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In This Issue

BORROWING FOR CASH FLOW: PAYABLE FROM WHAT ANTICIPATED REVENUE?

Governments and individuals can have a cash flow problem when the time money is received is out of sync with the schedule for paying bills and other obligations. Louisiana state government has more than a cash flow problem because anticipated revenue may never be received. In this situation, a budget deficit occurs—spending exceeds revenue. As discussed in the PAR "Legislative Bulletin" of May 26, 1987, the state had a \$202 million budget deficit in 1985-86, appears likely to have a \$100-\$150 million budget deficit in 1986-87, and faces another deficit for 1987-88 of \$360 million, depending on the action taken this legislative session.

Louisiana's state general fund has had a year-end cash shortage since fiscal 1982-83, but this fund did not show a budget deficit until fiscal 1985-86. This occurred because the state achieved a balanced budget through paper transactions that produced no cash in the treasury: a switch from cash to accrual accounting, changed due dates for taxes and other revenue so that more than 12 months' collections were counted in a fiscal year; use of surpluses in restricted funds for general fund spending, and use of cash set aside for capital projects. When possibilities for such tactics were exhausted, the state's budget deficit situation emerged.

Revenue Anticipation Notes for Cash Flow

HB 1551 (amended and passed the House) would extend for a year Act 28 of 1986, scheduled to expire on June 30, 1987. Act 28 authorized a new state policy to deal with a cash shortage by giving the State Bond Commission sole authority to issue revenue anticipation notes payable from general fund revenue; proceeds from the notes are to be invested with interest earnings going to the state general fund. The amount of notes that can be issued under Act 28 is limited to 20% of general fund revenue anticipated but not received for the year. Hence, the earlier in the year notes are issued, the more that can be borrowed. Under HB 1551, if revenue anticipation notes were sold at the beginning of fiscal 1987-88, about \$800 million could be borrowed, based on 20% of \$4 billion estimated general fund revenue.

The state's first revenue anticipation notes were sold March 24, 1987. These notes, amounting to \$61.3 million, are not payable from anticipated general fund revenue but rather, from "savings" achieved by refunding, on February 1, 1987, some \$1.2 billion in general obligation bonds. The savings consist of postponing debt repayment previously scheduled in March through June 1987, and lowering interest rates. The state is paying no interest on the notes, bought by the Louisiana

NOTE: Status of Bills is Reported as of May 27, 1987

Public Facilities Authority, and is earning interest on invested proceeds.

Comment

The state has a serious cash flow problem, and it also has a serious cumulative and looming budget deficit problem. The inability to repay the notes from present state revenue sources is but one of many difficulties that may arise.

1. **Ability to Repay.** HB 1551 is intended to ease the state's cash flow problem until revenues come in later in the year, but extra money to repay the notes is highly unlikely, short of later approval of new sources of revenue.

If the state were unable to repay the notes within the one-year deadline, refunding might be attempted to extend the due date. The interest rate of the refunding could not exceed the initial issue, according to a constitutional provision, and the Legislature would have to approve the refunding by a two-thirds vote. Extending repayment through refunding would add another layer to the state's already excessive debt burden.

2. **Making a profit.** One argument for approving the 1986 act was that the state could make a profit by paying low interest on the tax-exempt notes and investing proceeds. As noted, the state is paying no interest on the 1987 issue, but under a unique arrangement.

Under the 1986 federal tax reform act, the state can make a profit and keep it if the cumulative cash flow deficit over a six-month period equals 90% of the face value of notes issued. This requires accurate projections of the cash flow deficit over a six-month period, or the state has to return the profit to the federal government. Under Act 26, a system of cash flow reporting has been devised and should be continued, whether or not Act 26 is extended.

3. **Constitutionality.** There is a constitutional question on incurring debt for a cash shortage, since it is not one of the constitutionally specified purposes.

Conclusion

Short-term borrowing to ease or correct cash flow can be an important financial tool—if used prudently and under circumstances where repayment within a year is assured. However, because of the state's current financial situation and dismal outlook, issuing revenue anticipation notes to ease a cash shortage could exacerbate the state's financial condition.

