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TRANSITION COMMITTEE ON FISCAL MATTERS

Transition Advisory Team

Governor-Elect John Bel Edwards

January 14, 2016

Foster L. Campbell, *Chair*
Sharon B. Robinson, *Vice-Chair*

January 14, 2016

The Honorable John Bel Edwards
Governor-Elect, State of Louisiana
Kirby Smith Hall, 11th Floor
Louisiana State University
Baton Rouge, LA, 70803

Dear Governor-Elect Edwards,

On behalf of the Transition Committee on Fiscal Matters (the "Committee"), it is our pleasure to submit this report. Your charge to us was to review Louisiana's fiscal structure, budget situation, and tax code in order to find ways to make our systems fairer, more stable, and more competitive, both for businesses and individuals across the state.

Our report presents options for reforming several parts of the state's tax and fiscal structure to decrease its complexity, the inequities it produces across the taxpayer spectrum, and the inability of the legislature and the governor to effectively respond to financial downturns. We hope some combination of these options will be helpful in moving the state toward a healthier, fairer, and more competitive revenue and budgetary situation.

On behalf of the Committee, we thank the various policy experts and professionals who prepared numerous reports and presentations for the Committee's review. These include the staff of the House Fiscal Division, the Legislative Fiscal Office, the Senate's budget and revenue staff, the Committee of 100, Dr. Jim Richardson, the Louisiana Association of Business and Industry, the Tax Foundation, and many others. Their participation was essential to the Committee's deliberations.

Our special appreciation goes to the members of the Commission whose input, service, and expertise were so invaluable to these efforts.

Best regards,

The Honorable Foster L. Campbell	Mrs. Sharon B. Robinson
Committee Chair	Committee Vice Chair

TRANSITION COMMITTEE ON FISCAL MATTERS

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Special thanks to Robert Keaton, Former Assistant to the President for Budget, Louisiana State University, for serving as advisor to the committee and providing support for report preparation; Kimberly Robinson, Transition Advisor to the Governor on Revenue; Jerry Luke LeBlanc, Transition Advisor to the Governor on Fiscal Matters; and to Bruce Parker for staffing the transition team.

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EXECUTIVE SUMMARY

The Transition Committee on Fiscal Matters heard three days of testimony from state and national public finance experts hailing from state government, academia and the private sector. While the perspectives sometimes differed, there was consensus that Louisiana faces structural deficits that pose immediate and long-term threats to state government's ability to provide basic services such as health care, education, transportation and public safety that citizens expect.

During its December meetings, the committee noted that the incoming administration faces a general fund shortfall of at least $227 million in the current-year budget (Fiscal Year 2016), and a gap of more than $1 billion between revenues and projected expenses in the Fiscal Year 2017 budget. With low energy prices continuing to ripple through Louisiana's economy, putting downward pressure on state tax collections, there is strong reason to believe the gaps will grow even larger in the coming weeks.

Beyond that lie several "horizon issues" that require attention, including a backlog of transportation needs, restoring higher education funding, deferred maintenance on college campuses, stagnant pay for teachers and state employees, and the ever-rising costs of health care services and state employee pensions. While budget cuts and program efficiencies will continue to be part of the solution, the committee found that the repeated use of cuts, consolidations, privatization and financing substitutions over the past seven years has diminished and in some cases eliminated the viability of these measures for coping with the current budget crisis.

The committee established 10 guiding principles and provided options for the new administration to consider. The principles make clear that new revenues should only be considered as a last resort, and should be spread as evenly as possible among individuals and businesses to ensure that sacrifice is broadly shared. Additionally, any revenue-raising measure should also serve to modernize Louisiana's tax structure by making it less complex and more efficient.

The revenue options to be considered include:

- Reduce Louisiana's income-tax rates across the board, if the voters agree to eliminate the deduction for federal income taxes and certain other deductions.
- Reduce excess itemized deductions and return to the tax brackets voters originally adopted in the Stelly Plan.
- Establish a flat corporate tax rate, if the voters agree to eliminate the federal income tax deduction.

- Phase out or reform the corporate franchise tax
- Modernize the corporate tax code to broaden the base in a manner consistent with the rest of the South.
- Expand the existing state sales tax to cover certain services, and work toward a single collection and distribution system that would allow Louisiana to tax online sales in the event of changes to federal law.
- Suspend some part of the sales tax exemption on business utilities.
- Increase the fuel tax to bring it in line with the national average and index it to grow with inflation.
- Review and modify the industrial tax exemption.
- Subject tax expenditures to the same rigorous review as expenditures contained in the state budget; eliminate those that are the least productive and modernize those that are retained so that they produce the maximum benefit to the state.
- Further reform the horizontal drilling exemption.
- Establish a processing tax on hydrocarbons

REPORT OF THE TRANSITION COMMITTEE ON FISCAL MATTERS

The Transition Committee on Fiscal Matters has taken seriously its charge to review the state's budget situation and present options to the incoming administration. In this regard, the Committee sought the expertise of individuals who have worked in the budget arena in non-partisan positions, faculty members from the state's public and private universities, and business-minded groups that offer advice and recommendations on public policies dealing with finance. Combined, these individuals and business-minded groups have hundreds of years of experience in public finance as well as a long history of dealing with budget crises.

