

USING THE RAINY DAY FUND *to Ensure our Recovery and Prosperity*



The Rainy Day Fund Is Part of a Balanced Approach

Texas faces a devastating revenue shortfall. We are about \$18 billion short of being able to maintain spending at its current level and at least \$27 billion short of being able to maintain services at their current level. Whichever way you look at it, we face a larger revenue shortfall than during the last recession in 2003 and even larger than during the global energy price collapse in the 1980s.

A cuts-only approach to dealing with a shortfall this large would undermine our economic recovery and threaten our future prosperity. Instead, we need a balanced approach, one that includes using our Rainy Day Fund to minimize damaging cuts to critical public services such as education. As part of a balanced approach, the Rainy Day Fund can cover about a third of the shortfall. Inside we explain how the fund works and why it should be used.



HOW THE RAINY DAY FUND WORKS

The Rainy Day Fund Saves Money in Good Times to Spend in Bad Times to Maintain Services

In early 1986, increased overseas oil production sparked a steep decline in oil prices, causing a severe economic slowdown in Texas. Comptroller Bob Bullock cut the 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 took a balanced approach—both cutting spending and raising taxes.

Dealing with the crisis was a painful experience, and the Legislature took steps to ensure the state never had to endure such pain again. In 1987, to cope with any future economic downturn, the Legislature proposed a constitutional amendment to create the Economic Stabilization Fund, commonly called the Rainy Day Fund. The fund's purpose was to save money in good times to spend in bad times to maintain services.

The House Research Organization prepared a Bill Analysis (May 8, 1987) to explain the proposed amendment to House members: "Should the state ever face another fiscal crisis like the current one, there would be money put aside for the state to fall back on. If the Economic Stabilization Fund existed now, the Legislature might not be facing the difficult choice between *falling short of maintaining current state services and raising taxes in difficult economic times. Money could be appropriated from the fund to support existing programs.*"

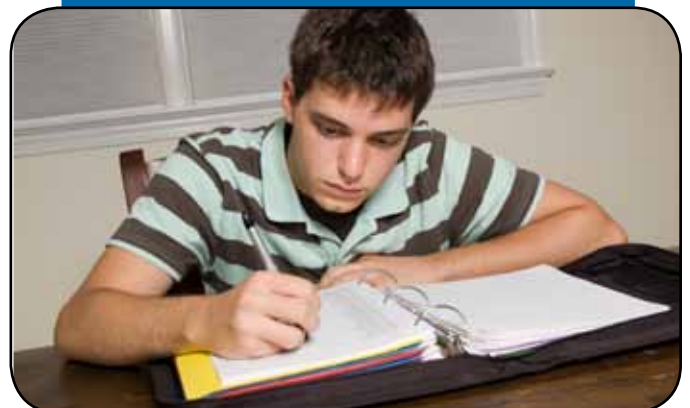
In its *Special Legislative Report on the 1988 Constitutional Amendments* (July 15, 1988), for use by voters in deciding how to vote on proposed amendments, the House Research Organization gave a similar explanation, summarizing supporters of the amendment as saying: "Texas needs a 'rainy day fund' to even out the wide fluctuations in state revenue that have plagued the state

over the past few years. The state would save money when times are relatively good to use when times are relatively bad. . . . *Should the state ever again face another fiscal crisis like the one caused by the collapse of energy prices in 1986, it would have enough set aside to cover a budget deficit and maintain essential state services at then-existing levels.*"

The Legislature told voters that if they saved tax dollars in the Rainy Day Fund, those dollars would be used to maintain current services in the event of an economic downturn. Voters took the deal, approving the constitutional amendment creating the fund in November 1988. The amendment became Article 3, Section 49-g, of the Texas Constitution.¹

1988 Ballot Language Establishing the Rainy Day Fund:

"The constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue."





Here is how the fund works: The Comptroller makes 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 appropriate money to the fund. The state reserves the revenue collected in good times to pay for services when General Revenue drops in bad times. As the economy recovers, General Revenue recovers, and the state picks up paying for ongoing or recurring costs with General Revenue.

