BUCKEYE POLICY BRIEF

Budget Priorities for a More Prosperous Ohio

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Introduction

As Ohio lawmakers prepare the biennial budget for fiscal years 2024-2025, they should take advantage of the state's robust surplus to make aggressive tax and education reforms. Ohio's rainy-day fund sits at a record $2.73 billion[1] and the budget stabilization fund will grow by nearly $750 thanks to recent legislation,[2] both of which give Ohio some financial flexibility to pursue meaningful tax and K-12 education policy reforms designed to make the state more competitive and its economy more sustainable in the long-run. But with economic growth already slowing, and forecasters warning of a coming downturn, policymakers must act quickly.[3]

Effective Tax Reform

Despite making some prudent tax reforms over the past decade, Ohio tax policy remains below average nationally. The Tax Foundation, for example, recently ranked Ohio 35th overall and 41st in individual taxes.[4] Those scores must improve for Ohio to remain economically competitive in today's global market. Lawmakers should strive to make the state's tax system simple and transparent, with low, broad-based taxes that do not discourage work or investment and do not encourage tax shelters and other tax-avoidance schemes. As economists at the Organization for Economic Community Development (OECD) have explained, "[tax systems] need…to minimize taxpayers' compliance costs and government's administrative cost, while also discouraging tax avoidance and evasion. But taxes also affect the decisions of households to save, supply labor and invest in human

[1] **State Budget Stabilization Fund**, Ohio Checkbook.gov (Last visited January 17, 2023).
[2] Jessie Balmert, Haley BeMiller, and Anna Staver **Ohio Statehouse Roundup: Which hot-button bills passed at the end of the 2022 session**, *The Cincinnati Enquirer*, December 15, 2022.
[3] Congressional Budget Office, **CBO's Current View of the Economy in 2023 and 2024 and the Budgetary Implications**, November 30, 2022.
[4] Janelle Cammenga and Jared Walczak, ***2022 State Business Tax Climate Index***, The Tax Foundation, 2021.

capital, the decisions of firms to produce, create jobs, invest and innovate, as well as the choice of savings channels and assets by investors."[5]

Accordingly, Ohio tax reform should focus on improving its most economically harmful taxes: the income tax and commercial activities tax (CAT).[6]

Individual Income Tax Reform

Taxing labor income reduces worker take-home pay, which discourages work and negatively affects investment and savings. According to the OECD, property taxes and broad-based consumption taxes offer better ways to collect tax revenue from individuals.[7] Ohio should move away from its complex multi-rate income tax system to a simpler consumption-based tax, either by eliminating the state income tax altogether or adopting a single rate flat tax that does not double-tax income from investments. With state coffers currently running a surplus, now is the time for policymakers to allow workers and their families to keep more of their hard-earned income by making a move to a more efficient, pro-labor tax system.

Commercial Activities Tax

Ohio's CAT is an economically harmful tax in several ways. First, it taxes the gross receipts, not the profits, of companies doing business in the state. That means that businesses with high sales and low profit margins—such as grocery stories, for example—are the most effected by the tax. And it also means that companies must pay the CAT even during difficult years when they lose money, inflicting even more financial pain during recessions or pandemics. Second, the CAT is a "pyramid tax" that taxes every business involved in the production of a good, which therefore raises the price of goods at every stage of their production. That means that consumers are at an economic disadvantage and must pay increasingly higher prices for goods made or sold in Ohio—higher prices that many can ill-afford during economic downturns or pandemics.

Unsurprisingly, economists report that businesses look to avoid such taxes and will even relocate to low-tax and non-CAT states.[8] Such tax-induced moves will plague Ohio consumers, employees, and residents as companies pull up stakes and take their jobs, products, tax revenues, and civic involvement with them. The CAT produces less than 10 percent of total Ohio taxes, but it saddles Ohio businesses and consumers with higher prices and operating costs that suppress consumption and growth. It is time for Ohio to abandon the CAT and pursue prosperity.

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[5] Organization for Economic Community Development, ***Tax Policy Reform and Economic Growth*** (OECD Publishing, 2010), pg. 18.
[6] Organization for Economic Community Development, ***Tax Policy Reform and Economic Growth*** (OECD Publishing, 2010), pg. 21.
[7] Organization for Economic Community Development, ***Tax Policy Reform and Economic Growth*** (OECD Publishing, 2010), pg. 21.
[8] William F. Fox and Matthew N. Murray, "Local Public Policies and Interregional Business Development," *Southern Economic Journal*, Volume 57, Number 2 (October 1990) p. 413-427.

