



A CASE STUDY FROM THE HEARTLAND

OHIO'S TAX COLLECTIONS REVEAL DANGER FROM BIG GOVERNMENT BAILOUT

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Introduction

By many accounts, Ohio has been an exemplar of how a fiscally responsible state should act during an economic downturn: prudently cutting its budget when the pandemic threatened fiscal solvency, preparing for hard times by building up its rainy day fund before the pandemic, and not exhausting those resources once the pandemic struck.¹ Other states would be wise to view Ohio as a case study for reform. But with the surging pandemic threatening Ohio's fiscal future, state lawmakers need to continue cutting wasteful spending, preparing for slow economic growth, and making strategic use of the rainy day fund.

The pandemic—and the response to it—unquestionably poked holes in state budgets across the country and threw sand in the engine of economic growth. Within about a month of the pandemic's start, Ohio experienced an unprecedented economic upheaval as its state budget went from surplus to shortfall seemingly overnight.² But with higher-than-expected tax revenue collections supported by an imperfect economic recovery, pandemic-relief proposals in Washington would give too much aid to states, incentivize states to spend beyond their needs, and reward states for imprudently neglecting their own rainy day funds before the pandemic.³

¹ **COVID-19 Update: State Budget Impact**, Governor Mike DeWine press release, May 5, 2020; Randy Ludlow, **Kasich Defends \$2.7 Billion Rainy Day Fund Against Raids**, *The Columbus Dispatch*, July 11, 2018; and **State Budget Stabilization Fund**, Checkbook.Ohio.gov (Last visited December 4, 2020).

² **COVID-19 Update: State Budget Impact**, Governor Mike DeWine press release.

³ **Ohio Office of Budget and Management Monthly Financial Report**, November 10, 2020; and **Tracking America's Recovery**, CNN (Last visited December 9, 2020).

Tough Choices to Close Fiscal Year 2020

Governor Mike DeWine should be commended for making the difficult decision to cut \$775 million from Ohio's budget and instituting a government hiring freeze to help balance the budget in the last fiscal year.⁴ Although the Ohio budget was running a surplus of nearly \$200 million by the end of February 2020, the balance quickly cratered nearly \$1 billion and ended April \$776.9 million below estimates. Fortunately, Ohio took immediate fiscally responsible action by freezing spending, prudently cutting the budget, and preserving the rainy day fund for possible long-term budget impacts even before the full toll of the pandemic on state finances was known.

As Governor DeWine stated, "I know that I have said that 'it's raining,' but we do not want to tap into the rainy day fund yet...The 'rain' is not a passing spring shower—it could be a long, cold, lingering storm, and we should not use the fund until it is necessary."⁵ This was the correct and responsible decision. With tax revenue now beating revised estimates as the economy recovers and a rainy day fund of nearly \$2.7 billion, Ohio is well-positioned to take up the biennial operating budget next year.⁶

Higher Than Expected Tax Collections Are Good News for Ohio's Next Budget

Even with significant financial aid coming from Washington, some projections still suggest that Ohio could be facing a budget shortfall upward of \$2 billion for the fiscal year that started in July 2020.⁷ A closer look at how Ohio tax revenue is holding up since the start of the pandemic provides some optimism and ultimately should prove useful in the state's upcoming budget discussions.

