

# 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](mailto:rsheridan@CommunitySolutions.com).*

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

## FY 2010 - FY 2011 State Budget: A Plethora of Sticky Wickets

A sticky wicket is a cricket term that has become a metaphor for difficult circumstances. It is an appropriate metaphor for the large number of policy changes that are included in Governor Strickland's proposed FY 2010 - FY 2011 state budget. For example, if the legislature does not approve the changes that Strickland proposes for criminal sentencing laws, then the adult inmate population will increase considerably above that which is assumed in setting the appropriate request for the Department of Rehabilitation and Corrections and may even require building one or more new prisons. Consequently, sentencing reform is one that the legislature will have to address in order to complete one of the components of a complex proposal on the next state budget.

It should be noted that to some degree every state budget includes changes in policy on which appropriations levels are dependent. What is different about this budget is the extent of such changes and the magnitude of the fiscal implications from failing to make them. What follows is a discussion of the major policy issues that will be the focus of legislative budget decision-making and which are so significant to keeping the proposed state budget in balance.

Sticking Point	Fiscal Implication
Sentencing Reform	\$58 million savings/biennium

The governor's budget assumes that the legislature will approve several changes in Ohio's criminal sentencing laws that are estimated to save the state \$29,061,124 in corrections costs each fiscal year. If these reforms are not enacted, the governor maintains that the state would have to provide funding for six new 2,000 bed, dormitory style prisons--and that would be based on the assumption of zero prison population growth. New construction would cost an estimated \$1.1 billion and the corrections department would need an additional \$250 million each year in General Revenue Fund (GRF), funding to operate the newly-constructed prisons. The sentencing policy reforms that the governor assumes the legislature will enact to avoid those costs are:

- An expansion of the existing community corrections diversion program that targets F-4 and F-5 felonies and probation/community control violators;
- An expansion of existing jail diversion programs targeting overcrowded jails;



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- Funding 220 existing but unused beds in 18 residential community-based correctional facilities;
- Raising the threshold amount for increased penalties for theft related offenses from \$500 to \$750;
- Expanding the current prison diversion child support sanctioning options and creating new sentencing alternatives;
- Permitting the Adult Parole Authority to utilize various sanctions instead of charging offenders who abscond from parole supervision with a new felony offense; and
- Reinstating the ability of prisoners to receive seven days of “earned credit” based on monthly program completion in qualified education, vocational, employment in prison industries, substance abuse or other constructive programming.

Of these several proposed reforms, the one that produces the most annual estimated savings is the last which is assumed in the budget to result in annual cost avoidance of \$11.4 million.

What is especially striking about the governor’s sentencing reform fiscal estimates is that the claimed savings is \$58 million for the biennium, but failure to enact them is estimated to cost \$250 million in new operating costs plus the cost of building new prisons and paying for the debt service costs of issuing bonds to pay for them. This disparity is likely to receive considerable legislative attention.

Sticking Point	Fiscal Implication
Refinancing GRF Debt	\$400 million revenue

The governor’s budget assumes that the legislature will take existing bonded indebtedness whose principal and interest payments are made with GRF money and extend the life of the bonds that would have been paid off by the end of the biennium by another ten years.

By extending the debt, the state would be obligating itself to making an additional \$89.9 million in interest payments. For many this may seem to be a steep

price to pay to avoid the other alternatives of cutting spending or raising taxes to produce \$400 million.

Sticking Point	Fiscal Implication
Collective Bargaining Agreement	\$170 million savings in FY 2010 and \$200 million in FY 2011

Agency budget requests have been reduced by a total of \$370 million for the biennium on the assumption that the governor will be able to get state employee unions to agree to a number of changes that will reduce payroll and benefit costs. The cost estimate assumes that the changes would apply to non-union employees as well but it is not clear whether failure to gain collective bargaining contract agreement changes for the union employees would still result in the governor applying the proposed changes to non-collective bargaining agreement employees. The proposed changes are:

- A graduated scale of pay reductions for both collective bargaining employees and exempt employees ranging from zero for employees below pay range 3 to 5 percent for those in pay ranges 12 and above; employees earning \$125,000 or more would be reduced by 6 percent;
- A reduction in the amount of dental, vision, and life insurance premiums the state pays on behalf of employees;
- Authority for the governor to mandate that employees be placed on furlough (layoffs);
- An increase in the statutory trigger for the establishment of a mandatory retirement incentive plan.

