Policy Brief
1.29.16
The Public Affairs Research Council of Louisiana

A PLAN TO CONTROL STATE SPENDING

PART I

Where we are and how we got here

The state's budget malady is the worst Louisiana has seen since the 1980s oil bust. The Legislature and new Gov. John Bel Edwards face an immediate, stupendous shortfall for the current year and even bigger ticket problems next year and in the long term. The governor is recommending major revenue increases to help solve the problem.

The Public Affairs Research Council of Louisiana recommends that the governor and the Legislature submit strong and specific assurances for budget cuts, controls and cost containments prior to approving tax increases. If additional revenues are to be extracted from business and individuals, then those taxpayers have a right to know what kind of government spending environment state leaders intend to promote. This point is particularly important because the tax debate in the special session comes before the budget process in the regular session.

The governor and the Legislature should submit strong and specific assurances for budget cuts, controls and cost containments prior to improving tax increases.

This report provides a specific list of budget controls and initiatives that, if followed, would reduce or hold down Louisiana government spending. The report also recommends a fiscal framework for figuring how to balance the budget as the Legislature and state leaders in the coming months debate various plans for revenue increases and spending cuts. In a forthcoming report, PAR will provide a citizens' guide to tax and revenue options.

Given more resources, will this new administration and Legislature spend wisely and judiciously on real state priorities, or fall into the same largesse and patterns of the past? Will every effort be made to control the state's major inflationary cost items, which include debt, pensions, employee benefits, pork projects and local government support as well as the usual budget focal points of education and health care?

By following the list of pledges in this PAR report, state leaders would demonstrate both a commitment and a strategy to control costs.

By February 13, the governor by law must present his executive budget draft for 2017. A day or so later, the Legislature will begin a special session to consider more than a billion dollars in new revenue proposals affecting the 2017 budget and beyond. A month later, the Legislature will engage in the actual budget crafting process. PAR's expectation is that the governor will assume no new taxes when he submits an executive budget reflecting deep cuts of up to $1.9 billion. The governor will then ask the Legislature to raise taxes to fill the gap or else live with the consequences of ravaged higher education and health care programs. If the past is any indication, this type of threatening situation usually works to get the Legislature to do what the governor wants.

The people of Louisiana deserve better. And besides, that strategy might not work so well this time around. By following the list of pledges in this PAR report, state leaders would demonstrate both a commitment and a strategy to control costs. These specific plans will help ensure the public that tax increases will not be used to allow unchecked government expansion or to distribute new revenue without accountability.

The state we're in

Aided by low oil prices, the previous Legislature and former Gov. Bobby Jindal produced a shortfall of more than a billion dollars for the current fiscal year, which thus far has been reduced to an estimated $750 million problem. The state faces about a $2 billion imbalance for fiscal 2017, which begins July 1. Leaders will be hard pressed to balance this and next years' budgets while also trying to build a foundation for long-term fiscal sustainability. Some of the long-term solutions for fiscal reform would not have near-term impacts on the budget.

The situation is serious, particularly considering the current economic outlook. A decline in state energy revenue is but one negative effect of lower oil and gas prices, which also are leading to job losses and an industry downturn and with no sure recovery in sight. At the same time, low energy prices are a benefit to many individuals and businesses in Louisiana. But in the context of the state budget, the net effect of low energy prices so far is a hole blown out of the state's financial forecast. Meanwhile, corporate and sales tax revenue collections are frustratingly below target. The long-anticipated surge in state revenue that many expected from successes in industrial recruitment does not appear to be robust enough to make up for the aggravating declines. One of the potential solutions to these state fiscal problems – higher taxes – could dampen future economic activity further.

Despite these problems, the state's overall recurring revenue has managed to inch up year to year since 2012.

