SUBJECT: Creating Texas Legacy Fund and dedicating earnings for certain spending

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; (*Registered, but did not testify*: Rene Lara, Texas AFL-CIO; 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)

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 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.

DIGEST:

CSHJR 10 would establish the Texas Legacy Fund (TLF) and redirect certain transfers of general revenue that currently go to the Economic Stabilization Fund (ESF) to the new fund, subject to a procedure established by the Legislature. CSHJR 10 also would create the Texas Legacy Distribution Fund (TLDF) to receive transfers from the TLF and would make the TLDF available for certain types of appropriations by the Legislature.

CSHJR 10 would authorize the Legislature to determine a sufficient balance of the ESF or a method to determine a sufficient balance.

Transfers of unencumbered general revenue balances. CSHJR 10 would reallocate the transfers of unencumbered balances of the general revenue fund that currently go to the ESF. If the ESF were at or above the sufficient balance, any general revenue unencumbered balance transfer would go to the TLF. If the ESF were below the sufficient balance, transfers would first go to the ESF until the sufficient balance was met. Any remaining funds would go to the TLF.

Transfers of severance taxes. CSHJR 10 would redirect to the TLF the one-half of general revenue that is derived from oil and gas production taxes and currently is transferred to the ESF, subject to the procedure established by the Legislature. The amount that would go to the State Highway Fund would not be changed.

CSHJR 10 would revise the procedure the Legislature could use to adjust the above allocation so that more of the severance tax revenue went to the ESF. Under CSHJR 10, the procedure would have to include the TLF, allowing the Legislature to create a process to adjust the amount of severance taxes going to the ESF, the TLF, and the highway fund. (The procedure for using the sufficient balance to determine when transfers were adjusted from the default would be established in HB 20, also on today's calendar.)

Texas Legacy Fund. CSHJR 10 would establish the Texas Legacy Fund as a special fund in the state treasury. Each fiscal year, a portion of the fund's interest and earnings would be transferred to the Texas Legacy Distribution Fund and could be spent according to parameters established in CSHJR 10.

The comptroller would have to determine the amount of the annual transfer in a manner to provide a stable and predictable stream of annual transfers while preserving the purchasing power of the principal amount of the Texas Legacy Fund. If the comptroller determined that the purchasing power of the principal of the TLF had diminished when computed for any 10-year period, the comptroller could reduce the amount of the annual transfers from the TLF to the TLDF and could retain a greater portion of the interest and earnings in the TLF.

The comptroller would be required to invest the TLF as provided by law, and the expenses of managing the fund's investments would be paid from the fund without appropriation. Interest and earnings from investing the fund, after any transfer to the TLDF, would be credited to the fund. Interest from the ESF that would increase the total in the fund in excess of the ESF cap would go to the TLF instead of the general revenue fund.

The Legislature could appropriate money to the TLF but could not appropriate money from the fund.

Texas Legacy Distribution Fund. CSHJR 10 would establish the Texas Legacy Distribution Fund as a special fund in the state treasury. The TLDF would receive transfers from the Texas Legacy Fund and could be spent only for purposes outlined in CSHJR 10.

The Legislature could appropriate money from the TLDF only for:

- the early redemption or retiring of state debt that depended on general revenue for debt service;
- unfunded liabilities of the Employees Retirement System (ERS) or the Teacher Retirement System (TRS);
- projects to repair, renovate, or construct state infrastructure other than transportation infrastructure or higher education facilities; or
- other state obligations that were considered long-term obligations under generally accepted accounting principles and were approved by the Legislature by a vote of two-thirds of the members present in each house.

Money appropriated from the TLDF for ERS or TRS would not count toward the cap on state spending imposed by Art. 8, sec. 22 of the Constitution, which limits the growth of the state budget from one biennium to the next.

The comptroller would be required to invest the TLDF as provided by law, and the fund's management expenses would be paid from the fund without appropriation. The fund's interest and earnings would go back into the fund.

The Legislature could make appropriations to the TLDF in addition to the transfers designated in CSHJR 10.

Investing the ESF. Under CSHJR 10, the comptroller would be required to invest the ESF as provided by law, and the fund's management expenses would be paid from the fund without appropriation. The comptroller would credit to the ESF the interest and other earnings from the investment.

Effective dates. Provisions creating the two funds would take effect January 1, 2020.

As soon as practicable after the effective date of CSHJR 10, the comptroller would be required to establish the TLF and the TLDF. The comptroller would have to transfer $500 million from the ESF to serve as the principal balance of the Texas Legacy Fund.

