

Morning Session
Friday, October 20, 1989

TRANSPORTATION FINANCE IN THE NEXT BIENNIUM

Moderator

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College of Business and Economics
University of Kentucky

Panelists

James Ramsey
Kentucky Finance and Administration Cabinet

The Honorable Michael R. Moloney
Chairman, Senate Appropriations and
Revenue Committee
Kentucky General Assembly

The Honorable Joe Clarke
Chairman, House appropriations and
Revenue Committee
Kentucky General Assembly

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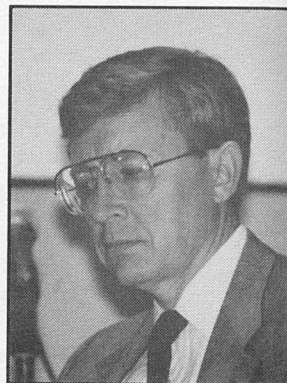
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Merl Hackbart

I appreciate the opportunity to be with you. This morning we're going to be dealing with a very important issue in terms of transportation. So far in this two-day conference, you've covered a number of issues dealing with the design of transportation systems, traffic safety, and transportation safety.

Certainly there is growing recognition that transportation is vitally important to the economic development process. Along with education, transportation is probably one of two major contributions the public sector makes to the economic development process. While education is vital to this process, a good solid, efficient transportation system is obviously critical to economic development of a state, a region, or a community. So, when we talk about investment from a state or local government level, we are often talking about investment of human capital or investment in education. We also talk about investment in infrastructure or investment in transportation systems as vital elements of the economic development process.



We see changes occurring in the economy across the country—we're moving from a goods-producing economy to a services-producing economy. We also see changes in terms of location of economic activity. With these changes, we need to have a system that is dynamic and highly flexible. While we realize transportation is important to the economic development process and to the future of the Commonwealth, there is another, obvious issue at the base of our progress in transportation system development. That is the issue of finances. Of course, finance has been an issue we've discussed in previous conferences, and to some extent, these issues haven't fundamentally changed during this decade. Certainly, the reduction in federal government support has placed increased burdens on state and local governments across the board. In public infrastructure or human service programs, fiscal stress has been placed on state and local governments proportional to reductions in federal government support.

There are growing demands for other services as well, with education having emerged as the number one issue in Kentucky in the 1980s. Additional stress will be placed on the ability of state and local governments to finance other vital public services and the public infrastructure by the degree of support directed to education. Unfortunately, the fiscal base of state and local governments has not expanded rapidly enough for them to easily deal with and support these needs in the future.

Consequently, the difficulty of financing transportation systems and other public sector services continues to be an issue that we have to face and an issue that doesn't change much. We simply have to deal with it over time.

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INTRODUCTIONS

Dr. Merl Hackbart is Senior Associate Dean of the College of Business and Economics at the University of Kentucky, and Professor of Finance and Public Administration. He is currently serving as State Budget Director for the Commonwealth of Kentucky. Also, Dr. Hackbart is a member of the Governor's Financial Policy Council and serves on the Kentucky Economic Round Table.

Representative Joe Clarke, serving his ninth term in the Kentucky House of Representatives, chairs the House Interim Appropriations and Revenue Committee. He has been extensively involved, both statewide and nationally, with the Council of State Governments and the National Council of State Legislatures. A native of Danville, Representative Clarke has a degree in civil engineering from Notre Dame University and is a graduate of Georgetown University Law School.

Senator Mike Moloney has served in the Kentucky State Senate since 1971 and for 10 years has served as Chairman of the Senate Appropriations and Revenue Committee. A partner in the law firm of Gerald, Moloney, and Jones, he has long been involved in legislative issues at both the state and national levels. Senator Moloney is a graduate of Xavier University and the University of Kentucky Law School.

Dr. Jim Ramsey is Chief Economist for the Commonwealth of Kentucky. He also serves as director of the Office of Investment and Debt Management, which has responsibility for investing the state portfolio, handling the state's bond issues, and providing the revenue forecast for the General Assembly. Dr. Ramsey is a graduate of Western Kentucky University and received a Ph.D from the University of Kentucky.

James Ramsey

It is indeed a pleasure for me to address the 26th Transportation Forum, and to be part of this panel discussion. As most of you know, Kentucky state government is much like other state and local governments in that we have a fund-basis of accounting. Our two primary funds in Kentucky are the general fund and the road fund. These funds finance most of the activities in the programs of state government.

