

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.

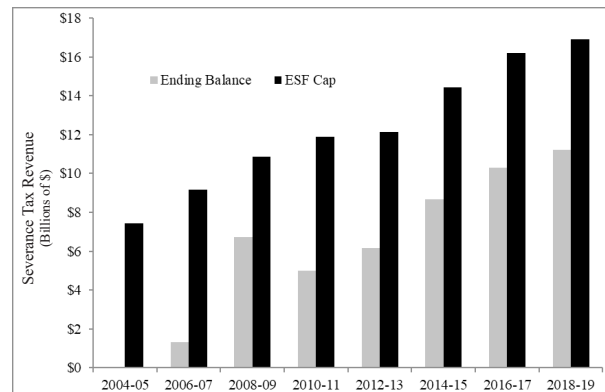
Texas voters approved the ESF with passage of a constitutional amendment in [1988](#) after an uncertain state revenue period when oil and gas comprised a large share of economic output and was highly volatile in the 1970s and 1980s. The ballot language that Texans approved was "The constitutional amendment 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.

The ballot language sold to Texas is clear that this money is to fill unexpected revenue declines. However, 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 2013, \$4 billion of ESF dollars were appropriated to fund expenditures for education and Medicaid above what was appropriated in 2011. Texans approved amendments in 2013 to take \$2 billion from the ESF to pay for water projects and in 2014 to direct a portion of severance taxes to the State Highway Fund (SHF) instead of the ESF. In 2017, the Legislature appropriated \$1 billion from the ESF primarily for state facilities (\$778 million) but also for disaster relief and one-time grants to local entities. Clearly, a more stringent use of the fund outside of its intended purpose is warranted.

Despite the use of severance taxes for one-time and ongoing expenditures, the ESF's balance is expected to be \$11.9 billion at the end of the 2018-19 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 **Figure** (next page) shows ESF dollars are likely to rise to the highest cap share of 70% compared with only 14% in the 2006-07 period.

These funds are a one-time resource to the state. The cap of 10% on biennial GR-related funds is really 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.

Economic Stabilization Fund Reaches Closer to Constitutional Cap



Source: Legislative Budget Board

Using 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 recommended. The state should use precious taxpayer dollars to spend within its budget and not tap one-time funds for reasons never approved by Texans.

The Facts

- The ESF is expected to increase to \$11.9 billion by the end of FY2019, which would be a record high.
- Using one-time funds to pay for ongoing expenses is poor public policy.

Recommendations

- Raise 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 for tax relief instead of spending or investing it in riskier assets.

Resources

[Economic Stabilization Fund Overview](#), Legislative Budget Board (March 2018).

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

[Weathering the Next Recession: How Prepared Are the 50 States?](#) by Erick Elder, Mercatus Center (Jan. 2016).