February 9, 2021

Indiana General Assembly - Session Report #1:

Back to the Future

The first five weeks of this session of the Indiana General Assembly felt a little like Marty McFly scrambling for the keys to his legislative DeLorean…eager to plan for the future (namely, the 2022-2023 budget cycle), but in many ways stuck in the past: We're all ready to forget about 2020, but lawmakers are still dealing with controversies and challenges growing out of the last turbulent year – reopening businesses, rethinking law enforcement, playing catch-up in the classroom while still trying to educate adults on public health protocols.

And while dealing with all this, there's still a $35+ billion biennial budget to pass as the defining business of this session. Governor Holcomb's plan has been introduced with minor changes in the House (HB1001), where the Ways & Means Committee has held its first round of hearings and prepares for a deeper dive this week. The budget proposal increases K-12 spending, restores (and boosts) higher education funding, meets the Medicaid forecast and brings some – though not all – agency budgets back to pre-COVID footing.

Revenue Recap:

The budget avoids the dire predictions of austerity that were common last spring, as COVID ravaged state revenues. Agency spending was slashed (15% for most non-education functions) to meet shortfalls, and the extension of last year's income tax filing deadline to July 15th also pushed more than $900 million in planned revenue from FY2020 to 2021 – delayed payments that helped refill the state rainy day fund and leave the state's finances in fairly stable condition as we welcomed 2021.

The FY2022-2023 forecast was similarly "better than expected," $34.95 billion in anticipated general fund revenues, year-over-year growth across all major revenue sources from FY2021 (also revised) through 2023. (See the forecast materials here.)

Restarting the Economy:

January revenues are already exceeding the December forecast, a good omen. But longer-term projections depend on Indiana's economic output fully recovering in early 2021, with payroll employment catching up to early 2020 levels by mid-2022 (the halfway point of the next biennium). To nudge the recovery forward and strengthen the fiscal foundation of the next budget, lawmakers are acting on a number of proposals:

- SB1 and HB1002 protect employers from civil immunity related to COVID, a broadly-supported move to help businesses re-open with confidence – these bills have passed third reading and swapped chambers for further discussion and reconciliation;

- HB1004 also passed third reading on a fast track, establishing a $30 million Small Business Restart Grant program, allowing the Indiana Economic Development Corporation to support small business recovery (continuing its efforts deploying CARES Act funding for similar purposes);

- HB1235 and SB44 establish work sharing programs to encourage businesses to retain employees – even at reduced hours – with partial unemployment benefits to reduce the longer-term challenge of displaced workers (and ease the task of employers struggling to balance their bottom lines while avoiding layoffs).

A COVID Cliff?

The economic outlook accompanying the December revenue forecast emphasized education – noting that reopening schools would accelerate the recovery (by helping parents get back to normal work schedules, among other reasons) and reiterating that educational attainment is also drives long-term growth. Education is certainly a priority in the 2022-23 budget, but the pandemic has also created more immediate issues:

- First, fixing a funding loophole: SB2 and HB1003 address the definition of virtual education for schools that shifted from in-person to remote learning in response to COVID to protect against funding cuts (both have passed third reading);
- Educators talk about the routine challenge of "summer slide" – the expected learning losses that occur during school breaks; with the pandemic disrupting education for a full year, are student facing a COVID cliff of lost classroom lessons and a monumentally more difficult task of catching up?
- To address this concern, HB1008 creates a $150 million Student Learning Recovery Grant Program to combat learning losses through COVID (it's passed third reading and been referred to the Senate).

The funding for this Recovery Grant Program deserves some attention, as it highlights another (hopefully) short-term fiscal challenge for K-12. In Indiana, most education funding is allocated per student as tuition support; districts receive monthly allocations based on fall and spring enrollment data (Average Daily Membership, or ADM counts).

But roughly 15,000 fewer students were attending Indiana public schools during the COVID-impacted September 2020 ADM, meaning the state disbursed less tuition support than expected. By law, unused education appropriations go back into the state's general fund – so this low count sent $100+ million meant for schools headed towards the state surplus instead.

Because of the unusual circumstances and strain on K-12 through the pandemic, HB1008 is funded from the current fiscal year and effective immediately upon passage, essentially recapturing the education reversion to address the crisis of learning loss

(And it is a crisis: Just take a look at this sobering analysis from Stanford that finds Indiana students have lost – on average – the equivalent of 120+ days of classroom instruction in reading and nearly 200 days of math.)

Budget Basics:

Speaking of tough math, uncertainty about how quickly enrollment will recover also complicates the task of dividing the education dollars in the next budget, as lawmakers wait for the next ADM (happening later this month) to add more specificity. So let's start our overview of HB1001 with the obvious:

<u>K-12 Education</u>:

- K-12 education expenditures would again make up half of all state spending in FY2022 and 2023, growing by 2% in 2022 and another 1% in 2023 above current levels; overall, nearly $18 billion of the $35+ billion budget goes to elementary and secondary education, including $15.4 billion in direct tuition support;
- As noted above, tuition support "follows the student" to support local schools based on enrollment.
- However, tuition support is divided into categories, starting with the foundation grant (core funding for every student). In addition, a "complexity" grant targeted to students living in poverty or facing other unique circumstances, as well as conditional funding for students requiring special education, enrolled in career and technical education or earning an honors diploma.

