PAR LOUISIANA | COMMENTARY

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Savings Account Shuffle

Proposal to rework trust funds should ensure state maintains solid financial reserves

The governor's ambitious tax reform package includes a merger of two Louisiana trust funds that help promote financial stability for the state, a change that lawmakers should weigh carefully.

The proposal that lawmakers will consider in the upcoming special session on taxes involves the Budget Stabilization Fund (commonly known as the state's "rainy day" fund) and the Revenue Stabilization Trust Fund. Their consolidation is part of a wide-ranging recommended rewrite of the budget and tax section of the constitution.

Together, the two accounts contain nearly $3.8 billion, according to data from the Louisiana treasurer's office.

The Budget Stabilization Fund has helped prior governors and lawmakers to manage financial downturns and lessen damaging cuts to state services. The Revenue Stabilization Trust Fund has helped the state to reduce its reliance on volatile tax types, specifically corporate taxes and collections tied to the oil and gas industry.

Among a series of constitutional changes, Gov. Jeff Landry proposes to eliminate the Revenue Stabilization Trust Fund by 2027. He's asking lawmakers to move some of the fund balance into the rainy day fund and use another portion as a financial sweetener to give a one-time payment to parishes that end their property tax charges on businesses' inventory.

The rest of the money in the Revenue Stabilization Trust Fund – along with new dollars that would have otherwise flowed into the fund – instead would be diverted to the state general fund and available for spending, though some of it with restrictions.

These two savings accounts perform important functions. The governor and lawmakers should work to retain the funds' purpose of reducing fiscal instability.

Suggestions for Merged Rainy Day Fund

- **Change the way deposits would be made to further hedge against revenue volatility.**
- **Allow lawmakers to increase both the balance cap and deposit levels with a 2/3 vote.**

The Public Affairs Research Council of Louisiana broadly backs the governor's efforts to make Louisiana's tax structure simpler, fairer and more competitive. But we believe more work needs to be done on the mechanics of the fund merger included in the tax overhaul.

PAR supports combining the two funds into the Budget Stabilization Fund because the move will provide stronger protections for the money and make it harder to raid for non-emergency items. We are grateful the Landry administration already has accepted some of PAR's recommendations.

However, **we recommend** additional safeguards that hedge against the historic boom-and-bust cycles of corporate tax and mineral revenue collections and that give lawmakers the ability to boost the savings account balance without needing to amend the constitution again in the future.

How are the Accounts Structured Now?

Louisiana has had a version of the Budget Stabilization Fund in its constitution since 1990. Its current balance tops $1 billion, according to state treasury figures.

That rainy day fund receives a quarter of any state budget surplus, along with certain taxes and fees collected from oil and gas activity in times of a mineral revenue boom. A state law requires a minimum payment of $25 million into the savings account annually if no dollars would otherwise be deposited. In recent years, deposits have come from surpluses.

The fund can be tapped when the state faces a budget deficit, with limits on how much can be used. No more than one-third of the balance can be spent in a two-year period, and a two-thirds legislative vote is required.

Lawmakers also can appropriate money from the reserve account to respond to a federally declared disaster in Louisiana, again with a limit to spending no more than one-third of the balance and a two-thirds legislative vote requirement. The withdrawal also can't exceed the state's costs associated with the disaster.

