



**Report 24**  
**The Enacted Budget for Fiscal Years 2008 and 2009:  
Much More than Meets the Eye**

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## *Fiscal Policy Report 24*

# *The Enacted Budget for Fiscal Years 2008 and 2009: Much More than Meets the Eye*

*Mark D. Brown*

### **Introduction:**

On April 29<sup>th</sup>, 2007, the Indiana General Assembly enacted the State's fiscal years 2008 and 2009 Biennial Budget (Budget). On May 11<sup>th</sup>, Governor Daniels signed the Budget into law.

Strictly speaking, the Budget's general fund and property tax replacement fund<sup>1</sup> appropriates \$26.4 billion for the two years. In addition, the Budget (including appropriations in legislation passed outside the budget act) appropriated \$23.6 billion of dedicated funds and federal funds.<sup>2</sup> In total and from all sources of funds, then, the state of Indiana's Budget appropriated \$50 billion for expenditures that will be made in fiscal years 2008 and 2009.

The major funding sources – sales tax, individual and corporate income taxes, and gaming taxes – are used primarily to fund general and property tax replacement fund appropriations. Dedicated and federal funding sources are just that – “dedicated” for specific programs. This Budget Report will focus primarily on the general fund and property tax replacement fund portion of the Budget.

In the Indiana Fiscal Policy Institute's (IFPI) Budget Brief published in January 2007,<sup>3</sup> we constructed three benchmarks for the purpose of evaluating the Budget. In this Budget Report, we will analyze the enacted budget and associated legislation from the perspective of what the Budget says about the State's priorities and evaluate it using the three benchmarks.

Those benchmarks are:

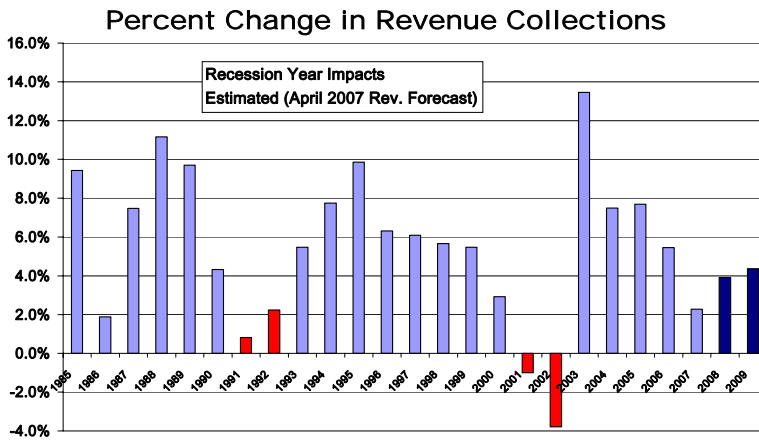
1. The Budget must be structurally balanced.
2. The Budget must reverse the payment delays remaining from the last recession in 2001.
3. The Budget must build total reserve balances to at least 10% of revenue (or \$1.35 billion) by the end of the biennium on June 30, 2009.

Finally, because the property tax was such an integral part of the budget debate entering the Legislative Session – and became the single most important factor at the end of the Session – this report will evaluate the current state of the property tax “issue” and make some recommendations for future action.

**The Revenue Outlook:**

Since the State’s revenue collection nadir in FY 2002, when revenue collections were 3.8% less than in FY 2001, Indiana has experienced four consecutive years of revenue

**Figure 1.**



Source: Indiana State Budget Agency, IFPI Calculations.

growth. Tax restructuring, enacted in 2002, jump-started revenue increases, with total revenue collections growing by more than 13%. Revenue growth averaged nearly 7% in the next three fiscal years.

The most recent revenue forecast (April 16, 2007) projects revenue growth in FY 2007 of only 2.3%, but revenue collections as of the date of this Report

indicate that actual FY 2007 revenue growth may exceed 4%. That revenue forecast projected modest revenue growth of 3.9% and 4.4% in FYs 2008 and 2009. Those increases are consistent with historical revenue growth in Indiana at this point – several years removed from the last recession - in the business cycle.

Revenue Source	State FY 2007	State FY 2008		State FY 2009			
	Forecast Dollars	Forecast Dollars	Increase in Dollars	Percent	Forecast Dollars	Increase in Dollars	Percent
<b>General &amp; PTR Funds</b>							
Sales	5,341.2	5,577.5	236.3	4.4%	5,827.1	249.6	4.5%
Individual	4,477.3	4,681.4	204.1	4.6%	4,933.6	252.2	5.4%
Corporate	908.0	924.3	16.3	1.8%	947.1	22.8	2.5%
Subtotal "Big Three"	10,726.5	11,183.2	456.7	4.3%	11,707.8	524.6	4.7%
Gaming	625.4	647.3	21.9	3.5%	677.9	30.6	4.7%
Cigarette	300.9	303.9	3.0	1.0%	307.8	3.9	1.3%
AB Taxes	15.1	15.4	0.3	2.0%	15.7	0.3	1.9%
Inheritance	147.5	147.5	-	0.0%	147.5	-	0.0%
Insurance	177.2	177.2	-	0.0%	177.2	-	0.0%
Interest	130.6	130.6	-	0.0%	130.6	-	0.0%
Other	212.5	212.5	-	0.0%	212.5	-	0.0%
Subtotal	983.8	987.1	3.3	0.3%	991.3	4.2	0.4%
<b>Total General &amp; PTR Funds</b>	<b>12,335.7</b>	<b>12,817.6</b>	<b>481.9</b>	<b>3.9%</b>	<b>13,377.0</b>	<b>559.4</b>	<b>4.4%</b>

