Indiana Fiscal Policy Institute Brief

INDIANA'S REVENUE FORECAST, APRIL 2017

and

A COMPARISON OF BUDGET PROPOSALS FROM GOVERNOR HOLCOMB, THE HOUSE AND THE SENATE

By John Ketzenberger and John Stafford
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INDIANA'S REVENUE FORECAST, APRIL 2017

Summary

Indiana's gradually improving economy is expected to produce about $201.2 million more in tax revenue than previously forecast in December 2016. It's a relatively small uptick in a two-year budget that will spend more than $30 billion.

Most of the growth is expected to come from individual income tax, thanks to expected higher wages. Income taxes are expected to generate about $119.2 million more than previously forecast.

Confidence is higher in the forecast thanks to changes made in December to models for sales taxes. The models are better able to account for sales tax receipts on gasoline. Reductions in the price over the last two years meant the forecast significantly missed its mark through December.

While the forecast was generally optimistic, the economic forecast again came with a caveat that changes in federal policy regarding trade and taxes could have a significant effect on the actual outcome.

Introduction

Indiana's two-pronged approach to estimating how much tax revenue will be available for lawmakers to appropriate in the budget was the subject of a recent study by the Indiana Fiscal Policy Institute (available at www.indianafiscal.org). It's a relatively rare and effective bi-partisan exercise that eliminates arguments over available revenue, instead focusing discussion on appropriations.

The first step is an economic outlook for Indiana, which is delivered by a non-partisan third-party, IHS Markit. The second step is the actual revenue forecast, conducted by a bi-partisan committee of experts who use the economic forecast as the basis for determining how much tax revenue the state should expect over the next two years.

Economic Outlook

Indiana's economy, as measured by real gross state product, is expected to grow 1.8 percent this year, 2.3 percent in 2018 and 2.0 percent in 2019, according to IHS Markit's economic forecast. The forecast was revised down 0.1 percent for the current year and was unchanged for 2018.

The forecast expects the state's economy to grow at a slightly higher rate than in recent years, but it's still the same modest growth curve the state has experienced since the 2008-09 recession. A pair of encouraging trends are emerging, however, that lead directly to higher expectations for income tax receipts.

Wage income is expected to reach 5.0 percent next year and 4.9 percent in '19, according to the economic forecast. The expectation is based on higher productivity and wage gains by existing employees since payroll employment growth is expected to grow at a slower pace over the next 2-1/2 years.

Growth in single-family housing starts are expected to boost personal consumption of durable goods too, although it's expected to sustain current spending levels.

Manufacturing jobs remain the state's economic mainstay, though the reliance on automobile and related supply-chain manufacturing dampen growth as IHS Markit expects new-car sales to remain flat in coming years. Service-Sector employment is growing in the state, but at a rate less than the national average. The lack of population growth affects this, according the forecast.

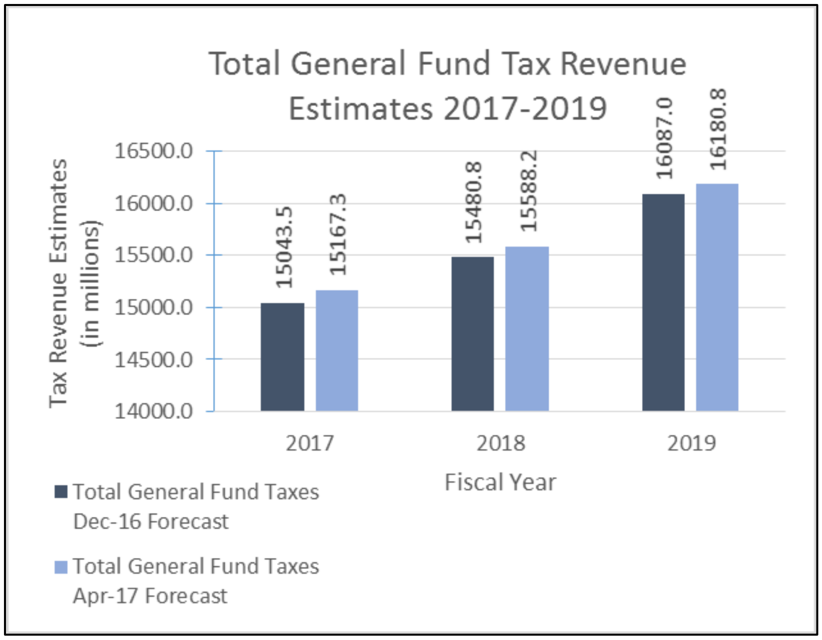
Even so, the Health and Social Services segment was just behind Manufacturing as the leading source of job growth between February 2016 and February 2017. Professional and business services, which account for most of the technology related jobs, was a close third. The Transportation and Warehousing sector experienced the largest job loss, just over 6,000 in the state during the period.