Sticking Point	Fiscal Implication
Expanding SCHIP	Indeterminate Cost

The executive budget request includes funding in an amount nowhere specified in the supporting budget documentation supplied thus far to expand the state’s Medicaid health care coverage of children from 200 percent of poverty to 300 percent of poverty. This ex-

pansion was approved, and funded, by the legislature for the current biennium but the administration did not implement the expansion. As a result it is likely that the expansion, as well as all program expansions included in the governor’s budget request, will receive renewed attention as the legislature struggles with the problem of producing a balanced budget for the coming biennium.

Sticking Point	Fiscal Implication
Film Industry Tax Credit	\$10 million GRF revenue loss annually

At a cost of \$20 million in GRF revenues for the biennium the governor proposes a refundable tax credit of 25 percent on qualified production expenditures of film production companies producing eligible films in the state. The stated purpose of the proposed new tax credit is to “encourage and develop a strong cinematic production industry in the state of Ohio and to compete with neighboring states in attracting new film production to Ohio.”

Should the legislature not approve the credit (highly unlikely considering they passed a similar and more costly tax credit which the governor vetoed last year) the state could add \$20 million to its GRF revenue estimates. More likely is that the legislature will attempt to locate additional resources to increase the tax credit.

The governor’s budget proposes additional tax credits but has pushed their fiscal effects in future biennia. One would increase the existing Technology Investment Tax Credit cap from \$30 million to \$45 million at an annual cost of \$15 million (delayed for three to five years). Another would establish a new markets investment tax credit for purchasers of qualified low-income community equity and long term debt investments. The first year that the tax credit can be claimed is expected to be FY 2013 and will result in the loss of an estimated \$12 million in GRF tax revenues that fiscal year. Because these proposals do not affect the current biennium it can be expected that the legislature will not only approve them but look for

ways of expanding them or adding other tax credits and postponing their fiscal effects beyond the expiration of the current legislative terms of office.

Sticking Point	Fiscal Implication
Fee Increases	\$188 million in GRF revenues (excluding proposed Medicaid fee increases)

The difference between a tax and a fee is that the former is applied generally while a fee is levied only on those who benefit from the service that the fee supports. It should be noted that various fees have been increased every single biennium since at least 1971 including a number of years in which the governor and the legislature took credit for enacted budgets with “no tax increases.” However, in this biennium the number of fee increases, and the revenue they are expected to generate, exceeds those included in any of the budget of those prior years.

Excluding proposed fee increases for nursing homes, hospitals and ICF/MR (intermediate care facilities/mental retardation) Medicaid providers, the governor is proposing numerous individual fee increases to produce a total of \$236 million in additional state revenues, \$188 million of which will be in GRF receipts.

Outside of the Medicaid provider increases the state agencies that would receive the biggest boost in revenues to support their programs are the Environmental Protection Agency (\$15 million for an increase in the Tire Fee), the EPA and natural resources agencies (\$17 million for increases in municipal solid waste disposal, construction, demolition and debris fees); the courts (\$42.8 million from various fee increases); the Department of Public Safety (\$131.4 million); the Departments of Health and Natural Resources (\$9.7 million each). Lobbyists for all of the interests affected by the fee increases can be expected to resist the proposed increases resulting in considerable scrambling in the legislature to find ways of avoiding them. The difficulty will be in finding ways to cut spending to avoid the fee increases and raising general taxes.

Sticking Point	Fiscal Implication
Continue Tax Cuts	GRF tax loss of \$3.914.5 million in FY 2010

The governor’s budget request estimates that the GRF tax loss in FY 2010 from implementing the fifth year of earlier enacted cuts in the personal income tax will be \$2,272.6 million and another \$1,642.2 million from the phase out of the corporate franchise tax. As it becomes more clear that that balancing the current budget will require more revenue than anticipated legislators will find themselves examining whether postponing the implementation of the final phase of the five-year tax reductions is good fiscal policy. There is already considerable discussion of at least altering the reduction in the personal income tax to exclude certain higher income taxpayers.

Before a final budget is enacted, issues of whether to continue, modify, or completely postpone the implementation of previously approved tax cuts will receive considerable attention. Although less likely, there is also the possibility of revisiting the decision made in the enactment of the current budget to phase out the tangible personal property tax at a cost of \$1.621 million in GRF funds in FY 2010.