THE BUDGET IMBALANCE

As of our December review, the incoming administration faces a projected budget shortfall in the current fiscal year (Fiscal Year 2016) of at least $227 million and as high as $500 million. The trouble continues in the following Fiscal Year 2017, with a projected gap of at least $1 billion and as high as $1.5 billion between revenues and expenses. Addressing shortfalls of this magnitude, especially the Fiscal Year 2016 shortfall with only 4 ½ months remaining in the fiscal year, may require extraordinary revenue raising measures and/or the complete and total shutdown of a significant number of state programs.

Both of these shortfalls must be resolved to comply with the constitutional mandate that the budget must be balanced, and this resolution can only be achieved through budget cuts, revenue enhancements, or some combination of both. Additionally, Louisiana's budget has a built-in structural deficit[1] that must be addressed if the state is to ever break out of the crisis-management mode that has driven the executive and legislative agendas for much of the last eight years.

Beyond the immediate pressure to re-balance the budget lie several "horizon issues" that require attention if government is ever going to be able to function more like an ongoing enterprise. These include a backlog of transportation infrastructure needs, deferred maintenance on college campuses, stagnant pay for teachers and state employees, coastal restoration, the state's financial partnership with local governments and the ever-rising demand for and costs of healthcare services.

These challenges would be formidable under any circumstance. But they are made all the more daunting because reserves have been depleted, most avenues for efficiencies have

[1] A structural deficit exists when the state's revenues are consistently less than its expenditures.

already been exploited, and Louisiana voters have been told that all is well and that government can continue to provide critical public services without any need to increase the revenue required to fund those services.

ADDRESSING THE BUDGET PROBLEM

To address the overall budget problem, four general tasks must be undertaken simultaneously:

1. Eliminate the current-year shortfall;
2. Produce a plan for a balanced budget in fiscal year 2017 and address the projected shortfall in fiscal year 2019;
3. Restructure the revenue and expenditure systems to eliminate the long-term structural deficit;
4. Plan for addressing the "horizon issues" once the state regains its financial footing.

To help in this effort the Committee established 10 guiding principles and is providing options for the new administration to consider. None of these options will be easy to implement, and all will require bipartisan support in the Legislature as well as the understanding and support of the private and corporate citizens of Louisiana. The incoming administration has the daunting task of making its case to Louisiana citizens, who depend heavily on government services to provide critical services like education, health care and public safety yet have not been well informed about the dire budget situation and how things got so bad.

GUIDING PRINCIPLES

1. The budget shortfalls are so large that all citizens - private and corporate - will have to participate in the solution. This means some programs that sustained cuts in the past will likely have to be cut more and areas of spending that have been "off the table" for cuts, including programs financed from dedicated funds, will face reductions.
2. After all cuts have been made that do not jeopardize public safety, economic security, health care, and the orderly functioning of government, then and only then should additional revenue be considered.
3. Any revenue enhancements should be spread as evenly as possible among various groups of taxpayers and should be structured in a way that does not make Louisiana's tax system more regressive.
4. The imperative to address the immediate budget shortfalls should not overshadow the long-range goal of eliminating the long-term structural imbalance between revenues and expenditures.
5. The state's solution to its budget problems should not be disproportionately transferred to its political subdivisions. Measures should be implemented to allow local governments to raise their revenue independent of the state.

6. The budget solutions should be permanent and should not include an over reliance on one-time revenues, postponement of expenditures, or other gimmicks that result in a return to budget shortfalls in ensuing fiscal years.
7. Any changes to the tax system should be completely transparent in regards to how the distribution of the tax burden would change among individuals in different income brackets, businesses of various types and how Louisiana's tax structure would compare to neighboring states in our region.
8. To the extent practical, any proposals to raise revenues should also modernize the revenue structure with an eye toward improving efficiency, promoting compliance, and reducing litigation.
9. Reserves have been reduced and there is little margin for error, therefore, the budget solution should contain some accommodation for contingencies.
10. Strategic investments should be made to enhance the various departments' ability to collect all revenue legally due the state.

