The Aspirational State: Indiana as a Guide for Reformers

Ryan Streeter, Ph.D.
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Aspiration America: The Indiana Model

Indiana seems to be turning into the Texas of the Midwest – a state in which an inviting policy environment is evolving into a self-reinforcing opportunity environment. What is going on? And why does the state seem poised to grow in ways not available to its neighbors?

Ryan Streeter, Ph.D.

Policy Brief
One

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Defining Reform in the 21st Century: Inverting the Great Inversion

In his 2011 book, *Keeping the Republic*, Indiana Governor Mitch Daniels argues that government's original purpose of serving the public has suffered what he calls “the great inversion.” Instead of a government of, for and by the people, we now find that ordinary private citizens seem to be spending a greater share of their paychecks supporting the interests of bloated bureaucracies. Daniels writes:

“[T]he traditional concept of public service has been stood on its head. With almost no one noticing, government workers rose from underpaid public servants to the position of a privileged elite...Americans who always thought that ‘public service’ meant that the government works for them must now wonder if they had it wrong.”

The American ideal of government, upheld in the Federalist Papers and related writings of the founders, is the representative, institutional protection of the rights of the citizenry. The great challenge for reformers today is restoring government to its original purpose of safeguarding the public. This is no easy task, and some would say the more expansive version of government today is here to stay.

But is it all that unreasonable to expect that our governments – municipal, state, and federal – recover their original stance toward the citizens whose rights they purportedly protect? No, of course not. And one way to get started is to ensure that as much government as possible is serving the life, liberty, and happiness envisioned by the founders – and seriously interrogate the remaining parts of government that aren’t, even if it means shutting them down.

Getting a bit more practical, one way to pursue the original ideal of government is, first, to respect the choices of citizens as much as possible when it comes to service provision, and second, work hard to make sure that citizens believe the services are worth the taxes. A third element, of course, is to do all of this in a way that both lessens the burden of the state on citizens’ pocketbooks and increases opportunity and quality of life.

Mitch Daniels has been celebrated on the national stage for what his fiscal discipline hath wrought, such as a AAA credit rating and a sizeable surplus. He is popular at home, however, more because he has governed according to the terms in the previous paragraph than because Hoosiers love a parsimonious cost-cutter. In fact there’s something of an equation in his approach to governance that other states can model. We might call it the “Indiana Formula.”

The Indiana Formula: The Citizen Standard, Opportunity Environment, and Accountable Public Square

The Indiana Formula (my term, not an official expression of the State of Indiana or the Daniels administration) has made it possible for Indiana to make its property taxes the lowest in the nation while simultaneously turning a $700 million deficit into a $1.8 billion surplus. The policy briefs that follow are aimed at helping public officials in other states and policymakers in general understand the Indiana Formula, and consider ways that the Formula can be replicated.

States differ from each other in important ways, and some leaders in other states will immediately object that they lack particular authorities to achieve what Indiana achieved. This is fair and to be expected. Nevertheless, the Indiana experience can serve as a model policy environment that states can either replicate or attempt to approximate through various reforms.

So what is the Indiana Formula? It consists of three parts. The first is a practical approach to citizen-centric policymaking. “Citizen-centrism” is a perennial hobby of civic activists and politicians everywhere who claim we need more democratic engagement and so on. In Indiana such
centrism is pretty straightforward and less idealistic: improve the quality-of-life choices available to people as much as possible and reduce the burden the state places on individuals. The Hoosier State achieved this through its new performance measures on public agencies and reforms to education and health care.

The second element of the Formula is prioritizing the opportunity environment. The state has fallen short of a goal the Daniels administration set before the recession of raising disposable income for ordinary families. The economic downturn pretty much guaranteed that. But Indiana has arguably done more than any other U.S. state to improve opportunity for residents and businesses amidst a historically unique economic downturn. Its leadership on broadband innovation and ability to improve its standing as a business destination have made Indiana a bright spot for opportunity in the Midwest, which as a whole has taken quite a beating in recent years.

The third part of the Formula is the accountable public square. Transparency, performance, and a balanced budget have been central to the Daniels administration. Before 2005, Indiana had no central agency tasked with overseeing the state’s finances and approving spending decisions in a coordinated way. Daniels, former OMB director in the Bush administration that he was, created a state-level OMB in Indiana that has revolutionized public accounting and given the people of Indiana a chance to review public spending online, out in the open, for the first time.

Taken together, this tripartite formula has:

- Made Indiana one of just nine AAA-rated states, the first time the Hoosier State has reached AAA status from all three agencies.
- Made Indiana’s property taxes the lowest in the nation.
- Turned a $700 million deficit into a $1.8 billion surplus during the worst recession since the Great Depression.
- Through its education reforms, given Indiana parents the broadest set of options in the nation for choosing the best school for their children.
- Given Indiana consistent and notable boosts in a number of highly-respected national rankings of states’ business environments.
- Laid the groundwork for Indiana to become the nation’s first right-to-work state in a decade and the first in Great Lakes region.

It’s too early to say whether these reforms will result in accelerated near-term job and economic growth in the Hoosier State. In one recent study, also a part of the Sagamore Aspiration Indiana series, Dr. Mike Hicks of Ball State University finds a correlation between Indiana’s improved fiscal condition and positive economic performance. Whatever the case, as popular state rankings for business-friendliness suggest, there is an undeniable commercial appeal to a state that gets its house in order.

For instance, in CEO Magazine’s ranking of the top states for doing business, Indiana jumped from #16 in 2010 to #6 in 2011. In CNBC’s annual ranking of the best states for business, Indiana jumped from #21 to #15 during the same period, scoring in the top 10 in the index’s “Cost of Doing Business” and “Business Friendliness” sub-indexes.

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Source: CNBC
es. And, of course, Indiana’s fiscal strength as an underlying factor of its stable economic environment gave the state a boost even earlier. The Government and Fiscal Policy sub-index in the Beacon Hill State Competitiveness Report in 2012 ranked Indiana 3rd nationally, the only Midwestern state in the top 10.

**The Citizen Standard**

It is commonplace for elected officials to say they are acting on behalf of the citizenry, and yet when voters see politicians acting on behalf of special or narrow interests, it’s pretty easy to see why cynicism follows close behind.

Rather than focusing on so-called democratic engagement or trendy citizen-centric technology innovations (which certainly have their place if done properly), a practical citizens-first approach to governing expands choice and satisfaction in core services. For instance, take the following examples from the Indiana model:

*Health Care.* As the fourth policy brief in this series, Indiana provided consumer-directed health care plans to public employees and lower-income Hoosiers. The result has been improved prevention services and overall high satisfaction levels at lower-than-average costs.

*Education.* While education reform is always controversial, Indiana’s reform effort, as the sixth brief in this series details, was a multi-pronged initiative at expanding family choice in education. More than a voucher plan, for example, Indiana’s reforms dissolved school district lines to allow parents to send their children to better-performing public schools with no additional tuition costs. Families have become the fundamental unit of education policy rather than the school district. These types of reforms will probably look even more radical in the future after we realize their full effects.

*Services.* The most-celebrated example of improving service delivery in Indiana has been the BMV, the Bureau of Motor Vehicles. While this may not seem as flashy as trendier government innovation experiments, the reality is everyone over the age of 16 comes in contact with the BMV – and most forward to going there as much as the dentist. Indiana revolutionized its entire BMV operations, reducing wait times to around or less than eight minutes. Customer satisfaction has been incredibly high ever since.

Overall, satisfaction with government services has continued to increase under the Daniels administration – at the same time the public payroll has been cut to a level not seen since the 1970s. The theory is pretty simple: set aside your ideological stance on what government is for and instead ask questions such as: what do you prefer as a parent of a child in the school system? What would make getting your driver’s license easier? Given that we need health insurance, what kinds of choices would you like to have?
**Opportunity Environment**

The late Jack Kemp once said, “Republicans many times can’t get the words ‘equality of opportunity’ out of their mouths. Their lips do not form that way.” Mitch Daniels, a Republican, is something of an exception to Kemp’s formulation. His lips do form that way. His administration might be considered more in the tradition of the Republican Party of old, whose 1908 platform included “Equality of Opportunity” as a central plank. The Daniels administration might also be remembered by historians as the moment when opportunity came back to Indiana.

Opportunity, as Kemp conceived it, is best understood as having a shot at pursuing and achieving a dream for a better life. The job for policymakers is to clear away barriers and disincentives to doing so. During the worst recession since the Great Depression, the Hoosier State sought to recreate a groundwork for opportunity in a few concrete ways:

**Taxes.** In 2009, Indiana reformed its property tax framework. Taxes were cut by more than 30 percent on average and capped at one percent of assessed value. As the result, the Hoosier State has the lowest property taxes in the nation, estimated at .79 percent of income. This is a critical step in creating a solid quality-of-life environment that is essential to attracting workers and families.