One of the responsibilities of our office is to forecast, predict, estimate, or guess (whatever you wish to call it) what the general fund and road fund revenues will be in the future. For example, some of you may have seen the recent press reports of our preliminary revenue forecast for the general fund and road fund for the July 1, 1990 to June 30, 1992 biennium. In preparing our estimates for the road and general funds, we look at the history of revenue receipts and collections and then develop an economic outlook for the future based on what we think will happen to the economy in the years ahead.



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My focus this morning is on the road fund, the road fund receipts for the past decade, and the economic outlook for the next two years. For two reasons I think it is instructive for us to look at the 1980s and see what happened during this period of time. The 1980s began with a fairly severe and deep recession followed by seven years of unprecedented economic growth in the national economy. In fact, this sustained economic growth of the last seven years leads many people to believe that we cannot continue such growth and increases the probability that we are in for an economic downturn or recession somewhere in the near future. I think the 1980s also are interesting from a second perspective. We have seen a fundamental change in the fiscal relationships between the federal, state, and local governments during this time.

There are many ways to define what we mean by the road fund. This morning I am going to compare the road fund at two different points in time, 1980 and 1989. In 1980 the largest source of funding for state highway programs was federal dollars, representing 33 percent of the total funds. In 1989, federal dollars had fallen to 21.5 percent of total available dollars for expenditure. The absolute federal dollars flowing into our road fund were \$205 million in 1980 and \$200 million in 1989. So, from the first year to the last year of the decade, we really haven't had a change in absolute dollars. You can see that over the last five years, we've had a continual decline in federal support for our highway programs. This shifting of fiscal responsibility from federal government to state and local governments was a goal of the Reagan Administration, and as we evaluate this period of time, most of us are led to the conclusion that some, and in many cases, significant shifting of fiscal responsibility has occurred.

Do we expect this trend to occur in the future? Probably so. With the attention on the federal budget deficit, anticipation is that federal funds for all programs will be tight and that some retention of federal highway trust dollars will occur to deal with the deficit. Also, while President Bush has submitted only one budget to Congress, experts who analyzed that budget concluded that while he may have prepared his budget differently from how President Reagan prepared budgets, the results are very much the same. So, we expect this trend to continue.

Regarding the road fund, excluding federal dollars, there has been very little change in the composition of the road fund during the 1980s. Most of us are aware that the motor fuels tax makes up the largest component of the road fund (46.1 percent in 1989) and is primarily, though not exclusively, comprised of the excise tax we pay on gasoline. The next largest component of the road fund is the motor vehicle usage tax, which is basically the sales tax on the sale of automobiles both new and used. As you can see, there have been slight increases in the relative collection of these two accounts from 1980 to 1989, but no dramatic changes.

The license and privilege tax has stayed pretty constant from 1980 to 1989—between 18 and 19 percent. What is interesting here is how the composition of that tax changed dramatically during this period of time. During the early 1980s a portion of coal severance tax receipts were deposited to the license and privilege tax account, but that practice was discontinued in 1983. Since that time we've had a weight-distance tax, which was then replaced by

a truck decal tax, later declared unconstitutional by the Supreme Court of the United States. We then reinstated a weight-distance tax.

Looking at absolute dollars is sometimes more instructive than looking at percentages. Absolute dollars in the road fund has grown from about \$400 million in 1980 to \$729 million in the fiscal year just ended June 30, 1989. The growth rate, however, has been somewhat volatile during this period. During the 1980s we had some years of positive growth in the road fund, but we also have had some years characterized by negative growth. The positive growth in 1982 can be explained, in part, by an increase in the motor fuel tax from nine cents to 10 cents per gallon.

We also had growth in 1984 and 1985, primarily a reflection of economic growth—greater spending and greater consumption of gasoline and so forth. There was a dramatic increase in the road fund in 1987, which reflects the five-cent-per-gallon increase in the gasoline tax as well as the addition of the truck decal tax. A drop in receipts in 1988 reflected the Supreme Court's decision declaring the truck decal tax unconstitutional (we had not yet replaced it with the weight-distance tax). The weight-distance tax went into effect in 1989.

