SUBJECT: Transferring and managing funds in the ESF and Texas Legacy Fund

COMMITTEE: Appropriations — committee substitute recommended

VOTE: 21 ayes — Zerwas, Longoria, C. Bell, G. Bonnen, Capriglione, Cortez, S. Davis, M. González, Hefner, Howard, Jarvis Johnson, Miller, Muñoz, Schaefer, Sherman, Smith, Stucky, Toth, VanDeaver, Walle, Wilson

1 nay — J. Turner

5 absent — Buckley, Minjarez, Rose, Sheffield, Wu

WITNESSES: For — Dale Craymer, Texas Taxpayers and Research Association; Stephen Bailey, The Pew Charitable Trusts; (*Registered, but did not testify*: Joe Hamill, AFSCME Texas Corrections, American Federation of State, County and Municipal Employees; Leticia Van de Putte, San Antonio Chamber of Commerce; Rene Lara, Texas AFL-CIO; Dwight Harris, Texas American Federation of Teachers; Lance Lowry, Texas Association of Taxpayers; Windy Johnson, Texas Conference of Urban Counties; Cheri Siegelin, Texas Correctional Employees-Huntsville; Timothy Lee, Texas Retired Teachers Association; Calvin Tillman; Al Zito)

Against — Vance Ginn, Texas Public Policy Foundation

On — Phillip Ashley, Comptroller of Public Accounts; (*Registered, but did not testify*: Paul Ballard, Comptroller of Public Accounts, Texas Treasury Safekeeping Trust Company; James Bass, Texas Department of Transportation)

BACKGROUND: Revenue for the Economic Stabilization Fund (ESF), also known as the rainy day fund, comes almost entirely from oil and natural gas production taxes, also known as severance taxes. Before fiscal 2015, the ESF received 75 percent of any severance tax revenue that exceeded the amount collected in fiscal 1987. A constitutional amendment adopted in 2014 requires the comptroller to send one-half of this amount to the State

Highway Fund, with the rest continuing to go to the ESF.

The comptroller reduces or withholds allocations to the State Highway Fund as needed to maintain a sufficient balance in the ESF. As required by Government Code sec. 316.092, the select legislative committee to determine a sufficient balance of the ESF determined $7.5 billion to be a sufficient minimum balance for fiscal 2020-21. The section also establishes procedures for the Legislature to approve or change the sufficient balance adopted by the committee.

The comptroller also must transfer one-half of any unencumbered balance remaining in the general revenue fund at the end of a biennium to the ESF (Art. 3, sec. 49-g). Such a balance has been transferred to the ESF under this provision only twice, once in fiscal 1992 and again in fiscal 2008.

The ESF may not exceed 10 percent of the total amount deposited into the general revenue fund (minus certain types of income and funds) during the previous biennium.

Government Code sec. 404.0241 requires the comptroller to invest a percentage of the ESF that exceeds the sufficient balance in accordance with certain investment standards.

DIGEST:

CSHB 20 would revise how the sufficient balance of the Economic Stabilization Fund (ESF) was determined and revise the transfer of funds to the ESF so that if the sufficient balance were met, some funds would be sent to the newly created Texas Legacy Fund. The bill also would outline the management and investment parameters for the ESF and the two funds that would be created by HJR 10, the Texas Legacy Fund (TLF) and the Texas Legacy Distribution Fund (TLDF).

Sufficient balance in the ESF. CSHB 20 would establish the sufficient balance in the ESF as 7 percent of certified general revenue-related appropriations for the fiscal biennium in which the determination was made. Current provisions requiring a select legislative committee to set the sufficient balance would be repealed.

Transfers of severance taxes. If the ESF was at or above the sufficient balance at the time the comptroller was to transfer the required amount of severance tax revenue to the fund each biennium, the portion of severance tax that would go to the ESF under current law would be redirected to the TLF. If the ESF were below the sufficient balance, transfers of severance taxes would be adjusted so that the amount that would go to the TLF would go instead to the ESF until the sufficient balance was met. The amount that would go to the State Highway Fund would not be reduced.