**Broadband.** Expanding broadband access has been critical to increasing economic opportunities. The eighth brief in this series looks at the oft-overlooked Indiana success story that broadband expansion immediately became. About $400 million in new investments followed in less than two years after Indiana’s multi-faceted effort to liberalize the telecom sector. The success prompted a number of states to follow the Hoosier model.

**Education.** This has been mentioned earlier but is worth revisiting in this context. Vouchers are a staple of education reform. They are often considered as the best tool for helping children in failing schools find a better school. In Indiana all students within a specific income range can receive vouchers, not just those in failing schools. This is a central pillar to the Hoosier ideal of opportunity. All students who start behind the starting line of life, not just those within specific schools, get a shot at a better education.

**Infrastructure.** Daniels made national headlines when he decided to lease the Indiana Toll Road to a private firm, which the seventh brief in this series discusses. The lease infused cash into the state’s budget and allowed Indiana to ramp up infrastructure spending as other states were cutting back. The result is a $10 billion infrastructure plan that is directly contributing to Indiana’s rise in a number of respected indexes of the best states for doing business.

Low taxes, rich school options, infrastructure investment and an environment that support high-
tech growth. These are important building blocks in today’s opportunity environment. When we look at the last Census, it’s clear that Americans are moving to parts of the country that have these kinds of building blocks. For governors and state legislatures looking to expand their opportunity culture, the Indiana model is worth a look. Getting taxes, schools, roads and broadband efficiency right is probably more important to creating an opportunity environment than some of the trendier options on order these days.

The Accountable Public Square
Making government accountable to the public has no enemies. Everyone wants to change government to make it more transparent, fairer, more in line with what we meant by “government of, for, and by the people.” This has led to a number of efforts to reinvent government in recent decades.

Reinventing government. It sounds sexy. During the time between Osborne and Gaebler’s 1992 book on the subject to Al Gore’s efforts on the topic as Vice President, reinventing the public sector took on an aura of futuristic possibility. The reason government reinvention frequently never goes anywhere, though, is because actually doing the work is much less sexy. Reinventing government often requires reverting to boring, old-fashioned things such as balancing budgets by cutting spending, shopping around for the best service providers, and refusing to hire people for jobs that aren’t needed today simply because they were needed yesterday.

Indiana took the boring work of public accountability to new, exciting, elevated heights. This non-sexy work of reinventing government was the most important step toward achieving the much sexier-sounding AAA rating, for starters, so it’s worth a look. There are three elements that bear examination by any state hoping to emulate Indiana’s success:

**The OMB Factor.** Prior to 2005, no single entity within the governor’s office oversaw all budgeting throughout the state government. With the creation of the first-ever Office of Management and Budget, the Daniels administration began implementing accountability plans for each agency—and making performance results available to the public. When the office was established in 2005, 62 percent of the agencies were rated unsatisfactory. That figure dropped to 28 percent just three years later. This and related institutional reforms are the subjects of the second and third briefs in this series.

**Impoundment.** This authority, which gives the governor the power to spend less than what the legislature appropriates each year, is a key part of fiscal discipline. It is examined in the fifth brief in this series.
Indiana governors have had the authority for years, but political pressures have typically kept them from using it. Daniels used impoundment authority systematically, building savings into the budget each year. In the first year, impoundment was used to save $222 million, and by 2010, it was used to save $785 million. Customer satisfaction went up during these years.

Balanced Budgets. The OMB, impoundment, and a variety of other measures added up not only to a balanced budget, but also a $1.8 billion surplus following a $700 million deficit in the early years. The essence of balanced budgeting rests in keeping the interests of taxpayers ahead of the other interests governors too frequently prioritize ahead of the citizenry – whether lobbyists on the outside or agency bureaucrats on the inside.

All of this activity has given the Daniels administration the ability to keep agencies in check and share the results of government spending reform with the public. All performance reviews of government agencies are available to taxpayers. Reinventing government in Indiana is essentially the combination of taking practical steps to ensure fiscal discipline and ensuring the entire process is open to the public.

Conclusion: Searching for the Aspirational Edge

One of America’s most under-appreciated dynamic assets is its interstate competition. We are one country with a common language and common culture that has 50 laboratories of democracy, 50 regulatory environments separate from the national regulatory environment, 50 state school systems, 50 state capitals, and 50 economic development agencies issuing marketing material saying why their particular state is the best place to invest in America.

Every day, the United States of America are competing with each other to attract people and businesses. Americans speak the same language with no dialects – however different our accents might be – and buy appliances, groceries, and iPods in stores that look exactly alike no matter where they live. So leaving one state for another is relatively easy to do, personal attachments aside. All of this helps states that figure out how to create the economic opportunity and overall quality of life better than other states. Opportunity and quality of life are key drivers, since people know that they will find Best Buy, Starbucks, and the same brands in grocery stores no matter where they go – not to mention people who speak the same language and watch the same TV shows.

There is no exact comparison to the United States anywhere in the world. The European Union was created to achieve a similar political unity as that enjoyed by Americans. But you cannot move from Copenhagen to Milan as easily as you can move from Minneapolis to Austin.

A state that offers more opportunity and a better quality of life than its neighbors or competitors is what we call an aspirational state. It is a place that makes it easier than elsewhere to pursue the American Dream, to start a business, to give your children a better life than you had. It’s a state that stands out from the rest in the way it embodies the American ideal.

Indiana is turning heads because it seems to be figuring out this aspirational ideal. Other states are as well. Given both the economic downturn from which recovery is a slow road and the continuing crisis of government finances across America, the most aspirational states in the next decade will likely reap the rewards of their reforms faster than in the past – as families and businesses give up on stagnating places for incubators of upward mobility.

The test for public leaders in the next few years comes in how quickly they realize this, and how effectively they can act upon it.
The Aspirational State:
Indiana as a Guide for Reformers

Getting the AAA Rating:
The Indiana Path

Not long after its credit rating had been downgraded twice in two years, Indiana became one of nine states to attain a AAA rating. How did they do it?

Ryan Streeter, Ph.D.*

Policy Brief
Two

Sagamore Institute
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Introduction

One of the most positive effects of the Daniels administration reforms was Indiana's attainment of a AAA credit rating. As one of only nine states nationwide with AAA status, Indiana enjoys an elevated position among rivals as a place businesses feel welcome and taxpayers free of the burden they carry in less fiscally sound states.

Before taking a look at the policies and procedures that helped pave Indiana's path to its AAA rating, two things are worth understanding: first, why a high credit rating is important, and second, how the rating agencies go about determining a state's overall credit rating.

A higher credit rating is important for several reasons. First, it indicates a strong and diversified economic profile. Second, it allows a state and its municipal governments to borrow money at a lower interest rate, which in turn translates to a stronger debt profile and a more manageable liability structure. Third, and arguably the most important, it helps market to outside enterprises the value of operating in a state because the rating is a signal of predictability and stability.

The main ratings agencies, Fitch, Moody’s and Standard and Poor’s, have a specific methodology in determining state credit ratings. From a bird's eye view, these agencies assign credit ratings to states based on the following factors: government framework, financial management, economy, budgetary performance, and debt and liability profile. Each of these factors is comprised of several metrics that determine strength or weakness. The agencies score these factors on a scale from 1 (strongest) to 4 (weakest) then combine and average the scores with equal weighting to arrive at an overall score.

Governor Daniels’ portfolio of reforms combined to address these rating criteria in a way that ultimately led to a strong AAA credit rating.

Indiana before the Daniels Administration

When Governor Daniels took office in 2005, Indiana was bankrupt. Spending was out of control and the government was spending hundreds of millions of dollars more on an annual basis than the state took in from tax collections. Debt exceeded cash balances by over $200 million, and the state was forcibly borrowing from other units of government and raiding pension funds to fund discretionary spending (for instance, the state government borrowed over $750 million from schools, local municipalities, and universities). Indiana also had had seven consecutive years of unbalanced budgets resulting in a budget that was $700 million out of balance in the 2004 fiscal year and spending grew by nearly 6 percent per year—well in excess of revenue growth.

The result? Indiana's credit rating was lowered twice between 2002 and 2004. Overall, Indiana's economy was in decline, businesses were moving out instead of in, and the economic base lacked diversity given its overly-high concentration in manufacturing.

Clarity and Accountability

Like many other states, Indiana was beset with outdated and multiple budgeting systems. Without a singular “dashboard” with which a governor can look at a state's financial situation, governing itself is a challenge. For this reason, Governor Daniels created the Indiana State Office of Management.
and Budget (OMB) at the outset. OMB provided common management of seven previously separate finance departments. Daniels created the Government Efficiency division within the OMB that was charged with setting clear performance standards and employing techniques to hold agencies fiscally accountable. He also consolidated Indiana’s multiple debt-issuing agencies into the Indiana Finance Authority. The creation and successful management of these new and improved agencies and departments helped to streamline the government, improve efficiency, create standards and performance benchmarks, and increase accountability for improving Indiana’s economic situation. It would have been nearly impossible for Daniels to achieve the savings and budget reductions for which he is now well-known without the creation of OMB.