PART 1 – THE BUDGET PROBLEM

The budget problem can be divided into three parts. The first is the unfinished business of balancing the Fiscal Year 2016 budget. The solution to the current year shortfall proposed by the governor and approved by the Joint Legislative Committee on the Budget on November 20, 2015 left major gaps in the budgets for Medicaid, TOPS and other programs that must be dealt with before the June 30, 2016 end of the fiscal year. The incoming Edwards administration will need to find at least $227 million (probably more) in State General Fund dollars – either from existing programs or new revenues – just to keep the current-year budget in balance. A fiscally sound solution to this predicament is out of reach since budget cuts with over half of the fiscal year already transpired would have to be doubled, leaving almost no time remaining to mitigate the impact. A revenue solution would be equally challenging since there would be virtually no time to implement any change in the tax code and collect additional revenue before the end of the fiscal year.

Estimated Remaining Shortfall for Fiscal Year 2016

• State match for Medicaid shortfall	$190 million
• Unimplemented Preamble cuts	18 million
• Estimated shortage in TOPS funding	19 million
TOTAL	$227 million*

*Possible additional requirements for Sheriff's Housing of State Inmates and Minimum Foundation Program, but not available in December, at the time of this report.

The second part of the budget problem that must be addressed by the incoming Edwards administration is the projected shortfalls for Fiscal Years 2017 and 2019. The Five-Year Base-Line Budget Report shows a shortfall of $1.037 billion in Fiscal Year 2017 and a $1.3 billion shortfall in Fiscal Year 2019. These shortfalls are due in large part to the use of patchwork "one-time" revenues for recurring expenses, the expiration of certain revenue measures enacted in the 2015 Regular Session and the requirement to repay certain revenues used in Fiscal Year 2016 over a three-year period beginning in Fiscal Year 2018. The budget report also shows a shortfall in Fiscal Year 2018, but that number is lower than the shortfall projection for Fiscal Year 2017 and the Committee assumes that if the shortfall for Fiscal Year 2017 is solved in a sustainable manner there may be no significant gap in Fiscal Year 2018.

Projected shortfalls Fiscal Years 2017 and 2019	
• Five-Year Base-Line Budget Report shortfall	$1.037 billion
• Additional shortfall Fiscal Year 2019 from sunset of revenue measures used to balance Fiscal Year 2016 budget	.230 billion
TOTAL	$1.267 billion

As noted earlier in the report, the Fiscal Year 2016 and 2017 shortfalls are likely to be considerably higher than described here by as much as $300 million more in Fiscal Year 2016 and another $500 million plus in Fiscal Year 2017. The compressed time frame for having to deal with the Fiscal Year 2016 shortfall as well as the sheer magnitude of the numbers for both fiscal years will require solutions that press the limits of imagination and political viability.

The third budget problem that will have to be addressed at some point in the future is what the executive and legislative budget shops frequently call "horizon issues." These issues are situations that may require additional expenditures in the future but that are excluded from the legally required budget status reports because they are not mandated and the exact cost has not been determined. Consequently, they are not part of the projected budget shortfalls that appear on the Five-Year Base-Line Budget Report. These issues are discussed in more detail in Part 5 of the report.

PART 2 – EXPENDITURE OPTIONS

Budget cuts are always a valid means for coping with budget shortfalls. However, the utilization of budget cuts, consolidations, eliminations, privatizations, and substitutions to address recurring shortfalls over the past seven years significantly diminishes the viability of these measures for dealing with the magnitude of the projected shortfalls outlined in this report.

This is not to say that there are no more savings to be achieved through economies, efficiencies, and outright cuts, but it would be unrealistic to expect that the yield from such actions could match what was achieved when the budgets were much larger. Taxpayers need to be aware that the slogan, "doing more with less" only stretches so far and at some point agencies reach the level where, despite their best efforts, the result is they can only "do less with less." Fewer and lower-quality services are the tradeoff for a smaller revenue component to the budget shortfall solution.

A review of budget cuts, economies, and efficiencies utilized over the past seven years provides a perspective for understanding why such actions may not have the same beneficial effects in the future. The list below, while far from exhaustive, outlines the major areas of <u>cuts</u>, <u>economies</u>, and <u>efficiencies</u> that have been implemented over the past seven years to address recurring budget shortfalls. The aggregate amount of the budget reduction or savings is not available for every item.

K – 12 EDUCATION

The following items were eliminated:

- 2.75 percent growth factor for the MFP eliminated in fiscal year 10 until fiscal year 14 Floor Amendment in the amount of $69 million. State support per K-12 student was $463 less in 2014 than in 2008, on an inflation-adjusted basis.
- Stipends for teachers
- State Activity Programs for K-12/additional Math and Reading Programs
- Non-public transportation funding

HIGHER EDUCATION

- Reduced State General Fund support for Higher Education by a total of almost $700 million, and full-time faculty positions by 859 from fiscal year 2008 to fiscal year 2014.
- Shifted funding burden to students through tuition increases.
- Stopped merit increases for most college faculty and staff for several years.

