INDIANA UNIVERSITY PUBLIC POLICY INSTITUTE
POLICY CHOICES
for Indiana's Future

REPORT ON POLICY CHOICES AND OPTIONS

Commission on State and Local Tax Policy

February 2012

11-C41

SCHOOL OF PUBLIC AND ENVIRONMENTAL AFFAIRS

INDIANA UNIVERSITY

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ABOUT POLICY CHOICES FOR INDIANA'S FUTURE

In fall 2009, staff and faculty of the Indiana University Public Policy Institute (PPI) and the School of Public and Environmental Affairs (SPEA) began discussions regarding the critical questions that Indiana must address to secure our success now and in the future. Through the PPI Board of Advisors, work started in January 2010, on Policy Choices for Indiana's Future, a nonpartisan initiative to analyze the issues that will face the state's next legislature and governor.

As the project developed, focus began to center on the overarching idea of improving the economic health of the state, its citizens, and its businesses. Analysts began to gather data regarding the current and future economic conditions in Indiana, within the broader context of the Midwest (Illinois, Indiana, Iowa, Michigan, Minnesota, Ohio, and Wisconsin). Three key areas were identified that depend in part on our ability to:

- *develop the highly-skilled workforce necessary for economic growth in a knowledge economy,*
- *leverage the state's energy resources and assets in an environmentally responsible, productive manner, and*
- *create a balanced tax environment that allows individuals and businesses to flourish while generating the revenue required for the state to efficiently deliver the essential services necessary to keep Indiana competitive.*

Because the issues involved are large and complex, Policy Choices relied on the work of three commissions:

- *Commission on Education and Workforce Development*
- *Commission on Energy and the Environment*
- *Commission on State and Local Tax Policy*

Each commission included members of the PPI Board of Advisors and additional members from around the state selected based on their subject-matter expertise. Randall Shepard, Chief Justice of the Indiana Supreme Court, and Mark Miles, president and CEO of the Central Indiana Corporate Partnership, led the overall project.

Each commission was staffed by policy analysts from PPI and met several times through October 2011. The commissions gathered information and listened to presentations from topic area experts. Each commission developed a set of policy options to address the challenges facing our state. These options with supporting information are presented in each commission's technical report (available along with other Policy Choices work products at www.policyinstitute.iu.edu/PolicyChoices).

The goal of Policy Choices is to start the discussion among government, nonprofit, and private sector leaders about these topics now—to provide policy options for action. Recognizing that these are long-range issues, PPI will continue to analyze these questions and engage leaders, policy makers, and other partners in continuing the discussions.

COMMISSION ON STATE AND LOCAL TAX POLICY

11-C41

EXECUTIVE SUMMARY

For Indiana, the last decade has presented ongoing financial challenges. We have responded with fiscal discipline, presenting our state with significant opportunity and serious choices that will affect our economy and long-term prospects for growth.

Concerted efforts at maintaining fiscal health through the financial crisis and resulting economic downturn enables Indiana to have policy options about the future of public finance in Indiana. The state government is in a relatively strong position in the short term, with revenues sufficient to cover budgeted costs through FY 2013.

At the same time, Indiana lost 250,000 of 3.1 million total jobs between 2008 and 2011. Adjusted for inflation, Indiana personal income grew by 4 percent since 2000, compared to 14 percent for the nation. The economic recovery from the most recent recession has been constrained by people paying off debts instead of spending at historical (credit-fueled) levels; household debt as a percent of income grew 11 percent from 2000 to 2008 but has dropped 15 percent since. While less household debt is a positive sign for long-term fiscal health, in the near term, businesses remain uncertain about the economic changes that will fuel growth and create more jobs.

Indiana now owes the federal government over $1.8 billion for unemployment benefits and we are currently paying interest on that debt. The unfunded liability of Indiana teacher pensions has grown from $7.5 billion in 2000 to $11 billion in 2010. The Indiana Department of Transportation expects that the Major Moves construction fund will be depleted in 2013. Gas tax revenues are not adequate to fund the preservation of the existing system.

Going forward, we are encouraged in the short term that state government can pay its bills, but demographic changes create ongoing pressure on government to increase services without an increase in revenue. The number of retirees in Indiana will grow faster than the workforce, reducing tax revenues based on income and increasing spending on health care and support services. In rural areas, the number of people available to work is expected to be smaller in 20 years than it is today.

Need for Action

The challenges and complexities of tax administration in a 21st century economy are extensive. We need to structure our system of raising revenue to fund government in a way that best addresses these challenges and does so simply, directly, and efficiently.

In support of Policy Choices for Indiana's Future, a project of the Indiana University Public Policy Institute, this report provides a set of policy options and strategies in tax policy and administration. The Commission on State and Local Tax Policy (Commission) evaluated Indiana government finances, identified critical issues, and made focused proposals regarding the system for delivering and funding public services and investments. While federal policy significantly affects state delivery of public services, the Commission's focus was on Indiana and what we control.

The Commission is comprised of experts with budgeting experience in diverse settings. The Commission members brought to the process the thoughtfulness, cooperation, and coordination necessary to address the challenges that the state is facing. We agreed that maintaining certain elements of our tax system, as well as making the following set of reforms, will improve our competitive position and chances for economic growth, and ensure government is able to deliver its services to Indiana's citizens.

Guiding Principles and Scope of Work

Good policy requires specific goals; understanding our strengths, weaknesses, threats, and opportunities; intentional decision making; and continual evaluation of results. We support a tax system that does the following:

- Enables economic growth, business and individual well-being
- Takes a balanced approach to taxation through broad bases and low rates
- Emphasizes a long-term and comprehensive strategy for infrastructure preservation and enhancement
- Facilitates consistency, clarity, and effectiveness through a purposeful structure and operation of state and local government
- Recognizes regional differences in approaches to economic growth
- Tracks the results of decisions for periodic evaluation of tax policy

This report offers findings and recommendations to improve the wealth of Indiana's citizens. We believe the most effective way of accomplishing this objective through tax and fiscal policy involves improvements in three areas:

(1) Preserving an attractive business climate

(2) Designing a government structure to enable a 21st century growth economy

(3) Funding necessary maintenance and enhancement of our infrastructure

The ability to deliver sound tax policy for our state rests in part on the ability of our tax system to operate fairly, professionally, and consistently. The system must also deliver proceeds to invest in key assets (such as roads, bridges, sewers, and broadband infrastructure) and services (such as education, health services, and public safety) to make Indiana a desired destination and domicile for individuals and businesses.

In this pursuit, this report reflects a comprehensive and integrated approach to tax policy. Accomplishing the steps we recommend requires a concerted effort by state and local leadership. Our economy and lives have changed in fundamental ways since our jurisdictional boundaries and methods for taxation were initially developed. Our system of taxing and spending needs to adapt.

Federal Outlook

Federal reforms to spending on infrastructure, entitlement programs, and health services could have significant effects on Indiana's fiscal position. In addition, corporate taxation at the federal level presents challenges in attracting business investment and retaining global-economy industries in the country.

For example, the United States now has the second-highest corporate tax rate across member countries of the Organization for Economic Cooperation and Development (OECD), and is one of a very few industrialized countries to impose taxation on foreign earnings and is offering relatively fewer incentives that encourage innovation. These disparities challenge the competitiveness of U.S.-headquartered firms and contribute to U.S. companies moving manufacturing operations.

The Governor of Indiana and leaders of the General Assembly should work collaboratively with our neighboring Midwest states so that there is consistent federal tax policy that makes the United States attractive to foreign investment.

State Conditions

Property tax reform, increases in the state sales tax rate, and corporate tax restructuring have altered the mix of revenue; government now relies more on income and sales tax.

Local governments have been particularly hard-hit. Revenue losses from property tax caps and stagnant growth in local income taxes are forcing local leaders to cut costs and reduce services.

Indiana state government had negative net income in eight of the last ten fiscal years, yet a combination of constrained spending, use of reserve funds, and federal stimulus have enabled a cash balance heading into the FY12-13 biennium. Indiana is one of very few states with a cash balance. Near-term revenue forecasts are positive, but with existing economic uncertainty the state faces challenges. Sustained economic growth is necessary to meet base spending.

Indiana's economy requires an infrastructure to move people, goods, energy, water, and information. In the near term, the money that funds maintenance and expansion of our roads is shrinking. The Major Moves lease proceeds are nearly spent and the state is without a replacement for those funds. State and local needs are in excess of $1 billion just to maintain the current road system. That figure does not address needs for road expansion, transit, sewers, and broadband access. Indiana needs a plan for funding infrastructure investment in the state.

The downward pressure on government revenues means we must continue to look at the design of state and local government. The structure of our government, especially at the local level, reflects our history. We need our government to be structured around serving the citizen. Done well, restructuring could deliver resources to address other needs.

SUMMARY OF PROPOSALS

While government does not create economic growth, it can encourage growth through its many roles and decisions. The following proposals better orient our government to enable real growth in the economy and in the well-being of Indiana's citizens.

1. Business Climate

The most effective means of raising revenue for public services is through a balanced and diversified portfolio of revenues drawn from taxes on income, consumption, and property. In general, we support keeping the tax base broad so that rates can be low.

We believe that taxation must be clear and methods certain. Certainty promotes confident decision making which contributes to improving the economy. The Commission agreed early on to recommend tax increases only where necessary to fill gaps in existing funding. In its work, the Commission found a significant shortfall in funding for preservation and expansion of roads.

Balance in revenues

We support maintaining a balance among income, sales, and property tax revenues. The ability to raise money to fund government should not be compromised by undue susceptibility to business cycles or overreliance on one type of tax.

Individual income tax

We support retaining the current individual income tax rate. Indiana's individual income tax is relatively low among states with flat rates, one rate for all payers regardless of income. The Earned Income Credit provides some progressivity to the tax structure, a financial relief for people who earn less. To keep the individual income tax at its present rate provides certainty for individuals and for small businesses that use it instead of the corporate income tax rate.

Corporate income tax

We support retaining the current, recently-reduced corporate income tax rate. We support the recently enacted reduction in the corporate tax rate from 8.5 to 6.5 percent and establishing a single sales factor approach. Those changes improve our state to state comparisons and competitive position for business investment. Another percentage point decrease in the rate would get Indiana closer to the average rate nationally, but we can't afford it.

We suggest reviewing tax credits, deductions, and exemptions. Tax incentives are hidden spending. In some cases they are effective at stimulating investment and behavior, but we often do not know the return received for our investment. Future decisions should be driven by data, evidence, and real-time information on what works. Those incentives that do not provide an adequate return on lost revenues should be changed to better capture intended benefits.

We suggest limiting tax incentives and tax breaks to initiatives of highest priority and expected return on investment.

Sales tax

Our 7 percent sales tax rate is high and proceeds from the sales tax are now the largest component of total state revenues. Also, our economy and consumption continue to trend toward services and away from goods. Nearly 60 percent of all spending is on services, with an increasing share of that going to medical and health services.

We suggest that Indiana consider how to reduce the state sales tax rate by broadening the sales tax base on a revenue-neutral basis to include more services. Other states have tried taxing services with varying results, none of them a unanimous success. Yet growing the sales tax base to reduce the rate would improve our profile in comparison with other states, and potentially be more equitable among payers and enterprises. The state should study the issue and should include input from citizens, business, academia, and government.

Property Tax

We suggest conducting a comprehensive evaluation of the impact of the 2008 property tax reforms. Local governments are just now feeling the full effect of Indiana phasing in lower property tax rates and caps. The impact of our ability to pay for services is not yet clear. This study should address the fiscal position of local government under the property tax cap system and consider the options to meet funding needs.

We suggest continuing efforts to reduce reliance on the business equipment and machinery tax revenue. Indiana's tax on business equipment and machinery, called business personal property, is an impediment to attracting and growing business investment in capital equipment. However, local government needs the revenue and loss through a change would need to be replaced. A study would need to identify options to replace this revenue in a way that minimizes other distortions private sector behavior.

Cities and Regions

Tax policy should enable cities and regions to do the projects that support their economic plans. Economic activity of services, purchases, and employment happen across government boundaries. That implies rethinking how to fund government.

We suggest encouraging regional planning and projects and allowing regional taxing districts. Investments in regional transportation and internet are examples of 21st century economic needs that cross county boundaries.

We suggest helping city centers by sharing a modest portion of local option income tax revenues between counties of residence and counties of work. Centers of employment incur costs to serve people who work but don't live in that city or county. We suggest that a quarter or less of local income taxes, especially those not designed to replace property taxes, be directed to the county of work instead of the county of residence. Consistent with our principle of data-driven decision making, the distribution of local income tax should be analyzed in concert with the impact of property tax caps.

Tax administration

Indiana's system of tax administration should be predictable, fair, and professional.

We suggest expanding the capabilities of the Department of Revenue to analyze collections and costs and benefits of tax policy. Challenges in cross-state and international commerce require advanced capabilities to administer, assess, audit, and review compliance and appeals. The state should provide consistency in applying case history to future decisions. Businesses and individuals should know what to expect based on their circumstances.

We suggest providing sufficient resources to the Department of Revenue to enforce collection of the sales tax on Internet purchases. E-commerce comprises an increasing share of total sales. Estimates are that Indiana forgoes $150-200 million annually in e-commerce revenues by not enforcing the use tax.

We suggest a standardized treatment of not-for-profit organizations. Many not-for-profits consume large amounts of public services and it would be fair for them to contribute a payment. The study should strive to create an approach for dealing with these situations statewide.

We suggest establishing a Midwest interstate compact to coordinate economic development efforts. Competition between locations using tax incentives dilutes the common strengths of Indiana and its neighboring states. A planned system of incentives and tax administration improves the prospects for regional economic growth.

2. Structure of Government

Financial pressure is growing over time. Structuring government around good delivery provides budget relief and saves time and money for all. Increasingly, organizations have the opportunity to integrate information and empower employees to make more decisions. In turn, they can serve the customer faster and more completely. Indiana should pursue improvements in government design and organization.

We encourage evaluating the organization of government, the quality of service delivery, spans of control, and organization layers. Employees who deal with the public need the authority and information to make decisions. Activities should be coordinated to minimize duplication of effort or conflicts in intent. Managers and employees should be empowered to make decisions within prescribed boundaries. Constituents should not have to make multiple stops to resolve basic needs.

We promote joint purchasing and other inter-local agreements between local government units. Cost savings, and better practices can be achieved through coordination of operations and purchasing.

Structuring government around good delivery of services provides budget relief and saves time and money for all. Increasingly, organizations have the opportunity to integrate information and empower employees to make more decisions. In turn, they can serve the customer faster and more completely. Indiana should pursue improvements in government design and organization.

Making government more efficient involves both legal reform and reforms to administrative practices and operations. We encourage local leaders to consider potential alternatives to providing services in the case where a levy is eliminated. Identify services that can be provided without the levy and those that cannot. A rethinking of the service provision model at the local level supports the need for efficiency in operations.