**Governor Daniels’ 4 Step Plan**

When Governor Daniels took office, he knew he had to get the house in order and restore Indiana’s economy. To achieve this, he came up with a four step plan—1) balance the budget, 2) pay back debts, 3) build net worth, 4) cut taxes. All evidence suggests that this simple and effective plan worked.

**Balance the Budget**

When recurring revenues exceed recurring expenses, you have a balanced budget. If revenues decline, recurring spending must be cut as well. When Daniels took office in 2005, Indiana was nowhere close to budget balance. It was clear from the beginning that Indiana needed to cut spending to achieve a balanced budget.

[Figure 1: Indiana Government Per Capita Expenditures, 2004-2011. Indiana Office of Management and Budget.]

Daniels achieved spending cuts in several ways. First, he dramatically reduced workforce costs. The main factor in reduced workforce costs was an employee headcount reduction. This was not primarily achieved through retirements, but through consolidation of depart-

It would have been nearly impossible for Daniels to achieve the savings and budget reductions for which he is now well-known without the creation of OMB.
ments and an intense process of scrutinizing every new open position. Indiana achieved a 16 percent workforce reduction, taking the public employee head count back to levels not seen since the late 1970s, all while performance state agencies increased. Indiana currently has the fewest number of state employees per capita in the U.S.

In addition to reducing headcounts, Daniels also revoked the collective bargaining agreements for Indiana state employees and cancelled settlement agreements for approximately 25,000 state workers. Ending or modifying collective bargaining powers – by which state workers to negotiate pay, benefits, work rules, layoffs and other matters – is a contentious affair, as we have seen in 2011 in the highly publicized cases of Wisconsin and Ohio. In Indiana collective bargaining for government workers had been established by executive order, so Daniels was able to end it without the protracted legislative battles seen elsewhere. With collective bargaining a thing of the past, the Daniels team had more flexibility to reform the government and further reduce workforce costs

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Source: National Association of State Budget Officials Semi-Annual Surveys

The second major step to balancing the budget was Daniels’ use of impoundment powers—the power to spend less than what the legislature appropriates. This is sometimes referred to “allotment” authority. This is an important tool that allowed Daniels to cut costs administratively instead of having to spend every dollar that the legislature appropriated. Agencies generally receive appropriations based on what they received the year before. In order to maximize the amount of money they receive, these agencies will generally spend the entire amount for fear of receiving a reduced appropriation the following year. By using the allotment powers, Daniels could dispense only portions of appropriations and could withhold greater percentages of funds from agencies not meeting performance and efficiency criteria. Revenue can deviate significantly from what was assumed when the budget passed and there

Impoundment authority is the power of an executive “to zero out some of the spending pile that a legislature dumps on the front lawn. It is executive pushback against wretched legislative excess.”

– Daniel Henninger, Wall Street Journal
Pay Back Debts

Once Daniels was able to get the budget in balance, the next step was to pay back debts as quickly as possible. As mentioned earlier, before he took office, Indiana’s debt exceeded cash balances by over $200 million. Repaying these debts—which had included pension fund raids, delayed payments, deferred interest payments and other loopholes where liabilities were pushed into the future to make room for current spending—strengthened the overall economy and put Indiana in a better position to keep the budget in balance. Since 2004, the 49 other states in America increased their debt levels by an average of 40 percent. Indiana paid down its debt by 40 percent.

Build Net Worth

Once the budget was balanced and most of Indiana’s debts were repaid, Daniels started to build up reserves. He did this primarily by applying a straightforward principle that too many states ignore: set savings targets during the good times. Before the recession, the Daniels administration set savings targets for each agency each year. This not only injects a needed bit of fiscal discipline into state budgeting, it also helps build reserves. Reserves are important because they allow a state to prepare for economic downturns or other events that reduce revenue. Cash reserves grew from a negative balance to approximately $1.4 billion from 2004 – 2009.
Cut Taxes

Once the budget had been balanced, debts had been repaid, and reserves had been established, Daniels next step was to return money back to tax payers. Daniels took an aggressive approach to cutting taxes that stimulated the economy and put more money in Hoosier's pockets. He implemented the largest tax cut in state history, the bulk of which came from property tax reductions. Property taxes were cut by approximately $600 million in 2010, making the Hoosier State's property taxes the lowest in the United States. In addition to this tax cut, Daniels implemented another $375 million in business tax cuts leading to more small businesses and an increase in jobs.

A final step in Daniels' tax cut plan was his proposal for an automatic taxpayer refund. The main idea behind this plan is that if sound fiscal management produces “savings,” taxpayers should realize some of those savings themselves rather than just letting them accumulate for
future government use. The Daniels plan proposes that once Indiana’s reserves reach 10 percent of appropriations, the tax refund kicks in and allows Hoosier families to claim their share of the surplus through a refundable tax credit.

There are several advantages to this plan. First, it eliminates the temptation to spend excess reserves; second, it gives legislators incentive to restrict excessive spending so that their constituents get a refund; and third, it puts more money in taxpayers’ pockets. Currently, the refund has not been enacted.

Indiana, Post-Reform

Taken together, these reforms paint a picture of health. Daniels’ four-step plan helped get Indiana back on a fiscally sound economic course. The state is no longer bankrupt. The budget was structurally balanced for four consecutive years prior to the great recession. Debts to other units are fully repaid and the state debt has been reduced by 40 percent. There were established reserves in excess of $1.4 billion dollars before the recession, and reserves remained strong in fiscal year 2010 at over $800 million. Hoosiers are paying the lowest property taxes in the United States. The fiscal year 2012 structural deficit is the lowest in the United States at 2 percent. Daniels was able to navigate the national recession without a tax increase while maintaining this strong level of reserves. The ratings agency applied their methodology discussed above and found marked improvements in several of the major categories due to the policies discussed throughout this paper. Daniels hard work, aggressive fiscal policies, and common sense strategy resulted in Indiana’s credit rating being upgraded three times since June 2005 and receiving its first AAA credit rating in history in July 2008. Indiana is currently only one of nine states with a AAA rating.

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The fiscal crisis too many states are experiencing boils down to the inability to keep budgets in balance, despite the fact that states are constitutionally required to do so. How did Indiana pull it off?

Ryan Streeter, Ph.D. with Jason Simons

Policy Brief
Three

Sagamore Institute
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This study was made possible through the generous support of The Lynde and Harry Bradley Foundation.
Balanced budgets made a lot of news in 2011 – as a topic of debate in Washington. The issue of balanced budgeting generally makes fewer headlines as a state issue, even though it is state finances are affected by it directly. Many states are required to balance budgets but manage to find ways not to – by stretching what is acceptable within legal boundaries.

Indiana was no different. Through accounting gimmicks, administrations before the Mitch Daniels era found ways to punt certain bills into the future so that the state’s budget would appear sound in any given fiscal year. In reality the state was effectively bankrupt by 2004. Six years later, Indiana had become the poster child for fiscal sobriety and discipline, and Governor Daniels has been credited more than once nationally for his commitment to getting tough on budgets and spending back when times were good. States that waited until a recession forced fiscal discipline upon them have been learning what an unhappy choice they actually made.

The Daniels administration in Indiana utilized authorities that are, in one way or another, generally available to other states. Whether a state’s budget is balanced or out of whack is almost always a story of political will, leadership, and discipline – or their opposites. Critical to Daniels’ success in Indiana was an understanding of how to combine new forms of oversight and accountability with existing authorities for controlling costs. Each of these elements is described below. First, though, it helps to understand the budgeting environment in Indiana.

**The Indiana Budget Process**

Indiana’s budget process is pretty straightforward. The Indiana State Budget is biennial with appropriations made for a two-year period. The State Budget Agency and the Budget Committee, which is composed of four legislators—one Republican and one Democrat from each House—and the Director of the State Budget Agency, work together to conduct hearings, develop a revenue forecast, and an itemized budget report and initial budget proposal. The committee sends the budget report and budget to the governor, who revises the report and budget to meet his policy objectives and delivers a final report and a proposed budget to the legislature. Both the House and Senate conduct hearings, submit the budget to a full vote, and then resolve differences in a conference committee. Once the bill has passed both houses, it goes to the governor for signature. Indiana’s governor is one of only six governors nationwide who do not have line-item veto authority and must sign the bill in the form it was passed by the legislature.¹

**The Balanced Budget Canard: Houdini as Accountant**

State governments are supposedly oriented by a primary overarching objective: developing structurally balanced budgets. When you have recurring revenues exceeding recurring expenditures, your budget is balanced. When revenues match expenditures but come from one-time sources or borrowed funds, the budget is not really balanced because costs are deferred into the future.

