



Fiscal Policy

MEMORANDUM

TO: Board of Governors, Indiana Fiscal Policy Institute

SUBJECT: The State Budget

DATE: March 12, 1991

The Underlying Problem. The budgetary crisis now facing the State of Indiana was not created by the current economic slump. As projected by the Fiscal Policy Institute over two years ago, the 1991-93 biennium would present policymakers with the choice of raising taxes or reducing the rate of expenditure growth. The recession has simply magnified an already existing problem.

Since the last recession, annual personal income growth in Indiana has averaged 6 percent....state expenditure growth has averaged 8.8 percent. Even with economic expansion, this imbalance sets the stage for periodic tax increases.

Indiana Fiscal Position. Nearly every state east of the Mississippi is confronting underestimated expenditures, revenue shortfalls, or both. Indiana, however is virtually alone in its ability to maintain essentially the same level of services without a state-level tax increase.

State ended FY90 with \$849 million in reserves that can be brought to bear on the problem (in millions):

General Fund working balance	\$ 372
Lottery balance	15
Tuition reserve	144
Rainy Day Fund	<u>318</u>
	\$ 849

(About 15 percent of revenues.)

Budget proposals. Both the State Budget Agency (SBA) budget and the appropriation measure (H.B. 1800) that passed the House of Representatives on February 20, 1991, would essentially deplete the working balance during the coming biennium, while providing slow growth in state spending through FY93.

Biggest budget increases: Medicaid and operating new correctional facilities.

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Two key items:

- (1) Both budget proposals would use lottery revenues to balance the budget rather than for certain local construction projects and teacher retirement financing. Lottery revenues estimated at about \$190 million per year by SBA, \$170 million by House bill....Neither estimate is certain.
- (2) Neither proposal would tap the Rainy Day Fund set up in 1982 to permit state to adjust to lowered revenues. Economy will not be weak enough to automatically trigger Rainy Day Fund transfer, but there will be great pressure to amend the law to use Rainy Day Fund balances. If this occurs before FY93, state cash position will almost certainly be seriously compromised and a tax increase would be the next step.

Property taxes. Although state-level tax increases are unlikely before 1992, look for pressure to increase local property taxes. Battleground is elementary-secondary education which will receive \$150-175 million less from the state during 1991-93 than it would have without budget constraints. Local school taxes will rise by \$164 million during the biennium, but employee contracts, other rising expenditures will force local school corporations to cut costs or ask voters for even higher property taxes.

Outlook. No state-level tax increase in 1991. But look for major proposals in 1992, perhaps as late as after November election. Much depends on performance of the economy and success in controlling state spending in FY92 and FY93.

Silver lining is the opportunity to eliminate marginal items of expenditure. Revenue shortfalls often provide political incentive to make at least a few hard decisions on spending.

(More detail will be found in Fiscal Policy Bulletin 1991:1 to be released shortly.)



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