The expected wage growth bodes well for Indiana's tax revenue collections, especially since the individual income tax is the second-most important. The challenge remains further diversification of the state's economic sectors, developing new well-paying jobs in technology and services to gradually replace the state's manufacturing base.

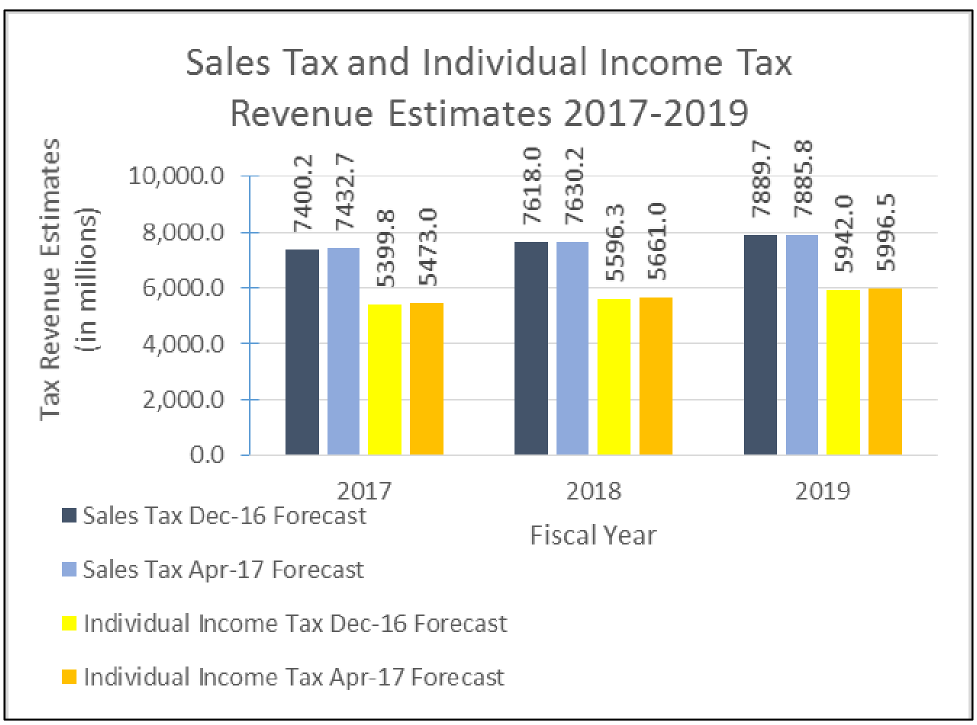
Tax Revenue Forecast

The forecast released April 12 is the second and last one before the General Assembly concludes work on Indiana's next two-year budget. While the forecast anticipates $201.2 million more in tax revenue than the December forecast, it's doubtful lawmakers will choose to go on a spending spree. It's more likely the surplus statement generated from the budget proposal will show a healthier bottom line.

Despite the good news, the forecast expects the current budget that expires on June 30 will outspend projected revenue by $254.4 million. That's an improvement of $124 million compared with the December forecast, though, which reflects the generally optimistic outlook going forward.