Sticking Point	Fiscal Implication
Hospital Fee Increase	\$282.8 million in FY 2010 and \$315.6 million in FY 2011 of additional state revenue

The governor is proposing to institute a 1.27 percent assessment on hospitals for their total facility costs in FY 2010 and 1.37 percent in FY 2011, and every succeeding year, to gain \$598.4 million in additional state revenue for the biennium, \$513.9 million of which inures to the GRF. Hospitals can be expected to resist the new fee. Legislators will be under considerable pressure to find alternative revenues.

Sticking Point	Fiscal Implication
Nursing Home Fee Increase	\$122.2 million in FY 2010 and \$162.9 million in FY 2011 of additional state revenue

The governor is proposing to increase the nursing facility franchise fee from \$6.25 per bed per day to \$11 resulting in additional state revenue of \$285.1 million for the biennium, \$233.5 million of which would be GRF funds. Since the effect of the increase will be to increase the costs to individual nursing homes, this is likely to be a contentious issue during legislative deliberations. Failure to approve the increase would force the legislature to find that amount of additional state money by making cuts elsewhere.

The governor also proposes to increase the fees for intermediate care facilities for persons with mental retardation to raise an additional \$6 million in GRF revenues for the biennium (\$8.6 million in all funds). This increase is also likely to receive legislative scrutiny.

Sticking Point	Fiscal Implication
Paying for Managed Care Retrospectively	\$270.4 million (all funds) one-time savings

Currently the state pays Medicaid managed care providers for services before they are actually rendered (prospectively). By changing to a retrospective reimbursement basis, the state could obtain a one-time, non-recurring cost avoidance of \$270.4 million in state and federal funds. On its surface this proposal appears non-controversial. However, managed care provider agencies will have to have sufficient resources to cover their costs during the transition period from prospective to retrospective reimbursement. Not all such agencies are likely to have sufficient cash reserves to accommodate the change and therefore this is likely to become an issue for legislative debate.

Sticking Point	Fiscal Implication
Eliminating Budget Earmarks	Indeterminate

The Office of Budget and Management has identified 263 earmarks that were approved in the current state budget (H.B 119 of the 127th General Assembly). These include 33 set-asides in the appropriation for Temporary Assistance to Needy Families in the Department of Job and Family Services and include specific amounts that must be provided to specific agencies. Other line items with large numbers of earmarks include travel and tourism grants, school improvement initiatives, and child and family services.

An earmark works to carve out a specific amount of money and makes it available to the specified agency without regard to its effect on overall program funding.

And there is another effect as well.

When it is necessary to reduce appropriations, either because of overall budget cutbacks or simply because the estimated receipt of funds to support an appropriation line item is not forthcoming, the earmarked money is protected from any reduction. Once again it means that those benefiting from the line item that are not earmarked will bear the brunt of any reduction in spending, while the earmarked agency receives its total earmarked funds and its budget remains unscathed.

Governor Strickland's decision not to include earmarks in H.B. 1 poses an interesting problem for lobbyists and for legislators. Lobbyists who would otherwise be devoting their attentions to advocating for an increase in spending for those programs that benefit their organizations will now have to devote more of their attention to convincing the legislature of the desirability of re-inserting their earmarks. Legislators, meanwhile, will be under pressure to consider the fiscal implications of singling out pet agencies for special treatment especially in a budget so difficult to bring or keep in balance as this one is. The issue of

whether or not to earmark could very well become quite contentious as the budget proceeds through the legislative process.

Sticking Point	Fiscal Implication
Higher Education Tuition Freeze	Could reduce state appropriations if modified

The governor's budget adds money to the appropriations for higher education institutions to pay for the tuition money that those institutions will forego to comply with the recommendation that there be no increases in tuition at four-year schools during FY 2010, increase by only 3.5 percent in FY 2011 and remain flat at branch campuses and community colleges for the next two years. There is likely to be legislative consideration of altering this proposal to free up state money for other uses.

Throughout the country, states have seen tuition and fees rise at institutions of higher learning, including states like California that had long prided themselves for low tuition. Free or low-cost state-supported higher education has never been considered a basic state service required by the state constitution as is primary and secondary education. In difficult economic times it is often the case that legislators determine that those who wish to pursue an education beyond the 12 years avail themselves of the numerous low-interest loan opportunities underwritten by the federal and state governments.