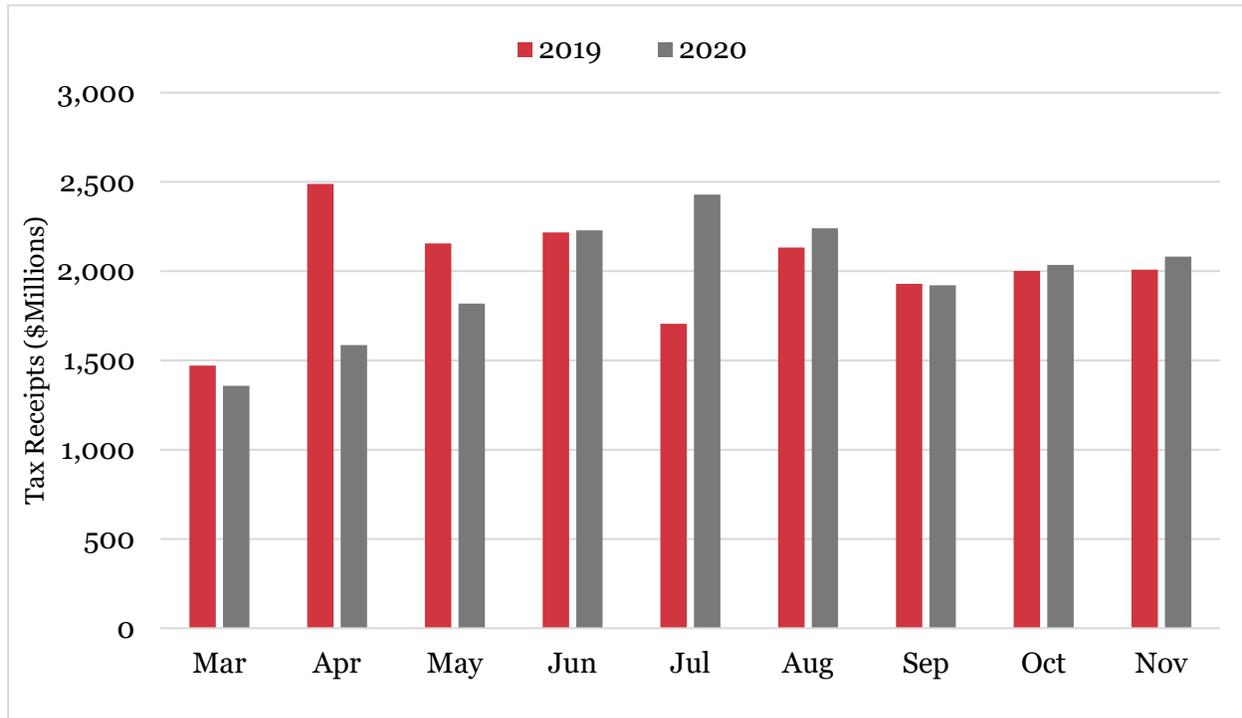
Figure 1 compares Ohio tax revenue since the start of the pandemic-related budget hits in March 2020 to the same time period in the previous year. Over the past nine months, Ohio has raised \$412 million less in tax revenue than it did during the same timeframe in 2019. That may sound like a lot, but it represents less than a 2.3 percent drop and has been driven almost entirely by the early months of the pandemic. Although March, April, and May registered \$1.35 billion below 2019 revenues, partially driven by an extension of the income tax payment deadline, tax revenue collections since June are up \$941 million over the same period. Ohio has already weathered the pandemic's initial revenue shock, so if Ohio can keep the pandemic at bay and avoid further economic disruptions, the state appears to be in sound fiscal shape heading into budget discussions early next year.

⁴ *Ibid.*

⁵ *Ibid.*

⁶ **State Budget Stabilization Fund**, Checkbook.Ohio.gov (Last visited December 4, 2020).

⁷ Jeremy Pelzer, **Ohio Leaders Will Have to Fix \$2 Billion Budget Shortfall, Top Lawmaker Says**, Cleveland.com, November 5, 2020; and **Ohio Office of Budget and Management Monthly Financial Report**, June 10, 2020.

Figure 1: Comparison of 2019 and 2020 General Revenue Fund Tax Collection⁸

Of the \$412 million decline in tax receipts from March to November, 90.8 percent of that net decline was driven by lower personal income tax revenue. Ohio's unemployment rates fell for six consecutive months since their peak in April (according to the Bureau of Labor Statistics), but unemployment claims have risen in recent weeks, making it too soon to tell whether the Ohio labor market is making its way toward full recovery.⁹ If the state's unemployment rate continues falling, then Ohio's income tax revenue may continue to beat recent estimates.¹⁰ Regardless of how the unemployment rate trends in the near future, however, Ohio lawmakers must avoid disruptive labor market temptations, such as tax increases to balance the budget, that could place more Ohioans on the public dole.

