Louisiana Budget Project
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Home to Roost: Income Tax Cuts Costing State Millions Needed for Services

Louisiana's fiscal chickens are coming home to roost. The state no longer generates sufficient revenues to fund necessary services. This problem is due in part to specific tax cuts that hurt Louisiana's most vulnerable populations, reduce education opportunities, and impede the state's ability to recover from the deepest recession since the Great Depression. It didn't have to be this way.

One Step Forward

In 2002, Louisiana revamped its state tax structure to make it more equitable. Without changing the total amount of money collected from taxes, the state eased the obligations of low- and middle-income households by reducing the sales tax and responsibly increasing the income tax on those best able to pay. While initially revenue neutral, over time, the revamped tax system would actually create more revenue for the state as the state's economy grew and people's income increased. The net effect would more than offset the revenue lost from the cuts in sales taxes.

The Stelly Plan, named for its sponsor, Rep. Vic Stelly, eliminated state sales tax on utilities, groceries, and medicines and imposed limited increases in income taxes primarily affecting upper-income taxpayers. Everyone paid lower sales taxes as a result, but because low- and middle-income households have to devote a larger percentage of their income to the purchase of necessities than do the wealthiest households, they got the most benefit.

To offset the loss of revenue from these sales tax exemptions, Stelly made two changes to the state income tax: eliminating taxpayers' ability to subtract from their state income tax federal itemized deductions exceeding the standard deduction; and altering the tax brackets so the top rate would take effect at $50,000 of income for joint filers instead of $100,000. Stelly took effect January 1, 2003.

Two Steps Back

The well-balanced system only lasted a few years. In 2007 under Gov. Kathleen Blanco and again in 2008 under Gov. Bobby Jindal, the state rolled back key portions of the Stelly Plan and helped set the stage for today's fiscal disaster.

During those two years, Louisiana enacted the largest income tax cuts in the state's history and left in effect the sales tax exemptions. Everyone would still pay lower sales taxes, but the state was giving up the money it needed to maintain the same level of services.

Table 1 Louisiana's Income Brackets for Joint Filers			
	2 Percent	**4 Percent**	**6 percent**
Pre-Stelly Plan	$0-$20,000	$20,000-$100,000	$100,000 and over
Stelly Plan	$0-$25,000	$25,000-$50,000	$50,000 and over
Repeal of Stelly Plan	$0-$25,000	$25,000-$100,000	$100,000 and over

Source: Fiscal Notes prepared by the Louisiana Fiscal Office

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 income tax rate of 6 percent once again applied only to income over $100,000 for joint filers, not $50,000 as had been the case under Stelly (Table 1).

The projected three-year cost of these tax cuts is $1.8 billion, according to estimates by the respected Institute on Taxation and Economic Policy (ITEP). Partially due to these tax cuts, Louisiana now faces its worst fiscal crisis since the oil bust in the 1970s, with a multi-year projected shortfall in state revenues of $2.4 billion. Without additional revenues, the state faces long-term damage to vital health and human services, public schools, higher education, and economic development initiatives. As a result, Louisiana will be less attractive to potential employers that can provide the jobs and economic growth Louisiana needs.

Budget Impact of Income Tax Cuts

The revenue loss caused by the Stelly rollbacks, coupled with the impact of the national economic downturn and shortfalls in mineral revenues, leave Louisiana with insufficient revenues to maintain services at current levels at a time of growing needs.

The state's April estimate of the revenue shortfall for Fiscal Year 2010 is $567 million. (Table 2). That is $82 million ***less*** than the projected cost of the Stelly rollbacks for the year (Table 2). In other words, had the state not enacted the Stelly rollbacks, it would not have faced a Fiscal Year 2010 budget shortfall — and the shortfall for the next two fiscal years would be substantially less.

Table 2 Fiscal Effect of Stelly Repeals versus Budget Shortfalls (in millions)				
	2010	**2011**	**2012**	**Total**
Budget Shortfall[1]	($567)	($924)	($937)	($2,428)
Cost of Stelly Repeals[2]	$649	$567	$609	$1,825
Difference	**$82**	**($357)**	**($328)**	**($603)**

Source: Estimates by the Institute on Taxation and Economic Policy (ITEP)

Based on the Legislative Fiscal Office's estimate, updated by ITEP, of the effects of the Stelly repeals, more than 60 percent of the projected budget shortfall for Fiscal Year 2011 (which began July 1, 2010) and 65 percent of the Fiscal Year 2012 shortfall are due to the Stelly repeals.

