

State Budgeting Matters

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The governor faces many challenges in producing and maintaining a balanced budget that meets Ohio's needs.

This series is an opportunity for our readers to get involved by e-mailing their Ohio budget questions to our Ohio budget expert, Richard G. Sheridan, at rsheridan@CommunitySolutions.com.

Please note that Richard G. Sheridan's opinions are not necessarily those of The Center for Community Solutions.



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Rebalancing the State's Budget: Misconceptions, Puzzlements, and Risks

"The announcement today by Gov. Strickland concerning the continued deterioration of the financial condition of the state of Ohio is troubling. Earlier this year, the administration chose to take action to solve the most optimistic of three budget scenarios outlined by OBM. And while that action did include some budget reductions, it also included a number of questionable fiscal management proposals such as Keno, delaying program expenditures from one fiscal year to the next and short term cash management actions.

Gov. Strickland's plan is not making real progress toward putting Ohio's fiscal house in order and unfortunately, by continuing to delay structural reform to the state budget, we have lost valuable time which would have been better spent on advancing serious budget balancing solutions." —Auditor of State Mary Taylor¹

This statement by Auditor Taylor was issued on the day that Governor Strickland determined that state revenues would produce even less revenue in Fiscal Year (FY) 2009 than originally expected when the state's budget was enacted 14 months ago, and even less than when it was revised downward seven months ago. The governor's announcement on September 10, that the Office of Budget and Management (OBM) had revised FY 2009 revenues estimates downward by \$540 million was incorrectly reported by the press throughout the state as "Budget Cut by \$540 million" and "Strickland Orders \$540 million in Additional Cuts for FY 09." Nothing could be further from the truth.

Auditor Taylor rightly points out that in addressing the February conclusion that the biennial (both FY 2008 and FY 2009) budgets would be out of balance by \$733 million, the administration chose to address the problem with few actual reductions in spending and the same is true for the additional \$540 million in expected reduced revenues, where only about 22 percent of the proposed solution is to come from actual reductions in spending authority. This is only one of a number of confusions about actions taken to keep the state's current budget in balance. This issue of *SBM* examines some of the misconceptions about the state's budget shortfall as well as a series of "puzzlements" that make it difficult to satisfactorily analyze the nature of the state's fiscal problems and proposed solutions. Finally, there is a discussion of some of the risks still remaining before this budget year closes on June 30, 2009.

Some Misconceptions

These are some of the misconceptions about the state's budget problems, and the

¹ *The Hannah Report*, Vol. 127, No. 428, September 10, 2008.

actions announced to address them, that should be corrected:

- Once the \$1.273 million problem has been resolved, the state will be “out of the woods.”
- The state’s budget problem is solely the result of revenues coming in below estimates.
- The decline in revenues is exclusively the result of the downturn in the economy.
- The state budget has been “cut” by a total of \$1.273 billion for the biennium.
- Local governments are not adversely affected by what is happening to the state budget.

The Size of the Problem

When, in late January of this year, the administration first decided that there was a problem with the current budget, the problem was stated as a \$733 million problem. As described, the problem consisted of two parts: less revenues coming in than projected and Medicaid spending exceeding estimates. And, importantly the problem covered both fiscal years of the current biennium. Administrative actions were taken to bring the budget back

into balance and FY 2008 ended with state accounting records showing a healthy balance, largely as a result of permitting \$434 million worth of FY 2008 Medicaid bills to be paid out of FY 2009 appropriations authority (a subject discussed further below). Then, after just two months into the new fiscal year, the administration announced that revenues would be even lower than anticipated in January; no mention was made of Medicaid, so it must be assumed that the earlier projection of a Medicaid shortfall remains constant. So, the size of the budget problem for FY 2009 is really \$1,509 million as shown in the following table.