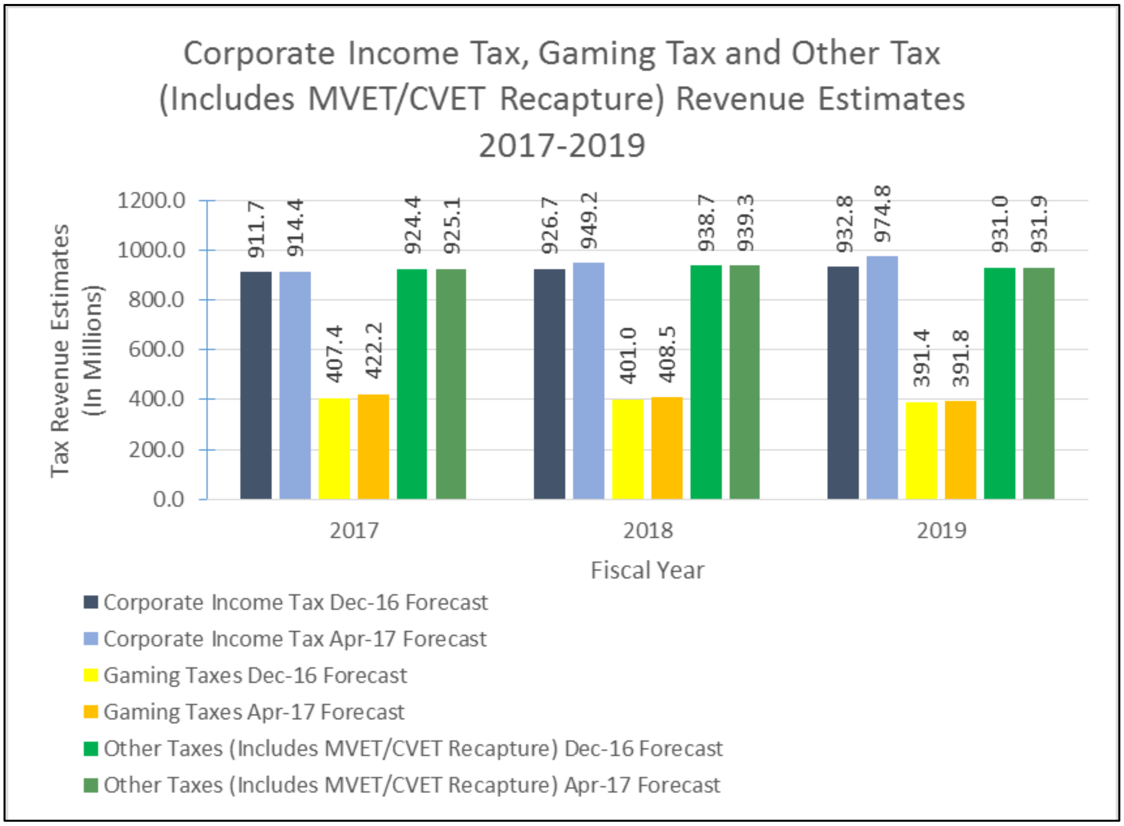


The revised revenue forecast expects the state will collect $15.167 billion through the end of the current fiscal year. It projects revenue of $15.588 billion in fiscal year 2018 and $16.181 billion in FY 2019. That amounts to a 6 percent increase over the next two fiscal years.



The state's sales tax and individual income tax are the two largest sources of revenue, accounting for about 80 percent of all the money Indiana has to spend. Sales tax collections were expected to reach $7.4 billion by the end of this fiscal year, a 0.4 percent increase from the December forecast, a figure that's expected to increase slightly to $7.6 billion in FY 2018. While sales tax collections should reach $7.9 billion in FY 2019, the revised forecast is 0.05 percent lower than the December forecast.

The individual income tax is expected to rise from $5.5 billion at the end of the current fiscal year to about $6 billion by the end of FY 2019, a 9.6 percent increase.



The forecast provided a mixed result for gambling taxes. While it still anticipates a decline in gambling taxes through June 30, 2019, the revised forecast expects slightly more revenue than in the December forecast, or about $7.9 million.

