Buckeye Policy Brief

Weathering the Storm

Budgeting for Prosperity in a Time of Crisis

By Greg R. Lawson

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Introduction

As the dust settles from the 2020 election, Ohio policymakers will soon take up the most important piece of legislation they will consider over the next two years—Ohio's biennial operating budget, which promises to be one of the most challenging in recent memory. The COVID-19 pandemic presents ongoing uncertainty for businesses, families, educators, public health officials, and policymakers. Federal action has buoyed state revenues for now, but Ohio lawmakers must carefully craft a budget that balances constrained government revenues, higher spending on core government services, and a pro-growth tax code that promotes prosperity for all Ohioans.

This difficult balancing act requires Ohio to fund critical public health, education, and public safety services, while adhering to the following clear and prudent budgeting principles:

- Cut wasteful spending;
- Promote economic growth and private investment[1] with a fair and equitable tax policy;[2]
- Adopt simple local tax codes and promote targeted revenue sharing programs to effectively and efficiently use local tax dollars;[3]
- Make Ohio's full budget transparent;
- Avoid new spending by returning revenue surpluses to taxpayers;[4] and
- Give the state budget more rigorous safeguards to avoid future overspending.[5]

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[1] Rea S. Hederman Jr., Andrew J. Kidd, Ph.D., Tyler Shankel, and James Woodward, Ph.D., ***Sustaining Economic Growth: Tax and Budget Principles for Ohio***, The Buckeye Institute, February 21, 2019.
[2] Rea S. Hederman Jr., Tom Lampman, Greg R. Lawson, and Joe Nichols, ***Tax Reform Principles for Ohio***, The Buckeye Institute, February 2, 2015.
[3] *Ibid.*
[4] *Ibid.*
[5] *Ibid.*

Had policymakers followed these principles more rigorously in previous budgets, Ohio could have saved $4 billion, been better positioned to weather the fiscal storm brought by COVID-19, and recovered from it more quickly.

Retaining a Pro-Growth Budget During a Fiscal Crisis

As The Buckeye Institute testified before the General Assembly in 2019:

> "Even if the next recession is not just around the corner, now is the time to pursue meaningful, sustainable reform and take full advantage of this biennial opportunity to make Ohio more prosperous, while avoiding missteps that could lead to unpleasant financial consequences…The state's present spending trend risks derailing Ohio's economic recovery and further hindering its below-average economic growth rate."[6]

Unfortunately, Ohio's balanced, fair-weather budget was not built to withstand the storms of a recession, much less the swift, deep recession blown in by COVID-19. Governor Mike DeWine deserves credit for the state's hiring freeze and for ordering state-based budget cuts of $775 million.[7] And although state tax revenues have tracked closely with or slightly eclipsed projections since the start of fiscal year 2021,[8] the upcoming budget will likely see reduced financial resources. Even if Washington continues to provide a temporary port in the storm with additional federal aid, difficult fiscal policy decisions loom before the budget is due next June.

Ohio can offset some of the expected revenue shortfalls by judiciously using the Budget Stabilization Fund, commonly known as the rainy day fund, which currently boasts a strong $2.7 billion balance.[9] Governor DeWine wisely has resisted tapping into the rainy day fund, but also has made clear that he anticipates most of its balance will be spent in the next budget cycle[10] as pressure mounts for more state spending on public health, public education, and aid for cash-strapped local governments.

State policymakers must address these priorities while adhering to the following six fundamental, pro-growth tax principles that will keep Ohio on the road to a prompt and prosperous recovery.

Principle 1: Cut Wasteful Spending

The Buckeye Institute's biennial *Piglet Book* highlights many of the state's undisciplined, counter-productive, and wasteful spending programs.[11] The 2019 edition found at least $2.5 billion in

[6] Greg R. Lawson, research fellow, The Buckeye Institute, **Testimony** before the Ohio Senate Finance Committee, May 23, 2019.
[7] **COVID-19 Update: State Budget Impact**, Governor Mike DeWine press release, May 5, 2020.
[8] **Monthly Financial Report-September 2020**, archives.obm.ohio.gov (Last visited October 14, 2020).
[9] **State Budget Stabilization Fund**, Checkbook.Ohio.gov (Last visited October 14, 2020).
[10] Andrew J. Tobias, **Ohio Gov. Mike DeWine Expects to Spend State's Entire $2.7 Billion Rainy Day Fund During Coronavirus Crisis**, Cleveland.com. July 7, 2020.
[11] Greg R. Lawson, ***Piglet Book****,* The Buckeye Institute, April 10, 2019.

savings by limiting the growth of the budget, and eliminating corporate welfare and government intrusion into private philanthropy.[12] Examples of unnecessary spending include $3 million to Ohio Grape Industries, $20 million to TourismOhio and $33 million to the Ohio Arts Council.[13] The costs of such waste are compounded when lawmakers eye tax hikes to pay for them, so it is imperative to resist the temptation to raise taxes instead of cutting costs, especially during a fledgling economic recovery.