Fix the Broken Municipal Tax System

Ohio's municipal income tax system does not reflect the realities of a more transient workforce or the needs of small businesses.[9] It taxes many workers twice and imposes expensive compliance requirements that punish small businesses. The system is outmoded and has been all but abandoned as a failure across the country. State and local policymakers should strategically transition toward a more sustainable, long-term municipal revenue source, such as property taxes, that protects the core needs of Ohio's communities without handicapping longer-term economic growth.

Furthermore, state lawmakers should pursue policies that strengthen rather than weaken local and municipal budgets. As the Buckeye Institute has previously advised, this can be done in several ways.[10] For starters, Columbus should eliminate unfunded mandates on local governments. Unfunded state demands on local governments limit financial flexibility and make it harder for local communities to adhere to their budgets while still meeting their constituents' needs. Those mandates should stop. Next, state resources should be spent on specific, critical needs at the local level. State tax dollars should be designated for local accounts used to address specific needs—not dumped into nondescript accounts that facilitate unfocused spending. And finally, state policymakers should limit broad-based revenue sharing to local governments and communities that genuinely need state assistance to provide critical goods and services to constituents.

These policies will help local governments align their local tax burden with government capacities and allow Ohio to unwind its long-standing use of over-the-top property tax abatements. Such a transition will be critical for strengthening local property tax bases to meet revenue demand without raising the total local tax burden.

Effective K-12 Education Reform

Ohio has recently helped parents seek and provide the best education for their children. Lawmakers have expanded eligibility and increased amounts available for EdChoice scholarships, created a tax credit for contributions to scholarship granting organizations, and—inspired by The Buckeye Institute's recommendation—established the Afterschool Child Enrichment Program (ACE), the first education savings account (ESA) in Ohio for any child at or below 400 percent of the poverty line.[11] Those are big wins for Ohio families, and state officials should build on their momentum.

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[9] Greg R. Lawson, Rea S. Hederman Jr., Andrew J. Geisler, ***Sustainable Ohio: How to Fund Ohio's Cities in the 21st Century*,** The Buckeye Institute, January 24, 2022

[10] Greg R. Lawson, ***Local Government Funding Reform: Cost-Saving Alternatives to State Revenue Sharing***, The Buckeye Institute, March 7, 2019.

[11] Greg R. Lawson, **Buckeye Institute-Inspired ACE Program Launches,** The Buckeye Institute, April 11, 2022.

Fund Students First

It is time to fund students before bureaucracy.

Ohio has taken some strides to ensure that K-12 education funding follow students to where they learn rather than where they live. Unfortunately, the current funding plan continues to view school districts and the education bureaucracy as the first and most important recipient of taxpayer money. This has it backwards. Districts should have to compete to earn the business of families seeking the best education for their kids—but they won't, unless they know families can take their education dollars elsewhere.

As students look to recover lost academic ground due to COVID-related school closures, policymakers should look to make every educational option and resource available and more affordable for parents. The COVID-19 pandemic cost some K-12 students semesters of formative education and, if unaddressed, this learning loss will cost them—and their futures—even more. To recoup their students' losses, parents should be equipped with educational tools and resources tailored to their child's unique learning needs. Expanded school choice options have taken steps in the right direction, but even more flexibility and funding are needed to maximize academic opportunities for all K-12 students.

As The Buckeye Institute explained in *#StudentsFirst: Empowering Parents to Help Students Regain Lost Learning*, Ohio's next budget should pursue the following three K-12 education policy reforms:[12]

1) *Embrace Robust ESAs for Any Student that Wants One.* ESAs can pay for tuition at private schools like vouchers. But they can also be used to purchase additional educational resources such as textbooks, tutors, online classes, and group learning pods.

2) *Increase the Scholarship Donation Tax Credit.* Ohio allows for a $750 per taxpayer tax credit if a taxpayer donates to a qualified scholarship granting organization. This was a good first step, but the relatively low amount of the credit makes it difficult and time-consuming to quickly piece donations together to create scholarships large enough to be used by the students they are meant to help. Raising this credit to $2,500 would allow taxpayers to help fund more scholarships for more students.

3) *Make Inter-District Open Enrollment Mandatory for All School Districts.* Although roughly 80 percent of Ohio's public-school districts offer some form of inter-district open enrollment, those that do not are largely in the metropolitan suburbs. Their nonparticipation diminishes opportunities for students in the state's most challenged schools where students already suffer from long-standing achievement gaps. School districts refusing to participate in inter-district enrollment put disadvantaged students last, not first. That needs to change, and the General Assembly should require it.

[12] Greg R. Lawson, ***#StudentsFirst: Empowering Parents to Help Students Regain Lost Learning***, The Buckeye Institute, September 6, 2022.

Rather than writing blank checks made out directly to public school districts, the state should send new checks to the families of students first.

