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Indiana General Assembly 2021 – IFPI Session Report #3:
The Senate Strikes Back

The release of the Indiana Senate's version of HB1001 on Thursday wasn't quite as dramatic as this title implies, but the amendment does feature some significant departures from the House plan, most notably on education funding. Like the House, the Senate increases K-12 appropriations, restores higher education funding (with a slight second-year increase) to pre-COVID levels and meets the biennial Medicaid forecast. See the full amendment here.

The Senate also preserves a $2 billion surplus (roughly 11% of annual expenditures at the end of FY2023) while spending nearly $36 billion in general fund revenues over the next two years…but forgoes the 50 cent-per-pack cigarette tax increase proposed in the latest budget draft.

In shuffling spending priorities, the Senate budget-writers did have a key advantage over their House peers.

A Deus ex Machina of Federal Funding:
The federal American Rescue Plan passed Congress and was signed into law in mid-March; within the massive $1.9 trillion bill was $350 billion in aid to state and local governments, including an estimated $5.6 billion allocated to Indiana.

Unlike the CARES Act, much of this funding could be flexibly targeted to ongoing budget challenges – Senate appropriators seized the opportunity to use roughly $900 million for various grant programs and other investments aimed at economic recovery, small business support, water infrastructure and more. (Many of these commitments were also included in the House plan, paid for via general fund revenues.)

Up in Smoke:
Among other changes, this influx of funding helped the Senate forgo the 50 cent-per-pack cigarette tax increase proposed by the House (and the $300+ million it would have generated for the biennium). Any pressure to add revenue was also eased by strong reports from February and March, as sales taxes finished $92 million (10%) above the two-month forecast. (We expect the April 15th forecast update to deliver more optimistic news, providing a little more breathing room on budget negotiations down the stretch.)

Doing the Math on K-12 Spending:

Starting with education, the largest – and most scrutinized – category of state spending: The Senate allocated slightly more than the House (rounded to $15.5 billion) to the K-12 tuition support that follows students to support local schools, but divides the dollars a little differently.

As a brief refresher, tuition support is dominated by the foundation grant, core funding equally applied to every student. A 'complexity' grant is added for students in poverty to address resource disparities and challenges outside the classroom, along with additional funding for special education and non-English speaking students. The same categorical grants follow students to brick-and-mortar charter schools, along with an additional grant (currently $750) to account for charters not receiving local property tax revenue. Students taking advantage of school choice scholarships receive tiered funding based on household income.

Here's how the Senate tackled the school funding formula proposed by the House:

- Eased the expansion of school choice and launch of a new education scholarship account (ESA) program originally in HB1005, with higher income eligibility for choice scholarships and limiting ESAs with students requiring special education services;
- Increased the additional charter school grant per student to $1,000 for 2022 and 2023 (the House set the charter grant at $1,000 in 2022 and delivered an additional bump to $1,250 in '23);
- Grew the foundation grant per student to $5,760 in 2022 and $5,846 in 2023 (ending up about $60 less than the House formula) but significantly boosted the complexity grant for students in poverty: Complexity is set at 66% of the foundation grant ($3,858 in '23), while the House flatlined it at $3,675;
- To digress, this feels a little familiar: The Senate proposed a similar 66% formula for complexity in 2019 in response to a House budget that also more heavily favored the foundation grant – the current $3,675 grant was a modest compromise over the FY2018-2019 cycle;
- Finally, the Senate increased English Language Learner (ELL) funding by $10 million and special education funding by $190 million (versus the House) – in all, a more favorable proposal for districts that serve higher-poverty communities with higher concentrations of at-risk students.

So looking ahead, will a stronger revenue forecast allow for compromise on complexity funding and school choice programs as the amended HB1001 cruises through the Senate towards conference committee?

It is also notable that HB1008, putting $150 million into K-12 learning loss prevention grants from the current year's general fund, has passed third reading in the Senate and heads back to the House in an amended form. The American Rescue Plan also includes significant resources for educational recovery and stabilization.

Highlights from the 'Other Half:'

As for the other 50% of the budget, there are more shifts from House to Senate in the nearly $18 billion spanning the rest of state government obligations for 2022 and 2023:

- The Senate fully-funds the Medicaid forecast at $5.5 billion; with the flexibility granted by federal stimulus and moving $150 million in unspent appropriations from 2021, the plan accommodates a $240 million biennial increase without any additional cigarette tax revenue;
- On higher education, the latest budget restores funding to pre-COVID levels in FY2022 with a 2% increase in FY2023, versus the House (a 1% increase in '23) and the Governor's originally proposed 1% in both years of the biennium – within the $4.2 billion two-year total, there's some advance repayment of capital debt but no new construction projects;
- The Senate maintains commitments to workforce programs like Next Level Jobs and adds $2.5 million to efforts to align secondary STEM programs with high-demand careers;
- The Department of Child Services (DCS) broke its recent cycle of increasing funding requests this year amid declining caseloads; the Senate fulfills the agency's recommended budget but moves $25 million from administration to raise rates for front-line service providers (a concern raised repeatedly during Senate budget hearings);