Let's look ahead to the current year and the next two years. We expect total road fund receipts of \$749 million in the current year, an increase of \$20 million. For fiscal year 1991, we expect \$754 million for the road fund, an increase of only \$4.9 million or a nominal percentage change of 0.7 percent. In real economic growth, this is 2.3 percent. For the second year of the biennium, fiscal year 1992, we are forecasting total fund collections of \$771 million, an increase of \$17.2 million, a nominal growth of 2.3 percent and real economic growth of 2.9 percent. These forecasts are based upon a national economic scenario of continued, steady growth.

The road fund in Kentucky is what we call inelastic. In economics, we use the concept of elasticity to measure the responsiveness of a tax or revenue system to changes in the economy. Our road fund in Kentucky is very inelastic; that is, as personal income grows in Kentucky, our road fund grows by a smaller amount. In fact, the elasticity of our road fund is only 0.45 percent; that means for every one-percent growth in our economy or in personal income in Kentucky, our road fund can only be expected to grow by about 0.45 percent. As we look to the next biennium, we are forecasting growth and personal income of between five and six percent. The road fund will grow by only 0.45 percent of this amount or two to three percent per year. Our road fund has been inelastic for a number of years and this does not allow for natural growth. I think you can see that the General Assembly has, on a number of occasions, recognized this fact and dealt with the problem through the imposition of new taxes and new revenue sources.

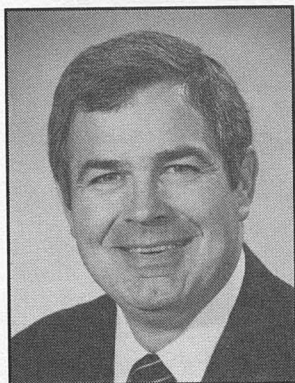
In the early 1980s, about 25 percent of the road fund receipts were dedicated to repayment of debt incurred by the Turnpike Authority and the Transportation Cabinet. This reflects the issuance of the resource recovery road bonds in the late 1970s and the economic development road bonds in the mid-1980s. There have been no new issues of turnpike debt in the last several years. Consequently, with the growth in the road fund, the percentage of debt service to road fund receipts dropped in the last several years.

In conclusion, the two points I've attempted to leave with you this morning are: (1) we have experienced a continued reduction in federal funds

for our highway programs in Kentucky during the 1980s and can expect this trend to continue in the future, and (2) our road fund has a very inelastic revenue base. Again, this means that the road fund does not naturally grow with growth in our economy. With the forecast of steady growth into the future, we can only expect slow, steady growth in the road fund in the next biennium.

Mike Moloney

For a number of years, the road fund was an issue to which several of us in the Legislature paid little attention. The way the budgets were structured it really didn't make any difference. Under the laws in existence at the time, once the General Assembly went home, the Transportation Cabinet did what they pleased anyway. That has changed, and we now have a situation where a much closer look is being taken at the road fund.



Jim has given you the figure of \$729 million, with \$734 million in the current year, jumping up to \$749 million over the next two years. Now that's the total road fund dollars, but I think we have to remember that backed out of this are some figures we need to keep in mind. We differ a little on the figures. Our figures show that approximately \$132 million of each of these figures is currently dedicated for debt service. There's nothing we can do about that; we have to pay it. Those bonds have been sold and the obligation is there, so that money

is not available for current use. In addition to that, the rural secondary road program gets \$78 million, the county road aid program gets \$64 million, and a municipal road aid program gets \$27 million. These figures increase a little because they are percentage figures. What that actually leaves in the road fund for fiscal year 1989 (according to the figures our staff has put together) is \$560 million. In fiscal year 1990, it is \$558 million because of the graduated calculations, and in 1991 it is going to jump to \$576 million.

My concern is this: these growth figures don't really move up very fast. You have already heard how we're going to solve all of our state's problems by selling \$600 million worth of bonds. The figures I've seen indicate this is going to take an additional \$69 million a year out of operating monies to pay debt service. When you put the debt service percentage to actual expendable dollars (after you back out current debt service and after you back out the rural secondary road program, the county road aid program and the municipal aid program) the percentage of debt service touches 35 percent. Now, you tell me that anyone would want to operate a business with 35 percent of their total available dollars going for debt service.