We suggest continuing to advocate local government reform and consolidation as a means of improving delivery of services with maximum efficiency, transparency, and accountability. We support the recommendations contained in the Kernan-Shepard Report on Local Government Reform. Indiana should continue to pursue reforms that encourage faster and better provision of public services. Some recommendations have been enacted into law. We encourage continued look at the creation of a County Chief Executive; integration of work of the county Treasurer, Auditor, and Assessor; and a statewide benchmarking system for government productivity and fiscal performance.

3. Spending and Investment

The two other commissions of the Policy Choices project address and make recommendations regarding Indiana's education and workforce development and energy and environmental policy.

As the Tax Policy Commission reviewed state and local finances, we found an immediate shortfall in funds to preserve our existing system of state and local roads. We have not estimated a shortfall in road expansion, transit, sewer, and broadband infrastructure investment but feel that a consolidated infrastructure needs report should be developed.

Our primary concern is that the Major Moves Construction funds are depleted in 2012 and Indiana will have insufficient revenues to preserve our system of roads.

We suggest considering increasing the gas tax to align with neighboring states and index it to inflation to preserve the existing system of roads and bridges. We suggest using tolls to finance future road expansion projects.

We encourage developing a state plan for water, energy, information, and transit infrastructure. We suggest using a state infrastructure bank and public private partnerships to support financing, enhance private investment potential, and offset risks.

Aside from infrastructure, state universities are another key asset in attracting businesses and providing a high quality of life. Universities create knowledge, innovation, and entrepreneurship which are critical components of Indiana's economy. State funding for higher education has decreased and the universities operate under state rules and restrictions.

We challenge universities and the General Assembly to devise a sustainable strategy for funding higher education to maintain a strong source of innovation.

CONCLUSIONS

Indiana is in a tenuous but manageable fiscal position. Indiana's tax rates are competitive. We want our tax structure to be dependable, consistent, and simple. The tax base should be diverse and broad. State and local leaders should have accurate forecasts for budgeting and decision making. Taxing jurisdictions should reflect goals, modern life, and economic conditions as they organize to provide services and raise revenue. Tax systems should support the vitality of city cores and the relationship to regional economies. Systems of infrastructure – transportation of people, goods, energy, and information – are necessary to quality of life and business development.

Indiana is in a position to make choices for the 21st century economy. The challenges facing us are significant but with clear goals, strong leadership, and shared effort, the reforms we propose should position Indiana for the future.

THE COMMISSION ON STATE AND LOCAL TAX POLICY AND ITS WORK

Initiated by Indiana University's School of Public and Environmental Affairs and the IU Public Policy Institute, a group of experts in state and local tax policy agreed to serve on the Commission on State and Local Tax Policy (Commission). The charge of the Commission was to identify options on how state and local public finance structures can improve the economic well-being of the state and its citizens.

While federal policies greatly influence what policy choices are available to the states, this Commission focused on what Indiana's policy leaders can control at the state and local level. Our charge as a Commission was to identify the critical issues facing the administration of taxes and spending in Indiana, and to propose options and recommendations improving it in the interest of Indiana's citizens and businesses. Rather than continue a piecemeal approach to tax policy, the Commission sought to create a comprehensive strategy of reform that works toward the goals of efficiency, economic competitiveness, and sustainability.

The Commission wants a tax system that raises sufficient revenues to meet the needs of our citizens, invest in critical infrastructure, and that makes Indiana economically competitive on a regional, national, and global scale. Above all, the Commission wants a system that accomplishes these things efficiently, effectively, and transparently.

The Commission is diverse demographically, in geographic representation, and in perspectives on how best to modernize our system of taxation and spending. Its combined expertise in state and local finance and in the private sector provides the Commission a wealth of knowledge and insight about the challenges and potential solutions to state and local tax policy in Indiana.

The Commission co-chairs are:

- Kathy Davis, Owner, Davis Design Group LLC
- David Lewis, Vice President for Global Taxes & Chief Tax Executive, Eli Lilly and Company

Other members of the Commission are:

- David Bennett, Executive Director, Community Foundation of Greater Fort Wayne
- Jean Blackwell, Executive Vice-President, Corporate Responsibility, Cummins Inc., CEO Cummins Foundation
- Gretchen Gutman, Associate Vice President, Government Relations, Ball State University
- Matthew Hall, Director, Projects and Finance, BioCrossroads
- Craig Johnson, Associate Professor, School of Public and Environmental Affairs, Indiana University
- Mike Norris, Vice President of Global Taxes, Zimmer Corporation
- Charles Schalliol, Counsel, Baker Daniels
- James Steele, CFO City-County Council, City of Anderson
- Bill Waltz, Vice President, Taxation & Public Finance, Indiana Chamber of Commerce
- Kurt Zorn, Professor and Associate Vice Provost for Undergraduate Education, Indiana University

The Commission was staffed by the Indiana University Public Policy Institute (PPI), a research organization that is part of the IU School of Public and Environmental Affairs. Commission costs were underwritten by the IU School of Public and Environmental Affairs, located at the Bloomington and Indianapolis campuses, and the Central Indiana Corporate Partnership.

The Tax Commission staff includes:

- Matt Nagle, Tax Commission coordinator
- Erin Braun, Graduate Assistant
- Markie Rexroat, Graduate Assistant
- Aryn Schounce, Graduate Assistant
- Samuel Stone, Graduate Assistant

The Commission met bi-monthly for a period of 18 months and incorporated input from a variety of sources and experts in the areas of tax policy, economic development and site consulting, transportation funding, and federal tax policy. PPI staff researched the current state of Indiana's state and local finances, gathered information on the needs of Indiana's economy in the 21st century, and researched infrastructure needs for the state.

The Commission would like to thank the following people and groups for their invaluable insights and contributions to the body of research that helped inform our discussions:

- Jeff Chapman, Project Manager, Research, Pew Center on the States
- Larry DeBoer, Professor of Agricultural Economics, Purdue University
- Sarah Emmans, Manager of Research and Information, Pew Center on the States
- Dennis Faulkenberg, President, Appian Advisors
- Larry Gigerich, Managing Director, Ginovus Corporation
- Scott Hodge, President, The Tax Foundation
- John Ketzenberger, President, Indiana Fiscal Policy Institute
- Laurie Maudlin, Principal, Appian Advisors
- Ron Snell, Senior Fellow, National Council of State Legislatures
- Robert Zahradnik, Direct of Research, Pew Center on the States

Guiding Principles for the Tax Commission

Public finance is a means of raising money to invest in communities and provide essential services that the private sector cannot (or will not) do. The collection of services and investments go a long way toward defining the attractiveness of a particular area to individuals and to businesses. Well-maintained roads, bridges, and sewers; adequate and comprehensive public safety resources; and education and workforce training are all key components of the "quality" of our state.

The Commission adopted a set of principles to guide the decision-making process toward these goals. In some cases, these principles conflict with one another. A tax policy that enables economic growth is sometimes one that distorts behavior, albeit in a positive way for the state. Tax streams that promote equity and fairness may create administrative burdens. As a group, the Commission took great care to balance these competing needs and devise a set of options and recommendations that met as many of the guiding principles as possible.

Specifically, our system of public finance should:

- **Enable economic growth, and business and individual well-being**

  Tax and spending policy should be used to provide the precursors to an attractive and sustainable business climate. Rather than chasing jobs, Indiana should create a climate that makes them come to us. An educated and trained workforce; a well-maintained and comprehensive system of roads, utilities, and high tech infrastructure; and access to quality-of-life amenities benefit citizens and employers alike. State and local government should raise revenue in a way that does not create negative consequences on personal and business behaviors.

- **Take a balanced approach to taxation with broad bases and low rates**

  Revenues should come from a variety of sources and should be drawn from broad tax bases using low rates. Diversification of revenues provides a better mechanism of tying revenues to economic growth. Credits, exemptions, and deductions erode the tax base, necessitate higher rates to achieve policy goals, reduce elasticity to economic growth, and alter natural decision making processes in the market.

- **Emphasize a long-term and comprehensive strategy for infrastructure preservation and enhancement**

  Our system should raise revenues that are sufficient to meet ongoing obligations and to provide additional revenue for needed investments.

- **Facilitate consistency, clarity, and effectiveness through a purposeful structure and operation of state and local government**

  Our system should be easy to understand and should be open in its rules and administration. Simplicity and transparency lead to trust in the system, increased compliance, and decreased costs and burdens of excess administration. Taxpayers in similar situations should be taxed similarly; taxpayers in different circumstances should be taxed differently and according to the circumstances. Sufficient resources should be directed to identify areas where there is a medium-to-high risk of non-compliance with our tax laws. Not only would this promote fairness, it would have the added benefit of expanding the tax base.

- **Recognize regional differences in approaches to economic growth**

  Tax and spending policy should account for regional differences and allow localities to adapt to changing market conditions as they happen. Revenue streams should possess a certain amount of elasticity that allows them to grow as the economy grows.

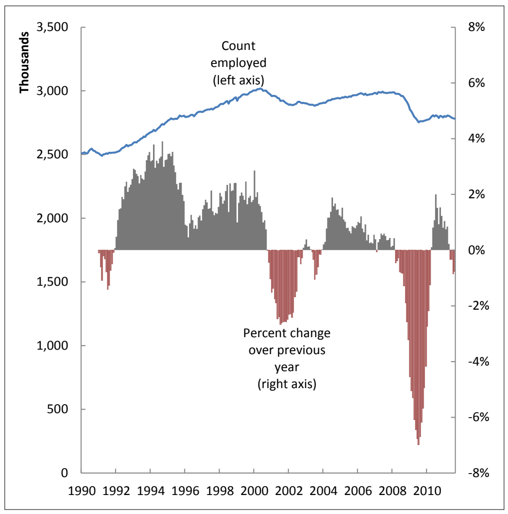
CHALLENGES FACING THE STATE

Economic recovery

Concerted efforts at maintaining fiscal health through the financial crisis and resulting economic downturn enables Indiana to have policy options about the future of public finance in Indiana. The state government is in a relatively strong position in the short term, with a $1.2B cash balance as of the close of FY2011. Revenues appear to be sufficient to cover budgeted costs through FY 2013.

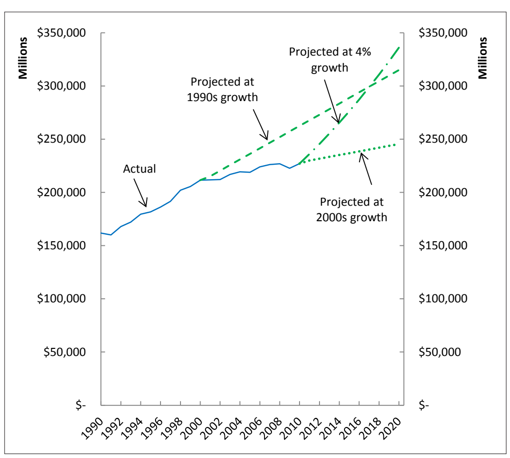
The last decade presented major challenges for Indiana's economy and long-term prospects for growth. Indiana lost 250,000 of 3.1 million total jobs between 2008 and 2011 (Figure 1). Adjusted for inflation, Indiana personal income grew by a modest 4 percent in total since 2000, compared to 14 percent for the nation (Figure 2). Estimates of personal income growth depend heavily on economic conditions, so a sustained period of economic expansion and jobs creation will need to occur to continue the growth pattern of the last 18 months. State forecasts predict personal income growth on the order of three to four percent annually through 2013, though recent economic troubles make this growth level an optimistic one.

Figure 1. Indiana monthly non-farm payrolls, 1990-2011



Source: U.S. Bureau of Labor Statistics

Figure 2. Indiana personal income, adjusted for inflation, 1980-2010 and projections to 2020



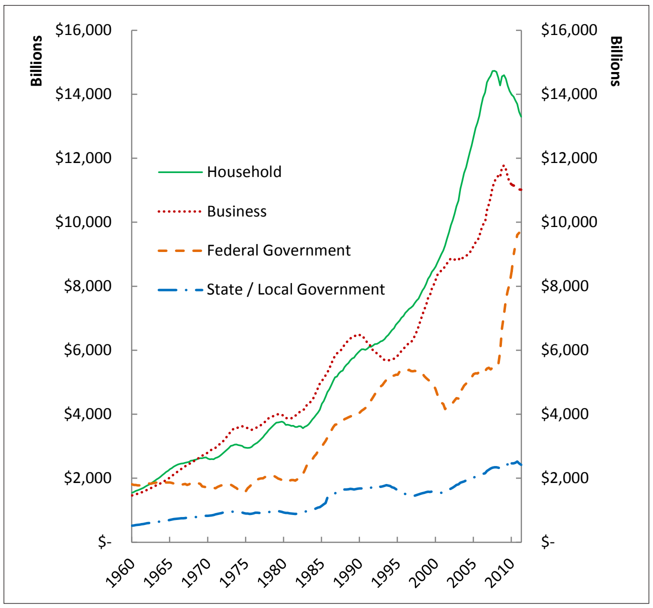
Note: 2010=100

Source: Calculated from the data; U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis

The economic recovery from the most recent recession has been constrained by people paying off debts instead of spending; household debt as a percent of income grew 11 percent from 2000 to 2008 but has dropped 15 percent since. As with nearly all sectors of the economy, American households accumulated large amounts of debt over the last decade. Since the recession of 2008, these households have undertaken a large-scale process of de-leveraging (Figure 3). People have constrained their spending habits so that they can pay off debts and regain a solid financial footing.

De-leveraging on this level has decreased prospects for economic expansion because less consumer spending means lower expectations and more uncertainty for businesses. Constrained demand for private goods and services has caused businesses to refrain from investments and from hiring new workers. Ultimately, while these circumstances are putting citizens in a better fiscal situation, they present challenges for state governments that rely on sales taxes and other consumption-related revenues to fund services.

Figure 3. Quarterly debt outstanding by sector

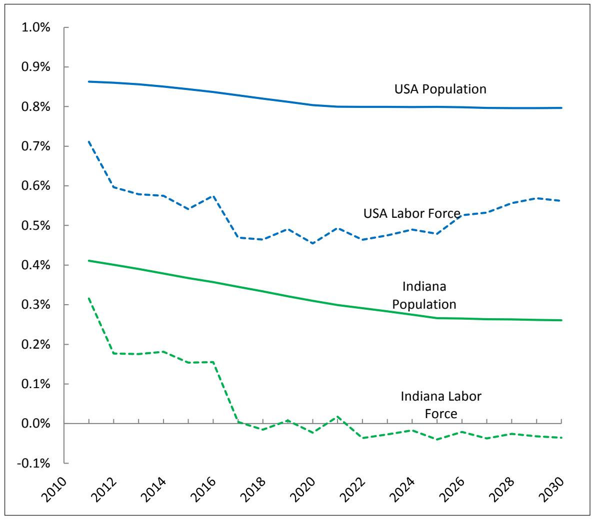


Source: Board of Governors of the Federal Reserve System

Demographic shifts

As the baby-boom generation reaches retirement age, the result is fewer people in the workforce, less potential for robust growth in personal income, and less revenue from the individual income tax. While the national labor force is expected to grow 10 percent over the next 20 years, Indiana's will only grow by 1 percent (Figure 4). In other words, there will be a larger share of retirees relying on fewer working people to drive the economy that ultimately supports them. These retirees will consume different services than younger generations, many of which go untaxed. Spending on health services, retirement programs, and Medicaid, are likely to increase as our population ages.