Sticking Point	Fiscal Implication
Government Reorganization	\$12 million savings/year

The governor's budget request includes a number of proposed organizational changes, most of which will have little or no impact on state funding. For example, the governor proposes to move the separately administered State School for the Blind and the State School for the Deaf to the control of the Department of Education. The governor also proposes to create a Center for Early Childhood Development in the education department. While proposed changes such as

these will require legislative attention and approval, the only reorganization that assumes a savings in state outlays is the proposed consolidation of support services for the state's 28 licensing and regulatory boards and commissions.

Currently each of these boards duplicates administrative functions and each prepares its own budget, does its own accounting and personnel work and other back office support services. By combining those functions under one agency, the governor reports that the state could save as much as \$12 million per year. It is not clear how much would actually have to be added back to each of the agencies' appropriations total if the consolidation is not accomplished (nor is there any evidence that there is any opposition to the governor's plan).

Sticking Point	Fiscal Implication
Expand Health Care Coverage to "children" up to age 29	\$6 million tax loss in FY 2011

The governor proposes to require that group health policies be required to cover 21,650 of the estimated 371,000 Ohioans between ages 19 and 29 who do not have coverage under their parent's health insurance policy. To pay for this requirement the governor proposes to extend the state tax deduction to employer coverage of these "older children" and other dependents. If the legislature decides not to approve this policy recommendation the state could add \$6 million to its FY 2010 GRF revenue estimates.

Sticking Point	Fiscal Implication
Education Reform	Redistribution of money

The changes that the governor proposes for primary and secondary education involve numerous policy issues that impact the distribution of state and local moneys to individual school districts. Much of the public's attention to the proposals so far have focused on proposed changes in how educational success is to be measured, extensions of the school year, changes in teacher tenure and similar aspects of the governor's

plan to transform Ohio's public education system. But the budget request also proposes a major change in the funding mechanism used to provide basic aid to school districts.

The current state school financing system is called a "Building Blocks" approach where costs of certain educational components that are linked to academic success are identified and then state aid is provided based on those costs and the assumed local share of them. The governor proposes to eliminate that concept and instead base funding on the unique needs of individual students in what is called the Ohio Evidence-Based Model (OEBM). The changes that the conversion will entail are numerous and complicated and will become the subject of considerable legislative debate as will the non-funding policy changes the governor proposes.

What is likely to happen is that in the end much of the discussion of funding changes will revolve around "who gets what" or "legislation by printout" (of individual school district state aid).

The school funding formula has always been seen as a mechanism by which the state can push school districts toward spending to achieve state-determined objectives. The fact that less than half of the money school districts receive, on average, comes from the state makes it difficult for the state to really use the funding device to achieve those objectives; local funds would have to be committed to the same objectives to achieve that result. So what typically happens in the legislative process is that the fiscal debate centers on two questions: (1) how much more money can be "found" to add to the total the governor recommends for primary and secondary education; and (2) how can the formula be juggled to make certain that the school districts of the most influential state legislators receive the largest significant increases in state aid. Since there is no reason to believe that the 128th General Assembly will be any different than its predecessors, by the time the primary and secondary education budget is settled (which may go beyond June 30) the end result will undoubtedly be a reshuffling of "who gets what" among the school districts

and a school funding formula jerry-rigged to achieve the legislatively-desired results for individual school districts.

Sticking Point	Fiscal Implication
"Raiding" Other Funds	\$1,945.6 million

The executive budget request proposes to use up the entire balance of the state's Budget Stabilization or Rainy Day Fund (\$948 million to be used in FY 2011) and the accumulated ending cash balance (\$249 million), balances in various state special revenue (rotaries) funds (\$116.8 million in FY 2010 and \$151.8 million in FY 2011), a portion of the balance in the unclaimed fund (\$200 million in FY 2008 and \$80 million in FY 2011) and \$200 million in a "loan" from the cash being held by the Ohio School Facilities Commission. These one-time raids on other funds are in addition to the one-time moneys the state expects to receive from the federal stimulus legislation as well as the \$400 million the governor estimates can be received from extending current state GRF debt for another two years (described above) and \$270.4 million if the legislature agrees to change the way that managed care providers are reimbursed (described above). In total, the governor's budget request is predicated on about \$6 billion in one-time, non-recurring receipts.

