



Fiscal Policy BRIEF

August 1995

Maintaining Indiana's Strong Fiscal Position

The State of Indiana ended FY 1995 with a record \$1.3 billion in total cash/operating balances (general fund, rainy day fund, and tuition reserve). A better indicator of the state's fiscal health, however, is the level of operating balances as a percent of state operating revenue. As Figure 1 illustrates, state balances as a percent of operating revenue reached 17.8% at the end of FY 1995, the state's highest proportion since FY 1980 when reserves were 25.9% of revenue. While state balances have reached a fifteen year high, the state's current fiscal position is comparable to that prior to the 1990-91 recession. The combination of a deficit reduction plan, Medicaid cost containment initiatives, and, more importantly, a rapidly improving national economy enabled the state to rebound from the 1990-91 recession and the ensuing slow growth period.

Background. As Indiana entered the 1993-95 biennium, three significant fiscal challenges confronted the state. First, the projected growth in state revenue over the biennium (4.3% in FY94 and 3.9% in FY95) was significantly less than the average annual long-term growth rate of state revenue of 5.4%. Second, the rapid rise in state Medicaid expenditures was projected to continue in the 1993-95 biennium, thereby threatening the level of state support for all other government functions, including education. Third, state operating

balances were approaching unmanageably low levels. At the end of FY 1993, state operating balances totaled \$490.3 million, and without the administration's intervention were projected to fall to \$293.3 million or 4.4% of total state operating revenue, a percentage lower than that experienced during the 1982-83 fiscal crisis.

While the adoption of a deficit reduction plan and various Medicaid cost containment initiatives addressed two of these challenges and contributed to the current surplus, Indiana's healthy fiscal position heading into the 1995-97 biennium is primarily due to a resurgent national (and state) economy.

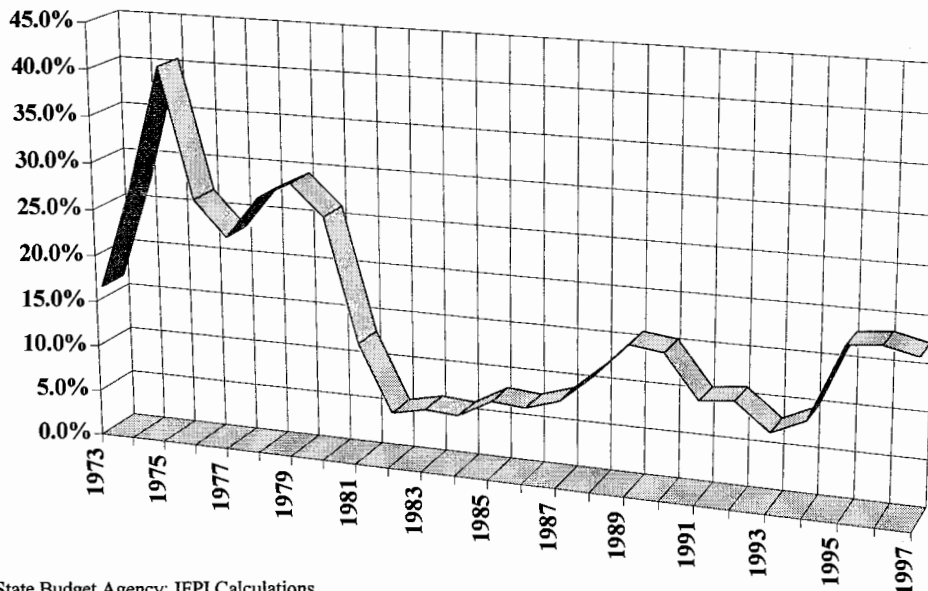
Economic Recovery. A rapidly improving economy and the resulting slowdown in the growth of the Medicaid recipient base over the last two years enabled the state to overcome the fiscal challenges it faced heading into the 1993-95 biennium. Though projected to grow at a nominal annual rate of 5.2% over the two year period of CY 1993 and CY 1994, the nation's economy actually grew at a compound annual rate of 6.4%. Consequently, state revenue grew by 7.7% in FY 1994 and 9.9% in FY 1995, compared to forecast rates of 4.3% and 3.9%. In other words, state GF/PTRF revenue collections exceeded the originally forecasted levels by \$802.8 million in the

1993-95 biennium. In addition, the slowdown in the Medicaid recipient base and the implementation of Medicaid cost containment measures dropped net state Medicaid expenditures \$373.1 million below expected levels.

