Indiana Fiscal Policy Institute – General Assembly Review:

Paycheck Priorities

Chris Watts, IFPI President – April 26, 2019

The 2019 General Assembly crossed the finish line this week, dropping the gavel on nearly five months of work, more than a thousand introduced bills and a single constitutional duty: Passing a biennial state budget for 2020 and 2021.

This session featured a number of contentious issues: Lawmakers rolled the dice on sports wagering and dealt a new hand to the casino operators. They played referee among downtown Indianapolis hoteliers and hospitality interests. They added high-tech tools to the state's economic development arsenal and labored to fashion a compromise on bias crimes as an economic and criminal justice imperative.

But the legacy of a budget year is usually embedded within HB1001 – and 2019 put teacher compensation atop the legislative priority list.

And while education advocates rallied for higher pay, the latest state revenue reports offer a reminder that personal income growth for all Hoosiers remains perhaps our most daunting long term economic – and fiscal – challenge. Here are a few highlights:

School Daze (and Dollars): What happened with K-12 funding?

- Each iteration of HB1001 upped the ante on overall K-12 funding, including the final budget deal, which delivered a 5% (2.5% annual) bump in state tuition support.
- Governor Holcomb and the GOP majorities in the House and Senate stuck to their belief that additional funding should empower school districts to raise teacher pay locally, without state mandates. (The budget did ultimately include $75 million for Teacher Appreciation Grants targeted to bonuses and base pay.)
- After the Senate initially took a tougher position on charters, conferees met in the middle at $750 per-student support (a two-year total of $45 million in the Charter Innovation Grant Fund) and 85% of tuition support for virtual programs (down from the 90% status quo).
- The budget also adds a new tier for school vouchers, 70% of tuition for families at 100-125% of free/reduced lunch eligibility.
- In all, the final version of HB1001 includes $763 million in new/increased K-12 funding (still roughly half the state's overall spending as a total category), including $539 million in added tuition support and $150 million for advance payments to teacher pensions to free up more local resources.

Investing in Income Growth (it's complicated):

Teacher salaries aren't the only "paycheck" issue that relates to K-12 education. Last week's updated state revenue forecast featured a significant decline in income tax projections, as analysts cut $160 million from earlier biennial predictions amid fears of a softening economy and manufacturing slowdown.

But lagging per capita income is a longer-term trend that, in turn, drives sluggish income tax collections. Education is one of the most powerful catalysts for employment and earning potential. Increasing Indiana's educational attainment means impacting students who aren't already on a clear trajectory towards a high school diploma, college and career success.

That's where complexity funding comes in – additional aid for higher-poverty school corporations where socioeconomic challenges are more numerous and opportunities for upward mobility (just look at the data) are limited. This emerged as a key issue as the K-12 funding formula evolved:

- An early version of the budget basically flatlined complexity support at $3,539 per student, an effective cut of roughly $100 million based on overall K-12 growth;
- This position was later eased, tying complexity back to tuition support (at 66% of the tuition grant, per student complexity grants would have grown to $3,724 in 2020 and $3,794 in 2021);
- The approved budget again detached complexity from tuition support, but found a middle ground on the funding level ($3,650 for '20, $3,675 in '21) and urged an interim study committee on the most accurate way to count students in poverty (recognizing the limitations of using federal poverty programs with varying eligibility guidelines) and reflect equity in the K-12 formula.
- To prepare students for higher-paying jobs, the budget also included funds for STEM programs, new money for ($3 million a year) for computer science teacher training and $1.5 million for Industry Credentialing Organizations to support career and technical education partnerships.

Workforce and Economic Development:

From training tomorrow's workers to supporting today's, there was general consensus on workforce priorities through the legislative process: The General Assembly heeded Governor Holcomb's request to double Workforce Ready and Next Level Employer grants to support and align training efforts with job market demands (and expanded eligibility for these programs beyond Ivy Tech and Vincennes).

To stoke demand for these upskilled workers, there was broad agreement on economic development matters as well, as IEDC priorities fared well (and lawmakers showed confidence in the public-private business development model by spinning off a similar quasi-government agency to promote tourism).

- Though the Senate originally trimmed appropriations for the Business Promotion & Innovation Fund, the final budget ($15.5 and $17 million) even exceeded the Governor's original request – though the money will also be used to cover any remaining Regional Cities project needs, as the Regional Cities Development Fund was eliminated as a separate account.

