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# Indiana's Revenue Forecast: Modest hope after the hardships of 2020

We're all eager to say goodbye to 2020 in two weeks. But there's six more months before we can turn the page to a new fiscal year, and the next state budget cycle – with plenty of work in the interim.

Last week marked an important milestone in the process, as the State Budget Committee received a revenue forecast that projected modest growth in FY2022-2023: $34.95 billion in anticipated general fund revenues, versus $33.1 billion (estimated) for the current COVID-ravaged biennium. (See the forecast materials here.)

Even though observers were socially distanced or watching virtually, you could almost hear the collective sigh – one part relief, one part resignation. Even though the forecast was "better than expected," it certainly wasn't robust enough to avoid tough choices and some difficult negotiations over the next budget.

### Big Picture: Revenue gains erased by Medicaid spending

The new projections show year-over-year growth across all major revenue sources from FY2021 (also revised) through 2023, after adjusting for the impact of deferred income tax payments from 2020 to 2021. But the $34.95 billion predicted for 2022-23 is only $360 million above the current budget (as passed), and is quickly erased by a Medicaid forecast seeking $475 million in additional state funding over FY2022 and 2023.

### Notes on Revenues:

Revenues for the current budget are trending $515 million below last December's forecast; most of this gap comes from individual income taxes, driven by COVID's sharp impact on jobs and taxable earnings. The economic outlook presented on Wednesday shows state GDP fully recovering in early 2021, with payrolls slowly catching up to pass their Q1 2020 peak in mid-2022 (the halfway point of the next biennium).

**Individual Income Tax:** This employment trajectory explains the moderate 2% growth in individual income taxes from FY2021 to '22 ($6.25 billion to $6.37 billion), accelerating to 3.6% to hit $6.6 billion in FY2023 as Hoosiers get fully back to work at pre-pandemic levels.

**Sales Tax:** Sales tax revenues have been more stable, even exceeding expectations in recent months to help the state escape this biennium without K-12 cuts or deeper sacrifices elsewhere. Consumer spending was buoyed by federal stimulus and enhanced unemployment benefits through the summer, and broader taxation of online transactions captured shifting retail habits during COVID.

But this suggests less 'room to grow' for Indiana's largest revenue stream (and a return to normalcy may also mean resumption of spending habits on services, which aren't taxed, versus durable goods). So sales tax collections are expected to grow steadily, 4% for the biennium to reach $8.81 billion in FY2023 (from $8.47 billion expected in 2021).

After adjusting for delayed and extended payments, **corporate income tax** collections are projected to rise from 2021 ($724 million) to 2022 ($765 million), with a bigger burst coming in the second half of the biennium (surging 16% to $888 million in 2023) as employment stabilizes and GDP continues to grow.

Among other major revenues, **riverboat and racino wagering** show strong growth (over 9%) from FY2021 to '22 (likely anticipating a burst of pent-up activity with economic re-opening and vaccine deployment), slowing in 2023 but generating a grand total of $850 million in revenue over two years.

### What does this mean for the FY2022-2023 budget?

First, the good news: The extension of the tax filing deadline this year to July 15th caused major cash flow headaches for state budget officials, moving nearly a billion dollars of anticipated revenue from FY2020 to 2021. But the state did collect these delayed payments, as agencies cut nearly $675 million from planned spending to offset the other budgetary effects of the pandemic (sparing K-12 funding from reductions).

Along with reversing a pre-COVID plan advancing $291 million in university construction projects, this leaves the state with an expected $2.33 billion surplus at the end of FY2021…amazingly, nearly matching the fund balances that greeted the start of FY2020.

The state has managed through this crisis well, and the solid revenue forecast released last week suggests that fiscal leaders won't need to wield a heavy axe against budget priorities. But a closer look at the numbers will have them sharpening their scalpels.

**$360 million – now you see it, now you don't:** As noted earlier, the $34.95 billion general fund forecast for 2022-23 is only $360 million above the current budget as originally approved, before reversions and other adjustments. But for an hour or so on Wednesday, this offered a little breathing room towards the next biennium.

That is, until the Budget Committee moved to the next item on its agenda, and heard a Medicaid forecast seeking $475 million in additional state funding over FY2022 and '23 – leaving the other 85% (roughly) of state spending to be divided among competing demands for scarce resources.

**Doing the math on K-12:** This constrained outlook collides with sizable commitments to education. There is strong support for continuing (increasing, if possible) state K-12 support at current levels. Governor Holcomb has further expressed his desire to restore higher education funding to levels passed in 2019 (before absorbing a 7% cut as part of April's COVID belt-tightening measures).

All told, this would add up to more than $21.5 billion in spending over the biennium (based on FY2020-21 appropriations including higher ed construction and teacher pension obligations).

**Other budget priorities:** In the past, increased funding requests from the Department of Child Services (DCS) have further complicated the budget math. In last week's agency hearings, however, DCS requested $70 million less over the coming biennium.

But these potential savings were balanced by a higher request ($80 million) from the Department of Corrections, another area where cutbacks could prove challenging.

**All the categories referenced above – education, Medicaid, corrections and child welfare – add up to more than $30 billion in potential spending over the two-year budget** (again, based on the current biennial baseline)**.** Suddenly, finding more than $100 million in cuts looms more significantly over areas like economic development, transportation, and workforce and pre-K programs separate from core education appropriations. And it certainly makes the prospect of a cigarette tax increase earmarked for public health seem less like a pipe dream (pun intended).

Stay tuned for more detail on the evolving budget negotiations once the gavel drops on the 2021 session of the General Assembly on January 4th.