The nation's credit rating firms have taken notice. Moody's started sounding the alarm about Louisiana's "growing structural budget imbalance" a year ago. Fitch criticized the state's November budget adjustments as "largely stop-gap measures" that "will not address the state's persistent budget challenges." The rating firms have warned that they are looking for strong leadership to develop a consensus in Louisiana to bring recurring revenues and expenses into a more stable alignment to pay for government operations. After 13 years of credit rating improvements, Louisiana is on the verge of a costly downgrade.

In larger amounts each legislative session, Louisiana budget crafters have borrowed and utilized financial resources that were not available to them in subsequent years. As a PAR commentary said in April 2015, the state's executive budget "would very likely still leave the state short by hundreds of millions of dollars. The result could be a mixture of mid-year budget cuts, cash flow problems and a year-end deficit. The governor [Jindal] will be in office only until January 2016, and so the real impact of these shortcomings will fall upon the next governor and legislators elected this fall." That was not fortune-telling. It was simply the logical outcome of the state's actions.

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This report briefly reviews the main reasons for this situation and recommends that the administration make commitments to control spending. Tax increases should be a last resort, and then only in amounts sufficient and justified to meet the state's necessary priorities. Long-term tax reform and budget stability should be key considerations.

Factors affecting the state fiscal imbalance

The state's finances were riding high in the post-Katrina years as a result of increased income taxes, residential and business recovery spending, federal aid and insurance coverage. Louisiana's general

fund, which is fed by state revenues, reached a peak in 2008 of $10.4 billion, a record that still stands. Tax cuts under Gov. Blanco in 2007 and Gov. Jindal in 2008 for individuals and businesses amount to about a $1 billion difference in annual state revenue today, although it should be noted that much of that taxpayer savings was circulated back into the economy.

The national recession was delayed in hitting Louisiana but eventually took its toll, eased temporarily by the federal bailout of the states. Tax credit programs – many in the form of state cash payments to recipients -- grew substantially during these years. Corporate income tax revenue that soared above $1 billion in the post-Katrina rush have fallen to a third that amount. Just recently, oil and gas revenue has declined by more than $400 million and has led to private sector layoffs and falling business profits.

Despite these problems, the state's overall recurring revenue managed to inch up each year after 2012 until hitting a slump in 2016. The general fund is projected at $8.2 billion for fiscal 2017, which would be down 2% from collections in fiscal 2015.

On the spending side, the federal matching rate for Medicaid money in Louisiana was revised downward after Hurricane Katrina, eventually costing the state approximately a billion more dollars per year. Louisiana dropped from near the top of the list to 23rd among states for its basic federal Medicaid match rate, known as the FMAP. States such as North Carolina and Georgia, normally considered among the wealthier states in the South, have a higher federal match rate than Louisiana. Meanwhile, Medicaid enrollment and expenses grew. From fiscal 2008 to 2016, the state's share of the Medicaid budget nearly doubled to $2.9 billion while the federal amount grew only slightly.

Now the task before us is to balance the budget realistically, fully and durably, for this year and beyond.

Budget practices added to the imbalance over time. Trust fund depletions, debt defeasance maneuvers and four tax amnesty programs were examples of ways the state borrowed from the future and spent money from sources that were not available in subsequent years. The Legislature counted on certain efficiency measures being implemented by agencies to save money but the savings in some cases appeared to be only on paper. The previous administration and the Legislature also passed budgets that chronically underfunded the true expenses of Medicaid, TOPS college scholarships and the state's K-12 funding program. As a result, mid-year budget shortfalls became a regular occurrence.

If the state budget were likened to a sinking ship, then a lot of stuff already has been thrown overboard. Government cuts and consolidations were a part of the Jindal administration's handling of fiscal matters. Thousands of state positions were eliminated and thousands more jobs were privatized, mostly notably during the state Charity hospital privatizations. In some cases the ultimate savings are still in question. Several state agencies took significant cuts in state general fund spending over time and some others, such as the corrections department, saw no budget growth.

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The most dramatic cuts in direct state support were aimed at higher education, which made up most of the lost ground with tuition hikes, new fees and increased enrollments. Health care and the judicial branch had significant budget increases. Meanwhile, the state's annual expenses for the public pensions and the government employee Group Health insurance program increased.

