



USE ALL OF THE RAINY DAY FUND: A BALANCED APPROACH TO BALANCING THE STATE BUDGET

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 Legislative Budget Board forecasts that the fund will have \$9.6 billion available for appropriation through 2012-13. The Legislature has in the past often spent all of the Rainy Day Fund to maintain the state's investments in critical public structures and systems such as education. It should do so again in 2011.

The Legislature should not hold back part of the fund for future sessions to cope with the ongoing structural deficit it created with the 2006 school property tax cut. That is not the purpose of the Rainy Day Fund, nor can the fund cover this deficit on a long-term basis. The Legislature must instead fix this ongoing deficit with changes in the structure of our state and local revenue system.

What is the State's Rainy Day Fund?

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 had fallen 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.

The Legislature 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. It 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, it permitted pari-mutual betting on horse races and greyhound races for the first time, subject to voter approval

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

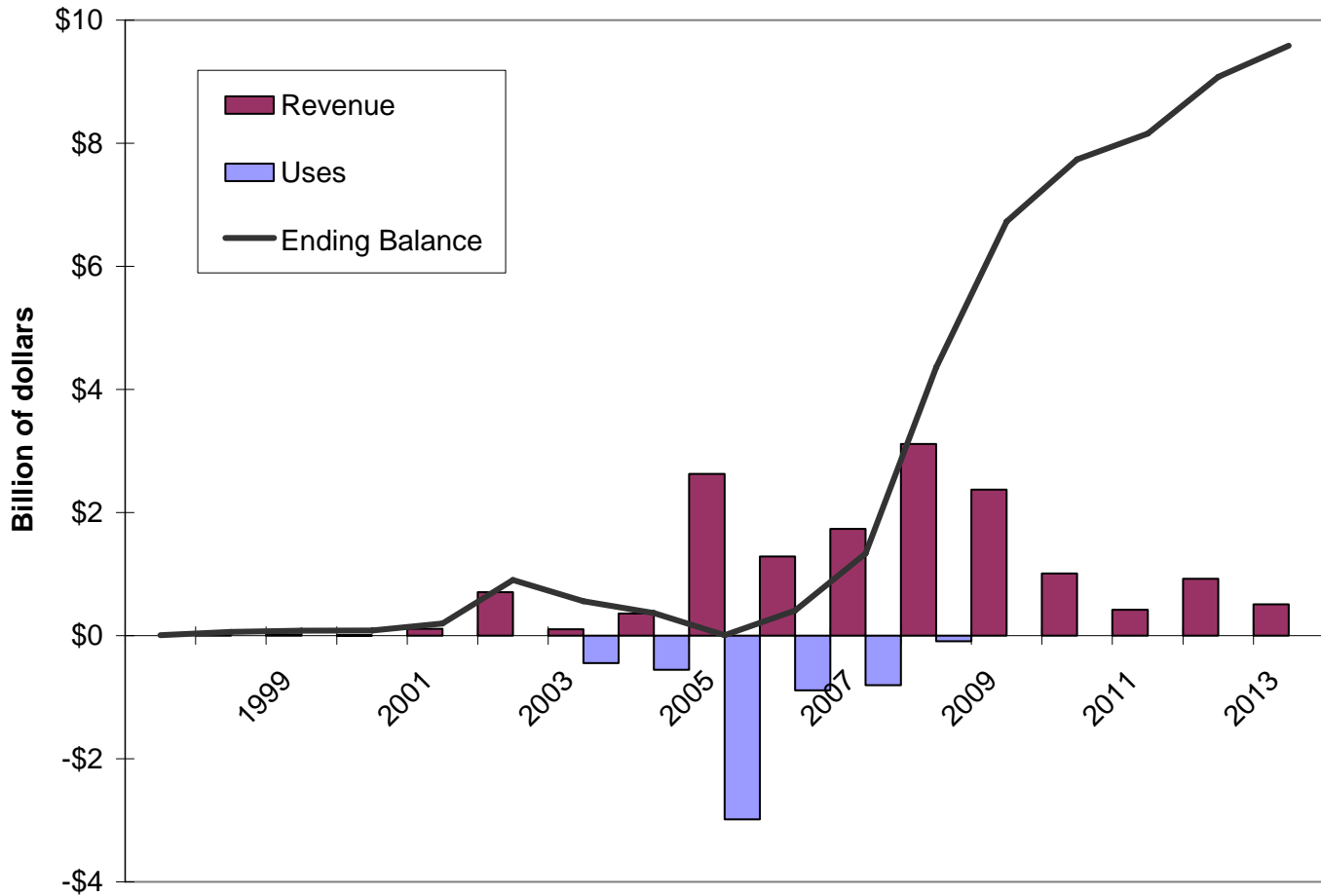
savings account for the state budget. Voters adopted the fund as a constitutional amendment in November 1988, and it is now Article 3, section 49-g, of the Texas Constitution.¹

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 never has) appropriate money to the fund.

How Much is in the Fund?

