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# Calm before the Storm: The 2020 Indiana General Assembly in Review

**Indiana Fiscal Policy Institute – Commentary by IFPI President Chris Watts**

First, acknowledging the obvious: The world has changed in the week since the close of the 2020 session of the Indiana General Assembly. The human toll of the COVID-19 pandemic is paramount, as Hoosiers join the world in facing a public health emergency unlike any in more than a century. But for our purposes, let's begin with a few words framing the potential fiscal consequences.

The coronavirus crisis has wreaked havoc on global supply chains, putting more pressure on a U.S. manufacturing sector already experiencing a 2020 slump in factory orders; Ball State's Michael Hicks wrote recently about the threat to the nation's most production-intensive state economy. Indiana's state and local tax structure is also more reliant on sales versus property taxes than the rest of the nation, adding volatility to our revenue base that could be magnified with the obvious impact of the outbreak on the retail sector.

It's a far cry from the optimistic outlook that accompanied the start of the session; much of the early legislative debate was driven by the swelling state surplus and how to allocate some portion to other priorities. We may be in uncharted territory, but it's worth noting that revenue forecasts were off more than 5% over the trough of the Great Recession (2009-10). Applied to the 2020-21 budget plan, a negative variance of this scale means $1.8 billion in lost revenue over the biennium – erasing most of today's surplus.

It shows the need for caution when eyeing the state's rainy day reserves, as the confidence of a decade-long recovery can quickly be overtaken by unforeseen circumstances…leaving lawmakers considering belt-tightening contingencies and wondering if we have a big enough umbrella to weather the economic storms.

### A Strong Start to the Short Session:

Back when 'corona' was something you wanted with lime after a long day of committee hearings, there was some buzz that 2020 might not be a 'typical' short session of the Indiana General Assembly.

There was already a push to spend down $300 million of the state surplus (targeting a $2 billion 'rainy day' reserve) when the December revenue forecast projected another $260 million in potential growth over the 2020-21 biennium above and beyond the final budget plan. Amid this rush of good news, Governor Holcomb dropped a few pre-State of the State hints about "doing more" on teacher pay.

Would he coax the legislature to re-open the budget? Would the clout of 'Red for Ed' and the drama of Speaker Bosma's retirement add momentum for action? Would lawmakers relax their reluctance to make significant fiscal decisions in a non-budget year to address issues like healthcare costs, too? And how many of the more than 900 introduced bills would ultimately land on the Governor's desk?

Ultimately, despite a heavy workload and plenty of consequential policymaking, the session settled into a more familiar pattern: The first ten weeks of the new decade certainly delivered some legislative fireworks, but most of the action impacting the state's bottom line will wait until next year.

Here are a few observations on key issues that were debated, decided, or deferred:

### Tackling Teacher Pay:

Harry Truman would hate Indiana's debate over teacher pay.

Given the complexities how school funding is raised, appropriated and administered, the buck stops nowhere…certainly not in teacher paychecks, education advocates would argue. But while salaries are negotiated at the district level, it's easy to focus on the Governor and General Assembly holding the purse strings for most K-12 operating budgets statewide.

That's why the 2020 session started on Organization Day with 15,000 expectant educators rallying around the Statehouse. GOP lawmakers were quick to point out that the two-year budget passed last year featured $763 million in new education funding, including a $539 million bump in tuition support and $150 million in teacher pension payments to free up local resources.

Critics were just as eager to note that the new budget only nudged K-12 funding growth slightly above inflation, after lagging cost of living (and dropping as a percent of Gross State Product) in the decade since property tax reform led the state to shoulder more education costs via increased sales taxes.

Emboldened by 'Red for Ed,' Democratic legislators increased calls for further K-12 commitments, starting by redirecting surplus dollars earmarked for capital projects by Governor Holcomb to teacher compensation instead (i.e. boosting Teacher Appreciation Grants).

