INDIANA BUDGET UPDATE

REASON FOR OPTIMISM

By: John Ketzenberger, President
Indiana Fiscal Policy Institute

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About the Author

John Ketzenberger is president of the Indiana Fiscal Policy Institute. Previously he was a reporter and editor for several Indiana newspapers.

Executive Summary

Indiana is poised to work its way out of the worst economic crisis to hit the state since the recession of 1981-82 hammered the manufacturing sector. As Legislators consider a new two-year budget there is reason to be cautiously optimistic about the state's fiscal health for the first time since 2008.

One reason for optimism is the recent trend in Indiana's revenue reports. The state's revenue from taxes exceeded revised expectations for the fifth straight month in March. Better yet, growth of the three major categories in the year-over-year comparison is strong. Sales taxes are up 5 percent over last year while individual income tax collections are up 16 percent and corporate income taxes are up 41 percent.

The General Assembly's sober approach to the new two-year budget also is another reason for optimism. The House of Representatives sent the Senate a budget that held the line on spending and did not increase taxes. The House budget would eliminate the state's structural deficit and is expected to produce about $600 million in surplus funds by the end of FY 2013.

Still, there are reasons to be wary. The economy remains unsettled. Fuel prices are climbing and natural disasters shake confidence. Meanwhile the budget battles in Congress may produce new unfunded mandates for states, especially in Medicaid.

Another problem looming for Indiana: unfunded liability for a couple of prominent scholarship programs started when times were better in the economy. One estimate pegs the liability in seven years at $450 million for the 21st Century Scholars Program and the Children of Disable Veterans Fund. Meanwhile, general education spending remains flat.

The April 15 revenue forecast will guide budget consideration as it moves through the Senate and then the conference committee process. If the economy continues its modest recovery and the General Assembly's final budget resembles current proposals, then Indiana will be in the black by the time lawmakers reconvene in 2013 to consider the state's next budget.

How We Got Here

For many people spring is an optimistic season, though pessimism has reigned in recent years, at least among legislators charged with making Indiana's state budget and those who administer it. Recession ravaged revenue since the last budget was signed into law, essentially resetting the state's revenue to the level of 2005. State agency budgets were cut across the board. State payments for primary education were reduced by 3 percent, or $300 million, while secondary education funding was trimmed 6.5 percent, or $150 million. Federal funds helped soften the blow, especially in the categories of education and Medicaid, but those dollars have dried up. By the time the fiscal year ends on June 30, Indiana's $1.6 billion in reserve likely will be about $650 million. It's accurate to note Indiana's Office of Management and Budget and legislative fiscal leaders have scrambled to make ends meet during this most pernicious recession.

So it is with guarded optimism, then, that they await the April 15 revenue forecast. December's forecast predicted revenue growth in fiscal years 2012-13 despite lingering high unemployment rates. The December forecast anticipated a 3.5 percent overall increase in tax revenue for 2012 compared with 2011, including strong gains in the personal income (6.1 percent) and sales tax (3.3 percent) segments. For 2013, the forecast projects an overall increase of 4.1 percent, again with personal income (6 percent) and sales (4.5 percent) taxes leading the way.

FY 2011 Revenue vs. December 15 Forecast

(in millions)

	October	November	December	January	February	March	FY to date
Sales							
Actual	$493.3	$493.5	$505.2	$606.7	$487.7	$483.8	$4,620.1
Target	$509.0	$491.8	$495.7	$595.1	$470.4	$479.2	$4,596.7
Difference	-$15.6	$1.7	$9.5	$11.6	$17.3	$4.5	$23.3
Individual Income							
Actual	$316.9	$354.9	$325.8	$509.7	$144.5	$333.6	$2,993.1
Target	$319.3	$304.4	$324.5	$496.8	$143.6	$299.8	$2,906.1
Difference	-$2.5	$50.6	$1.3	$12.9	$1.0	$33.8	$87.1
Corporate Income							
Actual	$23.7	-$13.6	$145.5	-$0.3	-$7.0	$39.3	$349.6
Target	$35.2	$4.0	$114.7	-$5.2	-$4.4	$35.2	$341.2
Difference	-$11.5	-$17.6	$30.8	$5.0	-$2.6	$4.1	$8.5
Total GF							
Actual	$958.9	$917.4	$1,125.2	$1,276.9	$715.5	$977.2	$8,987.7
Target	$985.8	$879.5	$1,082.7	$1,236.2	$710.2	$945.4	$8,872.9
Difference	-$27.0	$37.9	$42.5	$40.8	$5.2	$31.8	$114.9

Source: State Budget Agency

Indiana's tax collections since late last year also give rise to the notion that the recovery is starting to take hold and that may affect the new revenue forecast.