What happened in September is that the second round of budget revisions were comprised exclusively to a reduction in anticipated tax revenues, whereas the February shortfall included assumptions about Medicaid spending and reimbursements for the federal share of additional needed Medicaid appropriations. It is important to note that for this fiscal year, the February and September revisions are additive so that the total problem for FY 2009

**Size of the State Budget Problem for FY 2008 and FY 2009
(amounts in millions of \$)**

Fiscal Year and Components	February Revisions	September Revisions
Fiscal Year 2008		NONE
• GRF Tax Revenues and Transfers	173	
• Federal Revenues	172	
• Medicaid Spending	154	
• Ending Fund Balance Estimate	(2)	
Total Problem	497	
Fiscal Year 2009		
• GRF Tax Revenues and Transfers	385	540
• Federal Revenues	(507)	(507)
• Medicaid Spending	406	406
• Ending Fund Balance Estimate	(56)	(56)
• Lapses Decrease	7	7
Total Problem	236	776
Size of Biennial Problem	733	1,509

is \$1,012 million when the Medicaid problem is included, or \$870.6 million if Medicaid is excluded. Especially noteworthy, is the fact that the new revenue forecasts are halfway between what OBM had projected in February as the “zero growth” forecast and the “recession” forecast for FY 2009. For “zero growth” OBM projected a state GRF tax receipt loss of \$726.3 million, compared to the budget assumptions, and a \$1,236.3 million loss under a “recession.” The new projections show FY 2009 tax receipts to be \$870.6 million below original estimates (excluding transfers). State tax receipts will have to drop by another \$350 million to reach the most dire “recession” scenario depicted by OBM in February.

The Components of the Problem

The FY 2009 budget problem consists of an expected shortfall in GRF tax revenues, primarily the state’s sales and individual income taxes, and Medicaid overspending. The following table shows the new estimates for GRF tax receipts compared to the enacted budget and the expected shortfall as of September.

Besides the revenue shortfall problem, consisting primarily (90 percent) of reduced sales and personal income tax collections, Medicaid spending has been exceeding the estimates upon which the budget was based.

In February, OBM Director J. Pari Sabety testified to the House Finance Committee that Medicaid would need an increase in federal and state funds of \$91 million in FY 2008 and \$271 million in FY 2009, the state share of which would be \$215 million. The legislature addressed this problem in Am. Sub. H.B. 562, which became effective on September 23. That measure appropriated an additional \$198 million in state money for Medicaid in FY 2009 permitting the state to drawdown \$128 million in federal Medicaid reimbursements. Although the amount appropriated was less than was originally requested, a provision in H.B. 562 permits OBM, with Controlling Board approval, to transfer up to \$63,333,420 from the Budget Stabilization Fund to the GRF, if additional appropriations are needed to fund the Medicaid program. Although the \$540 million budget problem described in September is comprised

**Comparison of FY 2009 GRF Tax Revenues:
September Revisions to H.B. 119 As Enacted
(amounts in millions of \$)**

Revenue Source	H.B. 119 As Enacted	September Revisions	Difference
Auto Sales & Use	1,023.90	860	163.9
Non-Auto Sales & Use	6,923.60	6,775	148.6
Personal Income	9,201	8,718	483
SUBTOTAL	17,148.50	16,353	795.5
Corporate Franchise	521.80	405	116.8
Public Utility	181	177.30	3.7
Kilowatt-Hour Tax	124.90	130	-5.1
Foreign Insurance	271	264.80	6.2
Domestic Insurance	172.50	167.70	4.8
Cigarette	941.70	917	24.7
Estate	87	65	22
TOTAL TAX RECEIPTS	19,563.60	18,685	878.6

exclusively of a revenue shortfall, the proposed “solution” includes the use of the authorized \$63 million of Rainy Day Funds to be spent on Medicaid. This is one of the several “puzzlements” about the state’s budget problem, discussed later.

The Causes of the Problem

There are several possible reasons for the state’s current budget problems. One, of course, could simply be bad revenue forecasts and bad Medicaid enrollment forecasts. In the case of the revenue estimates, there is nothing that would warrant that conclusion. Ohio’s record in revenue forecasting is quite good, when there is a history of collections that can be used for future projections and that is certainly the case with respect to the state’s sales and use tax and the personal income tax projections. Forecasting corporate taxes and collections from the new Commercial Activity Tax is not that easy because of a lack of such a history, but forecasting errors in these two taxes are minor problems compared to the sales and income tax shortfalls.