- The latest amendment also restores most mental health grants and services to FY2021 levels (having been reduced in the previous iteration) and funds $50 million for the public health-focused grant program envisioned by HB1007 via federal stimulus instead of general fund revenue;
- On public safety, the Senate similarly uses federal resources for $70 million in upgrades at the Indiana Law Enforcement Academy and $25 million for body cameras (versus $10 million for local grants in the House, though the $25 million is divided between local law enforcement and the Indiana State Police) – all investments consistent with HB1006, the bipartisan police reform package signed by Governor Holcomb;
- The Senate also adds $3 million to the House line item for state 'prisoner hold' reimbursements to county sheriffs – a modest increase to ease a significant local public safety liability, especially with the post-COVID uncertainty over jail populations;
- Finally, the Indiana Economic Development Corporation's (IEDC) agency request gets full funding; the 21st Century Fund gets a $10 million increase over the House baseline, while eligibility for the state's venture capital tax credit is expanded;
- In addition, several new and expanded economic development and infrastructure programs are backed by federal dollars, and merit special mention.

Economic Development & Infrastructure (and looking beyond the biennium):

Among the programs earmarked for Indiana's share of the American Rescue Plan are:

- $150 million over the biennium for the Regional Economic Acceleration and Development Initiative (READI) – which we assume is the latest name for Governor Holcomb's Regional Recovery Grant program, A.K.A. "Regional Cities 2.0," which aims to encourage regional partnerships around projects aimed at attracting people (and therefore employers and investment);
- $75 million for a new Career Accelerator Fund, similar to Next Level Jobs but targeted to shorter-term (six-month) vocational certificates to help individuals advance in the job market;
- $60 million for small business recovery grants – justifying the doubling of the original $30 million in HB1004 (the vehicle creating the program) before sending the bill back to the House recently;
- $250 million for broadband access expansion (assuming the fiscal impact of a variety of proposals around rural broadband this session, which have been largely consolidated into HB1449);
- $10 million over biennium for Next Level Flights (incentivizing the attraction of non-stop routes to Indiana airports, a priority as air travel rebounds from the pandemic);
- $100 million (over five years) against the state's long-term commitment to the Water Infrastructure Revolving Loan Program, along with $30 million per year for grants to locals for transportation and water infrastructure; and finally
- $1.2 million to develop an intermodal plan for Buffington Harbor on Lake Michigan in Gary, as the area prepares to transition to a commercial shipping hub after the closure of Majestic Star Casino.

In introducing these plans, Senate Appropriations Chair Ryan Mishler cautioned that "one-time money" should not create ongoing expenses (and expectations), a sentiment that has been echoed by OMB Director Cris Johnston. It is prudent thinking, but also a perceptual trade-off in funding these programs outside the general fund; after all, when it comes to economic development and physical infrastructure, the challenges addressed by most of these programs existed pre-COVID and will persist past the next biennium.

In the case of the Career Accelerator Fund, a mechanism is established to replenish financial aid to recipients (capturing the growth in income tax revenue generated by those who complete the program and get a better job).

Could a similar increment financing model be created for READI grants, for example? As a successor to the 2016 Regional Cities Initiative, READI would tackle long-term population and employment trends facing Indiana by investing in regional partnerships around "transformative" projects.

The necessity of state grants is based on a lack of local financing for such projects, especially in the urban and metropolitan counties with the greatest potential to attract population and business opportunities. The structure exists through Regional Development Authorities, but the fiscal capacity is not.

Just twenty of Indiana's 92 counties account for 75% of total Gross State Product and all the state's net population growth since 2010. But local governments in these counties also lost 13% of their combined property tax levy to cap credits in 2020, versus 8% across the other 72 counties – according to the 2018 Local Capacity-Cost Index, these counties lag the state average in revenue potential per capita.

This is one instance where a two-year infusion of federal stimulus can't fully address a fiscal dynamic that's grown over twenty years or more. In an earlier Senate hearing on the IEDC budget, Senator Holdman urged the agency to "think bigger" – this could include longer-term commitments to continuing these investments beyond the American Rescue Plan.

What's Next?

The sustainability of economic development and infrastructure initiatives (alongside the increasing demands of K-12, post-secondary education, Medicaid and other budget categories) depends on the continued stability of state revenues. As noted earlier, revenues for the first quarter of 2021 have outperformed even the more optimistic forecast delivered to the State Budget Committee in December by $426 million (enough to close any lingering revenue shortfall created by COVID).

The updated forecast will be presented this Thursday, April 15th – framing the final negotiations over HB1001. Stay tuned for IFPI's take on the revenue projections and implications for the FY2022-2023 budget.