The cigarette tax was raised in the 2015 session and several "fees" were implemented that were essentially taxes flowing new revenue into the state general fund. A number of business tax credits and exemptions have been trimmed or capped temporarily, but these changes so far have brought less revenue than projected and much of the money can be recovered by companies in later years.

All the above factors have figured into the current budget circumstance. Post-Katrina overconfidence, rising mandatory spending obligations, lower federal health care matches and snowballing budget malpractices created gaps in funding that were not sufficiently offset by Jindal's economic drive, agency cuts and eventual tax increases. Now the task before us is to balance the budget realistically, fully and durably, for this year and beyond.

Next steps

The governor should take two initial steps to deal with the current situation:

1) He should provide a **fiscal framework** of how he expects the various budget and revenue measures will result in a sustainable balanced budget for fiscal 2017 and beyond. Sure, the governor's first executive budget is likely to look like he's got no plan except raising revenue. But he and the Legislature should begin developing a realistic plan with a fiscal framework solution. The governor can do better than past executive budgets by establishing an enduring outlook rather than a temporary patchwork or a scare tactic.

2) He should **pledge** to a list of specific assurances for cutting, controlling and containing expenditures and he should ask the Legislature to join him in this pledge. This PAR report provides a specific outline for these steps. Other useful variations of these plans could be conceived.

PART II

Framework for a balanced budget

PAR recommends the governor identify the key categories for righting the revenue imbalance and propose goals for reaching the fiscal targets for each one. Even if he does not begin the negotiation this way, some type of fiscal framework balancing chart will be needed eventually.

Some revenue and spending measures, especially tax reforms, may take more than a year to be fully felt in the annual budget cycle. In those cases, if the long-term problem clearly is being fixed but the solution needs time to phase in, then a one-year stopgap measure to balance the budget would be permissible.

Here is a simplified example of a fiscal framework that offers one possible illustration of how the governor might categorize the solutions and propose to close a continuation budget gap of $1.9 billion. The specific numbers presumably would change and rebalance throughout the two upcoming legislative sessions as solutions are adopted or rejected.

Curing the Budget Imbalance
Simplified example of a fiscal framework

Cuts in continuation budget	**$600 million**
Freed dedications	**$150 million**
Limited use of one-time money	**$100 million**
Reduced tax credits	**$150 million**
Reduced sales tax exemptions	**$100 million**
Reduced individual subsidies and deductions	**$100 million**
New or increased tax programs	**$700 million**
Total	**$1,900 million**

Each of these categories presents options for short- and long-term impacts:

Continuation budget cuts. When people talk about a shortfall of $1.9 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 Medicaid. This government spending projection,

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which is known as a continuation budget, is a planning tool and not a mandatory target. The proposed list of budget cost controls is provided in the last section of this report.

Typically, executive budgets in the past have simply nullified some inflationary costs to achieve a balanced budget proposal, at least on paper. This practice can backfire. If the governor and Legislature actually intend to meet certain inflationary cost obligations -- such as matching Medicaid enrollments, fulfilling their TOPS pledge or providing full formula funding to the district school systems – then those costs should be included in the proposed and actual budgets. Otherwise, the state will simply fall short of funds during the next fiscal year, which has happened repeatedly in the recent past.

Freed dedications. Large portions of state revenue are locked up in various statutory and constitutionally protected dedications and therefore limit policymakers' options when setting budget priorities. Policymakers and the public should manage their expectations of how much budget flexibility and savings can be achieved by freeing up or cutting dedications. Some funds already are used to support state operations or to pay debt for bonded projects, and others are limited by state or federal regulations. Lawmakers for years have raided money from statutorily dedicated funds and then laundered them for use in the state operating budget, so the basic idea of using these funds is not new.