Another possibility is that the state’s economists failed to understand what was happening in the housing market, the credit market, and the financial market and were unduly optimistic about national and state economic trends. If the economic forecast is bad, so will the revenue forecasts based on them. The reality is that all of the important economic indicators used in the original forecast were too optimistic.

And there is also the problem of timing. The state’s budget problems would not change if, in February, the state had recognized that the economic forecasts were not, as then described, “low growth,” but rather recessionary. The same could be said for the September revision, which still fails to recognize the effects of an actual recession. The longer the recognition of the full extent of the problem is delayed, the more limited are the ways it can be resolved and the more drastic its solutions.

As to specifics, the state’s unemployment rate has risen to the point that, unlike what happened during the last recession, in 2001, income tax withholding has declined. In just two months, July and August, withholding is almost \$112 million below estimates. The reason this is significant is that withholding comes from current wages and, is therefore, a strong indicator of what to expect overall from income tax collections.

Sales tax revenues are also down, suggesting a contraction in consumer spending. After the first two months of this year, sales taxes collected from non-automobile purchases are the same as last year, after factoring out changes in local government fund transfers.

The reality is that all of the important economic indicators used in the original forecast were too optimistic.

With respect to Medicaid, the two big problems are increasing enrollments and an increase in

the number of persons enrolled in the most expensive eligibility category, the aged, blind, and disabled. As of the end of August, enrollments were in line with the enhanced projections used in making corrective appropriations in H.B. 562. Whether enrollments will begin escalating again depends to some extent on the effects of the continued deterioration of the economy where job losses increase daily.

How the Problem is Being Resolved

At the close of FY 2008, GRF tax receipts were below estimates by \$238.4 million. This was actually \$100 million less than was forecast in the February budget revision. The state budget ended with an unobligated GRF balance of \$807.6 million as a result of transferring monies into the GRF (\$115.8 million of which came from the Commercial Activity Tax, and \$120 million from the Medicaid Reserve Fund, both of which actions will require further scrutiny), agencies lapsing (not spending) all of their authorized appropriations (none of which appears to be the result of forced budget cuts), and the transference of \$434 million of Medicaid obligations into FY 2009.

Assuming that the Medicaid spending problem is resolved, which may be a questionable assumption, the FY 2009 revenue problem totals \$870.6 million. Its resolution, as proposed by OBM, will, once again, consist largely of injections of non-recurring one-time revenues to make up for lost tax receipts. They include reducing the anticipated ending cash balance by \$126.4 million, taking an additional \$40 million from the state’s tobacco securitization fund, taking another \$112 million from agency special revenue accounts, and somehow (see “some puzzlements” below) using \$63.3 million of Rainy Day Funds. Those actions are coupled with similar actions already taken to address the FY 2009 portion of the budget problem announced in February. How much of the state budget will actually be cut to solve the problem, is still undetermined.

State agencies will not receive line-item specific reductions until September 30, and so, they will not be implemented before October 1. However, an early list of budget cuts, totaling \$158.5 million was submitted to the agencies for planning purposes. Shortly thereafter, Budget Directive 7 issued by OBM to all state agencies, reports agency budget reductions of \$198.3 million, significantly changing many of the previously-announced budget cuts. In the latest round of announced cuts, several state agencies were completely exempted:

- Department of Rehabilitation and Correction
- Department of Youth Services
- The state legislature (which voluntarily agreed to cuts)
- State elected officials (some of which have announced their voluntary reductions)
- The Judiciary

Also exempt from budget cuts are debt service and tax relief. Most state agencies are reported to be scheduled to receive annual cuts of 4.75 percent (really 7.1 percent when implemented over nine rather than 12 months), but because it was determined that certain specific line items could not be cut, the agencies affected by hold-harmless line items will have to make higher cuts in the non-exempt line items in their budgets to reach the 4.75 percent scheduled cuts. Specific line items excluded from budget-cutting include:

