



WHEN IT RAINS, USE YOUR UMBRELLA

Texas should use the Economic Stabilization Fund, commonly called the Rainy Day Fund, to maintain essential services during tough economic times and to stimulate our economy. The state created the fund in reaction to the experience of 1986, when plummeting oil prices required the governor to call a special legislative session to cut the state budget and raise taxes. The constitutional purpose of the fund is to maintain vital state services during economic downturns. The comptroller forecasts that the fund will have \$9.1 billion available for appropriation through 2010-11.

What is the State's Rainy Day Fund?

Background

In early 1986, increased overseas oil production started a steep decline in oil prices that caused a severe economic slowdown in Texas and devastated state revenues. Then-comptroller Bob Bullock cut his revenue estimate three times in three months. By July 1986, the estimate fell 12.6 percent compared to the previous year's forecast. In response, the Legislature met in two special sessions to reduce the projected general-revenue deficit.

Legislators passed a one-year appropriations bill for 1987 that cut state spending by 4.65 percent and reduced the number of state employees by nearly 2,000 people. They also raised the state sales tax rate from 4 1/8 percent to 5 1/4 percent and increased the gasoline tax from 10 cents per gallon to 15 cents per gallon. In addition, pari-mutual betting on horse races and greyhound races was permitted for the first time, subject to voter approval.

Constitutional amendment

To avoid future drastic budget cuts and tax increases, the Legislature proposed the Economic Stabilization Fund, commonly called the Rainy Day Fund, to act as a forced savings account for the state budget. Voters adopted the fund as a constitutional amendment in November 1988, and it is now Article 3, section 49-g, of the Texas Constitution.¹

This provision requires deposits to the fund 1) when oil or gas production taxes collected in a fiscal year exceed the amounts each tax collected in 1987, and 2) when unencumbered General Revenue (GR) remains at the end of a biennium. The legislature can also (but has never chosen to) appropriate money to the fund.

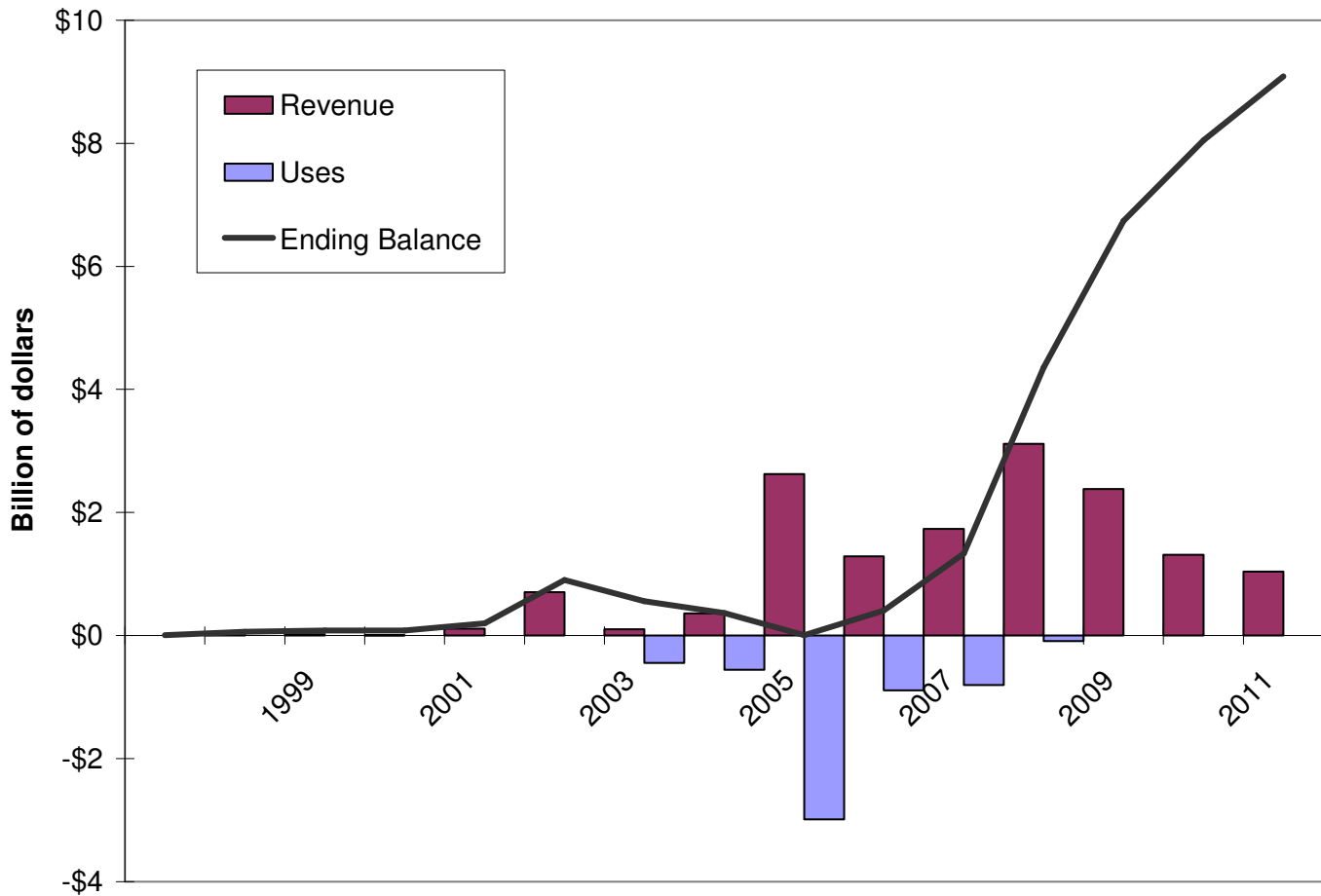
How Much is in the Fund?

