CHAPTER EIGHT

Financing State Government

Taxes and fees paid by people and business finance the state government. The state budget is an economic plan of how money is to be collected and spent. There are four major budgets created by the state: the operating budget, capital budget, transportation budget and Bureau of Worker's Compensation budget. Each budget covers two fiscal years (FY), also known as a biennium, and is therefore referred to as a biennial budget. Ohio's fiscal year begins on July 1 and runs through June 30 of the following year. The fiscal year is designated by the calendar year in which it ends; for example, the period July 1, 2019, through June 30, 2020, is FY 2020, or FY20. The biennial budget that begins July 1, 2019, and concludes June 30, 2021, is the FY 2020-21 budget. Law requires all states to balance their budget, i.e. expenses cannot exceed revenues for any biennium.

Ohio's "all funds" budget, containing taxes, federal funds and special purpose funds, totals $65.7 billion for FY 2018 and $67.1 billion for FY 2019. The major contributor to the totals is the General Revenue Fund, which is where Ohio deposits the major state-imposed taxes, such as sales, income and business taxes. Details in the fund show which taxes contribute the most and least to paying for state government. This information combined with tax rates and local taxing data can be used to analyze where Ohio has shifted the burden on taxpayers over time and to compare Ohio's tax practices to other states. The General Revenue Fund totals 32.2 billion in FY 2018 and 33.3 billion in FY 2019.

History of the State Budget

Ohio's early budgets reflect the larger nation's growth and rapid change. The first budget, in 1803, totaled only $20,000, with $1,400 of that allocated just to firewood; the state payroll was only $16,000. Sixty years later, in the midst of the Civil War, the budget climbed to $813,000. Well over a third -- $314,000 – was allocated to military expenditures, while social services consumed $159,000 and education $55,000. By 1931, early in the Great Depression, the state budget reached $65.7 million, allotting $3.1 million for agriculture, $4.2 million for welfare, $1.9 million for education and $4.5 million for the prohibition of alcohol.

Some jokingly say money from the fund has three purposes: to medicate, to educate, and to incarcerate – given that the top three expenditures are typically for Medicaid, schools, and prisons. In fact, as more of Ohio's population became dependent on Medicaid-funded services during the Great Recession that began in 2008 – services including nursing home care, indigent births, children's health insurance, mental health and addiction treatment, and more – the available budget for non-Medicaid social services grew less and less.

Nationally, there has been an overwhelming trend among states toward using annual rather than biennial budgets. Ohio is the largest state that continues to use biennial budgeting. Gov. John Kasich, however, instituted a more formal "mid-biennium review," beginning with the 2012-2013 biennium, than had previously existed. As a result, significant annual reviews of and changes to the budget are more common.

Because of the significant time and effort required to enact a budget, the state divides the work into an operating budget, transportation budget and bureau of Workers Compensation budget enacted in odd-numbered years and a capital budget enacted in even-numbered years. This chapter focuses primarily on the operating budget and, to a lesser extent, on the capital budget. In general, funding for state highways, bridges, public transportation and other transportation uses is allocated or appropriated through the biennial transportation budget. Funding for medical and compensation benefits for work-related injuries is allocated through the bureau's budget.

The Line-Item Veto

Most state governors, including Ohio's, have the ability to use a provision known as the line-item veto. The line-item veto provision allows the governor to veto a part of a bill that contains a fiscal appropriation while signing the rest of the bill into law. In 1996 the U.S. Congress passed a law granting the President the power to use the line-item veto; however, the U.S. Supreme Court ruled that the line-item veto at the federal level was unconstitutional. Ohio's governors continue to use it at their discretion, but only in matters relating to appropriations.

Operating Budget

The operating budget is the fiscal plan the state government creates to cover the general costs of state government operations. In odd-numbered years, the governor is responsible for presenting the executive budget to the General Assembly. This is the proposed financial plan for the next biennium and includes the governor's priorities for taxing and spending.

