Testimony on the Economic Stabilization Fund

Economic Stabilization Fund: Continue to study strategies to use the Economic Stabilization Fund (ESF) to generate additional revenue for state obligations without compromising the fund's intended purpose. Evaluate the current methodology used to set the ESF cap.

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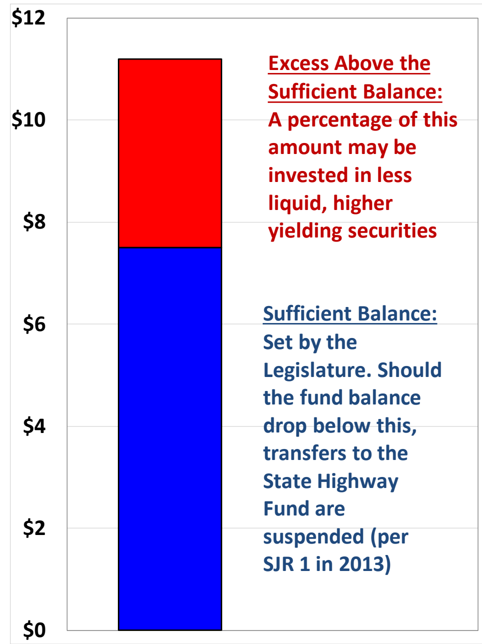
Strategies to Generate Additional Revenue

The Economic Stabilization Fund (ESF) is generally kept liquid—investing in short term securities so that funds may be accessed and used quickly should the Legislature tap the fund. While this is generally prudent, fund balances have become so substantial that the state has more than sufficient balances to address most immediate needs. Further, legislative appropriations are typically made well in advance of the actual use of an appropriation from the fund, obviating the need for immediate liquidity.

In 2013, as a part of a Constitutional amendment redirecting moneys for deposit into the ESF to be shared with the State Highway Fund, the Legislature was instructed to formally set an amount of "sufficient balance." Should the fund balance drop below this amount, transfers to the State Highway Fund are suspended. In 2015, HB 903 allowed the Comptroller to invest a percentage of the excess above the sufficient balance in higher-yielding, but generally less liquid, securities.

Estimated 2019 ESF Balance



Source: Comptroller of Public Accounts, Certification Revenue Estimate for 2018-19.

Recommendations:

1. The legislature should set the "sufficient balance" amount more in line with the historical use of the fund (the greatest single appropriation from the fund to date is $3.1 billion). This would allow a greater portion of the fund to be invested in higher yielding securities.

2. In the event the Legislature appropriates an amount that would cause the ESF to drop below the sufficient balance, the Comptroller should be allowed to use his discretion to draw from the more liquid moneys in the fund, and not be forced to immediately sell higher-yielding investments because:

   - The economic conditions necessitating the use of the ESF may also mean that the market for securities is temporarily depressed, forcing the state to sell securities at unfavorable terms; and
   - Having to sell the higher-yielding securities also means an appropriation from the ESF will result in a greater revenue loss to the state (because of reduced interest earnings).

Evaluate Alternative Limit Calculations

The balance of the Economic Stabilization Fund is "capped" at:

> *an amount equal to 10 percent of the total amount, excluding investment income, interest income, and amounts borrowed from special funds, deposited in general revenue during the preceding biennium. (Texas Constitution, Article 3, Section 49-g(g).*

In 1987, when the legislature passed the ESF resolution, this amount was roughly equivalent to what the Legislative Budget Board and the Comptroller define as "general revenue-related" funds (essentially funds affecting the Comptroller's certification of the budget).

In the ensuing years, the nature of the general revenue fund has changed. In 1987, roughly 2 percent of all federal money received was initially deposited into special funds, and not the general revenue fund. Many of these special funds were consolidated into the general revenue fund in 1991, increasing the amounts deposited into the fund. Today almost two-thirds of all federal money is deposited into the general revenue fund—artificially increasing the cap on the Economic Stabilization Fund by as much as $5 billion.

Federal revenue should not be included in calculating the limit on the fund because state money is not used to supplant federal funding. The loss of federal funds is not a risk to the general revenue fund, nor would removing them from the general revenue fund create a reduction in funds available for certifying the budget.

Unused excessive balances in the ESF can do harm to the Texas economy. To the extent the money is collected but not used, every dollar in the ESF is a dollar removed from the Texas economy, reducing investment, reducing jobs and reducing incomes.

In 2016, the National Association of State Budget Officers reported that Texas' balance in the ESF was equal to 18 percent of the state's annual general revenue expenditures and three times greater than the nationwide average of states with similar funds.

Recommendation:

1. The legislature should create a federal revenue fund outside of the general revenue fund to handle the deposit of federal moneys—as was the case when the ESF became law. This will reduce the amounts deposited into the general revenue fund, bringing the ESF limit more in line with the original intent of the fund's designers (reference HB 8 from 84R).