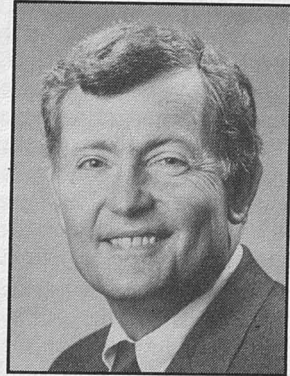
I know it's tough to be against a bond issue that is going to build a lot of roads, but I think the General Assembly's obligation is to the future of Kentucky and future generations of Kentuckians. Can we obligate them for 20 years and \$69 million a year in order to do a few things now? (When you look at the projects that can be built with \$600 million, particularly the ones being talked about, it is just a few things.) I think this is the ultimate policy issue.

A proposal for a \$600-million bond issue in 1987 would have brought an accusation of "credit-card mentality," but, of course, we don't have a credit card mentality anymore; we've elevated it to selling bonds. We need to give serious thought as to whether or not we want to encumber future generations with this kind of debt service and encumber our road program to the tune of 35 percent debt service.

Keep in mind two other figures. I say 35 percent. If the road fund had available to it all the money that should be available to it, there would be another \$77 million in it. Remember, that \$35 million went to the State Police. Also, there is \$42 million that hasn't been transferred from the general fund to the road fund to pay for resource recovery road bond issues, as was in the original issue and in the original bond documents. That is an obligation of the general fund that has not been met since 1980. The reason it hasn't been met is the overall economic condition of the Commonwealth, which I think Joe Clarke wants to address.

Joe Clarke

I think a quote ascribed to one of our state senators fits this situation. He's quoted as saying, "This is like 'deja vu' all over again." I was at this Forum last year, saying pretty much the same things, and things really haven't changed that much. I told you then, and I'll tell you again, I don't think the road fund would have problems if we could get the general fund in good shape so money from the road fund wasn't needed to support it. We've done a pretty good job, over the last several years, in providing road fund revenues and in taking the tough steps to increase those revenues where it was necessary. What we've run into though is our inability or unwillingness to deal with our general fund problems. Consequently, even though you were promised, severance tax monies (about \$42 million a year originally earmarked for the road fund to meet the resource recovery road bonds) have not been transferred to the road fund since 1980 or 1981. That's pretty much been standard behavior. Although you were promised that wouldn't happen any more, in the last budget the transfer was not made, and I'm not saying that's illegal or inappropriate. The way the bond issue reads, the Secretary of Finance has to certify that there's a need, so if the Secretary doesn't certify it, the money doesn't go over there. So, it's not illegal though it may be inconsistent with some of the things you've been told. In order to balance the last budget without new general fund revenues, not only was the severance money not transferred, but approximately \$36 million a year was transferred from the road fund for support of the State Police. Again, I think that is legal, constitutionally, because an argument can be made that those are road-type policies and procedures that are being managed by the State Police.



However, this depletes the amount of money in the road fund available for construction and maintenance. I don't see us continuing to raise revenues in the road fund when our real problem is in the general fund. The key is

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getting our general fund revenues in line so that we are able to deal effectively with our problems there. We can then leave the road fund alone and there will be enough money in it.

I share the concerns about the bond issue; debts are a little frightening. In the General Assembly, we've been struggling to reduce the debt; we'd like to have the revenue stream pay the bills. Every governor (and I'm on my sixth governor now) would like to build all the roads and buildings and other good things ever thought of for the next 20 years. I'm not sure that makes sense, or that it's fair. I know it will affect the road fund to the point where we'll have to raise road fund taxes to meet the debt service or else go out of business.

There are some other things we have to worry about concerning the road fund. Jim Ramsey has commented on the litigation over the decal tax which was struck down by the United States Supreme Court. We are now in a lawsuit over a refund of the monies that were not paid during the period of litigation. Our legal counsel tells us we have a good chance of winning this case. If we lose, another \$60 million will have to come out of the road fund. If it has to be paid, I don't know whether it could be paid in installments or in a lump sum. It is another problem we may have to deal with when the suit is finally resolved.

There is a lot of discussion among the legislators about the six-year road plan and its connection with the \$600 billion bond issue. It's going to be difficult for a lot of legislators to withhold support if the plan calls for significant roads in their districts. Legislators, having seen the four-year plan or the six-year plan over the years know that if you believe in these plans, you probably believe in the Tooth Fairy and the Easter Bunny too. We just completed a project in Boyle County that was on the four-year plan for 20 years before construction began.