Figure 4. Projected annual growth rates of population and labor force, 2010-2030

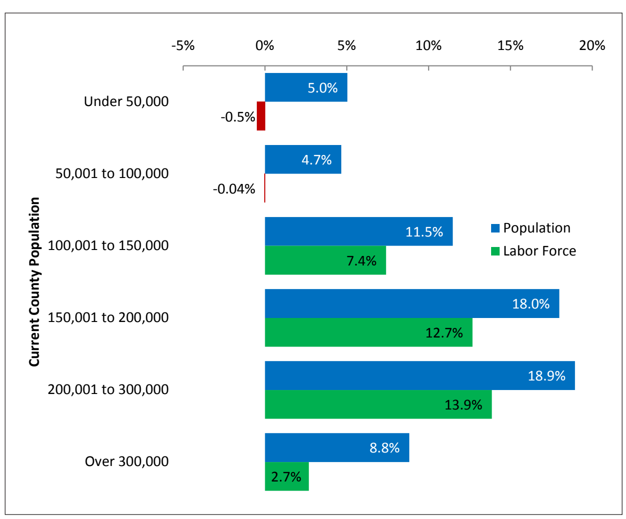


Source: Calculated from the data; U.S. Bureau of Labor Statistics, U.S. Census Bureau

About two-thirds of Indiana counties have seen flat growth in population (Figure 5). In rural areas, we can expect the labor force to be smaller in 20 years than it is now. A report by the Brookings Institution shows that about 80 percent of Indiana's population, jobs, and economic output are concentrated in metropolitan areas (Berube & Nadeau, 2011). Urban areas will have a greater ability to compete for 21st century jobs, which are focused in science, technology, engineering, and mathematics (STEM) fields, than will rural Indiana.

Strategies for economic development and long-term growth need to recognize that different areas have different needs, assets, and opportunities for growth. Ultimately, rural areas may need to consider more growth from within strategies that foster business development and innovations by people and businesses that are there for the long term. Conversely, urban areas can attract talented and skilled workers from around the country and the world, acting as a catalyst for growth in advanced economy jobs. Indiana should act to promote growth in urban economies while offering assistance to rural areas so that existing populations have sufficient support to prosper.

Figure 5. Indiana projected total percent growth in population and labor force, by current county population, 2010-2030



Source: Calculated from the data; U.S. Bureau of Labor Statistics, U.S. Census Bureau

Federal outlook

The Commission has focused on those policy areas with which Indiana can exert direct control. However, changes to federal tax and spending policy are expected to have significant effects on Indiana's fiscal position. Federal funds for infrastructure investments, entitlement programs, education, and other programs are all part of the debate over deficit spending. Medicaid funding in particular presents a challenge to Indiana. A recent projection related to federal healthcare reform shows that Indiana can expect 4 percent growth annually in Medicaid costs, nearly 50 percent in total from 2011 to 2020 (Milliman & Associates, 2010).

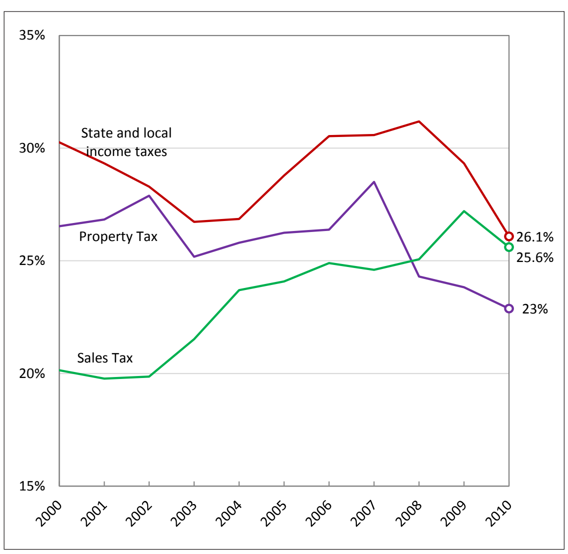
In addition, the structure and administration of corporate taxation at the federal level presents challenges in attracting business investment and retaining global economy industries to the country. The United States has one of the highest corporate income tax rates in the world and stands in a small minority of nations that impose a corporate income tax on the worldwide income of its home-grown companies. Twenty-six of the 34 OECD countries have adopted a dividend exemption or territorial form of international taxation. To ensure foreign earnings are invested within the United States, and possibly Indiana, without the current impediments embedded in the U.S. tax code, the United States will need to embrace a properly structured territorial form of international taxation. The United States is the only nation with both statutory corporate income tax rates above 30 percent and a worldwide system of taxing global companies.

The Commission recommends that the Governor and other elected officials of Indiana take an active role in promoting the interests of Indiana in these discussions in Washington, D.C. Changes to entitlement programs, infrastructure investments, and education spending have critical ramifications for the state's fiscal health. In addition, the ability of our national economy to secure and profit from globally-advanced industry jobs directly affects the sustainability of state economies as well. While Indiana cannot directly control what happens, it should encourage positive action at the federal level to create a business climate that benefits Indiana and other states.

State and local finances

Property tax reform, increases in the state sales tax rate, and corporate tax restructuring have altered the mix of revenue, in that government now relies more on income and consumption tax bases (Figure 6). Local governments have been particularly hard-hit. Revenue losses from property tax caps and stagnant growth in local income taxes are forcing local leaders to explore cost-cutting and reduction in services.

Figure 6. Share of state and local revenues from income, property, and sales taxes in Indiana (2010 dollars)



Source: Calculated from the data; Indiana Legislative Services Agency

The 2008 recession created an environment in which stagnant personal income growth produced a 16 percent decline in state and local revenue through 2010 (Table 1). Revenues as a percentage of income have dropped as more individuals pay off debt rather than spend or invest. This downturn, in combination with Indiana's increased reliance on consumption and income to drive revenue growth, caused revenue collections to decrease significantly (Table 2).

Table 1. Indiana state and local tax collections, 2010

Revenue class	2010 Revenue (millions $)	Annual % change (adjusted for inflation)			Total % change (adj. for inflation)
		2000-08	2009-10	2000-10	2000-10
Sales Tax	$5,936	2.80%	-5.90%	2.40%	27.10%
Property Tax (Net)	5,304	-1.1	-4	-1.5	-13.8
Individual Income Tax	3,875	0.4	-11.6	-2	-18.5
LOITs	1,589	4.2	2.4	4.6	56.7
Gaming taxes	875	5.3	-1.3	4.4	53.9
Motor fuels taxes	760	-0.6	-6.4	-2.1	-19
Corporate Income Tax	583	-3.7	-32.3	-7.3	-53.3
All tax collections	**23,428**	**1.3**	**-7.4**	**0.1**	**1.1**

Source: Indiana State Budget Agency; Indiana Department of Local Government Finance

Note: Excludes approximately $300M in corporate tax revenues collected through the E-Checks collection system. See http://www.in.gov/gov/files/Press/120611overview.pdf

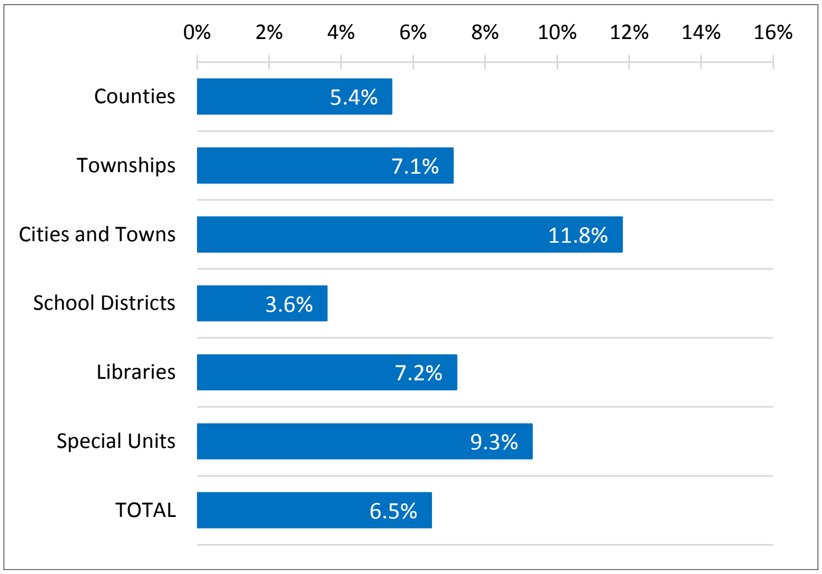
Table 2. Indiana state and local revenue and budgets as a percent of income and per capita (2010 dollars)

Year	As % Indiana personal income		Per capita	
	Revenue	Appropri-ations	Revenue	Appropri-ations
2000	10.9%	10.5%	$3,858	$3,642
2001	10.8	10.8	3,805	3,723
2002	11.2	10.6	3,745	3,670
2003	11	10.6	3,927	3,725
2004	11.2	11.1	4,044	3,915
2005	11.6	11	4,069	3,829
2006	11.5	10.7	4,230	3,805
2007	11.6	11	4,336	3,919
2008	11.4	10.9	4,256	3,865
2009	11.4	10.7	3,724	3,697
2010	10.3	9.6	3,499	3,358

Source: State Budget Agency; Department of Local Government Finance; Bureau of Labor Statistics; U.S. Census Bureau

Local governments face greater challenges for fiscal sustainability. Property tax caps and an increasing reliance on local option income taxes create more volatility in revenues to fund services. Generally, taxing districts with higher rates and those in city/town regions face higher losses of property tax revenue from the circuit breaker credits (Figure 7). Legislation enacted in 2008 and 2009 is having significant impacts on local budgets now and in subsequent years. Distributions of local income tax revenues exceeded collections in recession years, so the future distributions will be restrained to allow balances to grow. For 2012, 90 percent of all counties will have income tax distributions at or below 2011 levels, a complete reversal of historical trends (Table 3).

Figure 7. Circuit breaker credits as a percent of gross levy, by local government unit type, 2010



Note: Data exclude TIF allocations with Redevelopment Commission unit type.
Source: Indiana Legislative Services Agency, using data from Indiana Department of Local Government Finance

Table 3. Indiana local option income tax distributions, CY 2008-2012

% change in LOIT Certified Distribution	CY2008 - 2010			CY2011 - 2012		
	Number of counties	Total $ change (000s)	Average change per county (000s)	Number of counties	Total $ change (000s)	Average change per county (000s)
More than 10% drop	1	$ (2,069)	$ (2,069)	1	$ (2,879)	$ (2,879)
5 to 10% drop	3	$ (3,074)	$ (1,025)	7	$ (9,551)	$ (1,364)
Under 5% drop	5	$ (1,028)	$ (206)	28	$ (16,481)	$ (589)
No change	0			46	$ -	$ -
Under 5% increase	27	$ 11,320	$ 419	7	$ 732	$ 105
5 to 10% increase	33	$ 36,466	$ 1,105	2	$ 475	$ 238
More than 10% increase	22	$ 41,480	$ 1,885	0		
TOTAL	**91**	**$ 83,095**	**$ 913**	**91**	**$ (27,704)**	**$ (304)**

Notes: Excludes Lake County; includes COIT, CAGIT, CEDIT, and LOITs for public safety and property tax relief
Source: Indiana State Budget Agency

Infrastructure

Indiana, like the rest of the nation, faces a serious challenge in maintaining and enhancing its core assets to promote growth and attract people to live here. A well-maintained and comprehensive network of roads, bridges, sewers, utilities, and high speed internet access goes a long way toward defining the quality of life and quality of economy.

In the case of roads, much of Indiana's road network has surpassed its useful life span of 30 years and is in need of immediate repair. Indiana faces significant shortfalls in funding needed to meet current road needs. State Motor Vehicle Highway Funds have decreased due to less driving and the increased use of fuel efficient vehicles. The upcoming state budget has distributed less for highway programs than in previous years. In addition, the Major Moves Toll Lease proceeds are expected to have been spent by the end of FY13.

Along with these trends, potential and perhaps likely cuts in federal funds mean little to no additional capacity for new projects, and insufficient funding for the preservation of our current system. At the local level, recent estimates on local road needs show a $5.4 billion backlog on short-term projects (Table 4).

Table 4. Indiana local transportation funding shortfalls

Item	Short term backlog (millions $)	Long term annual needs (millions $)
Roads and streets	$ 3,504	$ 715
Bridges and culverts	$ 1,169	$ 117
Safety Improvements	$ 706	$ 26
Total	**$ 5,379**	**$ 858**

Source: Indiana Local Technical Assistance Program Center, 2009

POLICY CHOICES: A BLUEPRINT FOR TAX AND ORGANIZATIONAL REFORM IN INDIANA

Government should have clarity of purpose and mission, and its processes should be designed to efficiently deliver results for its people. Decision making should be coordinated and evidence-based. Data should inform our expectations about how government should work and guide forecasts of future needs of the state. Indiana needs to recognize the sources of our opportunities and challenges and how it can position itself more effectively to meet these challenges.

Indiana's localities and regions need to build and maintain a portfolio of integrated assets that meet the needs of its citizens, businesses, and industry clusters. Strengths and weaknesses will vary by region; we cannot rely on a one-size-fits-all approach to economic growth for Indiana. Many things contribute to our asset base and ultimate competitive position, including:

- Quality and skill sets of the labor force;
- Quality of infrastructure;
- Quality of life (access to cultural amenities);
- Tax and regulatory climate;
- Utility costs;
- Access to land, capital, markets, and materials; and
- Access to airports and key transportation modes.

There is no universally acknowledged "most important factor" that drives location decisions. Taxes and regulations matter most to firms in some industries, while access to transportation and distribution channels matter most to others. Still others may look for regions with cultural amenities, parks, quality schools, and other quality of life factors as a way to attract and retain highly educated and skilled workers who value these things most.

The Commission has concluded that the most effective means of promoting economic growth through tax and fiscal policy is to address critical issues in three areas:

1) Preserving an attractive business climate
2) Designing a government structure to enable a 21st century growth economy
3) Funding necessary maintenance and enhancement of our infrastructure

The Commission agreed early to recommend revenue increases only where necessary to fill shortfalls in existing funding. While not recommending specific levels of investments in infrastructure, the Commission identified financing to address a portion of the funding gap.

Critical Issue 1: Business Climate

Maintain a balance among income, sales, and property tax revenues

The most effective means of raising revenue for public services is through a balanced and diversified portfolio of revenues drawn from the tax bases of income, consumption, and property.

Keep the tax base broad so that rates can be low

A simple and transparent tax system using broad tax bases and low rates, investments in key infrastructure areas, and fundamental reforms at the state and local level can improve our ability to attract and retain quality jobs and improve the wellbeing of Indiana's citizens.