- The state share of instruction, Ohio Instructional Grants, Ohio Educational Grants in the Board of Regents
- Soil and water districts and the Division of Water in the Department of Natural Resources
- Pupil transportation, gifted pupil program, special education enhancements, career-technical education enhancements, foundation funding in

FY 2009 September Cuts to Health and Human Services Agencies

Agency	FY 2009 Appropriations	Proposed Cuts	Percent
Alcohol & Drug Addiction Services	\$44,285,051	\$1,126,817	2.54
Aging	\$211,339,148	\$20,533,763	9.71
Mental Health	\$578,029,979	\$24,600,000	4.25
MR/DD	\$389,282,941	\$12,987,100	3.33
Health	\$87,871,084	\$280,000	0.03
Rehabilitation Services Commission	\$26,884,552	\$2,688,455	9.99
SUBTOTAL	\$1,337,692,755	\$62,216,135	4.65
Job and Family Services	\$10,596,869,556	\$34,440,269	0.32
TOTAL	\$11,934,562,311	\$96,656,404	0.8

- the Department of Education
- Medicaid and disability financial assistance in the Department of Job and Family Services

Especially hard-hit in the \$158.5 million list of proposed budget cuts, are health and human services, two of which will have annual percentage reductions exceeding the announced 4.75 percent cuts. The following table shows the proposed cuts for those agencies and the percent of FY 2009 appropriations that the cuts represent.

Cuts to health

and human services agencies amount to almost two-thirds of the total \$159 million in budget cuts described by OBM in Directive 5. But, the new list makes significant changes to the cuts shown. Instead of a cut of \$1.1 million, the Department of Alcohol & Drug Addiction Services is cut twice as much (\$2.050 million) and Job and Family Services is cut by \$79.9 million, instead of \$34.4 million. Aging's \$20.5 million cut was halved to \$9.2 million and so was the Rehabilitation Services Commission (to \$1.1 million) and Health was raised from \$280,000 to \$4.1 million. Mental Health went down from \$24.6 million to \$10.4 million, while Mental Retardation was raised from \$13 million to \$16.9 million. Overall, health and human services cuts now total \$123.7 million, or close to two-thirds of the total cuts announced.

What is especially important to note, is that for FY 2009 appropriations reductions constitute only about 22 percent of the stated revenue shortfall (\$870 divided by \$198) portion of the budget problem. The bulk of the solution results from supplemented state GRF tax receipts with non-recurring revenues.

Local Government Effects

Not to be overlooked are the adverse effects of what is happening at the state level on local governments that are facing their own budget problems because of reduced tax revenues.

Cities, and those school districts that levy an income tax, will soon be feeling the effects of the state's high number of unemployed persons. Counties are already feeling the effects of less consumer spending on their sales tax receipts. And all units of local government, including school, health and human services special districts, will find their property tax collections slide downward to reflect

foreclosed property and, after the next reappraisals, reduced property values. As for state receipts, the state's general revenue-sharing program is

How can the state come up with enough revenue for the next biennium to continue spending at current (after budget cuts) levels?

set at 2.2 percent of state GRF receipts. Now that those receipts are declining, so will the amounts going to local governments. In addition, to the extent that budget cuts to health and human services agencies—especially mental health and mental retardation and developmental disabilities—result in reduced state subsidies to local special districts delivering those services, they will face additional budget problems as they prepare their next budgets.

"It's A Puzzlement"

Here are some questions about the state's budget rebalancing efforts that puzzle me:

- How much was spending actually reduced for FY 2008, and how much will it really be reduced in FY 2009?
- Under what authority were FY 2008 Medicaid bills paid for with FY 2009 money, and how can a spending increase of \$63 million for Medicaid help "solve" a revenue shortfall problem?
- Why were one-time, non-recurring actions taken to shore up spending for FY 2008 and FY 2009, rather than actual reductions in authorized spending?
- Under what authority are additional rotary fund "raids" to be undertaken?
- How and why was the decision made to disproportionately reduce health and human services spending while protecting a variety of other

spending areas, including higher education?

- How can the state come up with enough revenue for the next biennium to continue spending at current (after budget cuts) levels?