Lockdowns and stay-at-home orders were correctly projected to hammer consumer demand and slump sales tax revenue early in the pandemic.¹¹ But as those orders were lifted, a corresponding rebound in consumption has raised sales and use tax revenue significantly, helping to keep the

⁸ Source: Authors calculations from **Office of Budget and Management Monthly Financial Reports**; and Office of Budget and Management, **Office of Budget and Management Releases Preliminary November Revenue Data**, December 7, 2020; Notes: November results are preliminary. Extension of income tax payment deadline significantly influenced April and July tax figures in 2020.

⁹ U.S. Bureau of Labor Statistics, **Local Area Unemployment Statistics**, Ohio (Last visited December 4, 2020); Jeremy Pelzer, **Ohio Sees Jump in New Unemployment Claims**, Cleveland.com, November 19, 2020; **The Buckeye Institute: Ohio's Labor Market Roared Back to Life in October**, The Buckeye Institute press release, November 20, 2020.

¹⁰ For Ohio's unemployment rates see U.S. Bureau of Labor Statistics, **Local Area Unemployment Statistics**.

¹¹ Jeffrey Clemens and Stan Veuger, **Implications of the Covid-19 Pandemic for State Government Tax Revenue**, working paper 27426, National Bureau of Economic Research, June 2020.

Ohio budget afloat.¹² In fact, sales and use tax revenue has fallen less than 0.04 percent (only \$3 million) compared to the March through November timeline last year. Like many other tax revenue sources in Ohio, the sales and use tax revenues have only grown stronger in recent reports. They have surpassed expectations every month of this fiscal year¹³ and will likely rebound further as Ohioans feel more comfortable spending money at stores and football games.

The most recent data from the Bureau of Economic Analysis showing that Americans hold an annualized \$2.86 trillion in savings offers still another sign for cautious optimism.¹⁴ Federal aid packages undoubtedly supported the economy during the pandemic and contributed to higher than usual household savings, so if a vaccine can be deployed before these savings are depleted, Ohio's sales tax revenue should rebound further once the pandemic subsides.

How Washington Should View the Tax Rebound

With tax revenues performing significantly better than expected in Ohio and across the nation, many federal proposals to bailout state and local governments should be revised downward. Initial proposals by congressional Democrats suggested \$1 trillion in bailouts, with a more recent proposal asking for \$436 billion.¹⁵ Republicans suggested \$250 billion in the fall, and a new bipartisan plan this December proposed a more reasonable \$160 billion.¹⁶

Washington could always revisit these bailout figures if state and local revenues start performing worse than expected, but for now Ohio's recent tax revenue is consistently beating newly revised expectations, making significant bailouts unnecessary. Jared Walczac of the Tax Foundation estimates that under each of the three most likely methods of distributing the smallest federal proposal, Washington would send Ohio more than \$5 billion in state and local aid.¹⁷ Given that local governments tend to rely on more stable revenue sources, such as property taxes, they also tend to see smaller revenue contractions during economic downturns.¹⁸ Thus, sending Ohio \$5 billion to cover an anticipated \$2 billion state-level shortfall in the next fiscal year is not a

¹² Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team, **Opportunity Insights: Economic Tracker**, Percent Change in All Consumer Spending (Last visited December 4, 2020); and Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team, **The Economic Impacts of COVID-19: Evidence from a New Public Database Built Using Private Sector Data**, latest version November 2020.

¹³ **Ohio Office of Budget and Management Monthly Financial Report**, November 10, 2020.

¹⁴ Bureau of Economic Analysis, **National Income and Product Accounts**, Table 2.1 (Last visited December 4, 2020).