Limit tax incentives and tax breaks to initiatives of highest priority and expected return on investment

Credits and exemptions are tax expenditures: they are monies foregone with the hopes of creating positive incentives for economic growth and promoting equity in the tax system. Tax expenditures are not subject to budget reviews and can go without formal evaluation for years, with valuable revenue dollars doled out in the process. While some tax expenditures such as the Research and Development Tax Credit have been shown to provide tangible benefits for the state, the performances of the myriad other tax expenditures are not tracked to the extent they should be.

Retain the current individual income tax structure

The Commission makes no proposed changes to the current rate and structure of Indiana's individual income tax rate. Indiana's state-level individual income tax is relatively low among states with flat rate structures and the Earned Income Credit provides some progressivity.

Economic challenges and government spending pressures create an environment where adjustments to this tax could create significant opportunity costs. Indiana takes about 25 percent of its total state and local revenues from the income tax, so to keep the individual income tax at its present rate provides certainty for individuals and for small businesses that are often organized such that their profits are taxed under the individual tax system.

Retain the current, recently reduced corporate income tax rate

The Commission recommends retaining the current corporate rate and tax structure. However, the changes made over the past several years should be evaluated and the resulting data used to drive future decisions. To decrease the corporate rate to 5 percent would bring Indiana in line with the national average. While this may be desirable, the Commission finds that this move is currently not affordable. Pressing economic and fiscal challenges necessitate the need for consistent revenue sources.

However, data should be used to drive these decisions. What has the state gained in economic activity after recent corporate tax reforms? If the gains have outweighed the losses in revenue, are further changes likely to provide more than a marginal benefit? Understanding how these factors drive business decisions, policymakers can make more informed and less arbitrary policy moves to enhance economic growth for our state.

Review tax credits, deductions, and exemptions

Indiana is just one of six states in the country that does not conduct regular reviews of its tax expenditures (Levitis, Johnson, & Koulish, 2009). The effectiveness of tax expenditures should be evaluated in an apolitical setting by independent, professional, and disinterested parties. The goal is to ascertain if the cost of the credit is exceeded by the benefit in economic terms. This is an extremely subjective and difficult task, but a focus on the circumstances in which the credits are claimed and whether the taxpayer was, in fact, more likely than not to make the particular level of investment is the real question.

Above all, Indiana taxpayers should be made fully aware of how tax dollars are spent, and how effective those expenditures are in creating positive economic outcomes. The state should know what works and what doesn't and have an efficient mechanism for eliminating poor performers.

The Center of Budget and Policy Priorities offers a checklist of information that a proper tax expenditure report should contain (Table 5).

Table 5. Principles and elements of an effective tax expenditure report

Principle	Element
ACCESSIBILITY	*The report should be:*
	Published regularly
	Incorporated into the budget process
	Available on the Internet for public use
SCOPE	*The report should include:*
	All tax expenditures, including those with lower costs or those benefitting few taxpayers
	Explicit and implicit tax expenditures
	Tax expenditures enacted by the state that affect local government
DETAIL	*The report should include:*
	A description of the tax expenditure
	The relevant legal citation and year of enactment
	The cost of tax expenditures using current data
	The cost in future years to allow for comparisons with other proposed expenditures
	Detail on the taxpayers who benefit from the expenditure
	Separate reporting for the state and local revenue losses, where applicable
ANALYSIS	*The report should:*
	Classify tax expenditures using the same categories as direct spending
	State the purpose of each tax expenditure
	Evaluate the extent to which that purpose has been accomplished
	Analyze the distribution of benefits by income level and size of business

Source: Taken from Levitis, Johnson, & Koulish, 2009

As a result of the period independent review of tax credits, deductions, and exemptions, the state will best be able to consider whether a particular tax expenditure item is performing as intended and is relevant to current needs.

Consider how to reduce the state sales tax rate by broadening the sales tax base on a revenue-neutral basis to include more services

Indiana's 7 percent general sales tax rate is high compared to other states, and revenue from this tax is now the largest component of total state revenues. Our economy and consumption continue to trend toward services and away from goods. The Commission suggests that the state study the inclusion of more services into the sales tax base, allowing us to reduce the sales tax rate. Other states have experimented with taxing more services but with inconsistent results. Indiana must approach this issue methodically. Implementation presents significant policy and administrative challenges; all factors must be understood before moving forward.

The premise is that the sales tax is a levy on consumption and, as such, the consumption of services should be included in the base. Broad classes of services that ensure ease of compliance and administration should be considered for inclusion to the sales tax base.

Indiana's sales and use tax rate at 7 percent is the second highest in the nation. The sales tax has been the go-to source of increased revenue over the last 10 years, as Indiana has increased the rate twice to cover costs associated with property tax reform and increased education and county welfare funding at the state level. At the same time, the base has been relatively narrowly defined, including only about one in every seven categories of services available.

Ultimately, including more services gives the sales tax base desirable properties from the perspective of good tax policy. Horizontal and vertical equity are increased and the consumption-type nature of the sales tax is strengthened. Elasticity, reliability, and adequacy of revenues are improved as the tax base captures more of the extent of economic and consumption activity. Distortions in economic decision making (make or buy, repair, or replace, etc.) are reduced.

To be clear, there are costs and distortions associated with a sales tax base that includes more services. The issue of pyramiding, in which a consumption item is taxed at multiple stages in its delivery to the end consumer, should be avoided. Second, the issue of point-of-production versus point-of-consumption for sales across state lines should be addressed. This issue is closely related to taxing e-commerce transactions. Indiana signed on to the Streamlined Sales Tax in October 2005, to "reduce the burden of collecting, reporting and remitting sales and use tax across state lines for both e-commerce and traditional brick-and-mortar businesses" (Indiana Department of Revenue, n.d.). This was a good step in the right direction, but efficiency of execution on the administrative end should be reviewed.

A third issue concerns which services or classes of services should be included in the base. Those classes of services consumed mostly by businesses (computer services, professional services, etc.) are difficult to pinpoint as items of end consumption by the business or as intermediate components in the production of their own goods and services. Other classes such as personal services (haircuts, tailoring, etc.) are much easier to identify as end-products of consumption.

Though these issues create logistical and administrative challenges, the general principle of broad-base/lower rate taxation will create tangible benefits for Indiana's economy and public finance position.

See Appendix 3 for more detail.

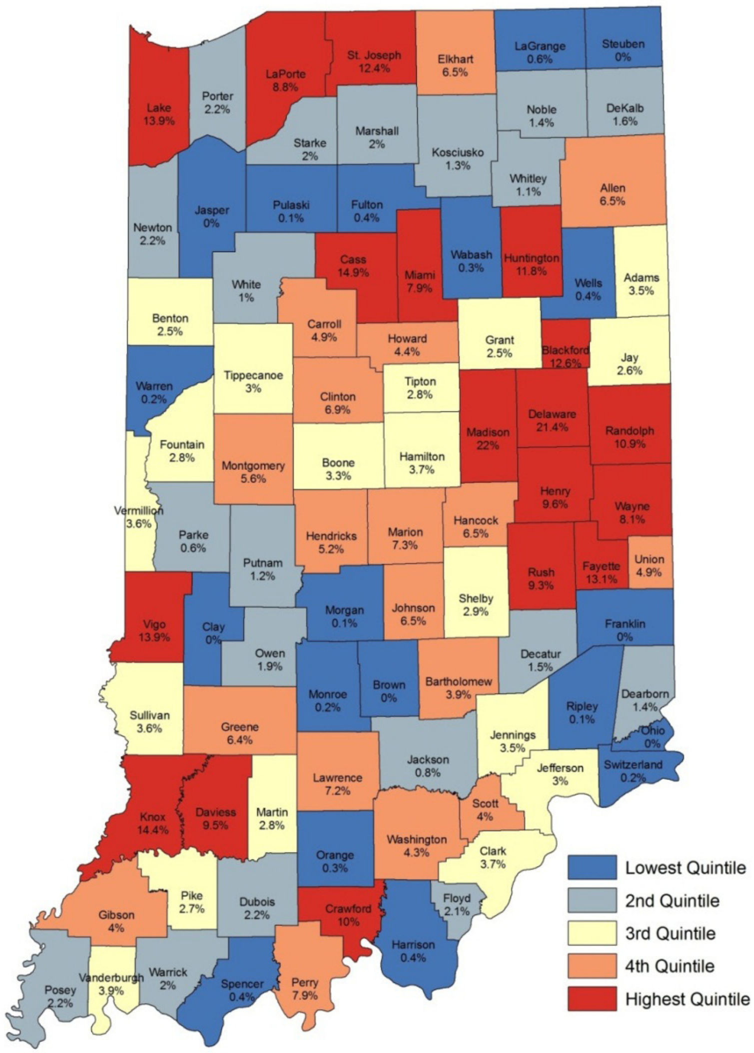
Conduct a comprehensive evaluation of the impact of the 2008 property tax reforms

Property taxes are a key source of revenue in the state. Since local governments establish levies to fund services, circuit breaker credits effectively limit the total levy for a local unit and as such represent lost revenue for local government (Nagle, 2011).

In 2009, there were $163 million in circuit breaker credits issued to property owners. In 2010, circuit breaker losses increased drastically to $430 M. As a share of total gross levies, circuit breaker credits represented larger losses for districts with higher tax rates, upwards of 15 percent for districts with rates over $3 per $100 assessed values (Map 1). City/town governments were generally hardest hit, with nearly 12 percent of total levies lost to circuit breaker credits. Since city/towns impose an additional rate to the property tax rate, and since city/towns tend to have more commercial and business property, a larger share of properties become eligible for credits.

As the provider of last resort, local governments must have sufficient means for raising revenue to fund services. Property tax caps and the creation of additional local option incomes have shifted the tax base away from property and toward income for funding local government. To ensure that we did the right thing from a policy perspective, we should analyze all available data to assess the impact of our changes. Indiana leaders should encourage new and innovative ideas for local government to meet fiscal challenges.

Map 1. Property tax circuit breaker credits as a percent of the gross levy, 2010



Source: Indiana Legislative Services Agency

Continue efforts to reduce reliance on business equipment and machinery tax revenue

Indiana's property tax on business personal property is often mentioned as an impediment to attracting out of state businesses. This is especially true in asset-intensive businesses exploring options for relocation. Indiana's tax on business machinery, equipment, furnishings, and supplies puts us at a disadvantage in competing with states that do not impose this tax (specifically, Ohio and Illinois).

However, to abolish this tax would be a substantial hit to local government revenues. Personal property taxes represent about 15 percent of property tax revenue, or about $900 million annually (Table 6). In an environment in which property tax caps limit upward growth in revenues, there is a large opportunity cost to removing this item from the ledger.

Table 6. Indiana net property tax payments by property type

Year	In millions $			Bus/Equip as % Total
	Real Property Tax	Bus/Equip Property Tax	Total Property Tax	
2007	$ 5,428.9	$ 988.0	$ 6,416.9	15%
2008	$ 5,149.5	$ 1,000.5	$ 6,150.0	16%
2009	$ 5,132.3	$ 928.0	$ 6,060.3	15%
2010	$ 5,042.3	$ 919.5	$ 5,961.8	15%
2011 (est)	$ 5,141.6	$ 951.3	$ 6,092.9	16%
2012 (est)	$ 5,243.6	$ 924.6	$ 6,168.2	15%

Sources: Legislative Services Agency; Department of Local Government Finance

The Commission suggests that Indiana make the elimination of personal property tax a goal, but in the meantime find ways to reduce the current level of dependence. Possible actions include improved abatements, increased deductions, additional depreciation, and elimination or reduction of the 30 percent floor, which minimizes the cumulative level of depreciation for a taxpayer. Allow local entities to exempt personal property if to do so would improve their competitive position in interstate location decision making. Refine the rules to exclude as many types and categories of personal property as possible.

Encourage regional planning and projects and allow regional taxing districts

The Commission suggests that local units be given the option to institute regional taxing districts. Investments in regional transportation and in broadband/high speed internet access are examples of critical needs for 21st century economies where use of infrastructure crosses county boundaries. Our civil, city and town, township, and county taxing units were created at a time when property owners likely consumed nearly all their public services within that territory. Often, Hoosiers consume, reside, and work regionally and across district boundaries. Infrastructure projects funded on general obligation bonds, TIF districts, or county option taxes create a free rider problem. Those who reside outside a jurisdiction but use infrastructure inside of it do not pay for its preservation and improvement.

Indiana must provide greater means for regional taxation to be imposed on those who benefit from infrastructure and/or services from adjacent jurisdictions without bearing any of the tax burdens. With the right process and state leadership, a mechanism to break down the turfism could advance the greater cause of sharing the burden.

With this focus on regional infrastructure taxing districts, there should be an effort to connect relevant taxation with relevant investment projects. For instance, some rural areas are lacking access to broadband and have poor highway and bridge infrastructure. These regional taxing districts might consider using taxes on internet and gas, respectively, to pay for these investments.

Help city centers by sharing a modest portion of local option income tax revenues between counties of residence and counties of work

Tax policy should recognize the increasing divide between rural and urban Indiana. Services, consumption, and employment in city-regions commonly occur across traditional government boundaries and require a rethinking of how to fund government. The system of funding services through taxation should reflect this reality.

Urban centers pay for the required infrastructure and public safety needs for larger employers. This causes higher property taxes. Many of their employees live outside the county, where property taxes are lower. In addition, urban centers support large regional and often tax-exempt facilities that benefit all. Generally speaking, County Option Income Tax (COIT) and County Adjusted Gross Income Tax (CAGIT) dollars paid by employees go to the county of residence. Local option income taxes create the potential for tax competition between county jurisdictions. The possibility arises for inter-local tax competition, encouraging longer commute times and increasing the burdens on government to maintain and build out infrastructure to support regions.

In Marion County, for example, the combined COIT and local option income tax (LOIT) rate of 1.62 percent is higher than all but one of its surrounding counties. The engine of the Indianapolis region is centered in Marion County, and those individuals who live in surrounding counties but work in Marion County consume the services (road and infrastructure, public safety, and utilities) without necessarily contributing the requisite tax dollars to fund those services.

A preferred alternative is to share the distribution of COIT/CAGIT funds and also the Local Option Income Tax (LOIT) for Public Safety. The state should research the optimal split amount so that businesses are not incented to relocate to lower taxing districts. The allocation of LOIT for Property Tax Relief should be left as is. Regarding the LOIT for Public Safety, these dollars should be shared between place of employment and place of residence as well. Individuals residing outside the county in which they work also consume and benefit public safety services in their place-of-employment county. The revenue collection method should reflect that usage.

We recognize that this split raises the potential for revenue concerns. Consistent with our principle of data-driven decision making, the distribution of local income tax should be analyzed in concert with the impact of property tax cap system of 2008 so that new revenue crises are avoided by particular counties while promoting the fiscal health of larger regions.

Expand the capabilities of the Department of Revenue to analyze collections and costs and benefits of tax policy

Indiana's system of tax administration should be consistent, predictable, fair, and professional. The Commission suggests that the analytical capabilities of the Indiana Department of Revenue (DOR) be enhanced to meet the needs of an increasingly complex economy. Challenges in cross-state and international commerce require advanced capabilities to administer, assess, audit, and review compliance and appeals. Increase and promote consistency via research and data mining on previous cases and on emerging tax trends.