Biennial Spending Reductions

It appears that for FY 2008, despite earlier testimony from OBM, agency budgets were not actually cut during FY 2008. With respect to FY 2009, agencies were given target amounts to reduce their budgets and have until the end of September to negotiate the specific line items to be cut. An early list of cuts totaled \$158,497,032, but OBM also announced that the “solution” to the latest iteration of the FY 2009 budget problem would require \$198 million in cuts. Considering the fact that announced cuts for FY 2008 were never made, and FY 2009 cuts are subject to negotiation, when and how much will actually be cut in which agency line items? *It’s a puzzlement.*

Medicaid Machinations

On the last day in FY 2008, instead of paying \$434 million due for FY 2008 Medicaid bills, OBM paid those bills out of this year’s (FY 2009) appropriations. Without additional appropriations authority in that amount for FY 2009, that means the state will not be able to pay that amount of FY 2009 Medicaid spending obligations before the end of the biennium. There is no legal authority for the state to pay the bills of one biennium in a future biennium. However, despite legal questions about carrying disbursements from one biennium into the next biennium, it appears that the state took a similar action at the end of the last biennium, thereby carrying FY 2007 Medicaid bills into the current biennium. The Legislative Services Commission reports that \$35.1 million of inpatient and outpatient hospital claims were budgeted for FY 2007, but paid in FY 2009.² Not only does this raise legal questions, the continuation of this kind of action escalates each succeeding biennium and amounts to little more than deficit spending. The state can be expected to be \$434 million—at least—in the red when it begins the next biennium as a result of this action. How

² Ohio Legislative Service Commission, Budget Footnotes, July, 2008, p. 14.

can this be justified and where will it end? *It’s a puzzlement.*

The only way that a loss of revenue can be addressed is by cutting spending or adding revenues. As part of the solution to the latest \$540 million GRF revenue shortfall, OBM has announced that it will use \$63.3 million of Rainy Day Funds to pay for Medicaid cost overruns. If the money were simply transferred to the GRF then it could be used to make up for the revenue shortfall. But, to use it for Medicaid spending, presumably already in balance with actions taken by the legislature in the July enactment of H.B. 562, there should be no need for more money to be used for Medicaid. So how can additional spending on Medicaid, paid for by the Rainy Day Fund, shore up sagging state tax receipts? *It’s a puzzlement.*

One-time Solutions

It appears that the state managed to end FY 2008 in the black, without the need to cut state budgets and, apparently, also without having to “raid” any of the rotaries. The ability to do so was undoubtedly aided by transferring \$434 million in Medicaid spending into FY 2009, which fails to solve the problem and simply pushes it into a new fiscal year. Still, for FY 2009, as was the case in the proposed budget solution for FY 2008, the bulk of the plan consists of using non-recurring, one-time revenues to shore up spending. The effect of this is to make it more difficult to provide continuation spending in the next biennium, where revenues will decline because of scheduled tax relief reductions regardless of what happens to the economy. This will probably continue to erode state GRF receipts. How, and why, was the decision made to minimize budget cuts in addressing the problem of declining state GRF receipts and rising Medicaid costs? *It’s a puzzlement.*

Rotary Raids

When the original \$733 million problem was announced, OBM identified its proposed solution, and included a detailed examination of special revenue funds, generally known as “rotaries,” to determine how much of their balances are unnecessary and could

be transferred to the GRF to compensate for lowered tax receipts. The proposal was to “raid” those rotaries in the amount of \$55 million. In H.B. 562, the legislature included a provision permitting OBM to make a total of \$120 million of such raids—more than OBM needed. However, in September’s budget balancing announcement, an additional “raid” of \$112 million was listed as part of the solution to the additional \$540 million problem. That would total \$167 million in transfers, compared to a legislatively-authorized total of \$120 million. How can OBM transfer more rotary monies than currently authorized in legislation? Or, why were no rotary funds “raided” as planned during FY 2008? *It’s a puzzlement.*

