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POLICY REPORT

Revenue Sharing Reform: On the Road to Ohio's Recovery

by Greg R. Lawson

Executive Summary

There has been a great deal of discussion about cuts made by the Kasich Administration and the General Assembly to revenue sharing programs that redistribute state dollars to local governments. Critics of the cuts maintain that they are too severe and will disrupt various government services.

The critics' concerns, however, miss the mark for several reasons:

1) Local government tax revenues, particularly municipal income and county sales tax, have been increasing, not decreasing as the critics would have us believe. Aggregate municipal income tax revenue rose by $230 million in 2012, and aggregate county sales tax revenue increased over $80 million in 2013. In both cases, only a handful of local governments implemented new taxes or raised rates.

2) Nine out of ten Ohio counties have a surplus in unassigned General Revenue reserve funds greater than the 5% reserve that the state must maintain in its "rainy day" fund. Nearly 90 percent of municipalities do as well.

3) Ohio's Local Government Fund (LGF)—one of the state's redistribution programs subject to recent cuts—represents a very small percentage of what the state spends supporting local governments; roughly 2.5 percent of the $13.6 billion expected to be spent in 2014. Even before any of the Administration's revenue sharing cuts, the LGF was less than 5 cents of every dollar in total state support for local governments and a little over 1 percent of total local revenues.

Ultimately, the long-term fiscal health of the state's local governments will be determined by Ohio's economic growth, not by perpetual state subsidies or the redistributive preferences embodied in revenue sharing. By slowly beginning to reform Ohio's revenue sharing system, Ohio policymakers are embracing a new approach to government spending that will empower local taxpayers to assert greater control over local decisions and facilitate local governments re-thinking how they operate. Over time, this shift should lead to more fiscal discipline from government at every level, and more space for the private sector to create the economic growth and opportunities Ohio needs.

Introduction

As Ohio continues to pull itself up by its economic bootstraps, the fiscal health of the state's local governments and municipalities will be determined in the long run by Ohio's growth and opportunity, not by perpetual state subsidies or the redistributive preferences of big-government advocates.

Advocates of big government believe that economic growth is best achieved through the tax-and-spend powers of the state. Thus, they continue to champion revenue sharing schemes like the Local Government Fund (LGF), the Tangible Personal Property Tax (TPP), and the Public Utility Tangible Property Tax (PUTP) reimbursement programs that take tax revenues from throughout the state and redistribute those funds. For decades the state has used various subsidy programs like these to prop-up the dizzying labyrinth of over 6,000 different local governmental entities at the cost of significant prosperity and job growth. Unfortunately, these programs have proven time and again to be inefficient paths to economic growth, and have the dubious distinction of creating moral hazards[1] and undermining local control and fiscal accountability.[2] To continue down this road is to remain mired in economic mediocrity or worse, and yet that is precisely what big-government spenders seem to so staunchly support.

As Governor Kasich and his allies in the General Assembly have worked to enact substantive pro-growth measures such as reducing the LGF, repealing the state's death tax, and phasing-out various subsidies to local governments, their big-government opponents decry those efforts as draconian spending cuts that force local officials to impose painful cuts to services for their constituents.[3] But a closer look at the recent fiscal health of local municipalities—even after these so-called "draconian" measures—shows that this has not been the case and the doomsday forecasts so often announced by the prophets of government spending are overblown.

First, data from local governments show that the overwhelming majority of the state's local municipalities are fiscally healthy. Local tax revenues have increased rapidly. Nine out of ten counties and nearly nine out of ten municipalities now have reserve funds that, in terms of percentage, far outweigh the statutorily required reserve that Ohio maintains in its "rainy day" fund.

Second, the LGF actually represents a very small percentage of the overall amount of state support for local governments—roughly 2.5 percent of approximately $13.6 billion.[4] Even before any of the so-called "draconian" reductions, the LGF amounted to less than 5 cents of every dollar in total state support for local governments.[5] It also only represented a little over one cent of every dollar in total local revenues.[6] But by reducing payments to the LGF the state gains flexibility to promote growth in other ways and encourages local governments to better prioritize spending and ser-

1 See Robert D. Ebel & John E. Petersen, *The Oxford Handbook of State and Local Government Finance*, 2012, p. 711.

2 Ibid.

3 See, e.g., Jim Siegel, "FitzGerald Criticizes Local Government Fund Cuts," *Columbus Dispatch*, February 13, 2014, http://www.dispatch.com/content/stories/local/2014/02/13/FitzGerald-criticizes-local-government-cuts.html (accessed May 23, 2014). See also One Ohio Now, Cuts Hurt Ohio, http://www.cutshurtohio.com/ (accessed May 23, 2014).