A state government cannot go bankrupt, but it can get itself into a situation where it is unable to pay its bills. Louisiana state government is on the verge of that situation. HB 1551 could obligate the state even more without a realistic way to repay the loans. The state's debt credit rating is already the lowest among states—due to imprudent financial policies and practices.

HOW MUCH LEGISLATIVE CONTROL OF THE $1 BILLION MFP?

Louisiana's constitution specifically requires a minimum foundation program (MFP) as the primary method for state aid to local schools. The MFP is to assure each child has an equitable financial opportunity for a minimum education. Louisiana has had an MFP since 1930; basic components of the present formula date back to 1956.

The constitution specifies how the MFP is to be formulated and financed. The state Board of Elementary and Secondary Education (BESE) must adopt MFP formulas, subject to legislative approval, to equitably distribute state MFP money to local school systems, and the Legislature must appropriate sufficient money to ensure an MFP in all public elementary and secondary schools.

Under the MFP concept, the state determines how much is needed to assure a minimum education for each child (total cost), based on a determination of components of the program. A uniform local support factor (5.5 mills of taxable assessed property value) is subtracted from the total MFP cost. The difference represents the amount of state aid. Local school systems can supplement state aid through local property and sales tax revenues.

No changes have been made in Louisiana's MFP formula since adoption of HCR 74 in 1984 because of an impasse between BESE and the Legislature in reaching a consensus for change. A February 27, 1984 attorney general's opinion states that the Legislature has authority to amend or change the BESE-adopted MFP formula, but the Legislature has not used this authority.

Fiscal 1986-87 was the first time, in recent history at least, that the state did not fully fund the MFP. A 4.5% cut was made in the general appropriations act and the Governor cut another 5% which he later restored. An October 8, 1986 attorney general's opinion affirms the Legislature's authority to appropriate less than full MFP funding, provided the level of funding is enough to assure a minimum foundation program. This question is now before the courts.

Legislative Proposals

SCR 38 (in Senate committee) represents BESE's proposed MFP formula which is essentially the same as the formula currently in effect. Cost of a fully funded formula for 1986-87 was $1,034.6 million, with the state providing $973.8 million (94.1%) and local support totaling $60.8 million, or 5.9%. Special education represented 15.5% of the cost and regular education, the balance of 84.5%.

There are more than a dozen legislative proposals regarding approval and financing of the MFP; four (HB 103, SB 29, SB 34 which are proposed constitutional amendments and SB 98) have moved toward approval.

HB 103 (amended and passed House) would add a provision that local school systems must contribute to the cost of the MFP. It would prohibit the Legislature from appropriating less than needed to fully fund the MFP, but would allow the governor to make cuts if approved by written consent of two thirds of members of the Legislature. It also would allow the Legislature to amend the BESE-adopted MFP formula by inserting the phrase "as provided by law" in the process for final approval.

SB 29 (amended and passed the Senate) also would specify that local contributions be required to finance the MFP. The Legislature could amend the formula by a two-thirds vote of the Legislature or two-thirds legislative approval of a gubernatorial reduction. The proposal also adds a stipulation that if the Legislature failed to approve a new formula, then the last formula adopted and approved would be used for the MFP program and allocation of appropriated funds. It is not clear if the amount appropriated and distributed the last time a formula was adopted would prevail, or if monetary changes could be made. The Legislature usually adopts a new formula through a concurrent resolution and no dollar amounts are specified in the resolution; rather, they are appropriated in the general appropriations act each year.

SB 34 (up for Senate vote) would require full MFP funding and prohibit the Legislature or governor from reducing such appropriation. Like SB 29, it would specify that if a new MFP formula were not approved, the last approved formula would be used to determine cost and allocation of appropriated funds.

SB 98 (passed by the Senate) would prohibit a governor from cutting MFP funding without written approval of two thirds of legislative members.