The state's situation will only get worse. By Fiscal Year 2012, the *cumulative* shortfall in projected state general fund revenues is $2.4 billion. If the 2010-2012 budget shortfall is not addressed with either increases in *recurring* revenues or reductions in *recurring* expenses, the projected shortfall for Fiscal Years 2013 and 2014 is similarly large.

As shown in Table 3, the Governor's plan to balance the 2011 budget came at the expense of human services and education. Unfortunately, these budget cuts come at a time when the needs of the state are markedly increasing. In the past five years, families needing food stamps have increased 20 percent, and Medicaid enrollment is up 13

[1] Calculated during corresponding state fiscal year.
[2] Calculated during corresponding tax year. Estimates do not take into account possible changes in the Bush tax cuts.

percent. Students enrolled at community colleges increased by 37 percent between the fall of 2004 and 2009. The state's unemployment rate increased from 5.4 percent in December of 2004 to 7.3 percent in December of 2009.

Table 3 Total Spending on Human and Education Services (in millions)			
Department	**FY10 Existing Operating Budget as of 12/1/09**	**FY11 Budget (Enrolled)**	**Percent Change**
Education	$5,686	$5,461	-4.0%
Health & Hospitals	$8,201	$8,192	-0.1%
Higher Education	$3,049	$2,945	-3.4%
Social Services[3]	$1,192	$950	-20.3%
Total State Budget	**$34,344**	**$30,319**	**-11.7%**

Source: FY11 Executive Budget

Louisiana has been sheltered from the full impact of its revenue shortfalls by the infusion of federal funds from the American Recovery and Reinvestment Act passed in February 2009. During the 2010 fiscal year, the state used an estimated $1.6 billion in federal Recovery funding to replace state general fund spending.

The Fiscal Year 2011 budget continues to use Recovery funds to replace state spending, but the provisions of the Act are scheduled to expire before the end of the next fiscal year. When the money runs out, the state will need replacement funds to avoid further cuts in services.

So far, Louisiana has pursued a course of meeting revenue declines only with spending cuts, unlike 33 states that, in response to the nationwide financial crisis now know as the Great Recession, have enacted revenue increases in addition to spending cuts. Governor Jindal, who initially opposed the 2008 Stelly rollback but then changed his position, has repeatedly said he will not support increasing taxes. While the potential political appeal of such a stand is obvious, it is equally true that research shows relying too heavily on spending cuts is bad for a state's economy.

During weak economic times, increasing revenue from the wealthiest taxpayers rather than cutting government programs may be more beneficial to the economy. The state's future prosperity requires we consider a balanced approach that includes revenues rather than a cuts-only strategy that can cost jobs and hold back economic growth.

What the State Should Do

Louisiana needs additional revenue. Rep. Michael Jackson's House Concurrent Resolution 187 calls for the House Committee on Ways and Means and the Senate Committee on Revenue and Fiscal Affairs to review the goals and purposes of various tax exemptions, credits, and deductions, including the tax break for those who itemize their deductions. Recognizing that the losses to the state's tax base "have and will continue to impact Louisiana's ability to meet its obligations in areas such as education, health care, roads, capital needs, and the unfunded accrued liability of the retirement systems," the resolution asks the House and Senate committees to "review the goals and purposes of various state tax exemptions, credits, and deductions" in anticipation of the 2011 legislative session,

[3] Rehabilitation Services was removed from the FY10 Operating Budget because the unit was transferred to the Louisiana Workforce Commission in FY11.

during which consideration of tax increases are permissible. (In Louisiana, unless called into special session, the legislature can only consider legislation that increases taxes in sessions occurring during odd-numbered years.)

There are other steps the state should take. One is to make the state income tax structure more equitable. Under the current structure, wealthier people pay a lower percentage of their income in state and local taxes than do low- and middle-income people. Louisiana taxpayers in the top 1 percent income bracket, earning on average over $1 million per year, pay just 5 percent of their income in state and local taxes while those in the bottom 20 percent, earning on average just $ 9,800 per year, pay over 10 percent, according to a 2009 study by the Institute on Taxation and Economic Policy.

If Louisiana increased the rate of the state income tax for joint filers with income between $250,000 and $500,000 to 7% from the current 6% and increased the state income tax on those earning more than $500,000 from the current 6% to 8%; the state would raise an additional $58 million in 2011, according to ITEP estimates. The tax increase would affect only 1% of the state's taxpayers.

To help avoid another fiscal crisis in Louisiana and to reduce the damage caused by this crisis, the state needs to make revenues part of the solution. Relying instead on spending cuts threatens the state's present wellbeing, its future economic development, and its ability to recover once the recession ends.