RESEARCH BRIEF
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PAR Guide to the State Budget Crisis

How we got here – The Jindal record – The real priorities

Louisiana is facing its toughest state budget challenge since the 1980s oil industry depression. Required by law to construct a balanced budget, the Legislature is seeking ways to close a $1.6 billion gap between expected general fund revenue and the initial estimate for spending in the 2016 fiscal year. This report reviews the decisions and circumstances that created Louisiana's chronic and compounding budget sustainability problem. It serves as an educational primer on state budgeting and it investigates the familiar as well as the obscure but critical elements of state taxing and spending. A forthcoming PAR report will examine specific problems and proposed solutions for the 2016 budget. Special sections in this report include:

-The costly inventory tax and credit system, pg. 22
-State pension burdens on the budget, pg. 4
-The role of budgetary dedications, p.11

If budgets came with warning labels, the fiscal 2016 version would have flashing red lights. The risks are running high that the outcome will mean deep funding cuts at universities, strains on health care, a shift of tax burdens onto businesses and eventual deficits and cash flow problems for the state. The executive budget proposal contains large holes. So far, the balancing act has avoided discussion of spending cuts in some sacred areas. Also, some state leaders are showing continued tolerance of inflationary tax credit programs that fail to demonstrate a fair return on investment for taxpayers. The current administration will be in office only for the first half of the fiscal year that begins July 1, meaning that the next elected governor and Legislature will inherit whatever is wrought at this spring's session. Legislators and commentators are questioning whether the current governor will be engaged with finding plausible solutions now that he has offered his executive budget and is sharply focused on the national stage.

The state has options for reducing the imbalance, but the measures may further deplete resources and reduce liquidity

Surveying the scene with regard to Louisiana's debt ratings, Moody's Investor Services recently gave the state's finances a "negative outlook." That stigma "reflects the state's growing structural budget imbalance, projected at $1.6 billion for fiscal 2016, or about 18% of the $8.7 billion general fund even after significant budget cuts of recent years," Moody's said. This reversal in outlook comes after Moody's and other debt ranking firms had upgraded Louisiana's credit rating multiple times since 2003.

"The state has options for reducing the imbalance, including scaling back various tax credit programs, but the overall scale of balancing measures needed may further deplete resources and reduce the state's liquidity, which has been one of its strengths," Moody's said.

How did we get into this situation? And how can we get out of it? In the past PAR has warned of fiscal practices that would result in larger budget shortfalls. Many parties and events played a role, and so the best long-term solutions will require a number of different steps.

THE STATE BUDGET SEESAW

There are many types of financial figures in the mosaic of state budgeting. Two are of central importance. The most obvious is the *total spending budget*, which is supported by state taxes and fees, federal dollars, college tuition and other resources. Each year's budget contains a spending amount from the *state general fund*, which depends on state taxes. Both figures are useful measures. The general fund is basically the state's revenue minus dedicated spending (such as fuel taxes for the transportation) and other special fees and tuition. The state's general fund provides the critical dollars for K-12 education, direct support to colleges and matches for federal health care money. Many of the operations of the state – such as elections, social services, prisons, general government, the courts and the Legislature – depend on the state general fund.

When people talk about a shortfall of $1.6 billion for the upcoming budget year, they are referring to an estimated shortage in the general fund. This calculation assumes government is going to keep operating the same way plus inflationary costs, payroll growth, higher funding mandates and increased demands on services, such as health care. This government spending projection, which is known as a continuation budget, is a planning tool and not a mandatory target.

Stormy revenues

Comparisons between past and current state budgets will show very different results depending on the period of time.[1] One useful comparison is to look at today's state budget versus the budget before the fiscal turmoil caused by the 2005 hurricanes. Another good comparison is to examine the budget during the Jindal period, reflecting policy and fiscal practices under a particular administration.

Since fiscal year 2005, general fund spending has risen by 30%, which is equal to an average annual increase of 2.4%. But the general fund has had a rough up-and-down and up-again ride. In fiscal year 2005, just before Hurricanes Katrina and Rita hit, general fund spending was $6.5 billion and total spending was $16.5 billion. After the fateful storm and flood, tax collections swelled from a large temporary private sector workforce during the recovery and a surge of purchases for replacing wardrobes and cars and rebuilt homes and workplaces. Federal aid and private insurance dollars poured in. For fiscal year 2007, general fund spending rose to $9.3 billion and the total budget was $26.1 billion, buoyed by a 76% increase in federal dollars.

The post-Katrina total state budget of fiscal 2008 was $28.6 billion, still a record amount. The state general fund that year approached $10.4 billion, its highest point in history, even unto today.

The boom continued the following year, with hurricane recovery expenses making a big impact on the budget. The general fund approached $10.4 billion, its highest point in history, even unto today. The total budget was $28.6 billion, also still a record amount. That was the last budget during the term of Gov. Kathleen Blanco. She approved a significant income tax cut by restoring excess itemized deductions as a personal income tax exemption. This change was a partial repeal of the 2002 Stelly Plan, which raised income taxes for many people while cutting sales taxes on food and home utilities. Blanco and the Legislature gave across-the-board state employee and teacher pay raises, among other budget enhancements, and spent surplus dollars on infrastructure.

The 2008 turning point

Then, a lot happened in 2008 that is still being felt today. Gov. Bobby Jindal and a newly elected Legislature took office in January. The Legislature passed a further repeal of the Stelly Plan's income tax increases by changing the tax brackets, with the governor eventually signing on. The Legislature also provided businesses with a further phase-out and final permanent exemption on sales tax for the purchase of utilities. Combined, the tax repeals of 2007 and 2008 have an estimated value today of close to $1 billion, which is a savings to taxpayers but also a decrease in annual state revenue. Later in 2008, the mortgage crisis and the collapse of the financial markets threw the country into the Great Recession, which had a definite though delayed impact on Louisiana. That year also marked the beginning of a decline in tax revenue resulting from the tapering Katrina recovery. In Jindal's first budget year (fiscal 2009), general fund spending was $9.4 billion and the total budget was $25 billion.

The state general fund fell by almost $3 billion between fiscal 2008 and 2011 before beginning to recover, and then only slowly.

The state general fund would continue to decline for two more years. In the period from fiscal 2008 to 2011, the state general fund fell by almost $3 billion before beginning to recover, and then only slowly. Billions of dollars in federal stimulus money during the recession buoyed the state's total spending budget. Recently, state tax revenue has been on a slight upward trend overall, even with the notable exception of about $400 million in declining oil and gas tax receipts due to lower energy prices. The official estimates, still subject to change, put general fund direct revenue at $8.4 billion for the current year and about $8.5 billion for next year. The total budget this year is about $25.3 billion and next year's is scheduled for a decline to $24.6 billion.

THE JINDAL YEARS

The decisions and initiatives during the Jindal years have helped shaped the current situation. In some ways the governor and Legislature cut the budget, and in some ways the budget cut them. The declines in spending for many agencies and programs have been a mix of strategy and the cold facts of necessity. Federal spending decisions also had a major impact. On the plus side, federal stimulus payments boosted the state budget during the recession. On the minus side, federal regulations determined that Louisiana would get a smaller share of federal health care dollars because the state economy had suddenly boomed during the storm recovery. Of course the recovery was only temporary but the state's match rate was short-changed by the overly inflexible federal formula (Federal Medical Assistance Percentages, or FMAPs). This became one of the reasons for privatizing the Charity hospitals.

Fewer state employees

Jindal privatized and consolidated government programs and significantly reduced the state employee workforce, which reversed a long and persistent trend of swelling numbers of state workers. The privatization of the Charity hospitals moved thousands of medical and administrative workers off the state payroll and into the private sector. So the state budget is supporting fewer state workers but more private sector employment. Some of the newly privatized hospital operations are showing signs of improved clinical outcomes and expanded health care for the traditional Charity patients. The hospital privatizations also shifted some of the state's health costs to the parishes (for prisoner and mental health care) and to some of the hospitals that were not part of the state's Charity privatization.

Jindal's administration also ended the state's routine practice of annual 4% pay increases for nearly all state employees, a generous rate that was well above inflation. Universities received less and less direct support from the state general fund but were allowed to increase tuition and fees to make up much of the difference.

A key economic measure that affects the state budget is employment. Total employment growth in Louisiana was a modest 5% over the span of Jindal's first seven years in office, which included the national recession and, more recently, layoffs in energy-related industries. Private sector job growth was closer to 7%. During Jindal's period, the number of government jobs fell 8%, with most of the decrease coming from state government positions.

The budgetary burdens of state pensions

The annual cost to maintain the state employee and teacher retirement programs and to make payments to cover the unfunded accrued liability (UAL) is about $2 billion. The UAL is an estimate of how much money the retirement systems need, in addition to current assets, to pay for all future benefits. Louisiana has a UAL of more than $20 billion for its four state retirement systems combined. Most of that debt resides with the teachers' pension.

Among all states, Louisiana has one of the lowest funding level ratios to meet its long-term retirement needs. However, the state has consistently met its payment schedule to try to catch up. The UAL basically is being handled like a set of loans. For a large, old portion of the UAL, small payments began in the early 1990s that did not even service the interest; the payments were scheduled to increase over time and were heavily back-loaded. The reckoning is now upon us. Only recently did the state begin paying down the actual principal of the initial UAL.