Many Houdini-like appropriators in states across the land have mastered the art of hiding or moving funds illusorily through a variety of techniques. For example, many states have heavily relied on stimulus funds in recent years to subsidize declining revenues and maintain preexisting levels of services (and, as a result, expenditures) and have passed balanced budgets. Of course, when stimulus funds are exhausted, these states are forced to confront fiscal environments in which expenditures suddenly outpace revenues and drive the state toward increased borrowing. Indiana was no different than the next state.
Governor Daniels put reforms into place before stimulus funds became available and instructed state federal agencies to use stimulus funds sparingly, increase the efficiency and accountability of state agencies, and reduce expenditures without dramatically reducing the quality of state services. As a result, Indiana has once again implemented structurally balanced budgets, shed its negative cash balance, developed healthy cash reserves, and earned a AAA credit rating.

He managed to balance a budget and run a surplus during the greatest financial downturn since the Great Depression. How did he do it? He used five main tools that aren’t sexy and whose implementation wouldn’t necessarily make a good movie, but they have been critical to improving the material condition of a U.S. state.

**Tools for Creating a Structurally Balanced Budget**

Since most states are required by their own constitutions or statutes to pass balanced budgets, they manage to motor along fairly well when revenues are steady or increasing from year-to-year. But balanced budgeting can become exponentially harder overnight when revenues drop sharply as they did in the most recent recession.

It is for this reason that Mitch Daniels has struck so many observers as an intriguing counter-example to how most states entered the recession. Somehow, he managed to balance a budget and run a surplus during the greatest financial downturn since the Great Depression. How did he do it? He used five main tools that aren’t sexy and whose implementation wouldn’t necessarily make a good movie, but they have been critical to improving the material condition of a U.S. state.

**Creating the Office of Management and Budget (OMB)**

Governor Daniels’ creation of the Indiana State Office of Management and Budget (OMB) in January 2005 was perhaps the single most important step in restoring Indiana’s fiscal health. Prior to its creation, the state had no system for measuring government performance.\(^2\) Government – as is the case in many other states – just kind of “happened” with relatively undisciplined oversight of budgetary and fiscal matters.

Governor Daniels charged the new agency with increasing accountability and improving government performance while bringing balance to the state budget. To accomplish these tasks, he created a Government Efficiency division by setting clear performance standards and employing techniques to hold agencies accountable.\(^3\) The division has significantly increased the availability of performance information available to decision-makers and has also made that information readily available to the public through the Performance Measure Dashboard,\(^4\) which displays key performance measures for each agency. When the system was established in 2005, 62 percent of results were rated unsatisfactory and 16 percent superior. By August 2008, unsatisfactory measures had dropped to 28 percent and superior measures had risen to 45 percent.\(^5\)

When the system was established in 2005, 62 percent of results were rated unsatisfactory and 16 percent superior. By August 2008, unsatisfactory measures had dropped to 28 percent and superior measures had risen to 45 percent.
Additionally, Governor Daniels created the Indiana Finance Authority, also housed within the OMB, to combine multiple debt issuing authorities into a single agency in order to ensure that Indiana didn’t use borrowing to avoid difficult budget decisions. This division has significantly contributed to the development of structurally balanced budgets by equipping decision-makers with key information concerning the financial impact of certain decisions.

Reducing Workforce Costs

Governor Daniels has overseen a 16 percent reduction in the number of state employees, a return to employment levels not seen since the late 1970s. During the same time that state employee rolls were dropping, customer satisfaction with government services increased. So much for the theory that larger government is a necessary precondition for the happiness of the people.

How did the Daniels administration achieve its workforce reductions? By prioritizing a pay-per-performance bonus system, slowing hiring through prioritization rather than a hiring freeze, and revoking or declining to renew collective bargaining for government workers.

On his first day in office, Governor Daniels terminated an existing executive order that gave public employee unions collective bargaining rights, the benefits of which were twofold: it reduced the political pressures that often stagnate state governments and allowed him to create incentives to reward employee performance. He implemented a pay-for-performance system, with bonuses ranging between four and ten percent, to reward employees for achieving hard-dollar savings, meeting or exceeding explicit agency goals, and/or improving customer service in place of the common public sector practice of across-the-board raises. And perhaps most importantly, he created a strategic hiring committee to prioritize new positions for hir...
Agencies are required to provide evidence that each new hire is critical to advancing their mission. When you as a government agency know that you will have to justify each new hire to the Governor’s office, it’s amazing how judicious you become. You begin to think about new hires more like small business owner would. As a result of this process, Indiana’s government was able to control overall hiring levels without implementing a hiring freeze.

**Competitive Contracts**

Competitive sourcing is not a new concept. But using it effectively is still a rarity. Governor Daniels directed agencies to review existing contracts and create new contracts in a way that both reduces costs and provides better quality for the citizens of Indiana. Over the past twenty years, many public officials have used competitive bids with the aim of lowering costs, often looking for just a few big wins to demonstrate their commitment to “innovation.” In Indiana, competition has become the modus operandi of the state government and is used in even the most mundane, “non-sexy” aspects of government. The Daniels administration consolidated the systems of major welfare programs in 2007 to the tune of $10 million savings annually and realized $29 million in savings by re-negotiating the state’s Medicaid systems, but it also saved $1.6 million by privatizing its mail and document delivery system the same year. The list of small-item savings goes on and on. Taken together, the long list of savings through competition has played a big role in the larger story of Daniels’ success as a cost-cutter.

**Impoundment Authority**

The State Budget Agency and the OMB dispense appropriations to agencies periodically throughout the year according, allowing them to control expenditures. The governor has the authority to dispense less than the amount appropriated to agencies. This tool is useful when revenues are less than projected, but it is especially useful for a governor who is serious about trimming government where it has gotten too big – a governor like Mitch Daniels. Daniels has used impoundment authority to shrink agency budgets from one year to the next, correcting years of swelling budgets that benefited government objectives more than the public’s. For more information, see the brief in this series, “You Don’t Have to Spend It All.”

**Consolidate Information Technology Services**

Indiana consolidated information technology (IT) departments in different agencies into a single IT agency. This agency has been highly effective and has focused on improving IT capabilities of the state government and has also sought to reduce staffing burdens for certain services by providing self-service options for certain services. The most notable example of this is the Bureau of Motor Vehicles, which has received national media attention. By allowing customers to access a number of services online, such as renewing their drivers licenses and license plates among other things, the average wait time was reduced from more than 40 minutes to 28 minutes in 2006, to about 12 minutes in 2007, to 8:54 minutes (to be exact) in 2008 – and single-digit wait times have held steady since then.9 As a result, customer satisfaction rose to 97 percent in 2008, an increase of 20 percent since 2005.10 Together with the new
performance culture that OMB created across government, IT consolidation can go a long way to improving both service quality and satisfaction.

The Benefits of Balanced Budgeting

For those who find the subject of balanced budgeting “ideological” or too extreme for how the real world works, consider how getting finances under control has worked in Indiana:

- Per capita state spending declined by approximately 8 percent as of August 2009. As one might recall, this was in the thick of the economic downturn.
- Indiana’s debt was paid off in Governor Daniels’ first term. Indiana has now enjoyed five straight years of positive cash balances, reaching a high point of $1.3 billion in cash reserves and rainy day funds with no debts to other units of government.
- Indiana has gone from the verge of bankruptcy to having five percent of its budget in cash reserves by the end of 2011.
- The size of state government has decreased by more than 10 percent.
- Indiana’s credit rating was upgraded to AAA, the highest rating, and is only one of nine states to have earned such a rating.
- Though the use of the impoundment authority, the state has saved $2.672 billion. About $2 billion of these reversions occurred in the 2009-2011 budget cycles as America (and Indiana) struggled through the after-effects of a brutal recession.
- The $759.7 million in anticipated reversions in fiscal year 2011 were parlayed into reduced appropriations by about the same amount in the governor’s recommended 2011-2013 budget.

Any state would love to enjoy numbers such as these. But these benefits are not free. They take leadership, discipline, and a willingness to confront so-called indispensable interests with a harder truth: what is indispensable to some is clearly dispensable for the sake of the general public. This all requires courage and an unbending commitment to fiscal sobriety. Those public leaders who figure this out will enjoy a competitive advantage in the public square.
Endnotes


3. Christopher Ruhl, “Indiana’s Path to Fiscal Prosperity,”


5. Indiana State Performance Report, Volume IV No. 1, August 2008

6. Ibid.


10. Ibid.
Health Care As If Consumers Mattered: The Indiana Health Care Reform Model

Health Savings Accounts and consumer-directed insurance programs have been on the rise since 2003, but not too many states have made them the centerpiece of public sector health care reform. Why did Indiana choose to do so, and how did the Hoosier State do it?

Ryan Streeter, Ph.D. with Jason Simons

Policy Brief
Four

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“In Indiana we have chosen a path that respects the right of our people to make their own health care choices, and trusts their ability to do so. We have pursued policies that restore the true concept of insurance to the health marketplace, and in the process have restored a measure of the consumerism that presses for quality and cost control in every other economic area.”

