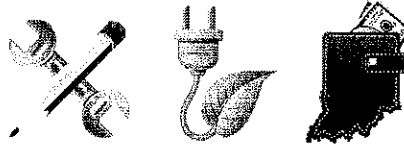


THREE KEYS TO INDIANA'S ECONOMIC FUTURE



AN EDUCATED WORKFORCE

AN ENVIRONMENTALLY SOUND ENERGY POLICY

A BALANCED TAX POLICY

Like many states, Indiana faces significant challenges in a 21st-century economy. But addressing today's demands should not detract from intentional efforts to shape Indiana's future.

The Indiana University Public Policy Institute, part of the IU School of Public and Environmental Affairs, developed Policy Choices for Indiana's Future to identify critical issues facing Indiana in the long run. For elected officials, candidates for public office, their policy advisors and those who seek to inform their decisions, Policy Choices also provides objective, nonpartisan analysis and recommendations of policy options to address these key issues.

Job One: The Economy – and Three Keys to Improving it

Any objective look at a state's future could cover a wide range of issues – from homeland security to arts and culture, entitlement programs to economic development, pre-school education to eldercare. But everything we do or hope to do – everything – depends on the future of our state's economy.

For that reason, Policy Choices for Indiana's Future chose to focus its research and recommendations on three areas that will have major impact on the collective well-being of our state and the people who live and work here:

Education and workforce: Develop the highly skilled workforce necessary for economic growth in a knowledge economy.

Energy and the environment: Leverage the state's energy assets in an environmentally responsible, productive manner.

Tax policy: Create a balanced tax environment that: 1) Enables growth, and 2) Generates the revenue required to efficiently deliver essential services and make the infrastructure investments that will keep Indiana competitive.

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

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

Each commission included members of the Public Policy Institute's Board of Advisors, plus additional members from around the state selected because of their subject-matter expertise.

Randall Shepard, Chief Justice of the Indiana Supreme Court and Mark Miles, President and CEO of the Central

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Indiana Corporate Partnership, led the overall project. Staff leadership was provided by the IU Public Policy Institute. Policy Choices work products are at www.policyinstitute.iu.edu/PolicyChoices

The three commissions worked for 18 months to conduct research, prepare analysis and develop options for effective public policy. The three commission reports were then presented to and accepted by the IU Public Policy Institute's Board of Advisors, which now presents these findings, recommendations and choices to Indiana policymakers. The board hopes that policy choices resulting from this report will help Indiana secure a bright economic future.

Context: How is Indiana Doing?

For Indiana to succeed, Hoosier workers and businesses must succeed. Though government cannot solve every problem, it plays an essential role in establishing the policies, controlling the costs and providing the leadership necessary for job growth and retention. Indiana's ultimate success will require the cooperation of every stakeholder – corporations, individual residents, nonprofits and policymakers. To determine how well we're doing in these areas, Policy Choices considered current and projected economic conditions within the context of the Midwest.

Working for less

In 2010, Indiana's per capita personal income was only 85.2 percent of the national average, down from 90.6 percent in 2000 and 92.7 percent in 1980 (U.S. Bureau of Economic Analysis). Even more discouraging, the previous decade saw Indiana's per capita personal income decline for the first time in several decades (Table 1).

Table 1. 2000-2010 percent change in per capita income

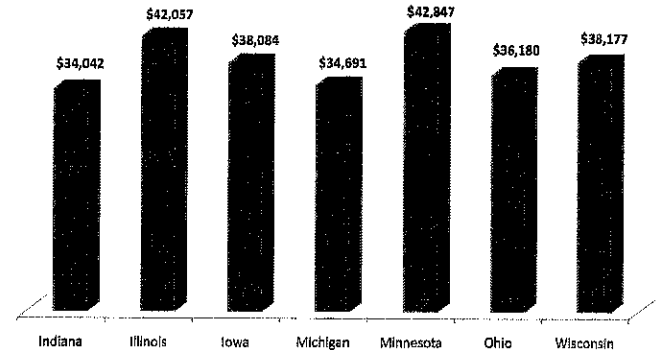
Indiana	-0.5%
Illinois	3.4%
Iowa	12.0%
Michigan	-5.3%
Minnesota	5.5%
Ohio	1.2%
Wisconsin	5.2%