Transfers of general revenue balances. CSHB 20 would revise the transfer of unencumbered balances of the general revenue fund. If the ESF was at or above the sufficient balance, the comptroller would transfer any general revenue unencumbered balance to the TLF. If the ESF was below the sufficient balance, these transfers would first go to the ESF until the sufficient balance was met. Any remaining funds would go to the TLF.

Management and investment parameter of the funds. CSHB 20 would outline the management and investment parameters for the ESF and the two new funds that would be created by HJR 10, the TLF and the TLDF. Each fund would have investment objectives and purposes.

The ESF's objectives and purposes would be to preserve the fund's principal, the purchasing power of the principal, and the fund's liquidity. HB 20 would repeal current requirements that the comptroller invest a percentage of the ESF according to the investment standard specified in statute.

The TLF's objectives and purposes would be to generate earnings on its principal to maintain and increase the principal's purchasing power and to provide for predictable and stable annual earnings transfers to the Texas Legacy Distribution Fund.

The TLDF's objective and purpose would be to maintain sufficient liquidity to meet the fund's needs.

The bill would establish criteria for the management of the funds. The comptroller would be given authority to acquire, exchange, sell, supervise, manage, or retain any type of investment in relation to the funds that a prudent investor who was exercising reasonable care, skill, and caution would pursue. The comptroller's actions would have to be done in light of the purposes, terms, distribution requirements, and other circumstances prevailing at that time for the fund and would have to consider the investment of all the assets of the fund rather than a single investment.

The comptroller would be authorized to pool assets of the funds with other state funds for investment purposes.

Effective date. CSHB 20 would take effect January 1, 2020, only if the constitutional amendment providing for the creation of the TLF and the TLDF as proposed by HJR 10 were approved by the voters.

SUPPORTERS SAY:

CSHB 20 would implement the changes to the state's savings and investment strategy that would be established by HJR 10 by Capriglione, also on today's calendar. These changes would provide the state with a responsible way to steward taxpayer dollars to meet both unforeseen needs through the ESF and long-term obligations through the creation of the Texas Legacy Fund (TLF).

The bill would establish prudent mechanics to transfer severance taxes and unencumbered general revenue balances to the newly created TLF as long as the ESF's sufficient balance was met. If the sufficient balance were not met, the mechanisms in CSHB 20 would replenish the ESF so that the state had a strong savings account. Transportation funding would be protected because transfers to the State Highway Fund would not be reduced by CSHB 20.

The bill would revise the way the sufficient balance of the ESF was determined so that it was set in a more objective manner, rather than being decided by a committee. CSHB 20 would set the sufficient balance at 7 percent of spending, which would ensure that enough was set aside to deal with unexpected economic or natural events while simplifying and depoliticizing the calculation.

The bill would set appropriate investment objectives and purposes for each account and fund for the comptroller to follow and would give the comptroller flexibility to make investment decisions. All accounts and funds would be subject to the prudent-investor standard, which is well defined and would allow investments to keep pace with inflation and maintain purchasing power.

OPPONENTS SAY:

CSHB 20 would establish mechanisms that could place some state funds off limits, even in case of an emergency. The state should continue to have its savings available in case of an economic downturn or disaster.

By removing legislative input in determining the sufficient balance and instead setting it as a percentage of the budget, the bill could make it difficult for the Legislature to use ESF funds that go below that threshold. The sufficient balance can be seen as a floor to the ESF, and the bill would set what might be seen as an inflexible floor. This could make it difficult to garner support to use the funds and would make it impossible for the Legislature to adjust that floor, even if it felt such adjustment was necessary.

OTHER OPPONENTS SAY:

CSHB 20 would further the unwise policy of using the ESF to try to raise revenue, which could be used to increase government spending. The state should return excess taxes to taxpayers and work toward structurally reforming its long-term debt obligations.

NOTES:

CSHB 20 is the enabling legislation for HJR 10 by Capriglione, which is on the Constitutional Amendments Calendar for second reading consideration today.