– Governor Mitch Daniels, Keeping the Republic: Saving America by Trusting Americans

**Health Care that Puts Consumers in the Driver’s Seat**

As any policymaker or public executive in America knows, rising health care costs present a serious threat to both private businesses and public finances. Costs are rising in large part because of the flawed incentives at various levels within the health care system. One way to change incentives is to make consumer choices central to health care resource allocation – much in the same way that consumers choose their auto insurance and care for their cars: we all know how much an oil change costs and don’t expect our auto insurance to pay for it. Reworking health insurance to recreate this dynamic is one important step toward successful health care reform.

Governor Daniels advocated for just this kind of reform during his first term. He argued that Indiana needed a system that included a consumer-directed health insurance option, based upon a Health Savings Account (HSA). HSA plans combine higher-deductible insurance coverage with pre-tax deposits into a savings account, which participants use to cover routine medical expenses. Unused savings balances can be carried forward from year to year.

The consumer-directed health care reforms that followed consisted of two important parts: a plan for state employees and a plan for lower-income families. Daniels secured support for the state workers plan first, and it was first implemented in 2007.

Conventional wisdom among skeptics of consumer-driven health plans holds that people generally won’t like the plans or shouldn’t have to bear the burden of greater choice in the health system. In Indiana a simple reading of the facts challenges this view. The Indiana plan grew in popularity among state employees so significantly that its framework became the basis for the Healthy Indiana Plan (HIP) – the program that extends health coverage to lower-income residents who earn too much to qualify for Medicaid. In the first two years of the program, 45,000 lower-income Hoosiers gained access to healthcare coverage, many for the first time, with another 49,000 added to the waiting list. As a result of the program’s popularity, effectiveness, and affordability, particularly in the face of unpopular healthcare reform measures at the federal level, the program caught the attention of national media outlets and policy think tanks. Its future, however, is very much tied to the Affordable Care Act, which threatens to shut it down unless additional reforms are made at the federal level.

By 2010, over 70 percent of the 30,000 state employees in Indiana had opted into the plan, and by 2011, the figure had grown to 85 percent.

**How Indiana’s Health Care Plan Works**

Governor Daniels began initial healthcare reform efforts by offering HSAs to state employees. No pressure was applied to employees to sign up for the new plans. They could opt into the plan if they desired, but they were not required to do so. If they chose not to join the new program, they were able to keep the same level of coverage that they had previously at the same rate. In the first year of the program, only 4 percent of employees opted into the plan.

But it didn’t take long for word of the program’s benefits to get around. By 2010, over 70 percent of the 30,000 state employees in Indiana had opted into the plan, and by 2011, the figure had grown to 85 percent. Moreover, only about 3 percent of the employees who have opted into the plan have gone back to
the PPO plan. Under the HSA plan for Indiana state employees, the state deposits $2,250 annually in a private HSA account that the employee uses to cover medical costs up to their insurance plan deductible. Any unspent money at the end of the year become the permanent property of employees. In the rare case where the employee uses the entire balance of the account, as with any HSA plan, the high deductible insurance plan coverage kicks in.

In 2007, Governor Daniels worked to build support for expansion of HSA options to lower-income Hoosiers through the Healthy Indiana Plan (HIP). The plan was built in a bipartisan manner—Governor Daniels worked closely with state senator Patricia Miller, a Republican, and state representative Charlie Brown, a Democrat, to develop a fiscally-responsible plan that would attract bipartisan support.

The plan was implemented with three core principles in mind: individual control of health-care spending, protection for taxpayers with the stipulation that enrollment couldn’t grow faster than available funding, and disease prevention by incentivizing preventative care.

Much like the HSA option for state employees, HIP utilizes a HSA account, called a Personal Wellness and Responsibility (POWER) Account to residents who earn between 19 and 200 percent of the federal poverty line and are accepted into the program. If able, enrollees must make a monthly deposit into their Power account on a sliding scale of two to five percent of their gross income. The state also pays into the account and adds catastrophic coverage as well as zero-deductibility for preventative services, so enrollees can take advantage of preventative care at no cost. The plan also increases the number of children and pregnant women eligible for Medicaid, creates an insurance pool for small businesses, and provides tax incentives for employers who offer health care insurance.

HIP has grown steadily and rapidly. It grew to over 45,000 enrollees by the end of 2009, two years after the program began. Six months later, HIP had enrolled more than 61,000 adults, with another 51,000 applicants on the non-caretaker waiting list, and by the end of 2010, enrollees had grown to more than 77,000 and the wait list had expanded to more than 55,000. Approximately 70 percent of enrollees’ incomes were at or below the federal poverty level. Additionally, in the first two years of the program, only 26 percent of those ever enrolled left the program. Taken together, these figures represent nothing less than a cultural shift in how lower-income individuals and families access health care

**How Do You Pay for This?**

HIP is partly funded by a 44-cent increase in the cigarette sales tax, contributions from eligible participants in the program, and federal funding. The program received a Medicaid 1115 waiver, an exemption granted by the U.S. Department of Health and Human Services that allows states to test “substantially new ideas of policy merit,” in the hopes of increasing the overall quality of the Medicaid program. The waiver allows Indiana to implement HIP while continuing to receive federal Medicaid funding. Individual contributions to POWER accounts also plays an important role as individuals contribute up to $1,100 to their accounts. Individuals with incomes less than 200 percent of the poverty threshold may purchase coverage based on a sliding scale of two to five percent of their adjusted gross income, with the balance between their contributions and the $1,100 annual savings threshold subsidized by the state. As of December 2010, 79 percent of all program participants made contributions to their Power accounts.
Mercer, an independent health-care consulting firm, has estimated that state’s costs are being reduced by 11 percent solely due to the HSA option. In 2010 alone, Indiana will save at least $20 million because of HSA enrollment. Has It Worked?
The HSA option to state employees has increased savings for employees and the state. Mercer, an independent health-care consulting firm, has estimated that state’s costs are being reduced by 11 percent solely due to the HSA option. In 2010 alone, Indiana will save at least $20 million because of HSA enrollment. Moreover, state employees who have opted into the HSA plan saved $8 million more on healthcare-related expenses than their counterparts with traditional PPO plans. Thus, the state system benefits state employees and taxpayers alike.

HSA options in Indiana have dramatically reduced health care costs to the system by increasing access to preventive care and reducing the number of times enrollees access high-cost health care options. Hoosiers in HSA plans are actually more likely than those in other plans to use preventative care measures like mammograms, wellness visits, and prenatal care. According to Governor Daniels, in 2009, state workers with HSA plans visited emergency rooms 67 percent less frequently than other state employees, were much more likely to use generic prescription drugs—saving $18 per prescription on average, and were admitted to hospital about 50 percent less frequently than other employees.

These changing patterns of behavior have led to significantly reduced costs on a per-person basis. Enrollees, on average, incurred only $65 of health care costs for every $100 incurred by state employees on PPO plans. All of these figures point to one important thing—consumer-directed health care changes behavior concerning healthcare in favor of more economical, cost-effective solutions. Creating cost-conscious consumers will be the most important feature of any healthcare policy reform going forward in order for states to contain costs while expanding coverage. As such, HIP provides potentially promising policy alternatives for effective healthcare reform in the future.

Uncertain Future: The Feds Threaten to Kill State-Based Innovation
The federal health care reform bill, if it can ever clear legal hurdles, threatens to end the Healthy Indiana Plan. The original agreement the state negotiated with the Department of Health and Human Services to provide alternative options to Medicaid participants expires in 2012, and the threat of the deal not being renewed given the Obama administration’s priorities. However, the Indiana model remains a compelling model for continued reform at the federal level, and if the administration chooses to support rather than stifle continued state-level innovation, the model is ripe for replication in other states.
Endnotes


2. Ibid.


4. Ibid.

5. Ibid.


9. Ibid.


13. Ibid.
You Don't Have to Spend it All: How to Use Impoundment to Keep State Spending Down

One of the most effective tools for controlling spending is the authority NOT to spend everything the legislature appropriates. If a governor has such authority, it becomes a matter of the courage to use it.

Ryan Streeter, Ph.D. with Jason Simons

Policy Brief
Five

Sagamore Institute
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In an op-ed in January 2011, Wall Street Journal columnist Daniel Henninger cited Governor Daniels’ use of what some consider an arcane authority: impoundment. Impoundment authority, as Henninger puts is, is the “power of a president or governor to zero out some of the spending pile that a legislature dumps on the front lawn. It is executive pushback against wretched legislative excess. He says 43 governors have such authority, though many don’t use it all that aggressively. Strangely, not that many people have heard of it – which is doubly odd given how much support it has enjoyed throughout history. Henninger writes:

Here is a list of U.S. presidents and public figures who have used or supported the impoundment power:
Abe Lincoln, Franklin Roosevelt, Harry Truman, JFK, LBJ, Bill Clinton, the Bushes, John McCain, John Kerry, Al Gore, Pat Buchanan, Jeb Hensarling, Russ Feingold, Joe Lieberman, Judd Gregg, and not least both Paul Ryan, the new House Budget chairman, and Barack Obama.¹

As Governor of Indiana, Mitch Daniels could be added to the list. Not only has he supported the idea of using impoundment authority, he has used it: to the tune of $2 billion in spending cuts in Indiana’s 2009-2011 budget cycles.