At both the state and local level, government should have sufficient capability to forecast revenues. The Commission suggests that the DOR provide more frequent updates and information on income tax collections. Local units should have as much information at hand when creating budgets and preparing for future operations.

A comprehensive peer-review and publication process should be instituted for all cases and rulings. Letters of findings should be published in an organized fashion and establish precedential value audits and protests. This step would assure that a position taken by the DOR in one case would create consistency in rulings in other cases. This consistency works for both the DOR and for the taxpayer, as precedence of decision making provides evidence for future cases.

The increasing level of cross-border commerce creates greater complexities in our tax system. DOR staff should have the highest level of sophistication in assessing, auditing, and reviewing revenue scenarios. DOR should try to attract and retain qualified individuals that might otherwise work at higher paying jobs (though in similar working circumstances) in the private sector.

Provide sufficient resources to the Department of Revenue to enforce collection of the sales tax on Internet purchases

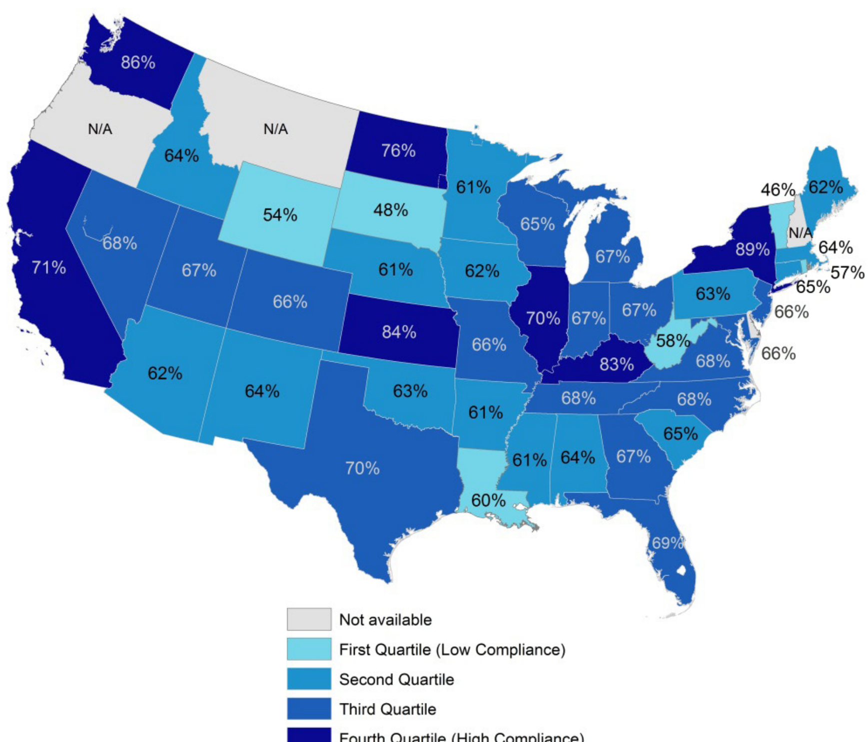
Sales of goods and services over the internet continue to capture a larger share of total commerce in the United States. In 2009, over $3 trillion in commercial sales and shipments in the United States were transacted through e-commerce, nearly 17 percent of the total for all channels. In inflation adjusted dollars, e-commerce sales have increased by nearly seven percent annually since 2004, compared to a slight decline for all sales channels.

A recent study on the impact of e-commerce on state government revenues puts Indiana's annual losses of sales tax revenue between at about $150m annually and potentially $200m in 2012 (Bruce, Fox, & Luna, 2009) (Figure 8). Large retailer compliance with the use tax in e-commerce transactions is at about 65 percent, with Indiana at 67 percent (Map 1). It is incumbent upon the state to ensure that these revenue are collected without violating U. S. Constitutional protections against impeding interstate commerce.

Current tax law imposes the burden onto the consumer for paying taxes for online purchases in the form of a use tax. Compliance with this use tax is low and creates inconsistencies in the tax system. Brick-and-mortar businesses are at a disadvantage because they must impose the 7 percent sales tax whereas out-of-state online retailers do not. In addition, interstate commerce allows businesses without a true nexus in the state to set up operations and still avoid collecting taxes on sales within the state.

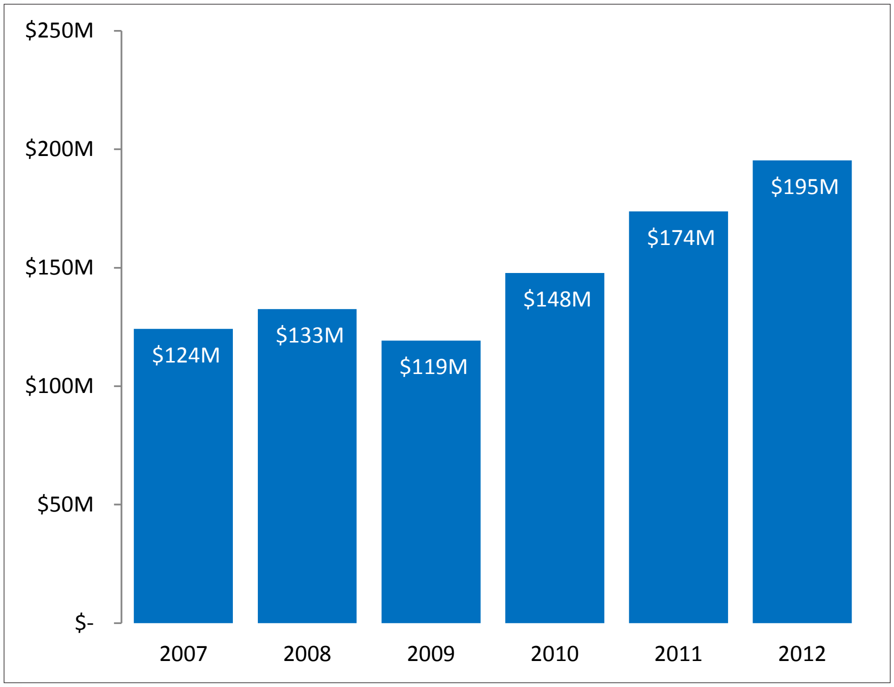
See Appendix 4 for state-by-state comparisons.

Map 2. **Percent of large retailers compliant in reporting business-to-consumer e-commerce transations**



Source: Bruce, Fox, & Luna, 2009

Figure 8. Indiana estimated losses in use tax revenue from e-commerce sales



Source: Bruce, Fox, & Luna, 2009
Note: The Indiana Fiscal Policy Institute has more conservative estimates of tax revenue losses. See http://www.indianafiscal.org/pdf/IFPI-Internet-Sales-Tax-11.21.11.pdf

Standardize tax treatment of not-for-profit organizations

Many nonprofit organizations consume large amounts of public services. There should be uniform criteria for the tax policy concerning nonprofits, regardless of location. In other words, the taxation treatment of a hospital in one place should be consistent and fair to any and all other places. For those groups and organizations that enjoy tax exempt status, there should be clearly defined rules and classifications for determining the burden that they create on infrastructure and service consumption at the local level. Payments in lieu of taxes should be administered consistently across the state and better represent a real benefit to society.

A bipartisan and independent task force should be established to identify the critical issues in defining entities that receive tax-exempt status and for establishing an appropriate mechanism for enforcing standards and collection procedures for payments in lieu of taxes. Consistent with other policy choices listed, there should be certainty and clarity in tax administration, regardless of location.

Establish a Midwest interstate compact to coordinate economic development efforts

The Commission suggests that a Midwest Interstate Compact for tax administration and economic competitiveness be established. Unnecessary tax competition dilutes the common strengths of Indiana and its neighboring states. A streamlined and consistent system of incentives and tax administration improves the prospects for economic growth.

An interstate compact would create a formal relationship between states (likely between Indiana, Illinois, Kentucky, Ohio, Michigan, and Wisconsin) that would coordinate economic development efforts as they are affected by tax and fiscal policy and serve to minimize undue competition for business location and investment decisions. An interstate commission should be created to offer the same maximum tax incentives and general guidelines on tax policy as they affect the site selection process. States could also use the compact to share lessons learned and best practices in dealing with complex tax administration issues, especially with respect to multistate and multinational corporations.

The consortium could modify standard maximums to compete for individual projects vs. non-U.S. or other U.S. regions. The compact should reduce complexity and distortions caused by incompatible tax incentives and policies and then use the streamlined and consistent tax environment as a strategic advantage for regional development. Economies of scale would also be realized (Council of State Governments, 2011).

Such a compact already exists in the form of the Multistate Tax Compact (www.mtc.gov). Indiana is not a full member of this compact but does participate in an associate/project member capacity. A Great Lakes compact will provide further efficiencies and competitive advantages beyond what a nationwide compact can do toward developing our regional economy.

Critical Issue 2: Structure of Government

Many prior studies, most notable and recent, the Kernan-Shepard report on local government reform, have concluded that Indiana would benefit from changes to its form of local government. These studies have not fully addressed the inextricable ties between the structure of government and the structure of taxation. The most compelling and fundamental reasons for making changes to our form of local government relate directly to the negative impact the status quo has on our tax structure.

Jurisdictional boundaries, both physical/geographical and legal/legislative, directly control and dictate the degree and form of local taxation. And they more subtly influence the efficiency and effectiveness of taxation at the local level.

Jurisdictional boundaries also serve as taxing district boundaries. These boundaries define who can be taxed, what they can be taxed for, and ultimately how much they can be taxed. Moreover, the boundaries determine who will guide the tax policies and oversee the administration of tax dollars. A taxpayer's burden depends largely on where they reside. So it is these boundaries – the local government structure – that drives local taxation.

With property taxes, the tax base is established by the total value of real and personal property (assessed valuation, or AV) in the jurisdictional boundary. Officials elected to represent the jurisdiction decide how much they want to spend (the property tax levy). The rate is the product of a simple mathematical function (the levy divided by the AV). The higher the AV, the lower the rate needs to be to meet government obligations.

Likewise, with local income taxes, the base is equal to the aggregate income of all the residents within the jurisdictional boundary. A larger income base creates a smaller rate needed to generate a particular amount of revenue.

It is all about the base. This is why politicians and academics alike speak of the virtue of a broad tax base – using the broad base, low rate axiom. The most desirable government structure is one that results in as broad a tax base as is practical for a given community. Our current structure ignores this principle, instead fostering artificial, ancient, and unjustifiable boundaries.

Delineating more reasonable and equitable taxing boundaries is no easy task, but is vital to improving the overall fairness and effectiveness of our tax system. Antiquated jurisdictional boundaries too often leave one group of taxpayers paying for infrastructure and services that benefit taxpayers in many surrounding jurisdictions. Significant changes to the structure of local government are necessary to accomplish this. Such changes are needed to ensure the continued prosperity of Indiana communities, large and small.

The physical and operational parameters of taxing authority/districts/jurisdictions need to be reinvented such that taxpayers can easily correlate the taxes they pay to the level of services they receive without the confusion of layered jurisdictions, multiple elected officials with opaque responsibility, or the existence of arbitrary, meaningless boundaries.

Terms generally intended to be descriptive of good government—accountability, transparency, efficiency and effectiveness—are all by-products of a good tax structure.

Evaluate the organization of government, the quality of service delivery, spans of control and organization layers

Reducing the number of management layers in government can have numerous benefits, including faster decision-making, more cooperation within and between agencies, and a greater sense among citizens that Indiana government is performing as best as it can. However, Indiana should not consolidate just for the sake of consolidation. It should be intentional about its decision-making and rationalize the delivery of government across the state in accordance with specific criteria. When resources are scarce, it is important that organizations are able to innovate to continue fulfilling their duties. This is particularly important in the public sector, where there may be less incentive to identify and adopt innovative working practices. Innovation can and should be promoted and rewarded in the public sector (Patterson, Kerrin, Gatto-Roissard, & Coan, 2009), and this includes removing the number of layers between the employee or taxpayer and the decision maker.

In essence, the length of time a Hoosier government employee spends working on a task under his or her own discretion before requiring approval to continue must be determined, and then it must be decided whether or not that is the appropriate amount of management. For example, it might be recommended that no more than four layers exist between the highest and lowest employee within any local agency. When it comes to transactional activities, the span of control could be in a supervisor-to-subordinate ratio of 10-to-1. For operational activities, it could be 7-to-1, and when it comes to strategic or high value activities, the span of control could be 4-to-1.

These are suggestions only. Determining the optimal management layers and span of control will take further research and input, as different levels of government have different requirements to meet and constituencies to serve. Currently, the exact number of layers in our governmental structures is not known. Some may be necessary, some may not be, but government designed to deliver results for its people must clearly indicate to its people that its employees have every possible resource at their disposal, including empowered and innovative decision-making.

In close relationship to a de-layered government oriented toward the citizens that consume its services, are consolidation of administration and efforts, best price purchasing, and a statewide contract with efficiency consultants would help cities, towns, counties, and other local units to secure better rates and terms in procuring goods and services. The state should create operational excellence teams and joint purchasing arrangements for local units.

Promote joint purchasing and other inter-local agreements between local government units

Making government more efficient involves both legal reform and reforms to administrative practices and operations. Local leaders should consider potential alternatives to providing services in the case where a levy is eliminated. Identify those services that can be provided without the levy and those that cannot. A rethinking of service provision models at the local level supports the need for efficiency in operations and creates a mindset of constant improvement in methods and means of service delivery.

Continue to advocate local government reform and consolidation as a means of improving delivery of services with maximum efficiency, transparency, and accountability

The Kernan-Shepard Report on Local Government Reform answered the question as to whether Indiana's structure of local government delivers the most effective service in the most efficient way possible. Local government should strive to increase accountability with fewer levels and with districts that match the services provided and consumed.

The Commission suggests a continued effort to restructure and streamline local government. Where large inefficiencies exist, cost savings garnered from this restructuring and streamlining could provide "recovered" revenue for state and local municipalities to fund the provision and delivery of services and make investment in infrastructure, such as roads, bridges, and internet access.

Ball State University examined the Kernan-Shepard recommendations and found that with the proposed consolidation in non-school taxing districts, up to $200 million in savings may be available (Hicks & Bohanon, 2008). While some recommendations dealing with these issues have been enacted into law, many key components remain.

Logical steps and options that would represent meaningful advancements include the following:

- Establish (either by election or council appointment) a County Executive and consolidate efforts of the county Treasurer, Auditor, and Assessor into a County Financial Officer position. Assessing/appeals, taxing, and operating functions should be part of one cohesive and consistent system of administering county government.
- Give counties the authority to hold a referendum to eliminate township government
- Create cross-county information sharing boards that reduce or eliminate the possibility for multiple homestead deductions by citizens who own houses in different counties.
- Establish a statewide benchmarking system to provide the public and policy makers with current information about local government productivity, efficiency, and progress
- Designate a state office to provide technical assistance to local government

See Appendix 5 for more information on the Kernan-Shepard Report.

