

ECONOMIC STABILIZATION FUND

Texas Comptroller of Public Accounts – July 2018

Background

The Economic Stabilization Fund (ESF) — commonly called the “Rainy Day Fund” — was created by the passage of an amendment to the Texas Constitution in November 1988. The ESF is established in Article III, Section 49-g of the Constitution and became effective on Sept. 1, 1989.

Section 49-g spells out:

- Revenue sources deposited *to* the ESF and
- Requirements for making appropriations *from* the ESF

In November 2014, a constitutional amendment was passed allocating at least one-half of certain severance taxes to the ESF and the remainder to the State Highway Fund. Statute provided that the Legislature must establish a sufficient balance in the ESF. Depending on the amount established compared to the balance at the time of transfer, more than half of the allocated severance taxes could be moved to the ESF in order to maintain the sufficient balance.

In May 2015, the 84th Legislature passed House Bill 903 instructing the Comptroller to invest a percentage of the fund balance in a state fiscal biennium that exceeds the amount of the sufficient fund balance adopted under Section 316.092, Government Code. Investments are made in accordance with Section 404.024(j), also known as the prudent investment standard. The Comptroller adjusts the investment portfolio periodically to ensure the balance is adequate to meet the cash flow requirements of the fund.

How the ESF is funded

The ESF receives:

- An amount from General Revenue (GR) of at least one-half of 75 percent of Oil Production and Natural Gas Production tax revenues in any fiscal year that exceeds fiscal 1987 collections, exclusive of legislative action altering that amount, with the remainder going to the State Highway Fund. These taxes are also referred to collectively as “severance” taxes.
- One-half of any unencumbered GR surplus at the end of each biennium. Unencumbered GR is net of the amount of any tax allocations yet to be made, state agency encumbrances, accounts payable and payroll accruals, dedicated account balances and any required transfers to the ESF.
- All of the interest earned on the ESF balance.
- Direct appropriations to the ESF by the Legislature. Through fiscal 2017, no direct appropriations to the ESF have been made.
- The Comptroller’s office has up to 90 days after the end of the fiscal year to make transfers to the ESF — transfers are typically performed in late November.

The ESF Cap

The Constitution caps the *maximum* biennial ESF balance at an amount not to exceed 10 percent of certain GR deposited during the previous biennium. *Certain* GR is defined as the total amount deposited in the General Revenue Fund during the previous biennium *excluding* these revenue sources:

- Investment income
- Interest income
- Amounts borrowed from special funds

KEY FACTS

- ❖ Fiscal 1987 collections thresholds:
 - Natural gas production = \$599.8M
 - Oil production = \$531.9M
- ❖ Result of passed November 2014 constitutional amendment:
 - One-half of 75% of Oil and Natural Gas Production tax revenues transfer to ESF; remainder to State Highway Fund contingent on legislative actions
- ❖ Fiscal 2016 Oil and Natural Gas Production tax revenues triggered a \$879.0M transfer in November 2016, \$439.5M to ESF and \$439.5M to State Highway Fund
 - Ending fiscal 2017 ESF cash balance was \$8.1B with \$2.2B in investments for a total balance of \$10.3B
- ❖ Fiscal 2017 Oil and Natural Gas Production tax revenues triggered a \$1.5B transfer in November 2017, \$734.4M to ESF and \$734.4M to State Highway Fund
- ❖ The ESF cap for the 2018-19 biennium is \$16.9B
- ❖ The ESF sufficient balance for the 2018–19 biennium is \$7.5B
- ❖ The ESF balance is expected to remain below the cap through the end of the 2018–19 biennium

STATUTORY REFERENCE
Texas Constitution,
Article III, Section 49-g



Reaching the ESF Cap

If the ESF were to reach the cap, the Texas Comptroller of Public Accounts (Comptroller's office) would:

- Reduce or eliminate transfers to the ESF to prevent the balance from exceeding the cap and
- Credit interest earned on the ESF balance to the General Revenue Fund

Transfers to and retention of interest in the ESF would resume in the first biennium in which the cap exceeds the ESF balance as a result of:

- An increase in the cap amount and/or
- A decrease in the ESF balance resulting from an appropriation

Calculating the ESF Cap

The ESF cap for each biennium is based on certain revenue collections in the *previous* biennium. For example, the ESF cap for the 2018–19 biennium is based on revenue collections in fiscal 2016 and 2017.

As provided by the Constitution, the Comptroller's office calculates the ESF cap for each biennium by:

1. Starting with total net revenue deposited to the General Revenue (GR) Fund (excluding federal funds). This number is taken from Table 1: Statement of Cash Position in the [State of Texas Annual Cash Report](#) for each fiscal year of the previous biennium.
2. Adding total Federal revenue deposited to the GR Fund. This number is taken from Table 1: Statement of Cash Position in the *State of Texas Annual Cash Report* for each fiscal year of the previous biennium.
3. Deducting interest and investment income deposited to the GR Fund. This number is taken from Table 1: Statement of Cash Position in the *State of Texas Annual Cash Report* for each fiscal year of the previous biennium.
4. Adding revenue deposited to the Tobacco Settlement Fund, excluding accounting transfers. This number is taken from the Fund Detail section of the *State of Texas Annual Cash Report* for each fiscal year of the previous biennium (listed as GR Account — Tobacco Settlement 5040).
5. Adding the results for the two years together to produce the revenue base for calculating the ESF cap. Ten percent of the revenue base is the ESF maximum limit for the following biennium.

