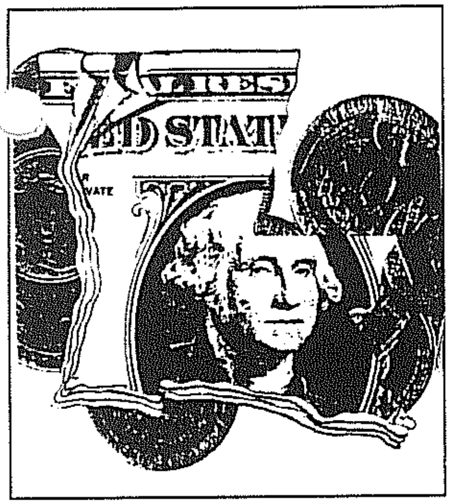

Report No. 3 August 1992

Loui$iana Fi$cal Focu$

Public Affairs Research Council of La., Inc.

1992 Constitutional Convention PAR Recommendations

Due to the state's tax instability, Louisiana has been riding a fiscal roller coaster for the past two decades. The effects of fluctuating oil prices, national recessions, declining mineral production, demands for new and improved government services, and tax exemptions and credits for various types of taxpayers have stressed the state's fiscal structure.

Significant tax changes have been enacted almost every year. A stable tax structure is essential to provide continuity in state services and encourage economic development. Tax certainty is almost as important as tax burden for many businesses.

The upcoming constitutional convention should be viewed as an opportunity to reform structurally the spending and taxing sides of government. The convention should act as a revenue-neutral vehicle to bring meaningful reform to the state's tax system. Tax changes proposed by the convention should not be self-implementing, but instead should require additional action by the Legislature or a local governing body and voters.

Not all of the desirable components of fiscal reform can nor should be addressed entirely in the constitution. Many of the needed changes and detailed procedures must be provided by statute.

As much as possible, the constitution should be a basic framework with implementation detail left to legislation. However, constitutional changes are needed to clear the way for legislative action in many cases.

PAR has several general recommendations regarding the course of action that should be followed by the convention. These recommendations are outlined below. The remainder of this report outlines more specific recommendations on government spending and taxes .

General Recommendations

1. Convention proposals on tax issues should be limited to structural changes of state and local tax provisions.
2. Convention proposals should emphasize structural changes on the spending side of government.
3. Any state tax increases should require a two-thirds vote of both houses of the Louisiana Legislature; there should be no self-implementing increases as a result of the convention.
4. Any new local taxes should require a vote of the taxpayers prior to levy.
5. Expenditure proposals should be submitted to the voters as separate items.

Expenditure Reform

Any expenditure reforms should attempt to meet the following objectives.

1. To provide meaningful limits on the growth of government spending.

2. To reduce the debt of state government.

3. To require that operational expenses be funded with recurring revenues.

4. To eliminate loopholes used to circumvent constitutional requirements.

5. To adopt a framework that prevents the postponement of obligations to future generations.

6. To adopt budget procedures that require adequate planning, review and controls.

PAR Recommendations

1. The existing constitutional provision that attempts to limit the growth of government should be strengthened and clarified.

a. The limit should be based on all money deposited in the state treasury except for federal funds. This would include all taxes, fees, self-generated revenues and dedicated funds.

b. The actual 1991-92 appropriations from these sources should be specifically stated as the basis of the official 1991-92 expenditure limit.

c. The expenditure limit should be automatically adjusted, up or down, for any programs that are transferred between the state, local government, private sector, special district and/or any quasi-state agency.

d. A three-fourths vote of both houses of the Legislature should be required to exceed the expenditure limit.

e. The required three-fourths vote to exceed the expenditure limit should be by specific legislative instrument that clearly states the intent to exceed.

f. The official spending limit for the following year should be adopted prior to each regular legislative session.

g. If a three-fourths vote is obtained to exceed the limit, the new limit should be the appropriation for that year.

Louisiana voters in 1990 approved a constitutional amendment intended to limit the growth of state government spending. Under the amendment, the growth in appropriations from state general funds and dedicated funds cannot exceed a factor related to the growth of Louisiana personal income,unless two thirds of the members of the House and Senate vote to exceed it. The growth factor for fiscal 1992-93 should have been 5.9%. However, confusion over definitions has made the limit virtually inoperable.

Meeting the original intent of the limit to restrict the growth of tax-supported spending will be possible by clarifying the provisions of the limit. A limit tied to the growth in Louisiana personal income--a measure of the ability of citizens to pay for government--is a legitimate expectation of the state's citizens.