The Office of Budget and Management drafts an operating budget request for the governor based on the office's evaluation of funding requests submitted by each state agency and expected income. The governor's office then prepares and introduces the two-year executive budget in the Ohio House of Representatives, where all revenue proposals must originate. This typically happens in late January or early February, although newly elected governors are often granted more time to develop their first budget. The budget bill undergoes significant change as it passes through the normal legislative process of hearings and debates, first in the House, beginning in the House Finance Committee and its various subcommittees. The budget then undergoes the same process in the Senate.

A conference committee is almost always necessary to resolve differences between the House and Senate budget bills. The governor must then approve and sign the spending plan with or without line-item vetoes, by June 30 of the odd-numbered year. The governor's line-item veto power allows him/her to remove any line in the budget as well as any policy changes attached to the monetary appropriation, but he/she cannot add new language or move lines within the bill. The legislature may override vetoes if it can muster the necessary supermajority of 60 percent of the votes in each chamber.

The General Assembly is responsible for appropriating money for specific programs and levying sufficient taxes to ensure that revenues are available to pay for the programs authorized. Taxes are usually created and controlled through legislation but may also be increased or decreased by constitutional amendments proposed through legislative action or initiative petition. After passage of the budget, the Office of Budget and Management is responsible for monitoring and controlling spending. The budget passed by the General Assembly and signed into law by the governor is still nothing more than a plan based on expected revenues and expenditures. If economic conditions shift and revenues do not meet expectations, expenditures must be cut to conform to actual revenues. The governor must bring spending into balance with state income because the Ohio Constitution requires that the budget be balanced at the end of each biennium. In times of economic prosperity, revenues may exceed budgeted expectations while spending remains as appropriated, resulting in new spending or, more likely, a deposit into the state's Budget Stabilization Fund, commonly called the rainy day fund. The Ohio General Assembly created the rainy day fund with the intent this reserve fund be built up over time and used in emergencies.

The seven-member Controlling Board, explained on page 20, provides continuing legislative oversight.

Structure of the Operating Budget

The state uses hundreds of separate funds, much like checking accounts, to manage its finances. Each fund has a revenue source or sources, and each fund makes payments for designated state programs, services, or projects. The budget is complex and includes both state revenues as well as federal funds. Analysts may refer to the "all funds" budget which includes both state and federal money, or "state-funds-only" budget. The largest state fund is the General Revenue Fund (GRF). All revenues coming into the state treasury that are not allocated by law to a specific fund or purpose are deposited into the GRF. Ohio is one of a handful of states that places federal monies in the GRF.

Revenue

In the most recent budget, federal funds comprise 30 percent of the GRF. Among state sources, taxes levied on sales and personal income are the greatest sources of revenue. **Sales and use tax**: The Ohio sales tax applies to the retail sale, lease and rental of tangible personal property as well as the sale of selected services in Ohio. When a vendor fails to apply the sales tax, as is often the case with online purchases, the buyer is responsible for paying the equivalent Ohio use tax directly to the state using a consumer's tax form.

As of this publication, the state sales and use tax rate is 5.75 percent. Counties and regional transit authorities may levy additional sales and use taxes. Starting in 2004, in response to a budget shortfall, the General Assembly began extending the sales tax to collect money on services and goods that were previously exempted, such as lawn care, snow removal and equipment bought to provide internet services. Such an extension reflects Ohio's transition from a manufacturing-based economy to a service-based economy. This is the largest source of taxpayer revenue in the GRF. Others include:

1. Income tax: The personal income tax on earnings, investments and retirement income was established in 1971 and will account for 25 percent of revenue in the FY 2018-19 budget.
2. Commercial activity tax: The CAT, as the tax is commonly called, is an annual tax imposed on the "privilege of doing business in Ohio," and applies to businesses with Ohio taxable gross receipts of $150,000 or more per calendar year. A similar tax, called the financial institutions tax, or FIT, is applied to banks, savings and loan associations and small lenders.
3. Other state taxes: Ohio levies taxes on utilities, so-called "sin taxes" that apply to the sale of alcoholic beverages and tobacco, severance taxes, insurance taxes, the gross casino revenue tax, a motor fuel tax and more. Property taxes and municipal income taxes are collected locally, by a county or municipality, and are not considered state taxes.

