Indiana Fiscal Policy Institute

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NEWS RELEASE

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For Immediate Release
January 28, 2005

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Governor Daniels' First Budget: Defeating the Deficit – Chapter 1

The Indiana Fiscal Policy Institute (IFPI) today released the first in a series of Budget Briefs that will analyze and report on the progress of the Indiana budget on its road to enactment in April.

In July 2004, the Indiana Fiscal Policy Institute reviewed Indiana's fiscal condition and outlook in "Hard Questions, Tougher Decisions" (http://www.indianafiscal.org/docs/Bulletin2004-1.pdf). In that preface to the 2006-2007 budget deliberations, we reported a precarious fiscal outlook for fiscal year 2005 and beyond. We posited several hard questions the General Assembly and the next Governor needed to answer in order to bring structural balance and fiscal integrity back to Indiana's budget.

With a new Governor, administration, and General Assembly in place, the questions the Indiana Fiscal Policy Institute asked in July deserve answers. Governor Mitch Daniels' proposed budget provides an initial set of answers:

- **Should the State reverse over $700 million of payment delays, and when?**

  The Governor's budget is silent regarding if, when, or how those payment delays will be reversed.

- **Should the State stop raiding the Pension Stabilization Fund to subsidize the General Fund's obligations to the Teachers' Retirement Fund?**

  The Governor's budget stops the use of the Pension Stabilization Fund to subsidize the General Fund and every budget proposal going forward should do the same.

- **Should the State adequately fund capital asset maintenance and rehabilitation?**

  The Governor's budget flatlines capital asset maintenance, rehabilitation, and construction at the current biennial level.

- **Can the State maintain current funding levels for high priority programs, particularly education and Medicaid?**

  The Governor's budget limits spending for K-12 and higher education to the calendar year 2005 amount, seeks to reduce the Medicaid budget's rate of growth from a forecasted 10% per year to 5% per year, and freezes property tax replacement credit distributions to local schools and governmental units.

These proposals illustrate the severity of the fiscal challenge Indiana faces. K-12 education appropriations did not grow this slowly for this extended period of time (at the end of the 2006-2007 biennium, 4 years) in either of the previous recessions (1980-1982 and 1990-1991). In addition, the PTR freeze amounts to a freeze on a significant subset of local revenue.

- **Should the State begin rebuilding reserves, particularly as the current business cycle matures?**

The Governor's budget does not provide for deposits to the Rainy Day Fund, except as might occur based on the statutory formula in I.C. 4-10-18.

- **Should the State raise taxes?**

The Governor's budget presumes a one year increase in the individual income tax rate from 3.4% to 4.4% for those taxpayers whose Indiana income is greater than $100,000. A taxpayer (or couple filing a joint return) whose income was $150,000 would see a one year increase in their income tax of $1,500.

In sum, the Governor's budget recommendation employs spending controls as the primary method to defeat the deficit.

IFPI calculations show that by the end of fiscal year 2007, the General Fund will have $399.2 million, but the Rainy Day Fund will remain nearly $300 million below its cap (the projected cap, based on the revenue forecast, is $579.1 million). However, the total combined balance of $953.0 million will represent only 7.7% of operating revenue. That is less than one-half of the amount available to the state entering each of the last three recessions.

According to Steve Johnson, President of the Institute, "The good news is that the inappropriate use of the Pension Stabilization Fund has been stopped. But, while balances will grow and the deficit will be closed in year, Indiana's revenue structure remains inadequate unless similar spending restraint is extrapolated into subsequent years."

The Indiana Fiscal Policy Institute finds that the Governor's first budget proposal attacks and, in the short term, defeats the deficit. Yet, more than Indiana's next biennial budget is at stake. Indiana's ability to invest, grow, weather the inevitable next downturn in the economic cycle, and—in the Governor's own words—rebuild Indiana, relies upon more comprehensive answers to our questions.

Chapter 2 will be written in the House of Representatives, and the IFPI will be looking for more answers.

This report is available through the following hyperlink: Governor Daniels' First Budget: Defeating the Deficit – Chapter 1 on-line at http://www.indianafiscal.org/pubs.html or by contacting the Indiana Fiscal Policy Institute, One North Pennsylvania Street, Suite 1000, Indianapolis, IN 46204, Telephone 317-237-2890, FAX 317-237-2893, or email us at IFPI@indianafiscal.org.

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