The comptroller's Certification Revenue Estimate indicates that the fund will end the current 2010-11 biennium with a balance of \$8.2 billion.² In addition, the Legislative Budget Board forecasts that the fund will grow by another \$1.4 billion during the 2012-13 biennium³, giving the Legislature a total of \$9.6 billion available to appropriate to help fund the 2012-13 budget.

Under the Umbrella: Rainy Day Fund Helps Texas Weather Severe Economic Storms



Recent rapid growth in the fund is due almost entirely to higher collections of natural gas and oil severance taxes. The chart above shows recent deposits to the fund have frequently exceeded \$1 billion per year, reaching \$2.6 billion in 2005, \$3.1 billion in 2008 and \$2.4 billion in 2009. The comptroller projects that another \$1.0 billion will be deposited in 2010, followed by \$420 million 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.”⁴ If all members were present, a two-thirds vote would require 100 votes in the House and 21 in the Senate.

The Legislature may also, by a three-fifths vote of the members present, use the Rainy Day Fund to prevent a deficit in a current budget.⁵ If the Comptroller certified that appropriations from general revenue for the current 2010-11 biennium would exceed the amount of general revenue projected to be raised and any cash balances, then the Legislature could, during the 2011 regular session, appropriate from the fund an amount equal to the deficit in the 2010-11 budget. This appropriation could be only for a General Revenue appropriation had already been made in the budget.

The Constitution also allows appropriation from the fund by a three-fifths vote of the members present if the comptroller estimated that the revenue expected for the next biennium would be less than the amount available in the current biennium.⁶

In other words, only a three-fifths vote is required to spend the Rainy Day Fund in order to prevent a deficit in the current budget or to offset a decline in available revenue for a future budget. A three-fifths vote would require 90 votes in the House and 19 in the Senate, if all members were present.

How Should the Fund be Used?

What is the purpose of the fund?

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 severe budget cuts as well as tax increases. The fund serves as a savings account for the state, to be tapped to support ongoing services when revenues fall due to an economic turndown.

How has the fund been used in the past?

The Legislature has used the fund when needed in the past, frequently spending the entire amount available. The ending balance in the fund did not exceed \$1 billion until 2007 (its 18th year of existence) and then only because actual revenue to the fund greatly exceeded the amount forecast when the Legislature met to write the 2006-07 budget.

In 1991 the Legislature spent the entire balance of the fund (\$28.8 million) on public schools, and in 1993 spent \$197 million for criminal justice. The 2003 Legislature appropriated \$1.2 billion from the Rainy Day Fund—almost all that legislators expected it to contain through 2005. One-third was for Children’s Health Insurance Program (CHIP) 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). These appropriations spent almost all of the \$2 billion that was forecast to be available in the fund.

However, higher-than-anticipated oil and gas prices brought in billions of dollars of unexpected revenue to the fund, which ended fiscal 2007 with a balance of \$1.3 billion.

The Legislature did not appropriate any money from the fund in 2007, when general revenue for the next biennium was expected to continue to grow quickly, or in 2009, when the federal government provided \$7 billion in stimulus aid used in place of general revenue.

Would using the fund hurt the state’s credit?

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”⁷ 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.

Would the fund be replenished in the future?

The fund automatically replenishes. The comptroller forecasts that the Rainy Day Fund will have a balance of \$8.2 billion at the end of 2011. The Legislative Budget Board has made additional forecasts that deposits in 2012 and 2013 will total another \$1.4 billion, giving the Legislature \$9.6 billion available to be spent from the fund

to eliminate any deficit in the 2010-11 budget and to fund the 2012-13 budget.

Shouldn't part of the fund be saved to cover the structural deficit in 2013?

Our revenue problems have two different sources. The national economic recession has temporarily reduced sales tax and other revenue. The Rainy Day Fund was created to deal with just such temporary cyclical shortfalls and should be spent to maintain the state's investments in critical public structures until the economy recovers.

The state is also facing a long-term structural deficit in our budget, caused by the 2006 property tax cuts. The amount of new state revenue raised by the changes in the franchise tax and the increase in the cigarette tax replace only one-third of the property tax revenue foregone by school districts. The rest must be covered by state general

revenue, reducing the amount available for all other state services. [Click here](#) for more information.

This long-term structural deficit can be eliminated only with a structural change in Texas' state-local tax system, so that state revenue and school property taxes are able to reliably provide the continuing stream of support needed to adequately educate our children. The Rainy Day Fund – the state's saving account – can't take care of an ongoing shortfall.

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.

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

² <http://www.window.state.tx.us/taxbud/cre1011/tables.html#a8> (November, 2009)

³ Testimony of John O'Brien, Director of the Legislative Budget Board, before the House Ways and Means Committee, January 13, 2010.

⁴ Texas Constitution, Art. 3, Sec. 49-g (m) at www.statutes.legis.state.tx.us/SOTWDocs/CN/htm/CN.3.htm#3.49-g

⁵ Texas Constitution, Art. 3, Sec. 49-g (k)

⁶ Texas Constitution, Art. 3, Sec. 49-g (l)

⁷ See: www2.standardandpoors.com/portal/site/sp/en/us/page.article_print/3.1.1.0.1204837014383.html

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