Fiscal Crossroads

2021 Legislative Session could lead state to success or disappointment

If money talks, the Louisiana Legislature's 2021 session may be the most loquacious ever. Rising state revenue combined with eye-blinking billions of federal stimulus dollars – plus major tax reform proposals – will drive decisions impacting the state and its citizens for many years to come. This could go well. Or not.

Added to that are a host of bills sure to catch the public's attention, including proposals to expand the state supreme court, legalize marijuana, decriminalize and protect sex workers, loosen concealed-carry laws, legislate sexual harassment issues, promote mandatory kindergarten, return to closed primary elections, shed light on river pilot operations and move a casino across state. Sowed throughout are enough seeds for a bumper crop of constitutional amendments. It should be an entertaining 60 days.

In this commentary, the Public Affairs Research Council of Louisiana (PAR) highlights the major tax and spending initiatives of this "fiscal session," an odd-year occurrence that focuses on revenues but allows a limited number of bills of unlimited subject matter. Lawmakers may need a special session to deal with appropriations arising from the federal stimulus because of the large sums and multi-year time span involved, as well as the need to clarify what types of spending will be allowed. But first, let's talk about tax reform

Sales Tax Collection Streamlining

PAR supports a centralized sales tax system with a governance body that is appropriately accountable to taxpayers.

A major initiative calls for a central taxing authority for state and local collections, which is the way it's done in other states. This reform does not attempt to achieve uniform base and rates between the various jurisdictions, but it would be a great leap forward if successful. And it would create a much better environment for business. The House Speaker is herding the various state, local and business players to agree to simpler collection methods and rules-making for Louisiana's wildly disparate sales tax collection system that is questionably legal under the U.S. Constitution. A state constitutional amendment is required to achieve effective results. With a seat on the multi-stakeholder task force initiating this effort last year, *PAR supports a centralized sales tax system with a governance body that is appropriately accountable to taxpayers and state and local governments.*

Income Tax Reform

PAR's shelves are groaning under the weight of the vast number of tax reform studies recommending that Louisiana eliminate the state income tax deduction for federal taxes paid along with corresponding lower income tax rates. Excess itemized deductions also could be part of the equation. This move would decouple Washington's revolving up and down tax policies from Louisiana's revenue outlook, creating more reliable revenue forecasts and less fluctuation in taxpayers' liability from year to year. It would also allow the state to lower its relatively high income tax rates while conserving similar levels of revenue. Louisiana has the second highest upper rate for individual income tax in the Southeast, where three states have no income tax. The change will require a constitutional amendment that could be applied to individual and corporate income taxes. *This reform is long overdue.*

The Franchise Tax

A disincentive to investment and business development, the franchise tax is probably the most toxic tax type in Louisiana's rogues' gallery of bad tax structures. It aims at retained earnings and paid-in capital rather than profits. Most other states have long since shed this antiquated tax or are phasing it out, including neighbor Mississippi. Those hanging on to it are charging only a small amount compared to Louisiana, whose franchise tax liability in some years exceeds $400 million. No constitutional amendment is required to change the franchise tax directly. *PAR supports a phase out or a conversion to a type of minimum tax and has suggested a number of potential revenue offsets.*

PAR also has recommended raising the floor of the taxable base of the franchise tax. This would have the effect of releasing tens of thousands of companies from being subject to this complicated and litigious tax while reducing state revenue by a very modest amount. This latter reform was implemented temporarily last year and should be reinstituted this year permanently and in a way that assures constitutional compliance.

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The Inventory Tax

A significant proposal is in the works for phasing out the inventory tax on business property, a local tax that in many cases is reimbursed by state payments or credits to the companies that pay it. The broadest reforms require a constitutional amendment. Solutions are challenging and we will be monitoring the latest proposals. *PAR supports efforts to lessen the negative impacts of the inventory tax, which few other states allow.*

Constitutional Amendments

If the Legislature passes any constitutional amendments, those proposals must go to a statewide vote of the people for final approval. The question has arisen about when these would be placed on a ballot. There is no regularly scheduled statewide election in 2021. The nearest likely date is October 9, 2021, which is the date for New Orleans and other municipal and parochial elections. The current cost of that election to the state is about $4 million. If that date were expanded to become a statewide election with constitutional amendments, the total cost of the election would be about $6 million. The $2 million extra cost is a topic of discussion at the Capitol.

