Indiana Fiscal Policy Institute report finds local finances more exposed to economic downturn as experts predict recession

IU professors analyze an era of dramatic change in fiscal policy & property tax reform, leaving local governments downsized & more dependent on less predictable taxes

(March 6, 2019 – INDIANAPOLIS, Ind.) A report commissioned by the Indiana Fiscal Policy Institute (IFPI) finds that Indiana's counties, cities and towns are spending at 2002 levels (per capita, 2015 dollars), well below the average budgets of local governments across the nation. State policies over the last forty years have reduced reliance on property taxes while introducing the uncertainty of tax caps and volatility of income tax revenues.

But with budgets already downsized over the last decade – while the economy recovered from the Great Recession – the study's authors ask: Can local governments keep up with public safety commitments, infrastructure demands and debt obligations when a future recession takes a toll on Hoosier paychecks and income tax collections?

"A Fiscal History of Indiana Local Government," by Professors Craig Johnson and Justin Ross of Indiana University's School of Public & Environmental Affairs, looks at how state and local governments have swapped responsibilities and restructured revenues since the 'Bowen tax package' began replacing property taxes with state sales taxes to support education, through the last decade of property tax caps and declining revenues.

"Indiana has given more predictable property tax bills to homeowners, farmers and employers, in exchange for a less predictable fiscal outlook for local government," said IFPI president Chris Watts. "While much of the public sector has rebuilt budgets since the Great Recession, local government in Indiana has continued to cut in response to property tax caps and the annual uncertainty of 'circuit breaker' shortfalls."

The report finds that local budgets nationwide have been rebounding from a period of belt-tightening since 2012, while Indiana expenditures continued to contract. In 2015 (the last data analyzed), local per capita spending had climbed back to 2010 levels across the U.S., while Indiana's had declined to a post-9/11 low.

"Some responsibilities shifted to the state, like county welfare administration, and we also noted a wave of local government consolidation from 2007 to 2012," noted Johnson. "We didn't attempt to assess the consequences for the quality of public services, but we can say that Indiana's local governments have managed to keep expenditures in line with revenues – for now."

More troubling, according to Johnson and Ross, is the uncertainty inherent in today's system.

"Property tax caps create a perpetual risk of deficits for local governments as their overlapping levies push properties against the constitutional limits," explained Ross. "Shifting the onus to income taxes creates another kind of volatility, as these revenues are tied to economic cycles."

With per capita local property tax revenues dropping nearly 40% since 2005 and income tax revenues dipping in tandem with reductions in the state's real personal income since 2000, Johnson and Ross raise concerns about the sustainability of Indiana's local finances during a future recession.

"The local revenue system is vulnerable to our cyclical economy and pressured by declining property tax collections," added Ross. "A downturn could expose these issues, and state government – also increasingly dependent on income and sales taxes and burdened with formerly local commitments to education and welfare – could be hard-pressed to intervene."

Johnson and Ross also find that public health costs, public safety and debt service are among the fastest-growing categories of local budgets, offering little discretionary room for further cutbacks; capital spending has declined even faster than overall expenditures.

"Our intention with this report isn't to be alarmist, but with three in four economists predicting a national recession by the end of 2021, we're overdue to consider the impacts on local government," said Watts, referencing a recent survey by the National Association of Business Economics. "A full-blown recession combined with the constraints of property tax caps would be uncharted territory."

According to Watts, the report also raises "a host of other issues in need of further exploration."

"We don't have the information to know if critical local capital projects are going unfunded, or what potential investments are being crowded out of tighter budgets," he finished. "But clearly, we need to think about a revenue system built to weather a future recession and support long-term economic competitiveness and quality of life, so we can appeal to new taxpayers and attract more business opportunities."

"A Fiscal History of Local Government" is available for download at www.IndianaFiscal.org.

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About the Indiana Fiscal Policy Institute:
The Indiana Fiscal Policy Institute (IFPI) is Indiana's only independent, statewide source of ongoing research and analysis into state and local taxing and spending policies. The IFPI is privately supported by a variety of organizations, businesses, associations, and individuals across Indiana.

IFPI's mission is to enhance the effectiveness and accountability of state and local government through a dialogue with policymakers, the private sector and public-at-large on critical fiscal issues and the longer-term consequences of policies addressing them. IFPI does not lobby, support, or oppose candidates for public office, instead relying on objective research for assessing and influencing sound fiscal strategies.

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