Still, some portion of the many dedicated funds could be eliminated or released from their restrictions, with the money freed for use in the operating budget. All statutory funds should be sunset and renewed only after legislative scrutiny. Funds with an overlapping purpose should be consolidated, a type of initiative that has been demonstrated by the Department of Agriculture. A small percentage of the revenue that goes into the dedicated funds could be tapped by the general fund to cover state overhead costs for administration and review. Or, interest earnings from the dedications could flow into the general fund.

Limited and responsible use of one-time money. Use of one-time money, especially when used to offset special one-time expenses, can be fiscally sustainable if implemented in a very limited and responsible manner. Unfortunately this practice has been abused in the past. This type of spending could be a bridge in 2017 if other long-term fiscal measures are firmly underway.

Reduced tax credits and sales tax exemptions. The House and Senate tax committees should work with the Legislative Fiscal Office and the governor to take on the task of reaching a dollar level goal in state savings on tax credits and sales tax exemptions. For sales tax exemptions, the aim is to spread the impact and cut those that fail to serve an important state purpose. As the Revenue Study Commission three years ago found out, most sales tax exemptions have a vocal constituency, but a few do not. This approach would be a better alternative to the current administration proposal to deeply gouge a single type of sales tax exemption while doing nothing to clean up the mess of exemptions that have accumulated over the years. Cutting sales tax exemptions is hard work but this is the type of work all the candidates for governor pledged to do.

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Reduced individual subsidies and deductions. The Legislature granted several expensive gifts to individuals during the post-Katrina heyday budgets, such as the reimbursement for the Citizens insurance assessment, the private school tuition deduction and the $25 tax credit for being the parent of a student. They represent either gratuitous state expenditures or bad tax policy and they should be eliminated.

New or increased tax rates or programs. Only after the above goals have been determined should the

state seek to raise tax rates or start new taxing methods. The aim should be to close only the remaining gap in establishing a sustainable budget, and that gap ought to be thoroughly justified.

PART III

A pledge to control the budget

Government will grow as big as we let it. As the governor asks the Legislature to raise taxes, he should provide specific assurances of his plans to cut and contain costs in the state budget. The Legislature, too, should support such a plan, mindful of the budget work ahead during the regular session.

Plenty of constituencies inside and outside government – some with legitimate needs -- are yearning to see more money spent on a host of state-financed programs. But this is the time to establish a sustainable budget and meet the state's essential purposes, not to expand programs and spending obligations.

PAR recommends here a list of pledges that state leaders should make to demonstrate both a commitment and a strategy to control costs and to ensure the public that tax increases will not be used simply to allow unchecked government expansion or to distribute new revenue without accountability. Some of these recommendations are designed to prevent short-term gain-taking that would cost the state more in the long term. Perhaps the governor would want to construct a list of his own.

A list of cost controls & budget practices

The governor should work to improve the fiscal situation by pledging to support a number of specific and general goals. He should call upon the Legislature to join him in pursuing these cost controls. He should begin by addressing the major high-priority costs for the state that are nearly automatic inflation factors: debt, pensions and Group Health benefits.

Debt

- Do not bust the state debt cap.
- Do not implement bond refinancing that takes the savings up front but costs more later. A recently proposed tobacco settlement refinancing would be an example of the wrong way to go.
- Do not borrow for building programs outside the capital outlay or debt limit process. Past loan programs for new buildings at community and technical colleges is an example of bad borrowing practice.

State retirement systems

- Maintain the current schedule of Unfunded Accrued Liability payments, recognizing that these payments will increase almost every year until 2028 as we write down the state's enormous obligations.
- Do not allow bills that seek to push off retirement costs into the future, such as extending the debt payment schedule.
- Support the cost-of-living-adjustment (COLA) reform in Act 399 of the 2014 session, which allows COLAs for retiree benefits but controls state costs.
- Support a lower, more realistic assumed rate of return that would take effect in fiscal 2018. This will cost more short term and help us out long term.
- Pay for retirement system administrative costs on an annual basis. Stop the state's practice of basically borrowing to pay for the systems' operating costs. Increase the contribution from employees or new hires to help cover this increased cost.
- Follow the Legislative Auditor's recommendations for better retirement system sustainability, such as improved methods of amortization.