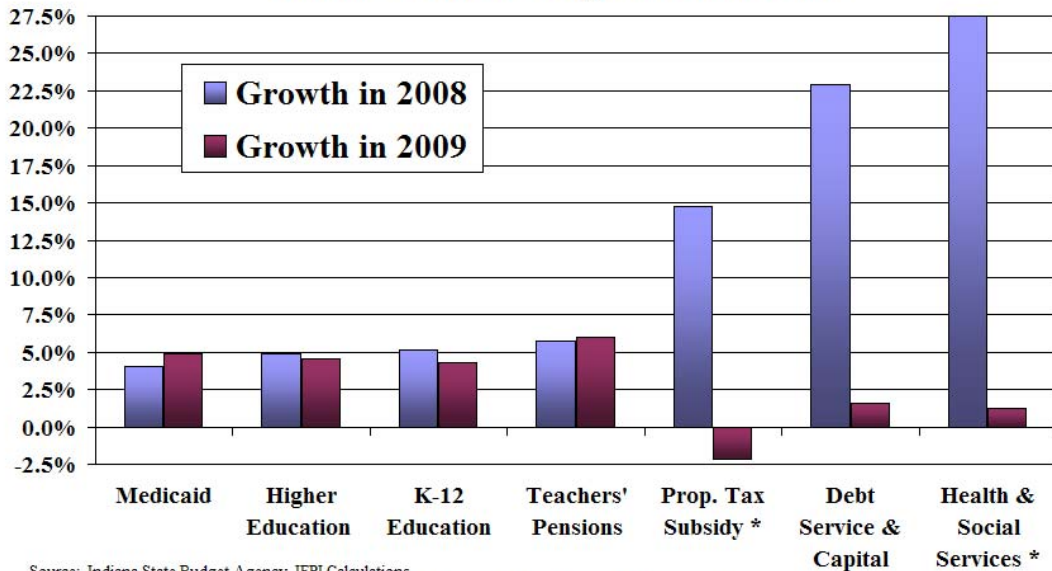
Source: Indiana State Budget Agency.

Yet, precisely because Indiana is now nearly six years from the end of the 2001 recession, the revenue forecast should be viewed with caution. As was the case in 2000 and 2001, the “turn” from economic expansion to recession almost always comes quickly and is often without warning. As Dr. Gary Baxter, the Chairman of the State’s Economic Forecast Committee, stated in his remarks at the revenue forecast in April,

*Although our forecast, particularly near-term, is not especially upbeat, the risks seem mostly to the downside. The housing sector continues to be a source of danger... A return to much higher energy prices could carry the same risk. In either case, there would be a risk of recession<sup>4</sup>.*

**The Budget’s Spending Priorities:**

**Figure 2**  
**Where the Budget Appropriated the Money**  
**Annual Percent Change over Prior Year**



Source: Indiana State Budget Agency, IFPI Calculations

\* Prop. Tax Subsidy includes funding from slot licenses at horse tracks & Health & Social Services includes Cigarette Tax Revenue.

For the first time since before the 2001 recession, the General Assembly provided significant budget increases in most budget categories. Specifically, K-12 and higher education, property tax subsidies to local governments that lower property taxes, and the myriad of state government programs and services included in the “other” category received appropriation increases of 5% or more.<sup>5</sup>

Medicaid and teachers’ pensions received essentially the same increases as they did in the FYs 2006 and 2007 budget. Other health and social services and state and higher education debt service received increases greater than they received two years ago.

As has been the case historically, education receives the majority of the State’s general fund appropriations. K-12 education appropriations total over \$4.2 billion in FY 2008 and nearly \$4.4 billion in FY 2009. K-12 education remains, by far, the single largest category of budget expenditures, with appropriations encompassing nearly a third of the budget. Higher education appropriations require about 11.5% of the budget in each year.

Property tax replacement, the category that includes state subsidies to local governments and schools which reduce property taxes paid by individuals and businesses, are the second largest category of appropriations. Although the FYs 2006 and 2007 budget capped state expenditures for property tax relief, legislation that directed the proceeds from the sale of slot machine licenses to property tax relief ended that brief attempt to restrain this major budget category’s growth.<sup>6</sup>

*Table 2*  
**Appropriations & Percent of Total Budget**  
*Selected Budget Categories*

