HOUSE
RESEARCH
ORGANIZATION bill analysis 5/3/2017

HB 855
Capriglione, et al.
(CSHB 855 by Raney)

SUBJECT: Managing, investing new stabilization, legacy accounts within ESF

COMMITTEE: Appropriations — committee substitute recommended

VOTE: 24 ayes — Zerwas, Longoria, Ashby, G. Bonnen, Capriglione, Cosper, S. Davis, Dean, Giddings, Gonzales, González, Howard, Koop, Miller, Muñoz, Perez, Phelan, Raney, Roberts, J. Rodriguez, Sheffield, Simmons, VanDeaver, Walle

0 nays

3 absent — Dukes, Rose, Wu

WITNESSES: For — (*Registered, but did not testify*: Ted Melina Raab, Texas AFT (American Federation of Teachers); Drew Scherberle, The Greater Austin Chamber of Commerce)

Against — (*Registered, but did not testify*: Adam Cahn, Cahnman's Musings)

On — Glenn Hegar and Paul Ballard, Comptroller of Public Accounts; (*Registered, but did not testify*: Phillip Ashley, Piper Montemayor, and Victoria North, Comptroller of Public Accounts)

BACKGROUND: The Economic Stabilization Fund (ESF), also known as the rainy day fund, is expected to reach $11.9 billion by the end of fiscal 2018-19, absent appropriations from the fund, according to the comptroller's biennial revenue estimate. Revenue for the ESF comes almost entirely from oil and natural gas production taxes. Before fiscal 2015, the ESF received 75 percent of any oil or natural gas production 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 (Fund 6), with the rest continuing to go to the ESF.

The comptroller reduces or withholds allocations to Fund 6 as needed to maintain a sufficient balance in the ESF. As required by Government Code, sec. 316.092, the Select Committee to Determine a Sufficient Balance of the Economic Stabilization Fund recently determined $7.5 billion to be a sufficient minimum balance for fiscal 2018-19. Government Code, sec. 316.092(d) 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). Only twice has such a balance been transferred to the ESF under this provision — once in fiscal 1992 ($20.2 million) and again in fiscal 2008 ($1.8 billion).

The ESF may not exceed 10 percent of the total amount deposited into general revenue (minus certain types of income and funds) during the previous biennium. The cap for fiscal 2018-19 is $16.9 billion.

Spending money from the ESF requires legislative approval. At least three-fifths of the members present in each house of the Legislature must approve spending from the ESF to cover but not exceed an unanticipated deficit in a current budget or offset a decline in revenue for a future budget. However, any amount from the ESF may be spent for any purpose if approved by at least two-thirds of the members present in each house. Money drawn from the ESF counts toward the state's constitutional spending limit, according to the Legislative Budget Board.

DIGEST:

CSHB 855 would outline the management and investment parameters for two new accounts that could be created by constitutional amendment within the Economic Stabilization Fund (ESF) and one new fund that could be a repository of some money that currently goes into the ESF.

The bill would apply to three new entities that could be established under Sec. 49-g, Art. 3 of the Texas Constitution:

- the Texas stabilization account in the ESF;

- the Texas legacy account in the ESF; and
- the Texas legacy distribution fund.

The bill would establish criteria for the management of these funds. The comptroller would be given authority related to the funds to acquire, exchange, sell, supervise, manage, or retain any type of investment 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 account or fund. The comptroller's management would be subject to procedures and restrictions the comptroller establishes and in amounts the comptroller considers appropriate.

The objectives and purposes of the Texas stabilization account would be to preserve the account's principal, the purchasing power of the principal, and the account's liquidity.

The investment objectives and purposes of the Texas legacy account would be to generate earnings on its principal to maintain and increase the principal's purchasing power and to provide for annual earnings distribution to the Texas legacy fund.