Critical Issue 3: Spending and Investment

Indiana, like the rest of the nation, faces a serious challenge in maintaining and enhancing its core assets to promote growth and attract people to live here. A well-maintained and comprehensive network of roads, bridges, sewers, utilities, and high speed internet access goes a long way toward defining the quality of life and quality of economy. For Indiana to fail to meet the need to improve our infrastructure puts Indiana at a competitive disadvantage and does a disservice to ourselves as citizens.

While the need for infrastructure investment is great, there is also a need for more information on the condition and funding necessary to meet these needs. Indiana should develop a comprehensive infrastructure plan to guide investment.

In one area where costs can and have been quantified, Indiana faces significant shortfalls in funding needed to meet preservation of roads and bridges. State Motor Vehicle Highway Funds have decreased due to less driving and the increased use of fuel efficient vehicles. The upcoming state budget has distributed less for highway programs than in previous years. In addition, the Major Moves Toll Lease proceeds will be spent by the end of FY13.

Along with these trends, potential and perhaps likely cuts in federal funds mean little to no additional capacity for new projects, and not nearly enough funding for the preservation of our current system. At the local level, recent estimates on local road needs show a $5.4 billion backlog on short-term maintenance projects. To keep our road system at just the current state of repair, the INDOT construction budget will need to be no less than $1.2B annually, and local agencies will need an additional $500M annually (Indiana Local Technical Assistance Program, 2009).

Additional revenue must be dedicated and directed at investments in roads, bridges, sewers, broadband infrastructure, and other utilities. While our urban cores comprise a large share of total infrastructure needs, Indiana needs to take a regional approach to a statewide infrastructure plan. Rural and underserved areas must not be left behind, but rather should have a basic level of infrastructure to sustain population needs.

See Appendix 7 for more information on transportation and infrastructure issues nationwide.

Consider increasing the gas tax to align with neighboring states and index it to inflation to preserve the existing system of roads and bridges

The state Gasoline Tax stands at $0.18 per gallon and has been at that level since 2003. Along with related fuel and motor carrier surcharge taxes, Indiana has received around $800M annually from this tax class. However, since the tax is a per-gallon charge, the increasing usage of fuel efficient and alternative energy vehicles has eroded the revenue stream even with modest increases in road usage. Adjusted for inflation, gas tax revenues have declined nearly 3 percent on average annually (Table 7).

Table 7. Indiana gas/fuel tax revenues and vehicle miles traveled

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	Annualized rate of change
Indiana Gas/Fuel Tax Revenue (Mil $)	$ 871	$ 881	$ 856	$ 799	$ 760	-3.36%
Adjusted for Inflation (2010=100)	$ 942	$ 926	$ 867	$ 812	$ 760	-5.24%
Indiana Vehicle Miles (Mil)	71,215	71,478	70,973	76,628	78,637	2.5%
United States Vehicle Miles (Mil)	3,014,000	3,032,000	2,974,000	2,979,000	2,998,797	-0.1%

Sources: Indiana Legislative Services Agency; U.S. Bureau of Labor Statistics, Consumer Price Index; Federal Highway Administration

For motor fuels taxes applicable to regular (non-carrier) vehicles, Indiana has the capacity to increase the per-gallon rate. Note that Indiana's high general sales tax contributes to the total rate; work toward lowering the sales tax rate by expanding the base to include services would have an effect on improving competitiveness in motor fuels tax rates in the region. Gas taxes should be indexed for inflation to better account for changes in fuel prices and to counteract losses from the alternative fuel vehicles market.

See Appendix 1 for motor fuels tax rates nationwide.

Table 8. Midwest state motor fuels tax rates, as of January 1, 2011

	Component Rates (cents per gallon)						Sales Tax Applied	Total Rate by Vehicle Type (cents per gallon)					
	Gasoline		Diesel		Gasohol			Gasoline		Diesel		Gasohol	
	Base Rate	Carrier Surcharge	Base Rate	Carrier Surcharge	Base Rate	Carrier Surcharge		Regular Vehicles	Carriers	Regular Vehicles	Carriers	Regular Vehicles	Carriers
Illinois	20.1	12.3	22.6	13.5	20.1	12.3	6.25	26.4	38.7	28.9	42.4	26.4	38.7
Indiana	**18**	**11**	**16**	**11**	**18**	**11**	**7**	**25.0**	**36.0**	**23.0**	**34.0**	**25.0**	**36.0**
Kentucky	24.1	2	21.1	4.7	24.1	4.7	n/a	24.1	26.1	21.1	25.8	24.1	28.8
Michigan	19	n/a	15	n/a	19	n/a	6	25.0	25.0	21.0	21.0	25.0	25.0
Ohio	28	n/a	28	n/a	28	n/a	n/a	28.0	28.0	28.0	28.0	28.0	28.0
Wisconsin	32.9	n/a	32.9	n/a	32.9	n/a	n/a	32.9	32.9	32.9	32.9	32.9	32.9

Note: Base rate includes applicable environmental fees

Source Federation of Tax Administrators

An alternative approach would be to institute a direct tax on road usage, commonly known as a Vehicle Miles Traveled (VMT) tax. The VMT charge would move us toward a benefits-received approach to road use, as drivers would pay more money for more road use. At current rates of road use, a VMT charge of about 3 cents per mile would cover additional needs for road maintenance and expansion. The VMT tax could be used to fund other infrastructure projects as well, with a marginal increase in the per-mile rate. Challenges to administration and data collection are valid and common counterarguments. Nonetheless, Indiana should investigate the feasibility of the VMT or other funding sources as Indiana's citizens buy vehicles that have better fuel economy standards and that do not use fuel at all.

Use tolls to finance future road expansion projects

The leasing of the I-80/90 corridor and establishment of the $3.4B Major Moves Fund has supported a robust highway program for eight years. The money received by the Major Moves Toll Lease proceeds will be spent by the end of FY13, and Indiana must now develop strategies for funding after its proceeds are consumed. Tolls can be a robust mechanism for tying infrastructure funding to usage charges on that infrastructure. Bridges, sewers, water treatment, energy, education and workforce, and broadband infrastructure could also be funded in this way.

Develop a state plan for water, energy, information, and transit infrastructure

Government has a clearly defined role in preserving roads, bridges, and sewers, but its role in areas such as internet availability is less clear. Indiana should achieve a clear and focused vision of how to ensure that all Hoosier citizens and businesses have access to information delivery services, regardless of geography.

In addition, Indiana should work to create and maintain a comprehensive needs and investment plan that details conditions, costs, and revenue shortfalls (where applicable) for all types of infrastructure.

Use a State Infrastructure Bank (SIB) to support financing, enhance private investment potential, and offset risks

State Infrastructure Banks help states manage risks associated with large, complex infrastructure projects while acting as a revolving fund to finance more projects within a given timeframe. States can use this mechanism to enhance the possibility of private investment and offset risks associated with other bonding mechanisms (Council of State Governments, 2011). SIBs can offer loans and credit assistance to decrease delays in project starts and completions.

However, Indiana utilizes its SIB (established in 1999) minimally. Indiana has entered into only one SIB loan agreement since 2001. In contrast, Ohio has entered into 35, Texas 25, Michigan 23, Maine 22, and Pennsylvania and Florida 15 (Drike, Genetti, & Sinha, 2002). With Indiana's SIB capital so limited, the funding technique may be more useful on the local level. Another challenge to Indiana better utilizing its SIB is that when it was created, the Indiana Department of Transportation (INDOT) specified that SIB assistance go to local entities. At the time, the legislation authorizing the SIB also limited the amount it could disburse, making it difficult to finance larger projects that are needed, and tailoring it for smaller projects that are shorter term and more local or regional in scope.

This being the case, one option is that the Indiana SIB be made available to more entities that meet the legal requirements for construction projects, so that larger and more strategic projects can be created. The objectives of Indiana's SIB also need to be defined publicly and should include scope of work and eligibility requirements, so that entities are better informed on how to utilize this innovative financing technique.

Some common characteristics of active and effective SIBs have been noted. Stronger support from high level officials within INDOT will be needed, along with coordinated implementation within that agency's management structure. In addition, a large capital base from the state and the legal authority to leverage SIBs with bonds are needed. As of 2001, only nine states had the authority to issue debt through their SIB (Indiana was not one of them). This lack of legislative authority limits Indiana's ability to increase capitalization (U.S. Department of Transportation, 2002).

Many states and municipalities privatize all or portions of power plants, airports, and any other publicly-owned asset with a revenue stream. To the extent that it makes long-term fiscal sense for the state or for municipalities, Public Private Partnerships (P3s) can be a cost-effective investment with potential benefits including the sharing of risks and a more efficient operation. The administration must be careful not to use P3s as a means of short-term budget relief rather than long-term infrastructure investments. To ensure P3s are being used in the most effective way possible to benefit the state, the state should establish (1) cross-agency review and identification of best practices, (2) a best practices pool, and (3) a portfolio-based approach (Likosky, Ishimatsu & Miller, 2011). As with any partnership, there are risks, and these must be carefully considered during the planning process.

Challenge universities and the General Assembly to devise a sustainable strategy for funding higher education to maintain a strong source of innovation

In addition to infrastructure needs, Indiana's system of higher education is in need of attention. State funding for higher education has decreased in recent years. Universities are a critical and valuable asset for Indiana's economy. Quality of life, innovation, entrepreneurship, knowledge creation, and the attraction of growth economy jobs are all by-products from a vibrant system of higher education.

A university education system is a crucial component in producing and retaining highly skilled and educated workers that employers in high technology and advanced manufacturing industries require. Indiana's approach to the funding of higher education institutions as a state asset has sent a message of indifference. Indiana University, Purdue, Ball State, and other universities have a great base of research specialties and abilities to educate people for the most demanding and technically sophisticated types of employment today. While the community college system fills a vital role in marrying skill gaps and vocational jobs, Indiana should not forget about the universities that create intellectual capital for 21st century firms that are the true drivers of economic growth and innovation for the state.

The Commission proposes a challenge to universities and to the General Assembly. Universities should be clear on what they need to operate and to grow and how the current system either enables or prohibits their mission. Universities should also propose a set of options that the state could do differently to make it easier to achieve stated goals. The General Assembly should create a focused strategy for funding world-class institutions of learning and engagement. The state should have all information, interests, and opinions available to answer a fundamental question: Which is the most effective means of funding universities—more state money and more regulatory oversight or less state money and more university discretion?

CONCLUSION

Our tax structure should provide a sense of certainty, consistency, and simplicity. Our tax bases should be diversified and broadly defined. Both state and local leaders should have accurate pictures of revenue forecasts for improved budgeting and decision making. Taxing jurisdictions should reflect modern life and economic conditions as they provide services and raise revenue. Government should recognize the vitality of city cores and the interrelationship to regional economies. Also of great importance, infrastructure investments are necessary as a component of quality of life and also as a means of improving prospects for business development.

Through effective leadership, Indiana is now in a favorable position to make proper and focused choices on how to respond to the challenges of a 21st century economy. The challenges facing us are significant but with concerted effort and strong leadership, the reforms we propose should position Indiana well into the future.

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Appendix 1: State Rates of Taxation

Note: Current as of January 1, 2011

Source: Federation of Tax Administrators

State	Individual Income Tax			Corporate Income Tax			General Sales Tax (%)	Motor fuels excise taxes (cents per gallon)		
	Count of brackets	Tax Rate Range (%)	Bracket Range ($)	Count of brackets	Tax Rate Range (%)	Bracket Range ($)		Gasoline	Diesel	Gasohol
Alabama	3	2 - 5	500 - 3,000	1	6.5	.	4.0	18	19	18
Alaska	*(No individual income tax)*			10	1.0 - 9.4	10,000 - 90,000	0.0	8	8	8
Arizona	5	2.59 - 4.54	10,000 - 150,000	1	6.968	.	5.6	18	18	18
Arkansas	6	1 - 7.0	3,899 - 32,600	6	1.0 - 6.5	3,000 - 100,000	6.0	21.5	22.5	21.5
California	6	1.25 - 9.55	7,300 - 47,900	1	8.84	.	8.25	18	18	18
Colorado	1	4.63	.	1	4.63	.	2.9	22	20.5	22
Connecticut	3	3 - 6.5	10,000 - 500,001	1	7.5	.	6.0	25	37	25
Delaware	6	2.2 - 6.95	5,000 - 60,001	1	8.7	.	0.0	23	22	23
Dist. of Columbia	3	4 - 8.5	10,000 - 40,000	1	9.975	.	6	20	20	20
Florida	*(No individual income tax)*			1	5.5	.	6.0	16	29.6	16
Georgia	6	1 - 6	750 - 7,000	1	6.0	.	4.0	16.8	17.5	16.8
Hawaii	12	1.4 - 11	2,400 - 200,001	3	4.4 - 6.4	25,000 - 100,000	4.0	17	17	17
Idaho	8	1.6 - 7.8	1,320 - 26,418	1	7.6	.	6.0	26	26	26
Illinois	1	3	.	1	7.3	.	6.25	20.1	22.6	20.1
Indiana	**1**	**3.4**	**.**	**1**	**8.5**	**.**	**7.0**	**18**	**16**	**18**
Iowa	9	0.36 - 8.98	1,407 - 63,316	4	6.0 - 12.0	25,000 - 250,000	6.0	22.5	22.5	19
Kansas	3	3.5 - 6.45	15,000 - 30,000	1	4	.	5.3	24	26	24
Kentucky	6	2 - 6	3,000 - 75,000	3	4.0 - 6.0	50,000 - 100,000	6.0	24.1	21.1	24.1
Louisiana	3	2 - 6	12,500 - 50,000	5	4.0 - 8.0	25,000 - 200,000	4.0	20	20	20
Maine	4	2 - 8.5	4,949 - 19,750	4	3.5 - 8.93	25,000 - 250,000	5.0	29.5	30.7	29.5
Maryland	8	2 - 6.25	1,000 - 1,000,001	1	8.25	.	6.0	23.5	24.25	23.5
Massachusetts	1	5.3	.	1	8.75	.	6.25	21 .0	21	21
Michigan	1	4.35	.	1	4.95	.	6.0	19	15	19
Minnesota	3	5.35 - 7.85	22,770 - 74,781	1	9.8	.	6.875	27.1	27.1	27.1
Mississippi	3	3 - 5	5,000 - 10,000	3	3.0 - 5.0	5,000 - 10,000	7.0	18.4	18.4	18.4
Missouri	10	1.5 - 6	1,000 - 9,000	1	6.25	.	4.225	17.55	17.55	17.55
Montana	7	1 - 6.9	2600 - 15401	1	6.75	.	0	27	27.75	27
Nebraska	4	2.56 - 6.84	2,400 - 27,001	2	5.58 - 7.81	100,000	5.5	27.7	27.1	27.7
Nevada	*(No individual income tax)*			*(No corporate income tax)*			6.85	24.055	27	24.055
New Hampshire	*(No individual income tax)*			1	8.5	.	0.0	19.625	19.625	19.625
New Jersey	8	1.4 - 10.75	20,000 - 1,000,000	1	9	.	7.0	14.5	17.5	14.5
New Mexico	4	1.7 - 4.9	5,500 - 16,000	3	4.8 - 7.6	500,000 - 1 mil	5.0	18.875	22.875	18.875
New York	7	4 - 8.97	8,000 - 500,000	1	7.1	.	4.0	24.4	22.65	24.4
North Carolina	3	6 - 7.75	12,750 - 60,000	1	6.9	.	5.75	30.55	30.55	30.55
North Dakota	5	1.84 - 4.86	34,000 - 373,650	3	2.1 - 6.4	25,000 - 50,000	5.0	23	23	23
Ohio	9	0.618 - 6.24	5,000 - 200,000	*0*	*(Commercial Activity Tax)*		5.5	28	28	28
Oklahoma	7	0.5 - 5.5	1,000 - 8,701	1	6.0	.	4.5	17	14	17
Oregon	5	5 - 11	2,000 - 250,000	2	6.6 - 7.9	250,000	0.0	24	24	24
Pennsylvania	1	3.07	.	1	9.99	.	6.0	31.2	38.1	31.2
Rhode Island	5	3.8 - 9.9	33,500 372,950	1	9	.	7.0	31	31	31
South Carolina	6	0 - 7	2,740 - 13,701	1	5.0	.	6.0	16	16	16
South Dakota	*(No individual income tax)*			n/a	n/a	n/a	4.0	22	22	22
Tennessee	*(No individual income tax)*			1	6.5	.	7.0	21.4	18.4	21.4
Texas	*(No individual income tax)*			*0*	*(Franchise Tax)*		6.25	20	20	20
Utah	1	5 -	.	n/a	5	n/a	4.7	24.5	24.5	24.5
Vermont	5	3.55 - 8.95	33,950 - 372,951	3	6.0 - 8.5	10,000 - 250,000	6.0	24.5	29	24.5
Virginia	4	2 - 5.75	3,000 - 17,000	1	6.0	.	5	17.5	17.5	17.5
Washington	*(No individual income tax)*			*(No corporate income tax)*			6.5	37.5	37.5	37.5
West Virginia	5	3 - 6.5	10,000 - 60,000	1	8.5	.	6.0	32.2	32.2	32.2
Wisconsin	5	4.6 - 7.75	10,220 - 225,001	1	7.9	.	5.0	32.9	32.9	32.9
Wyoming	*(No individual income tax)*			*(No corporate income tax)*			4.0	14	14	14
U.S.A. average	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*5.1*	*22.3*	*23.0*	*22.2*