### Sticking to the Script:

In the end, revisiting K-12 funding will wait for 2021, as Governor Holcomb did unveil plans to pay down teacher pension liabilities in his State of the State – but not until next year. In the meantime, he continued to push upfront capital spending as the most prudent use for 'excess' surplus funds.

Democrats were unsuccessful in other attempts to shift surplus funds to education and initiatives to lower healthcare costs, as HB1007 moved quickly through the legislative process and landed on the Governor's desk for an early signature. The bill spends nearly $300 million of the larger-than-expected surplus on higher education capital projects (the House declined to go "whole hog" on the Governor's original priority list, which included the Swine Barn at the State Fairgrounds).

It was a rare foray into budget territory typically off-limits in a short session, as a late revenue surge in 2019 pushed reserves to nearly 14% of annual spending (deemed excessive in the pre-pandemic budget calculus).

### Regional Development:

Amid the back-and-forth over Indiana making the grade on K-12 funding, state education support has grown to more than a third of total local revenues ('own source' taxes and other aid), eclipsing property taxes and local option income taxes. Aside from schools, public safety, roads and debt payments dominate local budgets – county and municipal governments are often left with little flexibility to invest beyond the basics.

The 2015 'Regional Cities' initiative offered competitive state grants to spur interlocal collaboration and investment in quality of life programs aimed at boosting population growth, with early promise. But with scarce hope of a Regional Cities sequel, local officials have sought a new model to pursue similar priorities.

This year, Senator Holdman introduced SB350, creating "investment hubs" that expanded the power of Regional Development Authorities (RDAs) to raise and spend revenues on capital projects to elevate quality of life and economic competitiveness across county and city lines. But the final bill would look very different.

It was ultimately limited to focus on Central Indiana, allowing the existing Regional Development Authority of the state's largest metro to create a comprehensive economic development strategy. The RDA will be able to work in tandem with the Indianapolis Metropolitan Planning Organization (MPO), now independent from the City of Indianapolis and tasked with long-term transportation planning and infrastructure assessment.

SB350 creates a governance structure that allows the RDA and MPO to study transportation and infrastructure, housing, land use, quality of life and other challenges – but without fiscal tools to implement any resulting strategies, postponing discussion of local and regional revenue capacity and reform until 2021. (It also fails to acknowledge the cooperative efforts well underway in Northeast Indiana and elsewhere.)

We've previewed a soon-to-be-released report from Larry DeBoer of Purdue University, updating an earlier analysis of how potential revenues are keeping up with average costs for Indiana's local governments. DeBoer creates a single value (the Revenue Capacity-Service Cost Index) that compares fiscal conditions from county to county (see the methodology here – page 4-5) . A negative Index implies pressure to raise taxes or cut expenditures, while a positive result means flexibility to reduce tax rates or spend more.

We asked Professor DeBoer to create 'collective' Cost-Capacity Index values for the groupings of counties currently organized as Regional Development Authorities – the results (top of page 4) show that all but two regions would have negative fiscal capacity, and the two with positive Indexes (Northeast and Southwest) have below-average revenue capacity ($2,890 per capita in local revenue at state-average tax rates).

Even if regions truly shared revenues and costs seamlessly across city and county lines (unrealistic for a number of practical and political reasons), most RDAs would operate under minor – not insurmountable – budget strain, with East Central lagging further behind and Northeast and Southwest boasting more capacity.

This implies the need for added revenue capacity to support regional priorities, even acknowledging untapped local income tax potential among counties below their maximum LIT rates (the most fiscal stress being felt in urban counties that already having income and property tax rates well above most of the state).

