

PUBLIC AFFAIRS RESEARCH COUNCIL OF LOUISIANA, INC.

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MEMO TO: Members of Louisiana Legislature

FROM: Public Affairs Research Council of Louisiana, Inc.

SUBJECT: Update on Fiscal Reforms

The 1987 legislative session is scheduled to terminate on July 13 but may adjourn as early as June 30. Early adjournment means little time remains to enact important measures to bring about much needed fiscal reforms.

This memo discusses three of the most important fiscal reforms: establishment of a mineral stabilization fund to stop the erratic and uncertain financing of state government; adoption of a procedure for official, consensus revenue estimates on which proposed and enacted balanced budgets would be based; and establishment of a prudent funding policy for public retirement systems.

If Louisiana state government is to operate on a sounder and more rational basis, it is important that fiscal reforms be approved—and at this session. Louisiana can no longer afford the luxury of postponing reforms in the hope that another windfall will bail it out. Crisis management must stop, and reality dictates that the time is now.

**MINERAL STABILIZATION FUND UPDATE: PAPER REFORM**

The importance of establishing a meaningful mineral stabilization fund for the future economic development of Louisiana has been stressed by PAR, the Governor, the LSU/CABL tax study and the Governor's Economic Development Commission. PAR's recommendations include the following:

- establish the fund by constitutional amendment;
- set a base of \$700 million if gas severance taxes are included or a \$580 million base without this source;
- protect the principal in the trust fund from appropriation, especially for recurring purposes; and
- deposit interest earnings into the state general fund so that they become a predictable, recurring revenue source.

SB 36, adopted by the Senate, would establish a Mineral Endowment Fund in the constitution. However, significant alterations in the concepts discussed above are contained in SB 36 that would seriously impair the fund's ability to stabilize Louisiana's revenues and expenditures and thereby would have little impact. It should be noted that gas severance taxes would not be included in the proposed endowment fund and would continue to be deposited into the state general fund.

• Only oil severance taxes, royalties from state lands, and bonus and rental payments above \$1 billion would be deposited into the fund. Deposits into the endowment fund would be unlikely for the next 10 years or until oil prices exceeded \$28 per barrel. (See Table 1.)

**TABLE 1**  
**SB 36 Impact as Amended by Senate**  
**Projected Deposits Into Mineral Endowment Fund and Interest Earnings\***  
**(In Millions)**

<u>Fiscal Year</u>	<u>Oil Severance Tax</u>	<u>Royalties</u>	<u>Bonuses and Rentals</u>	<u>Total</u>	<u>Annual Deposits to Mineral Endowment Fund</u>	<u>Interest Earnings</u>
1987-88	\$ 395.3	\$ 275.2	\$ 30.0	\$ 700.5	\$ 0.0	\$ 0.0
1988-89	411.7	274.3	35.0	721.0	0.0	0.0
1989-90	424.6	278.5	40.0	743.1	0.0	0.0
1990-91	437.8	282.8	45.0	765.6	0.0	0.0
1991-92	451.3	287.3	50.0	788.6	0.0	0.0
1992-93	465.3	291.9	55.0	812.2	0.0	0.0
1993-94	479.7	296.6	60.0	836.3	0.0	0.0
1994-95	494.5	301.4	65.0	860.9	0.0	0.0
1995-96	509.8	306.3	70.0	886.1	0.0	0.0
1996-97	525.5	311.3	75.0	911.8	0.0	0.0
1997-98	541.6	316.5	80.0	938.1	0.0	0.0

\* Based on assumptions of \$19 to \$28.12 price per barrel of oil and price of \$1.70 to \$2.42 per MCF for royalties paid on natural gas produced from state lands plus an average annual 1% decline in oil production, 1.2% decline in royalty oil, 4% increase in the price of oil, 3.5% decline in royalty gas, and 4% increase in the price of gas on which royalties are paid.

- Up to 50% of the principal could be appropriated by a two-thirds vote for economic development, coastal erosion projects or, after five years from the initial deposit, to avoid deficits.

- No consideration is given to establishment of a separate fund for gas severance taxes. If gas taxes were changed from a volume to value base in the future and prices increased, these revenues could become a significant and erratic source of income as oil has been in the past.

### Conclusion

SB 36 would not provide the budget stability necessary for economic development as it would allow the state budget to be subjected to erratic oil prices that could easily range from \$10-\$28 per barrel. It also would allow future access to 50% of the fund balance, which could severely deplete the fund in a few years.

### CONSENSUS REVENUE ESTIMATING ESSENTIAL

Official consensus revenue estimating at critical points in decisionmaking would correct serious flaws in Louisiana's budgeting procedures. Two proposals which substantially embody PAR recommendations are on their way to approval: HB 107, a proposed constitutional amendment, is up for House vote; and HB 1689, a substitute bill for HB 637, HB 1426 and HB 1446, has passed the House and is in Senate committee.

HB 107 would give constitutional protection for a consensus revenue estimating procedure. It would establish a Revenue Estimating Conference, prohibit a governor from submitting a spending budget which exceeded the official revenue estimates, and prohibit approved spending from being more than the projected revenues. The proposed amendment enumerates the membership of the conference and requires unanimous decisions to establish the official revenue estimates. However, a two-thirds vote of the Legislature could change the membership and vote requirement.

HB 1689 is, in effect, a companion bill to HB 107, although its effectiveness is not tied to ratification of the constitutional amendment. Official revenue estimates would be used to formulate the governor's executive budget, enact a balanced budget, and monitor implementation.

## Conclusion

HB 107 and HB 1689 would stop "politicizing" revenue estimates and do much to ensure fiscal sanity.

## RETIREMENT FUNDING POLICY

Two similar bills (SB 35 and HB 48) are moving toward providing the state a much needed funding policy for public retirement systems. SB 35 has passed the Senate and awaits a hearing in House committee, while HB 48 is up for House vote.

Both proposed constitutional amendments would ensure that the four state and nine statewide systems receive the actuarially determined contributions needed to make them fully funded over a 40-year period.

The bills prohibit any actions by the Legislature or system boards that would upset the balance between future liabilities and assets, with certain exceptions needed to operate the systems. Unfortunately, system members have lobbied amendments to allow their boards to grant cost-of-living increases (COLAs), although only when a system is approaching actuarial soundness. (SB 35 adds a limit for state-funded system boards that the COLA may not increase contributions.)

The employee-dominated system boards now have statutory authority to grant COLAs, typically with a 3% ceiling. The state employees' board, in particular, has taken advantage of this authority to the detriment of the system's funding. The amended bills may be interpreted as giving constitutional COLA authority to the boards free of current statutory limitations. The boards would be assured of receiving actuarially correct contributions and, whenever investment earnings exceeded the long-run actuarial expected earnings, they could grant COLAs and use up the extra assets. Later, when earnings fall below the expected average, the earlier gains would not be available to make up the difference and the state would have to increase its contributions by many millions of dollars.

## Conclusion

Employee benefits should be determined by the Legislature, not by member-dominated retirement boards. If the exception for board-granted COLAs is to be placed in the constitution, it should at least be made clear that they would be granted only "as provided by law."

It is essential that a firm, rational funding policy for public retirement be established now. But language should not be placed in the constitution that *might* be interpreted as giving the systems a blank check to draw on the state treasury.