Budget Category	Fiscal Year 2008		Fiscal Year 2009	
	millions of \$\$\$	Percent of Total	millions of \$\$\$	Percent of Total
<b>K-12 Education</b>	<b>4,209.3</b>	<b>31.4%</b>	<b>4,389.3</b>	<b>32.3%</b>
<b>Higher Education</b>	<b>1,528.5</b>	<b>11.4%</b>	<b>1,598.6</b>	<b>11.8%</b>
<b>Medicaid</b>	<b>1,586.6</b>	<b>11.8%</b>	<b>1,663.7</b>	<b>12.2%</b>
<b>Property Tax Replacement*</b>	<b>2,440.4</b>	<b>18.2%</b>	<b>2,166.5</b>	<b>16.0%</b>
<b>Other FSSA &amp; Health*</b>	<b>1,096.7</b>	<b>8.2%</b>	<b>1,110.1</b>	<b>8.2%</b>
<b>Correction</b>	<b>616.0</b>	<b>4.6%</b>	<b>635.5</b>	<b>4.7%</b>
<b>Teachers' Pensions</b>	<b>621.2</b>	<b>4.6%</b>	<b>658.4</b>	<b>4.8%</b>
<b>Other</b>	<b>915.9</b>	<b>6.8%</b>	<b>947.3</b>	<b>7.0%</b>
<b>Total Debt Service &amp; Capital</b>	<b>406.4</b>	<b>3.0%</b>	<b>413.3</b>	<b>3.0%</b>
<b>Total Appropriations</b>	<b>13,421.0</b>		<b>13,582.6</b>	

Source: Indiana State Budget Agency, IFPI calculations.

\* Property Tax Replacement includes funding from slot licenses at horse tracks & Health & Social Services includes Cigarette Tax Revenue.

The enactment of the Governor’s cigarette tax funded health care initiative increased spending in the category of “other FSSA and health.” For the first time, this budget category will spend in excess of \$1.0 billion per year. It now comprises over eight percent of the budget.

**Priorities within Budget Categories:**

After three Governors proposed its funding and more than a decade of debate, the General Assembly enacted the beginnings of funding for full day kindergarten. The Budget provides \$25 million in FY 2008 and \$50 million in FY 2009 specifically for full

*Table 3*  
**Increases in K-12 Line Item Programs**

Program	FY 2007	FY 2008	Increase from FY 2007 to FY 2008	FY 2009	Increase from FY 2008 to FY 2009
<b>Full Day Kindergarten</b>	8,500,000	33,500,000	25,000,000	58,500,000	25,000,000
<b>Textbook Reimbursement</b>	19,902,644	39,000,000	19,097,356	39,000,000	-
<b>Testing and Remediation</b>	31,410,450	41,000,000	9,589,550	41,000,000	-
<b>Gifted and Talented</b>	5,836,340	13,000,000	7,163,660	13,000,000	-
<b>Non-English Speaking Program</b>	700,000	6,929,246	6,229,246	6,965,055	35,809
<b>Special Education (S-5)</b>	27,173,300	32,400,000	5,226,700	32,400,000	-
<b>Totals (for these programs only)</b>	<b>93,522,734</b>	<b>165,829,246</b>	<b>72,306,512</b>	<b>190,865,055</b>	<b>25,035,809</b>

Source: Indiana State Budget Agency

day kindergarten. In addition, the Budget funds increases in textbook reimbursement, testing and remediation, gifted and talented programs, non-english speaking programs, and special education.

The school formula appropriates \$3.89 billion in FY 2008 and \$4.04 billion in FY 2009. The school formula provides funding to local schools on a calendar year (CY) basis, and the formula increases funding by 3.9% in CY 2008 and CY 2009. If local schools choose to “fully fund” the formula, the property tax share of the formula will increase by approximately the same amounts in each year.

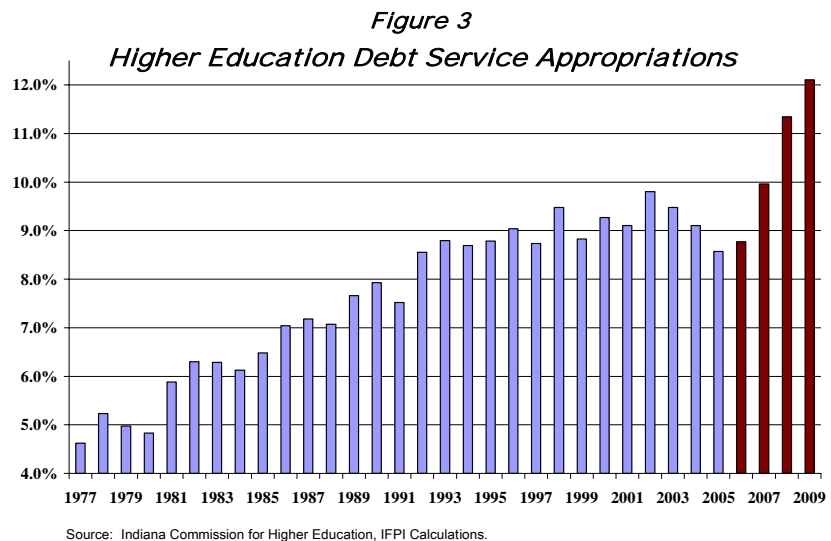
**Table 4**  
*Percentage Increases in Higher Education Appropriations*