Comment

Louisiana's MFP formula is in drastic need of revision but BESE has been reluctant to make basic and needed changes. PAR will issue a report in the near future proposing a new approach. A growing number of legislators appear to want to revamp the formula to emphasize quality classroom instruction, not preserving jobs for teachers and other school employees which is the thrust of the present formula. Several of the legislative proposals would give the Legislature an option in devising a new formula, not merely saying yes or no to the BESE-constructed MFP.

MINERAL STABILIZATION FUND UPDATE

Several critical budgetary issues are facing the 1987 Legislature including enactment of a balanced budget, establishment of a consensus revenue estimating procedure and the subject of this update, the establishment of a mineral stabilization fund. With the possibility that the current session may be over by the end of June, important legislation continues to languish in the committee of the house of origin. In order to prevent the recurrence of the budget chaos of the past few years, PAR recommends that the following steps be taken:

- *Establish a constitutionally protected trust fund for oil and gas revenues above reasonable dollar amount levels. In the case of the oil severance tax and royalties, the amount could be the expected 1987-88 collections; gas severance tax levels may be set higher than the 1987-88 expected level to account for possible future changes in gas tax laws.*
- *Protect the principal of the trust fund from appropriation, especially from recurring expenditures.*
- *Deposit interest earnings into the state general fund.*

(For a further discussion of mineral stabilization and "rainy day" funds, see PAR's recent special report, "Stabilizing State Mineral Revenues Critical" and PAR's "Legislative Bulletin," Vol. 35, No. 2.)

Other legislative proposals have opposite objectives in funding the MFP—either to prohibit reductions or to allow them with a super majority legislative vote.

The Legislature has the traditional power to control the state's purse strings through its appropriation authority, but this has been diminished through a host of dedications. As a result, it is becoming increasingly difficult to determine policies and priorities on how best to spend state money.

The Legislature should have a role, other than saying yes or no, to the BESE-devised MFP formula and it should be able to reduce funding when circumstances dictate a reshuffling of state spending. Not all state aid to local schools is through the MFP, such as textbooks, and those programs are subject to cuts. Moreover, to prohibit cuts in MFP funding would increase the potential for cuts in other spending areas not similarly protected, such as financing higher and vo-tech education.

VO-TECH REFORM PACKAGE: A MIXED BAG

The state-funded system of 52 postsecondary vocational-technical schools operates under the supervision and control of the Board of Elementary and Secondary Education (BESE). Serious management problems have long plagued the system. An adequate management information system has never been developed to provide data for policy analysis, cost comparisons and evaluation of effectiveness. Friction between a predominately elected board and an elected state superintendent of education has hampered accountability and supervision. BESE has refused to delegate administrative responsibility to the department, to regional directors or to school directors. Efforts to institute an equitable formula to fund the schools have failed.

The one major recent reform was the 1986 law allowing BESE to appoint the superintendent and thus place the education department staff directly under its control.

Last year, the Legislature funded a comprehensive study of postsecondary vo-tech education. The final report was delivered to BESE by Gulf South Research Institute (GSRI) on May 26. A package of bills based on preliminary conclusions of the GSRI study had already been introduced.

Legislative Package

The following include identical House and Senate bills for each proposal. All are in committee in their house of origin.

SB 510 and HB 991 would require BESE to prepare, adopt and submit annually to the Legislature a funding formula for vo-tech schools beginning in fiscal year 1988-89. The appropriation to fund the formula would go to BESE and be allocated to the schools. The school directors could spend their allocations as they wished, subject to approval of the "appropriate management board."

SB 665 and HB 1000 would allow BESE, upon recommendation of each school director, to set resident student tuition fees, by program, of up to $500 a year. The fees could be increased $100 a year up to $1,000.

SB 358 would create a vo-tech enterprise fund to receive self-generated revenues. Each school would be appropriated the amount it generated plus interest earned, and funds would be carried over from year to year.

SB 451 and HB 1209 would abolish the present vo-tech advisory councils required for each school and require BESE to appoint a seven-member management board for each school. The board members would serve four-year overlapping terms without compensation. The board would hire and fire the school director and assistant director (within BESE guidelines); hire and fire teachers and other employees (within the tenure law); approve the school budget; develop a management plan; contract for specialized training; and perform other functions approved by BESE.