What is Impoundment?
One of the most important tools a governor can use to control spending is the authority to impound state funds instead of spending them as directed by the legislature. Unlike the line-item veto, which a governor would use to make changes to the budget itself before signing it, “impoundment authority” equips fiscal reformers with the ability to adjust spending after the budget has been signed into law. The only thing stopping a governor who possesses this authority from using it is political pressure not to do so. Political pressure, as expected, often wins out.

But not in the case of Indiana Governor Mitch Daniels. He has used the authority as a major lever in his overall effort to lift Indiana onto to strong fiscal ground.

Section 30 of the 2009 Indiana state budget bill, HEA 1001, authorized the budget agency, with the approval of the governor, to “withhold allotments of any or all appropriations contained in this act for the 2009-2011 biennium, if it is considered necessary to do so in order to prevent a deficit financial situation.”²

The only thing stopping a governor who possesses this authority from using it is political pressure not to do so. Political pressure, as expected, often wins out.

Previous Impoundment Use
Though Daniels has been criticized for his use of this power, the authority did not originate with his administration, nor is it his administration the first to use it. The late Governor Frank O’Bannon, in fact, used this tool to slash state spending when revenues dropped during his second term.³ The same provision that authorizes the Daniels administration to use impoundment authority has appeared in biennial budget bills since before the beginning of Governor Daniels’ first term.⁴

How Governor Daniels Uses Impoundment Authority
Daniels’ creation of the Indiana State Office of Management and Budget (OMB), which was cast in the image of its namesake at the federal level. Governor Daniels served as OMB Director in the George W. Bush White House where he famously earned the nickname “The Blade” for his penchant for cost-cutting. Creating OMB in Indiana brought blade-like sharpness to the state’s budget processes and was perhaps the single
most important step in restoring Indiana’s fiscal health. Governor Daniels charged OMB with three primary tasks: increasing accountability, improving government performance, and bringing balance to the state budget. To help OMB accomplish these objectives, he created a Government Efficiency division that set clear performance standards and employed processes to hold agencies accountable. Additionally, he created the Indiana Finance Authority within OMB to combine multiple debt issuing authorities into a single agency in order to ensure that Indiana didn’t fall prey to that perennial sin that afflicts states across the land: borrowing to avoid difficult budget decisions.

Information generated by these divisions and the OMB as a whole has allowed Governor Daniels make critical use of impoundment authority and withhold funds from agencies as needed.

Figure 1: Annual Differences Between Appropriations from Expenditures in millions

Once the biennial budget bill is signed into law, the State Budget Agency creates allotments to agencies. OMB works with the agency at this point to limit the funds in accordance with the impoundment decisions the governor makes.

Figure 1 shows how Daniels has kept expenditures below the amounts signed into law every year since taking office. In a nation that has grown accustomed to Washington, DC, spending more than it appropriates each year, Figure 1 is an odd-looking chart indeed.

Why Impoundment Matters
Anyone paying attention to the tortuous budget debates in Washington or watching their own states wrangle with special interests’ influence on state budgets knows that budgeting taxpayer dollars is fraught with defects. At a basic level, incentives for lawmakers are flawed, and options for checking their behavior are limited. Impoundment authority is designed to help on both of these fronts.

One of the big problems at the federal and state level is that legislatures budget the public’s money without creating sufficient incentives for agencies to reduce costs and increase their efficiency. Most ap-
appropriation considerations by the legislature begin with the appropriation figure the agency received the year before. Agencies, which seek to maximize the appropriations they receive each year, will always attempt to spend the entire amount out of fear of having their appropriation reduced the next year. As a result, it is difficult to reduce expenditures. Rather, they tend to increase every year even as revenues decline. Impoundment authority helps correct this disincentive. By giving the governor the authority to dispense only portions of appropriations, he can use performance and efficiency criteria as grounds for funding, thereby creating the incentive for agencies to eliminate waste, prioritize performance, and be more diligent about customer satisfaction.

Impoundment authority gives a governor a stronger tool for checking appropriators’ discretion than traditional veto powers. Veto authority is usually an all-or-nothing affair, even in its line-item varieties: a governor either signs a bill into law as passed in the legislature or strikes out funding for some item entirely. Pressure to maintain funding for priorities is a strong check on a governor’s veto, which is typically why the power is used so rarely. In addition, there exist few checks on a legislature’s habit of spending as much as it can where it can. There is little incentive to generate a surplus by forcing efficiency into public systems, especially when the perceived importance of a public priority is itself a reason not to use veto powers. The threat of impoundment powers, on the other hand, changes the conversation with the legislature. Appropriators understand that political pressure is more about how much to fund a priority rather than whether to fund it. With a governor as willing as Daniels to use impoundment powers, legislators are forced to think through funding levels with more discipline. So long as a governor can make a case that there is waste and inefficiency in the system – something that is usually pretty easy to do for those willing to honestly examine public expenditures – appropriators cannot as effectively use political pressure to keep funding levels high.

Revenues can deviate significantly from projections when the budget was passed. As tax receipts come in, significant revenue shortfalls might occur. The Indiana General Assembly, like many state legislatures, is a part-time legislature and does not meet year-round, rendering it incapable of responding to crises while it is not in session. A governor needs to be able to use impoundment authority to adjust expenditures the budget realities of the moment.

**How Big is the Impact of Impoundment Authority?**

Impoundment authority is projected to have reduced expenditures by $2.672 billion during the period between when Governor Daniels first took office and the end of the 2011 fiscal year. Governor Daniels has used impoundment authority throughout his administration, and he has had to rely on it as an increasingly important tool since the recession hit. As a result of the recession, actual tax revenues fell below projected revenues in the budget. While some of the shortfall was subsidized by stimulus funds from the federal government, the bulk of the shortfall was made up for through impoundment.

Figure 2 shows the budget savings through impoundment since Daniels took office. It is important to note that the total impoundment figures reflect real cuts in government spending and do not include reversions from any federal stimulus funds the state received. The savings from the 2010-11 fiscal year reversions have been institutionalized and are carried forward in the recommended budget prepared by the
Daniels administration for the 2012-13 fiscal years. The reduced expenditure levels essentially match the actual expenditure levels in the 2010-11 fiscal year (projected to be $759.7 million).

This brings us to a final point about the importance of impoundment: it can be used as a tool to shrink the size of government. In Indiana’s case the $700-800 million in annual cuts made through reversions will not be added back into the next proposed budget. Through impoundment, the starting point for agencies has gotten smaller. These savings have been institutionalized, have led to reduced expenditure levels that approach mid-2000s expenditure levels, and are likely to carry on beyond the end of the Daniels’ administration. Without question, impoundment authority has played a critical role in restoring Indiana’s fiscal health.

**Figure 2: Annual Reversions from impoundment (in $millions)**

Impoundment can be used as a tool to shrink the size of government. In Indiana’s case the $700-800 million in annual cuts made through reversions will not be added back into the next proposed budget.
Endnotes


5. Christopher Ruhl, “Indiana’s Path to Fiscal Prosperity.”

6. Ibid.
The Aspirational State: Indiana as a Guide for Reformers

Indiana As America’s Leading Education Reform State

Not long ago, no one thought of Indiana as a national leader in education reform. Now, the state is heralded by many as the best example in America of expansive, full-spectrum education reform. What sets the Indiana model apart?

Ryan Streeter, Ph.D. with Jason Simons

Policy Brief
Six

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This study was made possible through the generous support of The Lynde and Harry Bradley Foundation.
When people think of education reform in America, their minds quickly turn to Florida. Former Governor Jeb Bush campaigned in 1998 on a wide-ranging set of reforms to education in the Sunshine State, and he went to work implementing them as soon as he entered office. The higher accountability standards, greater parental choice, and teacher performance standards have paid off: in 1998, 53 percent of Florida’s fourth-graders were reading at a basic or better level, and by 2009 that figure had risen to 73 percent. The state’s Hispanic students have the second-highest reading scores in the nation, and their African-American students rank fourth – quite an achievement for such a large and diverse state.

Florida’s success implementing its reform agenda has influenced states across America. For instance, Ohio’s lawmakers used Florida as a model for incremental reforms in the Buckeye State during the 2011 legislative session.1

Jeb Bush’s reform agenda also served as a model for Indiana Governor Mitch Daniels. And after six years of working up an education agenda of his own, Daniels pushed a reform package through the Indiana legislature in 2011 that surpassed even Florida’s model in its boldness and scope.