Budget impact

But here's the part that affects the state budget: the UAL payment schedule has required sharply escalating annual amounts in the past 10 years and still calls for moderately increasing amounts almost every year until 2027. The annual UAL payment for the teachers' and LASERS state employee systems will be $1.63 billion in 2016 and will graduate to $1.94 billion by 2027. By 2029, the oldest portion of the pension debt, known as the Initial UAL, will be paid off. From that point, the annual UAL payments will settle down to $1.36 billion until 2039. And that's *if* all goes as planned.

The money for these payments is borne by state agencies, universities and school districts. There is no separate line item for retirement expenses in the state appropriations bill. The agencies simply have to bear the cost within their assigned budgets. That means agencies and colleges have an escalating floor of retirement costs. Moody's recently raised concerns about the credit quality of Louisiana's universities and noted that the colleges' annual pension expenses constitute an oversized portion of their budgets. The college systems are looking for ways to get out of the pension program and are considering legislation and bond refinancing initiatives.

Privatizations

When the Charity hospitals were privatized two years ago, many state workers moved off the state payroll and stopped accruing state retirement benefits. As a result, the state will save retirement costs in the long run. However, the state is still obligated to provide retirement support according to the accrued benefits of those employees who left. The state Charity hospital system was able to use federal dollars to help pay its share of the UAL; since privatization, that portion of the UAL loan payment has been shifted to other state agencies, which do not have the same federal resources to assist with the payments. So, one of the potential effects of government privatization is to pile up more retirement cost burdens onto the remaining government agencies. That's not a criticism of privatization; it's just a fact of life.

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State Retirement

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Furthermore, state agencies and colleges must pay more to adjust to a new calculation of the state's investment return. State officials recently embraced a lower rate of return expected for most of the state retirement system investments and a new accounting method for employee contributions. It was a good move by the state; but it's also more costly for state agencies. [2]

State agencies must bear these retirement expenses along with rising costs for Group Benefits, risk management insurance and auditing fees. Actions by the Legislature and the administration would be needed to reduce the agencies' costs for these programs.

Past improvements

A number of measures in the past decade have lowered the cost of the state's pension obligations. For example, new employees hired in recent years do not have the same generous terms and earlier retirement age options as their more veteran co-workers. A law was passed to prevent windfall pension income resulting from salary spiking just before retirement. New provisions in law encourage the use of one-time revenue to reduce the UAL and some bonus payments have been made to write down the debt.

Attempts by the governor in 2012 to further curtail the state's pension costs were defeated in the Legislature and the courts. However, progress was made last year with a cost-saving improvement to the state retirement systems' method of providing cost-of-living adjustments. This change, supported by PAR, will save an estimated $5 billion over 30 years.

Future reforms

Because many individuals have accrued benefits over the years, most of Louisiana's UAL debt will remain no matter what pension reforms are made. But the existing financial burden and the risk of even higher levels of unfunded liabilities could be reduced. A first step would be to implement a retirement program for new employees that carries a zero or low risk of accumulating unfunded liabilities. Changes affecting current employees also could lessen the state's pension liabilities. These might include a higher retirement age or a longer span of years to calculate the final average compensation formula. These initiatives are complicated by constitutional protections for employees and lawmakers' concerns about fairness. It is legally easier for private sector companies to halt a pension program than it is for the state.

State employees and teachers are not enrolled or covered by the federal Social Security program, which provides a safety net for disability and survivor benefits as well as some guaranteed retirement income for the vast majority of American workers. This is a major element in the state retirement reform picture, particularly when compared to private sector employee retirement plans that offer a 401(k) combined with a base of Social Security benefits. A state move to coverage by Social Security is not recommended by many pension analysts because the federal system already is burdened by unfunded liabilities of its own and therefore would not produce a good bang for the buck in a new state retirement plan. However, Social Security benefits are portable between jobs.

The bottom line is that state agency budgets are burdened by rising retirement costs, much of which will simply have to be paid and some of which might be reduced under correct reforms. In the meantime, the state could make deeper payments using one-time money to reduce the UAL.

Economic progress must be evaluated regionally, not just statewide. The New Orleans region, repopulating after Katrina and growing overall economically, recorded job growth of 6% in Jindal's first seven years. Other metro areas in southern Louisiana grew jobs from 3% to 4%. But employment in the Alexandria and Shreveport regions fell more than 3%, and jobs in the Monroe area were down slightly. New announcements for well-paying jobs in these areas offer reason for optimism. Overall for the state, a robust rise in net employment growth would be favorable for the state's welfare. The real growth rate for the near future remains to be seen.

THE STATE'S FISCAL MANAGERS

A governor surely holds some responsibility for encouraging business expansion in the state and helping to create an environment fertile for commerce and investment. But a governor's primary job is to manage state government, not to control the national or state economy. The governor and the Legislature share responsibility for the state budget. The governor can take primary responsibility for some agency initiatives and cuts that do not come under direct Legislative control.

The inventory, horizontal and film tax credits grew from a combined cost of about $150 million in 2004 to $775 million in 2014.

During last year's legislative session, PAR warned of the strain on the state budget from pay raises for state employees, extra money for local schools and expanded health care programs. These were worthy and popular recurring spending programs totaling about $200 million, but we could not afford them and the larger budget they created. They were passed anyway.

Borrowing from the future

The current year's budget is also propped with a nearly $1 billion combination of trust fund depletions, a debt defeasance maneuver, a lawsuit settlement, fund sweeps and other short-term fixes. After Jindal's eight years in office, he will have overseen four tax amnesty programs, which is basically a way of accelerating collection of owed taxes and driving settlements in tax disputes with corporations. All of these measures were ways of borrowing from the future. As PAR and others warned, the majority of that $1 billion is unavailable for the fiscal 2016 budget-balancing act we now face. One-time money can occur for many justifiable reasons, such as when the state gets a lawsuit settlement. But when the government manufactures those opportunities by borrowing from the future and for no other purpose except to raise money for the operating budget, their use does long-term damage to the state fiscal outlook.[3]

For years the Legislature has been approving programs that result in new long-term costs. Tax credit programs are an example. The inventory, horizontal drilling and motion picture tax credits that were created more than 10 years ago have expanded in recent times. The three credits combined grew from an approximately $150 million cost in 2004 to $775 million in 2014. The largesse has continued, often in the name of economic development. For example, two years ago lawmakers passed bills for tax credit programs for New Markets, investors and import-exports, which the Legislative Fiscal Office said would decrease the state general fund. A $250 million program to construct buildings for community and technical colleges across Louisiana – outside the normal capital outlay process – will result in new facilities for many legislative districts but also has resulted in new debt payment obligations for years to come.

Trust in the trust funds

Money has been siphoned from trust funds to pay for operational expenses. The Medicaid Trust Fund for the Elderly, which was filled with a windfall of federal dollars more than a decade ago as a cushion for nursing homes and other services, had been raided of more than $800 million and is now depleted. The Medical Assistance Trust Fund also has been tapped but as of this year has found protection in the Constitution. The Artificial Reef Development Fund, tapped for tens of millions of dollars in recent years to pay state operating costs, has just been granted Constitutional protection by Louisiana voters. These funds are no longer offering easy money for the state operating budget. The Transportation Trust Fund, dedicated to financing roads and other transportation infrastructure, has forfeited $40 million annually in recent years to cover operational and retirement expenses for State Police. Jindal has proposed taking $72 million from the fund for operating costs next year.

STATE EMPLOYEE HEALTH CARE

State agencies and colleges are coping with rising costs for retirement debt, Group Benefits and mandatory expenses for risk management insurance and auditing fees. All of these costs are mostly out of the control of the agencies and colleges themselves. Separate actions by the Legislature or the administration will be needed -- and should be pursued -- to reduce the costs of these programs. *(See the sidebar on State Retirement costs, page 4.)*

An expensive program for Louisiana government is the health insurance and other benefits offered to state employees and retirees through the Office of Group Benefits. The terms of these plans are generous to state employees relative to plans in the private sector. The total budget for Group Benefits next year is scheduled to increase $106 million. The Jindal administration has begun the painful but necessary steps to revise the plans to save money and to encourage more efficient utilization of health care services.

Meanwhile, the fund that backs Group Benefits has been deeply tapped to keep up with rising costs. Also, premium rates have been insufficient to maintain a strong balance in the account. The premium rates are charged to the government and to employees. Essentially, the fund has been used indirectly to prop up state budget operating costs. This practice is another sign of an unsustainable state revenue and spending imbalance. PAR has recommended changes to provide a more objective, transparent and fiscally responsible method for setting Group Benefit rates.

This high cost of Group Benefits is a major focus of a study commissioned by the state with the private firm Alvarez and Marsal. Savings in Group Benefits is the single largest dollar figure for all types of savings recommended in the study. Overall, the study suggests cost-cutting measures, efficiencies and ways to leverage more federal dollars for the state among a large variety of programs. However, most of the study's impact would affect dollars outside the state general fund.

AGENCY BUDGET CUTS

A prevailing notion in state politics is that the state Constitution protects all areas from budget cuts except higher education and health care. A deeper look at the budget reveals a more complex situation. In recent years of tight budgets, many state agencies and programs in fact have received deep cuts, health care spending has grown rapidly and "dedicated" funds have been raided frequently. As this report explains further below, the truly most protected priorities are debt, pensions and expenditures on local governments. Tax credit programs and private schools also receive preferential treatment.

Losers and winners

In the past seven years, overall spending has been cut for the agriculture department (-25%), social services (-36%), youth services (-35%), culture, recreation and tourism (-15%) and economic development (-45%). The department of corrections has operated on a virtually stand-still budget. Also during this period, the courts and the Legislature have received expanding allowances. The Judiciary budget has risen 27%. The legislative budget has risen 33% overall and 7% within the general fund; most of that rise represents growth in the Legislative Auditor division because of post-Katrina auditing demands.

