



LEGISLATOR'S GUIDE TO THE ISSUES 2021-2022

Economic Stabilization Fund

The Issue

Production of crude oil and natural gas has historically fluctuated based on a number of market-driven and geopolitical factors. Because the Texas Legislature collects severance taxes from this volatile production to primarily fund the state's Economic Stabilization Fund (ESF), broadly considered the state's "rainy day fund," the purpose for and use of the ESF must be worthy.

Texas voters approved the ESF with passage of a constitutional amendment in 1988 after an uncertain state revenue period when oil and gas comprised a large share of economic output and was highly volatile in the 1970s and 1980s. The ballot language that Texans approved was "the constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue." The Texas Constitution requires a three-fifths vote in each house to close a revenue shortfall and a two-thirds vote in each house to use it for other reasons.

Since its inception, deposits to the fund have totaled \$21.8 billion. While there have been a number of proposed uses for the money in the ESF, the ballot language sold to Texas is clear that this money is to fill unexpected revenue declines. All told, only 27.4%, or \$3.2 billion, of the \$11.6 billion spent from the ESF since inception has been for general deficit reduction. In 2019, the Legislature appropriated \$4.9 billion from the ESF for the 2019 fiscal year supplemental budget to help pay for expenditures such as ongoing Hurricane Harvey related relief and an additional \$1.2 billion for 2020-21 biennium. Clearly, a more stringent use of this fund outside of its intended purpose is warranted. In addition, the current economic slowdown as a result of the COVID-19 pandemic and a significant drop in the demand for and subsequently price of oil will likely reduce expected deposits into the ESF.

Despite these uses of severance taxes for one-time and ongoing expenditures, the ESF's balance is expected to be \$8.9 billion at the end of the 2020-21 budget cycle. Given the ESF's constitutional limit of 10% of general revenue (GR)-related funds excluding interest and investment income in the previous budget cycle, the cap this period is \$16.9 billion.

The cap of 10% on biennial GR-related funds is a 20% annual cap. Every dollar not in the private sector without a clear purpose is wasting potential productivity that could help Texans prosper, so these dollars should be used wisely and not be excessively collected. Moreover, the state's economy, and therefore tax revenue, is much less reliant on oil and gas activity as previously experienced. Research shows that Texas could have a biennial cap closer to 7%, or annually 14%, to cover the most severe fiscal downturns, which should primarily be solved with spending restraint. Alternatively, if

this money is spent each session, the ESF will quickly dwindle, and the state's credit rating could be at risk.

There will likely be interest in tapping the rainy day fund in 2021 if the expected drop in revenue materializes and more demands are put on the budget. Any use of these one-time funds to pay for ongoing expenditures only delays needed difficult decisions that should be made with general revenue funds and depletes one-time funds available for revenue shortfalls, future emergencies, or tax relief. In addition, using ESF funds for investment purposes that could support a higher rate of return to fund unfunded state liabilities without considering major reforms to pensions and reductions to debt first is not warranted.

The Facts

- The ESF's balance is expected to increase to \$8.9 billion by the end of FY 2021.
- Using one-time funds to pay for ongoing expenses is poor public policy.

Recommendations

- Increase the threshold to use ESF money "at any time and for any purpose" from the current two-thirds of members present to four-fifths of all members in each chamber.
- Lower the constitutional cap from 10% to 7% of biennial GR-related funds in the previous biennium.
- Use excess state revenue above the ESF cap or from budget reductions to cut taxes instead of spending or investing it in riskier assets and growing the budget without reforms.

Resources

["Don't Grow Government with the Texas Rainy Day Fund,"](#) by Vance Ginn and Josh Marquette, Texas Public Policy Foundation (April 9, 2019).

[Fiscal Size Up 2020-2021 Biennium,](#) Legislative Budget Board (May 2020).

[Economic Stabilization Fund Overview,](#) Legislative Budget Board (Jan. 2019).

[Leaky Umbrella: The Need to Reform Texas' Rainy Day Fund](#) by Vance Ginn, Talmadge Heflin, and Owen Smitherman, Texas Public Policy Foundation (Oct. 2016).