The next most likely date would be November 8, 2022, which is already a statewide election date for seats in Congress. Some legislators don't want to wait until late 2022 to move their proposals forward but also don't want the criticism for the extra cost of the 2021 date. This may be like watching Antarctic penguins to see which bill jumps in the water first.

The Governor's Agenda

Released only four days before the session, Gov. Edwards' 2021 legislative agenda is focused mainly on managing the various financial and political situations the state confronts. Several sexual harassment bills are in the works. He offers nothing on tax reform, although in recent weeks he has signaled his tolerance of a revenue-neutral income tax rate reduction by way of repealing the federal tax deduction.

As usual, his priority is on higher pay for public employees, including teachers, school staff and corrections workers. This year the pay raises extend to higher education. There's a boost for college student Go Grants. Early childhood education funding, a key stated objective for the Governor's second term, has a second-class seat in his session budgetary plan. However, much federal stimulus money appears available for this purpose. The challenge will be to move forward on early childhood care and education in a sustainable way after the federal money runs out.

The Governor's full agenda contains a number of proposals that would affect ordinary people, including bills for mandatory kindergarten and workplace accommodations for pregnant women and postpartum workers. He is backing a bill that prohibits employers from retaliating against employees who discuss or disclose their compensation or from requesting an applicant's salary history as a condition of employment. That's a measure some businesses will not like, some will not care, and many employees would favor.

The Fortuitous Budget

The current fiscal year budget that started July 1 has benefited from federal pandemic stimulus money approved in 2020. Last year's CARES Act contributed $522 million to the state budget. The federal government also increased its Medicaid match rate, which freed up $309 million that the state was able to spend on other things. Add $90 million tapped from the Rainy Day Fund, and this year's state budget was propped with $921 million in special windfalls.

That might have left us way short of revenue for the next fiscal year budget, but the gifts just keep on coming. The federal government extended its increase in the Medicaid reimbursement rate, which will free up $608 million of state money. The post-pandemic economy is expected to rebound and contribute $406 million more in state revenue, and that forecast might go up again before the session is over. There is also $113 million extra in the lottery fund after the state placed some excess revenue there as a sort of unofficial, makeshift Rainy Day Fund.

The American Rescue Plan

All of that doesn't account for the $1.9 trillion American Rescue Plan, passed by Congress in March with even more largesse for the states. The money can be spent between now and the end of 2024. Louisiana state government will get $3.4 billion and its local governments will get about $1.9 billion. More than $700 million is going to childcare facilities. K-12 education will receive $2.6 billion, much of it going to the school districts (on top of the $2 billion already from last year's stimulus). Higher education in Louisiana is slated for $600 million, with $243 million of that going directly to students. ($1.1 billion total to higher education and college students counting all the aid in the past year.)

But there's more still. Several programs aimed at individuals and businesses will stimulate consumer spending and the economy, which could stimulate higher tax revenue. Qualified individuals can receive up to an additional $1,400 stimulus payment. The Child Tax Credit and Earned Income Tax Credit are both temporarily increased. Federal increases to unemployment assistance are extended to September. Business owners get a boost with more money in the Paycheck Protection Program along with expanded programs for specific industries like agriculture, airlines and restaurants.

Spending the Windfall

State and local governments will have broad discretion on how they can spend the direct stimulus money. They can use the funds to respond to the impacts of COVID, for the provision of services impacted by a reduction in revenue, infrastructure improvements for water, sewer or broadband or premium pay for essential workers. The funds cannot be used to finance a tax reduction or deposited into a pension fund. All funds must be spent by the end of 2024.