The very purpose of the Rainy Day Fund is to continue to pay for recurring expenses when General Revenue drops due to an economic downturn.

The Legislature Often Uses All the Fund

In 1991, the Legislature spent the entire balance (\$28.8 million) on public schools, and in 1993, spent the entire balance (\$197 million) for criminal justice. In 2003, to deal with the last economic downturn, the Legislature appropriated \$1.3 billion from the Rainy Day Fund—almost every penny of the balance the Comptroller forecast through 2005. Again 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, spending almost all the \$2 billion that was forecast to be available. Higher-than-anticipated oil and gas prices ultimately brought in a flood 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 billions in stimulus aid used in place of General Revenue.

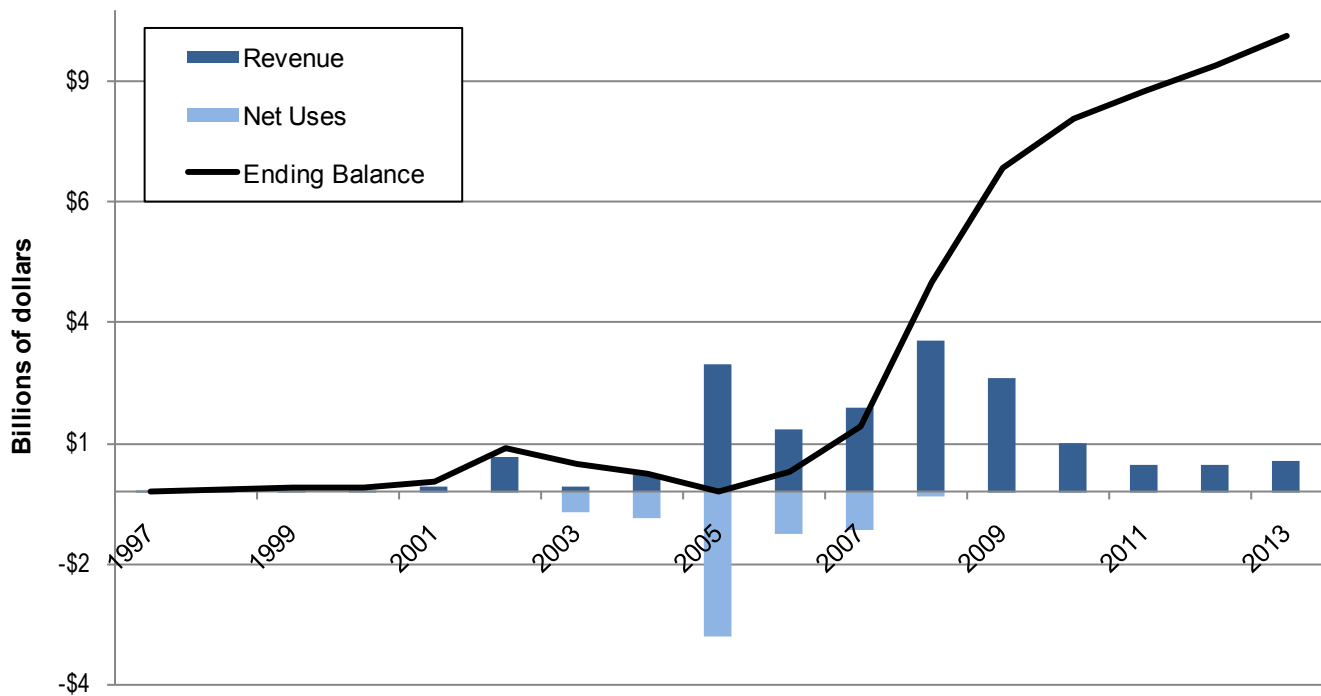
Bond Rating Agencies Expect States to Use Reserves

A strong credit rating is important so the state can borrow at reasonable rates the money needed for infrastructure. Indeed, 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 also emphasizes 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' experience from 2003 to 2005 confirms what Standard & Poor's says. Texas spent almost all the Rainy Day Fund, but suffered no adverse consequence to its bond rating. Indeed, three of the ten states with the highest bond rating (AAA) as of March 2007—Minnesota, North Carolina, and South Carolina—used their *entire* rainy day funds to respond to the last recession and like Texas did not suffer any drop in their bond rating.³

The Legislature and the Governor approved budgets in 2003 and 2005 that used almost every penny of the Rainy Day Fund, including paying for recurring expenses, because it was the right thing to do.