Source: Bureau of Economic Analysis (SA1-3 Personal Income Summary), 2010

As of 2010, Indiana had the lowest per capita income of seven Midwestern states (Indiana, Illinois, Iowa, Michigan, Minnesota, Ohio and Wisconsin), and with a per capita income of just \$34,042, Indiana ranked 41st among all states (Figure 1). In 2000, Indiana's per capita income trailed Minnesota's by slightly more than \$5,000. By 2010, this difference had grown to nearly \$9,000. Similarly, in 2000, Indiana had a higher per capita income than Iowa, but by 2010, Iowa's per capita income exceeded Indiana's by more than \$4,000. Only Michigan saw a similar decline in per

capita income during the previous decade. While much of the downward pressure can be attributed to the recession, Indiana must acknowledge that other states appear to have fared better under similar economic stresses.

Figure 1. 2010 per capita personal income



Source: Bureau of Economic Analysis (SA1-3 Personal Income Summary), 2010

More workers, fewer jobs

During the past decade, not only did Indiana wages stagnate, but job growth ground to a halt. While the recession certainly contributed to this scenario, even at its peak, employment during the past decade remained below the 3 million jobs with which Indiana entered the 21st century. These losses appear even more troubling in context: The net loss of 207,000 jobs from 2000 to 2010 occurred during a decade in which Indiana's population grew by more than 350,000 (U.S. Bureau of Labor Statistics, U.S. Census Bureau).

Among the biggest areas of job loss: Indiana's manufacturing sector. With \$74.9 billion in 2010 manufacturing output – 27 percent of Indiana's total economic output – Indiana has the most concentrated manufacturing industry in the country (U.S. Bureau of Economic Analysis). In 2000, the manufacturing sector employed 663,500 Hoosiers, or nearly one-quarter of Indiana's nonfarm labor force. By 2011, manufacturing employment had fallen to just 457,000, a 10-year decline in employment of more than 30 percent (Bureau of Labor Statistics).

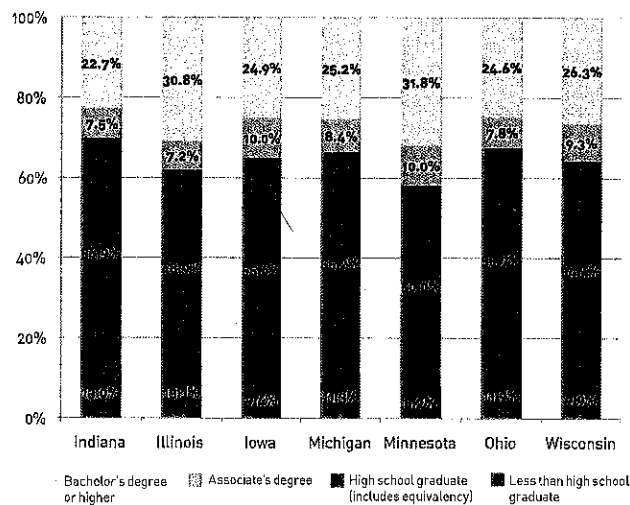
Wanted: New kinds of workers in different lines of work

The good news on the manufacturing front is that Indiana's industry has continued to increase output and productivity, even as it has shed jobs. Still, traditional manufacturing jobs are being replaced by higher-skilled, knowledge-economy positions – the kind that require more and different levels of education. In addition, some of these jobs will be in the energy industry, and Indiana already has (or has the potential for) an advantage in several sectors of this industry, including coal, biomass, and electric-vehicle production. Also, the Indianapolis metropolitan area is 12th on a list of "Top 100 Current and Potential Green Jobs through 2038" (Global Insight, The United States Conference of Mayors, 2008). All of that bodes well – if we put in place the educational, workforce-development and economic-development resources to capitalize on it.