The Legislature still could, by an extraordinary vote of three fourths, exceed the limit if circumstances demanded it.

2. The use of nonrecurring funds including, but not limited to, any state general fund surplus, settlements and special fund reserves for operational expenses should be prohibited. Such funds should be used to finance the state's capital outlay program.

The state consistently has used nonrecurring funds to finance recurring expenses over the last decade. These are used to continue and/or expand programs until new taxes are raised in a crisis atmosphere. In the 1992-93 fiscal year, over $500 million in these one-time funds are being used, thus creating a built-in deficit for next year. The proposed change would not only prevent such situations, but also provide cash funds for capital outlay.

3. The maximum amount of state tax-supported debt issued in 1993-94 should not exceed 90% of the amount of such debt retired in that year. The maximum issued in 1994-95 should not exceed 85% of the amount retired in that year. The percentage to be issued should be reduced by 5% each year until 50% is issued in 2001-02. The only exception should be in the case of a natural disaster; in such an instance, the Legislature should be able to authorize, by a two-thirds vote of each house, the necessary bonds to deal with the specific problem.

State debt service currently accounts for over 7% of annual state government expenditures, a higher percentage than that spent on many state programs. Not only is debt service a large proportion of state expenditures, but the dollar amount of general obligation debt service alone increased 166% between 1981-82 and 1991-92, from $210.9 million to $560.2 million. During the same time period, general state government expenditures increased by 35%. This has had the obvious effect of keeping the level of total state expenditures high but reducing the amount available for other state operating expenses.

To effectively reduce annual debt service costs, the amount of debt issued must be reduced and the state slowly weaned from its reliance on debt to finance capital outlay. PAR's recommendation should accomplish this by ensuring that less is issued than is retired each year.

4. The capital outlay process should be strengthened.

a. Every capital outlay project should be required to undergo an evaluation through a feasibility study prior to inclusion in the budget. The feasibility study should include an analysis of need and estimates of construction and operating costs.

The capital budget law allows projects to be placed in or added to the budget as long as the bill specifically states that the project is excluded from the requirements for a feasibility study. Although this exception has been rationalized as necessary for emergencies, it has been used instead as a way to "load the budget" during the legislative session with nonemergency projects.

No projects should be included in the budget which have not been evaluated. Emergencies should be the easiest projects to justify and should not be excluded from the evaluation requirements which can be done in a timely manner.

b. A more objective system should be required for setting priorities by which nonhighway construction projects are included and recommended for funding in the capital budget. Based on this system, projects to be funded in the first year should be ranked across departments by the Division of Administration.

The capital budget currently ranks requests by agency and by department only. This can result in "something for everyone," but no clear plan for the state as a whole.

The governor should be required to propose a capital budget which ranks capital requests across departments and explains the rankings. Priorities can be determined according to the reasons for the project such as safety, legal compliance, protection of existing facilities or increased demand. The state already has a priority system for highway and flood control construction.

c. A specified amount or percent should be allocated annually for building maintenance.

Funds for preventive maintenance often are an easy item to cut from a budget. However, the long-term effect can be much higher costs when the lack of maintenance results in higher repair costs, or even replacement.

5. The state should be prohibited from creating a political subdivision with authority to levy a tax or expend public funds for any purpose denied to the state by the constitution, unless such authority is otherwise specifically provided in the constitution.

The constitution does not allow the state Legislature to issue long-term debt to pay operating expenses [Article VII, Section 6 (A)]. In 1988, the state created the Louisiana Recovery District, with sales tax authority, to levy bonds to pay off the accumulated state operating deficit of the three prior years. The state Supreme Court ruled that bonds of the district, not part of state government, were legal. The state should not be allowed to thus subvert the prohibition on long-term borrowing to pay current expenses.

6. The expenditure of revenues received from lotteries and other gaming activities should be prohibited until the fiscal year following the calendar year in which they are received.

The 1992-93 state operating budget uses the estimated lottery receipts for calendar 1992 in the last half of fiscal 1992-93. This technically may meet the constitutional requirement that lottery funds not be appropriated for expenditure in the same calendar year in which they are received. The constitutional provision authorizing the lottery attempted to ensure that lottery funds would not be appropriated until they were safely in hand. As envisioned, the funds collected in calendar 1991 would be appropriated for use in fiscal 1992-93 and so on. The proposed change is designed to bring the lottery provisions in line with the original intent.

7. Higher education should be accorded budget stability equivalent to that received by K-12 education.

Higher education remains in the 30% portion of the state budget vulnerable to budget cuts. The Board of Regents has devised a higher education formula, but funding is far below the formula goal of the southern-state average. The Legislature has discretion in funding it.