Some state agencies depend on direct fees or self-generated revenue rather than the state general fund or federal money for their income. These would include the Department of Insurance, Wildlife & Fisheries, the Department of Environmental Quality, the Department of Natural Resources and the Public Service Commission. The agriculture and forestry department depends on a combination of general fund revenue and fees that flow to regulatory funds, which are sometimes raided for the state budget. The agriculture commissioner has raised concerns that health inspections might be compromised if funds are indiscriminately depleted.

The transportation funding swamp

The Department of Transportation and Development, which over the years has received very little or no operating money from the state general fund, relies on fees and state and federal fuel taxes to pay for road and infrastructure work. The Transportation Trust Fund, the State Highway Improvement Fund and other dedicated resources supply the financing.

The state gasoline and diesel fuel excise tax is 20 cents per gallon, which generates about $600 million when levied on about 3 billion gallons sold per year in Louisiana. About three-fourths of that usage is gasoline. Of this tax, 16 cents per gallon was the amount set in 1984 that flows mainly to the Transportation Trust Fund. The remaining 4 cents per gallon was created and dedicated in 1989 by the Constitution for 16 specific projects under the Transportation Infrastructure Model for Economic Development (TIMED) Program. All but two of those projects have been completed, but the 4-cent tax is committed to paying off long-term bonds and will not be available for new works for many years.

The problem is that fuel usage has not been increasing. This is a nationwide phenomenon, as cars and trucks overall have not appreciably extended the number of miles driven while new passenger and commercial vehicles have been achieving greater fuel efficiency, particularly with continued improvements to the internal combustion engine. Electric and alternative fuel powered vehicles are a minor though contributing reason. When fuel use is steady and the excise tax remains at the same rate for a long period, ordinary inflation diminishes buying power. The relative buying power of 16 cents in 1984 is about 7 cents today.

This transportation financing trend is made even more adverse by other factors. The federal fuel tax, which is the underpinning of federal highway aid to the states, is also a stagnant volume-based excise tax, last adjusted in 1993.[4] Meanwhile, the TIMED program has not been able to meet its debt payments based on the designated 4-cent tax. The state has been diverting about $10 million per year from the revenue generated by the state's 16-cent fuel tax to help pay the TIMED bill.

The Louisiana Transportation Trust Fund, which has seen virtually flat revenue for more than a decade, has been tapped in increasing amounts to pay for State Police operating costs

Also, the Louisiana Transportation Trust Fund, which has been virtually flat for more than a decade, has been tapped in increasing amounts to pay for State Police operating costs. The amount of that State Police portion grew to $60 million this year and the governor has proposed a $72 million tap for next year. The administration cites a constitutional provision allowing TTF money for State Police traffic control; whatever the legal justification, the diverted money is another clear indication of a significant sustainability problem in state finances. Meanwhile, some supporters of the state's ports and waterways want to ensure that more state infrastructure spending is focused on their needs, adding further pressure to limited highway resources.

Rather than raise new revenue, the state's answer to this funding challenge has been to schedule a major diversion of tax proceeds toward transportation in the future. A law passed in Jindal's first year will dedicate vehicle sales taxes to transportation and infrastructure, revenue that currently is flowing to the state general fund. That money, expected to be more than $400 million per year, will begin diverting in approximately 2020. We have to wait because basically the state general fund has to recover to its post-Katrina peak to "trigger" this diversion. Between now and then, the Legislature may decide to revisit or accelerate this initiative. A new governor might propose a different approach to highway funding. Considering the diversion's enormous impact on the general fund, it will have to be part of the conversation of how the state can create a more sustainable budget in the future.

The state's answer to the transportation and infrastructure funding challenge has been to schedule a major diversion of general fund tax proceeds in the future to highways and other projects.

THE HEALTH CARE MAW

Overall spending for health and hospitals has grown 23% to nearly $9.5 billion in the past seven years. The Department of Health and Hospitals' spending accounted for 31% of the overall state budget seven years ago, and now it is 40%. Even with that financial boost, the health care system is under immense pressure to keep up with inflationary pressures. Most of the health care budget is federal money that must be matched with a smaller percentage of state or local money. Louisiana's required match rate for adults and the disabled – now at about one-third -- has increased slightly, costing the state hundreds of millions more dollars.

The main expense is payments to physicians, hospitals, pharmacies, nursing homes and others who provide services to those enrolled in Medicaid. Enrollment has increased modestly. The state has saved money by reducing the reimbursement rates to health care providers taking Medicaid patients. (That is not a sustainable strategy because the lower the rates, the fewer the providers taking Medicaid patients.) A majority of the enrollees are children in low-income families but they make up a minority of the state's Medicaid costs. Medicaid care for children in Louisiana has historically been one of the lowest costs per child in the nation. The higher cost sectors in Medicaid are for people with developmental disabilities, mental illness and for institutional and home care for the elderly.

Federal dependence

In addition to these provider costs, the state draws federal money to reimburse hospitals and affiliated clinics for uncompensated care (UCC) services for the poor and uninsured. These UCC expenditures dropped dramatically under Jindal and then began to rebound. Meanwhile, Louisiana developed a Low-Income and Needy Care Collaboration Agreement (LINCCA) as a local match program that essentially pays hospitals for community and health services that the government or Charity hospitals might otherwise have provided. As UCC payments fell, LINCAA stepped in to provide supplemental payments that exceeded the UCC loss, although not for all hospitals. This LINCAA program is under scrutiny by federal regulators and its future is uncertain. Also, the federal plan is for UCC dollars eventually to decrease under the Affordable Care Act as more Americans gain private or Medicaid coverage under Obamacare. The impact of this potential UCC reduction on Louisiana is not yet known.

Major initiatives

Jindal launched two major health care reforms in Louisiana: Bayou Health and the privatization of the Charity hospitals. Both programs lean heavily on Medicaid and federal assistance matched with state dollars channeled through the Department of Health and Hospitals. Jindal chose not to expand Medicaid coverage to low-income adults under the federal Affordable Care Act.

The Bayou Health program revamped the old fee-for-service Medicaid system, a sort of pay-as-you-go model in which doctors and other health care providers were reimbursed for services to Medicaid patients. Under the new plan, private administrators now manage the care of Medicaid participants within health care networks. While still costly and unpopular with some segments of the medical industry, this reform brought a significant change in the state's system of Medicaid health care delivery and has improved utilization of services and health care outcomes. Medicaid costs overall have continued to rise, although Bayou Health may have slowed the increase.

Charity hospital reform

The Charity reform placed the role of the state's public hospitals into the hands of private operators, which have received preferential Medicaid reimbursement rates similar to what the government-run system enjoyed. The LSU System continues to oversee medical education but no longer operates the hospitals except for the small Lallie Kemp Regional Medical Center in Independence. Each Charity hospital community has its own arrangement. In some communities, the state tried to economize before the privatizations by cutting back on Charity services and dipping deep into the hospitals' reserve funds, but the amount and level of care under the private partners has rebounded and costs have continued to climb.

Uncertain outlook

Looking to the future, the next governor and Legislature may have to cope with greater limitations on federal UCC and LINCAA funding. One solution that is often cited is the idea of getting more adults covered by insurance, particularly in a state with so many poor and uninsured people accustomed to Louisiana's safety net hospital system. Louisiana has embraced an insurance model for children that relies heavily on Medicaid and LaCHIP, but does not do the same for adults. Even if Louisiana does not adopt a straight Medicaid expansion for low-income adults according to Obamacare, it may have other options to expand population coverage administered by private insurers under the Medicaid program, as other states have done. Also, the voting public last fall approved a Constitutional amendment that will allow a hospital fee that can be leveraged to generate new matching federal dollars for the hospitals. The Legislature placed the new system on the statewide ballot in the face of mild opposition from the anti-tax Jindal administration. Most hospitals, especially those offering urgent care, supported the plan. This financing system already is used in many states. In Louisiana, as a result of placing the program in the Constitution rather than in statute, the new system could create more budgetary restrictions. It can be activated during any legislative session but is not expected to be launched this year.

One solution that is often cited is the idea of getting more adults covered by insurance, particularly in a state with so many poor and uninsured people accustomed to Louisiana's safety net hospital system.

PUBLIC SCHOOLS

If you are looking for big budget cuts affecting the state general fund, then education and health care are the principal places to go, numerically speaking. Higher education, K-12 education and health care account for about 70% of general fund spending. Of that, public schools have the advantage.

While the Department of Education is vulnerable to cuts, state financing of local school districts is one of the most well-protected areas of the state budget. School districts combine state, local and federal funding to support K-12 public education, as they do in all states. Louisiana is about at the national average for the proportion of local public school support

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Lock it up but keep the key

Supporters of higher education and healthcare often bemoan that cuts often fall on them disproportionally because the other areas of state spending are protected. "If only all these dedications were removed," the argument goes, "then cuts could be spread more evenly." While this argument's logic has power, the situation is more complicated.

What are Budgetary Dedications?

First of all, what is a dedication? In general terms a dedication is a requirement that certain revenues are set aside in special funds which can only be used for specified purposes. Some funds are protected fully in the state Constitution. Others have constitutional protection but might still be tapped under economically hard times. Funds created by statute are vulnerable to the whims of the Legislature and can be partially raided by the governor in a revenue downturn.

