

## CHAPTER 1:

# The Legal Framework

**A**ny citizen concerned with how public dollars are spent must understand the basic concepts of state budgeting. An understanding of the vocabulary of public budgeting and its basic precepts is a prerequisite for skill development. This includes knowledge of both the universal principles of public budgeting and the legal framework that is largely unique to Ohio.

## Public and Private Budgets

Anyone familiar with private or nonprofit sector budgets should understand that public budgets are quite different. Government is concerned with the provision of services that cannot be measured by whether they produce a profit. Government is concerned with social problems of which there is little agreement on what matters to undertake or how best to solve them. The contrasts between public and private budgeting are numerous, as summarized in Table 1-1.

**Table 1-1: Comparing Governmental and Private Sector Budgeting<sup>1</sup>**

GOVERNMENTAL BUDGETING	PRIVATE SECTOR BUDGETING
Protects the interests of citizens and promotes business activity.	Based on self-interest; goal is to maximize profit without concern for facilitating the economic activity of other businesses.
Depends on finding agreement among decisionmakers on the existence and importance of societal problems.	Depends on market considerations to guide budget decisions.
Requires that budgeting decisions be made in a public forum open to taxpayers and the media.	Is conducted on the basis of formulas by professionals who work in private.
Incorporates extensive financial controls, many embedded in the constitution or through statute, that are designed to prevent financial mismanagement, excessive borrowing, inordinately high tax rates, and deficit spending.	Is conducted according to generally accepted financial practices that are controlled by the market and by accounting standards.
In the context of accountability to citizens, pursues goals of efficiency and effectiveness by balancing short-term and longer-term community interests.	Is insulated from the public and accountable only to shareholders; goal is to maximize profits in the short term.

## Defining Public Budgeting

Public administration and public finance theorists have offered a number of definitions of a “budget.” The late Aaron Wildavsky, widely regarded as a leading expert in public budgeting, provided a very simple definition: “a budget is a series of goals with price tags attached.”<sup>2</sup> Budgets, however, are much more complicated than this description. The best description of the comprehensive nature of a public budget comes from Sydney Duncombe, who in 1977 defined state budgets variously as:

- An instrument of planning;
- A work plan with a dollar sign attached;
- A means of balancing revenues and expenditures;
- An instrument of gubernatorial policy;
- Public relations;
- A semi-judicial process in which state agencies come to the legislature to plead their case;
- A system of control without which state agencies would bankrupt states in two years;
- An instrument of good management; and
- A system of accountability.<sup>3</sup>

The budget is not just the vehicle for funding public policies. It is where public policies are made, either implicitly or explicitly. Concisely, a public budget is a means of allocating resources and establishing priorities, thus defining competing interests and making choices from among those interests as part of setting state policy on a variety of public issues.

**Political Document.** In Ohio, the state budget is, first and foremost, a political document. It coherently articulates a statement of political goals, objectives, and priorities. It tells us in dollars and cents what can be expected from the party in power for the ensuing two years. It is the product not simply of accountants adding up numbers, but rather of the resolution of a series of conflicts. These may be any of the following: conflicts between a bureaucracy concerned with power and control and a public concerned with accountability, the tensions between ideology and political expediency, the conflicts between special and collective interests, the struggles between politicians and bureaucrats, the partisan conflicts between Republicans and Democrats, or the clash of rural and urban concerns. We cannot overstate the significance of the state budget in Ohio politics. The state budget is much more than a “moral document” or a “road map.” Perhaps, the late Speaker of the Ohio House of Representatives, Vernal G. Riffe, said it best: “The state budget is everything.”

## Types of Budgets

While local governments in Ohio budget on a calendar-year basis, the state’s fiscal year runs from July 1 to June 30.<sup>4</sup> In odd-numbered years, the governor submits the state’s operating budget to the General Assembly for its review and passage before the existing budget expires on June 30. This happens four weeks after the convening of a new General Assembly or by March 15 in the case of a newly elected governor. The Executive Budget Request spells out the governor’s major priorities. This document is still commonly referred to as the “Blue Book,” although it has been produced solely in electronic form for many years. The submission of several appropriations bills coincides or shortly follows the release of the Executive Budget Request. When enacted, these bills will become the “state’s budget” for the ensuing two-year period. Ohio is the second largest of the 20 states that still budget on a biennial rather than on an annual basis; Texas is the most populous state that budgets biennially.<sup>5</sup>

The format in which the governor submits the budget will have a significant impact on the questions the legislature will ask in deciding spending levels for agencies and programs. A program is defined as a cluster of activities or services with a common goal. The type of budgeting used dictates the format. The oldest and most universally used type of budgeting, though far from the best, are incremental and line-item budgeting.

