

VII. Options to Close the Budget Gap in FY 2012-2013

As we move toward the next biennium, Ohio faces a large structural deficit. This means that, year in and year out, the state is obligated to spend more than it actually will take in. It's called a "structural" deficit because the problem comes not from a temporary economic downturn but from the built-in limitations of Ohio's revenue system. Ohio's structural deficit for the biennium is more than \$8 billion, or \$4 billion per year.³⁶ There are no easy solutions, but it is essential that Ohio move forward with a balanced approach rather than relying on spending cuts alone. Cuts that took place in the previous budget and in House Bill 1 have been devastating to Ohio families. Further rounds of massive cuts will undermine the quality of life in the state for years to come. State leaders and the public must face up to the fact that Ohio's fiscal path is unsustainable.

There are reasonable approaches to revenue that would allow the state to reverse most of the cuts in this biennium, prevent a catastrophe in the next budget, and create a revenue structure that can meet long-term challenges. The 2005 tax changes lowered an income tax rate structure that was put in place in the early 1990s. Going back to the previous rate structure, especially for wealthy taxpayers, is a foundation for confronting the crisis. The Office of Budget and Management has estimated that reversing just one year of the income tax cuts will yield \$422 million dollars for the GRF. Further rollbacks are necessary. The effects on low-income families could be mitigated by further increasing the amount that households can make before owing state income tax. Ohio's threshold now is \$10,000. One way to address this is a state Earned Income Tax Credit structured like the federal EITC, an effective way to help working families rise out of poverty that traditionally has enjoyed strong bipartisan support. Twenty-four states plus the District of Columbia already have this credit in place.

The imbalance between business and individual taxes also should be addressed in a revenue package. The rate on the CAT is set too low to even reimburse schools and local governments for all the lost tangible property tax revenue, let alone to make up for lost revenue from the corporate franchise tax. The GRF must subsidize the reimbursement in this biennium. Each 1/100th of 1 percent increase in the CAT would raise \$50 million. The CAT rate, currently at 0.26 percent, must be reexamined to make sure that revenues are adequate to handle scheduled reimbursements and also return a significant amount of funds to the GRF.

The state should also strongly consider retaining at least some level of the income tax portion of the corporate franchise tax. The tax has performed much better in recent years than expected, and Ohio would be in line with most states around the nation. Forecasting revenues from the corporate franchise tax is difficult, because it depends on profits. Nonetheless, it is reasonable to expect that retaining at least one fifth of the former rate would yield at least \$200 million per year.

The expansion of the Homestead property tax credit, which took place in the FY 2008-2009 budget, is unsustainable in this fiscal environment. Not every senior needs it. Some who are in dire need of such assistance as adult protective services will not receive it because of budget cuts. Returning to former program parameters would save the state about \$257 million per year.

The sales tax is also in need of modernization. The sales tax was originally structured to apply to sales of tangible items. Some services that people purchase have been added over time, but not enough to keep pace with the increasing shift in consumption patterns away from goods and to-

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ward services. Before considering an increase in the sales tax rate, policymakers should examine whether the tax should cover untaxed services. Governor Taft had proposed covering entertainment admissions, for example, but the legislature did not agree. At the time, it was estimated that this change would bring in about \$55 million per year.

Ending various unproductive tax breaks is another essential process for straightening out Ohio's finances. The state loses over \$7 billion per year to deliberately created deductions, credits, and exemptions. Closing any loophole will be difficult because each has its particular interest group that will rise to its defense. For example, packaging equipment used by manufacturers is exempt from the sales tax, costing the state \$230 million each year. Telecommunications services provided by certain call centers are also exempt, creating a loss of \$21 million. Often, supporters of these exemptions justify them on the grounds of economic development and job creation. The state has to develop proper tools to evaluate these claims; in their absence, tax breaks stay on the books indefinitely without any proof that they benefit the public.

All options for dealing with the state's structural deficit have implications, and now more than ever it is critical that we understand the consequences of the tax and spending choices that lie ahead.

GRF appropriations (state and federal share) are expected to be \$25.9 billion in FY 2011. Even if tax receipts rose by a healthy 5 percent, and recurring non-tax receipts were flat, to maintain FY 2011 levels of spending the state would need another \$4 billion per year. And that leaves aside the reality that there also will be new spending pressures. The state remains committed to the phase-in of a new school funding model that will substantially increase state support for primary and secondary education; college tuition needs to

be kept affordable to support planned enrollment increases; Medicaid costs will continue to rise due to rising caseloads; and prison populations will keep rising absent fundamental state sentencing reform that redirects nonviolent offenders to community corrections.

To close the gap with budget cuts alone, FY 2011 state share GRF spending would have to be reduced by more than 21 percent. Cuts of that dimension would have to fall on every major state program. In primary and secondary education, foundation payments to public schools would be reduced by more than \$1.1 billion per year. Payments for student transportation would be reduced by another \$100 million. Thousands of teachers and non-teaching positions would be eliminated, undermining the quality of education across the state.

The state would be forced to reduce state share spending by \$700 million in the Medicaid budget, leading to an overall loss of \$2 billion per year when the federal share is included. Eligibility requirements would have to be lowered to federal minimums, causing many Ohioans who have no other options to go without basic health coverage. Payments to health care providers would be slashed, and optional services such as prescription drugs, intermediate care facilities for the mentally retarded (ICF/MRs), hospice, home- and community-based waivers, dental, vision, podiatry, home health, and private duty nursing would be reduced or eliminated as well.

A 21 percent cut would create a similar path of destruction across prisons, mental health, drug addiction, and child protective services – as well as any other service supported with GRF dollars.

The costs of reducing state funding by \$4 billion per year would have significant short- and long-term implications to vulnerable populations, to Ohio's future workforce, and to public safety – all fundamental responsibilities of state government.

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It would be reckless to believe that structural balance could be restored in the state through spending cuts alone.

This scenario is not inevitable. It is possible that federal health care reform will make major changes to the system that would affect state programs, although, as of this writing, most of the contemplated changes will not take effect until 2014. It is also possible that the federal government will ease the problem somewhat by extending some extra fiscal relief to the states after 2010. Federal policy actions could make the situation better, but they cannot solve all of Ohio's problems in future biennia any more than they could do so in the current one. The constant erosion of the state's tax base must stop; the state must create and maintain a revenue structure that is adequate to meet Ohio's responsibilities. Policy-makers cannot avoid coming to terms with the fiscal crisis facing the state. Our quality of life is at stake and it is worth fighting for.