It can be conceptually helpful to imagine a world where no dedications exist. Budgeting would consist of prioritizing the state's needs then taking all of the funding available and applying it to the top level priorities. Nothing would be safe from cuts and nothing would be "off the table." This approach would allow policymakers to focus on those areas that are truly important without being constrained by spending requirements and revenue restrictions that might prevent an optimal budget. Of course, a world without dedications does not create more revenue, it simply allows for the possibility that spending would be more focused on key policy areas. However, as dedications are examined more closely, the idea of simply eliminating them is not necessarily a budget elixir.

The various species of dedications

Dedications come in two basic forms. The first broad category is diversions of general fund dollars. These are state taxes set aside for specific purposes and that otherwise would flow into the general fund. The Revenue Estimating Conference, as part of its duty forecasting state revenue, forecasts the amount that certain dedicated funds will divert from the general fund. One example is the Legislative Technology Innovation Fund, whereby $10 million each year is removed from the general fund for this purpose. Another example is the Lottery Proceeds Fund, expected to generate $152.5 million in net proceeds next year. The Constitution dedicates those dollars to the state's K-12 Minimum Foundation Program.

Another example would be the Sports Facility Assistance Fund. This dedication takes state personal income tax dollars generated by nonresident professional athletes (i.e., the visiting team) in New Orleans and sends them to local sports facilities. There might be some advantage to removing the dedications from some of these funds; doing so would allow the $4 million that is diverted to the Sports Fund to be spent elsewhere in the budget. On the other hand, removing the dedication from the Lottery Fund in practice might not change much, since most of it is going to a program that is supported by the general fund anyway.

The other category of dedications is fees collected from particular groups to be spent on related programs. These vary widely. The Fisherman's Gear Compensation Fund (R.S. 56:700.2) assesses a fee on each lessee of a state mineral lease and each grantee of a state right of way located within the coastal zone boundary. These funds are then used to pay damage claims by commercial fishers as a result of their gear hitting or snagging on obstructions or hazards. Rather than commercial fishers and

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property lessees engaging in costly and complicated litigation to sort out the damages, the fund helps solve the problem in a consistent and regulated way. Many examples exist in agriculture. The Boll Weevil Eradication Fund (RS 3:1615) is collected from farmers to help pay for programs to eradicate or suppress the crop-destroying pests.

The problem with eliminating these dedications is that legally the money might not be used to support general fund programs like healthcare. Certain businesses, often by mutual agreement, are required to pay a fee to fund particular programs. The amount collected from a fee is supposed to be commensurate with the cost of providing the related service. Removing the Boll Weevil Fund dedication would not necessarily allow those dollars to be spent legally on whatever appropriation the Legislature decides. Politically, it is clear that those funds are not intended to be used elsewhere in the budget. Directing them elsewhere might result in farmers or businesses trying to remove themselves from a fee requirement and could cause the elimination of the revenue stream entirely.

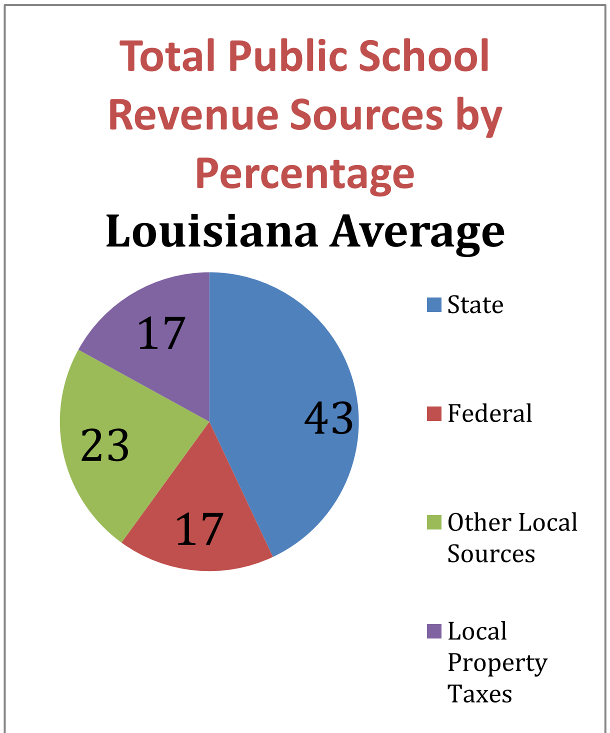
Solutions

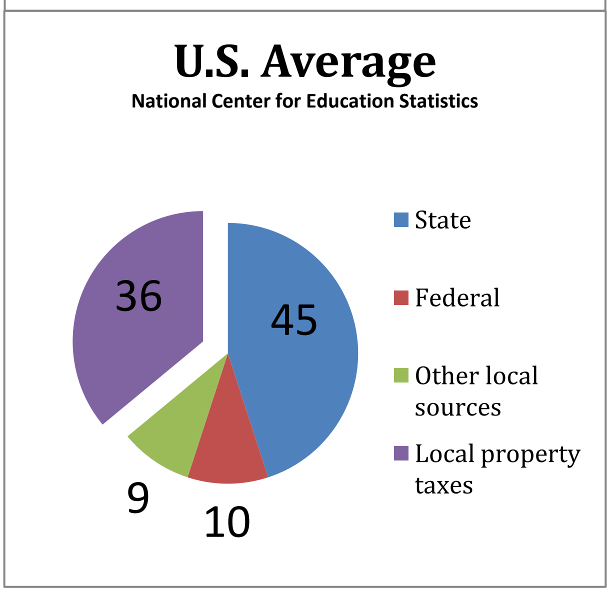
The current "solution" to dedicated funds is to sweep them. Since non-constitutional funds are created by an act of the Legislature, the legislative body contends that it can tap or move the funds around. The typical practice is to take, or "sweep," some portion of a fund above the amount the fund is expected to spend for its primary purpose. This amount is labeled an "overcollection" since it represents revenue beyond what is proclaimed to be needed. These sweeps are usually aggregated into the Overcollections Fund which is then appropriated as if it were a secondary general fund.

This routine practice is driven by the need to fill budget holes and can serve to spend idle state revenue on operating costs. No analysis is done as a part of the fund sweep process to determine if a fund should be continued or eliminated. In fact there is a large contradiction in the whole process when fees fill a fund that is swept; the amount of a fee is supposed to be only enough to pay for the cost of the government service implied, so why the extra money in the fund? The practice of fund sweeping can contribute to budget shortfalls in future years. When funds are swept, the same amount of overcollections may not be available the next year. This creation of short-term revenue becomes a form of one-time money used to pay for recurring state operating expenses.

Eliminating dedications can be difficult. Much like tax exemptions, each one has a constituency. To provide greater scrutiny, each non-constitutional dedication should have a sunset date. This provision would make elimination of dedications easier. Louisiana has approximately 400 state and local funds and dedications, so those sunset reviews should be staggered over several years. Fee-based dedications could contribute a small percentage of their revenue to the general fund as overhead. This could help pay for related but unfunded costs tied to the administration of the program, such as central accounting services or information technology support. While not the panacea it is popularly thought to be, a thorough review of dedications can give lawmakers the flexibility to better prioritize state needs.

In addition to dedicated funds, there are protected expenditures that do not necessarily have a related funding source. This often means that general fund revenue must be used to meet the expenditure requirement. These are usually labeled as non-discretionary spending. For example, the state is constitutionally obligated to fund K-12 education through the Minimum Foundation Program. Likewise, the state's first obligation is to pay the debt owed to bondholders. Some non-discretionary items do not receive constitutional protection, but are protected nonetheless. Prisoner healthcare, for example, must be provided at an adequate level or the state risks lawsuits and noncompliance with federal law. Some steps can be taken to reduce non-discretionary expenditures (such as refinancing debt at a lower interest rate to reduce annual payments) but typically they cannot be eliminated.





that comes from the state. Louisiana is well above average for the proportion of federal support to public schools and less than the national average for local sources of revenue. In particular, local property taxes account for only 17% of revenue for schools overall in Louisiana, compared with a 36% national average.

Through the Minimum Foundation Program (MFP), the state each year distributes cash to school departments across Louisiana according to a formula that is based partly on student population. Districts with low tax bases and larger shares of low-income students receive more money per pupil. The system helps lift poorer parishes but also serves as a disincentive for local governments to take a larger share of responsibility for education spending.

The Mighty MFP

The MFP budget is protected in the state Constitution and automatically rises with a higher student count.[5] This year the MFP is at $3.6 billion and serves about 694,000 students. A net increase of about 6,300 students is expected next school year, and so the MFP will be required to swell by $34.5 million. The state education board forms the distribution plan, which is subject to approval, but not direct modification, by the Legislature. Before the budget crunches started under Jindal, the state routinely gave the overall distribution a 2.75% boost on a per-pupil basis. The per-pupil amount cannot be reduced year to year. So when that boost was parceled with the MFP, the higher funding level was locked in and became a permanent recurring cost of the program. The practice of routine per-pupil increases ceased under tight budgets in recent years.

The state also protects general fund spending for private schools. Not counting the voucher program, the governor's budget for next year allocates $26.3 million in state general funds to non-public educational assistance, the same amount as this year. Among the costs, the state pays private schools for textbooks and to meet the regulatory and reporting requirements of the state and local districts. More dollars are passed to private schools through other channels.

The total value of state subsidies and tax exemptions for private schools amounts to $58.1 million this year, not counting vouchers. (By some measures vouchers save the state money.) These private school expenditures have more budgetary protections than Louisiana's public universities and many public health care priorities.