Principle 2: Promote Fair, Equitable, Pro-Growth Tax Policy

Ohio has made recent progress shifting from growth-stunting income taxes toward more equitable, growth-oriented sales taxes.[14] Now is not the time to impede that progress or raise taxes in an effort to balance the budget.

Taxes rightly fund essential government services, such as infrastructure, public health, and ensuring public safety. But taxes can also depress economic investments that create jobs and promote prosperity. Policymakers must strike the right balance to raise the requisite revenues without crippling the economy—especially as so much of the economy risks falling deeper into a pandemic-fueled recession. To help strike that balance, Ohio could suspend or reduce the state's commercial activities tax to spur more private-sector savings and growth.[15] Policymakers could also continue reforming Ohio's income tax regime by eliminating nearly $10 billion in tax expenditures and loopholes.[16] In 2018, for example, The Buckeye Institute found that closing a variety of tax expenditures—including the notorious "NetJets" exemption and the film tax credit, among other questionable special interest tax credits—could generate $1.8 billion in state revenues.[17] The last budget closed a few small tax loopholes, but most remain and continue to stymy pro-growth tax reform.

Taxes also present significant fairness and equity issues for taxpayers. A good tax code promotes equity by ensuring that it treats taxpayers in comparable situations comparably so that similar earners pay similar taxes, and it avoids taxing income multiple times. A good tax code does not give preferential treatment to specific industries or businesses, nor does it compel taxpayers to seek better tax treatment by merely changing their filing status.

Principle 3: Adopt Simple Local Tax Structures and Targeted Revenue Sharing

Ohio proudly relies on its home-rule traditions and depends on local governments to deliver basic public services. But Ohio's extraordinarily complex local government structure and municipal

[12] Greg R. Lawson, ***Piglet Book***, The Buckeye Institute, April 10, 2019.
[13] *Ibid.*
[14] Rea S. Hederman Jr., Andrew J. Kidd, Ph.D., Tyler Shankel, and James Woodward, Ph.D., ***Sustaining Economic Growth: Tax and Budget Principles for Ohio***, The Buckeye Institute, February 21, 2019.
[15] Rea S. Hederman, ***Policy Solutions for the Pandemic: Suspending the CAT will Help Ohio's Economy***, The Buckeye Institute, May 28, 2020.
[16] Ohio Department of Taxation, ***Tax Expenditure Report for Fiscal Years 2020-2021***, March 8, 2019.
[17] **The Buckeye Institute Identifies $1.8 Billion in Tax Loopholes that Should be Closed**, The Buckeye Institute press release, April 10, 2018.

income tax system hamper economic growth and routinely risk revenue shortfalls for municipalities.[18] Such risk increases during economic downturns and, according to the Brookings Institute, Ohio has four of the top five cities nationally with the most negative local revenue impact due to COVID-19 (Columbus, Cincinnati, Toledo, and Cleveland).[19] To mitigate the risk and better withstand potential revenue shortfalls, Ohio should adopt a more pro-growth, consumption-based mechanism to fund local governments, especially municipalities. At minimum, the General Assembly should standardize reciprocal municipal income tax credits across jurisdictions, especially considering the dramatic increase in telecommuting during the pandemic.

Without shifting to consumption-based taxes, Ohio may need to re-evaluate the Local Government Fund (LGF) to ensure that local governments have the necessary financial resources to provide core public health and safety services. But the need for additional assistance is not uniform across the state. Municipalities and counties that collect local income or sales taxes typically fare better than townships that rely primarily on property taxes.[20] So state policymakers should not authorize a blank-check LGF increase, which would incentivize localities to increase spending irresponsibly while expecting Columbus to pay for it. Instead, Ohio should offer LGF money targeted to local government accounts designated for specific municipal needs, and only local governments with limited tax bases should receive state assistance for providing critical public services. Such a targeted approach will help minimize wasting state taxpayer dollars on unnecessary local projects.[21]

Finally, to maximize efficient use of local tax dollars, lawmakers should promote revenue- and service-sharing programs among neighboring communities. Local neighboring communities can save money by working together efficiently to share emergency dispatch services, emergency vehicles, snowplows, and new technology purchases.[22]

Principle 4: Eliminate Ohio's "Shadow Budget"

Headlines across the state in 2019 announced a two-year state budget of $69.8 billion.[23] Those headlines were misleading. After accounting for all income to the state, the true biennial budget was $143.2 billion—more than twice the commonly cited total.[24] But there is more. Spending authorized by the state Controlling Board[25] and legislation outside the main budget process brings the total cost of state government to *more than* $152 billion—nearly 120 percent larger than the frequently cited amount. These auxiliary spending acts—along with new federal COVID-19 aid—