Legislative Outlook

Fiscal leaders weren't surprised by the updated revenue forecast. Economic news provided hope for additional revenue, but the uncertainty in Congress surrounding major issues like tax policy, international trade and insurance tempered expectations. Even though the forecast anticipates $911 million more in revenue over the next two fiscal years, lawmakers recognize between additional funding for roads, education and Medicaid there isn't much money to spread around.

The trend of reducing taxes likely ends during this session. In fact, it's likely the General Assembly will increase the gasoline tax and, possibly, the cigarette tax this session and use the proceeds for roads and Medicaid. Other means to generate revenue, such as tolling on interstates or issuing bonds for projects, are likely to get serious consideration as the session wanes.

The Medicaid forecast predicted the health program for the poor is expected to spend about $41 million more this fiscal year than forecast in December in a nearly $2 billion overall budget. Spending is expected to plateau over the next two years, although it's contingent on any changes made at the federal level. Medicaid, which has seen the sharpest spending increases over the last decade, still has the potential to blow a hole in the state's budget depending on what the federal government decides.

The session is expected to end by April 21 or 22, meaning budget negotiations are heating up. It appears the major differences between House and Senate Republicans involve managing the funding mechanism for the transportation program, whether to spend additional money on pre-kindergarten programs and a few related questions. While the talks could be thorny, they'll turn on philosophy and not the amount of money the state will have in tax revenue.

Expect the budget to be completed on time and for lawmakers to leave ample surpluses at the end of each fiscal year.

A COMPARISON OF BUDGET PROPOSALS FROM GOVERNOR HOLCOMB, THE HOUSE AND THE SENATE

As the 2017 session of the Indiana General Assembly enters potentially its last two weeks, many issues are yet to be settled in conference committees. Perhaps the most significant of these issues is finalization of the biennial budget – House Bill 1001. While the Senate, the House and governor's seat are all controlled by the Republicans there remain numerous fiscal policy differences among the key players in the final budget negotiations. The updated revenue forecast also plays a key role in determining the state budget's outcome.

Fiscal Impact Statements prepared by the Legislative Services Agency provide a breakout of HB1001 at each critical step in the legislative process. General Fund operating appropriations are totaled for each of 23 functional subcategories. General Fund construction spending is totaled for both Higher Education capital and all other capital spending. Spending supported by dedicated and federal funds are also aggregated into five basic categories. Appendix 1 illustrates the totals for the various functional subcategories for the FY 2016-17 budget as enacted by the General Assembly in April 2015, for the FY 2018-19 budget as prepared by Governor Holcomb and reflected in the introduced version of HB 1001, for the FY 2018-19 budget as passed the House of Representatives on Feb. 27, and for HB 1001 as passed the Senate on April 6.

While the remainder of this paper is devoted to a discussion of differences between the House and Senate versions of the budget, it should be noted that for several of the functional subcategories delineated by the Legislative Services Agency there was no practical difference in the appropriations proposed by the House and the Senate. These subcategories included such major items as General Fund allocations for Corrections (approximately $1.5 billion), several social services categories (totaling more than $2.4 billion), state student assistance for higher education ($693 million), the Teacher's Retirement Fund ($1.8 billion), and the allocation of Tobacco Settlement funds ($226 million).

The Cigarette Tax Increase and Use of the Sales Tax on Gasoline

The major revenue difference between the House and Senate is the House proposal to increase the cigarette tax by $1 per pack. The House would use the money to offset revenue lost by shifting the sales tax on gasoline from the general fund to transportation projects. The Senate proposal eliminated the cigarette tax increase and left the sales tax on gasoline in the general fund. The proposed cigarette tax is estimated to raise an additional $278.32 million in FY 2018 and $297.0 million in FY 2019. The House budget created the Medicaid Provider Reimbursement Fund and allocates nearly all the new revenue from the cigarette tax increase to that fund. Concurrently, the House budget shifts approximately $300 million in revenue from the sales and use tax on gasoline per fiscal year from the General Fund and dedicates it to state and local highway maintenance and improvement.

The Senate proposal eliminates the cigarette tax increase and reinstates the sales and use tax on gasoline as part of the general fund revenue. Certainly, the resolution of the significant differences in the transportation funding bill (HB 1002) will have an impact on the outcome of budget deliberations.

