



Indiana Fiscal Policy Institute

NEWS RELEASE

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The 2006-2007 Enacted Budget: Epilog - A \$24 Billion Gamble

The Indiana Fiscal Policy Institute (IFPI) today released the final in a series of Budget Briefs that followed the progress the Governor and the Indiana General Assembly made in enacting the next two year State budget. The questions we asked last July remain valid and the answers contained in the enacted budget illuminate the progress toward fiscal integrity and ultimate recovery from the impact of the 2001 recession.

While the enacted budget makes some good policy decisions, such as closing the structural deficit and protecting the Teachers' Retirement Fund and the Pension Stabilization Fund, the Indiana Fiscal Policy Institute rates this budget "R," for risky. "This is a precariously balanced budget," says Steve Johnson, President of the Institute. "Even a moderate slowdown in revenue collections – to about 2.5% per year – would require every dollar of the State's reserves to fund this budget."

The Indiana Fiscal Policy Institute Questions and Our Elected Policymakers' Answers

Question #1: Should the payment delays to local governments, schools, and higher education be reversed? No. HEA 1001 – 2005 retained the provision that allows the Budget Agency to reverse up to 50% of the payment delays at the end of fiscal year 2007, should the Budget Agency determine that the resources are available. Our analysis finds that this reversal is unlikely.

Question #2: Should the use of the Pension Relief Fund to subsidize the General Fund teacher's pension obligations stop? Yes. In addition, the budget recognized the development of an unfunded liability in the New Teachers' Retirement Fund Plan and dedicated a portion of the Pension Stabilization Fund to eliminate it.

Question #3: Should State and higher education capital asset maintenance, repair, and rehabilitation funding be returned to levels consistent with complete maintenance of state capital assets? Partially. The higher education repair and rehabilitation formula was funded at 50% of the 2003 formula, which doubles the appropriation from the last budget. Recent increases in the use of bonding authority for higher education capital projects led to a 15.6% increase in the debt service appropriation in fiscal year 2007 (over 2006).

Question #4: Should funding increases for education, Medicaid, and public safety continue, should they receive no increase, or be reduced? Yes and No.

- K-12 Education: Small increase. State General Fund and Property Tax Replacement Fund appropriations for K-12 education increased only marginally, relying primarily on local property tax levy increases to fund statewide average total increases of about 1.5% per year.

- Property Tax Relief: No Increase. The budget caps the growth of state funded property tax relief through the Property Tax Replacement Credit and the Homestead Credit.
- Higher Education: Small Increase. Higher education increased only marginally, by 0.9% in 2006 and by 1.9% in 2007.
- Medicaid: Increase. Medicaid received increases in appropriations at about 5% per year, which are less than the most recent Medicaid forecast projections of 5.4% in fiscal year 2006 and by 8.2% in fiscal year 2007, creating a current shortfall estimate of \$73.7 million over the course of the biennium.

Question #5: When should the State begin rebuilding its reserves in the now depleted Rainy Day Fund?

Not Yet. As with the payment delay reversal, the budget allows the Budget Agency to determine if this action is viable at the end of fiscal year 2007. Our analysis finds this action to be unlikely.

Question #6: Should taxes be increased to maintain funding levels consistent with the core priorities expressed by the General Assembly in recent budgets? No. There are no State tax increases in the budget.

What will be the Rest of the Story?

The enacted budget eliminates the structural deficit and stops the use of the Pension Stabilization Fund to subsidize the General Fund. But beyond those two very important fiscal policy steps, this budget is risky and new questions arise.

- The budget says it will reverse the payment delays, but when?
- The budget says it will only appropriate 5% growth in the Medicaid program, but how will the Governor meet that limit?
- The budget says it does not increase taxes, but it relies upon increased local property taxes for K-12 education funding and to offset a cap in Property Tax Replacement Credits that, until now, have subsidized local taxpayers and local governments.
- The budget says it will increase the Rainy Day Fund, but when will combined balances begin being rebuilt to levels that prepare us for the next recession?

Taken as a whole, this budget returns the State's structural budget balance after a very difficult and challenging period brought about by budget decisions during very good economic times and a very severe recession.

But, much work remains to be done. Despite claims to the contrary, the State is still relying upon budget management techniques (payment delays, use of dedicated funds) to meet its budget needs. Revenue growth must continue beyond the next biennium, into fiscal years 2008 and 2009, before the reversal of payment delays and the rebuilding of reserves can begin. Only then will the State be able to increase investments in education, economic development, and the overall well-being of Hoosiers.

This is indeed a risky budget. As the Governor's Director of the Office of Management and Budget, Chuck Schalliol, said so eloquently after the budget was passed, "If the economy goes south, though, all bets are off."

This report is available 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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