Indiana Fiscal Policy Institute – General Assembly Update:

Headed Towards Halftime

Chris Watts, IFPI President – February 25, 2019

Tip O'Neill famously remarked that "All politics is local." Teacher pay has certainly emerged as a political hot button for this year's budget session, and the crux of the debate could paraphrase the former Speaker: "Should all paychecks be local?" – that is, what's the role of state government versus local school districts in determining teacher salaries and schedules for raising them?

Governor Holcomb has proposed increasing state tuition support and freeing up additional funding with advance payments to teacher pension liabilities currently shouldered by local school systems, "encouraging" districts to devote most of the additional dollars to raising salaries.

House Republicans followed a similar blueprint, upping the ante with slightly higher K-12 funding in their version of the budget and setting efficiency targets (via HB1003) to nudge districts towards higher pay.

But these moves have been criticized for not requiring any changes in compensation. It's another example of the chronic tensions produced by 'fiscal federalism' in Indiana: Is teacher recruitment and retention a statewide priority, critical to educational achievement and economic competitiveness, or an issue best left to school boards and superintendents most familiar with local needs? Or is it simultaneously both?

It's a dynamic that comes up again and again around issues of home rule, local revenue challenges and ongoing efforts by lawmakers to referee the jostling of thousands of taxing units for space under the state's property tax caps. But at the Statehouse, the sole constitutional responsibility for this year's General Assembly is passing a biennial budget – so let's hit the highlights of the House budget deliberations with just hours before the chamber's third reading deadline:

House budget offers minor tweaks, not major transformation

The House budget proposal was introduced and passed out of the Ways & Means Committee last week, and will be on its way to a third reading vote as this report is posted.

As you'd expect, there were no jarring differences between Governor Holcomb's original plan and the amendment shaped by the House GOP's fiscal solons, only a few subtle differences in biennial spending:

- The House budget meets the Governor's request for $286 million in annual increases for the Department of Child Services (DCS) (despite earlier cautionary comments from Speaker Bosma) and covers the latest Medicaid forecast – holding the line on two high-dollar programmatic issues.
- The House does modestly increase K-12 tuition support, by 2.1% and 2.2% (FY2020 and '21, respectively), adding roughly $30 million to the Governor's $431 million biennial increase (2% annually).
- The House also agreed to a $150 million one-time payment to local teacher pension fund liabilities proposed by Governor Holcomb to free up another $70 million across Indiana's school districts.
- House Republicans didn't appreciate the Governor's move to repurpose Teacher Appreciation Grants, however, and restored a $30 million annual line item for the program, which has courted controversy from its performance pay origins.
- Harmony was restored on workforce and technical education issues: Funding for Workforce Ready (i.e. Next Level Jobs) and Next Level Employer Training grants was doubled, with these programs now approaching $50 million collectively for the biennium – and aligned with HB1002, adult learners who receive Workforce Ready grants will have more options on training and higher ed partners.
- Similarly, there was little disagreement on economic development matters, though the House did bump up annual funding for the relatively new (circa 2017) Business Promotion & Innovation program (used for a variety of purposes by the IEDC) to $16.5 million annually from the Governor's initial $15 million ask. (As a caveat, most substantive economic development policy issues, as well as plans for the Indianapolis Capital Improvement Board, are percolating first in the Senate.)
- The House and Governor also found common ground on what *not* to do in key areas, stiff-arming continued subsidies for the Hoosier State Line and extinguishing efforts to raise the cigarette tax despite attempted amendments in Ways & Means and on the floor.
- The House also turned back another amendment to drive funds directly to teacher salaries, with Ways & Means Chairman Tim Brown reiterating the 'federalist' argument that the General Assembly should avoid becoming the "deciding and influencing body of contracts of all [Indiana's] teachers…"
- Finally, the House did appropriate $25 million tied to the Water Assistance Fund & Program outlined in HB1406 – more on this (in the context of local budget and capital challenges) later.

Can we 'work smarter' to study teacher pay?

K-12 spending will again make up a majority of the proposed state budget. It's generally accepted that education is the greatest predictor of future earnings, employability and upward mobility. And research suggests that quality instruction – i.e. qualified teachers – has the largest effect on academic performance.

But consensus on the importance of teacher retention and pay is quickly fractured by the complexities of how funding is appropriated and administered. As noted earlier, Republican leadership has been hesitant to flatly mandate higher salaries, but aren't shy about their desire for school districts to make pay a priority.