HIGHER EDUCATION

Higher education relies on a combination of financing from the state general fund, tuition, fees, statutory dedications, federal dollars, endowments, money transferred from other agencies and various sources of self-generated revenue, such as dorm rent. Some budgeted programs within higher education cannot rely on tuition and fees, such as the LSU Ag Center, the Pennington Biomedical Research Center and the staffs of Regents and the system boards. The Legislature limits college tuition and fees. Louisiana colleges had lagged the Southern Regional Education Board averages for tuition but have been closing the gap; two-year colleges have caught or surpassed the regional average.

Before Jindal, the state appropriated money to universities largely according to the number of enrolled students, which was an unfortunate incentive for quantity over quality. The governor helped lead the way to a system of performance measures to determine state funding allocations and to allow colleges to raise tuition if certain goals were met. Some university officials are critical of the funding formulas, which were created through legislation and by the Regents. But the fundamental move away from enrollment-based state funding was a positive step. The key challenge now is that colleges have decreasing levels of direct state support, which is a problem for them no matter what type of funding formula they use.

The dominant financial theme for higher education in recent years has been a reduction in direct state support versus increases in tuition and fees

The dominant financial theme for higher education in recent years has been a reduction in direct state support versus increases in tuition and fees. University officials have said that a tuition increase does not provide the same funding power as direct state support on a dollar-for-dollar basis. The value of rising tuition revenue might be discounted because of rising costs for scholarships, for example. Another theme is that colleges have been hit with multiple mid-year budget cuts as well as lower annual appropriations of direct support. Mid-year budget cuts are difficult to remedy because a college does not have the full fiscal year to absorb the impact. Another important funding element is that Louisiana took advantage of the federal bailout during the recession to pump hundreds of millions of dollars in federal subsidies into higher education.

Choose your comparison

This PAR Guide identifies three valid ways of evaluating the trends in higher education funding.

Method One: All of Higher-Education. Gov. Jindal's first budget, in fiscal 2009, contained the largest general fund allocation to higher education, before or since. The amount was nearly $1.5 billion, about half of higher education's $2.9 billion overall budget. "Full funding" of higher education was a main component of Jindal's first executive budget proposal. That year, colleges collected $626.6 million in tuition and fees. For every dollar of general fund money, college tuition and fees amounted to 42 cents.

This year the state general fund contribution to higher education is $935 million, while tuition and fees are estimated at just under $1.2 billion. The new ratio is $1 in general fund money for every $1.27 in tuition and fees. The overall budget for higher education this year is $2.6 billion.

Method Two: Excluding Hospitals. Two years ago the state switched its public Charity hospitals to private operators. The LSU System continues to oversee medical education but has shed the responsibility of operating the health care institutions. If higher education's health and hospital operations are removed from the financial equation, then we see a $2.4 billion total budget in fiscal 2009 versus a $2.6 billion budget this year.

Method Three: Excluding Hospitals and TOPS. The above comparisons include state money for the Taylor Opportunity Program for Students, or TOPS.

Although TOPS is a cost to the state, the money offsets tuition. Some college leaders say TOPS does not really add to the overall financing of higher education, because the schools would have collected tuition from about the same number of students anyway. If TOPS and the hospitals are removed from the equation, then higher education in fiscal 2009 had overall financing of just over $2.4 billion compared with just under $2.3 billion this year.

Louisiana's TOPS provides college tuition costs and stipends for students who meet certain academic and test requirements.[6] Next year, 55,278 students are expected to qualify for TOPS awards for a total cost of $284.3 million, an increase of $34.3 million from this year. TOPS money comes from the general fund and special funds with dedicated revenue.

TOPS and the budget

TOPS plays a popular though controversial role in education financing. In theory, it provides the Legislature an incentive to keep tuition from rising substantially because the corresponding state budget expense for TOPS goes up with each rise in tuition. Yet, in reality the Legislature has allowed a near doubling of tuition and fees in the past seven years; under any system of tuition control, even if the colleges had been given tuition autonomy from the Legislature, that level of increase has to be considered ambitious.

The law does not require that TOPS awards be offered to every student who qualifies. Still, the Legislature has fully funded TOPS every year, meaning that all qualified students have gotten awards. If the Legislature decided not to fund TOPS fully, students on the lower tier of qualifications would be left out. A pre-set formula of qualifications would be used to decide. So, while there is no legal constraint on short-funding TOPS, the Legislature has wanted to continue to fulfill the promise of the program. A potential landmark bill filed this legislative session would continue to provide TOPS to all qualified students but in future years would not necessarily cover full rising tuition.

Colleges cope with tight budgets

Universities must cope with inflationary expenses, some of which they cannot control. The costs of maintaining pension liabilities, health benefits, liability insurance and auditing expenses are mandated by state laws and regulations, not by university management. A lack of pay raises has kept down costs but has adversely affected faculty retention. This cost structure should be considered when evaluating the impact of budget declines at state colleges.

As the budget changed, overall employment levels in higher education shrank.[7] According to a count by the Regents office that excludes the Charity hospitals, higher education employment between Fall 2008 and Fall 2014 fell by 4,374 positions, or 12%, to 32,988. Faculty positions, which make up more than one-third of higher education employment, fell 7%. The administrative and clerical categories both decreased by 25%.

A deeper look is offered by figures from the Civil Service Commission, which tracks state agency job numbers. Universities have compensated for budget cuts by relying more on part-time employees. The emphasis is on adjunct professors rather than full-time faculty. Removing the Charity hospitals and health care divisions from the equation, higher education's job count in the fall of 2009 was 27,758, with a total salary cost of $1.26 billion. (2008 figures are not available.) The figure for full-time equivalent employment, which adjusts for part-time work, was only about 3% lower than the total employment number. In other words, the colleges were relying on relatively few part-time workers in 2009.

Full-time equivalent employment at Louisiana colleges fell 24% in five years

In the fall of 2014, again excluding hospitals, the higher education job count had fallen 8% to 25,585. Payroll was down 9%. Significantly, full-time equivalent employment was down 24%. The figure for full-time equivalent employment was 19% lower than the total job count, indicating a greater reliance on part-timers. The job impacts have varied by school. For the University of New Orleans, total employment during this time was down 8%, full-time equivalent employment was down 33% and payroll was down 25%. Meanwhile, LSU's main campus had no decline in total jobs and a 4% drop in full-time equivalent employment; overall payroll increased 6% at LSU, according to Commission data. These numbers may not capture the full story, as LSU reports a net loss of more than 230 faculty members and the elimination of many programs and courses.

HIGHER EDUCATION OUTLOOK

The current budget situation for higher education is reaching a tipping point that could result in a significant decrease in educational opportunities in Louisiana. For years, colleges have raised tuition and fees to combat decreasing levels of state general fund support. But tuition and fees cannot be raised indefinitely without affecting enrollment. Some colleges are at the point of pricing themselves out of the competitive market. Although LSU's main campus probably has more head room, others have less so. A new analysis by the House Fiscal Division shows that the cost of tuition and fees at Louisiana four-year colleges has nearly caught up with the Southern regional average while tuition at two-year schools has surpassed the regional average.

The proposed Executive Budget assumes the Legislature goes along with, or somehow finds a substitute for, the governor's proposed controversial elimination of $526 million in refundable tax credits. Higher education leaders have pointed to the amount of general fund colleges would receive if the governor's reforms fail. Under that scenario, colleges would take an almost $600 million general fund cut, representing an over 80% reduction. In addition, the administration's executive budget assumes $70 million in overall tuition increases for higher education in next year's budget. Education leaders are saying the schools overall can only raise about half that much revenue because the ceiling for tuition and fees at many colleges has been reached. This worst case scenario would be desolating to higher education resulting in the elimination of many programs, majors and quite possibly campuses.

The best worst case

If the worst case scenario is unthinkable, the best case scenario as presented in the Executive Budget is of little comfort. Assuming the supplemental funds will be found, Jindal proposed a cut of $226 million in higher education general fund support next year (excluding TOPS and the LSU hospitals). The overall budget, including higher fees and tuition, would be cut $245 million (11%). While an 11% cut sounds much better than an 80% cut, it needs to be put in context. The proposed $245 million cut in all means of financing is larger than all the other cuts higher education has gotten during the last 7 years, combined ($153m). The concern is that the Legislature will work to avoid a devastating worst case, only to be left with a crippled higher education system.

Campus closings and consolidations are among the money-saving options that are often suggested for higher education. As a solution for various managerial, educational and long-term financial problems, these ideas have merit. As a solution for immediate big savings in the state budget, they don't produce.

For example, direct state support for Grambling University is $13.5 million this year. The school makes the rest of its money on tuition, fees and other sources of revenue. Louisiana State University–Alexandria gets $5.1 million in general fund support this year. Even if both those schools closed, the state still would be responsible for pension and legacy costs as well as any infrastructure debt, which would have to be counted against the relatively meager general fund savings. The point is, there may be good long-term reasons for dramatic restructuring and downsizing in higher education. But we should not over-rate the impact of such measures on a single year's budget.

The Regents point to evidence of the elimination of many courses and areas of study as well as removal of duplicative programs at Louisiana colleges in recent years. A downsizing has been under way. The continued budget crunch lends further focus to the old idea of consolidating the university systems, or at least some administrative structures such as human resources departments.

The endgame

By many indications, the long-term trend for higher education in Louisiana is one of vanishing state general fund support. Nichols, McNeese and Northwestern universities already are all well below $20 million each in annual general fund appropriations. The entire Southern system receives $45.9 million. The entire community and technical college system, with 12 locations and an online program, receives $116.2 million. These figures must be weighed against the prospect of several hundred million dollars more in forthcoming cuts in the next year or two, likely without commensurate tuition increases or new sources of state revenue.

