PAR Commentary
6.26.17
The Public Affairs Research Council of Louisiana

2017 Legislative Wrap-Up

The sessions produced a solid budget but no fiscal reforms while leaving questions about the cliff, transportation and Medicaid

The 2017 regular legislative session and the lagniappe special session have come and gone. Has Louisiana made any progress? Was significant tax reform achieved? And is the state prepared for what lies ahead? The answers are yes, no and not really. The state budget is on a more stable footing than in recent years and its prison population could be reduced thanks to a bipartisan package of criminal justice bills. But tax reform remained on the sideline and the so-called "fiscal cliff" still looms large in the not-too-distant future. Here's what you need to know about what happened and how the state is positioned for the next stage of the fiscal battle.

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Fiscal stability

In recent years, PAR and other observers warned about the snow-balling effect of balancing the state operating budget with one-time money and borrowing. State spending increased well beyond the state tax base because of fund depletions, debt manipulation and financing techniques that used sources of money that would have to be paid back later or would be unavailable in subsequent years. This budget gimmickry grew to mammoth proportions and became a formula for fiscal instability, poorer credit ratings, soaring college tuition and eventually tax increases. In fact, all of those outcomes were achieved.

But this session's budget is definitely different. The Governor and the Legislature are riding a higher revenue stream because of increased cigarette and alcohol taxes, temporarily reduced tax credits and a short-term hike in the state sales tax from 4% to 5%. Plus, a number of the usual sales tax exemptions do not apply to that fifth "clean penny" of sales tax, generating even more revenue. As a result, the budget for the next fiscal year is nearly free of gimmicks and one-time sources of money. Although arguments are made that it has not been downsized enough while others are concerned about shortchanging public services, this budget is one of the more solid and transparent plans we have seen in a long while.

Sufficiency is also a characteristic of this budget. The Legislature did not cut higher education and had enough money to pay for things lawmakers typically want but often cannot afford. For example, the budget fully funds TOPS, provides for a new State Police cadet class, opens a juvenile justice center and grants a $17 million base pay increase for state employees. Although much attention was focused on the stalemate and differences between the conservative and liberal spending agendas, in the final negotiations the most intensive disagreement concerned probably less than 1 percent of overall state spending. Still, the role played by those who wish to restrain spending is a vital one if the state wants to maintain a sustainable budget without raising taxes above the current level.

The fiscal cliff

The fifth penny was intended as a temporary boost to give legislators a couple of years of fiscal respite to re-invent and improve the Louisiana tax system. The recent fiscal session was the prime opportunity, but the Legislature neither passed tax reform nor extended the fifth penny beyond its sunset date of June 30, 2018. Despite holding six sessions in 18 months, this Legislature still has not performed its core job of establishing a sustainable budget outlook for the long term. This inaction potentially exposes the state to further bond credit rating downgrades and higher debt costs.

With the fifth penny expiring in mid-2018, the revenue from annual state taxes will fall from approximately $9.44 billion to $8.37 billion. (See Table 1.) Those figures represent one interpretation of what is meant by the "fiscal cliff," a revenue drop of more than $1 billion.

Taking a step further, budget analysts also try to factor spending growth into the calculation of the fiscal cliff. The budget for fiscal year 2018, which begins July 1, calls for $9.44 billion in state general fund spending. The cost of providing the same level of state services in fiscal year 2019 is anticipated to cost $9.70 billion. This increase is due to a variety of factors that include retirement costs, healthcare inflation, mandated K-12 formula spending and employee pay and benefits. By this measure, the fiscal cliff – or budget gap – is closer to $1.3 billion. State tax and budget analysts are still counting the beans, and so re-evaluations of the cliff are expected in the coming months.

In the regular session, House leaders pursued a strategy of trying to hold spending to a nearly standstill level for the next two years. This strategy was intended to lessen the fiscal cliff and to make the job of tax reform or tax renewals easier. House leaders succeeded in postponing action on taxes but did not achieve the constraints on the spending budget they had sought initially. Had they succeeded with two years of a standstill budget, then in theory the cliff would have been about $770 million.

But the Legislature collectively has shown little appetite for cutting its way out of the fiscal cliff.

Table 1

Components of the Fiscal Cliff

The cliff is mostly a result of the sales tax dropping from 5% to 4% but also contains a spending element.

	Current Fiscal Year 2016-2017	Next Fiscal Year 2017-2018	Cliff Year 2018-2019	Comparison between Next Year and Cliff Year
TOTAL REVENUES	**$9.14 billion**	**$9.44 billion**	**$8.37 billion**	Revenue will decrease by **> $1 billion**
TOTAL EXPENDITURES	**$9.14 billion**	**$9.44 billion**	**$9.4 to $9.7 billion** depending on the level of service provided	The legislature will spend **$0 - $253 million** more depending if there is a standstill or continuation budget
PROJECTED BALANCE	**~$0**	**~$0**	**-$1 to -$1.3 billion**	Resulting in a budget gap of **$1- $1.3 billion**

Source: House Fiscal Division and PAR analysis. Fiscal years begin on July 1.