Institution	Operating + R&R		Debt		Total	
	2008	2009	2008	2009	2008	2009
Indiana University	3.3%	4.0%	9.1%	5.3%	4.0%	4.2%
Purdue University	3.9%	4.6%	13.8%	12.2%	4.6%	5.2%
Indiana State University	1.8%	4.7%	30.1%	7.4%	4.3%	3.2%
University of Southern Indiana	7.6%	4.0%	61.0%	15.8%	15.2%	8.8%
Ball State University	3.4%	8.0%	14.8%	13.7%	4.3%	4.7%
Vincennes University	2.9%	3.4%	38.5%	24.1%	6.3%	6.6%
Ivy Tech Community College	6.6%	4.6%	58.0%	35.3%	10.8%	9.4%
<b>Total</b>	<b>3.9%</b>	<b>4.4%</b>	<b>19.8%</b>	<b>12.6%</b>	<b>5.4%</b>	<b>5.3%</b>

Source: Indiana Commission for Higher Education, IFPI Calculations.

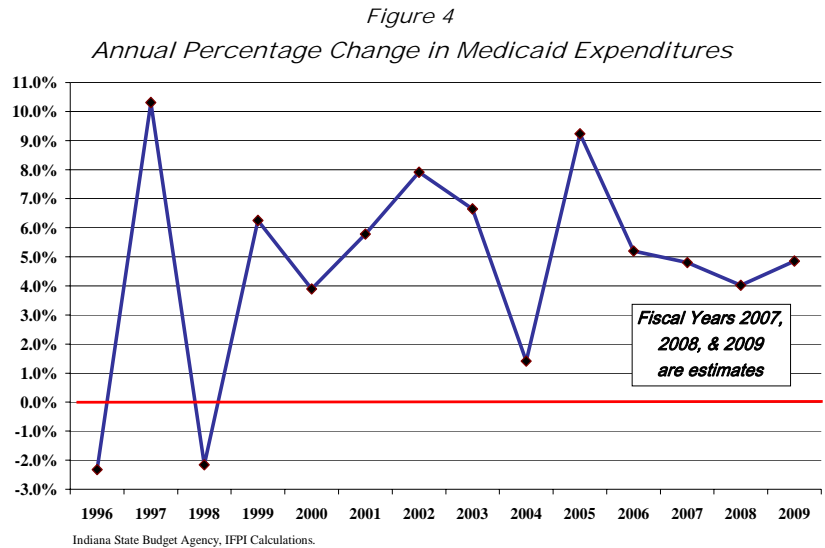
In total, appropriations for the seven state supported institutions of higher education increased by 5.4% in FY 2008 and by 5.3% in FY 2009. The largest increases were to fund new debt service payments from bonded construction authorized in this and previous budgets. Overall, debt service appropriations increased by 19.8% in FY 2008 and by 12.6% in FY 2009.

Over the past 30 years, the use of bonding authority – the General Assembly grants higher education institutions the ability to borrow for the purpose of constructing new buildings and other facilities – has increased steadily and unabated. In 1977, debt service appropriations for higher education institutions were about 4.6% of operating appropriations (including debt service). By 2002, that percentage had increased to 9.8%, before the



impact of the 2001 recession reduced state appropriations for debt service. The impact lasted for three years until, in 2006, the upward trend returned. The last two budgets, enacted in 2005 and 2007, increased debt service appropriations by over 60%, from \$110.2 million in FY 2006 to \$176.6 million in FY 2009.

Medicaid appropriations increased by about 5% in each year, making FYs 2008 and 2009 the third and fourth years in which appropriation increases have been at 5%. In the ten years from 1997 through 2007, Medicaid expenditures have increased at a compound average annual rate of just below 5.0%. The annual changes are volatile, however, ranging from a decrease in 1998 of about 2.0% to increases of over 10.0% in FY 1997 and 9.0% in FY 2005.



The last decade has seen Medicaid expenditures increase much more slowly than in earlier years, particularly the late 1980s and early 1990s. But, the Centers for Medicare and Medicaid Services project that Medicaid spending nationally will increase by an average of 8.1% percent per year from 2008 through 2016.<sup>7</sup>

Medicaid could become, once again, a budget challenge for Indiana, as well as for the rest of the states and the federal government. It is a budget category that bears watching closely during the budget biennium.

Table 5 (next page) presents the components of the Indiana Check-up Plan, which provides health care coverage for Indiana’s working poor. The program is funded with funding from a 44 cent increase in the cigarette tax.

Other priorities in the health and social services category include additional funding to complete the commitment to add 400 additional caseworkers in the Department of Child Services. The amount of additional appropriation is \$34.0 million in FY 2008 (which will carry over into FY 2009).