In this scenario, Louisiana is entering a new age of higher education, in which some colleges will become either privatized or convert into essentially regional public schools, perhaps relying partly on revenue from local governments in their areas. New levels of regional cooperation and funding may be needed for some colleges to survive. Louisiana would not be alone in this trend. Some states do not provide direct support to their universities and others are phasing out funding over time. In Louisiana, this transformation is taking place through a war of budgetary attrition and not according to a thoughtful policy or plan.

THE TOP PRIORITIES: DEBT AND LOCAL GOVERNMENT

Mandatory spending priorities shape much of the state budget. The state Constitution requires that Louisiana bond debt be paid above all else. State debts can be refinanced and restructured, which can affect the value of short-term and long-term payments. The state general fund helps support the payment of general obligation bonds.

Pension obligations have been a budget priority in the sense that the state has remained committed to making its scheduled payments. Also, some recent Constitutional changes have created better opportunities for paying down pension liabilities. However, the payment schedule over the years for a substantial portion of the pension liabilities actually postponed the heaviest burden of payments until the future, and that future is now. The minimum required pension payments have been a priority, but the burden of reducing the UAL debt was a procrastination that left us with a large bill today. *(See State Retirement sidebar on page 4.)*

The mother pelican

The give-and-take relationship between state and local governments is one of the strongest characteristics of the state financial situation, and yet much of what is spent is almost invisible to the budget process. The state allows major exemptions on local property taxes for homeowners and manufacturers but also pours billions of state tax dollars into local government coffers. For the poorer parishes with weak tax bases, the state financing is material. The system overall is inefficient and awards influence to legislators and state level officials.

Each year the state distributes money -- much of it from the general fund -- to local governments and school districts for a variety of programs. The foremost and largest of those obligations is the state's distribution to local school districts through the Minimum Foundation Program, valued this year at $3.6 billion. Beyond the MFP, the state has many obligations to local governments that are almost unseen in the state budgeting process. The inventory tax combined with the inventory tax credit program is an indirect state assistance discussed on page 22.

Protected local programs

Here are some other examples of state spending on local governments:

-**The Revenue Sharing Fund: $90 million.** The best kept secret in Louisiana, this fund was established in the state Constitution as a partial recompense for the homestead exemption. It guarantees that every year $90 million will be distributed directly from the state general fund to local governments through a formula based on population and homesteads. The money is not detailed in the appropriations bill; it is allocated in a separate bill each year that routinely receives unanimous House and Senate approval with minimal public discussion. Parishes spend the money strictly on local programs and projects, such as law enforcement, general operations, stoplights, playgrounds and sewers. Municipalities may receive some of the money. The revenue can be used to service local bonds, which means a local government may be dependent on the annual revenue stream to pay debts. This direct charge to the general fund for local projects is among the very highest spending priorities for the state. It cannot be interrupted by the Legislature or the governor without violating the Constitution.

-Supplemental Pay: $127 million. This subsidy is one of the most sensitive and protected areas of the budget. The state pays a sizeable portion of the salaries of municipal police, deputy sheriffs, firefighters, constables and Justices of the Peace. Much of the obligation is locked up by the state Constitution. More than 20,000 qualified police, deputies and firefighters with at least one year of service each receive $500 per month ($6,000 per year) in salary supplement from the state. This year the state's bill is $38.5 million for police, $53.7 million for deputies and $33.8 million for firefighters. Constables and Justices of the Peace receive $100 per month for a total cost of $1 million.

-Parish Transportation Program: $46.4 million. As part of this program, the state budgeted $38.4 million this year for the statutorily created Parish Roads appropriation. It distributes money for road maintenance to all 64 parishes according to a formula based on population and road mileage. This local money is separate from the highway funds available from the state-controlled Transportation Trust Fund. Also in this program, about $5 million is spread across a dozen cities and other recipients for support of mass transit. A small part of the Parish Transportation Program is used to match federal aid for railroad crossings and bridges.

-State Aid to Local Government Entities: $8.2 million. The state provides special direct funding to certain local entities for various purposes and under various laws and programs. Examples include: the St. Landry Parish Excellence Fund ($784,802); the Calcasieu Parish Fund ($899,361); Bossier Parish Truancy Fund ($592,063); Beautification for New Orleans Neighborhoods ($100,425); and the Greater New Orleans Sports Foundation ($1 million).

-Appropriations and Capital Outlay: Varies yearly. Appropriations bills and the state projects budget each year contain special funding for local programs and projects. Infrastructure, performing arts venues and a variety of pork spending have been approved.

-Tax and credit sharing. The state also shares revenue or provides benefits to locals on certain taxes, such as $42.4 million from the Video Draw Poker Device Fund that is distributed to local governments that have video poker. A state fee provides $21 million to locals through a fire insurance fund. Parishes get a share of severance tax, worth about $50 million this year. School readiness tax credits help leverage federal dollars for local districts. Tax increment financing deals (TIFs) devote state tax revenue growth to specific local real estate projects. Local governments do not have to pay state sales taxes on their purchases. The Legislature designates state hotel and motel taxes that are routed into local projects and organizations. The state diverts personal income taxes paid by professional athletes performing in New Orleans into revenue for the Superdome and local sports development.

How different would the state's revenue picture be if it focused its spending on more narrowly defined state matters?

The examples above are the more obvious cases of state channeling to the locals. Less visible are the benefits of many of the state's hundreds of dedicated funds that spill over to local interests. The total transfers of state money to locals are not all tallied here. The state has accumulated many diversions over many years.

The questions should be asked: What obligations should the state have toward local governments and local interests? How different would the state's revenue picture be if it focused its spending on more narrowly defined state matters? How much is the state collecting from taxpayers for the purpose of non-state priorities?

LOCAL LIMITS ON REVENUE

Although the state transfers considerable wealth to the local governments, state laws block local governments from certain revenue collections. The Constitution allows a homestead exemption on a primary residence. Basically that means the first $75,000 of a home's assessed value is not subject to most local property taxes. That amount is extraordinarily high and progressive compared to other states and helps rank Louisiana as one of the least taxing states for residential property.

Nearly 1.2 million Louisiana homesteads get the exemption, erasing about $761 million in local taxes. (Louisiana does not have a state property tax, although the Constitution allows one.) The state also allows special capped assessments for certain classes of homeowners, a policy that keeps millages higher on other taxpayers.

The industrial tax exemption

Louisiana also allows manufacturers an industrial tax exemption that relieves new plants and plant improvements from local property taxes for up to 10 years. Based on state data, about 21,000 such exemptions are currently active with an overall value that exceeds that of the homestead exemption. The exemption has varying local effects depending on the level of manufacturing activity, with the biggest impact felt on rural parishes with refineries, chemical plants and other large industrial sites.

Several revenue sources are special to local governments. The great majority of parishes, as well as their towns and subdistricts, charge a local sales tax that is higher than the state sales tax rate of 4%. These combined state-local sales taxes – at more than 9% average statewide -- give Louisiana one of the highest overall sales-tax rates in the nation. Local governments also collect occupational and general business license fees. Banks in Louisiana do not pay state corporate income taxes because they pay a special bank tax assessed and collected by local governments.

TAX EXEMPTIONS AND CREDITS

Every year, Louisiana's Department of Revenue compiles a 400-page book detailing the hundreds of tax credits, deductions, exclusions, exceptions, abatements and other privileges that offset tax liabilities or simply provide cash subsidies for particular activities. Called the Tax Exemption Budget, it refers to all these types of tax programs under the umbrella term "exemptions." It lists a total and growing value of about $8 billion in exemptions related to state taxes. Many other states produce such a document, but few do so annually. Other states and tax policy analysts typically will refer to exemptions as "tax expenditures," which reflects the justifiable view that these programs often are a form of state expense, even though they are not normally subject to the state appropriation process.

Breaks for regular folks

Although at times imperfect in quantifying past and future values of exemptions, Louisiana's Tax Exemption Budget is a useful and important document. It is frequently misunderstood and mischaracterized. It is not simply a list of tax breaks for businesses. Regular folks get a lot of the breaks. For example, among the larger exemptions are the personal income tax deductions for federal income tax (valued at $736 million in reduced state revenue), excess itemized deductions ($344 million) and the standard deduction ($279 million). Other notable exemptions are the state sales tax exemptions on grocery store food ($388 million), prescription drugs ($288 million) and residential utilities ($177 million).

There are income exclusions for many forms of retirement income ($228 million). Even though motorists pay a state excise tax on gasoline and diesel fuel, the book lists an exemption recognizing that the state long ago stopped charging a sales tax on vehicle fuel ($373 million). State and local governments do not pay state sales taxes ($200 million).

Corporate tax exemptions

The state has more than 50 exemptions totaling $1.7 billion counted against the corporate income tax. Five of those exemptions make up $1.6 billion of that amount. The largest is $535 million for the exclusion for Subchapter S corporations, which do not pay corporate income taxes but whose shareholders pay personal income taxes. This exclusion is a way of preventing double taxation.

As is common in other states, corporations in Louisiana get a break in the way they account net operating losses, which results in total exemptions worth $366 million. Like individuals, corporations can deduct their federal income tax amount from their state income, an exemption worth $204 million. Insurance companies can get an income tax credit for premium taxes they have paid, an exemption worth $26 million. The inventory tax credit accounts for $450 million. (See page 22)

Sales tax breaks

Many of the sales tax exemptions look like special favors but in fact represent special circumstances. For example, sales taxes are not charged when doing so would violate U.S. constitutional provisions protecting interstate commerce. Others are there because of court decisions, or simply as a clarification of what the tax law allows, or as needed to prevent double taxing on certain types of transactions.

