



June 23, 2011

The Indiana Exception? Yes, but...

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INDIANAPOLIS — Gov. [Mitch Daniels](#) sits in his grand cave of a Renaissance Revival office and reviews Indiana's economic fortunes, his self-effacing manner not entirely disguising satisfaction. The state's pension funds are relatively healthy, the unemployment rate is dropping slowly and per capita income is ticking up, slowly.

Such bragging rights are steps toward his goal, Mr. Daniels says, of overcoming Indiana's image as a "nondescript" state.

"Look, people think fiscal solvency, they think Indiana," he says. "People think great business climate, Indiana comes to mind. People think infrastructure, we're exactly who they think of."

Because recessionary winds have not toppled Indiana's house, this state is often overlooked in the news coverage of budget crises across the nation — particularly since its next-door neighbor Illinois offers such an outsize example of the financial ills afflicting state and local budgets.

But Indiana is no world apart, even if Mr. Daniels would like to suggest it is. Large cracks have opened in its economic foundation, a sign of just how severe the downturn remains.

Mr. Daniels alone cannot take all credit or shoulder blame for the health of Indiana's economy. But it is his work here — and his reputation as a cost-cutting, tough-on-labor conservative obsessed with fiscal problems — that fueled interest in his presidential ambitions before he announced that he would not run because of family considerations.

The state also serves as a case study of the often large tradeoffs required to balance the books when political leaders take the possibility of raising income taxes off the table. Fiscal conservatism, in other words, comes with its own costs.

"Much like the rest of the country, we did not survive unscathed," said Jessica Fraser, a research analyst with the Indiana Institute for Working Families.

Hundreds of thousands of Indiana residents are unemployed and underemployed. Although the state's unemployment rate is slightly better than that of its neighboring states, a striking

number of people here — a significantly greater percentage than in Illinois or Ohio — have simply left the work force altogether since the dawn of the recession.

For the second year in a row, Hoosiers ranked fifth nationally in personal bankruptcies, at 7.1 people per 1,000 residents. (Illinois came in 11th.) Indiana's median family income is just 86 percent of that of the rest of the country.

Property tax caps, put in place over the past few years, offer relief to limping homeowners but have pushed school boards and city leaders, they say, into rounds of budget cutting and layoffs.

The governor has streamlined agencies and privatized services, like prison food, printing operations and the state's toll road — the last reaping \$3.8 billion. But Mr. Daniels has made some notable missteps, as well, as when he first handed out and then revoked a contract worth more than \$1 billion to determine eligibility for public assistance.

“The idea that we're an island of prosperity makes for a great image, but I would argue that this is the worst shape the state has been in since [the Great Depression](#),” said Representative B. Patrick Bauer, the Democratic leader in Indiana's House, which is now controlled, as is the Senate, by Republicans. “We've seen drastic cuts to education, to social services, to public employees. We face problems we're not admitting.”

A Risk-Averse State

Indiana's history shapes its response to economic crisis. It experienced a vast speculative financial collapse in the 19th century, known as the Failure. In 1851, in the angry aftermath, its leaders were among the first in the nation to enact a balanced-budget requirement.

The state's DNA has remained conservative and cautious ever since.

“Indiana is risk averse; it's in the soil and the air,” said James H. Madison, a history professor at Indiana University Bloomington. “You add that to a moderate political orientation, and liberal welfare legislation is not highly regarded.”

Indiana is perhaps best understood through the different path it took from its more free-wheeling neighbor Illinois on two issues. Governors and the Legislature in Illinois have for several years skipped making full pension payments and taken all manner of ill-advised risky investments to cover the shortfalls. But a state transportation worker can retire on a livable \$35,000 or so a year.

In Indiana, leaders typically strive to make annual pension payments. But benefits are more modest. An employee earning \$30,000 a year retires after 25 years with an annual pension of

less than \$10,000.

Illinois favors a sturdy social safety net, with kindergarten and pre-kindergarten, and higher **Medicaid** and unemployment insurance benefits. (Its state work force, however, is one of the smallest, per capita, in the nation.) But legislators are reluctant to pass the taxes needed to underwrite such services. Its flat income tax of 3 percent was among the lowest in the nation. Only this year did it raise this tax to 5 percent.