<u>RDA 'Member' Counties</u>: (see next page)
*C Central: Boone, Hamilton, Hancock, Hendricks, Johnson, Madison, Marion, Morgan, Shelby*
*EC East Central: Blackford, Delaware, Henry, Jay, Randolph*
*NC North Central: Elkhart, Marshall, St. Joseph*
*NE Northeast: Adams, Allen, DeKalb, Huntington, Kosciusko, LaGrange, Noble, Steuben, Wabash, Wells, Whitley*
*NW Northwest: Lake, LaPorte, Porter*
*SW Southwest: Gibson, Posey, Vanderburgh, Warrick*
*WC West Central: Knox, Sullivan, Vigo*
*OSI Our Southern Indiana: Clark, Floyd, Jefferson, Scott and Washington*

**Components of Revenue Capacity**

| Regional Development Auth. | | Average Rate Property Taxes | Average Rate LIT Taxes | Actual School Aid | Actual Road Aid | All Other | Total Revenue Capacity |
|---|---|---|---|---|---|---|---|
| C | Central | 986 | 426 | 1,037 | 78 | 482 | 3,008 |
| EC | East Central | 721 | 271 | 962 | 131 | 482 | 2,567 |
| NC | North Central | 784 | 367 | 1,018 | 85 | 482 | 2,736 |
| NE | Northeast | 998 | 356 | 963 | 110 | 482 | 2,909 |
| NW | Northwest | 1,012 | 366 | 1,012 | 86 | 482 | 2,958 |
| OSI | Our Southern Indiana | 799 | 357 | 950 | 101 | 482 | 2,689 |
| SW | Southwest | 966 | 387 | 906 | 102 | 482 | 2,842 |
| WC | West Central | 856 | 289 | 941 | 124 | 482 | 2,691 |

**Components of Service Cost**

| Regional Development Auth. | | City/Town Pop 2018 | School Enrollment 2018 | County Road Miles '18 | City/Town Road Miles '18 | County Pop 2018 | Total Service Costs | Capacity-Cost Index |
|---|---|---|---|---|---|---|---|---|
| C | Central | 885 | 1,671 | 31 | 49 | 458 | 3,094 | (86) |
| EC | East Central | 682 | 1,513 | 128 | 70 | 458 | 2,851 | (285) |
| NC | North Central | 564 | 1,666 | 50 | 46 | 458 | 2,784 | (47) |
| NE | Northeast | 638 | 1,574 | 91 | 56 | 458 | 2,817 | 92 |
| NW | Northwest | 830 | 1,612 | 25 | 70 | 458 | 2,996 | (38) |
| OSI | Our Southern Indiana | 615 | 1,536 | 70 | 55 | 458 | 2,734 | (46) |
| SW | Southwest | 558 | 1,467 | 80 | 52 | 458 | 2,616 | 227 |
| WC | West Central | 609 | 1,450 | 126 | 70 | 458 | 2,714 | (23) |

## T21 and a Healthier Business Climate

Clearly, public health has taken on an entirely new dimension of urgency as we combat a global pandemic. At the outset of the session, lawmakers were primarily focused on the costs of healthcare – walking a fine line in tackling a complex issue without making a significant budget impact. This led to a regulatory focus on pricing and transparency:

- Limits on 'surprise billing' for out-of-network medical care while making (non-emergency) price estimates available to patients ahead of time (HB1004); and
- Requiring hospitals and other healthcare facilities to publish average cost information online, while creating a centralized 'all-claims database' to compile and compare healthcare pricing data (SB5).
- There was also significant discussion around a proposal regulating hospital fees and reimbursements for services performed at clinics or other secondary sites (which ultimately failed as rural hospitals voiced concerns).

But looking towards the future, SB1 might be the most impactful health legislation to pass this year, enforcing federal action to raise the legal age to purchase tobacco products from 18 to 21.

When 'T21' was introduced at the General Assembly in previous sessions, it came with a fiscal price tag of $7-14 million annually in lost cigarette tax revenue (from fewer teenage smokers paying the tax). With federal regulation in place and these revenue losses assumed, SB1 was assigned a positive fiscal impact as it doubled fines for retailers selling tobacco to minors.