4 Ohio Office of Budget and Management, Funding Ohio Communities, http://www.healthtransformation.ohio.gov/ (accessed June 3, 2014).

5 Ibid.

6 Ibid.

TABLE 1— MUNICIPAL INCOME TAXES

* Due to rounding, actual number closer to $228 million.

Number of municipalities levying income tax	**601**
2011 municipal income tax revenue	**$4.31 billion**
2012 municipal income tax revenue	**$4.54 billion**
2011–2012 change in income tax revenue	**+$230 million***
2011–2012 percent change in income tax revenue	**+5.3%**
Number of new or increased municipal income taxes	**19**

vices. In a competitive global economy, flexibility and accountability are vital to fostering economic growth.[7] Further, it becomes easier for local officials to act in fiscally irresponsible ways when they can deflect blame for their irresponsible decisions by pointing the finger at Columbus for any woes that their constituents experience.

Third, fears and concerns over the reforms to the TPP and PUTP discount the role that these reforms have played in Ohio's economic recovery. Further, aspects of these tax cuts and phase-downs have been pursued since 2005 as part of earlier reform agendas, and they remain vital components of today's pro-growth and fiscal responsibility initiatives.

Local Income and Sales Tax Revenue Growth

Contrary to the doom-and-gloom preaching of the big-government advocates, most local governments in Ohio have recently seen increases in major sources of their general revenue funds—and the vast majority of those municipalities are enjoying these increases without having raised their tax rates.

Like much of the nation, Ohio has been experiencing an economic recovery since 2010, and local municipalities have witnessed the growth along with everyone else. Ohio's aggregate municipal income tax collections rose 5.3 percent in 2012,[8] and aggregate county sales tax collections rose 5.2 percent in 2013.[9]

The 601 municipalities in Ohio that levied income taxes in 2012 saw their income tax revenues grow $228 million, or 5.3 percent, from slightly under $4.31 billion in 2011 to nearly $4.54 billion.[10] Of those 601 municipalities, over 70 percent of them (438) saw increases in income tax revenue[11] (see Table 1). Notably, only 19 of the 601 municipalities saw either a new income tax implemented or an increase in the rate. Indeed, four municipalities had the financial strength and

7 Vito Tanzi & Ludger Shucknecht, "Reforming Government in Industrial Countries," International Monetary Fund, 1996, https://www.imf.org/external/pubs/ft/fandd/1996/09/pdf/tanzi.pdf (accessed July 25, 2014). As the international economy becomes more competitive, and as capital and labor become more mobile, countries with big and especially inefficient governments risk falling behind in terms of growth and welfare. When voters and industries realize the long-term benefits of reform in such an environment, they and their representatives may push their governments toward reform. Ibid.

8 2012 is the most current year of data for municipal income tax from the Ohio Department of Taxation, http://www.tax.ohio.gov/tax_analysis/tax_data_series/individual_income/publications_tds_municipal.aspx (accessed May 26, 2014).

9 These calculations are based on tax collection data provided by the Ohio Department of Taxation, http://www.tax.ohio.gov/tax_analysis/tax_data_series/individual_income/publications_tds_municipal.aspx (accessed May 26, 2014).

10 Ibid.

11 In the reported Ohio Department of Taxation data, 24 municipalities had not reported their revenue, thus the 2011 data was republished in 2012.