When we look at the total cost of going along with this program and tying down this six-year plan (guaranteeing that projects promised are going to be delivered), we would probably have to raise taxes plus float a bond issue. There's simply not enough money in the proposed \$600 million bond issue to meet that six-year plan.

I want you to understand some of the problems in the general fund. In law enforcement and corrections, we are receiving about 500 new prisoners into our penitentiaries each year. I'm not talking about 500 coming in and 500 going out; I'm talking about a net increase of 500 prisoners annually. We are short 200 beds now, so we have these prisoners housed in municipal and county jails, and these jails are full. Conceivably, this could mean a new prison every year for the foreseeable future. In looking at the history of corrections, one can see we have been close to this number (an annual net gain of 500 new prisoners) for the past 10 years. However, we continue to pass laws with stiffer sentences and lock prisoners up for longer periods. A new prison to house 500 inmates cost about \$50 million at present rates and it takes us about three years to build one. It cost \$15,000 a year to house these prisoners. Unfortunately, we could almost send them to Harvard for about the same price, although, I don't think that is a viable option. We're going to have to take a hard look at this area.

In the human resources area, the Feds have revised welfare. There is a new welfare reform bill that emphasizes putting people to work. It's not a bad

idea, but a system can't be set up to train and place people in jobs without spending money up front. While it may save money down the road, the tab for Kentucky is in the range of about \$56 million for our obligations under the federal welfare reform and the Child Support Act. It's not an option—if we don't comply we won't receive funds for some of our programs. They would literally shut down the total welfare operation in this state.

There are a few other items that cost quite a bit. We have a severe water quality problem and we need to figure out what to do with the Kentucky River. The dams and locks, which are not in good shape, are going to be abandoned by the Corps of Engineers. We're going to have to take responsibility for their operation and pick up the tab. It's a very expensive item.

Not too long ago, the Kentucky Supreme Court declared our entire school system unconstitutional. No other state in the Union has had such a sweeping decision. The court looked at a simple sentence in the 1891 constitution that says the General Assembly shall provide an efficient system of common schools, and defined "efficient" as meaning adequate and equitable. Unfortunately for us, they didn't define what "adequate and equitable" were. They just said it was a problem for the General Assembly. Then they said, "Now, in your spare time, as a matter of this constitutional question, also eliminate waste, mismanagement, duplication, and politics." We're working on this now, but I want to tell you that there isn't any way that it's going to be free. People tell me, "You can do it; just get after it and you can do it without raising any more money at all." That just isn't so.

So, what we need in order to cure your road fund situation is your help in curing our general fund situation. It's going to be tough, but it's there and it isn't going to go away. To be honest with you, I haven't figured out what we're going to do in the 1990 session. I don't know how we're going to write a budget or what it's going to look like. Whatever we do write won't be real, because we're probably not going to deal with the revenue problem until we get through the regular session and into a special session to deal with the education difficulties. It looks like we won't have the answer to all this until about May or June of 1990. That's my best guess at this point.

But, the General Assembly is working diligently. Both Mike Moloney and I are on the Task Force on Education Reform. We also have the nice assignment of trying to figure out how to pay for reforms once the other committees decide what it is we ought to do in Kentucky. We can spend all day talking about that, but you are worried about roads, and I'd like try to answer any questions you have.

Question:

Can you make any projections on the lottery?

Answer:

That's an interesting question. For the current fiscal year, I think we forecasted that the net to the state would be \$116 million and \$97 million in each of the next two years. It is set up so that the money goes into a trust fund, so it really doesn't flow into the road fund or the general fund, it flows into a separate account.

Question:

What is that account used for?

Answer: (Jim Ramsey)

Right now it's invested waiting to be appropriated by the next session of the General Assembly (that's to the best knowledge). Senator Moloney and Representative Clarke may know more about that.

(Clarke)

We made the decision not to appropriate the lottery dollars until we had a handle on how much money we were going to get. We did not appropriate any of that money, that was a very ill-defined figure (there were estimates running anywhere from \$30 million to \$70 million). Obviously, even the Governor's expectations have been exceeded, a lot more money is coming in. Rather than trying to appropriate money when we didn't have any idea what was going to come in, we simply said we'd wait until 1990 (we'll need it then just as badly) so we didn't appropriate any of it. It will be available for appropriations in the session that will begin in January.