Funding for State Employees

How much money should the state set aside for salary and fringe benefit increases for state employees? The Governor asked for a $50 million appropriation for the biennium to the Personal Services/Fringe Benefit Contingency Fund. The House cut that to $20 million for the biennium for salary/fringe benefit contingencies. The Senate retained the $20 million biennium operating expense for contingencies and reinserted the Contingency Fund at an additional $60 million level. The $60 million in the Senate budget would be supported by funds remaining from prior years' appropriations.

The Senate version of the budget provides additional funding for the salary matrix for the State Police, Alcohol and Tobacco Commission staff, and Conservation Officers. The aggregate additional amount for these lines is approximately $17 million more than the House proposal. The additional funds would allow a two-year phased-in salary increase rather than spreading it out over a four-year period as suggested by the governor and the House.

Economic Development Proposals

There were several new economic development proposals included in the budget as offered by Gov. Holcomb. He requested $4 million for Regional Cities planning grants for FY 2019. The House eliminated this funding but the Senate put back one-half of the Governor's original request.

The governor asked the General Assembly to provide $20 million for a new Indiana Economic Development Corporation Innovation and Entrepreneurship initiative "for the purposes of advancing innovation and entrepreneurship education, programs, and practice through strategic partnerships with higher education and communities in Indiana". The House retained the $20 million in its version of the budget but the Senate version removes the initiative's appropriation. Both the House and Senate versions do include $20 million for the Indiana Bioscience Research Institute, a request that did not appear in the governor's budget.

The governor requested $20 million in General Fund support over the biennium for the Twenty-First Century Research and Technology Fund to augment a total of $40 million in appropriations from dedicated funds. Both the House and Senate removed the $20 million general fund appropriation. Lastly, the Governor requested a total of up to $10 million[1] to support direct overseas flights to and from Indiana's public airports. The House removed this request but the Senate restored $2 million per fiscal year for the initiative.

Medicaid

While the House and Senate approached Medicaid funding from different perspectives, both versions increase the amount allocated for Medicaid by $21 million more than the amount proposed by the Governor. This may well be the most difficult appropriation to forecast in the entire state budget given the uncertainty with Medicaid funding in the Congressional discussion of health care.

Veterans' Services

The Senate version of the budget provides more funding for veterans' services and support organizations than does either the governor's or House version. The Senate added $3.6 million over the biennium to the budget for the Department of Veteran's Affairs and an additional $1.6 million for the biennium for support to veteran service organizations.

Fiscal Management

The Senate reduced the appropriation for the Department of Revenue operating expenses by $16.4 million in FY 2018 and by $16.9 million in FY 2019 and increased the Department of Revenue Construction line by $33 million to provide the funding for the Department's information technology modernization program. The Senate Construction budget includes a total of $72.6 million over the biennium for the Department of Revenue. The Senate budget includes a one-time diversion of 0.5 percent of local income tax revenue in calendar year 2019 to help support this project.

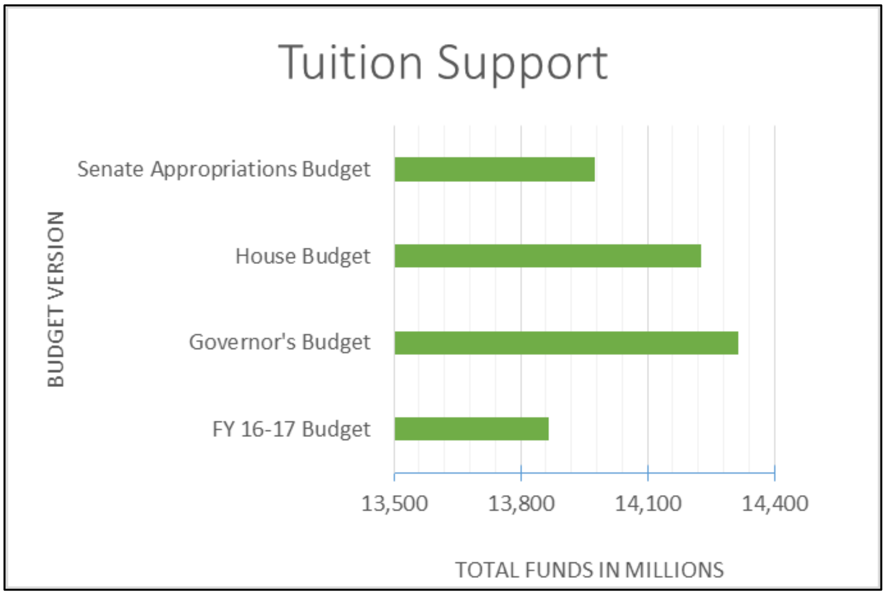
The Senate appropriates $4.5 million less over the biennium than did the House for the Management and Performance Hub. The Governor had proposed $20.2 million for the biennium for this initiative. Conversely, the Senate added $2.5 million to the House proposal and $5 million more than the Governor proposed for the Distressed Unit Appeals Board operations.

