HOUSE
RESEARCH
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Constitutional amendment analysis   Amendment No. 2   (HJR 2)

SUBJECT: Economic Stabilization ("rainy day") Fund

DIGEST: Amendment No. 2 would create an Economic Stabilization Fund in the State Treasury. State revenue would be set aside in the fund and saved for appropriation when revenue shortfalls occur. If approved by the voters, the provisions of the amendment would take effect on Sept. 1, 1989.

Transfers to the fund

Transfers into the stabilization fund would include:

-- one-half of any surplus in the state's general-revenue fund at the end of each two-year state budget cycle. This transfer would be made no later than the 90th day of the next biennium.

-- 75 percent of any oil or natural gas production tax revenue that exceeds oil or gas production-tax revenue collected in fiscal year 1987. (The oil tax raised $531.9 million in fiscal 1987, and the natural gas tax raised $644.8 million.) The remaining 25 percent would be deposited in the General Revenue Fund. The transfer to the stabilization fund would be made no later than the 90th day of each fiscal year.

-- any additional money that the Legislature chose to transfer.

In estimating the maximum amount of revenue available for appropriation by the Legislature, the comptroller would deduct the projected amount of mandatory transfers to the stabilization fund -- one-half of the surplus and 75 percent of oil and gas tax revenue exceeding revenue raised in fiscal 1987.

Cap on the fund

During each biennium, the amount in the stabilization fund could not exceed 10 percent of the amount of general revenue raised by the state during the prior biennium, excluding investment and interest income and money borrowed from special funds. Each of the transfers into the stabilization fund would be reduced proportionately to avoid exceeding the cap. Any interest accrued by the stabilization fund exceeding the 10-percent cap would be credited to the General Revenue Fund.

Appropriations from the fund

The Legislature could appropriate money from the Economic Stabilization Fund at any time and for any purpose by a two-thirds (67 percent) vote of the members present in each house.

The Legislature also could appropriate money from the Economic Stabilization Fund by a three-fifths (60 percent) vote of the members present in each house under the following conditions:

Current biennium. The Legislature could appropriate money from the stabilization fund for the current biennium only by a three-fifths (60 percent) vote of the members present in each house and only if the comptroller had certified that the current fiscal biennium would end with a budget deficit -- that appropriations from general revenue would exceed the amount of general revenue projected to be raised and any cash balances.

If the comptroller certified that a deficit would arise, then the Legislature could appropriate from the stabilization fund an amount no larger than the deficit. The deficit would be defined as the difference between already-appropriated revenue and a revenue estimate made when the comptroller is asked to certify a bill making an appropriation from the stabilization fund.

During a regular legislative session, the Legislature could appropriate money from the fund only for a purpose for which a general-revenue appropriation had been made by the preceding Legislature. (Each "legislature" serves for two years. For example, the 70th Legislature will serve from Jan. 13, 1987 to Jan. 10, 1989.)

During a <u>special</u> legislative session, the Legislature could appropriate money from the fund only for a purpose for which a general-revenue appropriation had been made in a previous session of the same legislature.

<u>Upcoming biennium</u>. The Legislature could appropriate money from the fund for a succeeding biennium only by a three-fifths (60 percent) vote of the members present in each house if the comptroller estimated that anticipated revenues for an upcoming biennium would be lower than the revenues for the current biennium.

At the end of each fiscal year, if the <u>actual</u> revenue shortfall was less than the <u>estimated</u> shortfall, the comptroller would have to transfer money from general revenue back to the Economic Stabilization Fund to make up the difference.

If the difference between estimated revenue and actual revenue was affected by a change in the tax rate or tax base, the comptroller would adjust the calculation of the revenue difference by determining what it would be if the tax rate or tax base had remained unchanged.

Any money appropriated from the Economic Stabilization Fund could be withheld or transferred under budget execution authority in the same manner as any other appropriated money. (Under current law budget execution authority allows the governor and the Legislative Budget Board to shift appropriated funds when the Legislature is not in session.)

<u>Use of the fund for cash management</u>

Money in the stabilization fund could be transferred temporarily to make up any cash shortfall in the General Revenue Fund. The money transferred temporarily to general revenue would not be available for appropriation. Any money transferred would have to be returned to the stabilization fund as soon as practicable, but no later than Aug. 31 of odd-numbered years (the end of a fiscal biennium). Interest on money in the stabilization fund would be deposited in the fund as if the money had not been temporarily transferred.

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

SUPPORTERS SAY:

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. If energy prices again reach levels that boost state revenue from oil and natural gas production taxes over the levels reached in fiscal 1987 (a year when prices were relatively low) most of that increase would be saved for later use. The fund also would receive half of any general-revenue surplus remaining at the end of a biennium. 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.

If the Economic Stabilization Fund had existed in 1986 and 1987, the state might have been spared the hard choice between reducing essential state services and raising taxes during difficult economic times. Money could have been appropriated from the fund to reduce or eliminate the budget deficit that occurred when state revenues fell below earlier estimates and might have prevented the record tax increase. A "rainy day" fund also could have been used to alleviate the cash-flow problems that have forced the state to borrow money to meet its payment schedules since November 1986 -- cash from the fund could have been temporarily transferred to the General Revenue Fund to cover state checks.

The Economic Stabilization Fund would bring greater certainty to state fiscal planning. The state would become less dependent on the oil and gas industry, since any budget shortfall produced by another energy-price decline would be cushioned by the money that had been put aside. On the other hand, any revenue windfall from increased oil and gas revenues would be absorbed by the fund for use when needed most. Changes in energy prices would have a less dramatic impact on state revenues available for spending, allowing the comptroller to issue more precise revenue estimates.

