SUBJECT: Dedicating funds in excess of ESF cap to retiring state debt early

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 21 ayes — Otto, Sylvester Turner, Ashby, Bell, G. Bonnen, Capriglione, Giddings, Gonzales, Howard, Hughes, Koop, Longoria, Miles, R. Miller, Muñoz, Price, Raney, J. Rodriguez, Sheffield, VanDeaver, Walle

0 nays

6 absent — Burkett, S. Davis, Dukes, Márquez, McClendon, Phelan

WITNESSES: *March 18 hearing*:
For — (*Registered, but did not testify*: Dale Craymer, Texas Taxpayers and Research Association)

Against — None

On — (*Registered, but did not testify*: Rob Coleman, Comptroller of Public Accounts)

March 19 hearing:
For — (*Registered, but did not testify*: Dale Craymer, Texas Taxpayers and Research Association)

Against — None

BACKGROUND: Texas Constitution Art. 3, sec. 49-g establishes the Economic Stabilization Fund (ESF), often called the rainy day fund. The fund's balance is expected to reach $11.1 billion by the end of fiscal 2016-17, absent any appropriations from the fund, according to the comptroller's January 2015 *Biennial Revenue Estimate*.

Sources of funding. Funds in the ESF come from biennium-ending balances in the general revenue fund and from a portion of oil and natural gas production taxes.

Sec. 49-g (b) requires the comptroller to transfer to the ESF one-half of any unencumbered balance remaining in the general revenue fund at the end of a biennium. Only twice has an unexpended balance been transferred to the fund under this provision, once in fiscal 1992 and again in fiscal 2008.

Under sec. 49-g (d) and (e), the comptroller is required to take 75 percent of any oil and natural gas production tax revenue that exceeds the amount collected in 1987 and send half of that amount to the ESF and half to the State Highway Fund. These allocations can be adjusted under certain circumstances. The Legislature, under sec. 49-g (c-2), is required to enact a law creating a procedure for allocating more than one-half of the funds to the ESF. Government Code, sec. 316.092 establishes this procedure by creating a select legislative committee and requiring that it determine a sufficient balance for the ESF for the next biennium. The balance must be an amount the committee estimates will ensure an appropriate amount of revenue in the ESF.

In December 2014, the Joint Select Committee to Study the Balance of the Economic Stabilization Fund determined that $7 billion was a sufficient minimum balance for the fund. The balance does not restrict appropriations from the fund but does affect the amounts transferred to the general revenue fund and the State Highway Fund.

ESF cap. Texas Constitution, Art. 3, sec. 49-g (g) sets a cap on the amount of money that the ESF can hold. The fund cannot exceed an amount equal to 10 percent of the total amount deposited into general revenue the previous biennium, minus investment income, interest income, and amounts borrowed from special funds. The fund has never reached the cap.

The cap for the current biennium is $14.1 billion, and the cap is estimated to be $16.1 billion for fiscal 2016-17 and $16.7 billion for fiscal 2018-19. Money drawn from the ESF counts toward the state’s constitutional spending limit, according to the Legislative Budget Board.

Under sec. 49-g (i), interest due to the ESF that would put the fund over its cap must be deposited in the general revenue fund.

Appropriations from the ESF. Any amount from the fund may be spent for any purpose if approved by at least two-thirds of the members present in each house. Funds also may be spent to cover an unanticipated deficit in a current budget or to offset a decline in revenue for a future budget with approval of at least three-fifths of the members present in each house.

DIGEST:

HJR 8 would amend Art. 3, sec. 49-g of the Texas Constitution to require money that the comptroller withholds from the ESF because it would put the fund over its constitutional cap to be deposited in a new general revenue account that could be appropriated only to retire state debt early. This would replace current law that leaves any money exceeding the cap in the general revenue fund. Any interest earnings that would put the ESF over its cap also would be deposited in the new account.

The ballot proposal would be presented to voters at an election on November 3, 2015. The ballot proposal would read: "The constitutional amendment to dedicate certain money to the purpose of retiring state debt early."

SUPPORTERS SAY:

HJR 8 would establish a fiscally responsible use for money that exceeds the cap on the ESF. The ESF never has been close to reaching its cap so the issue of what to do with excess funds generally has not been considered. HJR 8 would dedicate those funds to the early retirement of debt, which would benefit the state by reducing its debt burden and avoiding problems that could arise from allowing these funds to remain available for spending as general revenue.

Although the Legislature could appropriate spillover funds to early debt reduction without HJR 8, the amendment is needed to ensure fiscal discipline on this issue. Texas should not use money saved during good economic times to grow state government or to temporarily fund ongoing expenses, and HJR 8 would remove the temptation to use excess ESF funds for these purposes.