[1] Fiscal Impact Statement prepared by the Legislative Services Agency dated January 10, 2017.

K-12 Education

A great deal of attention has been given to the differences between the House and the Senate positions on Pre-K Education. The difference in the actual amounts appropriated in the two budget proposals is relatively small but the policy positions are quite different. The House allocated $10 million more than the current appropriation for On My Way Pre-K while the Senate limits the increase to $4 million, including $1 million for a new on-line Pre-K program.

The House and Senate also take somewhat different approaches to K-12 Tuition Support – one of the largest and most closely watched lines in the entire budget. The Senate version splits out the Choice Scholarship funds from Tuition Support. When the two categories are combined, the Senate adds a total of $40.25 million for Tuition Support in FY 2019 and $44.17 million in FY 2019. The Senate increased the portion of Tuition Support allocated to "complexity index" funding targeted at school districts with a higher concentration of students from lower income households by $80 million in FY 2018 and $90 million in FY 2019 compared with the House proposal. The Foundation Grant amount is concurrently reduced in the Senate version compared to the House by approximately $195 million in FY 2018 and by $222 million in FY 2019, though it's important to note the Choice Scholarships are separately broken out in the Senate version while they are included in the Foundation amounts in the House version.



The Senate removed the $5 million appropriation contained in the House version for School Efficiency Incentive Grants and the $3 million that the House had allocated for the Career Pathways Program. The Senate also reinserted, renamed, and reformatted the Teacher Performance Grant. The Governor had proposed a two-year allocation of $80 million. The House removed all funding for the performance grants. The Senate reinstated the $80 million but renamed the program Teacher Appreciation Grants. The grants would be distributed based on the number of students there are in eligible districts and charter schools. The amount would be $39 per student.

Higher Education Operating Expenses

The "Other Higher Education" subcategory in the Fiscal Impact Statements indicates that the Senate proposed spending $34.7 million more over the biennium than the House. Among the several Senate changes was a reduction in the Dual Credit funding from $50 per hour to $35 per hour, and a $13.6 million shift of the associated funds to higher education operating expenses for the respective institutions.

Miscellaneous General Government

The following is certainly not a complete listing of all the other differences between the House and Senate versions of the General Fund operating budget, but it does represent some of the substantial differences in operating appropriations not otherwise covered in this paper.

- The Senate adds $1 million over the biennium for the Commission on Race and Gender.
- The Senate increases the appropriation to the Public Defenders Commission over the biennium to address public defense assistance to children in need of assistance.

- The Senate reduced the appropriation to the Indiana Secured School Fund by $3 million over the biennium compared with the House version.
- The Senate adds about $5 million over the biennium to the Indiana Works Program.
- The Senate adds $5.6 million over the biennium to the Dropout Prevention Program compared to the House budget.
- The Senate adds $2.5 million to "Vote List Maintenance" that was not in the House budget.

Construction – Higher Education

Note that the Senate proposes to fund Higher Education capital with $100.25 million less in cash outlays compared with House version. Concurrently, the Senate proposes an additional $93.6 million in bonding authority for Higher Education projects than does the House. The Senate did remove $35.1 million of bonding authority for the Purdue Northwest Campus Bioscience Innovation Building.

