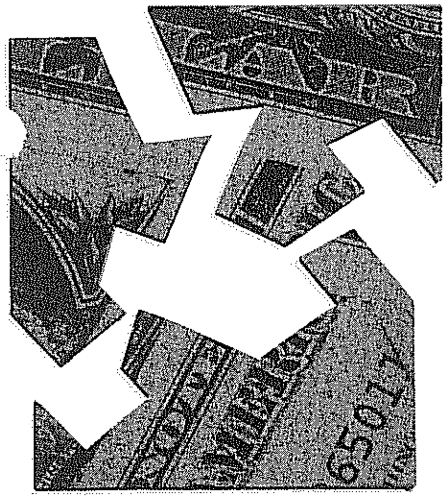
PAR SPECIAL REPORT #1



Financing Louisiana's Future

PUBLIC AFFAIRS RESEARCH COUNCIL OF LA., INC.

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Budget Reform Essential To Fiscal Sanity

Louisiana's pattern of increasing spending in boom times has resulted in an overall level of operating expenditures the state cannot support, even with frequent tax increases and budget cuts. For the past few years, state officials have been struggling with the need to balance the state budget. So far, the major tools used have been across-the-board and some selective cuts, hiring freezes, some layoffs, limits on travel and vehicle use, reduced work hours, and a drop in state-financed construction and highway maintenance. But these efforts of crisis management have been stop gap measures which have exacerbated the state's problems. For example, postponing highway maintenance can result in higher repair or construction costs later, impair economic development efforts, and endanger the receipt of federal funds.

Louisiana already has in place most of the fiscal discipline mechanisms used in other states. (See Table 1.) However, it does not fully utilize them. For example, one current state tax limit has never been effective. Louisiana's sunset review procedure has been ineffective and program evaluation rarely has been used. Fiscal notes are to be attached to bills affecting state or local government finances prior to their consideration by a committee; in practice, a bill may go through most or all of the legislative process without a fiscal note if no legislator objects.

Louisiana constitutionally endorses the balanced budget concept by requiring an adopted balanced budget. However, the governor is not required to propose a balanced budget and a year-end deficit is not required to be liquidated in the next fiscal year nor is it prohibited from being carried over into subsequent years. On a scale of zero to 10, the stringency of Louisiana's balanced budget requirements is rated as four by the U. S. Advisory Commission on Intergovernmental Relations (ACIR). Only six other states are rated this low or lower; over half of the states received a rating of 10.

Balanced Budget

Twelve states require that the governor submit a balanced budget, while eight states require that the legislature pass a balanced budget, according to ACIR. Connecticut, Maryland, Pennsylvania and Nevada require proposal and enactment of a balanced budget.

Louisiana's governor has proposed an unbalanced state budget two years in a row (fiscal 1985-86 and 1986-87). While the governor is not mandated to propose a balanced budget, the Legislature is re-

TABLE 1
Louisiana has in place most of the fiscal controls used in other states

Type of Control	Total States	Louisiana
Tax or expenditure limit	18	Yes
Balanced budget concept	49	Yes
Super-majority vote to pass tax	7	Yes
Indexed income tax	10	No
Gubernatorial line-item veto	43	Yes
Fiscal note review procedure	41	Yes
Program evaluation and sunset review	29	Yes
"Rainy Day" funds	24	No

SOURCE: *Significant Features of Fiscal Federalism, 1985-86 Edition*, U.S. Advisory Commission on Intergovernmental Relations.

quired to adopt a balanced budget, with the result that a governor can propose a budget the Legislature cannot legally adopt. Without the proposed budget being balanced within existing revenues, its usefulness as a guide is diminished. By proposing a budget balanced within existing revenues, the effect of maintaining or raising revenues could more easily be analyzed. Also, the Legislature could base its deliberations on a proposed budget balanced within existing revenue sources if a governor's proposed revenue increases failed.

The state constitution requires that the governor propose an annual budget and "cause to be submitted a general appropriation bill for proposed ordinary operating expenditures and, if necessary, a bill or bills to raise additional revenues." Although not specifically requiring that the proposed budget be balanced, the language implies that it be balanced within existing revenues. The constitution does require that the adopted budget or appropriation bill be balanced. It also states: "The governor shall veto line items or use means provided in the (budget) bill so that total appropriations for the year shall not exceed anticipated revenues for that year."