The policy decision concerning the use of these one-time moneys to pay for proposed spending this biennium does not involve making statutory changes or making decisions outside of appropriations decision-making, as are the other items discussed in this article. Nevertheless, it is included largely because a number of legislators have expressed concerns about the future implications of using one-time, non-recurring moneys to balance this biennial budget. In fact one-time, non-recurring funds have been used to shore up sagging revenues for decades with few recriminations and little concern about future fiscal implications of doing so. But there is a difference this time in terms of the magnitude of the one-time receipts and the dim prospects for a significant enough increase in GRF tax receipts in the future to equal the revenues produced by the one-time measures. De-

spite those problems the real concern that will guide decision-making on this policy issue is what the alternatives are.

With respect to the "raided" funds there would seem to be little reason to support letting them remain where unused when demands for public services are increasing as unemployment continues to rise and when the state's revenues are declining so rapidly. With respect to the federal funds, surely no one suggests not taking and using them. With respect to the several other one-time revenue sources, including the \$200 million loan, the \$400 million debt service extension and the \$270.4 million from restructuring payments to managed care providers there are other issues involved which will surely receive considerable legislative attention. However, the more the legislature removes one-time receipts from the proposed budget the more they will have to consider permanent tax increases and/or spending cuts to bring the state's budget in balance without the use of those receipts. The legislature may well find those alternatives less savory than accepting the fact that the next legislature may very well find itself bereft of further one-time revenue sources to balance the FY 2012 - FY 2013 budget and will have to "bite the bullet" on considering significant tax increases. It may sound cavalier but generally the legislative attitude is to let future legislatures "take care of themselves" while they concentrate on extant problems and issues.

## Long, Difficult Days Ahead

The number and extent of difficult policy choices contained in this budget is staggering and will consume endless hours of legislative debate that may well extend beyond June 30, the end of the current fiscal biennium, especially with regard to education reform. Complicating matters will be the fact that even before tackling these difficult issues the legislature will have to find ways to bring the governor's already out-of-balance budget request back into balance.

FY 2009 revenues are continuing to produce less revenue than were projected when the third downward revision of estimates was made in December, 2008. It now appears that legislators will have to come up

with about \$400 million to keep the current budget in balance and the possibility of doing so by cutting spending at this late date in the biennium is slim to non-existent. Also, the governor's budget assumed that FY 2009 would end with a GRF balance of \$420.6 million; now the estimate has been revised downward to \$137.1 million. That means that the governor will not be able to spend down (or use) the \$249 million he was counting on from FY 2009.<sup>1</sup> In addition, the governor's budget was predicated on the more generous state aid that was included in the congressional house's version of the economic stimulus bill; the one that was enacted provides considerably less money that the state can use to support general operating purposes leaving the legislature with another gap to fill. And, beyond those already-identified balancing problems, it would not surprise me to find that before the budget bill leaves the House of Representatives the administration will revise its revenue forecast for the coming biennium downward creating still another gap between proposed spending and the revenues needed to support it.

As the problems with this budget multiply there will be more and more attention given to the matter of tax increases, as repellant politically as that issue may be, and as difficult as it may be to consider during bad economic times. In the absence of a tax increase the legislature will have to consider such options as flat funding for primary and secondary education, tuition increases for higher education, elimination of optional Medicaid services and reductions in state aid to local governments (which would, of course, simply pass the state's problems on to localities). It is most likely that the legislature will be forced to reconsider the decision to continue the tax reductions approved by a prior general assembly. Small cuts in spending here and there will do little to address the problem of balancing this budget. Complicating matters are the numerous policy decisions with significant fiscal implications that the governor has made part of his biennial budget request.

1. The governor's budget request assumes an FY 2011 ending cash balance of \$171.6 million. Presumably the balance could be brought down to zero but that would still leave the governor's budget short by the difference between the \$249 million and the \$171.6 million that could be used (\$77.4 million).

Many long, difficult days lie ahead before H.B. 1 is finally enacted.

### **Do You Have Questions about Ohio's Budget?**

*E-mail your questions to budget expert Richard Sheridan at [rsheridan@CommunitySolutions.com](mailto:rsheridan@CommunitySolutions.com).*

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