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Unfortunately, just as the state and national economies have moved toward more knowledge-based industries, Indiana's workforce has lagged behind its peer states in educational attainment. This history is reflected by Indiana's high percentage of citizens with a high school diploma or less (Figure 2). Within the Midwest, Indiana has the lowest percentage of those 25 and older with a bachelor's degree or higher and exceeds only Illinois in the number of adults with an associate's degree. Not surprisingly, there is a strong correlation between educational attainment and per capita income. Those Midwest states with the highest per capita income (Minnesota and Illinois) also have the highest percentage of population with a bachelor's degree or higher. With most labor force projections estimating that well over half of all future jobs will require some post-secondary education, Indiana must produce far more workers with the degrees and credentials demanded by employers. If we don't address this immediately and in the long-term, we risk falling further behind.

Figure 2. 2010 Educational Attainment (percent of population 25 and older)



Source: U.S. Census Bureau, 2010 American Community Survey (S1501: Educational Attainment)

High rates of unemployment and poverty

From 2005 to 2010, Indiana saw its unemployment rate jump from 5.4 percent to 10.2 percent, nearly doubling in just five years. During this same period, only Michigan had a larger increase in its unemployment rate (Table 2). While Indiana's unemployment rate fell to 9.0 percent as of October 2011, its recovery has been much slower than many of its Midwestern peers. Indiana's 2010 poverty rate, at 16.3 percent, exceeded the national rate and was considerably higher than rates within the Midwest. Furthermore, it remains alarmingly high at a time when public and nonprofit support for at-risk populations is stretched beyond its limits.

Table 2. Unemployment rate by Midwest state, 2005, 2010

	2005	2010	Increase 2005 to 2010
Indiana	5.4%	10.2%	4.8%
Illinois	5.8%	10.3%	4.5%
Iowa	4.3%	6.1%	1.8%
Michigan	6.8%	12.5%	5.7%
Minnesota	4.2%	7.3%	3.1%
Ohio	5.9%	10.1%	4.2%
Wisconsin	4.8%	8.3%	3.5%

Source: Bureau of Economic Analysis, 2005, 2010

The impact of lower incomes, unemployment and poverty on state taxes

Indiana currently owes the federal government more than \$1.8 billion for unemployment benefits. The state's unfunded liability for teacher pensions has grown from \$7.5 billion in 2000 to \$11 billion in 2010. With a depressed housing market and prolonged unemployment, state revenues from sales, income and property taxes declined by 5.9 percent, 11.6 percent and 4 percent, respectively (Table 2), from 2009 to 2010. Finally, the Indiana Department of Transportation expects construction funds to be depleted by 2013. At the same time, gas tax revenues are insufficient to fully fund maintenance and preservation of existing infrastructure.

Table 3. Indiana state and local tax collections, 2010

Revenue class	2010 revenues (millions)	Annual % change 2009-2010 (adjusted for inflation)	Total % change 2000-2010 (adjusted for inflation)
Sales tax	\$5,936	-5.9%	27.1%
Property tax (net)	\$5,304	-4.0%	-13.8%
Individual income tax	\$3,875	-11.6%	-18.5%
LOITs	\$1,589	2.4%	56.7%
Gaming taxes	\$875	-1.3%	53.9%
Motor fuel tax	\$760	-6.4%	-19.0%
Corporate income tax	\$583	-32.3%	-53.3%
All tax collections	\$23,428	-7.4%	1.1%

With our state facing such troubling trends, our ability to change direction and set Indiana on a path to economic growth will depend on our willingness to face long-term reality, engage in candid conversations and make some

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difficult decisions. Policy Choices is a first step. By acting on the analysis and choices considered in this report, policymakers can promote economic growth, raise the earning power of workers statewide and plot a course that ensures a bright future for Indiana. But implementing these ideas will occur only if elected officials, business leaders, community leaders, and citizens get involved and collaborate.