State employee and retiree benefits

- Adjust benefits to save money and encourage more efficient utilization of health care services, more in line with plans in the private sector.
- Limit Office of Group Benefits cost increases for the state to a rate at or under the national healthcare inflation rate. Or, set a goal for state benefit costs not to increase more than $50 million in the next year, which would represent about half the growth expected this year.
- Use the Group Health Fund responsibly and not as a vehicle to boost the state operating budget.
- Follow a procedure for a transparent process to set the Group Health Fund balance at an actuarially sound level, with corresponding premiums to meet the goals. While the Legislature developed a new system for this purpose last year, the process needs improvement.
- As a possible exception and safeguard to the above recommendations, protect senior retirees from onerous cost increases.

State employee pay

- No merit pay increases for fiscal 2017.
- Implement furloughs where money can be saved for budget solutions. One calculation indicates a state savings of $700,000 - $900,000 per day.
- In future years, consider cost-of-living adjustments instead of more expensive merit pay increases to balance state budget and employee interests.

Other Spending

- Pledge that budget cuts will address a portion of the 2017 general fund shortfall.
- Pledge to support a reduction or no increase for the state's MFP expense. The current year's increase of 1.375% per student to local K-12 education was added outside the state's MFP formula. That means the education board and the Legislature could institute what would effectively be a $36 million cut by just not renewing that increase. This move would avoid the more complicated constitutional mechanism for cutting the MFP.
- Finish the Department of Health and Hospitals plan to move the remaining fee-for-service population (nursing homes patients and home and community-based waiver recipients) into managed care. These are the most expensive Medicaid patients and currently are carved out of managed care. Associated savings, based on the experience of rolling others into Bayou Health, could be as high as $70 million in state general fund money for the first year.
- Draw limits for 2017 for major health care expenses, including community and home-based care waivers.
- Increase efforts to remove individuals from the Medicaid rolls who are not eligible and focus on prevention and prosecution of fraud.
- Ask each agency for a plan and set a goal to reduce contracting costs.
- Trim the budgets of the legislative and judicial branches, which have seen spending increases for years.
- Promote long-term savings and a better corrections system through sentencing reforms that would reduce the prison population while maintaining public safety.
- Cut $200 million from state agencies, either across the board or, preferably, by requesting each agency to show how to meet their budget goals.

Transportation

- Put trust back in the Transportation Trust Fund by devoting motor fuel taxes solely to highway and other transportation and infrastructure needs. Abide by the new statutory limit on trust fund raids. If more money is not raised directly through a higher motor fuel tax, demonstrate that other tax increases will secure the TTF and lead to improved highway and port spending.

- Specifically, do not raid the Transportation Trust Fund by peeling off the new increased revenue from higher motor fuel tax collections.
- Limit the parish road fund allocation to the constitutionally required amount, and change the Constitution to repeal this mandatory dedication. The small portion used to match federal aid for rail crossings should remain.

Coastal Protection and Restoration

- Do not raid or launder money through the Coastal Protection and Restoration Fund. This defense of the fund will send a clear signal to the nation, Congress and federal oversight agencies that coastal infrastructure is a true priority in Louisiana. PAR has demonstrated how the Coastal Fund has been tapped to help fill operating budget gaps. The fund also has been used as a laundering mechanism to turn non-recurring dollars into money for the operating budget. These practices will stop.