Indiana’s reforms are similar in many respects to Florida’s focus on accountability, high standards, school choice, and teacher performance. But they institutionalize choice more broadly for families than is the case in Florida, and their key metric for schools, like Florida’s, is classroom-level performance – but in a way that goes a bit beyond Florida’s model.

For these reasons, many are heralding Indiana’s reforms as the new vanguard. As time progresses, analysts will be able to see whether and how student outcomes improve in Indiana compared to Florida, which will be the true measure of success.

Like any choice-oriented reform, the Indiana model makes vouchers a central component, but they represent only one essential element among several.

### Objective Number One: Give Families as Much Choice as Possible

Like any choice-oriented reform, the Indiana model makes vouchers a central component, but they represent only one essential element among several. The Indiana approach conceives choice rather broadly. Specifically, the Indiana model of choice is comprised of the following elements:

- **No more geographical boundaries.** In 2010, the state made it possible for students to transfer from one public school district to another freely and without tuition fees. This set the stage for further reforms aimed at making families’ choices, not school districts, the main unit of education policy.

- **Vouchers according to need, not school status.** Jeb Bush created the nation’s first statewide voucher program for students in failing schools, but it was struck down in 2006 in Florida’s Supreme Court. Daniels’ plan makes vouchers available to all students within specific income ranges, not just those in bad schools. It is the broadest voucher framework in the nation, aimed at both low-income and lower middle-class students. Linking the vouchers to family income rather than school performance infuses competition into the heart of Indiana’s school system and sets the stage for all the other reforms.

- **Vouchers on a universal basis.** The Indiana plan moves on a gradual basis to a universal program. The number of vouchers is capped at 7,500 for the first year, raised to 15,000 the following year, and then unlimited thereafter.

- **A pro-college-prep funding model.** Families that choose to transfer their children from a public to a private school receive $4,500 per child in K-8, but no limit on tuition for high school so long as the family meets the means-testing requirements. This also rewards the aspirations of those low-income students who make a goal of getting into private high schools, which typically have higher academic standards.

- **Expanding charters with greater parent empowerment and heightened accountability.** Thousands of

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2011 legislative session.
students are on waiting lists for Indiana’s 60 charter schools. Daniels’ reforms make it easier to start charters and increase the number of charter sponsors. They also install a “trigger” by which parents can convert failing schools into charter schools. Funding will follow the student rather than stay in a given school district. These reforms ultimately produce a vibrant marketplace aimed at disrupting the public school system’s monopoly.

- Encouraging private sector support of choice. Like Florida, Indiana offers a tax credit to those who donate money to organizations that provide choice scholarships to students. The new Indiana law raises the credit amount and aims at expanding overall participation.

Objective Number Two: Boost classroom performance as much as possible.

No Child Left Behind put the focus of school reform on schools and districts themselves. Real reform, however, needs to go to the classroom level. Indiana, like Florida, based its education plan on this simple idea.

Florida introduced a merit pay system under Bush. Indiana’s reform agenda is similar but goes a bit farther. Its fundamental elements are as follows:

- Paying teachers by what they do, not who they are. The Daniels reforms end tenure for new teachers, establish merit rather than seniority as the basis for pay increases, and include objective student performance as one element in evaluating teacher performance. In this way Indiana’s and Florida’s new laws are similar.
- Instituting a rigorous evaluation model. In order for the first point to work, the schools need a solid teacher evaluation process. Indiana’s new laws establish yearly evaluations for teachers and principals, require student achievement to be one component of the evaluations, assess how rigorously teachers use the best tools, and give teachers a score on a four-point scale.
- Limiting collective bargaining. It is difficult to implement an appropriate evaluation plan if collective bargaining can undo it or render it ineffective. The new Indiana law limits collective bargaining to teacher pay and wage-related benefits and removes all other extraneous matters (curriculum, class size, pedagogy, and a host of other provisions) from the bargaining process. Together with the first two points, this allows flexibility in focusing resources on the classroom, rewarding good teachers, and removing the underperformers.

Daniels supplemented these reforms by using the state budget to institute all-day kindergarten and a scholarship system for students who graduate from high school in three years.

Indiana’s reforms, considered together, achieve the following important education reform objectives:

- They are student-centric. By removing district boundaries, focusing on teacher performance in the classroom, and extending choice to students based on need rather than the school they attend, Indiana’s reforms have gone a long way to making students and their families the main focus of reform. Too often, the needs of just about everyone in the system come before students in discussions about reform. The Indiana model tried hard to turn the discussion upside down and began its design with the students in mind first.
- They align incentives properly. Dispensing with geographical boundaries and providing vouchers creates an environment where schools truly are competing with each other. Indiana has already begun to see instances of schools attracting students from their more poorly-performing neighbors. In addition, accountability and performance are clearly defined at the classroom level, and teachers benefit when their students’ performance improves. Finally, students that want to succeed are rewarded, whether in the form of a full-tuition voucher to a private school or a scholarship to college based on advancing through high school quickly.

Indiana is the culmination of decades of the best school reform ideas and efforts in many states and jurisdiction. Its success provides both a good model for other reformers and inspiration for those who are just getting started.2
Endnotes


Get Your Own Toll Road: Indiana’s Historic Infrastructure Achievement

Governor Mitch Daniels overcame great public opposition to leasing the Indiana Toll Road to a private company, and Indiana’s infrastructure (and finances) were the better for it. What lessons are there for other states?

Ryan Streeter, Ph.D. with Jason Simons

Policy Brief
Seven

Sagamore Institute
December 2011

This study was made possible through the generous support of The Lynde and Harry Bradley Foudation.
I don’t think Dwight Eisenhower, a Republican, would like that [a foreign company running the toll road] very much, because he sold the interstate system (as desirable), and he sold it for national security reasons.
– Indiana House Minority Leader, Patrick Bauer, D-South Bend, quoted in the Times of Northwest Indiana, January 22, 2006.

[T]he Indiana highway was auctioned off last week for $3.8 billion... Transportation was once one of the things Americans counted on their government to provide... But anybody who’s ever been caught in Washington traffic knows our elected officials lack the vision and the political will to deal with transportation issues that require difficult, politically unpopular decisions. Like raising taxes... Ducking tax increases is what motivated the state of Indiana and the city of Chicago to sell their toll roads.

“No Way!” Indiana Nearly Rejects the Toll Road Deal
After the fact, the story of the Indiana Toll Road makes the tax-hiking protectionism reflected in the two quotes above somewhat humorous. Governor Daniels’ decision to lease the Indiana Toll Road to a private company was one of the most controversial decisions of his administration. The public outrage elicited by the decision was at least as intense as a tax hike would have been, which the writer quoted at the outset suggests Daniels was “ducking.” Many people were highly critical of the proposal at the time and warned that it would inflict dramatic economic and fiscal harm on the state. Many offered doom-and-gloom forecasts – which never panned out. Five years in, it appears Indiana received the better end of the deal and has utilized the tremendous benefits to reinvest in infrastructure and maintain a balanced budget even during one of the worst economic periods in our nation’s history.

The lesson for other states is simple, if not challenging: find your own toll road. Too often governments are overextended owners of assets that would perform better in private hands.

From the Indianapolis Star, January 29, 2006, during the debate about the toll road’s lease.
The Details
In 2006, the State of Indiana held an auction for the rights to lease the Indiana Toll Road (ITR), a major highway running the entire east-west distance of northern Indiana. The highway is the main pipeline connecting Chicago to Detroit and Cleveland and beyond. The winning bid, $3.85 billion for a 75-year lease, came from the Spanish-Australian consortium Cintra-Macquarie. The toll road, previously maintained and operated by the Indiana Department of Transportation (INDOT), was leased to alleviate the cost burden on the state and improve the condition and overall operation of the road.

Operation of the toll road was inefficient at best and required considerable investment by the state. Prior to the lease, tolls had not been increased in 20 years, with some tolls still as low as 15 cents. The state estimated that it cost 34 cents on average to collect each toll, so Indiana was effectively losing money at toll booths along the highway.

The lease made it possible for the state to fund its Major Moves initiative. The Major Moves program reinvests in and improves the transportation infrastructure in Indiana, part of the governor’s multi-faceted plan to improve the business climate in Indiana and attract new businesses (and subsequently tax revenues and jobs) to the state. The program included more than 200 new construction projects as well as 200 major highway renovation projects between 2006 and 2015. At its inception in 2005, it faced a major funding gap. The revenue from the lease of the Indiana Toll Road provided the funds to fill the gap.

Under the terms of the lease agreement, the state received $3.85 billion from the lessees in return for operating rights and the revenues generated from the road. The actual value of the lease is higher: the company agreed to invest more than $200 million on improvements to the road upfront, as well as upwards of $4.4 billion in improvements over the life of the lease. This type of arrangement also has other benefits. The state also saved considerable money by paying for the majority of the costs of the Major Moves initiative upfront rather than financing the costs and paying interest over time.