Recommendation

The constitution should be amended to require that the governor propose a balanced budget based on existing revenue sources. If the governor proposes new or increased sources of revenue, spending from such revenue should be presented separately in a supplemental proposal which would document how the increased revenues would be spent.

Revenue Estimates

The constitution requires that the enacted state budget spending level be within anticipated revenues, but neither the constitution nor state law specifies who has responsibility for estimating the revenues—the governor or Legislature—and when. In 1986, the Legislature took the unprecedented step of specifying in the General Appropriation Act that $17 a barrel oil was the basis of financing the budget. Without an official revenue estimate against which to compare authorized expenditures, ensuring that the adopted budget is balanced obviously is difficult.

Florida has used a procedure of consensus revenue estimates since 1970. Professional staff of the legislature and the executive branch meet in a series of regularly scheduled "Consensus Estimating Conferences" to provide the forecasts needed to support the planning and budgeting process. The conferences are held at least three times a year: in the fall to provide forecasts for the governor's budget recommendations, in the spring to provide final estimates for the legislature's appropriation process, and in June to adjust the spring forecast to encompass legislative changes. The resulting estimates must be agreed to by all of the conference participants. All state agencies must use the estimates in their planning and budgeting activities. The legislature is not bound by the forecasts but since 1970 has always used them.

Such a procedure can discourage political "guesstimates" of revenue; reduce the issues in formulating, enacting and implementing the budget; and provide a monitoring system that will alert officials and the public on whether the state will end a year in the red.

Recommendation

Louisiana should establish a system for an official, consensus estimate of revenues which would be used at critical points when funding decisions are made. The governor and Legislature should be prohibited from authorizing expenditures in excess of this estimate. The estimate should be developed by a team consisting of a representative of each of the following: State Budget Office, Legislative Fiscal Office, and the Department of the Treasury. The team members could estimate revenue collections independently but would act as a unified staff in reaching a consensus estimate, which should be the result of unanimous agreement.

The revenue estimates should be published as official state documents and include the economic assumptions on which they were based. They should not be changed during a legislative session unless warranted by an unusual event such as a substantial drop in oil prices. After the budget is enacted, the unified staff should meet periodically to review revenue estimates and issue monthly reports on estimated and actual collections.

Consensus revenue estimates should be made:

1. Prior to December when agencies submit their budget requests.

2. Prior to the March submission of the executive budg

3. Prior to the April regular session.

4. After a legislative session to incorporate legal changes.

Long-Range Forecasts

In good times and bad, Louisiana has operated on a year-to-year basis without long-range plans on how to deal with future finances. Annual budgeting inspires short-term solutions rather than long-range planning. Louisiana's current fiscal situation and its swing from an "embarrassment of riches" highlight the need to consider the impact of current spending on future state finances. Annual budgeting may have encouraged the use of nonrecurring revenues to fund recurring expenses, since the impact on subsequent years is not addressed in an annual budget. A multiyear budget also would in cate the direction the state was heading in regarding revenue and spending policies and would highlight the consequences of policy decisions.

Twenty of the 50 states adopt a biennial budget, and one other state allows the governor to decide whether to submit an annual or biennial budget. Appropriations are made for the biennium in three states. In the remaining states with biennial budgets, separate appropriations are made for each year of the biennium. No state has a budget of more than two years.

Another type of multiyear financial planning is the use of long-range financial forecasting. This technique highlights the long-term consequences of current budgetary policies and spending decisions and forecasts anticipated future revenues and expenditures.

The experience of Fort Worth, Texas with long-range forecasting indicates its usefulness for other governmental entities. Fort Worth has used a five-year financial forecast since 1981. Benefits the city has realized from long-range financial forecasting include:

- assistance in making policy decisions with long-term implications;
- aid in anticipating future fiscal problems, enabling corrective action to be taken when necessary;
- assistance in operational planning;
- more accurate revenue and expenditure estimates, and
- an indication to bond rating agencies and others of systematic financial planning.

Florida also uses long-range (10-year) forecasts of revenues and expenditures in its budgeting process. It has found that:

"Economic, demographic and revenue forecasts are essential for a variety of governmental planning and budgeting functions. For example, the Governor's budget recommendations and the Legislative appropriations process require a wide range of multiple year forecasts." **(Florida Consensus Estimating Conference, Book 6)**

Recommendation

The state should develop a five-year financial operating plan as part of the yearly budget process, with the plan updated each year. The first year of the plan should be the basis for enactment of the annual operating budget, and the annual budget should be used as a tool to implement state priorities and policies.