Policy Choices Summary

The Policy Choices commission reports are designed to be a starting point for thoughtful, long-term policymaking that will help improve the state's economy, improve the well-being of its people and otherwise secure a bright future for Indiana.

Each of our three commissions engaged in a collaborative process that encouraged debate and dissent. Each commission brought a unique combination of experience and expertise to the process. As might be expected in a group of distinguished professionals from diverse political and career backgrounds, not every commissioner agreed completely with each and every detail of the included policies. However, there was general consensus on the basic concepts behind the policy options selected.

The IU Public Policy Institute's Board of Advisors accepted the commission reports and presents the choices here. The Institute will continue to work on these issues, providing additional analyses as needed and appropriate to further enhance and facilitate statewide discussion on how Indiana can best address these issues and improve our state's future.

The following sections summarize the policy prescriptions or choices produced by each of the three commissions. You'll find full reports – including background research, more complete discussions of commission topics, and references to the sources that informed each commission's deliberations – at www.policyinstitute.iu.edu/PolicyChoices. Separate policy briefs on each of the commission reports are also available at that site.

Commission on Education and Workforce Development



After engaging in policy discussions, hearing from expert panelists, and reviewing initiatives from around the country, the Commission on Education and Workforce Development agreed on three key priorities to address the long-term needs of Indiana's economy. The options should be seen as a set of actionable recommendations that represent a first step toward preparing Indiana and its workforce for the emerging knowledge economy.

It is also important to note what is not included in this report. After much consideration, commission members decided to exclude early childhood education and education funding from its deliberations. Commission members determined that while these are incredibly important to Indiana's educational attainment and workforce development, these two issues were outside the commission's purview and

would create unnecessary obstacles to consensus. While there are no recommendations here for early childhood education or appropriate levels of education funding, the commission recognizes how important early childhood education is to student success. Further, the findings assume at least sustained levels of public support for education in Indiana.

Though certainly not an exhaustive set of remedies, the policy choices selected by the commission represent a diverse set of initiatives designed to address many of the gaps that exist in Indiana's education and workforce-development systems.

1. Align college and career standards for high school graduation and admission to college

- Integrate the final year of high school with the initial year of postsecondary education for secondary school students who consistently demonstrate proficiency of college-and-career readiness academic standards.
- Increase dual credit enrollment so that two-thirds of Indiana students will leave high school with at least six college credits.
- Identify those students unprepared for postsecondary education and training and utilize the final year of high school to provide appropriate remediation.
- Increase the options available to Hoosiers in the delivery of secondary and postsecondary instruction through the use of technology, alternative schools and accelerated pathways.

2. Redesign the state's workforce training, economic development and postsecondary education strategies for workers to ensure that they remain competitive in the labor market

- Expand accelerated degrees and intermediate credentialing programs so that many more Hoosiers are prepared for good-paying, high-demand jobs.
- Create an Office of Economic and Workforce Development by integrating the Indiana Economic Development Corporation with the employment and training division of the Department of Workforce Development.
- Align the state's policy-setting initiatives for postsecondary education and training under the Commission for Higher Education, with specific emphasis on increasing system capacity and efficiency that will increase postsecondary attainment.
- Incorporate the majority of the state's career and technical education into the revamped Commission for Higher Education.

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- Increase promotion and utilization of The Benefit Bank to ensure residents are receiving all eligible federal and state benefits.

3. Increase participation by employers in the design and delivery of the workforce development system

- Provide tax incentives for businesses that hire new workers and train incumbent workers.
- Create a statewide skills bank to connect employers with the skilled workers they require.