- One issue worth watching is the level of complexity aid assigned to low-income students, a key point in budget negotiations in 2019 that's perhaps even more pressing now;
- It is broadly agreed that ample complexity funding is needed to provide equitable educational opportunities to all students regardless of family resources, but the specific division of finite resources among school corporations facing varying circumstances and challenges across rural, urban and suburban communities will certainly spark debate (for reference, the complexity grant for the current school year is $3,675, with a foundation grant of $5,703);
- Counting a student towards complexity is based on household enrollment in federal poverty programs (SNAP and TANF) or foster care; changing the measures of poverty for the purposes of complexity is another policy question that deserves further consideration, for this biennium or looking ahead.
- The allocation of K-12 resources beyond tuition support will also be shaped by supplemental state funding provided to charter schools (which do not current share in local property tax revenues, though there's a push underway to change that), and participation in school choice scholarships;
- Speaking of which, HB1005 expanding voucher eligibility passed the House Education Committee and was recommitted to Ways & Means (scheduled for a hearing on February 9th), among other provisions, the bill eliminates the tiered system of choice scholarship support by income, shifting an estimated $30+ million into the program;
- Not included in these totals is funding for the 'On My Way Pre-K' program, which takes a small cut (from $20 million to $18.9 million annually), likely based on reduced demand as parents hold children out of preschool during COVID.

Higher Education:

- Higher education, which absorbed a 7% cutback last spring, is fully restored and nudged higher by 1% each year for a total of $4.13 billion over the biennium;
- Clearly, higher education investments are critical to workforce and economic development – in December, IHS Markit economist Tom Jackson noted that high-skill employment had largely rebounded from the COVID shock, while lower-skill employment continued to trend nearly 15% below January 2020, highlighting the importance of post-secondary attainment to job creation and earnings growth;
- While institutions of higher education are eyeing more money in the next budget, they also face bigger challenges: Learning disruption among high schoolers will test their capacity to remediate incoming students for the classes of 2025 and 2026 in particular;
- State universities were also facing demographic declines (fewer K-12 students in their collective pipeline) now compounded by COVID-related enrollment delays (and lawmakers expressing caution about capital construction plans given uncertainty about the physical shape and scale of "campuses of the future").

Medicaid:

- At roughly $5.6 billion over the two-year budget, Medicaid edges higher education as the second-largest category of general fund spending; the budget accommodates the anticipated need for $475 million in additional state funding in FY2022 and '23;

- Beyond the current version of the budget, there is an opportunity to offset this increase by raising the state cigarette tax: HB1434 increases the tax from $1 to $1.995 per pack and imposes a tax on e-liquids that contain nicotine, potentially yielding $650 million over the biennium – the bill has passed committee, amended to dedicate two-thirds of this revenue to Medicaid.

Other Budget Priorities:

- Across the rest of the budget, some agencies saw funding restored to pre-COVID levels (or increased), while others continue at a lower baseline to balance shifts to education, Medicaid and other areas;
- For example, the Department of Child Services, where requests for additional funding had become almost routine, requests nearly $100 million less over the biennium (amid positive news of declining caseloads); however, this savings is effectively cancelled out by a requested increase from the Department of Corrections;
- The Indiana Economic Development Corporation goes forward at full strength after another solid year of job commitments (even during COVID);
- On the other hand, the Housing & Community Development Authority's annual funding is cut significantly from its last "normal" year (2019), though it appears that an influx of federal funding (via the CARES Act) has lessened the need for state appropriations;
- The budget includes nearly $5 billion in state transportation investments from the general fund and dedicated revenues (and stops transfers from the gas tax 'flexibility fund' to cover other expenses, getting back to the revenue shift foreseen by the 2017 transportation infrastructure funding package).

What's Next?

Later this week, Ways & Means will continue budget discussions, with the House version of HB1001 on its way; our next session update will dive into the differences among the proposals and the progress of other bills with a significant fiscal impact.

We'll also get back to the future of local finances. A proposal to limit public safety spending flexibility (SB42) has passed committee, adding a new level of complexity to crafting local budgets already dominated by police and fire, road construction and debt service, and various measures with "home rule" implications have been in the news throughout the first month of session.

Representative Jeff Thompson recently visited with the IFPI board of directors to share his plans to tie the growth of local maximum property tax levies to assessed value growth instead of personal income (HB1051) as well as adjusting limits on infrastructure projects under property tax caps (HB1363) to the size of the local tax base. Both measures would provide relief to growing communities where revenues aren't keeping up with costs – and all of the bills dealing with local budgets tend to have implications far beyond the current biennium…so stay tuned!