As soon as practicable after the effective date of the amendment, the comptroller of public accounts would have to invest the ESF, TLF, and TLDF, subject to the provisions included in the legislation.

Ballot language. The ballot proposal would be presented to voters at an election on November 5, 2019, and would read: "The constitutional amendment providing for the creation of the Texas legacy fund and the Texas legacy distribution fund, dedicating the Texas legacy distribution fund to certain state infrastructure projects or the reduction of certain long-term obligations, and providing for the transfer of certain general revenues to the economic stabilization fund, the Texas legacy fund, and the state highway fund."

SUPPORTERS SAY:

CSHJR 10 would create the mechanisms necessary for the state to responsibly safeguard and invest the wealth it gained from oil and gas, enabling that wealth to yield a higher rate of return and be used to meet long-term obligations. A constitutional amendment is necessary to revise the current flow of money into the Economic Stabilization Fund (ESF) and to create the Texas Legacy Fund (TLF), which would receive some severance taxes to invest. The amendment would continue efforts to modernize the state's savings and investment strategy with good stewardship of state resources and would be in line with how other states have handled their revenue from energy taxes.

CSHJR 10 would add an additional bucket for the currently required transfers of severance taxes and unencumbered general revenue. Currently those transfers go to the ESF and the State Highway Fund. Under CSHJR 10, as long as the ESF was at its sufficient balance, the portion that would have gone to the ESF would go instead to the newly created TLF.

This new structure is necessary to set up a long-term permanent endowment, similar to the Permanent School Fund, that could balance the state's needs for savings and for addressing long-term obligations. This would be similar to the way families might keep their funds in different types of financial accounts. The new fund would begin with a modest transfer of $500 million in seed money from the ESF and could receive future deposits of severance taxes. The fund would be invested and its earnings transferred to the new Texas Legacy Distribution Fund (TLDF), which would be designated to meet the state's long-term obligations.

Under CSHJR 10, the state would continue to have access to ample funds for emergencies or disasters. The ESF would remain available, and legislators could continue to appropriate any amount of that fund, including amounts that brought the fund below the sufficient balance. If the ESF did dip below its sufficient balance, transfers to it would resume until the sufficient balance was again reached. HB 20 by Capriglione, also on today's calendar, would set that sufficient balance at 7 percent of certified general revenue-related appropriations, giving the state a healthy reserve sufficient to meet any unforeseen need.

It would ultimately be up to the Legislature to decide whether to spend any of the TLF's earnings that were transferred to the TLDF. The amendment would ensure spending from the TLDF was made responsibly and did not go to new spending by restricting expenditures to specific long-term obligations. Appropriations from the TLDF would require a two-thirds vote to ensure there was a high bar for expenditures.

Spending for ERS or TRS obligations would not count toward the budget growth rate spending cap because it is important and fiscally responsible to make meaningful progress on the large unfunded obligations for these programs, which would be difficult under the cap. However, other spending from the TLDF would count toward the growth rate cap to ensure that the Legislature maintained fiscal discipline.

CSHJR 10 would authorize the comptroller to invest the ESF, TLF, and TLDF according to general law. Those standards would be established in HB 20.

CSHJR 10 would not harm transportation funding because the portion of revenue transfers going to the State Highway Fund would not be reduced or redirected to the TLF. If the ESF dipped below its sufficient balance, the state highway fund also would be protected and not reduced under the process authorized by CSHJR 10 and established in HB 20.

OPPONENTS SAY:

CSHJR 10 unwisely would siphon off state funds into an account that was completely off limits, even in the case of an emergency. In the event of a disaster or severe economic downturn, the state should have all its resources available. Because the TLF would be unavailable for appropriation, CSHJR 10 could effectively cap, at the balance of the ESF, the state's ability to respond to natural or economic disasters.

OTHER OPPONENTS SAY:

The state should keep the funds it needs in emergency reserves and return what it does not need to taxpayers to be used in the private sector. The state would see more returns in the long run with this strategy than it would from creating a new investment pool from taxes. The ESF was established to address unforeseen shortfalls in revenue, not as a way to raise revenue. Instead of establishing an endowment-like fund designed to support increased spending, the state should work to limit spending. Spending decisions, including those for long-term needs and debt, should take place within the framework of available general revenue, not through a pool of separate funds.

NOTES:

HB 20 by Capriglione, the enabling legislation for CSHJR 10, is on the Major State Calendar for second reading consideration today.

According to the Legislative Budget Board, CSHJR 10 would have a cost of $177,289 in general revenue in fiscal 2020 to publish the resolution. CSHJR 10 also would create a net positive impact of $286 million to other funds during the fiscal 2020-21 biennium.