Commission on Energy and the Environment



With significant reserves of coal and biomass resources, Indiana's future economic prosperity and its residents' quality of life will be significantly affected by the state's energy policies. To be sure, federal energy policies will impose some constraints. But by thoughtfully stewarding the

state's natural resources, aggressively pursuing emerging opportunities and actively supporting the development of new energy initiatives, Indiana's leaders can help Indiana capitalize on opportunities and respond to change.

Good public policy requires a clear understanding of available choices. In that spirit, the Commission on Energy and the Environment chose to identify policy options – and to outline their potential positive and negative consequences – rather than making specific recommendations.

Consequently, the options listed here do not necessarily represent the views of any particular commission member or the organizations they represent. This choices-and-consequences approach permitted the commission to tap the expertise of its members and outside experts while providing policymakers with the objective information needed to inform decision making. Balancing the many important factors and competing interests required careful consideration of every possible policy option.

Many of the policy options presented here focus on emerging technologies that have not yet become commercially available. By taking a long-term view of Indiana's energy assets and how we develop them, the commission hopes to capitalize on early-adapter advantages and position the state to maximize the inherent employment and economic benefits.

1. Advanced biofuels

- Support university research to develop new technologies and to study the economic and policy issues associated with producing advanced biofuels in Indiana.
- Support the development of new advanced biofuels production facilities by purchasing fuel through a reverse auction.
- Make traditional and specialized economic development incentives available to firms locating new advanced biofuels facilities in Indiana.

- Continue to promote ethanol and biodiesel production and flex fuel vehicle deployment.

2. Electric vehicles and battery technology

Electric vehicles

- Support in-state electric vehicle supply chains through economic development incentives.
- Support in-state purchase and use of electric vehicles.
- Support development of an adequate recharging infrastructure.
- Encourage off-peak charging of electric vehicles.
- Encourage state and local government adoption of electric vehicles.
- Support research to develop new technologies and to research the economic and policy issues associated with manufacturing electric vehicles.

Battery technology

- Support in-state development and manufacturing of batteries through economic development incentives.
- Support research to develop new technologies and to research the economic and policy issues associated with manufacturing batteries in Indiana.
- Support university initiatives to develop relevant curricula.
- Encourage/incent utilities to utilize used electric vehicle batteries in grid storage applications.

3. Energy efficiency

Utility policy

- Establish energy efficiency as a formal resource within long-term utility and energy planning.
- Address Indiana's annual energy savings goals:
 - Monitor energy savings program efficacy and enforce program goals.
 - Extend Indiana's annual savings goals to all electric and natural gas utilities, including municipal and co-op utilities.
 - Raise the goals of the program.
- Make Indiana's Clean Energy Portfolio Standard mandatory.
- Adopt decoupling or some other form of lost revenue adjustment for Indiana's electric utilities.
- Adopt utility performance incentives for achieving energy efficiency goals.
- Adopt time-based pricing for electricity.

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Industrial energy efficiency

- Provide incentives for combined heat and power.
- Provide incentives for other industrial energy efficiency programs.

Building codes

- Improve the process of adopting new building energy codes to allow the state to benefit quickly from advances in efficiency.
- Educate builders and building officials on new building codes, and track compliance.

Other state policies

- Expand state financial and information incentives to consumers for energy efficient improvements.
- Facilitate financing for energy efficiency retrofits to buildings.
- Fully implement energy efficient design standards for new state-owned buildings and retrofit existing buildings.
- Expand incentives for public university energy efficiency improvements.
 - Remove bonding limits for public universities for energy efficiency improvements.
 - Establish mechanisms to allow the reinvestment of energy efficiency savings in additional improvements.
- Encourage energy efficiency for local public buildings.
- Support research, development and demonstration.
- Support university initiatives to develop relevant curricula.
- Track and evaluate the efficacy of energy efficiency programs; strengthen programming if necessary.