PUBLIC SAFETY AND CORRECTIONS

- Closed adult prisons — Phelps Correctional Center, Dabadie Correctional Center, and Forcht-Wade Correctional Center.
- Reduced over 230 positions in Motor Vehicles/Instituted Public Tag Agent program.
- Closed Jetson Center for Youth.

DEPARTMENT OF HEALTH AND HOSPITALS

- Privatized Developmental Centers.
- Privatized Public Hospitals.
- Closure of the Hainkel Home, New Orleans Adolescent Hospital, and Southeast Hospital.

STATEWIDE

- Consolidated Information Technology.
- Consolidated Procurement Practices.
- Privatized Risk Management.
- Consolidated Human Capital Management.

- Reduced Group Benefits (medical insurance) for state workers while increasing employee premiums.
- Routinely froze employee merit increase.

Many committee members expressed concerns that additional deep budget cuts could be detrimental to the state and the people of Louisiana. Also, a number of legal and contractual agreements put some spending areas off limits for cuts. For example, the state has an obligation to pay interest and principal to its bondholders in a timely manner. The state's commitment to meet such obligations is closely watched by credit agencies like Moody's, Fitch, and Standard and Poor's that provide a credit rating on Louisiana's bonds and the credit instruments of its political subdivisions. The scrutiny of these agencies has recently peaked, as the state appears to be struggling with balancing its budget in a manner that will allow it to continue meeting all of its contractual obligations in a timely manner. A lowering of the state's credit rating would make it more expensive for the state to issue debt for current and future capital outlay projects and would send a bad signal to the financial world about the state's ability to manage its affairs.

A review of how the General Fund Budget breaks down along discretionary and non-discretionary lines (those legal, contractual, and binding agreements) is useful in better understanding the limitations on cutting the budget.

As seen in the chart below, the $9 billion General Fund budget breaks down into 68 percent for non-discretionary or mandated expenditures and 32 percent for discretionary expenditures.

Constitutionally mandated expenditures constitute a significant part of non-discretionary expenditures and there are severe limitations on when and how those expenditures can be cut. Specifically, constitutionally mandated expenditures can only be cut when a budget shortfall is projected **during** a fiscal year, and therefore such cuts could not be made to deal with the projected $1- 2 billion budget shortfall for Fiscal Year 2017.