That would be no easy task because the budget is consumed with state debt, pension obligations, spending mandates and an overall legislative commitment to maintain funding to local schools and major healthcare programs. While spending restraint can lessen the task, the dominant solution, if there is one, will likely come from the revenue side. This situation would have occurred even under a standstill budget. The simplest and most oft cited solution would be to extend the clean fifth penny for another few years or make it permanent. Variations on this theme would be to clean some of the other pennies in the state sales tax by reducing sales tax exemptions or expanding the sales tax to purchases of certain types of services, as Texas does currently. Another source of revenue might be to revisit or reestablish a host of initiatives made in 2015 to curtail temporarily the amount of credits, rebates and exemptions that companies receive through various incentive programs.

Trust and Transportation

An effort to raise fuel taxes for state infrastructure did not obtain the two-thirds of support needed in the House to gain passage. A vote was never taken on the House floor. For such a measure to pass in the future, both the Legislature and the transportation department may need to engender more public trust in their actions. As part of that exercise in trying to build trust, the Legislature passed House Bill 598. This bill was designed as an agency transparency measure to instill confidence that revenue from a fuel tax increase would be spent in an accountable manner. It calls for numerous reporting requirements and procedures to better reveal the transportation department's process in aligning highway project priorities. But amendments to the bill went too far in allowing legislative actions that could trump and perhaps even deem irrelevant the state's Highway Priority Program. Pork projects could take precedence over consensus-driven safety measures. A legislative committee would be able essentially to disregard the extensive planning and public input process the transportation department uses to prioritize and select projects. The Priority Program is not free of problems and politics, but for decades it has improved the decision-making system and has placed a high value on community and public contributions to the process. The governor should veto House Bill 598 and sign an executive order adopting the best agency transparency measures contained in the bill.

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Tax credit changes

Legislators eliminated an income tax education credit that provided $25 per child. This feel-good tax credit served more of a political than a policy purpose, and eliminating it will save the state $12 million a year. The Legislature also placed sunsets on several other tax credit programs starting in 2020 that would represent $34 million in savings unless they are renewed. Chief among the sunset credits is one granted to homeowners paying an assessment to support the Louisiana Citizens Property Insurance Corp. PAR recommended elimination of these credits, although the preferred path was to use the savings as a way to assist a tax reform with a reduction in rates or an adjustment to income tax brackets.

The Legislature made major changes to the state's motion picture tax credit program with a bill by Sen. J.P. Morrell and a companion House bill by Rep. Ted James. The new law sets a "front end" cap, meaning that the state will hand out tax credits only up to $150 million per year for qualified production expenses. Once the tax credits are awarded, they can be redeemed either through income tax filings or cashed in directly with the state at a rate of 90% (or in reality an 88% rate when new fees are applied). The new law keeps the existing $180 million "back end" cap, which limits the amount of these credits that can be redeemed each year. With only a back-end cap, the state was accumulating a large debt of unredeemed credits, which was bad fiscal policy and bad economic incentive policy.

PAR has long criticized the motion picture credit program for its poor return on investment. However, assuming that the program would continue, PAR recommended several improvements. PAR recommended the front-end cap be set at a lower level than the back-end cap in order to work off the debt, and that is what the Legislature did. The new law also includes PAR's recommendation to lower the base credit rate from 30% to 25%, which will serve to leverage more investment and production within the credit cap. PAR recommended a lower cap per production, which also will be implemented. But the law allows a new credit structure that may be overly generous or even unnecessary for some productions.

Looking ahead, the Legislature should resist creating more tax credit programs that will create higher spending costs for the state while offering questionable returns on investment. In the recent session, the Senate was correct to derail a House bill that would have paid up to $90 million a year to start a dubious Louisiana Rural Jobs tax credit program. Legislators frequently complain about tax credit programs that swell and then strain the state budget and yet they continue to try to create new ones. Generally, tax credit programs shift the burden of who pays taxes and ultimately place pressure on the Legislature to raise taxes.

TOPS

The Taylor Opportunity Program for Students, known as TOPS, provides college tuition coverage for students who qualify for the scholarship. Prior to the 2016-17 academic year, TOPS awards always matched the tuition charged at the institutions. As tuition rose, so did TOPS awards. The state's cost to fund the TOPS program therefore increased over time. A budget crunch last year led the Legislature to curtail the TOPS coverage to 70% of total tuition for the 2016-17 academic year. But the new budget will fully fund TOPS by covering all tuition for the next academic year. For comparison, TOPS cost the state $117 million in fiscal 2008 compared to the nearly $300 million in the budget that just passed.