TABLE 2— LOCAL SALES TAXES

Number of counties levying sales tax	**88**
2012 local sales tax revenue	**$1.56 billion**
2013 local sales tax revenue	**$1.64 billion**
2012–2013 change in local sales tax revenue	**+$80.5 million**
2012–2013 percent change in local sales tax revenue	**+5.2%**
Number of increased sales taxes (effective 2012–2013)	**5**

political resolve to lower their income tax rate in 2012, and the aggregate revenue across those four jurisdictions rose by more than $340,000.[12]

Similarly, 80 of Ohio's 88 counties, or 91 percent, saw their sales tax revenues increase in 2013 over 2012 (see Table 2). In the aggregate, the total local sales tax revenues increased $80.5 million, or 5.2 percent, from $1.56 billion to $1.64 billion during that same period.[13] Throughout all of 2012 and 2013, only 5 of 88 counties raised their local sales tax rates (Erie, Lake, Meigs, Richland, and Stark) and one (Marion) lowered its sales tax.[14] Meanwhile, there was also an increase in sales tax collected for the 8 regional transit authorities throughout Ohio. In the aggregate, their collections increased from $392.6 million in 2012 to $419.5 million in 2013.[15]

These numbers paint a decidedly different picture than the one offered by the big-government spending crowd. During the past four years of economic recovery, most local governments in Ohio have seen their general revenues rise even as their tax rates remain the same. Higher tax rates and redistributive spending policies are not the way to ensure sound fiscal health.

"Rainy Day" and Unassigned General Revenue Funds

Many local governments are actually sitting on significant unassigned general fund balances due to higher tax receipts. Unassigned general funds can be used however a local government prefers, including as "rainy day funds."[16] Thus, the amount that local governments retain within their unassigned general revenue fund balance is a good indication of the relative fiscal health of the community.[17]

To put these "rainy day funds" in perspective, consider that Ohio's current "Rainy Day Fund" (as defined by law)[18] is 5 percent of the previous fiscal year's general revenue funds, or $1.48 billion.[19] Eighty of the state's 88 counties have unassigned general revenue fund balances in excess of

12 Athens (from 1.75 to 1.65 percent), Oxford (from 2.1 to 2 percent), Rio Grande (from 1.5 to 1 percent), and Huron (from 1.375 to 1.25). See Appendix I for more details.

13 These calculations are based on sales and use tax collection data provided by the Ohio Department of Taxation, http://www.tax.ohio.gov/tax_analysis/tax_data_series/sales_and_use/publications_tds_sales.aspx (accessed May 26, 2014).

14 See Appendix I for more details. Franklin County passed a 0.5 percent sales tax increase in 2013, but the effective date was January 1, 2014. The Putnam County sales tax decreased by 0.25 percent on January 1, 2014.

15 These calculations are based on sales and use tax collection data provided by the Ohio Department of Taxation, http://www.tax.ohio.gov/tax_analysis/tax_data_series/sales_and_use/publications_tds_sales.aspx (accessed May 26, 2014).

16 See Ohio Government Accounting Standards Board, Fund Balance Reporting, http://www.gasb.org/cs/ (accessed May 22, 2014).

17 See Ohio Auditor Of State, Financial Health Indicators, https://ohioauditor.gov/indicators/FinancialHealthIndicatorsDocument.pdf (accessed May 22, 2014).

18 Ohio Rev. Code Ann. § 131.43 (1995).

19 Ohio Office of the Governor, Ohio's Rainy Day Fund, http://www.governor.ohio.gov/Portals/0/07.11.13%20Rainy%20Day%20Fund.pdf (accessed May 22, 2014).

TABLE 3—RAINY DAY FUND

	Number	Number with Balances Greater than 5% General Revenues	Total Unassigned and/or General Revenue Fund Balance
County	88	80 (91%)	$976 million
City	251	225 (90%)	$1.45 billion
Village	689	599 (87%)	$336 million

5 percent of their general revenues.[20] The Buckeye Institute was able to collect relevant data on 247 of Ohio's 251 cities. Of those 247, 225 had unassigned general revenue balances worth more than 5 percent of general revenue, 12 had a balance between 0 and 5 percent, and only nine suffered a deficit.[21] Of the 650 villages with available data, 599 had general fund balances greater than 5 percent of general revenue.[22] These numbers attest to relatively strong fiscal health (see Table 3).

In the aggregate, the unassigned general fund balances for counties, cities, and villages were $976 million, $1.45 billion, and $336 million respectively. Together, those funds represent nearly $1.3 billion more than the state's "Rainy Day Fund."