¹⁵ Billy House, **Stimulus Talks are Stuck in \$1 Trillion Ditch Over Aid to States**, Bloomberg Tax, August 14, 2020; and U.S. House Committee on Appropriations, **The Heroes Act One-Pager**, September 28, 2020.

¹⁶ Lindsey McPherson, **Exclusive: Mnuchin Coronavirus Relief Plan Includes More State, Local Funds**, *Roll Call*, September 30, 2020; and Seung Min Kim, Jeff Stein, and Mike DeBonis, **Bipartisan Group of Lawmakers Announces \$908 Billion Stimulus Plan, Aiming to Break Logjam**, *The Washington Post*, December 1, 2020.

¹⁷ Ohio would be given \$5.02 billion under the Heroes framework, \$5.736 billion if distributed by unemployment, and \$5.635 billion if Washington used population totals. See, Jared Walczac, **How Would the Proposed \$160 Billion in State and Local Aid Be Allocated?**, Tax Foundation, December 1, 2020.

¹⁸ Jared Walczac, **State Revenue Forecasts Indicate \$121 Billion 2-Year Tax Revenue Losses Compared to FY 2019**, Tax Foundation, July 15, 2020.

responsible proposal—especially considering that tax revenues are beating estimates and the state’s rainy day fund remains untouched.¹⁹

Ohio is by no means an outlier in tax revenue performance. Bureau of Economic Analysis data in the third quarter of the calendar year show that state and local tax collections are on the rise across the country.²⁰ Smaller states have seen revenue make a strong comeback. Forecasters in Kansas, for example, optimistically revised the projected deficit through the fiscal year ending in 2022 from \$1.4 billion to just \$119 million.²¹ North Carolina, a larger state, saw tax revenue drop only roughly 0.3 percent from April through October 2020 compared to the same period in 2019.²² Boosted by a roaring stock market and a recovering economy, recent figures suggest that California is beating revenue estimates in the fiscal year by nearly \$10 billion or 18.6 percent.²³ States across the country—small and large, liberal and conservative—have seen significant rebounds in their tax revenue as the economy trends upward.

Healthy Ohio Rainy Day Fund Should Be a Model

Ohio’s fiscal prudence sets an example for other states to follow. With a rainy day fund balance just under \$2.7 billion, Ohio is well-positioned relative to some of its peers.²⁴ Former-Governor John Kasich deserves praise for replenishing the fund before the pandemic—resisting demands to spend it during times of financial success.²⁵ Governor DeWine also deserves credit for making strategic budget cuts rather than making premature withdrawals from the rainy day fund.²⁶ These actions kept the rainy day fund available for the second year of Ohio’s biennial budget—which the state may need if pandemic cases continue to rise.²⁷

Importantly, despite the pandemic, Ohio’s rainy day fund exceeds the projected budget shortfall for the upcoming fiscal year. But before dipping into state savings, Ohio lawmakers should cut the \$4 billion in unnecessary spending that The Buckeye Institute has identified, and then turn to the rainy day fund if necessary.²⁸ Lawmakers then should prepare for future economic downturns by replacing any withdrawals once the economy bounces back.

¹⁹ Jeremy Pelzer, **Ohio Leaders Will Have to Fix \$2 Billion Budget Shortfall, Top Lawmaker Says**, Cleveland.com, November 5, 2020.

²⁰ Bureau of Economic Analysis, **National Income and Product Accounts**, Table 3.3, (Last visited December 4, 2020); For an analysis of this data see, Chris Edwards, **State and Local Tax Revenues are Rising**, Cato Institute’s Cato at Liberty Blog, October 30, 2020.

²¹ Michael Austin, **Legislature Could Turn Incoming Fiscal Shortfalls into Savings**, Kansas Policy Institute, November 18, 2020.

²² Joseph Coletti, **State Revenue Picture Continues to Improve**, John Locke Foundation, November 23, 2020.

²³ The Editorial Board, **State Tax Revenue Rebound**, *The Wall Street Journal*, November 16, 2020.