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[18] Michael A. Pagano and Christina K. McFarland, ***When Will Your City Feel the Impact of COVID-19?***, Brookings Institute, March 31, 2020.
[19] *Ibid.*
[20] *Ibid.*
[21] Greg R. Lawson, ***Local Government Funding Reform: Cost-Saving Alternatives to State Revenue Sharing***, The Buckeye Institute, March 7, 2019.
[22] *Ibid.*
[23] Associated Press, **DeWine Signs Next 2-Year, $69 Billion Ohio Budget, With 25 Vetoes**, 10TV.com, July 18, 2019.
[24] **Appropriation Spreadsheet House Bill 166-133rd General Assembly (As Enacted After Governor's Vetoes)**, Legislative Service Commission (Last visited November 22, 2019).
[25] **Controlling Board**, Ohio.gov (Last visited October 23, 2020).

create a “shadow budget,” which masks the true cost of government from the taxpayers and undermines accountability.[26]

Like taxes, government budgets should be clear, transparent and easy for constituents to understand. Taxpayers deserve to know how much their public servants and services really cost them.

Principle 5: Save or Return Budget Surpluses to Taxpayers

The rainy day fund’s $2.7 billion balance has Ohio better positioned than many states to navigate the pandemic crisis, and it would be wise to raise the fund’s statutory cap to allow even more savings to help weather future economic maelstroms.[27] Although a budget surplus in the next budget cycle seems unlikely, any surplus revenue should be returned to taxpayers or used to bolster the dwindling rainy day fund. Doing so will (1) help resist the temptation to overspend during an economic recession or recovery; and (2) ease potential budget shocks during recessions without having to resort to indiscriminate spending cuts or tax increases. As soon as practicable, policymakers should use budget surpluses either to advance pro-growth tax reform, such as income tax reductions, or else replenish Ohio’s rainy day fund after its expected depletion.

Principle 6: Give the State Budget Sustainable Safeguards

After the COVID-19 crisis subsides, Ohio policymakers should find prudent ways to trim the state budget and chart a more sustainable fiscal course with responsible safeguards and growth rates. Government budgets that exceed state growth rates are inherently unstable, but Ohio currently only applies a statutory appropriation limit—commonly called the SAL—to the General Revenue Fund (GRF) growth rate, which provides relatively flimsy protection against overspending.[28]

The SAL limits GRF spending growth to at least 3.5 percent or the sum of inflation plus population change, whichever is greater. Ohio’s population growth, however, has been near stagnant[29] and inflation has been low for years,[30] so the SAL has allowed the state to overspend in most years. A more rigorous limit below 3.5 percent would help prevent overspending the GRF.

Instead of the SAL-based status quo, Ohio should tie future GRF growth to dynamic inflation and population growth, while adjusting for the nuances of education and medical spending.[31] This tighter limit may still be subject to a disturbing number of accounting gimmicks, but it would better protect taxpayers from unnecessary spending increases and put Ohio’s budget on a more sustainable path.

[26] Jaren Walczak, ***State and Local Funding Totals Under the CARES Act,* Tax Foundation**, Tax Foundation, April 1, 2020.
[27] **State Budget Stabilization Fund**, Checkbook.Ohio.gov (Last visited November 2, 2020).
[28] Oh**io Revised Code 107.033 (2006).**
[29] **Quick Facts: Ohio**, Census.gov (Last visited November 3, 2020).
[30] **Consumer Price Index**, BLS.gov (Last visited November 3, 2020).
[31] *Ibid.*

Finally, specific federal funding meant to assist with unanticipated COVID-19 costs should be tracked and not added to the state's normal budget baseline. Excluding the unprecedented federal aid from the state budget will prevent a false, higher baseline from creeping into subsequent budgets and creating larger spending gaps in future downturns.

Conclusion

Budgeting for prosperity in times of crisis requires difficult choices and strategic vision. Adhering to sound, fundamental economic principles can help. As Ohio policymakers deliberate the next biennial operating budget—the most challenging in recent memory—they must resist the temptation to overspend and raise taxes, and instead look for ways to trim unnecessary spending, promote pro-growth tax reform, and chart a sustainable fiscal path forward. The hefty balance in Ohio's rainy day fund has served the state well during the current crisis. Fiscal prudence and a demonstrated willingness to save rather than spend have created that balance—a lesson that policymakers should not soon forget. Closing tax loopholes, incentivizing private investment, and strategically targeting local government revenue sharing should also be pursued as Ohio looks to avoid a protracted, pandemic-induced recession. With fiscal discipline and transparency, Ohio can emerge from the COVID-19 crisis with an even stronger, more durable economy and a more sustainable state budget in the years ahead.

About the Author

Greg R. Lawson is the research fellow at The Buckeye Institute and serves as Buckeye's liaison to officials in the legislative and executive branches, and educates policymakers on free-market solutions to Ohio's challenges. Lawson has nearly 20 years of experience, working closely on seven state budgets, and has a deep knowledge of state and local taxes, and Medicaid, education and transportation funding. He is the author of the *Piglet Book*, The Buckeye Institute's biennial publication outlining areas of government waste, and develops Buckeye's Top 10 Worst Capital Budget Requests list. He began his career in state policy as a Legislative Service Commission fellow with the Ohio General Assembly.

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