.

When lawmakers met in a 1984 special session to implement the proposed reforms of the Select Committee on Public Education chaired by H. Ross Perot, the treasury was bare. The Legislature responded by raising taxes to finance the education package.

In 1985, lawmakers passed a budget that was certified as balanced by then Comptroller Bob Bullock, only to see oil prices fall further, plunging the state into the red. Gov. Mark White called two special sessions in 1986 to address the shortfall, resulting in budget cuts and another major tax bill.

Lawmakers returned to Austin in 1987 only to find the state's budget woes worse than ever. A consensus package eventually came together. The result was the largest tax increase in the history of the state, which was written by House Ways and Means Committee Chairman Stan Schlueter (D-Killeen) and signed into law by conservative Republican Governor Bill Clements. The tax bill was another major step toward weaning the state from fluctuating oil revenues by diversifying the base of the sales tax.

With the state whipsawed from an oil-fueled cycle of booms and busts, Chairman Schlueter dusted off an idea he co-sponsored his freshman session 10 years earlier[1]—the creation of a reserve fund that could be used to stabilize volatile state revenue collections.

HJR 2 Creates the Economic Stabilization Fund. Schlueter's 1987 bill was a self-enabling constitutional amendment—*HJR 2: proposing a constitutional amendment relating to the establishment of an economic stabilization fund in the state treasury.*

[1]In 1977, State Rep. Ron Coleman introduced House Bill 672 which would have required a portion of the then burgeoning state surpluses be set aside and reserved in the capital reserve fund. Schlueter signed on as a cosponsor and amended the bill to set aside a portion of oil and natural gas production taxes. The bill would pass the House but ultimately die in the Senate.

In testimony presented at the bill's initial hearing before the House Appropriations Committee, Schlueter allowed that while many used the term "Rainy Day Fund," he preferred the name "Economic Stabilization Fund." The fund would be a management tool that would "smooth out the roller coaster … in our state revenues."

While it seemed remote at the time, he told the committee:

> *"We are going to have another oil boom in Texas. It is very important that we not build our spending pattern around the high price of oil. This bill will allow us to take care of necessities such as education and other things that sometimes suffer because of uncertainty during those [bad] times.[2]"*

During periods of fiscal prosperity, a portion of the state's largesse would be reserved, rather than be used to grow the budget. During periods of fiscal duress, the Legislature could draw from the fund rather than raise taxes or cut critical programs. A supermajority two-thirds vote would be required to draw money from the fund, but a lower standard (three-fifths) would be necessary if the state was facing either a deficit or a drop in revenues—the intended target use of the fund. The fund was not solely intended for one-time expenses, nor was it only a disaster response fund—in fact, either of those two uses actually requires a higher, two-thirds supermajority vote to access the fund.

When the bill came up for House floor consideration, it was laid out by one of its co-sponsors, Paul Colbert (D-Houston). In an unusually brief, and biblical, layout, Colbert stated:

> *"Back in ancient Egypt they had a problem. Sometimes the Nile would flood and sometimes the Nile wouldn't flood,[3] and sometimes they'd have crops and sometimes they wouldn't. A guy by the name of Joseph went down there and said, 'What you need to do is when you've got your seven full years you need to fill up the storehouses to get you through your seven years of lean. That's what this amendment does and I move adoption.'[4]"*

As initially passed by the House, HJR 2 would have set aside one half of each biennium's general revenue cash balance plus a portion of the state's oil and gas production taxes—any tax revenues attributable to a price of oil in excess of $15 per barrel, and any natural gas tax revenue stemming from a price in excess of $1.50 per MCF.

After Senate amendments and a conference committee, the bill passed the House 141-1 and the Senate 30-1.

The amendment was submitted to voters with the following ballot language:

> *The constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue.*

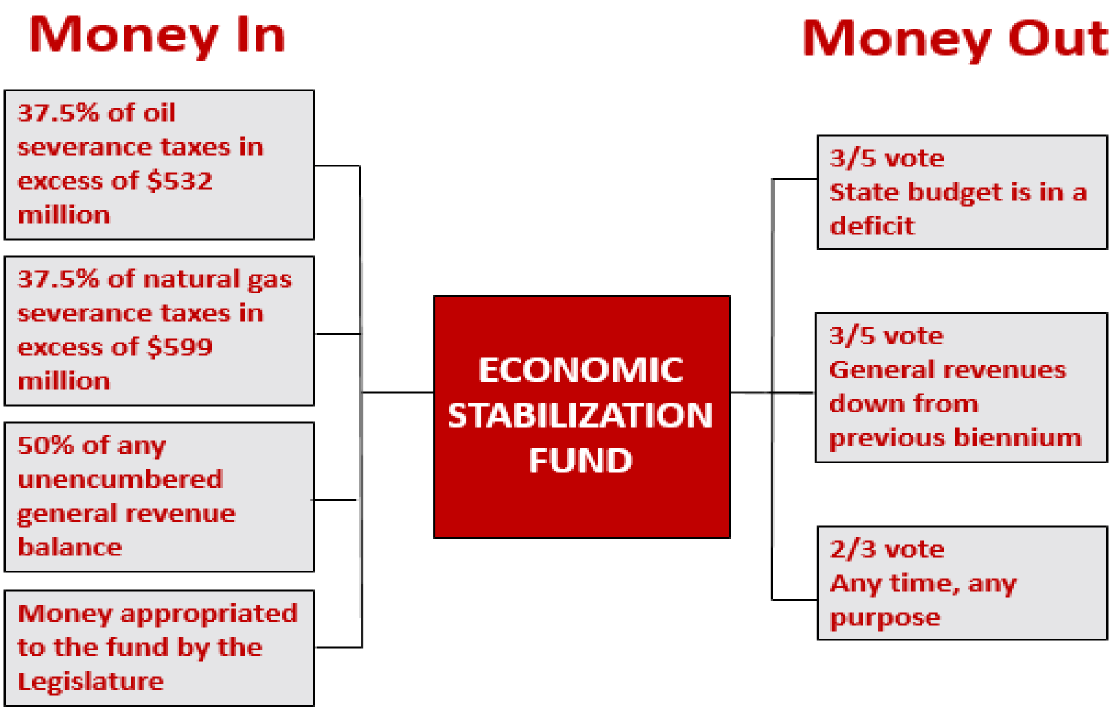
On Nov. 8, 1988, voters approved the amendment with 62 percent voting in favor, and the Economic Stabilization Fund, now Article 3, Section 49-g of the Texas Constitution, became law.

The final law provided that three-fourths of any oil and gas production taxes in excess of what the state collected in 1987 be transferred into the Economic Stabilization Fund (a proportion later reduced to 37.5 percent by a 2015 Constitutional amendment diverting a portion of future deposits instead to the State Highway Fund). Also automatically deposited into the fund is one-half of any *unencumbered* general revenue balances.[5] At their option, the Legislature also may *appropriate* revenue to the fund **(Figure 1)**.[6]

The fund is capped at 10 percent of the amount deposited into the General Revenue Fund during the previous biennium—an amount at the time that roughly corresponded to the Comptroller's estimate of revenues available for budget certification. In the years since, funds consolidation has increased the amount of money flowing into the general revenue fund—particularly federal funds—which inadvertently has led to a much higher cap amount than originally intended.

[2]Quotes are from Stan Schlueter, testimony before the House Committee on Appropriations, Feb. 16, 1987.
[3]While the reference to flooding might appear to relate to an unanticipated natural disaster, in fact, the flooding of the Nile is an annual event that brings rich soil to otherwise poor farmland, making the year's harvest possible.
[4]Paul Colbert comments on the House floor, May 8, 1987.

Figure 1
How the Economic Stabilization Fund Works

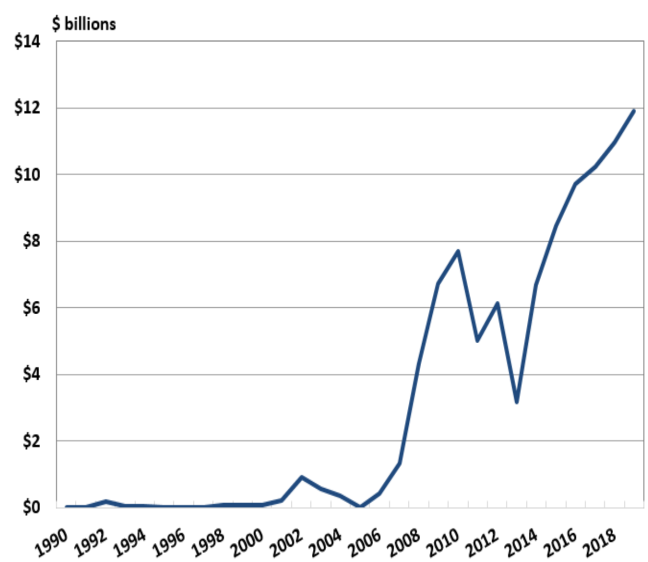


Withdrawing money takes a two-thirds supermajority vote of members present and voting. With the idea that the fund would be used to smooth over revenue fluctuations, a reduced voting threshold of three-fifths is required when the state faces declining revenues, either for a budget in place or for a budget being written:

- For the current budget: state revenues are below the amount the Comptroller initially certified for appropriation (i.e. the current state budget is in the red), or
- For the upcoming biennium: if prospective state revenues are less than the Comptroller's contemporaneous revenue forecast for the current biennium.