State income taxes in Ohio tend to be lower than in surrounding states. When considering only state taxes, Ohio has the lowest state tax collections per capita compared to nearby Midwestern (non-Appalachian) states. The first and historic reason for lower state taxes is rooted in the "home rule" history of Ohio and in the fact that most government services – from schools to child protection to mental health and addiction services – are state supervised but locally or county administered. That means that the state contributes a modest amount of funding but expects most funds to be raised locally, usually through property tax levies. When local taxes are included, Ohio's combination of state and local taxes places it roughly in the middle for tax burden nationally.

The second reason for lower state taxes is a significant personal income tax reduction enacted in 2005 (HB 66-126) and phased in over several years, accounting for a nearly 18 percent reduction in that tax, followed by another 6.3 percent personal income tax reduction enacted in 2015.

The remaining GRF revenue comes from non-tax sources including money collected from licenses, fees and permits; the sale of bonds and notes; and interest accumulated from investments. Profits from the sale of lottery tickets are also deposited into the GRF. Voters passed a constitutional amendment in 1990 mandating that at least 30 percent of lottery profits go into the Lottery Profits for Education Fund, a budget fund that finances primary and secondary education.

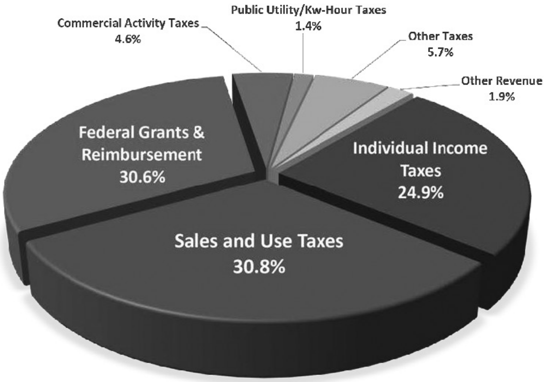
The General Assembly's standard practice since then is to deduct the amount of revenue contributed by the lottery fund from the amount that would normally have been appropriated for education purposes. As a result, the lottery's promised benefit to education has not been realized except to reduce reliance on other sources.

Over the years, federal funds have accounted for anywhere between 15 and 37 percent of revenue in the "all funds" budget. The increasing role of federal funds during the period 2008 to 2016 was due initially to federal stimulus funds appropriated to help the country recover from the Great Recession and then to the state's decision to expand Medicaid under the Affordable Care Act.

Most state revenues are deposited in the GRF and it is the principal fund used to pay for state operating costs and finance state services. GRF money provides support for local government, in part by reimbursing local governments for local revenue lost through homestead exemptions and rollbacks – two property tax relief programs enacted by the legislature. However, in 2011, the Local Government Fund was cut in half, reducing state tax revenue traditionally shared with local governments by a total of more than $1 billion by 2017. Other significant state cuts to local governments since then have included elimination of the estate tax (in January 2013) and the phasing out of the Tangible Personal Property Tax (TPPT), a tax applied on property used in business. Leaders of local governments across the state say that, taken all together, these losses have forced some local governments to reduce services or raise local taxes and fees.

Beyond the GRF, the overall state budget includes a number of restricted funds either generated by specific revenue sources (the Wildlife Fund, Workers' Compensation Fund) or that finance specified activities. Debt service funds exist to pay interest and principal on state debt incurred from the sale of bonds.