- Temporary cutbacks to the 21st Century Fund were also restored after pushback from the tech community, which also scored new tax incentives for equipment in data centers, the expansion of existing programs to cover high-growth, venture-backed firms, and funding for rural broadband initiatives.
- A new redevelopment tax credit will also give state and local economic development officials another tool for attracting investment to chronically-vacant properties, including blighted brownfield sites.

High-Tech Tax Tweaks:

While legislators looked for ways to incentivize investment from the technology sector, they were also eager to ensure tech-savvy consumers aren't a detriment to our tax base.

New policies (originally in SB322 but later amended into the budget) will require third-party hotel booking websites (like Expedia) to collect taxes based on retail (not wholesale) room prices, and puts short-term rental platforms on the hook for innkeeper's taxes. Another change amended into the budget puts the onus on online facilitators like Amazon to collect Indiana sales taxes.

Keeping in mind projected sales tax collections were off only slightly in the updated revenue forecast, these changes will certainly help close the gap. They'll also give a necessary shot in the arm to Indy's Capital Improvement Board, which earned extended and expanded authority to use innkeeper's and other revenue streams to upgrade downtown sports and convention facilities (via SB7).

Infrastructure Investment:

From taxing virtual transactions to spending on physical assets:

- The budget allocates over a billion dollars annually to ongoing highway maintenance and construction programs, continuing the level of investment supported by the 2017 legislative package that increased gasoline and other vehicle excise taxes and shifted the resulting revenues to infrastructure.
- Of note, lawmakers resisted the urge to tap into the 'special transportation fund' (where a portion of gas tax revenues can still be clawed back for general fund purposes before being earmarked for the highway fund) for the Department of Child Services budget – their reluctance bodes well for the integrity of Indiana's sustained infrastructure program.
- Legislators continued funding the Public Mass Transportation Fund at $45 million annually, and in a somewhat surprise move, reallocated $185 million to keep upgrades to the South Shore commuter rail line in Northern Indiana on track (pun intended), while holding firm on ending state subsidies to Amtrak's Hoosier State Line.
- Another $650 million will continue Governor Holcomb's 'Next Level Connections' initiative, a "multi-modal" infrastructure investment plan that covers broadband deployment, local trail grants, support for non-stop airline routes and a planned southeast Indiana (Ohio River) maritime port along with road construction.

Hometown Homework:

As pointed out by a recent Indiana Fiscal Policy Institute study, this kind of capacity to fund infrastructure – or other capital priorities – is limited across the state's local units of government. The last decade of capped property taxes has seen local expenditures retreat to 2002 (inflation-adjusted) levels, as Hoosier cities, counties and towns spend 75 cents per capita for every dollar spent by their peers across the U.S.

There were some financial wins for local officials at the Statehouse this year – increased flexibility to use TIF revenues on infrastructure, a new program to fund water system upgrades, and a fix for 'dark box' retail assessments. The Business Promotion & Innovation Fund and Next Level Connections Fund offer new opportunities to pursue local and regional development projects.

But aid to ease overcrowding in county jails was cut to $30 million a year (after hitting $42 million in an earlier amendment), and there was limited appetite for broader, structural revenue reforms.

But with the ink still drying on the state budget, legislative study topics slated for this summer and fall could have implications for local finances far beyond the 2020-21 budget cycle:

- HB1427 was amended to include an analysis of local income tax capacity and equities – i.e. a 'commuter tax' or other revenue allocation mechanisms;
- The budget also urges an interim study committee focused on state revenue-sharing for counties, taking into account the local option tax burden, assessed values and the impact of property tax caps;
- Language creating regional 'investment hubs' was added to SB565 late in the session, but was also shifted to a study committee: The investment hub concept allows cities, towns and counties to voluntarily form Regional Development Authorities and levy local option income or food and beverage taxes, keeping half the resulting revenue for local needs and adding half to a regional fund.

Collectively, a thoughtful discussion backed by thorough analysis on these topics could build positive momentum for long-term reform of Indiana's local revenue structure.

The current system has pushed county and municipal governments to be more frugal, but may also be compromising their long-term ability to provide basic services, commit to competitive infrastructure funding and explore more aspirational investments in economic development and quality of life.

IFPI is eager to build on our current body of research on state and local fiscal matters to help advance this important conversation. But with property tax caps chiseled into our constitution and sales tax revenue jealously guarded as the province of state government, reliance on income taxes will continue to expose local governments to the ups-and-downs of the economy (and payrolls).

And this prompts us to finish where we started – identifying personal income growth as a long-term fiscal priority that defies 'silver bullet' answers but demands focused attention.