SB 604 and HB 1210 would require BESE to draw a comprehensive plan to reorganize the vo-tech system under local control with local elected management boards, local financial participation and an accountability system. The BESE plan would be presented to the Legislature for approval in 1989.

Comment

In receiving the GSRI report, the BESE committee tentatively decided to postpone pressing for legislative consideration of the more controversial elements of the package—the bills to increase tuition and create local management boards.

It also would have been wise to have allowed an additional year to undertake the comprehensive vo-tech study which, although approved last year, was not contracted until March 10.

The formula funding proposal (SB 510 and HB 991) is crucial to establishing a rational, equitable and performance-based system of financing the vo-tech schools. This has long been a PAR recommendation. In 1978, BESE submitted a proposed formula which was stopped by legislators who apparently wished the schools in their districts to retain their funding advantages. A funding formula would force BESE to require a better information system and would permit better evaluation of school and program performance.

The funding proposal would give the director broad spending discretion within the school's lump sum allocation, subject to board approval. The proposal pre-supposes the creation of local management boards for this purpose. In the absence of such boards, the legislation should still permit considerable discretion within spending policy guidelines established by BESE. As the GSRI study notes, BESE has been far too involved in minor day-to-day spending and hiring decisions.

The proposal to allow increased tuition fees set by each school requires further development. PAR has recommended that tuition play a larger part in vo-tech funding to help reduce the state's cost and increase student commitment. The proposal, however, envisions allowing the schools broader discretion in using the tuition revenues to meet their special needs or program interests. Some local discretion in setting tuition and spending the proceeds may be useful, but a decision must be made as to how tuition will fit into the overall funding scheme. Tuition should be required to support a certain percentage (20%-25%) of the average cost of operating programs. Discretion should be permitted beyond that to give the schools flexibility. A greater reliance on tuition should be accompanied by provisions for state financial aid or loans for low income students.

The proposal for an enterprise fund to return self-generated revenues to the schools does not define what would be included. Apparently, tuition would be included. At present, vo-tech school self-generated funds revert to the state general fund and the school keeps only 50% of the small current tuition. Before committing all tuition revenues to the schools where they are collected, a decision must be made concerning the future of tuition in the overall funding scheme. If a firm policy is not put in place, the Legislature will continue to be tempted to supplant general fund support with tuition increases.

Under the GSRI study concept, BESE-appointed local management boards would set the stage for conversion to local elected boards to manage each school. The argument is that local control and local tax support would increase community interest and increase the school's flexibility in adjusting to local conditions, employer concerns and economic development needs.

BESE's role under this proposal would be to provide broad policy and oversight depending heavily on a well-developed information system, formula funding and a capacity for policy analysis, cost analysis and program evaluation. The problem is that none of these currently exist and the creation of greater local autonomy now would compound the management problem.

Even with the management tools in place, the local board concept, particularly the elected version, presents numerous concerns. Each school would apparently have a board, yet not all of the schools are now justified—boards would tend to perpetuate these. Multi-school parishes would have several boards. If elected, how would districts be determined? A number of parishes now have no school. Would these parishes push for their own boards and schools? Further, it is questionable whether qualified candidates would offer themselves or whether the electorate would be able to make informed decisions concerning candidates for this rather limited purpose governing board.

Louisiana has no history of local financial support for vo-tech education and not a great deal of support for elementary-secondary education. This would be a difficult time to add another competitor for limited local revenues. Vo-tech districts likely would be limited to property taxes since the sales tax is overused. With the present homestead exemption, this would mean an additional burden on business.

Conclusion

Serious problems exist in the management of the state's vo-tech school system. However, a major institutional change will occur with the move to an appointed education superintendent which offers an opportunity for BESE to redesign its management approach. Before an extensive delegation of power to the individual schools either by BESE policy, statute or constitutional amendment, the basic management reforms PAR has recommended for a decade—formula funding, information system, policy analysis and program evaluation—should be developed, in place and working. In the absence of these reforms, a structural change like the one suggested by the GSRI study would be doomed from the outset.

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