Construction – Other Than Higher Education

The "Other Construction" section of the budget is increased by $88.5 million in the Senate budget compared with the House version. Gov. Holcomb requested $10 million in FY 2019 in the Transportation operating budget for South Shore Rail Line Extension. Neither the House or Senate budgets included this $10 million in the transportation operating budget, but both did increase the construction budget appropriation for the Northwest Indiana Regional Development Authority from $12 million to $18 million for the biennium. Also in the Construction section of the budget, the Senate added $12 million for the White River State Park Commission and $1 million for the Maumee River Basin Commission.

Total Budgeted Expenditures

The Senate version appropriates $727.8 million more in General Fund operating expenses over the biennium than does the House budget and $735.1 million more in combined General Fund operating and construction expenditures. When all funds, general, dedicated and federal included in the budget are considered, the Senate version proposes spending $307.6 million more than does the House budget.[2]

Projected Year-End Surpluses

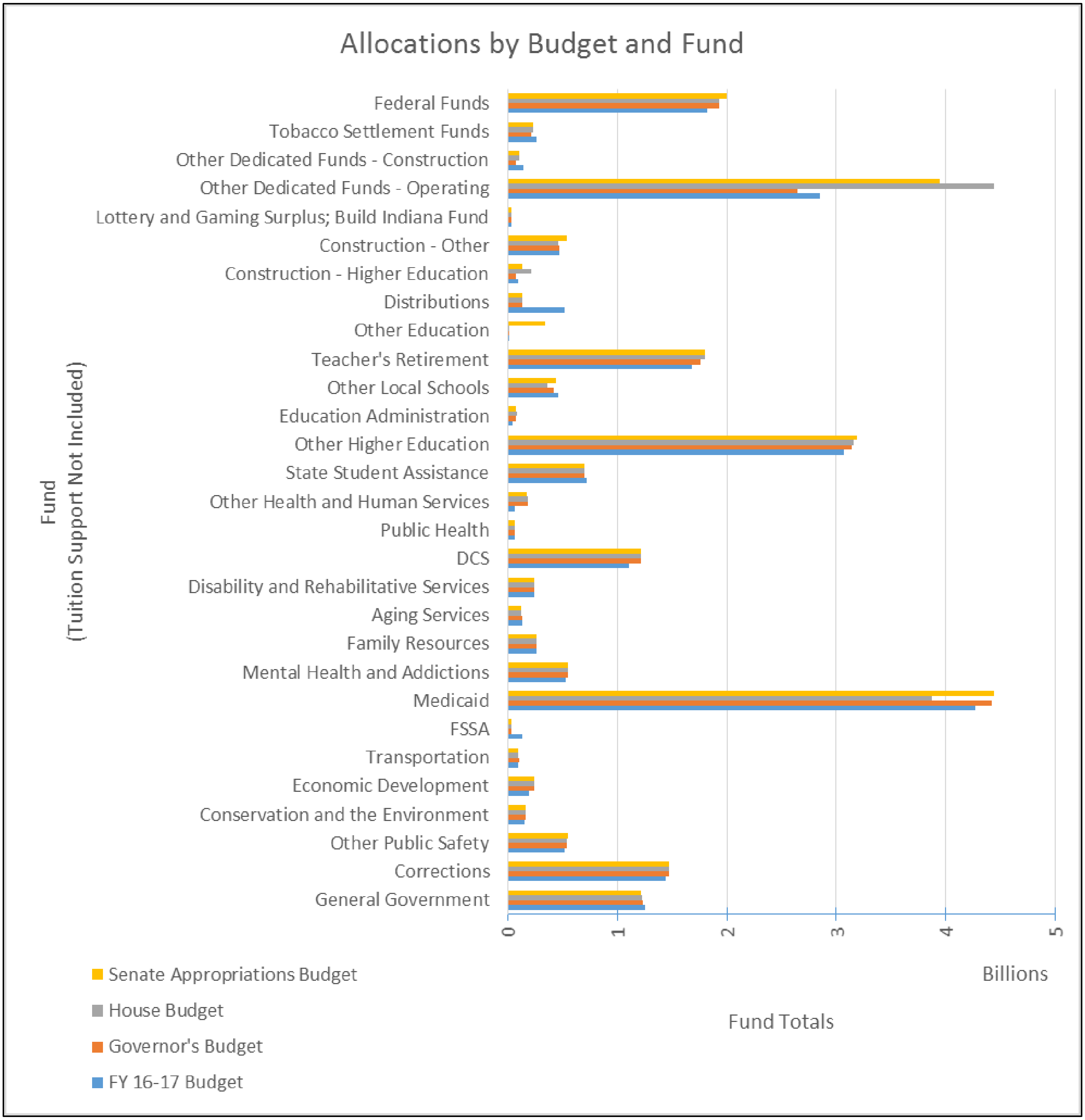
Both the House and Senate versions of the budget are expected to produce annual surpluses for each year of the biennium. The House estimated its version of the budget will result in a FY 2018 surplus of $115 million and a FY 2019 surplus of $252 million[3]. The Senate's budget is estimated to result in somewhat lower surpluses, $66 million in FY 2018 and $144.5 million in FY 2019.