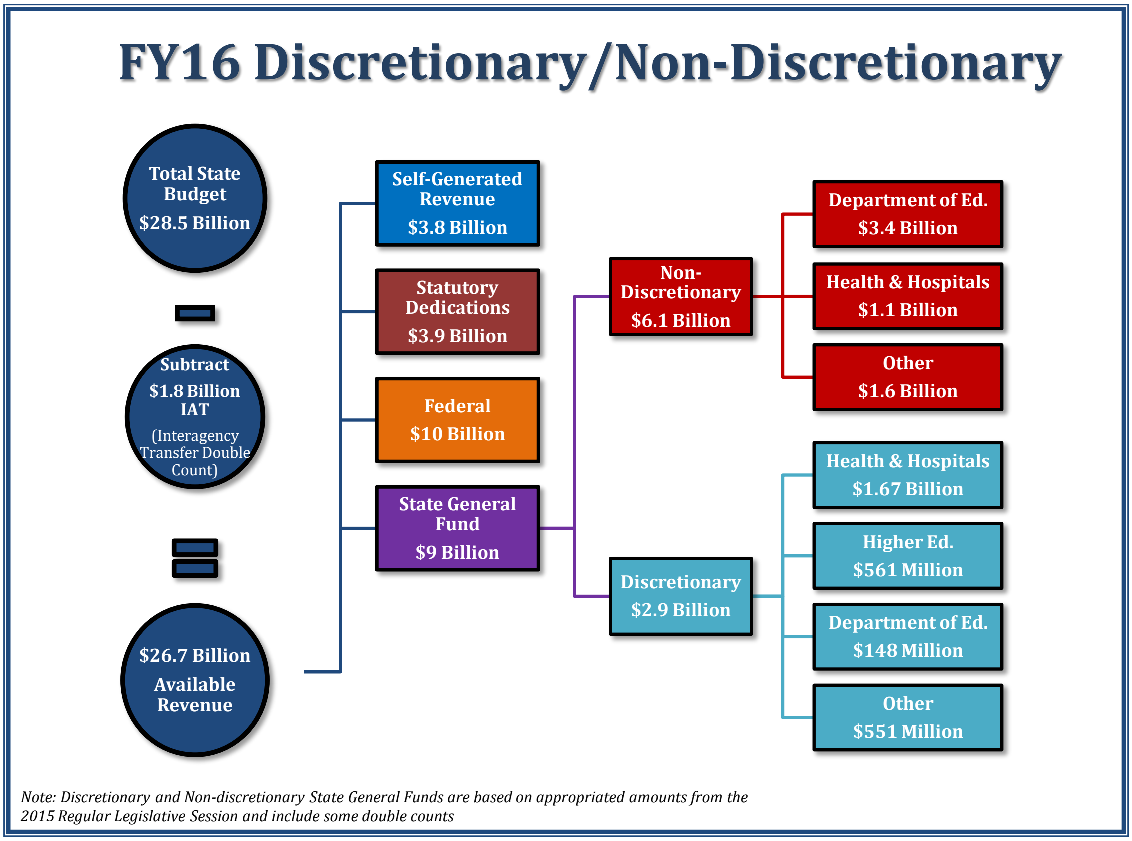

Chart courtesy of the House Fiscal Services Division

When non-discretionary expenditures are removed from the portion of the budget available to be cut, the incoming governor and legislature are left with only $2.9 billion from which to begin addressing the $1 billion projected shortfall for Fiscal Year 2017. Of this amount, 80 percent is allocated to higher education, health and hospitals (where a considerable portion of state expenditures draw a 3:1 federal match), and K-12 education. Higher education and health care have borne the brunt of previous budget cuts not because they are the least critical of all state services, but because they represent the only areas of the budget that can legally be cut without breaching contracts and amending the state Constitution.

One of the guiding principles of this report is that all citizens will have to participate in the budget solution, but the degree to which additional cuts should be borne by those programs that fall within the discretionary part of the state budget should be tempered by the recent history of cuts to those areas.

PART 3 – DEDICATIONS

Sometimes the legislature determines that a particular government service is so important that it is willing to levy a fee or raise a tax to support that program so that it does not have to compete with other government programs for funding. A good example of a dedication is the 20¢ per gallon gasoline tax that is dedicated primarily to transportation construction and maintenance.

Many of the dedications are statutory which means that they can be undone by the Legislature through the normal legislative process. However, many of the more costly dedications are ensconced in the state's Constitution, which means that they can only be changed by as supermajority vote of the legislature and ratification by majority vote of the citizens of Louisiana. Getting at the monies that are protected by dedications is not impossible; however, it is not as simple as some supporters of this approach have implied.

Another complication affecting the use of dedications to address budget shortfalls is that many political subdivisions bond the revenue stream that they receive from the state. Eliminating or reducing that stream without some equally stable source of revenue could impair the bonds and lead to rating downgrades and lawsuits that could adversely affect the state's current and long-term creditworthiness.

The chart on the next page gives some sense of the difficulty involved in tapping dedications to help alleviate a budget shortfall. Notice that of the $3.88 billion total amount dedicated, $2.15 billion has constitutional protection. The remaining $1.73 billion has a lesser level of protection, but so much of it goes to areas like higher education, K-12 education, health care, and public safety that are vital to sustaining a strong economy and have already been the target of big cuts in recent years.