These modest adjustments (positive or negative) don't address the broader implications of T21: With nine out of ten Hoosier smokers picking up the habit as teenagers, state enforcement of the federal mandate is fiscal and public health policy. Indiana's high smoking rate reduces productivity, increases workplace absenteeism and rates of chronic illness, and adds health costs for employers and individuals alike – taking a toll on taxable income and economic growth.

Not to mention the startling fact that nearly half our adult Medicaid population (46%) are smokers. With Indiana in the top tier of state Medicaid spending-per-enrollee, discouraging smoking is also a necessity to control underlying pressures on a program that's the second-largest state budget category after education.

### More Highlights:

What else happened before sine die and social distancing cleared out the Statehouse? A more thorough bill-by-bill analysis could consume dozens more pages – but here are a few more notes on enrolled legislation with implications for the future:

- HB1414 was one of the most publicly controversial bills of this session, seeking a temporary 'pause' on retirement of coal-fueled power plants that could overrule more immediate plans by utilities to shift resources to renewable electric generation:
  - The measure was criticized as a 'bailout' for Indiana's coal industry, while proponents argued that a deliberative process was necessary to safeguard a stable, sustainable power system for Hoosiers;
  - The final bill retains its May 2021 'end date' and directs the Indiana Utility Regulatory Commission to issue an analysis of any planned closures;
  - While HB1414 includes protections for displaced coal workers, the potential impact on the local tax base of affected counties also deserves further consideration; on the other hand, the fiscal upside of alternative energy development (i.e. significant jumps in assessed property values in counties with wind energy developments) also merits greater scrutiny.
- HB1065 dealt with local tax issues – property assessments, maximum levy calculations in fast-growing townships, and governance rules for local income tax councils; it earned headlines beyond these fairly technical adjustments for a Senate amendment allowing (though not mandating) public school corporations to share property tax referenda revenues with charter schools operating within the district;
- HB1065 was also amended to include an interim study committee on a film and media tax credit (formerly in SB262, which died in committee), signaling that Indiana could be ready for our close-up;
- SB408 also deals with a variety of school finance, state and local tax issues – primarily technical changes and clarifications (it briefly included language on Certified Technology Parks, which will wait for 2021);
- A local finance clarification with wider potential impact is found in SB190, which exempts roads, streets, and bridges from the definition of a controlled project that could trigger a public referendum or remonstrance process, paving the way (pun intended) for more streamlined basic infrastructure investment by local governments;
- Staying with local projects, the cost of criminal corrections is a growing issue for Indiana's local governments, with more and more counties actively exploring or engaged in building new or expanded county jails to deal with chronic overcrowding (more perspective here) – HB1346 creates a data-driven analysis of the jail capacity challenge and underlying criminal justice issues;

- Re-entry strategies to curb ex-offender recidivism is one such issue: SB335 (expungement for older criminal offenses) eases the path to employment for ex-offenders, but the bill was also notable as the temporary home for new panhandling restrictions that were ultimately moved to HB1022 (also – in future legislative trivia – the final bill sponsored by former Speaker Brian Bosma);
- HB1022 was an example of state oversight on a primarily local matter (aggressive panhandling as a public safety concern), but hardly the only one: HB1279 passed the Senate with language seeking to divert local income tax revenue from public transportation projects (leading to the bill being scuttled by the House), while SB148 contains landlord-tenant regulations that could pre-empt local ordinances around rental agreements (with most attention focused on regulations recently passed by the Indianapolis City-County Council) – clearly, issues of home rule and fiscal federalism emerge every year, and will continue to do so (likely with higher stakes) during the 2021 budget-writing session;
- Finally, a proposal that brings us back to today's mounting economic woes: HB1111 freezes rates of business contributions to the state unemployment trust fund for the next five years, as the fund eclipses $1 billion. Current rates may have been sufficient under the old federal formula – and with a stable economic outlook – but as calls grow to expand and accelerate unemployment benefits to mitigate the hardship of the COVID-19 crisis, is this decision destined for reconsideration next year?