It is possible to estimate the cap for the 2020–21 biennium. As with any *estimated* ESF Cap, the 2020–21 Cap is subject to revision based on any new estimates released by the Comptroller's office. The *actual* 2020–21 cap becomes final after fiscal 2019 closes and all collections affecting the 2018–19 biennium have been received.

EXAMPLE: CALCULATION OF THE ESF CAP FOR THE 2018–19 BIENNIUM

	Fiscal 2016	Fiscal 2017	Biennium
General Revenue Fund			
Total Net Revenue Excluding Federal Funds	\$57,334,486,345.86	\$57,881,762,108.25	\$115,216,248,454.06
Plus: Federal Revenue	\$27,049,059,995.40	\$25,499,783,767.47	\$52,548,843,762.87
Less: Interest and Investment Income	\$47,856,452.53	\$(945,513.49)	\$46,910,939.04
Adjusted Net Revenue	\$84,335,689,888.73	\$83,382,491,389.21	\$167,718,181,277.94
Plus: GR Account 5040 (Tobacco Settlement)	\$487,573,768.08	\$478,819,281.32	\$966,393,049.40
Revenue Base	\$84,823,263,656.81	\$83,861,310,670.53	\$162,684,547,327.34
Constitutional Limit			10%
			\$16,868,457,432.73



History of ESF Caps and Balances

The graph in Figure 1 compares each biennial ESF cap to the maximum balance during that biennium.

It also illustrates that from the fund's beginning in the 1990–91 biennium through the 2016–17 biennium, both the ESF cap and maximum balance generally increased.

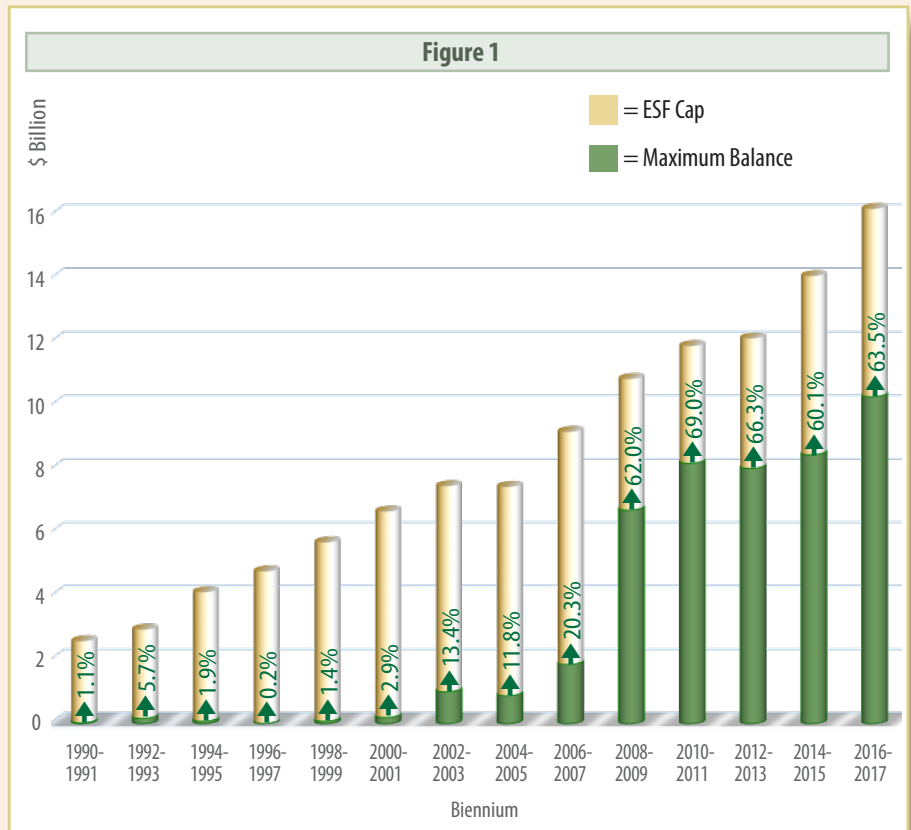
Each biennium's maximum balance is depicted as a percentage of the ESF cap. For the 2016–17 biennium, the maximum balance was 63.5 percent of the cap.

For more information, see [ESF History Table](#) that provides comprehensive data for the ESF cap calculations and includes the maximum and ending balances and percentages.

ESF History — by the Numbers

See the [ESF History Table](#) for a comprehensive history of:

- ESF revenues (transfers in)
- Appropriations (transfers out)
- Fiscal year-end balances
- Annual maximum balances
- Biennial caps
- Maximum balance as a percentage of the ESF cap
- Ending balance as a percentage of the ESF cap



ESF Impact on Credit Ratings

The rating agencies have methodologies to evaluate state credit that consider both quantitative and qualitative factors:

- States are generally seen as strong credits due to their considerable flexibility regarding taxing authority, revenue, spending and debt financing decisions.
- Primary areas of evaluation include: the economy, management, finances, budgetary performance and long-term liability/debt. The ESF funds generally represent a subcategory of one of those areas.
- The rating agencies focus on the overall health and strength of a state and consider the ESF, in context, as one of many tools available to address recession or unanticipated revenue or expenditure volatility.
- While the rating agencies evaluate the constitutional or statutory structure of the ESF, they also consider historical practices regarding balances, uses and restoration of balances if drawn upon.
- An ESF balance provides a flexible alternative, in addition to budgetary and revenue tools, to manage through challenging economic cycles. An ESF balance demonstrates fiscal strength and flexibility, but balances are not the only factor rating agencies consider.