General Revenue Fund Sources

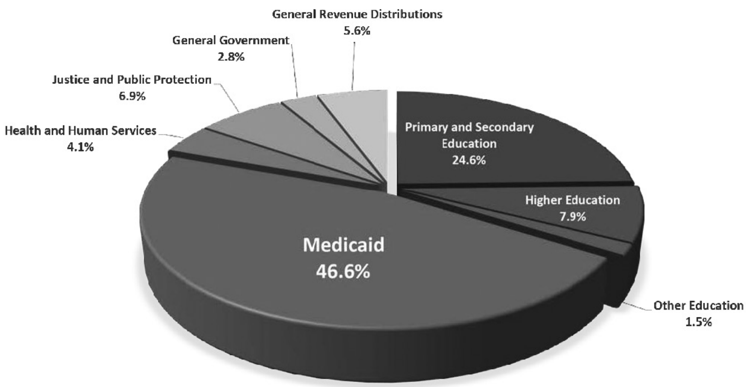


FY 2018-2019 Estimated (GRF) Revenue

State Taxes and Fees	\$23 billion	(69%)
Federal Funds	\$10.3 billion	(31%)

Source: Building for Ohio's Next Generation. Budget of the State of Ohio. Fiscal Years 2018-2019. https://obm.ohio.gov/Budget/operating/doc/fy-18-19/enacted/FY18-19_Enacted%20Budget%20 Highlights%20Book_rev%2010-2-17.pdf

Fiscal Year 2018-2019 Operating Budget



FY 2018-2019 (GRF) Appropriations

Health and Human Services and Medicaid	\$17 billion	(51%)
Education (Primary/Secondary, Higher Ed + other)	\$11.2 billion	(34%)
Justice and Public Protection	\$2.3 billion	(7%)
General government	\$900 million	(3%)

Source: Building for Ohio's Next Generation. Budget of the State of Ohio. Fiscal Years 2018-2019. https://obm.ohio.gov/Budget/operating/doc/fy-18-19/enacted/FY18-19_Enacted%20Budget%20 Highlights%20Book_rev%2010-2-17.pdf

Capital Budget

With the exception of items covered in the transportation budget, the capital budget pays for construction and repair of infrastructure – capital assets such as facilities and property used by state agencies, public colleges and universities, and school districts. Funds may also be allocated for community projects of local or regional interest, such as updating water and sewage treatment plants. The capital budget, however, differs from the state operating budget in a distinct way. Capital projects generally have a high initial cost that makes them difficult to fund with current revenues. To raise the money needed to finance capital projects, the state issues bonds, taking on long-term debt it repays over time.

Bonds, which are often characterized as IOU's sold to investors, are loans made to the state. Investors put up money needed for projects and are paid back with interest, generally spreading the cost of construction across seven to 20 years and thereby making construction projects affordable. Ohio issues general obligation bonds, special obligation bonds, revenue obligation bonds, and bond-like certificates of participation. The state Office of Debt Management facilitates bond sales and repayment.

General obligation bonds can be repaid from any type of state revenue. Special obligation bonds are repaid from revenues, fees, or payments the state receives for the use of the facilities being built. Revenue obligation bonds are used by specific governmental units for specific purposes. For example, the Ohio Turnpike and Infrastructure Commission issues these bonds to renovate the turnpike and pays off the bonds with toll money. A certificate of participation gives certificate buyers a share of the state's lease payments on a building or property in return for their money up front.

Budget Analysis

A number of research organizations, or "think tanks," provide analysis of and commentary on Ohio's budget. They are a source of useful – if sometimes partisan – information. They include the right-leaning Buckeye Institute (https://www.buckeyeinstitute.org/), the left-leaning Policy Matters Ohio (https://www.policymattersohio.org/), and the more centrist and human services-focused Center for Community Solutions (http://www.communitysolutions.com/). Beyond the research organizations, there are any number of advocacy groups and trade associations that examine budget issues and conduct public policy advocacy – including the League of Women Voters.

The biennial Capital Budget is prepared in line with the state's six-year Capital Improvements Plan. As with the biennial Operating Budget, the Office of Budget and Management reviews requests made by state agencies for capital projects, and the Governor's budget recommendations are introduced in the General Assembly. This bill may also include capital reappropriations, which reauthorize the appropriation of unspent funds from previously approved projects. Reappropriations allow construction to continue uninterrupted toward completion. The Capital Budget bill follows the same process as the Operating Budget for approval by the General Assembly and must be signed by the governor before the start of the fiscal biennium.