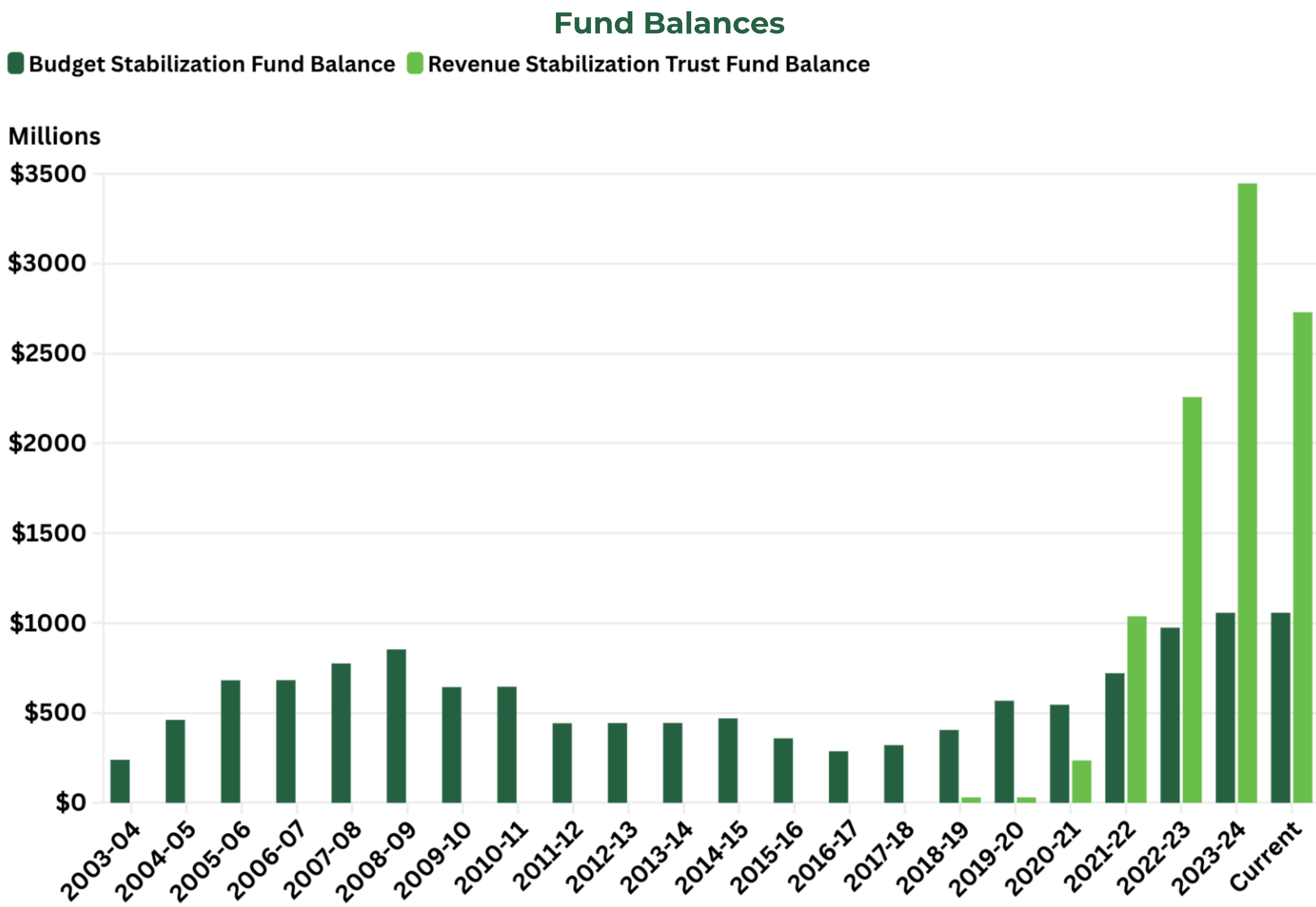
The Budget Stabilization Fund is capped and can receive no further deposits if it reaches 4% of the total state revenue receipts for the previous budget year. The account has never reached that cap, which was $1.5 billion in the last budget year, according to treasury data.

Lawmakers and voters created the Revenue Stabilization Trust Fund in 2016, and the account ballooned much more quickly than predicted amid the COVID-19 pandemic recovery, other economic surges and inflationary impacts on corporate profits.

The account's balance exceeds $2.7 billion, according to treasury figures. Another $440 million is expected to be deposited this budget year, under the state income forecast.

Louisiana deposits higher-than-usual business tax collections and certain dollars from oil and gas exploration into the savings account to lessen the overreliance on those less predictable income sources for the state budget. The trust fund keeps a governor and lawmakers from using the cash for ongoing expenses that might be unaffordable in the future because such large revenue collections are uncertain. The vast majority of the current money in the fund comes from corporate income and franchise tax collections.

Corporate income and franchise tax collections above $600 million annually and a portion of oil and gas production revenue (such as severance tax and royalty collections) above $660 million each year must flow to the trust fund, rather than to the state general fund.



Source: Louisiana Department of Treasury

Once the fund reaches $5 billion, lawmakers can spend up to 10% of the money on projects in the state construction budget and transportation infrastructure.

However, the constitution lets lawmakers, with a two-thirds vote of the House and Senate, change the minimum fund balance triggers and the allowable percentage that can be spent on those projects. It also allows lawmakers to use any amount of the balance in an undefined emergency at any time with a two-thirds vote.

Earlier this year, lawmakers diverted $717 million from the trust fund into other funds for spending on road and bridge work; infrastructure upgrades for state prisons, sheriffs' facilities and fire stations; higher education building repairs; and water and sewer system improvements.

What is the Governor Proposing?

The Landry administration is seeking a sweeping rewrite to the budget and tax portion (Article VII) of the Louisiana Constitution, with a companion bill that adjusts laws tied to the constitutional provisions. Those two pieces of legislation contain the merger and rule changes for the Budget Stabilization Fund and Revenue Stabilization Trust Fund.