A number of sales tax exemptions are aimed at the agriculture industry to hold down farm prices. Others are on the books because the state decided to be competitive with exemptions offered in other states. For example, the state has phased out sales taxes on new manufacturing machinery and equipment, which had served previously as a disincentive to industrial expansion.

Much of the total amount of tax exemptions are for breaks that are beneficial to all people or else have some legal or practical reason behind them

The point here is that the Tax Exemption Budget does in fact list some special favors, but much of the total amount of exemptions are for breaks that are beneficial to all people or else have some legal or practical reason behind them.

Tax credits as expenditures

The breaks that are of most concern are those tax credits that are expensive, serve narrow categories of individuals or companies and do not demonstrate a good return on the investment for the state. Whereas many exemptions redefine the tax base, tax credits are a dollar-for-dollar reduction in tax liability or a cash subsidy. They are truly expenditure programs. Most importantly, many tax credits are unlimited and therefore are uncontrolled as a state budget expense. If the qualifications are met for the credit, they are granted, often as cash payments such as in the film tax credit program.

These credits thrive in a completely separate state fiscal world that is not part of the legislative appropriations process. Tax credits are a major and usually automatic priority for the state's finances. They must be counted as part of the state's challenge in finding financial sustainability, particularly when their growth outpaces gains in state revenue.

THE BOTTOM LINE

This PAR Guide to the State Budget Crisis has explained how the state arrived at a position of falling short by $1.6 billion for its initially projected budget for fiscal 2016. Economics, major events and key decisions over the years all played a part in determining the revenue stream and the level of state expenditures. We have also seen that the state over time has accumulated a number of mandatory spending priorities that speak for much of the state's revenue before any real budget decisions are made. Likewise, inflationary tax credit programs have a life of their own outside the process of making priorities for the state budget.

In sum, the actual top order of priorities for that critical mass of money in the state general fund is debt, pensions, local governments, private schools and special tax credits. With what's left over, the state can begin to address its spending needs for operating state government, including higher education and managing health programs. Debt and pension obligations should continue to be top priorities, although as we have discussed, attention must be paid to avoid excessive debt and to resist temptations to borrow outside the debt limit. Pension changes and payments can be made to relieve the current unfunded liabilities, and new programs can be established to ensure the next generation does not inherit these same onerous retirement system burdens.

In the long term, if budget sustainability is to be achieved, all of these top priorities need to be brought into the conversation. Despite what we often hear from the Capitol, "everything" is not on the table when cuts are contemplated. Changes in these priorities, if done properly, will likely take some time and in some cases will require amendments to the state Constitution that would give the governor and Legislature more flexibility.

Meanwhile, the fiscal 2016 budget has been drafted by the administration with large unfilled holes and optimistic assumptions. In the past the state has chronically under-budgeted health care inflation and likely has again this budget cycle. The unfilled state budget gap is probably more than $800 million, unless legislative program fixes are made.

As Moody's has pointed out, these circumstances could lead to liquidity problems for the state. The optimistic budget assumptions could lead to a deficit at the end of next year if they do not reach their target. The fiscal 2017 budget may be just as challenging as the 2016 crisis.

The opportunity cost

These circumstances make it difficult for the state to act on meaningful tax reforms. For example, the state would generate more economic development with the elimination of the anti-competitive and burdensome franchise tax. Another beneficial change would be the lowering of the personal and corporate income tax rates through the elimination of certain deductions. New and simpler revenue sources could be used to offset the elimination of inefficient or anti-competitive tax policies. But these opportunities are less likely if the state continues to face a structural deficit. The temptation will be to find new revenue to plug budget holes rather than as offsets to fix poor tax systems.

As a businessman once said, "The easy part is laying out priorities. The hard part is prioritizing the priorities." The Louisiana Legislature's foremost priorities are in line before the members arrive at the state Capitol. An attempt to create a better set of priorities – namely for spending that first addresses primary state-level concerns – will be difficult. The current crisis may have ripened the discussion for that type of change.

Louisiana's costly inventory tax and credit deal

In Louisiana, companies pay their local governments a tax on inventory. The state then reimburses most of those companies with a credit for the inventory taxes paid. In effect, the state is paying local taxes, with companies acting as a pass-through. Money from state taxpayers is being used to foot the bill for parishes and other local governments. Compared to tax practices in other states, this arrangement is oddly constructed. The credit has no doubt been a recruitment tool for plant expansions and has alleviated tax burdens on more than 10,000 businesses, large and small. But the Louisiana way has become a tax system that actually incentivizes higher taxes. And it appears to be achieving that unintended result very well. The arrangement has grown tremendously in cost to the state in the past decade.

Background

Local governments in Louisiana and across the nation collect ad valorem property taxes from residential and business property owners. Although unmentioned in the state Constitution, "inventory" is included in property assessment values in Louisiana. Local governments collect a tax on inventories according to the local property tax millage. So, technically, in Louisiana there is not a separate inventory tax; inventories are just counted as part of a company's ad valorem taxable property.

Louisiana and 12 other states, particularly in the Southeast, allow a business inventory tax either fully or partially, according to the Tax Foundation. The Foundation and some other tax analysts view the inventory assessment as an antiquated type of property tax that lowers states' rankings for business competitiveness.

In the 1990s, Louisiana began compensating manufacturers, distributors and retailers for 100% of the inventory taxes they pay. The state issues a tax credit that can be counted against a company's state income or franchise taxes due. If the value of the credit exceeds a company's income or franchise tax liability, the state writes a refund check to the company to make up the difference. In fact, cash is the most common form of the credit. Last year the state issued inventory credits worth $452.7 million, of which $76 million offset tax liabilities and $376.7 million served as cash reimbursements. Like many tax credits, this money is spent directly from the state bank account with no appropriation, oversight or evaluation as a spending priority by the Legislature. The state revenue department writes the checks. Generally the public is largely unaware.

As part of his budget-balancing plan, Gov. Jindal has proposed that the refundable portion of tax credits be eliminated. The largest of these is the inventory credit.

A growing tax and expense

The inventory tax and the corresponding credit have grown tremendously in the past decade. Total assessments of the value of business inventories statewide increased from $2 billion in 2004 to $4.4 billion in 2014, according to data from the Louisiana Tax Commission. (The Commission provides oversight of assessors and tracks all forms of property assessments, including inventories.) Increases occurred every year except for a hiccup from the national recession in 2009. The actual inventory taxes applied to those assessments grew by a similar factor. The great majority of those taxes qualify for the state credits, at more than $460 million this year with additional growth expected next year. Manufacturers, especially those with large inventories of oil and gas, and major retailers make up the bulk of those inventories.

Several reasons have contributed to this scale of growth. Manufacturing expansion is one. Meanwhile, industrial plants and retailers have not had an incentive to reduce inventories because the tax credit wipes out the tax cost. A glut of low-priced energy commodities has caused stockpiling. Companies with multi-state operations might choose to consolidate inventories in Louisiana because of the tax credit advantage. Also, many companies have been converting to a new accounting technique that takes better advantage of Louisiana's inventory tax and credit arrangement. (A lawmaker has suggested that fuel transport regulatory conditions might also contribute to more inventories being counted.) In the Louisiana system, the taxpayer has less reason to curtail or protest an inventory assessment or to oppose a local property tax increase. The local taxing and assessment authorities are less likely to get resistance or challenges from taxpaying companies.

In sum, this tax and credit tradeoff places upward pressures on increased inventories in Louisiana because the companies essentially are operating in a non-tax environment. The system essentially promotes more inventories, which creates more taxes and more credit expenses that are footed by state taxpayers generally. In particular, those state taxpayers in parishes with relatively fewer inventory tax assessments are net contributors to the parishes with large inventory taxes. The system awkwardly redistributes wealth, most often from poorer parishes to richer or more industrialized parishes.

No easy answers

All the potential solutions to this problem are controversial. Based purely on best practices in other states, Louisiana should have no inventory tax and no offsetting state tax credit. Of course, if the inventory tax were eliminated, local governments would lose a source of revenue. For some, this loss would be very substantial. Inventories are concentrated in parishes with large populations or large refineries and chemical plants. For example, the three River Parishes – St. Charles, St. John and St. James – are among the top seven parishes statewide for inventory tax collections, which make up a major portion of their revenue bases.

Another idea would be to repeal or phase out the inventory tax and let local governments compensate by raising or phasing in revenue through other means. A more broadly applied property tax, a homestead exemption reduction or a curtailment of the state's industrial tax exemption program are among the initiatives that have been discussed. As noted above, the large differences in parish inventory tax collections is a complicating and potentially discriminating factor. An additional complication is that local governments have debt obligations that are serviced by property and inventory taxes.

Eliminating the tax

Another potential solution would be to eliminate the inventory tax and establish a new form of state subsidy directly to local governments to make up for the lost revenue. Under this plan, businesses would be free of the tax and the state would continue to subsidize local governments, but the state's cost could be controlled to prevent high inflation or to phase down the subsidy. This solution, too, would be complicated by the varying inventory tax collections among the parishes; making a state subsidy system equitable would be a challenge. The state has some precedent: the Revenue Sharing Fund, described earlier in this report, has a formula for state general fund distribution to the parishes to compensate them for the homestead exemption.