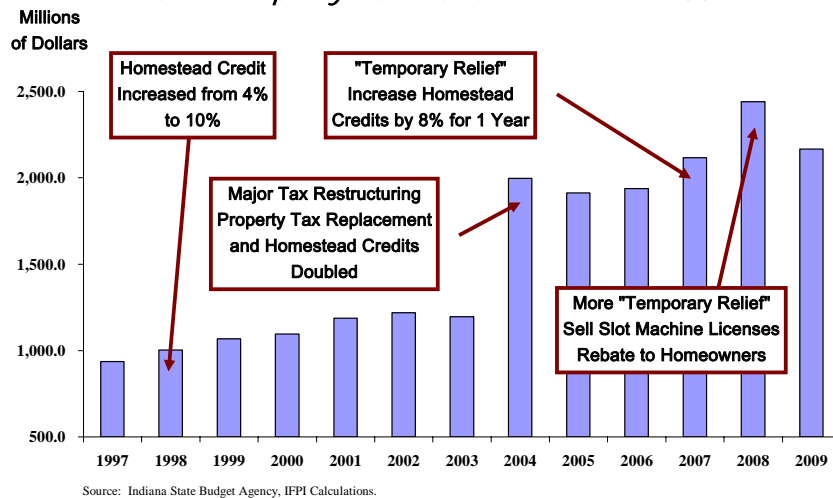
Table 5 Components of the Indiana Check-up Plan Breakdown of 44 cent per pack Cigarette Tax Increase		
Cigarette Tax Increase	Annual Revenue Estimate	Programmatic Obligations
\$0.05	\$23.5 mil.	\$1.2 mil. for IPTC, \$22.3 mil. for retiree healthcare plan
\$0.03	\$14.1 mil.	Covers revenue loss to General Fund from employer tax credit for establishment of Section 125 Plan for health care coverage
\$0.03	\$14.1 mil.	Supports Medicaid - current obligations spending related to provider rate reimbursement increases.
\$0.33	\$155.1 mil.	Deposited in Indiana Check-up Plan Trust Fund. \$11.0 mil. each year appropriated from Trust Fund to Department of Health for Immunizations, leaving \$144.1 annually to support Indiana Check-up Plan.

IPTC refers to the Indiana Tobacco and Prevention Cessation Trust Fund  
Source: Indiana State Budget Agency

Property taxes continue to be a major issue facing the General Assembly. Updated estimates projecting that homeowner property taxes would increase by an average of nearly 24% in 2007 provided legislators the impetus to find yet another “temporary solution.” They enacted legislation that allows the sale of licenses to operate slot machines at the two horse tracks. The revenue from the sale of those licenses and tax revenue from the income tax imposed on the license owners was used to fund a one-time rebate of property taxes paid by homeowners in CY 2007 and to fund an increase in the homestead credit in CY 2009.

The total cost of the program will be \$300 million in CY 2008 and \$250 million in CY 2009. As with many prior “one-time” or “temporary” programs, this one does not identify funding for state fiscal years 2010 and beyond. Yet, when the estimates of property tax bills are performed for those years, they will almost certainly predict another “crisis,” with homeowner property taxes increasing at overly burdensome rates.

Figure 5  
Cost of Property Tax Relief - FY 1997 - 2009



### **A New Budget Wrinkle – “Off-Budget” Spending Programs:**

The additional property tax subsidies and the cigarette tax funded Indiana Check-up Plan are “off-budget.” What off-budget means in this context is that the revenue from the funding sources – cigarette tax and slot machine licenses and taxes – are deposited in funds other than the general fund and property tax replacement fund. The effect of this seemingly straightforward decision is to keep additional spending of over \$550 million in FY 2008 and nearly \$300 million in FY 2009 out of the general fund and property tax replacement fund budget.

These two programs – property tax subsidies and health care assistance for low income Hoosiers – are expansions and additions to programs already in place and funded through the general fund and property tax replacement fund. Even the cigarette tax, used to fund the Indiana Check-up Plan, is primarily a general fund revenue source. But the General Assembly chose in this Budget to keep the funding of these programs outside of the general fund.

### **Total Expenditures:**

The state of Indiana’s total budget has historically included revenue from general, dedicated, and federal funds. Dedicated funds are used for programs such as transportation and some public safety, health and social services, natural resources, and environmental programs. For the first time in many years, though, two major new programs were added to the budget but funded through dedicated funds. Those two programs – the Indiana Check-up Plan and the latest temporary property tax subsidies – were described above.

The Indiana Check-up Plan will become a “base budget” program and become a permanent fixture in the budget. History has shown that all increases in expenditures for the purpose of property tax relief or replacement become permanent, as well. Therefore, to illustrate the total impact of the Budget on Indiana’s budget expenditures, we have included those two programs as part of the general fund and property tax replacement fund Budget. See Table 6 on the following page.

When including the two off-budget expenditures, this Budget increases total budget expenditures by 9.6% in FY 2008 and by 1.2% in FY 2009.

The inclusion of the two programs in our analysis results in a different presentation of the “surplus” statement, as well. The stated intention of the General Assembly was to provide \$300 million of property tax rebates in CY 2008 and \$250 million of additional homestead credits in CY 2009. Because the state operates on a fiscal year basis, assigning an amount of this program to each fiscal year is problematic. In addition, the revenue from the sales of the slot machine licenses will clearly be obtainable only one time.

<b>Table 6</b>			
<b>Combined Expenditures - General Fund, Property Tax Replacement Fund, Cigarette Tax Increase, &amp; Slot Licenses</b>			
	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Appropriations (Base)</b>	<b>12,246.0</b>	<b>12,853.9</b>	<b>13,289.5</b>
<b>Non-GF Appropriations</b>			
<b>Indiana Check Up Program</b>		<b>155.1</b>	<b>155.1</b>
<b>Property Tax Subsidy to Homeowners</b>	<b>-</b>	<b>412.0</b>	<b>138.0</b>
<b>Total On/Off Budget Expenditures</b>	<b>12,246.0</b>	<b>13,421.0</b>	<b>13,582.6</b>
<b>Percentage Increase in Budgeted Expenditures</b>		<b>9.6%</b>	<b>1.2%</b>

Source: Indiana State Budget Agency, IFPI Calculations.