The comptroller's Biennial Revenue Forecast indicates that the fund will total \$9.1 billion for 2010-11. Recent rapid growth in the fund is due almost entirely to higher collections of natural gas and oil severance taxes. The chart below shows that, starting in 2005, deposits to the fund have exceeded \$1 billion per year, reaching \$2.6 billion in 2005 and \$3.1 billion in 2008. The comptroller projects that another \$2.4 billion will be deposited in 2009, followed by \$1.3 billion in 2010 and \$1.0 billion in 2011.

When May the Fund Be Used?

The Texas Constitution provides that "the legislature may, by a two-thirds vote of the members present in each house, appropriate amounts from the economic stabilization fund at any time and for any purpose." But a separate provision allows a three-fifths vote of the members present to appropriate from the fund an amount not to exceed the difference between revenue expected for the next biennium and the amount available in the current biennium. The comptroller has forecast the difference between current and future available revenue to be \$9.1 billion.

Rainy Day Fund Revenue and Uses



In other words, only a three-fifths vote is required to spend the entire amount in the Rainy Day Fund in order to prevent a decline in available revenue. If all members were present, a two-thirds vote would require 100 votes in the House and 21 in the Senate, while a three-fifths vote would require 90 votes in the House and 19 in the Senate.

How Should the Fund be Used?

The constitutional purpose of the Economic Stabilization Fund is to help stabilize the state budget during a severe decline in state revenue. Texans did not want to repeat the experience of 1986, which required budget cuts and tax increases during an economic recession. The fund serves as a savings account for the state, to be tapped to fund ongoing services when revenues fall.

How has the fund been used in the past?

In 1991, the legislature spent \$29 million of the Rainy Day Fund on public schools, and in 1993, spent \$197 million for criminal justice. In 2003 the legislature appropriated \$1.2 billion from the Rainy Day Fund—almost all that legislators expected it to contain through 2005. One-third was for CHIP (Children’s Health Insurance Program) and Medicaid shortfalls for 2003. The legislature appropriated the remainder for 2004-05 to fund retired teachers’ health care and to create the Governor’s Texas Enterprise Fund for economic development incentives. In 2005, the legislature appropriated \$1.9 billion in Rainy Day Funds, using roughly half for 2005 shortfalls, and the other half for 2006-07 budget items (including the new Emerging Technology Fund and child protective services reforms). Legislators did not appropriate

any money from the fund in 2007. The fund is also used for interfund transfers as needed.

Would using the fund hurt the state's credit rating?

Standard & Poor's (S&P), the national credit rating agency, lists an established rainy day reserve at the top of its list of "Top 10 Management Characteristics of Highly Rated Credits in U.S. Public Finance"² because such reserves allow states to respond quickly to budget shortfalls.

S&P makes it clear that "it is important to keep in mind that use of budget stabilization reserves is not in and of itself a credit weakness. The reserves are clearly in place to be used."

Texas's fund meets several of the desirable characteristics listed by S&P. Texas has "a mechanism for rebuilding reserves once they are used," since the Constitution requires the comptroller to deposit three-quarters of oil and gas revenues over 1987 levels into the fund. Texas also has "formal policies established outlining under what circumstances reserves can be drawn down," including the supermajority voting requirements described above.

Legislators should therefore feel confident that the Rainy Day Fund can be used as necessary to stabilize the state budget without harm to the state's excellent credit rating.

Should the fund be used only for one-time expenditures or natural disasters?

The constitutional purpose of the fund is to stabilize the state budget during economic downturns. Arguing that the

fund should be spent only on one-time expenditures such as natural disaster recovery misunderstands the idea behind the fund. In an economic downturn, state revenue falls. When the economy recovers, state revenue recovers. In the meantime, the fund provides the money necessary to stabilize the budget.

Would the fund be replenished in the future?

The fund automatically replenishes. At the end of fiscal 2008, the Rainy Day Fund balance equaled \$4.4 billion. In 2009, the comptroller projects deposits of an additional \$2.4 billion, followed by \$1.3 billion in 2010 and \$1.0 billion in 2011, for a total of \$9.1 billion available to spend by 2011.

Most of the revenue comes from the natural gas tax. The price of natural gas is expected to average \$5.79 in 2009, then \$5.06 in 2010 and \$5.63 in 2011. The comptroller's latest economic forecast projects that natural gas prices will continue to rise—to \$6.29 in 2012 and \$7.04 in 2013. So, even though the comptroller makes no projections of Rainy Day balances beyond the 2010-11 biennium, we can reasonably expect money to continue to flow into the fund in 2012-13 at rates at least as great as projected for 2010-11—more than \$1 billion per year—and perhaps higher as the economy recovers.

Conclusion

The constitutional purpose of the Rainy Day Fund is to stabilize the state budget during periods of economic downturns. Texas should use the fund to stimulate the state economy by maintaining essential services during tough economic times.

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The Center for Public Policy Priorities is a nonpartisan, nonprofit policy institute committed to improving public policies to better the economic and social conditions of low- and moderate-income Texans.

¹ For the legislative history, go to www.las.lrl.state.tx.us/LASDOCS/70R/HJR2/HJR2_70R.pdf.

² See: www2.standardandpoors.com/portal/site/sp/en/us/page.article_print/3.1.1.0.1204837014383.html