Tax Reform

In proposing tax reform, the following objectives should be met.

1. To provide a stable tax structure.

2. To provide an equitable tax structure for individuals and business.

3. To encourage economic development.

4. To emphasize taxes deductible for federal tax purposes and to de-emphasize those that are not.

5. To provide local flexibility by increasing access to tax capacity and expanding the base of existing taxes where possible.

6. To strengthen local education revenue tax base.

PAR Recommendations

1. The present constitutional authority for a 5.75-mill state property tax should be retained, but the homestead exemption removed from any such levy. Revenues received from any such levy should be used only for property tax administration and distribution to local governments.

A 5.75-mill state tax would raise about $64 million; removing the homestead exemption would increase this to about $88 million. If the Legislature chooses to levy all or a portion of this tax, the revenues should be used first for property tax administration (Tax Commission operations, training of assessors and equipment upgrades), and secondly, to provide local assistance either as an addition to general revenue sharing or a formula distribution to general purpose governments (parishes and municipalities). The property tax should not be used as a direct revenue source for state government programs except to provide for property tax administration and local aid.

2. Annual reappraisal of all property should be required. The constitutional provision for automatic millage adjustment should be maintained.

The constitution presently requires that property be reappraised at least every four years. Under present statutes, assessors reappraise real estate every four years and personal property (e.g. inventory) every year. Public service property is reappraised annually. At each quadrennial reappraisal, millages are automatically rolled forward or back to assure that tax revenues are not increased or decreased due to the reappraisal. Article VII, Section 23 (C) allows local governing bodies to adjust those millages up to the prior-year level by two-thirds vote after a public hearing.

Annual reappraisal would eliminate the inequity in assessments between types of property and would permit local governments to benefit annually from any increases in property values. Annual reassessment does not require physical reappraisal. It can be done largely by use of computer programs and tracking of sales.

3. The homestead exemption for new or renewed millages should be reduced to $2,500 ($25,000). The $7,500 ($75,000) exemption should be retained for elderly homeowners. A circuit breaker for low income individuals should be allowed.

The homestead exemption originated in the Great Depression to help farmers and homeowners avoid losing their property to tax sales. Today, the $7,500 exemption (which covers a home worth $75,000) shields homeowners from paying their share of the cost of local services which directly affect them and the value of their property. The homestead exemption removes 36% of the assessed value from the tax rolls and fully covers 81% of all homes in the state. Reduction of the exemption would result in additional tax revenues if millage rates were not reduced also; or, reduction would permit a substantial reduction in millages. Currently, taxing jurisdictions in predominantly residential areas have little taxable base and require large millages to raise required revenues from nonexempt properties.

Reducing the exemption for future millages would allow the tax base for local governments to grow over time. The growth in revenues and taxpayer impact would be felt gradually. For example, if a 5-mill property tax were renewed with the homestead exemption on it reduced to $2,500, the additional tax for a home assessed at $7,500 ($75,000) or more would be $25 a year.

4. Parishes and municipalities should be given authority to impose a tax on individual income, with local voter approval, as provided by law enacted by two-thirds vote of the elected members of each house of the Legislature. Such a tax should be levied as a percentage of the state individual income tax liability and administered by the state. A cap should be specified.

Local governments are constitutionally prohibited from imposing taxes on severance, income, inheritance or motor fuel. One of these potential revenue bases--income--is an increasingly important local revenue source authorized in over a dozen states.

If the proposed local income tax authority were enacted and imposed statewide at a rate of 5% of tax liability, total collections would be about $42 million. If the property tax base is not expanded, a local piggyback on the state income tax would provide an alternative which would allow homeowners to tax themselves to pay for services. An income tax is a fair tax from the standpoint of ability to pay. By basing the local tax on state tax liability, low income individuals who do not pay state income tax also would not pay a local income tax.

5. The homestead exemption on municipal millage in Orleans Parish should be removed.

The homestead exemption is not applicable to millages in other municipalities and New Orleans should be treated the same.

6. The constitutional restrictions providing that state income tax rates shall never exceed the rates established in the 1974 statutes and requiring that federal income taxes be allowed as a deductible item should be removed. There should be a cap of 6%.

Removing these restrictions will give the Legislature more flexibility in utilizing the state income tax. The rates still could remain the same as currently and federal deductibility retained. However, such detail should be in the statutes rather than the state constitution and subject to the Legislature's authority to tax.

7. The inventory tax credit program already enacted by statute should be placed in the constitution.

This is an economic development initiative which should be protected.