Debunking the Critics: Indiana Benefits from the Toll Road
Thanks in large part to the lease, Indiana has the only fully-funded transportation investment program in the nation. It was estimated that the state was earning $6 per second or $500,000 per day from interest on its transportation fund, funded in large part by revenues from the lease, while other states’ transportation departments were drawing from state funds for investment. Indiana is projected to spend $11.9 billion on road improvement projects by 2015, while other states were majorly scaling back construction projects.

The Major Moves Initiative was designed to fix failing highway infrastructures and to reduce traffic congestion, which had been on the rise for several decades. The estimated costs resulting from traffic congestion totaled an estimated $360 million per year in lost wasted fuel and lost time. A Reason Foundation study estimated in 2006 that, in order to significantly reduce traffic congestion and prepare for growth expected by 2030, the state would need to add 2,270 new lane miles at an estimated cost of $3.1 billion. Major Moves, funded through the toll road lease, marked a significant step toward addressing these concerns.

By the end of 2010, 41 highway construction projects, totaling 185 new centerline miles, 2800 preserved centerline miles, and 588 rehabbed bridge projects, had been completed. One of the major aspects of the initiative, the extension of I-69 connecting Indianapolis to Evansville is well underway and promises to foster significant economic growth for towns in between.

The toll road has saved the state billions of dollars in costs, has helped the state maintain a balanced budget during difficult economic times, and most importantly, has allowed the state to reinvest in and develop the infrastructure necessary to attract new business to the state. The economic windfall resulting from the project will bring new jobs, additional tax revenues, and an injection of additional money into the state economy.
What Can Other States Learn?
While controversial initially, the toll road lease is now widely celebrated for the undeniable benefits it has brought the state. Certainly, it has helped maintain a healthy budget during difficult fiscal times while still investing in infrastructure improvements and addressing critical needs. In Governor Daniels’ own words, “We got a great deal...Indiana is the envy of America today.” The lease provided Indiana with the capital needed to make important investments and fund critical projects in the state.

In tough economic times, states should use a critical eye to evaluate their assets and identify opportunities like Indiana's toll road. There is a lot of talk these days about the influence of special interests on government. We often overlook the interests of two other important groups: interests within government, and the interests of users of government services who had nothing to do with the origins of the service and yet cannot imagine changes to the service. The former protect their interests not by providing exceptional service but by eliminating threats to their existence. The latter protects its interests through the dual inertias of daily life and bureaucratic operations. Government-held assets are too often holdovers from a previous era that under-serve the public good because of these two sets of interests.

The Indiana Toll Road is a story of how to disrupt those two complementary inertias. And the question for other states remains: can you find your own toll road?
Endnotes


2. Ibid.

3. Ibid.

The Aspirational State: Indiana as a Guide for Reformers

Broadband Leadership from the Hoosier State

No one expected Indiana to make such a leap forward on broadband access and become a national model? What happened, and why does it matter?

Ryan Streeter, Ph.D. with Jason Simons

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The Backdrop: Failed Federal Policy

The Federal Telecommunications Act of 1996 was hailed at the time of its passing as a landmark bill that would modernize telecom, save the country hundreds of billions of dollars, and create more than a million jobs. The estimated net boost to the economy was projected at $2 trillion, but it didn't take long for most observers to recognize that an alleged deregulatory effort had become a tool of the federal government to further constrain telecom. The net value of the telecommunications market fell by trillions and jobs were shed. Moreover, it failed to deliver on its goal to increase Internet connectivity across the country.

Over the years, states were no better when it came to telecom. They overregulated telecom with layers upon layers of outdated rules and governing bodies, and yet in the wake of federal failure, states began to get active on telecom liberalization.

Indiana Finds Its Own Way

Indiana was ahead of the pack on this front. In 2006 Governor Daniels signed Indiana House Bill 1279 into law, which was immediately praised by industry experts as the most far-reaching telecommunications reform package in the country.

In 2006 Governor Daniels signed Indiana House Bill 1279 into law, which was immediately praised by industry experts as the most far-reaching telecommunications reform package in the country. The bill was the first attempt to improve telecommunications in Indiana since 1985 and cleared away obtrusive, decades-old regulations that were long obsolete yet inhibited growth and development. The main purpose of the bill was to improve and increase broadband coverage in Indiana.

The law prohibited regulation of broadband and information services, deregulated basic telecom
services over three years, created a statewide video franchising system, and additional measures to liberalize the telecom sector. More specifically, it provides for deregulation of broadband when access to service reached 50 percent of the local telephone exchange area and requires full disclosure from companies during the transition. It also caps how much providers can increase service charges during the transition period, in addition to a number of other provisions to stimulate development and expansion, while allowing the Indiana Utilities Regulatory Commission to maintain regulatory control over certain aspects of telecommunications services including 211 call centers, cramming laws, interconnection agreements, and disputes among providers. The bill also provides quick and easy approval to telecommunication providers looking to expand within the state and has opened the door for expansion of high-speed fiber optic networks. The bill passed with broad bipartisan support and passed by wide majority.

Around the time of the bill’s passage, a national survey of CEOs found that broadband communication was the number one factor in persuading companies to move to a particular state. Indiana’s bill was therefore widely regarded as a forward-looking economic development initiative based on a proper understanding of broadband's role in regional economies – and it was enacted nearly five years before President Obama made a similar case for broadband expansion in his 2011 State of the Union address.

**Broadband Success Makes a Difference**

Broadband development is vital to business and technological development. A Brookings Institution study estimated that for every one percentage point increase in broadband connectivity, nonfarm private employment increases by 0.2 to 0.3 percent, at least a two-fold or three-fold return on investment (and probably more when one considers the benefits that accompany the increase in employment, i.e. tax revenue and increased consumer spending).

It also seems apparent that broadband is critical to experiencing growth in knowledge-based industries. As one recent study examining the relationship between broadband expansion and economic growth put it, “industries that rely more on technology inputs and on workers in computer specialist occupations—the industries that should benefit more from broadband—are those in which broadband expansion is associated with stronger employment growth.” The study found the highest percentage point employment changes due to broadband in professions such as the sciences, information technology, utilities, finance and insurance, enterprise management, and administrative support – all professions that have the highest share of their workforce using computers and applying technology.

**Average Measured Connection Speed by State**

<table>
<thead>
<tr>
<th>State</th>
<th>Q1 '11 Avg. Mbps</th>
<th>QoQ Change</th>
<th>YoY Change</th>
</tr>
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<tbody>
<tr>
<td>1 Delaware</td>
<td>7.5</td>
<td>3.5%</td>
<td>-0.7%</td>
</tr>
<tr>
<td>2 Rhode Island</td>
<td>6.8</td>
<td>-1.1%</td>
<td>18%</td>
</tr>
<tr>
<td>3 Wisconsin</td>
<td>6.0</td>
<td>7.7%</td>
<td>16%</td>
</tr>
<tr>
<td>4 New Hampshire</td>
<td>6.0</td>
<td>2.5%</td>
<td>2.4%</td>
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<tr>
<td>5 Connecticut</td>
<td>5.9</td>
<td>6.3%</td>
<td>7.8%</td>
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<tr>
<td>6 Indiana</td>
<td>5.8</td>
<td>4.8%</td>
<td>11%</td>
</tr>
<tr>
<td>7 Maine</td>
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<td>9 California</td>
<td>5.6</td>
<td>13%</td>
<td>15%</td>
</tr>
<tr>
<td>10 Utah</td>
<td>5.6</td>
<td>-0.1%</td>
<td>11%</td>
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At the time the Indiana bill was passed, Indiana ranked 34th among states in Internet connectivity according...
Indiana is a rare outpost in middle America as a broadband leader and even outpaces some states where providing Internet access should be much less challenging. The increase in Internet connectivity has corresponded with economic development. Within a year and a half after the bill was passed, the bill had created $400 million in new investment and had led to the creation of thousands of telecommunications jobs.

The sensible nature of the bill allowed it to begin creating change immediately. Forbes contributor Bret Swanson, president of Entropy Economics and an Indiana resident, remarked just three days after the bills passage, “This week, Indiana adopted the best telecommunications law anywhere in the nation and took a bold leap into the 21st century. Amazingly, it’s already working. The bill was passed just Tuesday night, but already—just three days later—I have seen telecom crews surveying rights of way near my house to lay new optical fiber.”

Every indicator suggests the Indiana broadband law has been positive for economic development in Indiana. Not only has it helped create jobs, it has had the additional impact of making Indiana more attractive economically to outside firms. While the Hoosier State is not a national high-tech leader, for its size and geography, it has fared well, especially in recent years since the bill passed. Cyberstates 2011 ranks Indiana 20th nationally in high-tech establishments and 23rd overall in the number of high-tech workers. Given how many states lost high-tech jobs in post-recession America, Indiana’s loss of just 300 high-tech jobs – while not good news – shows a resilience that other states have not enjoyed lately.
Endnotes


2. Ibid.

3. Ibid.