The next biennium will be the first under a new system of school finance – an "education fund" (supplied by state tuition support) to be used primarily for instructional expenses, including teacher pay, with some flexibility for transfers to an "operating fund" (collapsing administration, transportation and capital spending to a single category supported by local property taxes.

One legislative proposal (HB1003, now in the Senate) creates an 85% benchmark for state tuition support preserved in the education fund versus transfers to operations, aiming for efficiency and keeping more dollars "in the classroom" (and available for teacher compensation).

The 85/15 ratio is one useful metric, but doesn't account for school corporations with high assessed property values and the potential to collect more local revenue, and therefore keep more state money in the education fund without being especially efficient or making any extraordinary efforts on teacher pay.

To bring more insight to this issue, IFPI is working with the Indiana Business Research Center (IBRC) to create another measure – teacher salaries as a percentage of total salaries. Compensation is typically the largest single expense for school systems, and this metric would add clarity on how districts are dividing resources between classroom teachers and its broader workforce, including administrative functions.

This data has been difficult to collect due to variances in how schools report teacher headcount, but our partners at IBRC – which administers the 'Indiana Gateway' government transparency portal – earn extra credit for developing a methodology to do so. We look forward to the results in early April, in time for the closing weeks of session and the early deliberations of the Governor's Next Level Teacher Pay Commission.

Going Local (and Mark Twain's take on TIF)

As the General Assembly crafts a two-year state budget, lawmakers have also focused on a number of local fiscal challenges. Two studies of important issues moved forward last week:

- HB1427 (covering a variety of local tax matters) was amended in committee to include an analysis of local revenue equities – i.e. a 'commuter tax' or other revenue-sharing mechanisms – before passing the full House unanimously;
- The House budget was also amended by consent to include an interim study committee focused on state revenue-sharing for counties, taking into account the local option tax burden, assessed values and impact of property tax caps.

These topics dovetail with the conclusions of a soon-to-be-released IFPI report on fiscal policies and practices affecting local government since the mid-1970s. Indiana has gradually limited local property taxes, exchanging lost revenues with state sales taxes and local income taxes; major tax restructurings in 2002 (responding to the St. John 'market value' decision) and 2008 (property tax caps) accelerated this trend.

Our study finds that local (per capita) property tax revenues have dropped roughly 40% since a peak in 2005, while income taxes now represent more than 15% of local government revenue, introducing more limited and volatile revenues and greater budgetary uncertainty (from tax cap circuit breaker losses).

As a result, local spending per capita (in 2015 dollars) has retreated to 2002 levels, and capital expenditures have declined even further.

We don't try to assume the answers, but the report does raise questions: Do downsized local budgets compromise service quality, livability, infrastructure and economic competitiveness? And working under such revenue constraints, could local governments manage through a future economic downturn? A decade into the tax cap era, more forward-looking analysis of the local revenue structure is overdue.

There are proposals in play to address fiscal fault lines in local government – i.e. the rapid growth of public safety expenditures, and HB1622 to increase state reimbursement for Level 6 prisoners transferred to county jails (in limbo at this writing).

The creation of the Water Assistance Fund (HB1406) mentioned earlier could also be a byproduct of the limited ability of local governments to afford long-term capital investments (especially in non-road infrastructure, where local option wheel taxes are helping fill the pecuniary potholes).

To ensure that local revenues that could address capital needs aren't being hoarded away by tight-fisted trustees, the General Assembly is also taking aim at township surpluses: HB1177 requires townships with fund surpluses totaling 150% of their annual budgets to develop a capital improvement plan (or risk forfeiting their tax levy).

And finally, tax increment financing is an ever-popular (and often debated) means to fund certain capital needs. Last year the General Assembly created a special financing district for flood control; this year, SB566 allows for more flexible residential tax increment financing, addressing the need for 'workforce housing' (though limiting the option to counties with populations less than 100,000 appears to miss some areas with significant workforce demand and mobility issues).

SB87 (now in the House) also allows 15% of TIF revenue to be set aside for broader infrastructure needs within the allocation area. The pushback on HB1166 (giving a school board member voting rights on redevelopment commissions, likely dead for this year) and HB1596 (limiting redevelopment commission spending flexibility) shows the high stakes in TIF as a local funding and development option.

The proliferation of TIF may stray from its original intent, but brings to mind the old adage from Mark Twain: "To a man with a hammer, every problem looks like a nail."

Local governments have few tools to swing at their capital needs, and TIF is a hammer – the question is, can we (and how should we) expand the toolbox?