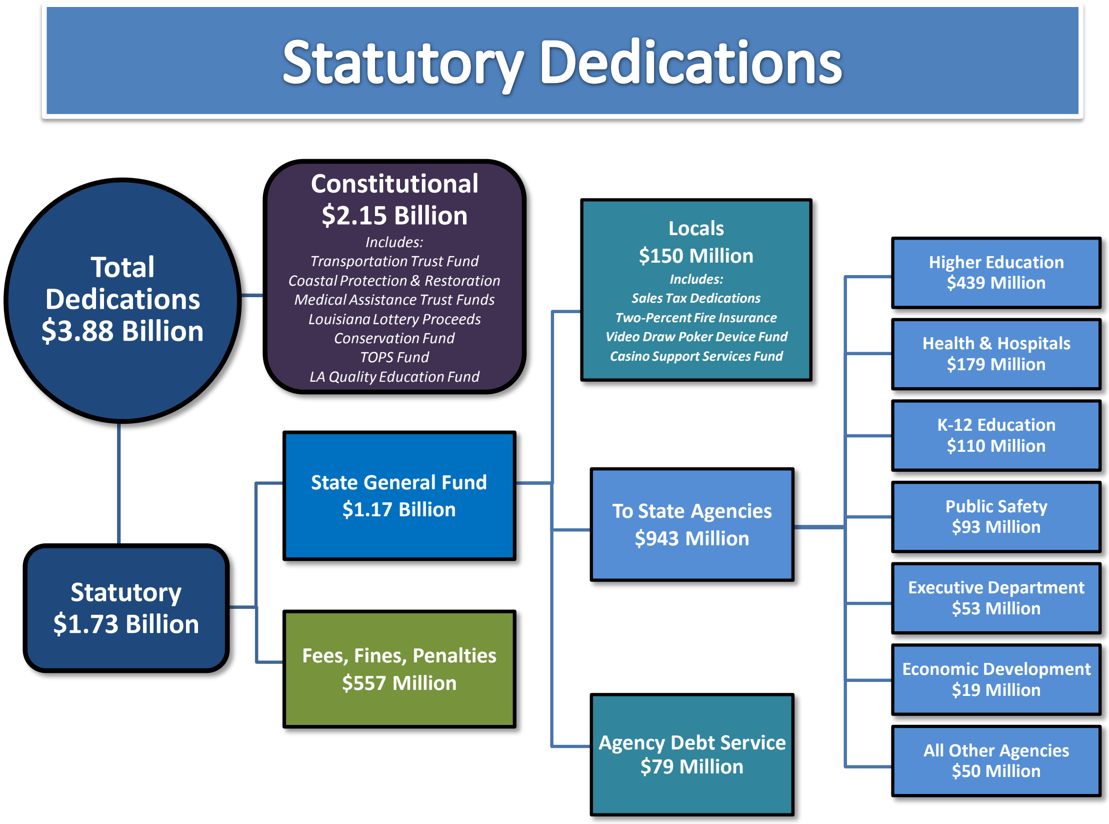

Chart courtesy of the House Fiscal Services Division

PART 4 – REVENUE OPTIONS

A series of natural, man-made, and economic catastrophes have rattled the Louisiana economy since 2005. First there were Hurricanes Katrina and Rita, then the Great Recession, then the Deepwater Horizon blowout, and most recently the collapse of oil prices. All of these events had an impact on the state budget, some in a very profound way and others indirectly and more subtly - but the effect was always negative.

The 2005 storms devastated the lower half of the state and Louisiana lost population from which it has never fully recovered. These natural disasters – and the man-made failure of the federal flood protection system - precipitated a massive influx of federal disaster funding that was used for rebuilding and replacing homes, businesses, and public infrastructure that was destroyed. The economic activity generated by this rebuilding resulted in massive infusions of revenue into the state coffers from income and sales taxes. So much so, that the state experienced budget surpluses of more than a billion dollars in Fiscal Years 2006 through 2008.

It was this so-called "embarrassment of riches," that convinced the Legislature to approve two massive cuts to personal income taxes in 2007 and 2008 through partial repeal of the Stelly Plan. The Stelly tax cuts reduced the state tax base by roughly $800 million. The BP blowout, the national recession, and the collapse of oil prices followed Katrina and each of these events compounded the state's inability to recover from the loss of revenue associated with the partial repeal of the Stelly Plan.

In a more traditional political environment, it might have been possible for the Legislature to address the loss of Stelly Plan revenue once the state economy returned to normal, but two extraordinary political events occurred in 2008. One was the beginning of term limits and the other was the election of a governor who had taken a pledge not to raise taxes during his term of office.

This preamble narrative to the Revenue section of the report is not intended to be critical but rather to be instructive. Unless those who will assume the reins of government on January 11, 2016 clearly understand how the state migrated from a position of relative fiscal well-being to the significant budget problems of the current and ensuing fiscal years, they will be unable to rectify the situation with a fix that is fair, sound, and sustainable.

The Committee was fortunate to have received information from numerous expert sources on the state's revenue situation including the Legislative Fiscal Office; the House Fiscal Division, Senate Fiscal Services, Dr. James Richardson, professor and director of the Public Administration Institute at LSU (also a member of the Revenue Estimating Conference); the Committee of 100; the Tax Foundation (an independent national tax policy research organization), various members of the Committee, and Foster Campbell, Chairman of the Committee.

The following discussion of revenue options is not intended to be recommendations or endorsement by the Transition Committee on Fiscal Matters. The ultimate decision on what revenue options to employ and to what extent ultimately rests with the newly elected governor and Legislature.

KEY REVENUE CONSIDERATIONS FOR THE INCOMING ADMINISTRATION

According to Dr. Richardson, tax reform is a multi-year process requiring information, analysis, and sound judgment. The committee agrees with Dr. Richardson's observation, but recognizes that the short-term imperative to address projected budget shortfalls for the current and ensuing fiscal years may overshadow early efforts at tax reform as envisioned by the experts who addressed the Committee.

Nevertheless, the Committee urges that any proposed legislation, immediate or longer term, that deals with the state's tax structure adheres to the Principles of a High Quality Revenue System developed and advocated by the National Conference of State Legislatures.