Selective Cutting

Reports that the FY 2009 budget cuts are 4.75 percent “across-the-board,” could not be further from the truth. Some agencies are completely exempted from the cuts. Some line items are exempted from the cuts. As a result, health and human services agencies will disproportionately feel the brunt of the announced \$158.5 million in cuts (the final figures, when made public, especially if they total the announced \$198 million, will be different) accounting for two-thirds of the cuts. None of those agencies receive a 4.75 percent cut, and, in reality, the percentage cuts shown, when applied to the nine months remaining in the biennium will effectively be 25 percent higher. What was the rationale used to decide on which agencies and line items to protect against cuts and what percentage to apply to those agencies whose budgets are to be cut? *It’s a puzzlement.*

Next Biennium

Much of what has been proposed to solve the state’s FY 2009 budget problem will have profound effects upon the FY 2010-2011 state budget, which the administration is in the midst of preparing. Agencies were already told to present their budget requests

as if they had only 95 percent of their FY 2009 available, implying that revenues to support the next budget will be 5 percent lower than this fiscal year. But that number was derived before the September revenue revision.

In OBM Directive 7, state agencies are told that “agencies must continue to use their current FY 2009 adjusted appropriation levels” in determining the 95 percent to be used in their next biennial budget request. After October 1, OBM will work with state agencies to adjust the FY 2009 appropriation levels downward. What that means is that agencies experiencing budget cuts for FY

2009 will actually end up being able to request that those reduced sums be restored in the next biennium. Of course, agency budget requests are always subject to OBM modification, so the impact of this action is less important than the fact that because of the way in which the overall FY 2009 state budget is being rebalanced, the likelihood that state revenues will support even 95 percent of current spending is small. So that raises the question of how the administration plans to present a balanced budget for the next biennium without the benefit of new, or increased, taxes? *It’s a puzzlement.*

Some Risks

The decision to shore up the current state budget by raiding other state funds and transferring their balances to the GRF, permits state agencies to continue spending at levels that will be sustainable in the next biennium, only if economic conditions improve significantly. Based on what is happening to financial markets, the likelihood that employment will spike, wages rise, and consumer spending and buying expand significantly in the next two years is a dream not shared by any notable economist. What economists see on the horizon is a worsening of the current undeclared recession and, with it, even further contractions of state taxes. The decision to

address the state's current budget problem with only modest cuts in authorized appropriation levels, has the effect of postponing the difficult choice of significant budget cuts, increases in tax rates, or expansions of tax bases into next February when the FY 2010-2011 state budget will be presented to the legislature for action.

Meanwhile, there are some indications that the current budget may not stay in balance for much longer. The latest revenue estimates are still not based on the most dire of the three scenarios postulated by OBM when the budget problems were first addressed this February. The continuing collapse of the financial and housing markets, translates into fewer jobs, more stringent consumer credit requirements, greater capital losses, and constrained consumer spending. The next few months may see state sales and income tax receipts dropping even further than the new estimates forecast. And there are some concerns about elements of the budget solution thus far adopted by the state.

One such problem is with the new Keno gambling game. The state is counting on receiving \$73 million in profits from the game. So far the proceeds have been such that the state will be lucky to receive half that amount before the fiscal year ends. Another problem involves the Commercial Activity Tax. The Franklin County Court of Appeals ruled that by including the gross income from the sales of food in the base of the new tax the tax violates the Ohio Constitution. Should this ruling be upheld by the state Supreme Court, the state tax department estimates it could cost the state an estimated \$188 million in lost revenue when the tax is fully phased-in.³ Although the proceeds of the tax now go to local governments, the state is obliged to make up these proceeds using GRF funds.

Other risks involve state spending

With unemployment rising, the potential for increased Medicaid enrollments also increases. Even without worsening economic conditions, there are large numbers of persons now eligible for Medicaid ³ For an excellent discussion of this issue see Driscoll & Fleeter, "On The Money," A Rotunda Publication, Vol. 127, No. 44, September 5, 2008.

whose enrollment could push spending higher than currently estimated. And, recently, OBM examined adult corrections population data suggesting the expectation of significant growth with today's prison population of 49,691 growing to about 70,058 in the next 10 years, unless something is done. Such growth would require new prison construction and, in 2007, it cost the state \$24,517 per year, per offender. These costs are increasing each year, especially as the prison population ages and require more expensive health care. According to the OBM analysis, between 2002 and 2007, GRF medical expenditures per inmate increased by 53.4 percent, to \$3,653. Cutting positions in 2008, will "inhibit the ability of the system to absorb additional projected population increases," according to OBM.⁴ Unless substantial policy changes are made in the near future, the costs of adult corrections, where 90 percent is borne by the state GRF, are destined to escalate, adding to future budget problems.