The bill would repeal the current calculation for determining the sufficient balance of the ESF and would establish a new calculation that would be applied to the Texas stabilization account. The sufficient balance of the Texas stabilization account would be equal to 8 percent of the certified general revenue-related appropriations for the biennium. The comptroller would be required to determine the sufficient balance amount.

The bill would take effect January 1, 2018, but only if a constitutional amendment approved by the 85th legislative session was approved by the voters.

SUPPORTERS SAY:

CSHB 855 would establish the management and investment framework for a revised Economic Stabilization Fund (ESF) that could ensure the state has adequate money available for the original purpose of the ESF while also addressing long-term obligations. A constitutional amendment would be needed to revise the structure of the ESF and to create the new accounts and the fund outlined in the bill. The bill would be part of the efforts to modernize the state's savings and investment strategy to continue good stewardship of state resources.

The bill would divide the current ESF into two buckets: the Texas stabilization account and the Texas legacy account. The Texas stabilization account would function as the ESF does today, as a savings account for the Legislature to use as it sees fit. The current constitutional mechanisms for spending would remain, including the vote thresholds. The bill would allow the stabilization account to be invested under the strategy that has been used since 2013 for a portion of the ESF and that maintains a stable, safe class of liquid assets. Under this strategy, investments could be targeted to earn at least inflation and to be available within days or soon thereafter.

The amount in the stabilization account would be determined by the sufficient balance calculation established by the bill and would ensure the state had adequate reserves. The bill would set this balance at 8 percent of certified general revenue related appropriations, which would be about $8.5 billion for the current biennium. This calculation would be close to the fiscal 2018-19 sufficient balance of $7.5 billion set by a legislative committee and would mirror credit rating agency guidelines.

Under the discussions for revising the Constitution along with CSHB 855, if stabilization account balance were lower than the sufficient balance amount, oil and gas severance taxes coming into the state would fill this fund first. Once the stabilization account had reached the sufficient balance, 50 percent of the oil and gas severance taxes would go to the State Highway Fund, with the rest to the newly created Texas legacy account.

The Texas legacy account would be the second bucket within the ESF and would function like an endowment. Under the discussions for a constitutional amendment, money in the legacy account would be invested and a portion of the earnings determined by the comptroller would be transferred to the Texas legacy distribution fund. The Texas legacy distribution fund would then be available for legislative appropriations under any parameters determined by a constitutional amendment.

Discussions have centered on allocating earnings from the legacy distribution fund for long-term needs and obligations such as retiring state debt, reducing unfunded pension liabilities, maintaining the actuarial soundness of the Texas Tomorrow Fund, and deferred maintenance. These important but often under-funded items can be a consideration when the state's credit rating is determined, making them appropriate uses of these funds. These obligations of the state need to be dealt with, and this bill would help grow the revenue to do so. Putting state assets to work to fund long-term obligations that often cannot be met with general revenue would be a responsible way to steward taxpayers' money and meet the state's obligations.

The comptroller has managed the current ESF in a safe, judicious manner and would continue to do the same with the accounts and funds established by the bill without making state funds vulnerable. The bill would set appropriate investment objectives and purposes for each account and fund for the comptroller to follow and 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 considered a best practice by intuitional investment managers.

The Legislature would retain its oversight of the spending of money from the accounts. The Texas stabilization account would be available, just like the ESF, for any appropriation the Legislature chooses to make, under the same parameters. Spending money from the Texas legacy distribution fund would have to be done by an appropriation, under guidelines that would be established in the Constitution.

OPPONENTS SAY:

CSHB 855 could subject the state's emergency cash reserves to unnecessary risk. To meet investment objectives, taxpayer dollars could be exposed to more risk, including from investing in private sector assets.

The state should keep what it needs in emergency reserves and return what it does not need to taxpayers. The Economic Stabilization Fund was set up as a way to stabilize spending caused by recession, depression, or other economic disruption or deal with an emergency, 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: A companion bill, SB 1222 by V. Taylor, was referred to the Senate Finance Committee on March 9.