Summary

Resolving the differences between the House and Senate budget proposals, while acknowledging the governor's spending priorities, will require a lot of compromise between the conference committee members. There are major differences in how to handle the sales and use tax on gasoline, education funding and capital projects, to name just a few. House Bill 1002, the transportation bill, will function on a parallel track providing an opportunity for compromise between the two bills and the challenge of managing new spending in an uncertain economic environment. The outcome will define not only the General Assembly's priorities, but those of the Republicans who control both houses and the governor's office.

[2] Fiscal Impact Statements prepared by the Legislative Services Agency dated February 27, 2017 and April 5, 2017
[3] FY 18/19 Budget Chairman's Amendment to HB 1001

Appendix 1



Allocations by Budget and Fund
Federal Funds
Tobacco Settlement Funds
Other Dedicated Funds - Construction
Other Dedicated Funds - Operating
Lottery and Gaming Surplus; Build Indiana Fund
Construction - Other
Construction - Higher Education
Distributions
Other Education
Teacher's Retirement
Other Local Schools
Education Administration
Other Higher Education
State Student Assistance
Other Health and Human Services
Public Health
DCS
Disability and Rehabilitative Services
Aging Services
Family Resources
Mental Health and Addictions
Medicaid
FSSA
Transportation
Economic Development
Conservation and the Environment
Other Public Safety
Corrections
General Government
Fund
(Tuition Support Not Included)
0
1
2
3
4
5
Billions
Fund Totals
Senate Appropriations Budget
House Budget
Governor's Budget
FY 16-17 Budget

About the Authors

John Ketzenberger is president of the Indiana Fiscal Policy Institute. He has studied and written about Indiana's budgets since 1991.

John Stafford is the interim director of the Community Research Institute at Indiana-Purdue University Fort Wayne. He has served in various positions in local government in Elkhart and Allen counties. He received the Ivan Brinegar Municipal Management Award in 1999 given by the Indiana Association of Cities and Towns. Stafford has authored several papers and reports for the Indiana Fiscal Policy Institute.

About the Indiana Fiscal Policy Institute

The Indiana Fiscal Policy Institute (IFPI), formed in 1987, is a private, non-profit government research organization. The IFPI's mission is to enhance the effectiveness and accountability of state and local government through the education of public sector, business and labor leaders on significant fiscal policy questions, and the consequences of state and local decisions. The IFPI makes a significant contribution to the important, on-going debate over the appropriate role of government. The IFPI does not lobby and does not support or oppose candidates for public office. Instead it relies on objective research evidence as the basis for assessing sound state fiscal policy.

Contact

John Ketzenberger
President
Indiana Fiscal Policy Institute
One American Square, Suite 150
Indianapolis, IN 46282
Phone: 317-366-2431
www.indianafiscal.org