²⁴ **State Budget Stabilization Fund**, Checkbook.Ohio.gov (Last visited December 4, 2020).

²⁵ Randy Ludlow, **Kasich Defends \$2.7 Billion Rainy Day Fund Against Raids**, *The Columbus Dispatch*, July 11, 2018.

²⁶ Barb Rosewicz, Justin Theal, and Joe Fleming, **COVID-19 Prompts States to Start Tapping Financial Reserves**, The Pew Charitable Trusts, October 13, 2020

²⁷ Carrie Ghose, **Here’s How Big a Bite Covid-19 is Taking Out of Ohio’s Budget for the Coming Year**, *Columbus Business First*, June 10, 2020.

²⁸ Greg R. Lawson, **Weathering the Storm: Budgeting for Prosperity in a Time of Crisis**, The Buckeye Institute, December 1, 2020.

Even with tax revenue beating projections, many states still forecast budget shortfalls of varying degrees through the next couple fiscal years and the surging pandemic jeopardizes the better-than-expected results. These uncertainties underscore the need for states to follow Ohio's lead and build healthy rainy day funds during times of prosperity in order to remain solvent during economic downturns. The Great Recession may have taught some states to maintain stronger rainy day funds—a lesson proving valuable as revenues recede in 2020. Heading into the Great Recession, the average rainy day fund balance accounted for only 4.8 percent of general revenue fund spending—but rose to eight percent in the most recent fiscal year before the pandemic.²⁹ The states held \$75.2 billion in rainy day funds—roughly \$43 billion more at the start of the current recession than before the Great Recession—and \$118.8 billion in total balances when including general fund surpluses.³⁰

Targeted federal aid to states may remain necessary as COVID-19 cases surge, but Washington must be careful not to overspend recklessly by guessing how much money states need. Federal policymakers should also be mindful not to create disincentives for fiscal prudence or punish states that wisely prepared their budgets for economic downturns. A misguided guess-and-check approach should be avoided entirely by tying federal aid to states' "demonstrated losses" created by pandemic-related shortfalls. But fairness demands that Washington adjust its aid according to each state's *pre-pandemic* rainy day fund balance in order to avoid punishing preparation and prudence. The federal government should want more states acting as Ohio did—making budget cuts to maintain fiscal solvency and preserving rainy day funds even during the initial stages of economic calamity. Smart fiscal policy would encourage states to follow Ohio's model approach.

Conclusion

These hard times have required tough choices. Ohio policymakers have set an example for other state and federal policymakers to follow. Ohio's tax revenues have performed better than expected and the state's rainy day fund exceeds projections for the upcoming fiscal year. Reasons for optimism abound. But reduced financial resources and a surging pandemic continue to threaten Ohio's recovery. State lawmakers should continue cutting unnecessary spending, starting with the \$4 billion that The Buckeye Institute has recommended.³¹ Most importantly, lawmakers must avoid tax increases and prepare for slow economic growth. With better-than-expected tax revenues and healthy rainy day funds across the country, Washington should reconsider how much aid state and local governments really need to weather this fiscal storm, and make sure that any federal aid remains appropriately tailored to meeting those needs. Ohio has charted a viable path forward that other policymakers would be prudent to take.

²⁹ National Association of State Budget Officers, **Fiscal Survey of the States: Overview**, Spring 2020; and Jared Walczac and Janelle Cammenga, **State Rainy Day Funds and the COVID-19 Crisis**, Tax Foundation, April 7, 2020.

³⁰ National Association of State Budget Officers, **Fiscal Survey of the States: Overview**, Spring 2020; and Rosewicz, Theal, and Fleming, **COVID-19 Prompts States to Start Tapping Financial Reserves**, The Pew Charitable Trusts, October 13, 2020.

³¹ Greg R. Lawson, **Weathering the Storm: Budgeting for Prosperity in a Time of Crisis**, The Buckeye Institute, December 1, 2020.

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