Enhance Higher Education Through Competition

With the new Intel plant and other high-tech businesses coming to Ohio, the state potentially has a generational opportunity to prepare today's workforce for tomorrow and transform its outdated economy. That preparation and transformation should start by making Ohio's higher education field more competitive. More competition means lower tuition, better education, more useful degrees and credentials, and a broader selection of education options to meet student and employer needs. Unfortunately, Ohio's current education-funding vehicle uses a "state share of instruction" (SSI) model that silos money for community colleges and traditional regional and four-year schools, which negates the benefits of competition. Although a tuition voucher system would drive competition between higher education institutions, other reforms could be included in the upcoming budget.

Rightsizing Funding by Reimagining State Share of Instruction

Ohio lawmakers should re-formulate how higher education institutions are funded to better capture schools that will train tomorrow's workforce and provide in-demand skillsets. The current SSI funding protocol largely funds community colleges and four-year universities based on the number of degrees and courses their students complete, with no metric for the market value of the education received. Community colleges receive half of their SSI funding from course completions, a quarter from degree completion, and a final quarter for "success points" earned by students completing a certain number of credit hours or courses.[13] Similarly, degree and course completions compose more than 80 percent of university SSI funding.[14] Thus, Ohio largely distributes SSI funds to schools simply based on the number of students who complete courses and earn degrees, regardless of what those courses or degrees may be or how well they translate into postgraduation employment, salaries, job retention, or student loan repayment. In 2019, for example, 87 percent of community college programs for liberal arts or general studies (the most popular field), yielded median earnings of $30,000 per year or less—below the median salary of a high school graduate.[15] That means most students completing a community college degree in the most popular program were set to earn less than most high school graduates. That should change.

A better SSI formula would take into account other metrics such as student loan repayment rates, postgraduation debt-to-earnings ratios, and gainful postgraduation employment. Colleges should be financially rewarded to encourage students to pursue courses in better-paying fields such as

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[13] Ohio Department of Higher Education, **State Share of Instruction (SSI) Information** (Last visited January 20, 2023).

[14] *Ibid.*

[15] Preston Cooper, **Why Free Community College Solves the Wrong Problem**, James G. Martin Center for Academic Renewal, September 17, 2021.

nursing, for instance, where the median salary of 94 percent of community college programs is $50,000 or more.[16] Offering schools SSI funds based on real-world, labor-market metrics—rather than just course completion and graduation rates—would incentivize community colleges and universities to offer courses that truly prepare students for the workforce, encourage classes and degrees that employers find useful, and at a price that graduates can afford.

Reform Ohio's "Pell-First" Policy

Ohio colleges and universities also rely on funding from the Ohio College Opportunity Grant (OCOG) program. Eligibility for that program or the state's Pell-First policy need to change. Ohio's Pell-First policy prohibits OCOG funding when a Pell grant covers expenses beyond tuition. That rule denies community college students OCOG funds because their tuition is more affordable, and it reinforces school funding silos that limit competition. Removing the flawed Pell-First policy would further level the funding playing field, increase competition across colleges, and reduce barriers to community college attendance by helping students pay for more than tuition.

Cap Administrative Spending

The price of higher education administration has raised the price of going to college. More is now spent on administration than teaching. According to the American Council of Trustees and Alumni, the cost of student services (29 percent) and administration (19 percent) have grown much more than instructional spending (17 percent).[17] Entire bureaucracies at major state-funded universities are now devoted to non-academic functions like "diversity, equity, and inclusion."[18] The Ohio State University, for example, employs nearly 90 people in this one area alone at a combined cost of $7.3 million in salaries and fringe benefits. Whatever the merit of such positions, they are not instructional positions that prepare students for careers in the 21st century workforce, but they do increase costs and add to student debt.

Some administrative staff is essential, of course, but administrative costs should not outpace instruction costs. The General Assembly should reasonably restrict non-core related expenses at taxpayer-funded colleges and universities. Failure to adhere to such restrictions should proportionally reduce SSI funding to the school.

Conclusion

Ohio has an opportunity to improve its economy and its workforce. As lawmakers prepare the state's biennial budget, tax and education policy reform should both be on the table as part of a concerted effort to make Ohio more affordable and its people more prosperous. The state trails in national economic rankings, but a strong rainy-day fund and a budget surplus offer policymakers a chance to fix broken tax systems and amend education policies to put students before

[16] *Ibid*.
[17] American Council of Trustees and Alumni Institute for Effective Governance, ***The Cost of Excess***, August 2021.
[18] Derek Draplin, **Ohio State Employs 88 Diversity-related Staffers at a Cost of $7.3 Million Annually**, The College Fix, September 6, 2018.

bureaucracies. Such proactive reforms today will make it easier to weather economic downturns tomorrow. More importantly, tax reforms that allow workers to keep more of their own money and education policies that empower parents and students instead of administrators will make Ohio a freer, less expensive, and more desirable place to live, learn, and work.

About the Authors

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