4. Carbon capture and storage

- Clarify pore space ownership.
 - Assign pore space property rights to surface estate owners.
 - Aggregate property rights using eminent domain with or without unitization and/or quick take provisions.
 - Declare pore space as public domain.
 - Make proximity payments to surface estate owners.
- Develop a regulatory framework for carbon dioxide pipelines.
 - Establish an intrastate pipeline regulatory framework.

- Advocate for a federal interstate framework similar to oil pipelines.
- Advocate for a federal interstate framework similar to natural gas pipelines.
- Advocate for a hybrid regulatory framework that combines elements of the current frameworks for oil and natural gas pipelines.
- State government facilitation of development of pipeline network.
- Address the long-term liability of carbon storage.
 - Advocate for expansion of federal Underground Injection Control (UIC) Program.
 - Use current state tort and contract laws.
 - Establish a specific state regulatory framework for liability.
- Facilitate research to establish additional carbon-capture technologies.
- Facilitate investigation and evaluation of Indiana's deep subsurface geology for carbon dioxide storage.
- Evaluate enhanced oil recovery opportunities within and outside the state.
- Provide economic development incentives to private-sector carbon capture and storage implementers.
- Create a state utility to develop carbon dioxide pipelines and/or storage facilities.

Commission on State and Local Tax Policy



State policy can enable a positive environment for economic growth. A balanced approach to taxation, one derived from a diverse and broad tax base, creates a climate in which individuals and businesses can flourish. A system of taxation that is clear and predictable, one in which rates and methods are certain, helps promote confidence in decision making among those living and working in Indiana.

The Commission on State and Local Tax Policy agreed early to recommend revenue increases only where necessary to fill shortfalls in existing funding. One such instance is the preservation and expansion of roads. While not recommending specific levels of investment in infrastructure, the commission identified financing to address a portion of the funding gap.

With growing financial pressure, delivering government services efficiently and pursuing improvements in government design and organization will be essential to maintaining a sound financial picture for Indiana.

Clear and balanced tax policy is vital to wealth creation in Indiana. The Commission on State and Local Tax Policy identified three critical areas to promoting this objective through fiscal policy:

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1. Preserving an attractive business climate

- Maintain a balance among income, sales and property tax revenues.
- Keep the tax base broad so rates can be low.
- Limit tax incentives and tax breaks to initiatives of highest priority and expected return on investment.
- Retain the current individual income tax rate.
- Retain the current, recently reduced corporate income tax rate.
- Review tax credits, deductions and exemptions.
- Consider how to reduce the state sales tax rate by broadening the sales tax base on a revenue-neutral basis to include more services.
- Conduct a comprehensive evaluation of the impact of the 2008 property tax reforms.
- Continue efforts to reduce reliance on business-equipment and machinery tax revenue.
- Encourage regional planning and projects, and allow regional taxing districts.
- Help city centers by sharing a modest portion of local-option income tax revenues between counties of residence and counties of work.
- Expand the capabilities of the Department of Revenue to analyze collections and costs and benefits of tax policy.
- Provide sufficient resources to the Department of Revenue to enforce collection of the sales tax on Internet purchases.
- Standardize tax treatment of not-for-profit organizations.
- Establish a Midwest interstate compact to coordinate economic-development efforts.

2. Structure of government

- Evaluate the organization of government, the quality of service delivery, spans of control and organization layers.
- Promote joint purchasing and other inter-local agreements between local government units.
- Continue to advocate local government reform and consolidation as a means of improving delivery of services with maximum efficiency, transparency and accountability.

3. Spending and investment

- Consider increasing the gas tax to align with neighboring states and index it to inflation to preserve the existing system of roads and bridges.
- Use tolls to finance future road expansion projects.
- Develop a state plan for water, energy, information and transit infrastructure.
- Use a State Infrastructure Bank to support financing, enhance private investment potential and offset risks.
- Challenge universities and the General Assembly to devise a sustainable strategy for funding higher education to maintain a strong source of innovation.

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