Principles of a High Quality Revenue System A high-quality revenue system:
• Comprises elements that are complementary, including the finances of both state and local governments. • Produces revenue in a reliable manner. Reliability involves stability, certainty and sufficiency. • Relies on a balanced variety of revenue sources. • Treats individuals equitably. Minimum requirements of an equitable system are that it imposes similar tax burdens on people in similar circumstances, that it minimizes regressivity, and that it minimizes taxes on low-income individuals. • Facilitates taxpayer compliance. It is easy to understand and minimizes compliance costs. • Promotes fair, efficient and effective administration. It is as simple as possible to administer, raises revenue efficiently, is administered professionally, and is applied uniformly. • Is responsive to interstate and international economic competition. • Minimizes its involvement in spending decisions and makes any such involvement explicit. • Is accountable to taxpayers.
Source: *National Conference of State Legislatures*

Based on the major issues identified in the Committee's findings above, we propose that the Governor and his administration consider the short- and long-term revenue options listed below that experts appearing before the committee have suggested might help address the impending budget shortfalls and address the structural deficit that results in recurring budget shortfalls.

- Individual Income Taxation
    - Lower the three existing tax bracket rates so that Louisiana has the lowest individual rates in the southeastern region, if the voters approve removing the ability to deduct federal tax liabilities.

    - Expand the tax base by reducing or eliminating the ability to deduct excess federal itemized deductions from one's state income taxes.
    - Return to the income tax brackets approved by the people in the Stelly Plan.
    - Expand the Earned Income Tax Credit available to the working poor.
- Corporate Income & Franchise Taxation
    - Combine the three existing corporate tax rates to a single flat rate, which would be more in line with other states in the southeastern region if we expand the base through modernizing reforms and if the people approve removing the deduction for federal tax liabilities.
    - Phase out or reform the corporate franchise tax.
    - Improve the base for the corporate income tax to better reflect modern tax principles used in much of the South (ex. an add back law).
    - Revise the process by which the income of a corporation that operates in multiple states is apportioned for tax purposes.
    - Reduce the number and simplify credits by maintaining only those that are important to maintaining a competitive economy.
- Sales & Use Taxes
    - Expand the application of sales tax to include certain services. For example, printing services where the printer provides the paper could be subject to sales tax.
    - Enact a single sales tax collection and administration system that would diminish time and compliance costs for businesses when trying to account for state and often multiple local sales tax collection regimes (would also open the door to the possibility of eventual taxation of online sales transactions).
    - Examine and review significant sales tax exemptions by allowing them to expire and then be revaluated so as to ensure only those that are the most significant in terms of economic growth are maintained.
    - Consider suspending some portion of the exemption for business utilities, which were taxed in Louisiana from 1986 to 2008.
    - Enact a cap on the amount of Vendor's Compensation a vendor may retain for collecting sales tax or other taxes (similar to other southern states). For Fiscal Year 2016, Louisiana is expected to pay over $40 million to vendors (vendor's compensation and tobacco discounts).
    - Renew the Telecommunications tax that is set to expire, and consider whether the rate should be equivalent to the general sales tax.
- Fuel Excise Taxes

- Increase the fuel tax so as to be more in line with the national average.
- Set the rate of the tax so that it adjusts in accordance with a set index that mirrors inflation.

- Property Taxes
    - Provide that a certain initial amount of the base value of immovable property is excluded from the homestead exemption, thus providing a system where everyone pays something in property taxes regardless of the value of the property.
    - Review and modify the industrial property tax exemption such that gives local governments input in the decision whether to grant the exemption and at what level. Also, change from 5 years with 5 years renewal to a single 7 year exemption. Change from a 100% exemption to an 80% exemption of property included in industrial tax exemption.
    - Assist local governments in finding ways to better fund their public services.

Severance Taxes

- Further reform horizontal drilling exemptions.
- Re-examine severance tax policy, which has been in place since the 1970's.

Processing Tax on Hydrocarbons

- Define processing broadly enough to capture all activities involving hydrocarbons in Louisiana including any offshore production landed in Louisiana or imported via pipeline or marine vessels most of which escapes the state's current system of taxation.
- The state severance tax would be eliminated.
- The rate would be set high enough to produce additional revenue without overburdening the industry or causing the relocation of facilities.

Additional Options

- Direct newly appointed department heads to review their departments to determine if there are areas where greater efficiency can be achieved, and redundancies and outdated functions eliminated.
- Review which tax exemptions and credits should be maintained or modified. All current tax exemptions and credits should have a sunset provision. Prior to sunsetting these exemptions, the benefactors should have to prove how these exemptions benefit the state and its citizens.
- Discontinue state sales tax holidays.
- Possible source of short-term revenue could be increasing fees that flow to funds that send excess collections to the state general fund.

