Where Did Our Surplus Go?

The good news came with such regularity. The flush times lasted so long. It’s hard to get used to the fact that Indiana’s huge state budget surplus is gone. But it is. How did it happen? Where did that big state surplus go?

On June 30, 1998, Indiana recorded a surplus of just over two billion dollars. It was the first time the state had ever had so much. It was 24% of the budget, the biggest percentage in almost twenty years.

The surplus is like a balance in the state’s checking account. If you deposit more than you spend, your balance grows. That’s what happened in the middle-1990s in Indiana. Every year revenues came in above the previous year’s forecast. Since we budgeted based on the forecast, we spent less than we took in. State balances grew large.

Just about everyone agreed that two billion dollars was too much. So, in 1999, the General Assembly passed a budget for the 1999-2001 biennium that spent more than forecast revenues. On purpose. The idea was to run the balance down to a more reasonable level, something like $1.2 billion dollars. That would still be 13% of the budget. Not too large, not too small.

What did we get out of that budget? Income tax cuts, for one thing. We increased the extra income tax deduction for children from $500 to $1,500. We allowed both businesses and homeowners to deduct their property taxes from their Indiana taxable income. We increased deductions for renters and people aged 65 and over. These and a few smaller cuts totaled about $450 million in reduced revenues.

We cut property taxes, too. Property taxes are almost entirely local taxes, for schools, counties, cities, towns, and other local governments. The state offered a property tax break to businesses on their first $12,500 in assessed inventories and equipment. Some mobile homeowners qualified, too. The state had to pay out about $280 million to replace the revenue local governments lost from that tax break.

The 1999-2001 budget also spent more on goods and services. The state, county and city highway departments usually depend on revenue from motor fuel taxes to support road maintenance. The 1999-2001 budget added about $200 million in new road funding above the fuel taxes. And, generally, spending for many state functions were increased more than it might have.
Things looked pretty rosy at first. The December 1999 revenue forecast increased expected revenues again, by $190 million. But when the state reported on its finances at the mid-year 2000 “close-out,” actual fiscal year 2000 revenues were about $40 million under the previous December’s forecast. As the economy slowed down at the end of 2000, monthly revenues failed to meet expectations. Then the December 2000 forecast cut estimated revenues for fiscal 2001 by $250 million, and the April 2001 forecast cut it another $230 million. All told, revenues for the 1999-2001 biennium were $325 million less than the original budget forecast. Suddenly the huge surplus was not so huge, down to about $900 million in June 2001.

The General Assembly passed a budget for 2001-03 that plans to spend about $550 million more than forecast revenues. The state will delay aid payments to schools and local governments to help balance the books. Governor O’Bannon let the budget become law without his signature. He worried that it was unrealistic, but said it might be the best the legislature could come up with.

The budget gambles that the economy will recover, and revenues will grow faster than expected. Unfortunately, July and August’s revenue reports came in $124 million less than forecast. Enough months like that, and the surplus will be gone. Indiana isn’t allowed to run a deficit.

We’ll have to get used to it. Our huge surplus is gone. And if the economy doesn’t start to recover pretty soon, the state’s budget could be in real trouble.