Appendix 2: State and Local Tax Collections

Sources: Census of Government Finance, U.S. Census Bureau; U.S. Bureau of Economic Analysis

State	State Tax Collections (2010)					State and Local Tax Collections (2008)				
	Value (millions)	Per Capita		As % Personal Income		Value (millions)	Per Capita		As % Personal Income	
		Value	Rank	Value	Rank		Value	Rank	Value	Rank
Alabama	$ 8,182	$ 1,712	40	5.2%	38	$ 14,041	$ 3,002	50	9.2%	48
Alaska	4,518	6,361	1	15.0	1	9,735	14,147	1	34.7	1
Arizona	10,199	1,596	47	4.7	42	22,992	3,538	38	10.5	33
Arkansas	7,279	2,496	17	7.8	9	9,406	3,280	45	10.5	35
California	104,841	2,814	12	6.7	15	186,015	5,085	9	11.8	12
Colorado	8,586	1,707	41	4.1	49	19,636	3,979	28	9.6	45
Connecticut	12,286	3,438	6	6.3	19	23,115	6,599	5	11.9	11
Delaware	2,770	3,085	9	7.9	7	3,712	4,237	21	10.7	26
District of Columbia	.	.	.	.	.	5,398	9,148	2	14.4	4
Florida	31,499	1,675	42	4.4	46	73,351	3,981	27	10.3	37
Georgia	14,783	1,526	49	4.4	45	33,633	3,468	39	10.2	38
Hawaii	4,838	3,556	5	8.9	4	6,737	5,233	7	12.9	6
Idaho	2,952	1,883	38	6.0	24	4,940	3,234	46	10.0	40
Illinois	29,762	2,320	21	5.5	34	57,834	4,503	15	10.8	24
Indiana	**13,796**	**2,128**	**30**	**6.3**	**20**	**22,954**	**3,593**	**33**	**10.7**	**27**
Iowa	6,809	2,235	25	6.0	23	11,541	3,855	30	10.8	25
Kansas	6,493	2,276	23	5.9	28	11,877	4,246	20	11.4	18
Kentucky	9,532	2,197	26	6.8	13	14,157	3,302	44	10.7	28
Louisiana	8,758	1,932	36	5.2	39	17,951	4,032	26	11.6	15
Maine	3,490	2,627	14	7.2	10	5,933	4,496	16	12.9	7
Maryland	15,224	2,637	13	5.5	33	27,651	4,887	11	10.5	36
Massachusetts	20,050	3,062	10	6.1	22	33,997	5,196	8	10.5	32
Michigan	22,626	2,289	22	6.6	16	37,650	3,764	31	11.0	23
Minnesota	17,209	3,245	8	7.8	8	24,724	4,727	13	11.4	19
Mississippi	6,269	2,113	31	7.0	12	9,213	3,133	47	10.7	29
Missouri	9,703	1,620	44	4.5	44	19,873	3,336	42	9.6	44
Montana	2,143	2,166	27	6.3	21	3,448	3,562	35	10.6	30
Nebraska	3,809	2,086	32	5.4	36	7,508	4,213	22	11.2	20
Nevada	5,836	2,161	28	5.9	29	10,588	4,048	24	10.1	39
New Hampshire	2,125	1,614	45	3.8	50	4,963	3,754	32	8.8	50
New Jersey	25,928	2,949	11	6.0	26	53,791	6,209	6	12.4	9
New Mexico	4,414	2,144	29	6.6	17	7,747	3,899	29	12.3	10
New York	63,529	3,278	7	7.0	11	138,288	7,103	3	14.9	3
North Carolina	21,511	2,256	24	6.6	18	33,208	3,591	34	10.5	34
North Dakota	2,646	3,934	3	10.0	3	3,174	4,948	10	13.6	5
Ohio	23,584	2,044	34	5.8	31	46,660	4,048	25	11.5	16
Oklahoma	7,080	1,887	37	5.4	37	12,315	3,379	41	9.9	41
Oregon	7,475	1,951	35	5.4	35	12,532	3,313	43	9.4	46
Pennsylvania	30,169	2,375	20	6.0	25	54,110	4,306	19	11.2	21
Rhode Island	2,569	2,441	18	5.9	27	4,874	4,626	14	11.5	17
South Carolina	6,804	1,471	50	4.6	43	13,163	2,923	51	9.3	47
South Dakota	1,304	1,602	46	4.2	47	2,500	3,107	48	8.6	51
Tennessee	10,514	1,657	43	4.9	40	19,000	3,045	49	9.0	49
Texas	39,399	1,567	48	4.1	48	86,383	3,554	36	9.8	42
Utah	5,092	1,842	39	5.8	30	9,371	3,436	40	11.1	22
Vermont	2,511	4,013	2	10.3	2	2,936	4,727	12	12.5	8
Virginia	16,411	2,051	33	4.7	41	32,707	4,196	23	9.8	43
Washington	16,106	2,395	19	5.6	32	28,590	4,354	17	10.5	31
West Virginia	4,655	2,512	16	8.0	6	6,428	3,542	37	11.8	13
Wisconsin	14,369	2,527	15	6.8	14	24,372	4,331	18	11.8	14
Wyoming	2,117	3,756	4	8.1	5	3,694	6,930	4	15.1	2
U.S. Total	*704,555*	*2,286*	*.*	*5.8*	*.*	*1,330,412*	*4,371*	*.*	*11.2*	*.*

Appendix 3: Services Taxed by State

Source: Federation of Tax Administrators, Survey of Services Taxation 2007

State	Utlities	Personal Services	Business Services	Computer Services	Admission / Amusement	Professional Services	Fabrication, Repair, and Installation	Other Services	TOTAL	% Total available
Count available to tax	**16**	**20**	**34**	**8**	**15**	**9**	**19**	**47**	**168**	**.**
Alabama	12	2	6	3	10	0	1	3	37	22%
Alaska	0	0	0	0	0	0	0	1	1	1%
Arkansas	16	7	12	1	12	0	11	13	72	43%
Arizona	12	2	7	0	9	0	2	23	55	33%
California	2	2	7	2	1	0	3	4	21	13%
Colorado	4	0	2	1	2	0	3	2	14	8%
Connecticut	10	9	20	6	10	0	10	14	79	47%
Delaware	9	20	33	6	10	9	19	37	143	85%
District of Columbia	13	7	15	6	8	0	12	12	73	43%
Floida	7	4	9	0	14	0	16	13	63	38%
Georgia	10	4	5	2	8	0	1	6	36	21%
Hawaii	16	20	34	8	14	9	18	41	160	95%
Iowa	13	15	18	1	14	0	13	20	94	56%
Idaho	0	3	5	0	11	0	6	4	29	17%
Illinois	12	1	1	1	0	0	1	1	17	10%
Indiana	**7**	**4**	**3**	**2**	**3**	**0**	**1**	**4**	**24**	**14%**
Kansas	10	11	9	1	13	0	15	15	74	44%
Kentucky	11	2	4	0	6	0	4	1	28	17%
Louisiana	10	8	5	3	9	0	13	7	55	33%
Maine	9	1	6	0	3	0	4	2	25	15%
Maryland	5	3	13	1	11	0	4	2	39	23%
Massachusetts	9	1	4	0	1	0	2	1	18	11%
Michigan	12	2	7	1	1	0	1	2	26	15%
Minnesota	15	7	12	2	13	0	6	11	66	39%
Mississippi	10	5	8	3	11	0	13	22	72	43%
Missouri	8	1	2	2	10	0	0	3	26	15%
Montana	12	0	0	0	2	0	0	4	18	11%
Nebraska	14	9	14	3	12	0	13	12	77	46%
Nevada	0	1	4	0	7	0	2	4	18	11%
New Hampshire	6	1	0	2	0	0	0	2	11	7%
New Jersey	12	5	16	1	6	0	15	19	74	44%
New Mexico	16	20	32	8	14	9	18	41	158	94%
New York	4	4	13	1	6	0	14	15	57	34%
North Carolina	10	4	5	0	9	0	1	1	30	18%
North Dakota	6	1	4	2	11	0	0	2	26	15%
Ohio	8	12	14	5	3	0	12	14	68	40%
Oklahoma	9	3	4	1	10	0	0	5	32	19%
Oregon	0	0	0	0	0	0	0	0	0	0%
Pennsylvania	9	5	16	1	1	0	15	8	55	33%
Rhode Island	10	1	6	3	4	0	3	2	29	17%
South Carolina	4	6	7	4	10	0	1	3	35	21%
South Dakota	14	19	28	8	13	5	18	41	146	87%
Tennessee	11	10	7	3	12	0	13	11	67	40%
Texas	12	10	14	8	12	1	10	16	83	49%
Utah	7	8	6	0	11	0	15	11	58	35%
Vermont	9	2	5	2	11	0	2	1	32	19%
Virginia	1	3	4	0	1	0	4	5	18	11%
Washington	16	20	33	8	13	9	16	43	158	94%
West Virginia	6	17	26	4	13	1	13	25	105	63%
Wisconsin	11	11	8	3	14	0	14	15	76	45%
Wyoming	10	6	6	2	6	0	16	12	58	35%
U.S.A. average	*9*	*6*	*10*	*2*	*8*	*1*	*8*	*11*	*56*	*33%*

Appendix 4: Estimated Use Tax Revenues Lost on E-Commerce Sales

Source: Bruce, D., Fox. W.F., Luna, L. (2009).

State	Estimated Tax Revenues (millions)					
	2007	2008	2009	2010	2011	2012
Alabama	$ 108.3	$ 115.5	$ 103.9	$ 128.9	$ 151.6	$ 170.4
Alaska	1.0	1.0	0.9	1.1	1.3	1.5
Arizona	235.2	250.8	225.6	279.8	329.0	369.8
Arkansas	72.4	77.2	69.5	86.2	101.3	113.9
California	1,211.2	1,291.6	1,162.1	1,441.1	1,694.4	1,904.5
Colorado	109.9	117.1	105.4	130.7	153.7	172.7
Connecticut	40.6	43.2	38.9	48.3	56.7	63.8
District	22.6	24.1	21.7	26.9	31.6	35.5
Florida	511.2	545.1	490.4	608.2	715.1	803.8
Georgia	260.9	278.2	250.3	310.4	365.0	410.3
Hawaii	38.2	40.7	36.6	45.4	53.4	60.0
Idaho	29.5	31.4	28.3	35.1	41.2	46.4
Illinois	322.3	343.7	309.3	383.5	450.9	506.8
Indiana	**124.2**	**132.5**	**119.2**	**147.8**	**173.8**	**195.3**
Iowa	56.4	60.1	54.1	67.1	78.9	88.7
Kansas	90.9	96.9	87.2	108.1	127.1	142.9
Kentucky	69.9	74.6	67.1	83.2	97.8	109.9
Louisiana	251.8	268.5	241.6	299.6	352.2	395.9
Maine	20.4	21.7	19.6	24.3	28.5	32.1
Maryland	117.1	124.9	112.4	139.3	163.8	184.1
Massachusetts	83.5	89.0	80.1	99.3	116.8	131.3
Michigan	90.0	96.0	86.3	107.1	125.9	141.5
Minnesota	149.6	159.6	143.6	178.0	209.3	235.3
Mississippi	85.8	91.5	82.3	102.1	120.0	134.9
Missouri	134.0	142.9	128.6	159.4	187.5	210.7
Nebraska	39.0	41.6	37.4	46.4	54.6	61.3
Nevada	107.4	114.6	103.1	127.8	150.3	168.9
New Jersey	128.8	137.3	123.5	153.2	180.1	202.5
New Mexico	76.6	81.7	73.5	91.1	107.2	120.5
New York	550.4	586.9	528.1	654.9	770.0	865.5
North Carolina	136.0	145.0	130.4	161.8	190.2	213.8
North Dakota	9.8	10.4	9.4	11.6	13.6	15.3
Ohio	195.8	208.8	187.9	233.0	274.0	307.9
Oklahoma	89.5	95.5	85.9	106.5	125.3	140.8
Pennsylvania	220.0	234.6	211.0	261.7	307.7	345.9
Rhode Island	18.5	19.7	17.7	22.0	25.8	29.0
South Carolina	79.2	84.5	76.0	94.2	110.8	124.5
South Dakota	18.9	20.2	18.2	22.5	26.5	29.8
Tennessee	261.3	278.6	250.7	310.9	365.5	410.8
Texas	553.6	590.3	531.1	658.6	774.4	870.4
Utah	56.3	60.0	54.0	66.9	78.7	88.5
Vermont	16.0	17.0	15.3	19.0	22.3	25.1
Virginia	131.6	140.4	126.3	156.6	184.1	207.0
Washington	179.3	191.2	172.0	213.3	250.8	281.9
West Virginia	32.2	34.3	30.9	38.3	45.0	50.6
Wisconsin	90.4	96.4	86.7	107.6	126.5	142.1
Wyoming	18.2	19.4	17.5	21.6	25.4	28.6
U.S. Total	*7,245.7*	*7,726.2*	*6,951.6*	*8,620.4*	*10,135.6*	*11,392.7*

Appendix 5: The Kernan-Shepard Report on Local Government Reform

In July of 2007, Governor Mitch Daniels commissioned the bipartisan Blue Ribbon Commission on Local Government Reform, and requested that the Indiana University Public Policy Institute administer the Commission's efforts through its Center for Urban Policy and the Environment. Governor Daniels enlisted Indiana Supreme Court Chief Justice Randall T. Shepard and former Governor Joseph E. Kernan to co-chair the Commission, and asked it to develop a set of recommendations that would find efficiencies and reduce the financial burden of local government on Indiana taxpayers. It was asked to answer the following questions and report any findings or proposal by the end of 2007:

- What local government offices might be eliminated to achieve efficiencies and cost savings for Hoosier taxpayers?
- What local units of government (including schools and libraries) might be successfully consolidated to reduce overhead and administrative expenses?
- What services or functions of local government might be reduced, eliminated or provided in new ways to achieve savings for Hoosier taxpayers?
- Is a Constitutional Convention necessary or desirable as a means to achieve significant reforms in the structure and organization of Indiana state government?