Higher education

- Eliminate the SAVE program. Although the program's tax credit is a phony apparatus, the SAVE legislation did create a state spending obligation and encourages an enrollment-based funding incentive.
- Support passage of a bill, such as the one by Sen. Donahue, to reduce the state's cost for the TOPS tuition subsidy program while keeping the eligibility standards in place.
- Cut 5%, or about $38 million not counting TOPS, from state funding of higher education for fiscal 2017.
- Work with higher education officials to streamline back-office and operational functions and consolidate academic programs and departments on a regional level where redundancy exists. Streamlining could include accounting, purchasing, IT, human resources and legal services across colleges.
- Support performance measures that will reduce higher education's incentives to base financing on enrollment.
- Support the ability of regions to raise money for their community and technical colleges, which is done in many competing states with effective programs.
- Implement the PAR recommendations from the 2015 report *Innovation in Louisiana*, including a more strategic use of the Board of Regents Support Fund.

The 50-50 goal for higher education

- Clarify the policy value of the governor's 50-50 goal of state support versus tuition revenue for higher education and begin to determine the cost and eventual measures needed to reach it.
- Explain how the governor's goal of 50-50 funding can be met without onerous costs to the state due to tuition and fee inflation. Does the calculation include TOPS? All fees? Is it institution-based or system-based? What about non-tuition institutions? Based on current financing figures, the estimated extra state cost of 50-50 funding for each institution would be $689 million, if TOPS were excluded as a state contribution, according to the House Fiscal Division. The gap would be $456 million if TOPS and financial aid were included in the state's 50% portion. These factors will have a huge impact on the cost and effectiveness of the governor's 50-50 pledge, and now is the time to address how this would work.
- Devise a plan and an understanding with higher education leaders to reach the 50-50 goal. The plan should include performance measures and a long-term cost-cutting and consolidation program in higher education as well as incentives to reduce tuition and fee inflation.

Local government funding

- Make transportation and higher education infrastructure the real state priorities in the capital

outlay process, and not local pork projects. The state has a backlog of billions of dollars in safety and maintenance needs for roads, bridges and college facilities.

- Remove the state general fund obligation in the Constitution to pay $90 million a year for local projects through the Revenue Sharing Fund. Phase out the fund and any bonded obligations.
- Let the state sweep or take a better portion of tax, fee and credit sharing programs with the local governments.
- To assist local governments, follow the recommendations of economists Jim Richardson and Steven Sheffrin in their report with regard to the industrial tax exemption and emphasize fee-in-lieu arrangements for industrial projects where appropriate.
- Support measures for a lower homestead exemption to assist local governments and to relieve pressure on state obligations to locals.
- Support the Legislative Auditor recommendations for local governments, including better court and local fee collections.

Other measures

- No more tax amnesty programs.
- Implement efficiencies that can be effective cost-savers but do not book savings into the annual budget unless or until the real savings are evident.
- Eliminate the state income tax deduction for private school tuition. Private schools enjoy about $61.6 million in direct state subsidies and indirect tax breaks, not including the vouchers program and school bus support. The tuition deduction costs the state $21.5 million, is not a top state priority and makes for bad tax policy.
- Eliminate the Citizens insurance assessment reimbursement, which costs the state about $47 million per year. Insured homeowners can turn in a form to get the cash or take the credit on their income tax form; this reimbursement is a straight state expenditure, not a real tax break or even a tax-related program.
- Eliminate the $25 credit that parents and guardians take for having a child who is a student.
- Do not revise or scale back the K-12 voucher program in a way that would cause greater expense for the state budget.
- Adopt the Legislative Auditor recommendations for better fiscal controls, such as those presented in the briefing for the House of Representatives.

Conclusion

PAR's recommendations center around the idea that every large and small solution – whether it be a spending item or a revenue stream – matters greatly in this discussion. Some will say that a $20 million budget savings won't solve the problem. But that would be incorrect. The state needs many similar-sized fixes stacked upon each other to reach the goal of budget sustainability and to spread the effects broadly among stakeholders in Louisiana.

So far, the new administration and many members of the Legislature have expressed a serious-minded interest in fixing the long-term budget imbalance. No matter what they choose to do, they will make decisions that will be unpopular with somebody, somewhere. A more informed citizenry would be a benefit to them and the difficult process ahead. PAR hopes this report will serve to educate and to offer hope and guidance for fair and sustainable solutions.

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