

# Louisiana's Hidden State Budget

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Louisiana will spend approximately \$8 billion in state revenues next fiscal year through the state budget. The state also will spend another \$7 billion-plus through what might be called the hidden budget.

What is this hidden budget? It's the total of more than 440 separate pieces of legislation, each of which exempts someone or something from some form of taxation. While the regular state budget is made up of money the state takes in and then sends back out, the hidden budget is money the state decides to forego in the first place. This form of spending is called "tax expenditures," and in Louisiana it has grown dramatically in recent years, even as regular state revenue has declined.

To more efficiently manage its finances and build a stronger future, Louisiana needs to shed more light on its hidden, tax-side spending.

## Why is tax-side spending hidden, and growing?

The regular state budget is proposed each year by the Governor and adopted by legislators who get the chance to scrutinize and debate how every penny is spent. The public, too, has the opportunity to comment on the state budget, and people can go online any time and look up any item in the budget at the Legislature's website, [www.legis.state.la.us](http://www.legis.state.la.us).

But the hidden budget works differently. After a specific tax break is approved, the money flows freely year after year—with little chance that this spending by the state will ever be evaluated. If the cost of a particular hidden budget item soars beyond original estimates, it's likely no one will even notice. In the hidden budget, there's no need to set priorities or weigh the value of state spending on one thing compared to another.

And once spending in the hidden budget starts, it's almost impossible to stop. That's because, unlike the regular state budget, the hidden budget can't be reduced by even a penny unless a full *two-thirds* of legislators vote to save the money. That's an unrealistically high bar.

Today, with the state in a fiscal crisis, shedding light on Louisiana's hidden budget is particularly important. As the state is preparing to reduce important services that Louisianans rely on, planning to lay off employees, considering increases in college tuition, and proposing reductions in access to health care in order to make up for declining revenues the hidden budget remains largely untouched and immune to any reductions.

## How much is the state spending through the tax code?

In fiscal year 2011, Louisiana projects spending \$7 billion through tax expenditures, nearly as much as it will take in from revenue. Since tax expenditures are largely ignored in the regular budget process, this means the legislative policy debate encompasses only *about half* of the state's total spending.

And, spending through the tax code is growing. It's projected that revenue lost to tax expenditures from 2006 through 2011 will have increased 28 percent – to \$7.1 billion from \$5.6 billion. State revenue, by contrast, is expected to *decrease* 3 percent.

## Are there examples of tax expenditures that deserve more attention?

Some spending from the hidden budget makes sense. For example, Louisiana exempts medicine and groceries from the sales tax. Most Louisianans probably would agree that's the right thing to do, even if it means the state gives up potential revenue. Louisiana also exempts residential utilities, including electricity, natural gas, and water, from the sales tax. But with 441 tax breaks on the books, and no systematic review process in place, there's little doubt that some of tax-side spending is overblown, outdated, or otherwise wasteful. If tax-side spending were prioritized alongside regular budget items, it is unlikely that all of the existing tax breaks could be justified.

Here are two examples of tax-side spending that deserve more attention:

- **Spending to help energy companies make profits**

Louisiana provides a two-year moratorium on severance taxes to encourage the drilling of horizontal oil and natural gas wells. This tax break was enacted in 1994, when the oil and gas industry was economically weaker due to lower product prices and horizontal drilling was in its infancy. Neither is true today. In the Haynesville Shale in north Louisiana, projected to contain one of the largest accumulations of natural gas ever discovered in the U.S., energy companies don't have to pay severance taxes for two years on wells they drill. But companies don't need additional incentive to explore and mine in the Haynesville Shale, given the enormous profit potential. In fiscal year 2011, tax exemptions on severance taxes are projected to cost Louisiana \$189 million. Drilling in the Haynesville Shale could drive this cost considerably higher when fully developed. That's money that's not going to our depleted university or health care systems.