Summary of Progress: In December 2007, the Commission issued its recommendations, and in 2008, a number of provisions were enacted by the Indiana General Assembly as part of property tax legislation. In 2009, many of the recommendations were submitted in the form of proposed legislation, but after debate, only a few minor provisions were enacted. Further recommendations were selected for proposed legislation in 2010, but again, only a few minor changes were made.

Recommendations: The Kernan-Shepard report was clear in its recommendations. It answered the question as to whether Indiana's patchwork of local government delivers the most effective service at the lowest possible expense. The answer was no. Briefly, the Kernan-Shepard recommendations encompassed the following:

- County governments should be led by a single county executive and a stronger city county council.
- The services performed by township personnel should be transferred to county governments.
- Only elected officials should have the power to levy taxes.
- All spending – including school spending – should be subject to more rigorous examination by elected officials.
- All of Indiana's school districts should be large enough to gather adequate resources for educating children in the 21st century.

This Commission recommends implementation of all changes that have yet to be made. While there has been some recognition that the status quo is not good enough, change will continue to be difficult, as evidenced by the summary of actions taken in 2008, 2009 and 2010, listed here. Efforts should continue.

Legislative Action on Kernan-Shepard Recommendations

As of December 31, 2010

No action ▭
Hearing but not passed ▽
Passed into law △

Item	Description	Action
1	Establish a single-person elected county chief executive.	▽
2	Establish a single, unified legislative body for county government. Expand legislative membership to ensure sufficient representation for included rural, suburban and urban populations.	▽
3	Transfer the responsibility for administering the duties of the county auditor, treasurer, recorder, assessor, surveyor, sheriff and coroner to the county executive. Transfer the varied duties of the clerk to the courts, to the county election board and to the county executive. Establish objective minimum professional qualifications and standards for certain county administrative functions.	▽
4	Retain a local government role for property tax assessment under a county assessor who is required to meet professional qualifications and appointed by the county executive.	△
5	Create a countywide body to oversee the provision of all public safety services.	▽
6	Consolidate emergency public safety dispatch by county or multi-county region. Require that new, local emergency communications systems be compatible with the Project Hoosier SAFE-T statewide 800 MHz communications system.	△
7	Transfer the responsibility for all funding of the state's trial court system to the state, including public defenders and probation.	▽
8	Move the funding of child welfare from counties to the state.	△
9	Transfer the responsibility for administering the duties of township government for assessment, poor relief, fire protection, emergency medical services (EMS), cemeteries and any other remaining responsibilities to the county executive. Establish a countywide poor relief levy.	▽
10	Transfer the responsibilities of the township small claims courts in Marion County to superior courts.	▽
11	Reorganize school districts to achieve a minimum student population of 2,000. Establish state standards and a county-based planning process similar to that established in 1959 legislation.	▽
12	Require that school corporation bonds be approved by the fiscal body of the municipal or county government containing the greatest proportion of assessed value in the school district.	△
13	Prompt joint purchasing by schools.	▭
14	Conduct all non-partisan school elections during November in even years.	▽
15	Allow the city council to appoint the city clerk in second-class cities.	▽
16	Move all municipal elections to an even-year cycle.	▽
17	Transfer the responsibilities of municipal health departments to the county health department.	▭
18	Reorganize library systems by county and provide permanent library service for all citizens.	▽
19	Require that the budgets and bonds of library and all other special districts be approved by the fiscal body of the municipal or county government containing the greatest proportion of assessed value in the unit seeking approval. Require that the budgets and bonds of library and all other special districts be approved by the fiscal body of the municipal or county government containing the greatest proportion of assessed value in the unit seeking approval (continued).	△
20	Strengthen the current joint purchasing infrastructure for libraries.	▭
21	Expand voluntary coordination and consolidation of units and services. Strengthen the power of voters to compel consolidation.	▽
22	Allow local governments to establish service districts with differentiated levels of service and corresponding tax rates.	▽
23	Facilitate local improvement efforts using best management and business practices. Strengthen state mechanisms that support these activities, particularly for collective purchasing.	▽
24	Prohibit employees of a local government unit from serving as elected officials within the same local government unit.	▽
25	Assign the Indiana Advisory Commission on Intergovernmental Relations to monitor progress toward these recommendations and conduct additional research as needed. Produce an annual report on progress through 2011.	▽
26	Establish a statewide benchmarking system to provide the public and policy-makers with current information about local government productivity and progress.	▽
27	Designate a state office to provide technical assistance to local government.	▽

Appendix 6: Summary of Research on 21st Century Economy Trends

This appendix summarizes a report available on the Policy Choices website of the IU Public Policy Institute titled The Next Economy (www.policyinstitute.iu.edu/PolicyChoices). The report examines the academic literature regarding what constitutes "good" tax policy and what the next economy might be for the United States, as well as steps Indiana can take in preparation. The report is divided into six main sections: workers, education, skills, infrastructure, the Midwest, and metropolitan areas.

WORKERS IN THE NEXT ECONOMY: There are three main implications for future workforce development: 1) a change in the required skills; 2) a change in the nature of the workplace, and 3) worker compensation. There will be high demand for skilled workers who can develop new technologies and bring them to market. Karoly et al. (2004) highlight three major trends shaping the next workforce, including shifting demographic patterns, the pace of technological change and the path of economic globalization. Presently, "blue collar" jobs (manufacturing, construction, natural resources) are 23 percent of the workforce but will decline to 21.4 percent by 2018 (Carnevale et al., 2010). In an industrial forecast for 13 industries from 2008 to 2018, researchers found that overall, service industries will have workforces dominated by 75 to 90 percent of workers with at least some postsecondary education. These include: information services, professional and business services, financial services, private education services, health care services and government and public education services. It is predicted that they will provide over 40 percent of all jobs in 2018.

EDUCATION IN THE NEXT ECONOMY: Growth in high school and college completion has slowed dramatically, barely increasing since the 1970s. This has enormous economic implications on the future, as post-secondary degrees have significantly higher earning potential, and the next economy will need workers with post-secondary degrees. For example, professional degrees earn approximately $4.6 million over a lifetime. In contrast, high school dropouts earn the least, $1.2 M. In addition to education needs, employers are examining the skill sets their employees possess with increasing frequency, and finding workers new to the marketplace lacking in critical skills. In 2007, the Commission on the Skills of the American Workforce identified the education and training system as a core problem in the United States.

SKILLS IN THE NEXT ECONOMY: Casner-Lotte and Barrington (2006) surveyed over 400 employers on the skill sets that new entrants to the U.S. workforce need to succeed. The three most important applied skills identified were: 1) professionalism/work ethic; 2) teamwork/collaboration and 3) oral communications. Knowledge of foreign languages, the ability to make appropriate health and wellness choices and creativity/innovation were also identified as increasing in importance. However, more than half of employer respondents (54.2 percent) report new workforce entrants as "deficient" in these skills.

INFRASTRUCTURE IN THE NEXT ECONOMY: Much of the literature on the next economy focuses on transportation needs. The United States faces a serious infrastructure deficit. According to the American Society of Civil Engineers, "we are currently spending $110 billion per year less than the amount needed to maintain the system at current performance levels" (Kahn & Levinson, 2001, p. 35). Without new revenue sources, this infrastructure deficit will continue to increase. Kahn and Levinson (2001) argue that existing infrastructure should be fixed first, expanded where necessary and only fund new projects in which efficient and effective management of infrastructure projects has been demonstrated. Under their proposal, states would finance expansion of existing roads and new construction through loans (replacing today's system of matching federal grants).

To make this possible, the authors argue that states should establish State Infrastructure Banks (SIBs), or enhance one if it already exists. 33 states have established one to finance transportation projects (generally through below market rate revolving loans and loan guarantees), but SIB's currently fall short of their full potential. If they are mainly used to finance wish-list transportation projects, researchers believe they are missing opportunities. Loans should be filtered through a competitive application process so states can be strategic about funding projects critical to the next economy. SIB projects should be evaluated according to return on investment, and not used only to fund roads and rails, but be expanded to fund energy and water infrastructure, as well as possibly school and manufacturing.

In addition, infrastructure needs extend far beyond transportation. Broadband infrastructure is an ever-growing need in a globalized world. Most of the literature exploring the connection between broadband access and economic growth show a positive relationship. Falck, Kretschmer, and Woessman (2009) note that broadband infrastructure "can lead to lower entry barriers and higher market transparency, thereby increasing both labor productivity and market competition and ultimately economic growth" (p. 2).

INDIANA AND THE MIDWEST IN THE NEXT ECONOMY: Vey et al. (2010) provide strategies that could bolster the Great Lakes region. According to their report, our region has significant resources in place for the next economy. It has the potential to be the largest clean energy research and new technology development engine. Our innovation infrastructure performs 29 percent of research and development in clean energy, and there are 32 major universities supporting innovation. The Midwest produces 36 percent of the nation's engineering graduates. However, to maximize these resources, the region must invest. These reports advocate four policy principles for state and local governments with an emphasis on infrastructure investments:

1) Prioritize investments for the future

2) Use existing infrastructure resources more efficiently (including investment in maintenance and the utilization of road pricing and user fees to address congestions

3) maximize new spending through projects subject to rigorous cost-benefit analysis and evaluations, such that only the ones with the greatest returns are chosen

4) implement transparent and accessible budgeting with timely, accurate and standardized financial reporting that facilitates taxpayer oversight. These actions can reduce borrowing costs.

THE ENGINES OF THE NEXT ECONOMY: The Brookings Rockefeller Project on State and Metropolitan Innovation (2010), authored by Katz, Bradley, and Liu, states that the next economy will be shaped, determined and delivered by metropolitan areas. Taken together, the nation's 366 metropolitan areas produce 85 percent of U.S. exports, 89 percent of working age people with post-secondary degrees, and 93 percent of people working in science and engineering. Indiana's 16 metropolitan areas account for 78 percent of its population, 81 percent of its jobs, and 83 percent of its economic outputs. As Indiana considers economic development possibilities, the crucial role that its metropolitan areas can play in driving the next economy cannot be ignored.

Appendix 7: Summary of Research on Transportation Infrastructure Needs in the United States

This appendix summarizes a report available on the Policy Choices website of the IU Public Policy Institute about transportation infrastructure (www.policyinstitute.iu.edu/PolicyChoices). The report takes a wide-ranging look at transportation issues. The report explores this problem in five sections: 1) An overview of the issue from a national perspective; 2) recommended policies and a look at State Infrastructure Banks; 3) details on the status of Indiana's roads and bridges; 4) investigating the link between investing in transportation infrastructure and economic growth; and 5) financing transportation investments in difficult economic times.

OVERVIEW OF THE ISSUE: There is consensus that the nation is in a transportation infrastructure funding crisis. The Highway Trust Fund was $23 billion in 2000. Today (November 2011), it has an estimated deficit of $8.1 billion and required a taxpayer bailout. The current transportation law expired over 600 days ago, and states are finding it difficult to plan for long-term investments without federal guidance on funding that will be available. More investment is needed, but politically difficult to impossible. Scholars recommend changing the way transportation investments are funded. This section includes specific possibilities for doing so, as well as a brief description of how public transportation dollars can possibly stimulate state and local economies. This section contains a detailed example of Denver, Colorado, which has been hailed as a model for investing in transportation infrastructure.

PRIORITIZING INVESTMENTS – FIX IT FIRST: American infrastructure needs have changed drastically since the highway system was built in the 1950s. A large portion of our infrastructure is in immediate need of repair, and states/localities are no exception. Many states have adopted Fix it First policies to offset the neglect that political expediency can sometimes cause. As large, visible, new highway projects are attractive to policy leaders, these can come at the expense of maintenance (and cause congestion, wear and tear on cars, lost work hours, etc.). This section also contains a relatively detailed analysis of State Infrastructure Banks (SIBs). Indiana should consider better utilization of its SIB. Further knowledge on its legislative limitations and how those might be overcome would be helpful.

THE STATE OF INDIANA'S ROADS: In 2009, the LTAP Center at Purdue University conducted a study on the needs of Indiana's roads and bridges and identified a severe shortage of funds. According to the report, detailed in this section, there is a $5 billion funding shortfall in the short-term (backlog) alone, just to fix what we have. In addition, there is an $858 million funding shortfall in the long-term (annual). Reforms to the way Indiana funds its transportation investments and uses its SIB will be needed to resolve this issue. More public awareness on the state of Indiana's roads needs to be achieved.

MAKING THE LINK BETWEEN INVESTMENT AND GROWTH: Many sources show a significant link between investing in transportation (public transit as well as roads and bridges) and economic growth. An analysis of the fiscal stimulus found that increased infrastructure spending had a 1:1.57 "bang for the buck." As public transportation attracts businesses, some cities are investing heavily in it, instead of reducing funding (as most cities are). For example, Washington D.C.'s Metro has generated almost $15 billion in private development surrounding its lines. Between 1980 and 1990 alone, 40 percent of the area's retail and office space was built within walking distance of a Metro Station. Transportation infrastructure investments should be based on strict returns on investment, and highlight the potential economic benefits of investing in greater transportation capacity.

FINANCING TRANSPORTATION INVESTMENTS: Despite a demonstrated need, and a demonstrated link to economic development, states continue to find it politically difficult to increase transportation funding. This section contains some lower cost options that might be more feasible, and would be steps toward improving the strategy for transportation infrastructure investments. For example, the Bus Rapid Transit highlighted in this section seems to have particularly beneficial properties for certain areas in the state, and BRTs have been shown to increase public will for more infrastructure, once the benefits of better public transit become known.

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