An additional problem is that not all companies paying the inventory tax are eligible for the tax credits; to make all parishes whole for all lost inventory taxes, the state would have to pay more overall than it does now through the tax credit program. One argument would be to let the non-credited companies – those that don't fall into the category of manufacturing, distribution and retail – continue paying the inventory tax as they do now.

The state could limit the tax credit program by setting caps or by offering the tax credits at less than 100 percent coverage. This plan would place a new cost on business and would likely result in lower inventory tax revenue for the parishes. But it could provide a dose of reality that would limit or reduce the state's liability and provide companies with an incentive to limit inventory and contest assessments. A potential impact of this plan is that it might lower inventories and inventory taxes overall. This is an important point. If such a plan were implemented and inventory taxes overall declined as a result, then the magnitude of the state's financial problems and potential remedies would be smaller.

Consumer impact

Car dealers provide an example of the potential consumer impact of an inventory tax credit reduction. Dealerships pay substantial inventory taxes and try to keep a variety of models with different options and colors on their lots to appeal to customers' tastes. The dealers typically have low net income for taxing purposes and therefore often receive their inventory tax credits as refunds. If faced with a large inventory tax and little or no compensating credit, a dealer might deploy fewer choices of vehicles ready for sale and might also have to raise prices to cover the new higher costs of doing business. In Texas, for example, auto dealers pay an inventory tax and often try to pass that cost to the consumer with an added fee at purchase.

Unintended results

Policymakers should keep in mind that if you change the rules, you change the behavior. A repeal of the inventory tax credits or, as the governor has proposed, the elimination of the refundable cash portion of the credit would have ripple effects. In such a new environment, companies might make decisions differently about their inventories, their accounting practices and their application of gains or losses. A major inventory tax credit reduction very likely would cause companies to reduce inventories, resulting in lower tax revenue for parishes. If only the refundable portion of the credit were removed, companies would seek to maximize their credits in the form of tax liability offsets. In that scenario, the governor's proposed figure for future revenue savings for the state would not fully materialize. This overestimate would contribute to cash flow and deficit problems for the state.

Constitutional issues

An elimination of the inventory tax would seem to require a Constitutional amendment, with a two-thirds majority vote of both the House and Senate and a majority voter approval on a statewide ballot. This change would be done probably by creating an exemption from general and ad valorem property taxation for inventory taxes in the Constitution's section on property taxes. As the Constitution neither protects the inventory tax credit nor requires a super majority vote to reduce or repeal the credit, a reduction or elimination of the inventory tax credit would not require a Constitutional change. Nevertheless, there likely will be disagreement within the chambers about whether the House and Senate should require a two-thirds or simple majority to cut the credit, as some will argue it is an increase in taxation. The Legislature's answer to this question might be swayed by law, politics or convenience.

The inventory tax credit was placed into law by statute. The constitutionality of this statute has not been challenged as of yet. The credit is not one of the approved property tax exemptions in the Constitution. And, in fact by definition it might not be considered an exemption; that is, the credit is an offset for a tax, not a clear exemption from having to pay the tax but maybe an exemption as an attempt to circumvent the prohibition. Legal minds might disagree on that point. If the inventory tax credit were challenged as a constitutionally prohibited donation of government assets, then the courts would have to decide whether it meets the tests for permitted transfers of public wealth to the private sector, such as whether the credit is not gratuitous.

Changes are not unusual for Louisiana tax credit programs

In recent years, several state tax credit programs have become too expensive because they produce a poor return on investment for the state, are ill-defined and inefficient incentives or have become too large a cost compared to other budget priorities. Some of these credit programs have been fixed, shelved or tweaked. The changes were made without calls of distress about whether a governor's or legislator's pledge for no new taxes would be affected. These are essentially state expenditures, with large amounts in the form of cash checks written by the state to certain defined recipients. For this reason, the credit programs are a concern for all taxpayers, who have a stake in how wisely their tax dollars are being spent. Any tax credit program that is not producing a good value for the general taxpayer should be revamped or repealed.

-**Alternative fuels tax credit.** Passed in 2009, the alternative fuels tax credit allows up to a $3,000 credit for purchase of a new alternative fuel vehicle. The original legislative fiscal forecast and the revenue department's annual estimate up until 2012 predicted a cost to the state of about $1 million per year. But by fiscal year 2012 the credit had exploded to a cost of $22 million. Left untouched, the program might have grown 10 times larger still, according to some estimates. The legislation ostensibly was aimed mainly at cars and trucks that run on "qualified clean-burning motor vehicle fuel," such as natural gas, biofuels and electricity. In fact, the legislation said the credit also would apply to vehicles that use ethanol if the fuel improved emissions, which turned out to include a fairly common type of gasoline-ethanol mix engine. Despite confusion between the private sector and the state revenue agency about which vehicles would qualify, no rules were made about which cars or trucks should be included until 2012, when alarms were raised about the program's escalating cost. The program was greatly restricted without raising questions about the governor's pledge for no new taxes. The sufficient reason for action was that the program had run wild due to poor government management and a failure of the Legislature and administration to follow up effectively once the program was made law. The credit now comes with a cost of about $4 million per year.

-**Solar tax credit.** The solar tax credit program is a state subsidy for those who install solar panels to supply themselves electric power. It can piggyback on a similar federal tax credit. The program's cost to the state grew from $16.1 million in 2012 to a current price of about $32 million annually. Two years ago the Legislature deemed the program too expensive and generous and passed a law that will cancel the solar tax credit in 2018.

-**Enterprise Zone credits.** The Enterprise Zone program offers a complex set of incentives for job creation. It was originally conceived as a program to revitalize economically distressed areas and hire workers from those areas but it is no longer so confined. Among its incentives, qualifying companies can receive a $2,500 tax credit annually for 10 years for each new job created if certain standards are met for hiring people with low incomes or who reside in low-income areas. For years the Louisiana Department of Economic Development has criticized the program, particularly for the state's poor return on investment in the retail sector. For example, major drug store retailers or fast food restaurants have gotten the subsidy even when opening in prosperous suburban corridors. This kind of subsidy offers a competitive advantage to the new stores even though they are mainly just shifting consumer spending from one place to another rather than developing new real wealth or economic diversity. The state development agency supports continuing the program for manufacturers. The Legislature changed the program in 2013 to squeeze out big box retailers and part-time workers. The impact of these changes could be positive and should be evaluated by the Legislature and the entire program should remain under scrutiny.

Motion picture tax credit and the motion picture infrastructure tax credit. The film tax credit program – which has cost the state more than $1.5 billion in cash and credits and continues to grow – has been adjusted multiple times since its creation in 2002. Revisions in 2005, 2007 and 2009 sought to improve the program's focus on movie spending with sharper economic impacts on Louisiana. The incentive has generated much film-making activity but serious questions have been raised about whether most of these productions produce a real and long-lasting economic effect on the state. The Department of Economic Development, which runs the program, and studies by economists have recommended several more changes. PAR is producing a separate study on this program.

A companion credit to support studios and other movie-making infrastructure projects was created in 2005. The new program became mired in disputes with ambitious developers seeking tax credits for expansive real estate and hotel projects, and the program was shelved by the Legislature.

These programs provide another example of tax credits that were revised in attempts to make them more efficient or less costly, without public controversies over whether doing so might impact a no-new-tax pledge.

Endnotes

1: The contrasting political messages about the state budget are undoubtedly contributing to public confusion about the facts. Gov. Jindal recently stated that in his tenure, "We have reduced the state's budget by more than $9 billion," whereas the president of the state's largest business lobby recently stated, "This state budget is roughly $9 billion higher than just a decade ago."

Jindal's claim is based on a budget conjecture by his predecessor Gov. Blanco eight years ago and not on the actual spending budget at the time. As a fiscal safeguard after Katrina, the state inflated its budget allowance for all potential federal and state recovery spending that might become available even though the state did not anticipate being able to obtain and spend all that money in a single year. Blanco's last real budget spending was about $3 billion more than Jindal's current year budget, not the $9 billion difference he claims. Stepping further back, total state spending has indeed risen about $9 billion since fiscal year 2005, an increase of 55%.

2: The previous actuarially assumed rate of return was 8% per year, which was considered by many observers to be too optimistic. For example, if the investment portfolio had failed to perform with least an 8% rate of return over a long period, the state would not have accumulated enough money to meet its anticipated retirement obligations on schedule. By lowering the expected rate of return to 7.75%, the state now has a more conservative projection of the future value of its pension portfolios. This move better anticipated what the actual portfolio values are apt to be and, as a result, moved the state closer to recognizing what the real UAL is.

3: In 2011 the House passed a measure known as the Geymann Rule, named after Rep. Brett Geymann, that called for a super-majority vote to use so-called one-time money above a certain threshold to pay for recurring state expenses. The amount of restricted "one-time money" that fits the definition and process of the Geymann Rule has decreased yearly. House-regulated one-time money under the Geymann Rule is only $50.5 million this year. However, outside this definition, the amount in this year's budget that is not recurring and will need to find replacement financing is almost $1.2 billion, according to the Legislative Fiscal Office.

4: The federal excise tax per gallon on retail gasoline is 18.4 cents and on diesel is 24.4 cents.

5: The Constitution does allow the Legislature under certain conditions to pass a resolution reducing the MFP.

6: TOPS is available in several forms. To qualify for the minimum award covering just tuition, students graduating high school must earn at least a 2.5 GPA in required core courses and a state average ACT score, which currently is 20.

7: The Southern Regional Education board maintains data on college indicators. From 2007-08 to 2011-12 (the most recent SREB figures), Louisiana was the only state among the SREB's 16-state region that showed a decline in higher education jobs.

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