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



Texas has \$9.4 Billion Available for Appropriation from the Rainy Day Fund

The Comptroller forecasts that the Rainy Day Fund will have a balance of \$8.2 billion at the end of 2011 and will grow by another \$1.2 billion in 2012-13, giving the Legislature \$9.4 billion to eliminate the current deficit remaining after budget cuts in 2011 and to write the budget for 2012-13. Recent rapid growth in the fund is due almost entirely to higher collections of natural gas and oil severance taxes. Recent deposits to the fund have frequently exceeded \$1 billion per year, reaching \$2.6 billion in 2005, \$3.1 billion in 2008, \$2.4 billion in 2009, and nearly \$1 billion in 2010. The Comptroller projects that another \$548 million will be deposited in 2011, followed by \$541 million in 2012 and \$623 million in 2013.

An Unusually Big Fund to Cope With the Extraordinary Great Recession

As the chart shows, the Rainy Day Fund did not have an ending balance of more than \$1 billion until 2007 (year 18 of its 22 years of existence), and then the fund exceeded \$1 billion only because actual revenue to the fund greatly exceeded the amount forecast when the Legislature met to write the 2006-07 budget. The present balance in the fund is the result of unusually high prices for oil and demand for natural gas. Even though demand and prices are likely to be strong in the years ahead, we can't count on the fund growing as fast in the next few years as in the last few. But at the same time, we aren't likely to be faced with another Great Recession either.

Texas has been blessed with an unusually large amount in the Rainy Day Fund just in time to cover an unusually large shortfall from the Great Recession.

Holding Money Back Isn't Best Course

In weighing whether any of the Rainy Day Fund should be saved for tomorrow, instead of used today, a risk assessment is useful. On the one hand, if we don't use all of the Rainy Day Fund now to help maintain vital public services, the damage in 2012-13 is certain and great. Cuts would imperil our economic recovery. In the short run, Texas would lose 250,000 public and private jobs just because of the cuts to public education. In the long run, cuts to education would threaten our future prosperity if we shortchanged an entire group of Texas children.

On the other hand, if we do use all the Rainy Day Fund now, the risk of not having adequate revenue to support services in 2014-15 is slight. The Comptroller forecasts a growing economy, and Dr. Ray Perryman, one of the state's leading economists, estimates that state revenue will grow by \$11.4 billion to help fund the 2014-15 budget. And, of course, over time the Rainy Day Fund will automatically replenish.

But the key point in a risk assessment is this: If revenue doesn't recover, we can always cut *later*; we have no reason to cut so deeply *now*. As we explain in the next section, we can adjust the budget as we go.

If revenue doesn't recover, we can always cut later; we have no reason to cut so deeply now.

We Have the Time and Process to Adjust the Budget as We Go

Why make a decision today to deeply cut critical public services for 2012-13 because we are worried that we might not have the money in 2014-15 to continue to provide the services? Texas has both the time and a process to adjust the budget if the economy does not continue to improve. This same process allows for budget adjustments to address any emergency such as a hurricane.

Here is how it works. If the present \$4.3 billion deficit for 2011-12 is reduced to about \$3 billion by efforts to cut spending in 2011, then about a third of the Rainy Day Fund can be used to cover the current deficit, leaving the remainder to fund 2012-13. But these remaining funds would be spent over the upcoming two years beginning September 1, not all at once.

As Texas moves forward, if sales tax collections don't continue to rebound, casting doubt on whether General Revenue growth will be adequate to fund current services in 2014-15, then the budget can be cut during 2012-13.

We already have a way to cut a budget during a biennium, called Budget Execution. Government Code, Chapter 317, sets out the process for budget execution, which would allow the Governor and Legislative Budget Board to cut spending during 2012-13 if it turns out to be necessary. And, of course, the Governor can always call a special session.