In Indiana, the state income tax is a flat 3.4 percent, but counties and cities also impose income taxes to make up shortfalls. The state's 7 percent sales tax is among the nation's highest.

Indiana, under Mr. Daniels, slashed the state's work force. After hitting nearly 40,000 workers in 1992, the number of people working full time for the state is now fewer than 29,000.

Such fiscal restraint has helped the state bookkeepers — Indiana's new budget envisions \$1 billion in reserves in two years. Many residents, however, struggle with a different reality.

One in three Hoosiers qualifies as low-income now, compared with one in four a decade earlier. And 58 percent of unemployed Indianans have burned through their benefits.

The Real 'Middletown'

Northeast of Indianapolis, Muncie is perhaps best known as the real location for "Middletown," a seminal sociological study published in 1929 examining the effects of industrialization on a city in Middle America. More recently, its economic spine — automobile manufacturing — has disintegrated, and tax revenues have stalled. And now officials in Delaware County, which includes Muncie, are seeing big drops in revenue, in part because of caps the state has imposed on property taxes.

Such caps have proven politically popular; many states already have limits, and legislatures elsewhere are weighing similar measures. Here, lawmakers, Republicans and Democrats alike, approved caps in 2008 amid a public outcry over rising tax bills. Last year residents overwhelmingly voted to add the caps to the State Constitution.

Mr. Daniels said it amounted to the biggest net tax cut in state history. (He has not opposed all taxes. He advocated an income tax increase for the wealthy in 2005, and later signed increases in the sales and cigarette taxes.)

Still, as one Delaware County official put it, when combined with the fallout from the downturn, the caps have "put us over a barrel."

"The thing that worries me is that you get what you pay for," said the official, Kevin Nemyer, a

County Council member and a Democrat. “Will services get down to a minimum so roads aren’t fixed, we don’t have animal control out there, people aren’t getting what they need?”

Delaware County took in nearly \$4 million less in revenue in 2010 because of tax caps, and its various townships, districts and other entities received almost \$20 million less under the caps.

Not long ago, the County Council reluctantly set out to slash spending, cutting 21 employees, raising health deductibles and ending an exercise program for public workers.

“We had already cut every paper clip, every supply, everything there was to cut, and it was either cutting employees or not pay our bills,” Mr. Nemyer said.

The cuts keep coming: \$8 million last fall, \$2 million more from the current budget, and the Council has been searching for an additional \$1 million.

Indiana’s property tax caps limit bills to 1 percent of the gross assessed value of owner-occupied homes, 2 percent for farms and rental buildings, and 3 percent for businesses. Local authorities can ask voters to break the caps for projects like new schools and jails; so far, the results are mixed, with rejected resolutions outpacing accepted ones.

The state’s Department of Local Government Finance says Indiana’s counties, cities and towns collected \$215 million less in revenues in 2010 than they would have without the tax caps. Townships, library districts, redevelopment commissions and other special districts lost an additional \$71 million.

Not all the news in Delaware County is grim. Officials have announced a new locomotive assembly plant and a facility to make wind turbine gears.

But unemployment remains high. And local governments continue to pare back. Residents balked at a proposal to turn off street lights as a money-saving measure, but the signs of stress are clear: Muncie has closed fire stations and a local sewer district has begun aggressively pursuing those who do not pay their bills.

“The state may look good from way up,” said Mike Jones, another Delaware County Council member. “But if you get close, it looks a lot different.”

Even with all the relentless budget cutting, more than a few residents say that vanishing businesses — not tax caps — are the real problem, and that local governments need to become leaner and more efficient.

“It’s not the state’s fault that this is happening,” said Tom Bennington, a former member of the County Council and former vice chairman of the local Republican Party. “County officials have

needed to make some tough decisions for a long time.”

A Backslide for Workers

Yvonne and Brian Meece have been jobless for the better part of two years. He is a roofer. She spent years as a night auditor at a hotel; then her boss stopped paying overtime, then he cut her pay to \$8 an hour from \$11, then he laid her off.

“No one wants to hire a 56-year-old,” she says. “They’ll tell you, ‘To be truthful, we prefer someone younger.’ ”

Mr. Meece, a trim ex-Marine, gets \$14 an hour when he works. A decade ago, he earned multiples of that. “Nothing is union anymore,” he says. “You’re just a **day laborer**.”