In the future, what will "fully funded" mean for TOPS? In an effort to maintain a strong program while controlling the rising cost of TOPS, the Legislature passed Senate Bill 71 by Sen. Jack Donahue. This new law is a modification and clarification of a similar law Donahue passed last year and which PAR has endorsed. It sets a target funding level for state support for TOPS at the level of full tuition charged by colleges in the 2016-17 academic year. Because the Legislature has not allowed colleges to raise tuition, this target amount will fully fund TOPS for the next academic year. If tuition increases in future years, students should be aware that the base-level commitment by the state is to provide tuition coverage at the level of 2016-17 funding. Under those circumstances, the full cost of higher tuition would not be covered for all students unless the Legislature agrees to finance TOPS above the new threshold. Meanwhile, the Legislature also passed a bill in the regular session allowing colleges to raise student fees, which are not covered by TOPS.

Criminal justice reform

In the midst of the rancor about taxes and the budget, the Legislature passed a bipartisan, comprehensive criminal justice reform package of 10 bills. The package aims at reducing the number prison inmates by focusing on nonviolent offenders. In addition to its social and workforce impacts, this effort is intended to create a savings as the cost of housing prisoners drops. Included in the package is House Bill 489 by Rep. Walt Leger that would require 70% of the savings to be reinvested into criminal justice reform efforts. The effect of these bills on the criminal justice system and the state budget may not be known for a few years. If savings materialize, the reform could serve as a lesson in how to use long-term solutions to tackle other large scale fiscal problems.

Medicaid expansion

Medicaid spending has an enormous impact on Louisiana's state budget. The state currently is operating under the Obamacare model, including Gov. John Bel Edwards' adoption last year of the Medicaid expansion for lower-income adults. The changes under debate in Congress could place the state under a new national model, in which the Medicaid expansion is revised or largely eliminated. Also, a large portion of the overall expenses for Medicaid could shift from the federal government to the states. If enacted, these changes might be phased in over several years, mitigating the immediate impacts on the state budget but necessitating a long-term financing plan. The major proportion of Medicaid expenses are for care of the elderly and those with disabilities, and so overall cuts in Medicaid could affect those populations as well as the children and low-income adults with Medicaid healthcare coverage.

If the adult Medicaid expansion in Louisiana continues, PAR has cautioned that the expense could become a heavy weight around the state's fiscal neck in the long term. Over the next three years the federal subsidy will shrink until 2020 when the state will have to pick up 10% of the expansion costs. To address this expense, the state has assessed a tax on hospitals. That tax assessment can be used to leverage more federal Medicaid dollars. The general hospitals of the state typically benefit from this mechanism and therefore have supported it.

The Louisiana Department of Health has stated that the assessment on hospitals is working to defray the costs of the Medicaid expansion and should continue to do so as long as the federal government does not revamp the program or lower the federal reimbursement rate. State health department officials have not yet made public the information on which they come to the conclusion that the expansion costs will be covered. Given the size and scope of Medicaid expansion and the potential changes under consideration in Congress, the public and all stakeholders deserve to see the numbers and assumptions the state is using. On an issue of this magnitude, it is important for the administration to "show their work."

Beyond the direct state fiscal impact of the Medicaid expansion is the potential effect on the private health insurance market. Some of those who join up with Medicaid as part of the expansion would have otherwise been on private employer-provided insurance. This shift from private insurance to public healthcare coverage is referred to as "crowd out." The level of crowd out in Louisiana is creating concerns among public and private stakeholders. The Louisiana Department of Health is taking steps to deal with this issue by restarting the Louisiana Health Insurance Premium Payment Program, or LaHIPP. Under this program the state will pay the employee share of employer-sponsored insurance when cost-effective to do so, if the insured person or a member of their family currently receives Medicaid. This initiative can reduce the cost to the state Medicaid program and help stabilize the private insurance market. This issue is another aspect of the expansion that will require close scrutiny as it unfolds over time. Of course, the biggest changes to the program could come from new federal legislation, if passed.

Constitutional amendments

Of the 50 constitutional amendment proposals filed in the fiscal session, three made it out of the Legislature and will go before voters statewide on October 14. PAR's *Guide to the Constitutional Amendments* will provide helpful information upon publication later this year.

- House Bill 145 by Rep. Ray Garofalo would establish a property tax exemption for the surviving spouse of a person who died while performing their duties as an emergency medical responder, technician, or paramedic.

- House Bill 354 by Rep. Major Thibaut would establish a "Construction Subfund" of the Transportation Trust Fund. Any revenue raised from future taxes would go into this fund, which could not be used for employee benefits or wages.
- Senate Bill 140 by Sen. Mike Walsworth would establish a property tax exemption for materials delivered to a construction site.

Summary

A great deal was left undone during the legislative session. Still, a solid budget is a welcome sight and has been a rarity lately, and the prison reform effort could have meaningful, lasting value. Tax reform fell far short of its potential. And unfortunately, the Legislature still has a $1 billion-plus problem left to handle. The fiscal cliff is staring us in the face and the state will have to deal with it head-on. As busy as our elected officials have been, they have a lot work left to do and a lot of politically difficult decisions to make.

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4664 Jamestown Ave., Suite 300, Baton Rouge, LA 70808.