Due to the “off-budget” nature of the two programs, we will exclude them from our analysis of the structural balance of the Budget and, accordingly, they are not included in our presentation of a “Condensed Surplus Statement” below.

However, the IFPI does not advocate the “off-budget” treatment of these, or any other, new program. It understates the total cost of providing state programs and services. In addition, additional revenue will have to be identified in order to continue the programs – particularly the property tax subsidy, into the next biennium. And finally, should the additional revenue not be forthcoming, the state will find itself in the position of returning to deficit budgets.

### **Evaluating the Budget – Three Benchmarks:**

The Budget is structurally balanced. Ongoing revenue of \$12.9 billion in FY 2008 and \$13.5 billion in FY 2009 exceeds base expenditures of \$12.85 billion in FY 2008 and \$13.3 billion in FY 2009. Structural balance, achieved in FY 2007 after several years of deficits, continues through the next biennium. At least, that is this Budget’s plan.

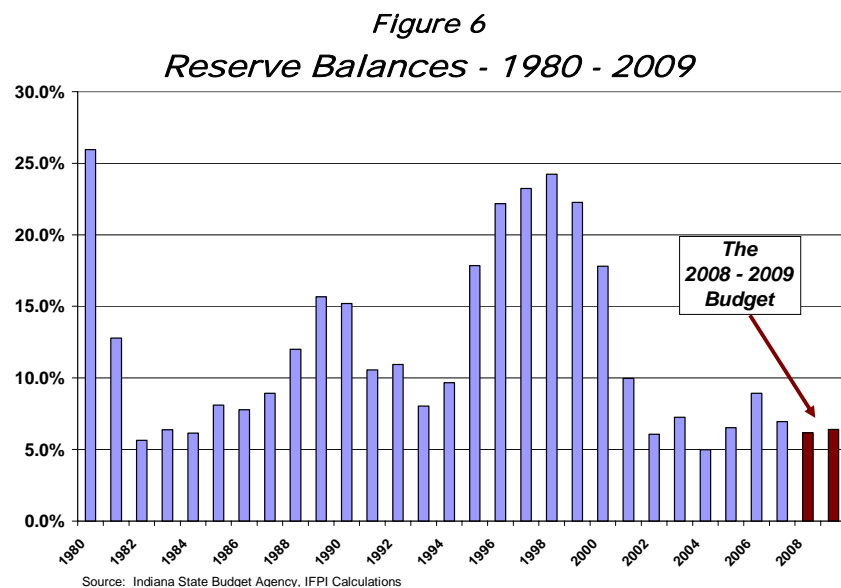
<b>Table 7</b>			
<b>Condensed Surplus Statement</b>			
	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>GF / PTRF Balance at July 1</b>	<b>410.7</b>	<b>70.1</b>	<b>120.7</b>
<b>Current Year Resource</b>	<b>12,310.4</b>	<b>12,908.1</b>	<b>13,456.3</b>
<b>Transfers of Balances (Medicaid, Rainy Day Fund)</b>		<b>130.0</b>	<b>0.0</b>
<b>Total Resources</b>	<b>12,721.1</b>	<b>13,108.2</b>	<b>13,577.0</b>
<b>Appropriations (Base)</b>	<b>12,246.0</b>	<b>12,853.9</b>	<b>13,289.5</b>
<b>Other Expenditures, Adjustments, &amp; Reversions</b>	<b>405.0</b>	<b>133.6</b>	<b>120.9</b>
<b>Total Net Expenditures</b>	<b>12,651.0</b>	<b>12,987.5</b>	<b>13,410.4</b>
<b>General Fund Reserve Balance at June 30</b>	<b>70.1</b>	<b>120.7</b>	<b>166.6</b>
<b>Other Reserve Balances</b>	<b>793.3</b>	<b>678.8</b>	<b>698.3</b>
<b>Combined Balances</b>	<b>863.4</b>	<b>799.6</b>	<b>864.9</b>
<b>Combined Balances as a Percent of Revenue</b>	<b>7.1%</b>	<b>6.2%</b>	<b>6.5%</b>

Source: Indiana State Budget Agency, IFPI Calculations.

The Budget reverses the remaining payment delays to higher education institutions and local governments. The reversal is accomplished in part in FY 2008 and in part in FY 2009. Unfortunately, the Budget fails with regard to building adequate reserve balances. From a combined balance starting point of \$863.4 million – 7.1% of revenue – on July 1, 2007, the budget spends every dollar of revenue, and then some, in FY 2008. Combined balances at the end of FY 2008 are \$63.8 million lower: they total \$799.6 million, or 6.2% of revenue. The combined balances increase during FY 2009, ending the year at approximately the same amount they were entering the biennium – at \$864.9 million.

However, as a percent of revenue, the ending balances are only 6.5% of revenue, far short of the 10% we set as a benchmark in January.