FY 2011 Monthly Revenue Year-Over-Year
March 31
(in millions)

	October	November	December	January	February	March	FY to date
Sales							
FY2010	$492.4	$466.6	$472.0	$572.7	$449.4	$460.3	$4,401.8
FY2011	$493.3	$493.5	$505.2	$606.7	$487.7	$483.8	$4,620.1
% change	0.2%	5.8%	7.0%	5.9%	8.5%	5.1%	5.0%
Individual Income							
FY2010	$271.5	$289.2	$300.0	$442.7	$110.2	$285.4	$2,580.6
FY2011	$316.9	$354.9	$325.8	$509.7	$144.5	$333.6	$2,993.1
% change	16.7%	22.7%	8.6%	15.1%	31.1%	16.9%	16.0%
Corporate Income							
FY2010	$68.2	($16.70)	$83.6	($37.3)	($18.8)	$37.3	$247.7
FY2011	$23.7	($13.6)	$145.5	($0.3)	($7.0)	$39.3	$349.6
% change	-65.3%	18.5%	74.0%	99.3%	63.1%	5.5%	41.2%
Total GF							
FY2010	$965.1	$811.2	$988.7	$1,147.5	$637.4	$908.4	$8,264.3
FY2011	$958.9	$917.4	$1,125.2	$1,276.9	$715.5	$977.2	$8,987.7
% change	-0.6%	13.1%	13.8%	11.3%	12.3%	7.6%	8.8%

Source: State Budget Agency

Any optimism, however, is tempered by the fact that revenue still does not match the targets upon which the current budget was built.

FY 2011 Monthly Revenue vs. Targets
Based on May 29, 2009 Revenue Forecast
(in millions)

	July	August	September	October	November	December
Total GF						
Actual	$917.0	$937.6	$1,162.0	$958.9	$917.4	$1,125.2
Adj. Target	$988.7	$939.5	$1,270.2	$1,040.2	$919.0	$1,142.0
Difference	($71.8)	($1.9)	($108.2)	($81.4)	($1.6)	($16.8)

	January	February	March	April	May	June	FY to date
Total GF							
Actual	$1,276.9	$715.5	$977.2	$0	$0	$0.0	$8,987.7
Adj. Target	$1,292.3	$740.8	$990.3	$1,612.3	$1,074.2	$1,600.2	$9,323.0
Difference	($15.4)	($25.3)	($13.1)	$0	$0	$0	($335.4)

Source: State Budget Agency

This is why the budget introduced by Gov. Mitch Daniels and modified by the House of Representatives does not include major new spending, and why it is unlikely the Senate's version will either. The new revenue forecast likely will show growth in the state's tax take, but there are so many uncertainties in the economy that legislators are not about to embark on a spending spree. Past crises, whether man-made like the banking meltdown, natural like the earthquake/tsunami in Japan or the ongoing credit crunch plaguing the European Union, have made an impression on members of Indiana's General Assembly. Add uncertainty about how federal spending policies will affect Indiana and you've got the recipe for a flat line budget intended to rebuild reserves without raising taxes.

Steady Momentum for the Future

Much has happened since the Indiana Fiscal Policy Institute estimated in September 2010 that the state faced a structural deficit of $1.3 billion in the next biennium. The state has continued to cut costs and draw down reserves. It also has benefitted from improving tax revenue. The task facing the General Assembly, therefore, is less daunting. Though it's difficult to estimate the deficit mid-year, revised estimates peg the current structural deficit, or the amount of spending over available revenue, at about $650 million. All budget proposals contemplate reaching structural surplus, or the point at which revenue exceeds expenditures, by the end of FY 2013.

Gov. Daniels' administration released its budget proposal Jan. 13. It anticipated spending $27.5 billion in general fund revenue between July 1 2011 and June 30, 2013. The governor's budget projected a $270 million spending gap at the end of FY 2012, but estimated revenue would exceed spending by $55.5 million at the end of FY 2013, based on the December 2010 revenue forecast. The proposed budget also showed an overall balance of funds at $725 million, or about half of the amount Gov. Daniels said he would like to have in reserve.

Described as a "flat-line" budget, the governor's proposal did not restore $300 million in cuts to primary education or general government. The basis for funding public schools, then, is $300 million less than it was in the current fiscal year. The proposed budget also trimmed higher education spending, which was cut last year by $150 million, or 6.5 percent, another 3 percent. The budget did, however, increase maintenance funds for buildings on Indiana's public college campuses.

The administration's budget sought to control Medicaid costs by reducing some optional services while injecting $135 million of new state funding into the system to help offset $300 million lost when federal dollars from the American Recovery and Reinvestment Act expired. The proposal also increased the state's contribution to its pension funds by $117 million to $952 million.

On February 18 the House Ways and Means Committee approved a proposal made by Chairman Jeff Espich, R-Uniondale, that differed slightly from the governor's budget. The budget cleared the House March 30. It spends about $60 million more over the biennium than the governor's proposal and ended the term with about $590 million in reserves.