They received unemployment checks for nearly two years, but their benefits ran out. Now they live in the Good News Family Shelter in Indianapolis.

Their plight is an Indiana conundrum. Workers here have done a backward slip-slide for more than a decade. Median income is falling — by 15 percent in the last decade. The so-called real unemployment rate, which includes those too discouraged to look for work, stood at 17.4 percent last year. And the percentage of Indianans who participate in the work force has dropped in the past two years, much faster than in Illinois and Ohio to the east.

“Indiana has touted jobs numbers, the governor has been happy to talk about it, but the reality is that they don’t pay nearly as much as the old union manufacturing jobs,” said John Ketzenberger, president of the Indiana Fiscal Policy Institute, a nonpartisan group. “People in Indiana are working harder and longer for less.”

Governor Daniels notes that income growth edged up promisingly in the last quarter, though from the lowest floor in the Midwest. He talks of his battle to keep costs low, by cutting bureaucracy and regulations.

In his first days in office, he recalled, he gathered his senior officials in a hotel suite and told them his goal: “We’re here to raise the net disposable income of Hoosiers.”

Mr. Daniels has pursued this goal by cutting taxes and fees for Hoosiers; he has had less success raising wages and adding jobs with benefits.

Leslie Eckerty is a mother of several children, living in Anderson, a factory town east of Indianapolis. She has lived with falling wages and a lack of benefits for much of the last decade. Now she is back in school, studying nursing. The mathematics of her life do not add up.

“How can you afford to commute when you’re making \$6 an hour?” she asks. “I’m working on a backup plan; I’m just not sure what it is yet.”

In the Schools

Public schools in Indiana stand on an especially ferocious firing line in this recession. When property caps were put in place, state government, as part of that deal, took over responsibility for financing public education.

At the time, the math added up on paper. Then tax revenues fell through the floor, sinking \$1.4 billion below what officials had expected during the state’s 2009 budget year.

In southern Indiana, the New Albany-Floyd school system has closed schools, consolidated classes, pared administrators and imposed a pay freeze on teachers. That is still not enough. Next year will bring layoffs.

Many state officials, and even some local board members, are unsympathetic. Rebecca Gardenour, who serves as vice president of the school board, voted for the property caps, without regrets. She regrets only that she voted to build two big new schools a few years back.

“Do I have buyer’s remorse? Yes, I do,” she said. “We don’t need Taj Mahals.”

Her view is often echoed by Republican state legislators. They portray public education, and the relatively modest pensions for teachers and bus drivers and janitors, as a fatted calf ready for the knife. Federal test scores here are above the national average, but a pervasive sense of dissatisfaction is heard from many Hoosiers about the state of public education.

“There is this notion that Indiana education is in crisis,” said Walton Robinson, spokesman for the Indiana State Teachers Association. “Indiana students test higher in math than the U.S. average, and in England and France. But you don’t hear a lot of celebration.”

Revenue collection forecasts have improved of late. Mr. Daniels recently announced he would allocate more than \$150 million to partly underwrite full-day kindergarten. Still, Indiana school districts are \$300 million below 2008 financing levels.

Even top state Education Department leaders paint a mixed picture. Last year, the superintendent of public instruction issued a release noting that federal test scores, while above average, remained mostly flat. And studies persistently show skills shortages in areas like nursing and high-tech factories, no small matter in a state that leans heavily on manufacturing jobs.

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The governor seems skeptical about some of the cries of public education, he says, spend a lot on overhead costs, and they should give sustained thought to merging districts, privatizing janitorial and cafeteria services and bulk buying of energy.

In late April, discussing the economy in his office, he brightened when asked about new legislation expected to encourage more **charter schools** and to provide state money for vouchers to go to private schools. “Until yesterday, I would have told you that the huge incomplete on our report card was public education and improving it in a big way,” Mr. Daniels said. “We think Indiana has gone from back of the class to front row in this respect.”

Tom Galovic, a barrel-chested former school principal and now chief financial officer for the Greater Clark County Schools near Louisville, shakes his head. He is a fan of Mr. Daniels over all, he said. But he sees a self-fulfilling prophecy taking shape around public education — the same problem that many others see with Indiana’s intent focus on the cost side of fiscal restraint.

“If you cut and cut,” he said, “you erode the system to the point that it snaps.”