There are still other spending areas that could become bothersome, but these are more easily managed. For example, in this biennium the state chose to put enough GRF money into the higher education budget to permit institutions of higher learning to freeze student tuitions. The goal was to continue the freeze until state tuition levels were brought down to the national levels. Continuing this policy may not be possible in the next biennium. Similarly, Governor Strickland has repeatedly stated his goal of reforming the state's primary and secondary education system, including how it is financed, in his next and final state budget. How that could be done without an infusion of additional state money remains to be seen, and the likelihood of finding additional state money, without addressing the issue of new or expanded state tax bases or rates, is virtually non-existent.

Reporting Problems

It should be clear from the forefront that greater transparency and clarity is needed with respect to reporting on the state of Ohio's finances. It is not clear from the state's monthly financial reports

⁴ See Office of Budget and Management, Monthly Financial Report, August 11, 2008.

prepared by OBM how the state managed to balance its FY 2008 without cutting budgets, without raiding rotaries, and without taking any of the other actions it reported necessary in late January, when it reported that there was a \$497 million problem for that fiscal year. It is not clear under what authority the state was able to pay Medicaid bills owed for FY 2008, out of FY 2009 funds and, more importantly, what the overall effect of that action is likely to be when the biennium ends. And there are still further questions requiring answers. For example:

- The state transferred \$472.7 million of monies collected from the Commercial Activity Tax, which are supposed to go to local governments, into the GRF “temporarily.” Then, there is also a “transfer-out” in the same amount. Why was this done?

The effect of this is to make the GRF appear to have more receipts than it actually has. Is this in order to keep the state’s general obligation capacity higher than it really is?

- The Monthly Financial Report for June 30, shows the GRF fund balance to be \$807.6 million, which therefore would become the beginning balance for the new biennium. The Monthly Financial Report for July failed to include a fund balance sheet (for unexplained reasons). Then, in the report for August, the beginning fund balance is reported at more than double the amount of the ending cash balance—\$1.682 billion. Where did the extra \$874 million come from? It is probably no coincidence that encumbrances also total \$874 million, but since when are encumbrances included in the beginning fund balance?

These are the kinds of questions that the legislature should be asking, particularly as they perform their role of overseeing the administrative branch of government. In the past, when questions like

these arose, the Legislative Budget Office (LBO), a non-partisan independent arm of the Legislative Service Commission (LSC), could be relied upon to ask these difficult questions, alert legislators of both political parties to fiscal problems, and keep the public informed about them through its publications, such as Budget Footnotes. For two decades the LBO performed this function, but then the office became politicized, and when legislative power was transferred to the opposite party, instead of simply replacing the LBO director, they essentially neutralized the LBO by abolishing its bipartisan legislative oversight body and transferring the staff to the LSC, whose mission and philosophy nowhere include acting as a check on the administrative branch of

government. Today, while Budget Footnotes is still published, it tackles none of the tough issues, and is so sterile that even

a skilled financial analyst would be hard-pressed to discover even a hint of a problem with how the administration is portraying its financial picture.

In any event, with the de-fanging of the LBO, the legislature no longer has an independent, non-partisan resource to look to for answers to questions posed in this article. In a checks-and-balances form of democracy, the legislative branch performs the important role of overseeing the executive branch to insure public accountability. This is especially important when it comes to state finances, and financial oversight requires continuous monitoring by expert staff. As competent as the fiscal staff of the LSC may be, they must also be responsible for advising legislative leadership when they observe problems, or have questions about fiscal actions taken by the administration so that they can exercise their oversight function and hold the administration accountable for its actions. The old LBO performed this function; the converted LBO does not.