The Stabilization Fund in Practice. In the early years of the Rainy Day Fund, the oil and gas industry remained fairly weak, and little money flowed into the fund. Revenues deposited into the fund were quickly spent. It was not until the early 2000s, with the application of hydraulic fracturing and new horizontal drilling techniques, that the fund began to accumulate substantial revenue (**Figure 2**).

Figure 2
Economic Stabilization Fund Balances



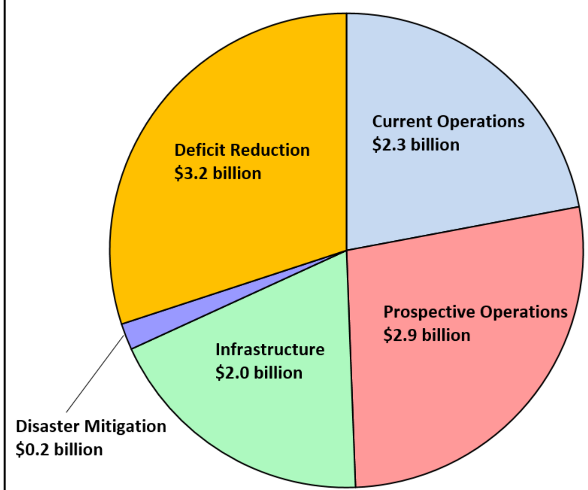
[5]The bill as passed the House simply required one-half of any positive general revenue balance be deposited into the fund. The Senate (and final) version limited that to "unencumbered" balances, which required the Comptroller to net any outstanding obligations before making the transfer. While the state commonly ends a biennium with a positive general revenue cash balance, outstanding obligations typically result in a negative determination.

[6]The word "appropriate" was used rather than "transfer" so that the action would be subject to the state's spending limit. In the event of huge surpluses, this would make it easier to cut taxes rather than to add to the Economic Stabilization Fund.

Since the inception of the fund, a total of $19.9 billion has been deposited into the fund and $10.6 billion has been appropriated. Almost all of the deposits have been from severance taxes, with taxes on natural gas topping those on oil for first place. Only twice has a portion of the state's unencumbered general revenue balance been transferred into the fund, and only one of those was substantial. Throughout the history of the fund the Legislature has never ***appropriated*** money ***into*** the fund as allowed under the Constitution.

The Legislature has made seven withdrawals totaling $10.7 billion for a variety of purposes (**Figures 3 and 4**). The first five of those withdrawals were primarily to augment on-going or prospective appropriations.

Figure 3
Historical Uses of the Economic Stabilization Fund



The first withdrawal from the fund came in the 1990 sixth special session of the 71st Legislature (a session dealing with school finance). Senate Bill 11 by Brooks, provided that "all amounts" in the fund were appropriated to the Foundation School Fund for the upcoming fiscal year. The blank check eventually totaled $29 million and wiped out the first balance in the fund.

In 1993, lawmakers in the 73rd regular session actually made two appropriations from the fund. Senate Bill 171 by Montford provided a $125.8 supplemental appropriation to the Department of Criminal Justice, then under court order, for the remainder of the current fiscal year. Senate Bill 532 by Whitmire appropriated $72 million from the fund for the upcoming biennium for the operation of new prisons and probation costs. Those measures, at the time, obligated all balances projected to be in the fund.

In 2003, the Legislature convened in Austin to the news that the current state budget had fallen into the red. Lawmakers were able to cut the budget back into the black, but used the Economic Stabilization Fund for a number of supplemental and prospective appropriations. HB 7 by Heflin appropriated $1.26 billion of the $1.29 billion estimated to be in the fund. About a third of the money appropriated in HB 7 was for supplemental appropriations to backfill agencies through the end of the then-current budget. Two-thirds of the appropriation was for prospective purposes—addressing the needs of the state's health insurance program for retired teachers (TRS-Care) and to fund the newly created Texas Enterprise Fund.

It was not until 2011 that the fund was actually used to alleviate a pending deficit, with lawmakers withdrawing $3.2 billion—a massive check, but one that still left $5 billion in the fund.

In 2013, lawmakers made the largest single withdrawal, although it was for a variety of purposes. The largest was to undo a one-time payment shift to schools (a payment shift previously used to balance the budget) and set aside $2 billion to jump-start the state's water plan. That same year, lawmakers proposed an amendment to the Constitution, subsequently approved by Texas voters, which diverted half of the amount of oil and gas taxes being transferred into the fund to the State Highway Fund.[7] To ensure that these highway diversions would not threaten the balance of the Economic Stabilization Fund, lawmakers created a committee to determine an amount they deem is a "sufficient balance." Should the balance fall below that amount, the diversions to the Highway Fund are automatically suspended until the Economic Stabilization Fund reaches the target balance.[8]

A further change was made in 2015. HB 903 by Capriglione provided that balances in the Economic Stabilization fund that exceeded the sufficient balance requirement could be invested in higher-yielding investment securities. Prior to that, the fund invested in short term notes in order

[7] SJR 1 by Nichols, 83rd Texas Legislature, third called session.
[8] HB 1 by Pickett, codified in Chapter 316, Government Code, Subchapter H.