(Hackbart)

If you look nationwide, lottery proceeds tend to be very variable across the states. There are 29 states now who have lotteries and I think the experience has been of tremendous variability. I think the Legislature basically made the decision to review the receipts before the appropriations process began on that particular revenue source.

Question:

How do the other general fund problems and revenues shape up for the regular session.

Answer: (Moloney)

We're going to have about \$200 million in growth money, that's new money. There will be about \$100 million from the lottery. That leaves about a \$100 million in the hole and nothing has yet been done with problems of human resources, corrections, state insurance policies, or the state insurance coverage for employees. The Courier-Journal did a very thorough article on it and they came up with a figure something like \$251 million in the hole. I don't really disagree with that figure.

Question:

Does that include the \$78 million in the road fund?

Answer: (Moloney)

No, it included \$35 million of it, not the \$42 million. In this current budget, we have about \$122 million that won't be there again, at least that was what we were told the first time it was included. That is the \$35 million from the road fund, money that wasn't paid to the teacher's retirement

system, Kentucky employer retirement system, and moneys taken from trust and agency accounts, the one-time accelerated tax collection of the Amnesty Program. That's not going to happen again, so we have to come up with that money somewhere. It might be of some value to comment on the growth money, too.

(Clarke)

I think Jim came up with his new figures the other day, it would be about \$170 million according to your last calculation the first year. Right?

(Ramsey)

The first year is \$171 million in new money, the second year is \$214 million.

(Clarke)

In our budget instructions, we told the agencies to allow for a three-percent increase in their budgets and then directed them to try to provide a five-percent increment to employees within that three-percent. That's a budget cut, as you can see. If you're going to increase salaries by that much, we are in effect cutting them going in. That three percent will take most of that growth, there won't be much left. Any discussion about the new growth money paying the bills, the new growth money just helps you stand still, that's all it does.

(Hackbart)

Certainly the \$170 million is not a lot of growth. The three major tax sources that have contributed to the slow growth. (1) Corporate income taxes are certainly an area where we have some problems, in terms of revenue for the next couple of years. Certainly, (2) a severance tax has been flat at best, and the other area, (3) property tax, at the state level also has been a slow growing area, of course going back to House Bill 44. The general fund does not have a lot of vibrant growth in the next biennium.

Question:

Concerning federal money: Uncle Sam is holding billions and billions of highway trust fund money from the states. What can state government do to help get that money back?

Answer: (Moloney)

I don't know the answer to that.

(Clarke)

We've been told by the United States Supreme Court that the states don't really have any standings; we used to be able to go to court under the 10th Amendment and make an argument that we were being mistreated by the federal government. A relatively recent court decision, which has created a lot of concern among legislators nationally, ruled that the states are just like

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any other special interest group and if we want to get anything done with Congress, we have to lobby. The Supreme Court is no longer going to entertain our efforts to go to court and establish that, as I understand the constitution when it was written, the states were supreme, and the federal government was given some responsibilities, but everything else belonged to the states. Well, the Supreme Court has basically said we've got to talk Congress into it, so we've got a major problem in this area.

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I served this year on a special task force to try to deal with that problem. Just how do we get ourselves back into the Constitution so we can have some status. There have been some discussions of Constitutional amendments—some ways to try to get the attention of the Congress. We don't seem to be able to get the attention of the courts, but it is a problem.

(Ramsey)

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I really do think the statement that our numbers don't agree may be a little bit of an overstatement. The numbers are the numbers. You can put certain things in and take certain things out, and then the numbers will disagree. The numbers I gave you look at one side of the equation. A budget is based upon revenues and expenditures, so in our denominator are the revenue side of it. I think Senator Moloney has taken out some of the things that are committed on the expenditure side. I don't want you to think that the Legislative Branch and the Executive Branch have different numbers from which to work. He has done something on the expenditure side which I did not do on the revenue side. That's why those numbers may have appeared to be more different than they really are.

(Moloney)

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The reason I did that on the expenditure side is because of the statute that says you've got to do it—unless that statute has changed.

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Question:

Is it realistic to expect conformity in the regular session with a tax increase in the special session?

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Answer: (Clarke)

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I'm going to speculate on what is realistic at the present time. My guess would be that it is not likely. I think you will see a package deal. I wouldn't be surprised to see the end result of this whole education operation being a one-vote proposition, with financing and the substantive measures, as well. But that is just my speculation. It's way too early to guess where we might wind up.