- **Spending to increase the incomes of the wealthy**

In 2007 and 2008, the state rolled back key portions of the 2002 Stelly Plan that resulted in the largest income tax cuts in the state's history and left in effect the sales tax exemptions passed in the original bill. In 2007, the Legislature began a phased-in reinstatement of the state deduction for federal itemized deductions, which effectively lowered income taxes for those who itemize their deductions -- primarily upper-income taxpayers. This became fully effective in 2009. In the 2008 legislative session, the income-tax-bracket changes were repealed, so the top 6-percent income tax rate once again applied only to income over \$100,000 for joint filers, not \$50,000 as had been the case under Stelly. The total projected cost of these tax cuts by fiscal year 2012 is \$2.2 billion, according to estimates by the nonpartisan state Legislative Fiscal Office.

## What's wrong with Louisiana's annual report on tax-side spending?

Louisiana has taken an important initial step to track tax-side spending. Each year, by statute, the Louisiana Department of Revenue must produce a "tax exemption budget" that estimates the cost of each tax expenditure and assesses its effectiveness.<sup>1</sup>

The tax exemption budget provides useful information, but not enough to get a handle on the revenue being spent through the tax code. For example, even though the law requires it, the Department of Revenue does not provide estimates of the cost of many tax expenditures. The Department says in its tax exemption budget that it lacks the data to estimate these costs accurately, but other states have found ways to make reasonable calculations of lost

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<sup>1</sup> Louisiana Revised Statutes, Title 47, Section 1517.

revenue.<sup>2</sup> Because Louisiana fails to employ these other methods, its tax exemption budget leaves legislators and the public with no idea how much certain tax expenditures are costing the state.

In addition, the Department's assessments of the effectiveness of tax expenditures lack the depth to inform meaningful legislative decisions or public debate. The law requires the Department to assess who benefits from each tax expenditure and whether each tax expenditure:

- (1) Has been successful in meeting the purpose for which it was enacted.
- (2) Is the most fiscally effective means of achieving its purpose.
- (3) Has unintended or inadvertent effects, including whether it conflicts with other state laws or regulations.
- (4) Simplifies or complicates the state tax statutes.

The tax exemption budget provides very minimal, if any, information in answer to these statutory concerns. The budget provides no assessment of the success of each expenditure, no details about the beneficiaries of expenditures (such as a break-out of beneficiaries by income category), no assessment of unintended effects, and no description of whether an expenditure simplifies or complicates state statutes. The budget's assessment of whether a particular expenditure is the most fiscally effective means of achieving its purpose is so minimal as to be useless. In every case, the budget simply repeats the line, "The purpose of this [tax expenditure] is achieved in a fiscally effective manner."

## What should Louisiana do?

At a time of severe budget crisis, Louisiana can no longer afford to put nearly half of its spending off limits from public scrutiny. To let the public into the debate, the state needs to do three things.

- **Improve the tax exemption budget report.** The report should follow the requirements of the law. It must estimate the cost of all (or nearly all) tax expenditures and assess each expenditure based on a variety of criteria.
- **Incorporate an evaluation of tax-side spending into the regular budget process.** Determining precisely how to do this will require legislative and public debate. One step would be to consider increasing the number of tax expenditures that include "sunsets" -- end-dates that force the legislature to choose whether or not to extend a particular expenditure in its current form. Only 20 percent of the tax expenditures Louisiana has created in the past 10 years include a sunset.
- **Reduce the unrealistically high bar for repealing or reducing tax expenditures.** Legislators may cut spending on items in the regular budget by majority vote, but it takes a two-thirds vote of both houses to repeal or reduce a spending item on the tax-side. This disparity makes it difficult for legislators to prioritize state spending. It allows a minority of legislators to continue allocating scarce state resources to a low-priority or even obsolete tax expenditure, at the expense of more important state services.

Every penny Louisiana spends should have a purpose; and every purpose should be scrutinized by the public and elected officials. The needs of the state are too great to allow billions of dollars a year to be spent without any evaluation of whether it is doing the job intended or taking away from a higher priority need.

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<sup>2</sup> For example, Louisiana's tax exemption budget does not include a cost estimate for the corporate income tax exemption for credit unions citing the reason as "No Reporting Requirement". However, Oregon's Tax Expenditure Report includes a cost estimate for this same exemption.