- Establish a State Tax Court of record for consideration of all state and local tax issues statewide with appeal directly to the state Supreme Court. This should have all judicial powers available to a state district court.
- Establish a Louisiana Tax Institute as an ongoing body to assist in reform, research and continuous revision of Louisiana tax laws. The Institute would be created by the Legislature and would be comprised of tax professionals as well as representatives of other facets of Louisiana citizenry. It would be housed at a state university and have a reporter and researchers.

PART 4A – USE OF RESERVE BALANCES

Employing reserve balances to deal with budget shortfalls is not a new practice in Louisiana budgeting, but this approach was used with considerable restraint prior to Fiscal Year 2011. A legislative audit report that can be found at http://App.LLA.state.La.US/PublicReports.nsf/0/8737044C6E294EEA86257F140061F49E/$FILE/summary0000B6BF.pdf shows that between Fiscal Years 2011 and 2015, managed assets in the State Treasury declined by $2.5 billion. According to the report, "The reduction in the state's assets was due to the liquidation of investments in order to fund legislative appropriations, reduction in state revenues, and fund sweeps from dedicated funds." Reserve balances are categorized as "non-recurring revenue" for budgeting purposes because they represent the accumulation of revenue over time and therefore cannot be expected to materialize annually for use in the operating budget that requires some consistency in revenue availability.

The use of non-recurring revenue to balance the state budget is primarily responsible for the Fiscal Year 2017 projected shortfall and this practice must be discontinued going forward. The significant decline in reserve balances affects the state's ability to manage its cash flow and therefore makes it more difficult for the Treasury Department to maximize the return on the money it invests. The overall cushion that reserves provide has been diminished and this is an indicator high on the list of stability measures used by credit rating agencies to evaluate the overall fiscal health of a governmental entity.

PART 5 – HORIZON ISSUES

Dealing with the impending budget shortfalls for Fiscal Years 2016, 2017, and 2018 is likely to consume any new revenue generated during a special legislative session. Even as these problems are resolved, there remain pressing issues that will ultimately have to be addressed if Louisiana is to move forward. Some of these issues will require public policy changes through legislation while others can be addressed with additional funding.

- Medicaid expenditures make up one-third of the state general fund expenditures and serves one-fourth of the state's population. The state should consider instituting a continuous auditing process by use of technology and better screening of providers. Ensuring payments are correct initially would lessen or prevent "pay and chase" situations after funds have been disbursed. The savings realized should exceed any investment made.

- State funding for higher education has been reduced by over $700 million in the past seven years. Some of this loss of revenue has been replaced by increases in tuition and fees but the result has been a net loss. In the process, the capacity for many institutions to increase tuition as a means of filling budget gaps or enhancing programs has been all but eliminated. The state should consider a plan that makes higher education institutions less reliant on tuition by gradually increasing the level of state support in the future.

- Maintenance of facilities is one of the first items to go when budgets have to be reduced. The chronic cuts in recent years have created a backlog of maintenance projects through state government. Higher education leads the list, but other state agencies also have a growing list of maintenance needs.

- Other items that go unfunded during prolonged periods of financial stress are merit pay and cost of living increases for state employees and teachers. In many departments, employee pay raises have not been given in six of the last seven years. Situations like this lead to morale problems that affect productivity and create recruitment problems in many critical positions throughout state government.

- The price of oil and natural gas is not likely to remain depressed forever. If there is any benefit to the state from the low oil and gas prices of today, it is that budget gaps created by these lower prices will have to be filled with spending cuts or other sources of revenue. This creates an opportunity for the state to invest any revenue generated above the current base due to rising prices in transportation infrastructure or some other capital outlay project that will be a permanent benefit to the state.

- The state faces a financial exposure of up to $1.2 billion relating to non-compliant expenditures of Federal Disaster Assistance money. Therefore, the incoming administration should strongly consider conducting a base-line study or friendly forensic audit of disaster programs immediately. Federal funds are available to pay for such a study.

  See Legislative Auditor Report at:

http://app.lla.state.la.us/PublicReports.nsf/0/C15AB83CF635009786257F1B0060E84C/$FILE/0000B7B2.pdf

Additional Information Sources:

Louisiana Fiscal Reform: A Framework for the Future

Prepared by the Tax Foundation - commissioned by the Committee of 100

http://www.c100la.org/files/Louisiana%20Fiscal%20Reform%20Final(1).pdf

Louisiana's Fiscal Outlook – Choices and Decisions, a presentation by Dr. James A. Richardson

Budget Basics – Louisiana Association of Business and Industry

http://labi.org/budget-basics