The Economic Stabilization Fund would not inhibit state spending for vitally needed services. The fund would only be filled in years when state revenues had substantially increased, mostly due to higher energy prices. If the fund takes effect on Sept. 1, 1989, it would receive very little money because revenue growth, while improved, remains relatively low. The fund would receive one-half of the general-revenue surplus (currently projected to be $52 million) and 75 percent of any oil and natural gas production tax revenues over the fiscal 1987 levels (oil tax revenue for fiscal 1989 is projected to almost equal fiscal 1987 levels, and natural gas taxes are projected to be only $6.7 million over fiscal 1987 levels). Therefore, the fund would start with only about <u>$31 million</u>, hardly a drag on a $38.5 <u>billion</u> budget.

The Economic Stabilization Fund would make the state more attractive to the business community and promote needed economic development and diversification. Corporations would be more likely to establish operations here if they did not fear that wild swings in the state budget would suddenly force new taxes or cuts in vital state services.

Thirty-one other states, including some of Texas' biggest competitors for industry, have some type of "rainy day" fund. Michigan, which is as dependent on the auto industry as Texas is on the oil industry, was able to weather a severe slump in 1980 by tapping $280 million from its stabilization fund to support state programs. Establishing such a fund would also improve the state's credit rating, since Wall Street bond houses consider state stabilization funds to be an indicator of conservative fiscal management.

By establishing a mandatory savings account for the state, this proposal would remove the temptation for the Legislature to spend every available penny of revenue when times are relatively good. State government went on a spending binge during the energy boom of the 1970s; by slowing the increase in available state revenue from any future energy boom, the growth of state government could be held in check.

Money from the Economic Stabilization Fund could be tapped only in times of real need and used for purposes for which a clear political consensus existed. Money from the fund could be spent only to avoid a budget deficit and a sharp reduction in state services and only with the approval of at least three-fifths of the members present in each house of the Legislature. Spending from the fund under any other circumstances would require strong, bipartisan support -- at least a two-thirds vote of each house.

While the stabilization fund would help control the growth of state revenue available for state spending, it would not unduly inhibit spending for essential needs. The fund could not grow in an unchecked fashion, locking up billions of dollars. The fund would be capped at 10 percent of general revenue raised during the prior fiscal biennium (about $2.58 billion during fiscal 1990-91 based on the $25.75 billion in general revenue projected to be raised in fiscal 1988-89). Once the fund reached the cap, the state actually would gain millions of dollars in new general revenue from interest generated from the fund. Also, the state could always use the "escape hatch" provision allowing the Legislature to approve spending from the fund for priority programs by a two-thirds vote of each house.

OPPONENTS SAY:

The state should not lock away revenue needed for vital state programs that have been starved for funds during the recent budget squeeze. Establishing a "rainy day" fund now would be like opening an IRA at age 75 -- saving for the future when the money is desperately needed now.

Rather than freeing the state budget from over-dependence on the energy industry, this amendment would sustain that dependence. By placing off limits most of any additional revenue resulting from higher energy prices, the fund would eliminate the opportunity to invest that additional revenue in education, transportation and other state services needed to diversify and strengthen the state economy and attract new business.

Skimming off one-half of any budget surplus and most of any increase in oil and gas production tax revenue would mean less money for long-postponed state spending priorities, such as public and higher education. If the state has less money for essential spending needs, then taxes might have to be raised to make up the difference. Encouraging steeper tax increases just to allow some of the revenue to be salted away is not the kind of the fiscal responsibility that is appreciated by the fiscal evaluators on Wall Street or by Texas voters.

The many dedicated funds created by the Texas Constitution already restrict budget flexibility too much and make the state budget process unwieldy. The state does not need another dedicated fund that could eventually grow to over $2.5 billion. Since the "rainy day" fund would be enshrined in the Constitution, it would be difficult to modify it to meet changing budgetary conditions. For example, in 1985 Ohio had to suspend its "rainy day" fund restrictions so that it could cut its income tax and still adequately finance state programs. Restricting so large a portion of the state budget would make planning that much more complicated.

OTHER OPPONENTS SAY:

If Texas once again finds itself with a large surplus in the General Revenue Fund, it should distribute that surplus back to the taxpayers, not squirrel it away for some uncertain future contingency. Many states that increased taxes in 1982 and 1983 to avoid budget deficits were able to roll back tax rates when economic conditions improved. A "rainy day" fund would limit the possibility of a similar tax cut in Texas. The state would horde, rather than share, the benefits of an economic recovery.

This needlessly complex provision is full of unanticipated pitfalls. The complicated restrictions on using the money stashed away in the stabilization fund would make it more like a mandatory savings account than a stabilizing influence. If an "economic stabilization" fund is desirable, then there should be less cumbersome ways to get at the money when a "rainy day" arrives. An emergency declaration by the governor or a separate, recorded vote by the Legislature to authorize spending money from the fund would be sufficient to call public attention to the fact that the fund was being tapped.

This proposed constitutional amendment is a classic example of the verbose, overly detailed provisions that have cluttered the Texas Constitution, making it more of a statutory code than the outline of government functions it was meant to be.

NOTES: HJR 2 was adopted by the Legislature during its 1987 regular session by 141 to 1 in the House and 30 to 0 in the Senate. During the second special session the Legislature changed the election date for submitting the proposed constitutional amendment to the voters from Nov. 3, 1987 to Nov. 8, 1988