Retiring debt early would be the best use of these funds because reducing the state's debt burden increases options for spending current revenue and for borrowing in the future. Texas had $44.3 billion in total debt outstanding at the end of fiscal 2014, and HJR 8 would apply only to retiring that debt early, not to paying regularly scheduled debt service. Retiring debt early would eliminate the state's long-term commitment to that debt, thereby reducing the ongoing amount of general revenue that must be budgeted for regularly scheduled debt service. This could free up state funds to be used as the Legislature chooses. In addition, retiring debt would increase the state's capacity to borrow again in the future and would be a positive factor for the state's credit position.

Allowing funds that spill over from the ESF cap to remain in general revenue could create problems if the funds were appropriated for ongoing, general state spending because the source of the funds would not be dependable from one biennium to the next. Using such funds for early debt reduction would be appropriate since it would not be a mandatory expenditure and could be made only when funds were available.

HJR 8 would neither reduce the ESF nor divert any money currently earmarked for the ESF. The amendment would apply only to funds above the ESF cap that would be slated to remain in the general revenue fund under current law. If the ESF were at its cap and legislators made an appropriation that dropped its balance below the cap, no funds would go to the new account until the cap was reached again.

The Legislature would retain full control over the spending of funds deposited in the new account under HJR 8. The Bond Review Board, the Texas Public Finance Authority, and other entities could identify debt that might be advantageous for the state to retire early. However, no funds would leave the new account unless appropriated by the Legislature. If the Legislature decided not to make an appropriation from the new fund to retire debt early or if there was no debt advantageous to retire, money would remain in the dedicated account.

Because HJR 8 would constitutionally dedicate funds to early debt retirement, appropriations of the funds would not count toward the state's spending limit, which constrains the use of certain tax revenue not dedicated by the Constitution. This arrangement would be appropriate because retiring debt early is a long-term fiscal strategy that would save the state money, and the spending cap is designed to limit general purpose spending.

Placing HJR 8 on the November 2015 ballot would allow the voters to determine whether the state should use excess ESF funds for early debt reduction. If HJR 8 were approved in conjunction with HB 8 by Otto, also on today's calendar, a significant amount of money could be available for early debt reduction beginning in fiscal 2018-19. If HB 8 were enacted, the ESF cap would decrease from an estimated $16.7 billion to $11.8 billion in fiscal 2018-19, according to the bill's fiscal note. Under the lowered cap, a projected $538 million would exceed the cap in 2018, making that amount available for debt reduction if HJR 8 were approved.

OPPONENTS SAY:

By dedicating funds in excess of the ESF cap for one purpose, HJR 8 would reduce the flexibility of lawmakers to direct state appropriations. Current law balances the needs of the state both to save money for the future and to meet other spending priorities. Once enough funds have been saved in the ESF to reach the cap, funds should continue to be available for any purpose, rather than being reserved for just one. The needs of the state change, and tying the use of revenue in excess of the ESF cap to one purpose would reduce the flexibility of lawmakers to meet those needs.

HJR 8 would result in funds being locked away for early debt retirement, even if it were not advantageous to the state to do so. Debt might be unavailable to retire early, interest on the debt could be so low that other uses of the money might be more beneficial to the state, or consistently retiring debt early could factor unfavorably into the way lenders structure the state's debt. Absent HJR 8, the Legislature could consider all factors and state needs in deciding whether funds exceeding the ESF cap should be used to retire debt or for another purpose.

The state could consider other worthy causes if it wants to dedicate funds that are in excess of the ESF cap. Using excess funds to make contributions to the Employees Retirement System, the Teacher Retirement System, or to the Texas Tomorrow Fund would pay down future liabilities of the state. Public education, higher education or taxpayer relief also could be appropriate uses for excess ESF funds.

The spending limit is designed as a check on state spending, and HJR 8 would work counter to this policy by constitutionally dedicating funds and removing them from the spending limit calculation. The Texas budget should be as transparent as possible and should count the spending of general revenue that spills over the cap toward the spending limit. The amendment also would not be in line with responsible budgeting if funds made available by retiring debt early were used to expand government.

NOTES:

HJR 8 would have no significant fiscal impact to the state, according to the Legislative Budget Board's (LBB's) fiscal note. The cost to the state for publishing the resolution would be $118,681. HJR 8 could result in an indeterminate savings of general revenue debt service payments, depending on the type and size of debt retired, according to the LBB.

The companion resolution, SJR 25 by Nelson, has been referred to the Senate Finance Committee.

HJR 137 by Keffer and its companion, SJR 37 by V. Taylor, also would require funds in excess of the ESF cap to be deposited in an account that could be appropriated only for specific purposes. These proposed constitutional amendments would allow appropriations of these funds to the Employees Retirement System, the Teacher Retirement System (TRS), the health plan for retired members of TRS, and the Texas Tomorrow Fund. They also would require that any funds left in the new account at the end of a biennium be transferred to the Permanent School Fund and the Permanent University Fund. HJR 137 has been referred to the House Appropriations Committee and SJR 37 to the Senate Finance Committee.