Outlook for 1995-97. According to forecasted revenues and legislatively enacted appropriations, Indiana's healthy operating balances will continue through FY 1997 (See Table 1). Furthermore, the presence of the record levels of reserves will all but assure legislative initiatives to "spend down" operating balances by either cutting taxes, increasing the state's expenditure base, or both in the 1996 (short) legislative session.

(continued)

Figure 1
State Operating Balances as a % of Operating Revenue
State of Indiana, FY 1973 to FY 1997



Source: State Budget Agency; IFPI Calculations.

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In contrast to the past four years, the principal problem facing the state in this biennium does not involve building adequate resources. Rather, it involves determining how large state operating balances should be in order to provide adequate working capital and a sufficient cushion against the next recession, while, at the same time, not hoarding funds that could be either returned to taxpayers or used to increase state services.

Conclusion. In view of these options, Indiana lawmakers should consider the following before cutting taxes or increasing state expenditures:

- 1) State operating balances perform three basic functions, including: protection against a revenue shortfall, funding for unforeseen expenditures, and cash flow management. While considering a tax cut or expansion of the state's expenditure base, it is important that lawmakers maintain balances that will allow state reserves to accomplish these tasks.
- 2) The 1990-91 recession took approximately \$1 billion from the state's revenue system between FY 1990 and FY 1994. In order to survive the next economic downturn, the state might want to consider increasing the level at which Rainy Day Fund balances are maintained. Currently, balances in this fund are capped at 7% of state GF revenue and the fund is at its cap. Increasing this level (to 10% for example) would establish a more realistic "insurance policy" against a recession driven tax increase.
- 3) Given the many uncertainties regarding federal budget policy and the national economy, it may be in the state's best interest to simply maintain the current level of balances through the next two years. Though the protection of reserves is not the only means available to the state to help offset a shift in expenditures to the state or to help neutralize the effects of a recession, an adequate cushion remains an important part of any overall strategy.

Table 1
Combined Statement of GF/PTRF Surplus
FY 1995 Actual, FY 1996 & FY 1997 Estimated
(dollars in millions)

	Actual FY 1995	Estimated FY 1996	Estimated FY 1997
Working Balance at 7/1	\$ 90.0	\$ 679.3	\$ 684.2
Resources:			
Revenues	7,306.9	7,164.3	7,491.9
Transfer (to) from Rainy Day Fund	(29.9)	20.1	0.5
Total Resources	7,277.0	7,184.4	7,492.4
Expenditures:			
Appropriations and Transfers Out	6,803.9	7,218.9	7,555.1
Less: Reversions	417.4	39.4	42.1
Transfers In	54.3		
Subtotal	471.7	39.4	42.1
Total Net Appropriations and Transfers	6,332.2	7,179.5	7,513.0
Acceleration of Delayed Expenditures			
Local Schools	199.0		
Property Tax Replacement Credits	156.5		
Subtotal	355.5		
Total Expenditures	\$ 6,687.7	\$ 7,179.5	\$ 7,513.0
Working Balance at 6/30	\$ 679.3	\$ 684.2	\$ 663.6
Combined Balances			
General Fund	679.3	684.2	663.6
Tuition Reserve	200.0	200.0	200.0
Rainy Day Fund	419.3	418.8	437.8
Total	1,298.6	1,303.0	1,301.4
Operating Surplus / (Deficit)	\$ 619.2	\$ (15.2)	\$ (21.1)

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