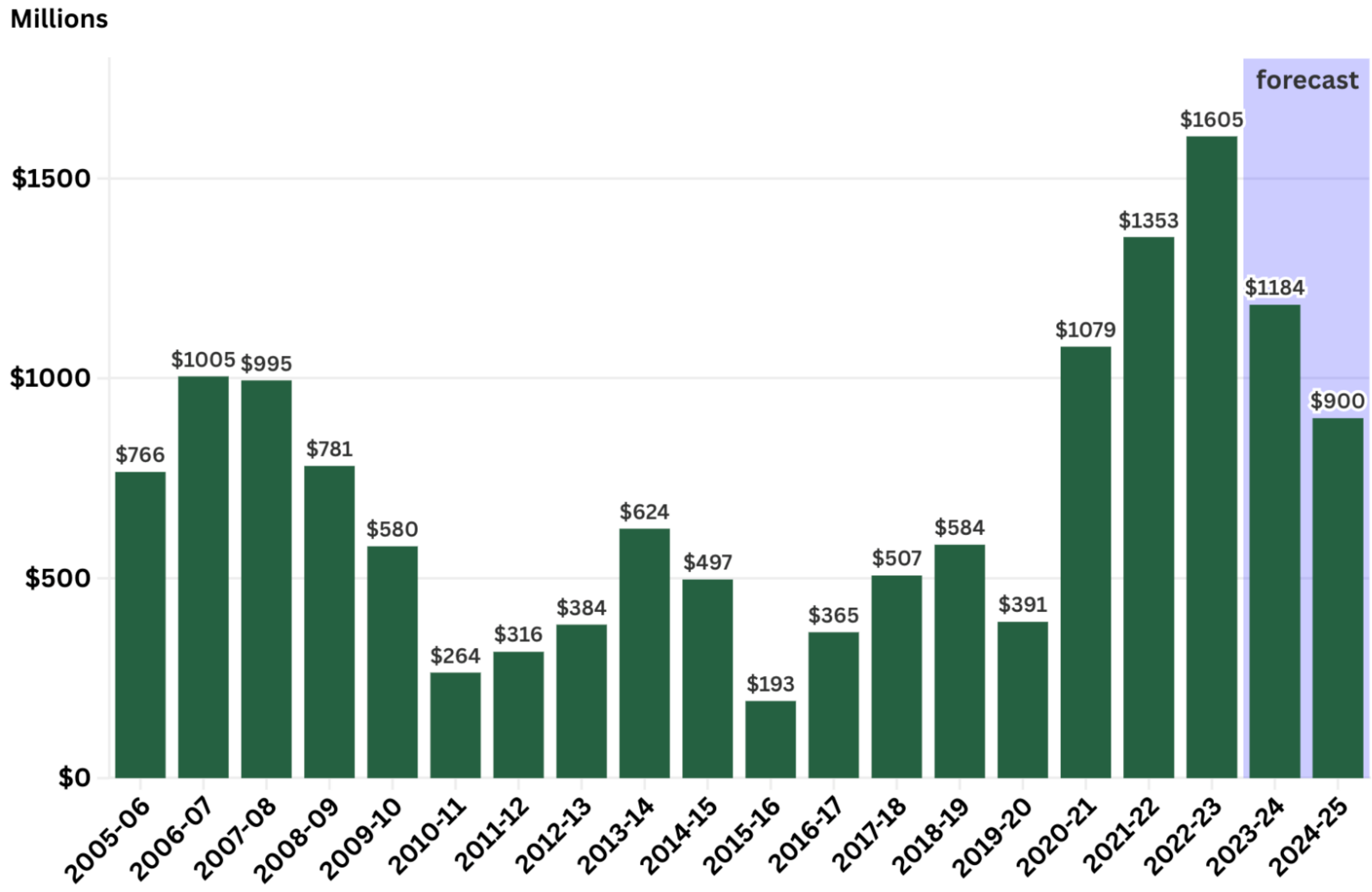
The proposal would remove the Revenue Stabilization Trust Fund from the constitution, transfer a portion of its balance to the rainy day fund and eliminate the revenue stabilization account by 2027.

Deposit and cap rules would change for the newly merged Budget Stabilization Fund. Percentages of revenue would be dedicated to the account, rather than collections above a specific dollar amount.

The governor's proposal would require 15% of both corporate tax collections and mineral revenue collections to be directed to the merged rainy day fund. Based on current state income projections, those deposits would be smaller than the amounts that would be socked away in savings under the current rules. Lawmakers should consider increasing the percentage.

For example, 15% of the $900 million in corporate tax collections the state is forecasted to receive in the current budget year is $135 million. Under the current rules where any corporate tax collections above $600 million must flow into the Revenue Stabilization Trust Fund, $300 million would be sent to the reserve account.

Corporate Tax Collections



Source: Louisiana Department of Revenue, Revenue Estimating Conference

In other words, $165 million less would be earmarked for a state savings account than under current rules, and more corporate tax collections and mineral revenue dollars would be available in the state general fund for lawmakers to spend any way they choose.