Year-End Deficit

Louisiana is only one of a few states that has no statutory or constitutional requirement mandating the speedy liquidation of a deficit. In 29 states, a deficit cannot be carried over into the next fiscal year. Seven other states prohibit a deficit being carried over into the next biennium and another seven states require that a deficit carried over must be corrected in the next fiscal year.

By delaying paying off a deficit until a future year, the deficit becomes a long-term liability. Also, when deficits are carried over, the current year's services must be paid for out of next year's, or later years', revenues.

One problem with a general fund deficit is that due to delays in finalizing the year-end financial report, the amount of the deficit is unknown until well into the next fiscal year. Many major state taxes (such as corporate and personal income) do not come due until the last third of the fiscal year, plus accrual accounting slows estimation of a year-end surplus or deficit. More accurate estimates could be developed if the state's fiscal year was from October 1 to September 30, instead of the present July 1 to June 30. The change also would allow better estimation of available federal funds.

The state ended the 1985-86 fiscal year with a $201,611,058 general fund deficit, according to the year-end financial report. The state has incurred such deficits before but none as large. (See Table 2.) Deficits in previous years were liquidated from revenues of the following year except for the fiscal 1960-61 and 1961-62 deficits. The latter were paid off through the issuance of $60 million in long-term bonds—an action that damaged the state's bond credit rating. Pursuant to action in the December 1986 special session, the fiscal 1985-86 deficit will be paid off over a four-year period.

TABLE 2
Louisiana has had general fund deficits several times in the past

Fiscal Year	Deficit Amount (In Thousands)
1941-42	$ 174
1960-61	14,604
1961-62	44,347
1967-68	7,325
1968-69	19,709
1969-70	51
1970-71	15,982
1985-86	201,611

Act 35 of the 1986 special session created the fiscal year 1985-86 Deficit Elimination Fund to liquidate that year's general fund deficit. At least $50 million will be deposited in the fund in each of the next four fiscal years to be transferred to the state general fund to pay off the deficit. The act dedicates to the fund until December 31, 1990 bonus payments from state mineral leases, prior-year general fund surpluses, unrestricted court settlement funds, and receipts from unclaimed property above that received in fiscal 1986-87. If these revenues do not equal at least $50 million each calendar year, the difference is to be made up from other general fund revenues at the beginning of the next fiscal year. On or before July 15, 1991, the difference between $203 million and total transfers from the fund to eliminate the deficit must be paid from the state general fund. The act self-destructs whenever total transfers from the Deficit Elimination Fund to the state general fund equal or exceed $203 million.

Recommendation

The state should be constitutionally required to appropriate sufficient funds to cover a general fund deficit out of funds in the immediately succeeding fiscal year. While final figures on a previous year's deficit may not be known until halfway into the next fiscal year, a reasonable estimate should be possible at the time the budget is adopted.

CONCLUSION

Louisiana's spending level has been upheld by windfall revenues, prior-year surpluses and tax increases. The first two conditions no longer exist and the last has been used increasingly in recent years when the state's economy has been depressed and ability to pay more taxes has been questionable.

Major changes are needed in how the state develops the figures on which budget and appropriation decisions are made. Although it is too late to forestall the current difficulties, the state should act to avoid their repetition.

Each of PAR's recommendations can stand on its own but would be more effective if enacted in concert with the others. A proposed budget that is balanc is necessary but would be more useful if there is assurance that it contains reliable revenue estimates developed by a consensus revenue estimating team. Also, the same group or team could be responsible for the long-range forecasts and for anticipating a pending deficit. By taking the steps recommended by PAR, more accurate and realistic budgets should result.

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Financing Louisiana's Future
PAR Special Project

Six months ago, PAR undertook a study of major issues of long-term importance critical to Louisiana's governmental and economic future. A series of reports analyzing these issues and providing specific solutions to problems is now being prepared for release. This report, "Budget Reform Essential to Fiscal Sanity," is the first of the series.

In 1987 citizens will decide on the state's new policymakers—the governor, other state officials and legislators. It is imperative that the candidates address these essential issues and solutions so that they can be judged by their stance on them. Statewide discussions and active debate over these issues will have a significant impact on our future.