The reality of the relative strength of these local "Rainy Day Funds" contrasts sharply with the fictional catastrophe so often peddled by big-government advocates. In fact, to the extent that some local governments may have more funds than necessary to meet the core needs of their communities, we might begin to wonder whether some of those revenues should be returned to their rightful owners—the taxpayers.

A Note on Townships

The picture for Ohio's 1,308 townships is admittedly more difficult to analyze, but current data suggest that the financial situation for townships may be slightly more negative than for counties and municipalities.[23] This is a provisional assessment, of course, and subject to inconsistent reporting from numerous townships across the examined period.[24] Of the 1,273 townships that reported financial information to the Auditor of State, their overall general revenues appear to have declined between 2011 and 2012.[25]

Reasons for this are varied and difficult to quantify, but as a general rule townships differ greatly in size and population, and have a greater degree of volatility in their revenue streams. Furthermore, unlike Ohio municipalities that may levy income taxes and counties that may levy sales taxes, townships predominately obtain revenues through property taxes and other, less predictable means such as lodging taxes and liquor permit fees,

20 See Appendix IV for more details.

21 See Appendix V for more details.

22 See Appendix VI for more details.

23 Township general revenue data is available through the Summarized Annual Financial Reports, available at the Ohio Auditor of State website. However, in many cases there are gaps of several years between reports. This makes a true year-to-year comparison practically impossible.

24 A more accurate and complete understanding would require a fuller examination of each township's financial records. See Greg R. Lawson, "Joining Forces: Consolidation Will Help Ohio's Local Governments If Compensation Package Costs Are Properly Managed," The Buckeye Institute for Public Policy Solutions, October 2011, http://www.buckeyeinstitute.org/uploads/files/10-31-11-Rethinking-Ohios-Government-Structure-Final%20for%20Release.pdf (accessed June 3, 2014).

25 These calculations are based on the Ohio Auditor of State, Summarized Annual Financial Reports, May 20, 2014, https://ohioauditor.gov/references/summarizedreports.html. Appendix IV includes the available data from the AOS.

among other taxes and fees.[26]

This may mean that townships may be more effected by modifications to the revenue sharing and LGF status quo. But townships are the exception, not the rule, and should not be the tail that wags the dog of Ohio's revenue sharing and economic growth policies.

LGF a Small Portion of Overall State Support for Local Governments

The LGF and the state's sales tax are hold-overs from the Great Depression and a time when local governments—like everyone else—were struggling financially.[27] Over the decades, of course, the state revenues dedicated to the LGF, not to mention the precise distribution of those funds across jurisdictions, has varied dramatically.

Whatever the big-government advocates may want us to believe about the sanctity of the LGF, it is crucial that we keep in mind that the LGF represents a small fraction of the state dollars spent on local government services. Currently, the LGF accounts for approximately 2.5 percent of the estimated $13.6 billion that the state will spend on local governments through various reimbursements, subsidies, distributions, funding for roads and bridges, and targeted property tax relief in fiscal year 2014.[28]

Advocates for more government spending will cry that these spending rates are due to more recent tax reforms and spending cuts authored by Governor Kasich and the General Assembly, and that the Governor and his allies have gutted the LGF and other subsidy programs. To be sure, in the 2011 calendar year, the state redistributed $661.9 million to municipalities and counties, but only $463.5 million in 2012.[29] And by 2013, the distribution was lowered again to only $357.5 million.[30] But even before these incremental reductions, the LGF represented less than 5 cents on every dollar of total state support for local entities.[31] Further, before the Governor's reforms, the LGF represented only a bit over one percent of the total local revenues, including both state and local support.[32] After the reductions, the LGF now accounts for slightly less than one cent of every dollar in total local revenues.[33] This decline is hardly draconian, and the results hardly cataclysmic.

Other Local Revenue Sharing Reforms

The LGF is not the only state-to-local subsidy program that has been reformed. Other revenue sharing plans also have been curtailed, including

26 Hearing on the Biennial Budget H.B. 59 Before the House Committee on Ways and Means, February 28, 2013 (statement of Matthew DeTemple, Exec. Dir., Ohio Township Association), http://www.ohiotownships.org/sites/default/files/HB%2056%20Testimony.pdf (accessed August 21, 2014).