The true impacts, however, could be murkier. Landry's tax package would lower corporate tax collections overall by eliminating the corporate franchise tax and making other adjustments.

Meanwhile, corporate tax collections have varied widely over the years, only reaching the current heights since the COVID-19 pandemic.

Before that, corporate tax collections regularly fell below the $600 million figure. Allowing significantly more corporate tax revenue to pour into the state general fund could see state programs and services over-reliant on taxes that aren't certain to arrive year after year.

Similarly, oil and gas revenue Louisiana receives has fluctuated sizably over the years.

The current system puts more money aside when revenue is booming but little to no funding in other years. The proposed system would send less money to the rainy day fund in good years but always put some money aside. A better system would use both approaches. That would add even more money in good times and provide greater stability for Louisiana's finances.

PAR recommends allowing lawmakers, with a two-thirds vote, to adjust the percentage of mineral and corporate revenue dedicated to the reserve account and to change the dollar amount above which collections accrue into the fund.

Under the governor's proposal, one quarter of any state surplus would still be required to flow to the Budget Stabilization Fund, and the rules for use of the reserves would remain limited to deficits or disasters with the same two-thirds vote required from lawmakers.

By transferring much of the Revenue Stabilization Trust Fund money into the rainy day fund, that makes it harder to access – and only for true financial troubles and other emergencies. That's a positive change.

The cap on the Budget Stabilization Fund would grow from the current 4% to 7.5% of total state revenue receipts for the previous budget year, to allow a larger fund balance since the other savings account would disappear.

But the rainy day fund would immediately hit the cap when dollars from the Revenue Stabilization Trust Fund are transferred there. Landry's Department of Revenue said it intends for the cap to equate to around $3 billion, though there's disagreement about whether a 7.5% cap would fall below that amount. Revenue officials said they'd support tweaking the cap percentage to ensure $3 billion is in the Budget Stabilization Fund.

Still, the intention is to set the fund cap at a lower amount than is contained in the two accounts separately.

Data from the National Association of State Budget Officers shows that in the current budget year the median rainy day fund balance for states is 15% of general fund spending. Louisiana's Budget Stabilization Fund falls below that level. If the fund grows to $3 billion, that would represent 25% of state general fund spending and move Louisiana to the top 10 of states.

The Pew Charitable Trusts, which assesses the fiscal health of states and recommends strong reserve balances, suggests calculating caps on rainy day funds based on a state's financial risk to economic downturns, essentially a budget stress test. At least 13 other states conduct budget stress tests, according to Pew's data.

Calculating a cap based on a stress test can't be done quickly. It's probably better to wait until any tax changes lawmakers pass take effect. Given this, **PAR recommends** the constitution should give lawmakers the ability to increase the cap with a two-thirds vote without having to return to the voters.

Once the Budget Stabilization Fund reaches its cap, any dollars in the future (from corporate taxes, mineral revenues or state surpluses) that would otherwise be earmarked for the account would be treated like surplus dollars. They'd be available for spending on one-time expenses like construction work, debt payments, coastal restoration efforts and road projects.

PAR appreciates that the Landry administration followed its suggestion to restrict use of those dollars above the cap for one-time items – rather than allowing the money to inflate the operating budget with unpredictable revenue and risk creating future budget gaps.

Beyond the money used to fill up the rainy day fund, other dollars would remain in the Revenue Stabilization Trust Fund for the next two years, to provide one-time incentive payments to each parish that chooses to stop charging property taxes on business inventory by 2026. In addition, if corporate tax collections don't reach $800 million each budget year before the fund disappears, lawmakers could tap the account to fill the gap between corporate collections and the $800 million, using that money for the state operating budget.

When the account is eliminated in 2027, any remaining balance would be handled like state surplus cash.

If lawmakers approve, the fund merger and rule changes would be tied to a constitutional amendment that would require voter support in the March 29 election to take effect.

Budget reserves offer a key safeguard against budget instability and financial downturns for states. Louisiana's done a commendable job of building its savings accounts and should make adjustments that continue the trend.

Budget Stabilization Fund (Rainy Day Fund)

	Current	**Proposed**
Deposits:	Greater of $25M or 25% of any nonrecurring revenue	Same
	Federal reimbursement of withdrawals used for disasters	Same
	Money in excess of the expenditure limit	Same
	Mineral revenue over $950M adjusted for inflation after certain dedications	15% of mineral and 15% of corporate tax revenue
		One-time transfer of about $2B from Revenue Stabilization Fund
Withdrawals:	Officially declared budget deficits	Same
	Costs associated with a federally declared disaster	Same
Cap:	4% of total state revenue receipts	7.5% of total state revenue receipts
If money exceeds cap:	No deposit made	Can only be spent on nonrecurring items (e.g. debt, infrastructure)