Figure 4
Historical Appropriations from the Economic Stabilization Fund

Bill	Year	Session	Agency	Amount($ml)	Type of Appropriation
SB 11	1990	71:6	Texas Education Agency	$29.0	Current Operations[1]
SB 171	1993	72:R	Dept. Criminal Justice	$125.8	Current Operations[1]
SB 532	1993	72:R	Dept. Criminal Justice	$72.0	Prospective Operations[2]
			Total	$197.8	
HB 7	2003	78:R	Dept. Human Services	$406.7	Current Operations[1]
			Dept. Health	$6.9	Current Operations[1]
			Children's Health Ins. Program	$26.4	Current Operations[1]
			Dept. Human Services	$6.4	Disaster-related Costs[1]
			Teacher Retirement: TRS-Care	$516.0	Prospective Operations[2]
			Governor: Texas Enterprise Fund	$295.0	Prospective Operations[3]
			Comptroller: Judgment Payment	$3.0	Current Operations[1]
			Total	$1,260.4	
HB 10	2005	79:R	Dept. Health	$92.4	Prospective Operations[3]
			Dept. Family & Protective Services	$200.0	Prospective Operations[3]
			Teacher Retirement System	$30.7	Prospective Operations[3]
			TEA: Foundation Program	$560.0	Prospective Operations[3]
			TEA: Textbooks	$175.0	Prospective Operations[3]
			Governor: Emerging Technology	$100.0	Prospective Operations[2]
			TEA: Foundation Program	$872.0	Prospective Operations[2]
			Total	$2,030.1	
HB 275	2011	82:R	General Revenue	$3,198.7	Deficit Reduction
HB 1025	2013	83:R	Texas A&M Engineering Ext.	$1.7	Reimbursement (Disaster)[1]
			Parks & Wildlife: Rev Shortfall	$0.9	Current Operations[3]
			Department of Public Safety	$2.7	Disaster-related Costs[1]
			Parks & Wildlife:	$4.9	Disaster-related Costs[3]
			Texas A&M Forest Service	$161.1	Disaster-related costs[1]
			Governor	$15.0	Disaster-related Costs[3]
			Texas Education Agency	$1,750.0	Current Operations[1,4]
			Texas Water Development Board	$2,000.0	Infrastructure Seed Money
			Total	$3,936.2	

1 Appropriation limited to the then-current budget period.
2 Appropriation made for the upcoming biennium.
3 Appropriation was made for the two-year period beginning the effective date of the act—extending into the next budget period.
4 Appropriation enabled Legislature to undo a one-time payment delay of state aid to schools.

to remain liquid in the event lawmakers needed to use the fund. Since the new law has taken effect, the average effective rate of interest has tripled, to near 3/10 of one percent.

The Economic Stabilization Fund Today. In the Biennial Revenue Estimate for 2018-19 (BRE), Comptroller Glenn Hegar projects that by the end of 2019, the Stabilization Fund will have a balance of $11.9 billion—up $1.6 billion from the start of the biennium in spite of a relatively weak period for the oil and gas industry and in spite of the fact that lawmakers and voters recently cut by half the severance tax revenue stream into the fund.

The BRE also projects that state revenues available for certification in 2018-19 will be down by $2.9 billion. That would allow the Legislature to access that amount with three-fifths of the members present and voting on the measure.

Another option lawmakers may consider is the approach taken in 2011. In that session, lawmakers budgeted enough funds for Medicaid to cover roughly 20 of the budget's 24 months, leaving it to the 2013 Legislature to appropriate funds to fund the remaining period. At the time, it was expected that lawmakers likely would have to tap the Economic Stabilization Fund to cover the required appropriation. In fact, state revenues rebounded with a vengeance, and sufficient general revenues materialized to close the gap.

TEXAS TAXPAYERS
TTARA
AND RESEARCH ASSOCIATION

Texas Taxpayers and Research Association
400 West 15th Street, Suite 400
Austin, Texas 78701

YOUR TTARA TEAM:

Dale Craymer, President

Debbie Cartwright, Counsel

John Kennedy, Senior Analyst

Sheryl Pace, Senior Analyst

George S. Christian, Consultant

Ryan Ash, Communications Director

Betty Wranischar, Office Manager

Nancy Shields, Membership and Marketing Director

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