27 Ohio County Commissioners Association Handbook, Chapter 23: Ohio's Local Government Funds, 2005, http://www.ccao.org/userfiles/HDBKCHAP023-2005%20%209-12-12.pdf (accessed June 3, 2014).

28 These calculations are based on data contained in Ohio's Office of Budget and Management report, "Funding Ohio Communities," http://www.healthtransformation.ohio.gov/LinkClick.aspx?fileticket=7kfh1pXjPlc%3D&tabid=149 (accessed June 3, 2014).

29 See Ohio Department of Taxation, Local Governments, http://www.tax.ohio.gov/tax_analysis/tax_data_series/local_government_funds/publications_tds_local.aspx (accessed June 3, 2014). Distributions to municipalities and counties occur and are measured by calendar years.

30 Ibid.

31 These calculations are based on appropriations contained in Amended Substitute House Bill 59 of the 130th General Assembly, http://www.legislature.state.oh.us/BillText130/130_HB_59_EN_N.html (accessed June 3, 2014).

32 These calculations are based on multiple tax collection data sets provided by the Ohio Department of Taxation, http://www.tax.ohio.gov/Researcher/other_tax_statistics.aspx (accessed June 3, 2014).

33 Ibid.

a more rapid phase-down of the Tangible Personal Property Tax (TPP) and Public Utility Tangible Property Tax (PUTP) reimbursements.

The TPP reimbursements flowed from revenues generated by the Commercial Activities Tax, and the PUTP reimbursements were generated through the Kilowatt Hours Tax and the Natural Gas Distribution Tax.[34] These reimbursements and original phase-downs were the result of previous tax reforms in 2005 that eliminated the TPP tax and would phase-out reimbursements completely by 2019.[35] Similarly, the PUTP was always scheduled to decline, though not be eliminated. In order to mitigate any negative repercussions for local entities likely to be disproportionately affected by the phase-down, a portion of the Commercial Activities Tax (CAT) on a specified percentage basis will continue to be directed to those local entities with a heavy reliance on the reimbursements[36] (see Table 4).

TABLE 4—REIMBURSEMENTS[37]

	Calendar Year Spending (millions)			
Revenue Source	**2010**	**2011**	**2012**	**2013**
TPP reimbursement	$482	$302	$192	$141
PUPT reimbursement	$81	$43	$12	$10

Conclusion

Most local governments in Ohio are again collecting a great deal of revenue, and accumulating relatively large “rainy day” funds. If they exercise fiscal discipline and commonsense, they should use that revenue to fund the local services required or preferred by their communities rather than running to Columbus looking for further state revenue sharing handouts. To help them exercise that much-needed commonsense, the Governor and General Assembly have enacted commonsense reforms in the state’s revenue sharing programs. These reforms have the benefit of promoting economic growth and opportunity for the entire state while also fostering flexibility and fiscal responsibility. These measures should be encouraged and pursued more vigorously. The tax-and-spenders among us would have us believe that these reforms jeopardize our local governments, impose harsh choices on our citizens, and threaten local government insolvency. The facts show otherwise. Revenue sharing reform is working. The state is on the mend, though more needs to be done. Turning back to the failed formulas of our economic past does not lead to a better economic future.

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34 Prior to Governor Kasich’s first budget, if CAT revenues or the KWH or MCF revenues were not sufficient to pay the reimbursements to local governments, state GRF was used to make up the difference.

35 Ohio Department of Taxation, Tangible Personal Property Tax, Phase Out and Replacement Payment Information, http://www.tax.ohio.gov/personal_property/phaseout.aspx (accessed May 31, 2014).

36 Ohio Department of Taxation, Explanation of Law Changes Enacted in 2011 Relating to the Reimbursement of Foregone Tangible Personal Property Taxes and Modifications to State Tax Revenue Streams, http://www.tax.ohio.gov/portals/0/personal_property/TPR_Reimb_Electric_Gas_Dereg_Reimb_May2012.pdf (accessed July 22, 2014).

37 Ohio Department of Taxation, Distributions–Commercial Activities Tax, http://www.tax.ohio.gov/government/distribution_cat.aspx (accessed July 23, 2014).