In dollar terms, the IFPI benchmark meant that combined balances should have reached \$1.34 billion at the end of the biennium. The Budget falls \$475 million short of the mark. Reserve balances, as a percentage of revenue, have been in excess of 10% of revenue in the year preceding each of last three recessions, yet the state had to raise taxes in two of the three downturns.<sup>8</sup> Fiscal prudence, integrity, and sound fiscal management require that the State increase its reserve balances – and soon. Waiting for the next budget in FY 2009 might be too late.



The Indiana Fiscal Policy Institute’s overall evaluation of the Budget? While the Budget is balanced and the payment delays were reversed, it spends too much money and does not adequately prepare the State to move forward. Reserves are historically low for this point in the economic cycle and there are large commitments made to keep homeowner property taxes from increasing that, to keep those increases at bay in the next biennium, will require resources not currently identified.

Moving forward means being able to invest in our economic future – which, for the past two budgets, has clearly been a priority, and some progress has been made. But whether

a recession comes sooner or later, that recession could take the state backward, unless we are fiscally prepared.

The new Director of OMB and the new Budget Director – Ryan Kitchell and Chris Ruhl, respectively – have significant challenges ahead. In addition to helping the Governor guide the state toward economic success, they must protect our fiscal integrity. While in most cases the two tasks complement each other, fiscal integrity must come first. Without the discipline to achieve and maintain fiscal integrity, choices that contribute to economic growth become limited.

The IFPI recommends:

- *If revenue exceeds forecast, don't spend it.*
- *If revenue meets forecast, limit spending to below budget*
- *If revenue falls short of forecast, stop spending*

While the fiscal years 2008 and 2009 budget makes important progress on several issues – full day kindergarten, health care for low income Hoosiers, case workers for child welfare, among others – many issues remain. In addition to the property tax issue discussed below, our analysis of the Budget raises several issues that should be monitored as the biennium unfolds. Questions include:

- From where will funding to expand full day kindergarten to all come?
- Is the level of borrowing to fund higher education capital too high, and what will be the impact of that construction on operating budgets?
- Will the state (and federal government) be able to contain the cost increases in Medicaid below the rates of growth commonly forecast?
- What further steps to provide health care and health care coverage to low income working Hoosiers and their families are needed, and from where will the funding for those programs come?
- When will the next recession come, and when it does, will the progress made since the last recession be undone, or will the state be able to weather the storm?

These important questions, among others, will have to be answered. The best answers, and the best choices for those answers, become available when long term vision and short term discipline work in tandem.

### **Epilog: The Real Looming Property Tax Crisis**

Thirty-five years after the enactment of the Bowen Property Tax Reform package, property taxes are still one the most difficult issues for the General Assembly. In nearly every non-recession legislative session since at least 1983 (the year of the creation of the Homestead Credit), there is discussion, debate, and more legislation proposed to “reform”

property taxes. If not “reform,” “relief” has been proposed. Often, debate rises to the consideration of “true reform” and enactment of a “permanent solution.”

One “true reform” occurred when, for property taxes payable in 2003, the state completed the first ever market value based general reassessment. The Supreme Court-ordered change in the assessment standard was supposed to improve the underlying assessment system upon which property taxes are built. It was supposed to result in a simpler, more understandable, more equitable method for valuing property for tax purposes.

In conjunction with the major tax restructuring enacted in the 2002 legislative session, the hope of many was that true reform would be accomplished and a permanent solution might be achievable. Unfortunately, an improved property assessment system that delivers understandable, correct, and consistent assessments is not yet in place. Indeed, since 2002, the call continues for reform and relief. In the years before restructuring and certainly in the years since, legislative action has been largely limited to temporary, one-time measures.

Some sort of reform or relief has been enacted every budget session going back at least 16 years. In addition, legislation was passed in several non-budget sessions to provide property tax relief. The cost to taxpayers – sales and income tax payers, primarily – of this relief now totals well in excess of \$2.0 billion per year. That total does not include direct state support of local public schools.

The reality today: the assessment system remains broken. The promise of reforming the assessment system to a market value standard has not been met. Local assessors & auditors are unable to complete assessment updates and complete tax bills on time. As the IFPI demonstrated in the November, 2005 Statewide Tax Equalization Study (Study),<sup>9</sup> inconsistent and incorrect assessments are rampant across the state. The Study provides evidence of systematic differences in assessment practice across property classes, across townships, and across counties.

The estimates of property tax increases for homeowners that lead to the enactment of the latest property tax relief demonstrate the need not only to fix the assessment system, but to require the collection and transmission of complete, accurate, and timely property tax data from local assessors and auditors to the state. It is precisely the lack of data – due in part to the tardiness of local officials in charge of assessments and property tax billing and collection and in part to their inadequate data systems – that lead to the 11<sup>th</sup> hour estimates from the Legislative Services Agency sounding a property tax crisis alarm.

In order to truly reform the property tax system, to find a permanent solution, the work needs to start at the very base of the system – at the foundation.