Budget Execution

Why make a decision today to deeply cut critical public services for 2012-13 because we are worried that we might not have the money in 2014-15 to continue to provide the services? Texas has both the time and a process through Budget Execution to adjust spending during the biennium if the economy does not continue to improve or if Texas faces an emergency such as a hurricane.

Casting a Vote

The Constitution requires a three-fifths vote of the members present to spend the Rainy Day Fund to prevent a deficit in a current budget or to offset a decline in available revenue for a future budget. If all members were present, that would require 90 votes in the House and 19 in the Senate.

The Constitution also provides that the Legislature may by a two-thirds vote of the members spend the Rainy Day Fund at any time and for any purpose. If all members were present, that would require 100 votes in the House and 21 in the Senate.

When the constitutional amendment creating a Rainy Day Fund was proposed, supporters explained that the greater-than-a-majority vote to use the fund was designed to ensure it was used "in times of real need" and for purposes "for which there was a clear consensus." The aftermath of the Great Recession is a time of real need and Texans of all stripes do not want to see funding deeply cut for public education, higher education, and health and human services.

The Rainy Day Fund was created by Texans who knew what it was like to deal with a crisis that threatens economic growth and future prosperity. While they wanted to preserve the fund for real crisis and important needs, they intended it to be used in the very sort of circumstances we now face. Texans will not abide billions kept in the treasury while classrooms are crowded and teachers are fired, while promising young Texans are denied access to college, and while low-income children, the elderly, and those with disabilities are denied the humane protection of a compassionate state.



ENDNOTES

- ¹ For the legislative history of the Rainy Day Fund, go to www.las.lrl.state.tx.us/LASDOCS/70R/HJR2/HJR2_70R.pdf.
- ² Robin Prunty and Karl Jacob, "Top 10 Management Characteristics of Highly Rated Credits in U.S. Public Finance," Standard and Poor's (January 11, 2006), at: www2.standardandpoors.com/portal/site/sp/en/us/page.article_print/3,1,1,0,1204837014383.html.
- ³ University of Tennessee Center for Business and Economic Research, "Rainy Day Funds, Analysis and Recommendations for Tennessee" (May 2007).

Texas Constitution, Article 3, Section 49-g. ECONOMIC STABILIZATION FUND*

(a) The economic stabilization fund is established as a special fund in the state treasury.

(k) Amounts from the economic stabilization fund may be appropriated during a regular legislative session only for a purpose for which an appropriation from general revenue was made by the preceding legislature and may be appropriated in a special session only for a purpose for which an appropriation from general revenue was made in a preceding legislative session of the same legislature. An appropriation from the economic stabilization fund may be made only if the comptroller certifies that appropriations from general revenue made by the preceding legislature for the current biennium exceed available general revenues and cash balances for the remainder of that biennium. The amount of an appropriation from the economic stabilization fund may not exceed the difference between the comptroller's estimate of general revenue for the current biennium at the time the comptroller receives for certification the bill making the appropriation and the amount of general revenue appropriations for that biennium previously certified by the comptroller. Appropriations from the economic stabilization fund under this subsection may not extend beyond the last day of the current biennium. An appropriation from the economic stabilization fund must be approved by a three-fifths vote of the members present in each house of the legislature.

(l) If an estimate of anticipated revenues for a succeeding biennium prepared by the comptroller pursuant to Article III, Section 49a, of this constitution is less than the revenues that are estimated at the same time by the comptroller to be available for the current biennium, the legislature may, by a three-fifths vote of the members present in each house, appropriate for the succeeding biennium from the economic stabilization fund an amount not to exceed this difference. Following each fiscal year, the actual amount of revenue shall be computed, and if the estimated difference exceeds the actual difference, the comptroller shall transfer the amount necessary from general revenue to the economic stabilization fund so that the actual difference shall not be exceeded. If all or a portion of the difference in revenue from one biennium to the next results, at least in part, from a change in a tax rate or base adopted by the legislature, the computation of revenue difference shall be adjusted to the amount that would have been available had the rate or base not been changed.

(m) In addition to the appropriation authority provided by Subsections (k) and (l) of this section, 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.

* For the complete text, go to <http://www.constitution.legis.state.tx.us/>.

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