What about the press—the self-appointed guardians of the public interest? Don’t they perform this

...greater transparency and clarity is needed with respect to reporting on the state of Ohio’s finances.

function? Don't they ask the critical questions and hold the administration accountable for their actions? Don't they "hold the administration's feet to the fire?"

With respect to press reporting on the state's fiscal crisis, every report that I have read has been a regurgitation of the press releases and comments issued by the administration. As noted at the beginning of this article, the September revenue revision was widely reported by the press as representing "\$540 million in budget cuts." Even the administration's statements show that is clearly not the case with cuts being proposed at \$198 million. There is no evidence that reporters desire, or even perhaps have the capability, of doing the kind of fiscal analysis needed to question some of the decisions made concerning the state's fiscal problems or provide the kind of reporting that would "safeguard the public interest."

The only way that the legislature, ultimately responsible for adopting the state's budget and setting appropriations levels, not to mention authorizing appropriate actions to keep the budget in balance, has been able to provide necessary oversight over the executive branch, is through its partisan fiscal staff. As competent as that staff is, it consists only of one staff analyst serving the House majority, and another serving the Senate majority. Not only is what that staff is able to do limited by size, it is limited because whatever it does, can be viewed as partisan and become the subject of partisan bickering.

So, when it comes to scrutinizing the state's financial problems, and insuring that the state's resources are being soundly managed, the legislature and the public clearly need an organization like the LBO once was. In its absence there needs to be more transparency in fiscal actions taken to balance the budget, especially when those actions deviate from announced plans, and greater clarity, and accuracy, in the administration's reporting on the state of Ohio's budget.

Commentary

All of budgeting is based on assumptions, and assumptions carry with them the possibility of being incorrect. That is especially problematic when external, uncontrollable events like a recession intercede once a budget has been set. Fortunately, Ohio has budget experts in the administration and in the legislature who continuously monitor state receipts and spending, and can respond quickly when it becomes clear that a circumstance like reduced personal income tax collections becomes an actionable event rather than an explainable aberration. Having said all that there is always a question of timing involved: when should action be taken? And there is also always a concern for the political ramifications of budget decision-making.

So far, the state has acted promptly to address the problem of reduced revenues, including the most recent actions taken just weeks before the November elections. Many observers were certain that such action would be postponed until after the elections, especially since there appears to be a possibility that political control of the House of Representatives could change. Acting promptly means that there will be more time to implement proposed responses to the lowered revenue estimates, and, it also means that agencies facing cuts will be able to spread them over more months. A 4.75 percent cut for FY 2009 implemented on October 1, translates to a 6.71 percent cut, whereas the same cut implemented on December 1, would effectively be 9.5 percent. In reality, most proposed agency cuts are lower than 4.75 percent because of the effect of exemptions of specific line items.

By choosing to avoid making severe budget cuts, and to protect decisions affecting higher education such as the expansion of scholarship programs and freezing tuitions, by shoring up sagging revenues with non-recurring non-tax revenues, Ohio joins the ranks of many other states in similar straits. Most, though not all, have also avoided the dreaded "tax increase" option. It is obviously politically difficult to raise taxes during bad economic times and

equally difficult to admit that the state cannot afford to pay for new and expanded spending considered fiscally viable just 14 months ago. But Ohio, along with other states in similar circumstances, will soon have to recognize that the budget problems are a long way from being solved, and the one-time fixes have pretty much dried up. That leaves the state in the position of having to draw down the Rainy Day Fund (already effectively reduced from \$1 billion to \$750 million because of actions taken in the recently enacted Job Bill and the proposed use of \$63 million for Medicaid) if things get worse this biennium, and seriously consider the spending cut and/or tax increase options to balance the next biennial budget.

Correction

The last issue of SBM erroneously referred to the declining unemployment rate. What is clearly happening is a continued increase in state unemployment, which significantly exceeds the national rate.

Do You Have Questions about Ohio's Budget?

E-mail your questions to budget expert Richard Sheridan at rsheridan@CommunitySolutions.com.

Answers to your questions could be the topic of future issues!