That foundation is the assessment system, and it must be fixed. Without accurate and consistent assessments, some taxpayers will pay more than their “fair share” while others will pay less. When taxpayers know that they are not treated equitably and / or they do

not understand how their tax bill is determined, they rightfully complain. Without complete, accurate and timely data, state officials cannot determine with accuracy what the problems are, and where.

To fix the foundation, The IFPI recommends truly reforming the assessment process by

- Eliminating townships as assessment jurisdictions,
- Professionalizing Administration
- Ensuring Property Valuation is done correctly and consistently
  - By conducting independent sales ratio studies
  - By equalizing property assessed values where necessary
- Obtaining good data and analyze it
  - To understand who actually pays what
  - To identify and understand the impact of existing policies

Only after the above reforms and improvements are made, can the General Assembly target any “relief” based on rational public policy and know that it will have the intended effect. Only then, will there not be unintended consequences of the kind that require a new “fix” each and every year.

With the cost of property tax “reform,” “relief,” and “replacement” in excess of \$2.0 billion per year to the state, it is time for true reform of Indiana’s property tax system. But that reform must begin at the property tax system’s foundation, the assessment system that sets the values upon which the rest of the structure is built. Without shoring up the foundation, the General Assembly will continue to find itself patching and fixing problems one year, only to find other problems, in other parts of the structure, cropping up the next year, and the next, and the next, and the next....

## **Acknowledgements:**

Many thanks go out to the Office of Management and Budget and the staffs of the four legislative caucuses. In particular, the IFPI would like to thank the State Budget Agency, the House Ways and Means fiscal staff, and the Senate fiscal staff. Without their cooperation, their intimate knowledge of the varying versions of the budget – along with their willingness to share that knowledge – and the insights into the thinking behind the policies the budget appropriations were intended to pursue, the IFPI budget brief series and this report would not have been possible.

The IFPI is greatly indebted to these people and our ability to provide analysis of state fiscal matters would be greatly diminished without their help.

Of course, any errors are the responsibility of the IFPI.

A final, personal, note: To the President and the supporters, members, and Board of Directors of the Indiana Fiscal Policy Institute, my heartfelt thanks. I have thoroughly enjoyed the opportunity to be a part of the unique and valuable organization that is the IFPI. It has been an honor to research, analyze, and report on the very important fiscal issues facing the state of Indiana. The IFPI has historically played an integral part in keeping state and local government in Indiana cognizant of the strategic and economic importance of long term stability and fiscal prudence and preparedness. I am grateful to have been a part of that mission.

The organization which I will now join – the Indiana Association of Realtors – has been a long time supporter and member of the IFPI.

## **Endnotes:**

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<sup>1</sup> The State spends its “budget” through its general fund, the property tax replacement fund, several “dedicated” funds, and federal funds. While dedicated and federal fund spending will approach \$10 billion annually in fiscal years 2008 and 2009, most observers are referring to the general and property tax replacement funds when discussing the “budget.”

<sup>2</sup> These appropriations include funding for transportation (including Major Moves), public safety and health and human services funded from dedicated revenue sources. Those sources include fuel taxes, vehicle licenses, and numerous charges, fess, fines, penalties, and sales.

<sup>3</sup> IFPI Budget Brief 2007:1 “Setting Fiscal Integrity Standards - Three Benchmarks.”  
See at <http://www.indianafiscal.org/docs/BudgetBrief2007-01.pdf>

<sup>4</sup> Dr. Gary Baxter, Chairman, Economic Forecast Committee. Remarks to the Indiana State Budget Committee at the Revenue Forecast on April 16, 2007. See submitted testimony at [http://www.in.gov/sba/budget/revforecast07\\_09/rev\\_forecast\\_20070416\\_projection.pdf](http://www.in.gov/sba/budget/revforecast07_09/rev_forecast_20070416_projection.pdf)

<sup>5</sup> The “other” category includes everything not specifically described in the major budget categories. It includes, among many other functions, state police and correction, state parks, environmental management, the administration of state government, including all elected officials, and the legislative and judicial branches of state government.

<sup>6</sup> For this table, the property tax subsidies funded by revenue from the sale of licenses to operate slot machines at horse tracks is included. In addition, the Indiana Check-up Plan expenditures are included in Other FSSA and Health. These programs are identical, or nearly so, to those historically funded from general fund revenue. At some point in the future, these programs and their funding sources should become part of the general fund budget.

<sup>7</sup> Centers for Medicare and Medicaid Services. National Health Care Expenditure Projections: 2006 – 2016, Forecast Summary, page 2. See at <http://www.cms.hhs.gov/NationalHealthExpendData/downloads/proj2006.pdf>

<sup>8</sup> Major tax increases were enacted during the “double dip” recessions of 1980 – 1982. A portion of the sales tax increase in the 2002 tax restructuring was directed at closing the budget gap.

<sup>9</sup> Brown, Mark D. with Almy, Richard, and Denne, Robert. “Indiana Statewide Property Tax Equalization Study.” Indiana Fiscal Policy Institute, November, 2005. See at <http://www.indianafiscal.org/study.html>

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For questions or additional information, contact Mark Brown or Steve Johnson at the IFPI.

Copies of this report can be obtained on the IFPI's website – [www.indianafiscal.org](http://www.indianafiscal.org) or by contacting our office:

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