There were several differences in revenue between the budgets. The House version did not include any revenue from the Public Depositories Insurance Fund; the governor intended to shift $200 million from the fund to the state's general fund. The House proposal also changed the 15 percent distribution to horse racing from racino slot machine proceeds. The change would shift $33.5 million over the biennium from horse racing purses, breed development funds and horsemen's association to the state's general fund and the 21st Century Research and Technology Fund. The proposal also would shift $53.6 million in cigarette tax proceeds from the State Retiree Health Benefit Trust to the general fund and $15.5 million in sales tax proceeds from the Public Mass Transportation Fund to the general fund.

On the expenditure side, the initial House proposal installed a formula for allocating primary school funding, which accounts for 47 percent of the state's expenditures. The proposed formula reduced the basic grant per student, changed enrollment factors and some grants for special needs that would shift funding away from schools with declining enrollments to those that are growing. (House Bill 1003, which also would affect school funding, is discussed in a later section) The House budget also restored the 3 percent cut that the governor proposed for higher education, but it did so by not including any money for building maintenance. It also proposed a tuition cap that would be set by the Indiana Commission for Higher Education and reviewed by the State Budget Committee and the State Budget Director. The House plan restored the administration's cuts to Medicaid services and increased spending 5 percent. The budget also freezes state agency budgets and postpones pay raises for legislators, judges and state elected officials.

Both proposals included provisions to refund reserves in excess of 10 percent of appropriations to taxpayers. The budget proposals anticipate reserves between 3 percent and 5 percent at the end of the FY 2012-13 biennium.

Key Legislative Proposals Have Fiscal Impact

Several Bills in the General Assembly would affect the state's fiscal outlook. They include:

House Bill 1450, which makes changes the state's Unemployment Insurance Compensation Fund. It was signed by Gov. Daniels on Feb. 24 and takes effect May 1.

The new law enacts a surcharge of 13 percent of the contribution rate an employer pays to raise an estimated $90 million a year. The money will be used to pay the interest on a federal loan of nearly $2 billion that was required to pay benefits. The new law also reduces the amount employers paid into the fund based on a 2009 law. Finally, the new law restricts eligibility and lowers the basis for figuring benefits.

All of the changes are expected to make the fund solvent again in 2020.

House Bill 1003 increases the tax credit available for contributions to certified scholarship granting organizations from 50 percent currently to 80 percent in 2014. The bill also creates a system that would allow up to 7,500 students with household incomes of up to 150 percent of the amount to qualify for free or reduced lunches to transfer with a state scholarship (or voucher) to another accredited public or private school. The total would be 15,000 the second year.

The scholarship of $4,500 would be paid for out of the state tuition grant to the district the student is leaving. The grant would be limited to the difference between state grants to districts if the student remains in a public school, and the remainder would be placed in the state's overall school funding formula. The remainder, however, could be affected if the formula includes minimum guarantees per student or additional grants to districts with declining enrollments (de-ghosters).

At this point we are unable to determine the impact of this program on the school funding formula.

Senate Bill 577 is a bill to place eligibility requirements on students who receive currently receive free tuition at state universities through a program for children of disabled veteran. There is growing interest in this program and the 21st Century Scholarship program as they increase in popularity. There is concern that the state may have difficulty funding the programs. There is one estimate that the programs could have an unfunded liability of $450 million in the next seven years unless changes are made to them.

Senate Bill 589 includes a reduction of the state's corporate adjusted gross income tax rate from 8.5 percent to 6.5 percent, among other provisions. This would reduce the revenue from corporate income taxes by an estimated $76.3 million in FY 2013, according to the Legislative Services Agency.

The bill also eliminates the exclusion of interest income from state and local bonds issued outside of Indiana, however, from both individual and corporate income taxes. This would result in a revenue gain of $65.9 million to the state, according to the LSA.

Finally, the bill eliminates a number of tax credits that would save the state $3.1 million.

The net effect of the changes, according to the LSA, would reduce the state's tax revenue by $7.3 million a year beginning in FY 2013.

Clarity in No Tax Hike

Neither budget proposal increases state revenue by raising tax rates. It is unlikely the Senate budget proposal will increase state tax rates either. The Senate Appropriations Committee conducted budget hearings in anticipation of receiving House Bill 1001. The committee has scheduled a final hearing on HB 1001 for April 18 and the full Senate is expected to consider the budget later that week.

Attempts by Democrats to eliminate the governor's discretion to spend less than the Legislature appropriates were rebuffed in the House and likely will be in the Senate, too.

Finally, legislative leaders have indicated a preference to move House Bill 1001 independently of the bill(s) that will reapportion the General Assembly's 150 districts. The budget in 2001, the last time redistricting occurred, did not include the legislative maps, which were in House Bill 1776 that year. However the bills did move in concert by agreement of leadership. In 1991, however, the new legislative maps were included in the budget bill, so recent history does not offer a clear indication of how matters will progress this year. It is likely the budget this year will be affected by the redistricting bill, we just don't know how and to what extent it will affect passage.

For more information, contact IFPI President John Ketzenberger at:

Indiana Fiscal Policy Institute
One American Square, Suite 150
Indianapolis, IN 46282
(317) 366-2431
www.IndianaFiscal.org