These additional funds can be a boon to Louisiana, but they could also put the state in the situation of profligate lottery winners who outspend their means. If these federal funds are put into recurring operational expenses, an enormous shortfall would occur when they run out. The Governor and legislative leaders have acknowledged this problem and have pledged to avoid it. *PAR's guidance is to spend the money in a way that is sustainable and that gets the best return on investments.*

The state should lay out its plan in plain language for the public to see, noting the various sources of funds along with their allowed uses. Then the plan should explain how Louisiana will spend the money and what the expected outcomes would be. For example, if some portion is used for expanding broadband access, the goals and number of households reached with greater connectivity should be stated.

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Public Information and Confidence

The state should provide a web portal that updates citizens on what is being spent and how the goals of the plan are being met. This should include spending figures and narrative reports. If the plan needs to change due to unforeseen circumstances, that should be done through a transparent process with changes reflected on the website.

Legislators already are considering a separate special session this summer to deal with the complexity of the federal legislation and the long-term spending plans. This is a good thing.

All of these efforts for greater public interface and confidence could be enhanced by standing up a new recovery commission, building upon last year's Resilient Louisiana Commission launched by the Governor and the separate commission run by the Legislature. This temporary commission could collect and disseminate information regarding Louisiana's recovery as well as monitor progress toward achieving the plan. They could take testimony from citizens and stakeholder groups as well as state agencies and local governments. While spending and policy decisions would be left to elected officials, this group could bring attention to how effectively billions of one-time dollars will be applied in Louisiana on both the state and local levels.

Potential Destinations for the Extra Money

Everyone is asking, where should all those dollars flow? There is already a general consensus that the funds should be treated as temporary and not used to overinflate ongoing expenses. Several worthy uses of the short-term dollars might be:

- **Early Childhood Education Fund.** This fund provides matching state dollars for local expenditures on early childhood education. Putting money into this fund will provide an incentive for locals to pick up some of the cost of providing this service to qualified families. While the fund receives a small amount of dedicated revenue, it is far short of its goals and needs.
- **State unemployment trust fund.** In strong financial shape before the pandemic, the unemployment fund ran dry and had to be supplemented with loans from the federal government. The Governor has already indicated this would be a priority.
- **Infrastructure.** Funds can clearly be used for water, sewer and broadband projects. It is possible though not yet clear if they can be used for other traditional infrastructure projects like roads and bridges and state buildings.

- **Technology upgrades.** The state has identified 157 legacy technology and software systems that are at risk to failure, with a total replacement cost of about $1 billion. We can see the impact of failing to upgrade outdated software by looking at how overwhelmed the Louisiana Workforce Commission's system became during the surge of unemployment during COVID.
- **Coastal restoration.** Dollars spent on coastal restoration can have long term benefits with risk reduction in damage due to flooding and hurricanes, and some projects boost jobs.
- **Education endowments.** While it would be a mistake to temporarily inflate college budgets with short-term money, there might be other opportunities to improve their financial position.
- **Rainy Day Fund**. This is an appropriate use. The state's fund is well below its upper limit.
- **More realistic retirement assumptions.** American Rescue Plan dollars cannot be deposited directly into public pension funds. However, an alternative could be to move the state retirement systems to more conservative assumptions about the long-term impact of their investment earnings. The current assumptions are considered by many experts to be too high. Every year, through the budgets of state agencies, the government pays huge sums to maintain and to pay catch-up dollars to address the state's pension costs. Lowering the pensions' return-on-investment assumptions would have the effect of putting more money in the retirement systems' portfolio accounts, which would eventually reduce costs. State agencies would bear higher pension maintenance costs in the short term. But it would save money in the long run.
- **Revolving loan programs**. Programs such as the Drinking Water Revolving Loan Fund Program or the state's infrastructure bank could benefit from an infusion of capital. These programs are designed to help local governments with low-cost loans. While the Water Fund has been operating since 1997, the infrastructure bank was created but never found an initial source of funds.

Summary

This list of potential uses is not exhaustive. Rather it helps demonstrates the types of long-term thinking that should be used when determining how to spend these dollars. Will the money be used to put the state in a better position for the future, or set up unsustainable spending? Will it be spent on good returns on investment? Those are the key questions that should guide funding decisions.

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