## **Incremental Budgeting**

Incremental budgeting is perhaps the least sophisticated approach to budgeting. Although it does provide important focus on the changes an agency or program proposes from its existing level of funding, it focuses solely on the margins. The justification for funding increases or decreases for agencies and programs is only provided for deviations from either the currently budgeted level of expenditures or from base-level expenditures. Most states, including Ohio, still use incremental budgeting in some form.

## **Line-Item Budgeting**

Line item budgeting has long served as the foundation for budgeting in many states. Lists of the goods and services to be purchased are the centerpieces of this kind of budgeting. In this format, agencies collect and report information on inputs (costs and materials) used in the production of government services. This information becomes the object of execution and legislative interest, debate, and finally, appropriations.

The line-item budget emerged over public concern that government spending should be controlled. It provided a way of ensuring the public that its money was spent legitimately. In spite of advances in budgeting processes that better recognize the importance of achieving intended outcomes from public expenditures, line-item budgeting persists largely because it is difficult for legislators to “give up control” over the details of the budget. While line-item budgeting provides some limited measure of legislative control and transparency, it is not necessarily over specific objects of expenditures, such as salaries and travel or even programs. For example, Ohio’s largest expenditure item, Medicaid Health Care Services, combines funding from state and federal sources and expenditures from various types of providers and Medicaid programs. Perhaps, more importantly though, this form of budgeting is widely criticized in that it has no concern for the actual results of spending, the purposes of the expenditures. Yet, it persists and even co-exists with other budget formats in many places, including Ohio.

## **Performance Budgeting**

By the 1950s, public budgeting had begun to focus on “outputs,” that is, the units of work produced and how efficiently they are produced, usually expressed in cost-benefit terms, borrowing from the field of economics. As originally cast, this kind of budgeting, with its main focus on planning, was more useful to the executive than the legislative branch of government. In Ohio, as in other states, the legislature has found it difficult to make budget decisions based on outputs or units of production, like numbers of prisoners processed per month.

**Program Planning and Budgeting.** Program Planning and Budgeting System was a system of budgeting first used by the U.S. Department of Defense, as they tried to convince Congress to support it after the peace settlement at the end of World War II. The agency provided Congress with economic

data intended to prove the need for a standing army in peacetime. Many states emulated the defense department's attempt to apply formal economic analysis to rationalize the basic budget question of how much money to allocate to a given program. However, the Program Planning and Budgeting System was short-lived. Its two biggest problems were its overwhelming need for detailed data and its virtual total disregard by legislative bodies. Out of this movement, however, the development and budgetary reporting of program goals, rather than agency goals, survived.

**Zero-based Budgeting.** The next evolution in performance budgeting was Zero-based Budgeting. The Zero-based Budgeting process was adapted from the private sector and popularized by President Jimmy Carter, who had employed it as Georgia's governor in the early 1970s. It requires government agencies to begin with the assumption that they have no resources. From there, managers develop "decision packages" to justify undertaking each agency's activity and to determine at what level it should be funded. Zero-based Budgeting was never fully developed in Ohio and other states have largely abandoned it for pretty much the same reasons that led to the demise of the Program Planning and Budgeting System: its overemphasis on detail, leading to what some called "paralysis by analysis." However, a modification of Zero-based Budgeting was incorporated into Ohio's fiscal year FY 1978–1979 budget when the legislature set "survival" levels of spending and requested that agencies justify any spending above that level. What developed in Ohio from the modification of Zero-based Budgeting was an approach to executive budget-making where the central budget office sets a base level of spending, somewhere below current level spending, and requires position papers to justify spending above that level. Chapter 3 provides details of this approach.

**Target-based Budgeting.** New budgetary formats continued to develop through the 1980s with Target-based Budgeting, which reduced the amount of information agencies had to submit to justify their requested appropriation level. Under a Target-based Budgeting approach, the central budget office tells the agency the maximum amount it can request. The central budget office establishes the target after determining current-level spending and the amount of spending needed to continue ongoing programs at future prices, while also allowing for any changes in priorities required by legislative or judicial action or external circumstances, such as changes in a program's enrollment. Once again, Ohio's current budget process, which is its own unique blend of the pure forms of each succeeding change in the form of budgeting, retains targeting as a key component.

**Results-based Budgeting.** Since 1993, budget reform has focused on performance as defined by results rather than units of service. In that year, Congress enacted the Government Performance and Results Act (GPRA) to assist federal government agencies to "re-engineer" their operations. It required agencies to prepare strategic plans on their long-term goals for each major function as well as annual performance plans and reports on meeting these goals. The act was an outgrowth of increased citizen concern that governmental moneys were either spent unwisely or were wasted. Survey after survey had found that the public believed that governments at all levels were unresponsive, gridlocked, and overly bureaucratic. Government and its leaders did not have the public's trust in their ability to achieve desired results from expending public moneys, whether those results were decreased crime, an educated populace, or a healthy environment. Thus, it was not surprising that the federal government's action was followed by resolutions from a number of prominent national organizations, including the Governmental Accounting Standards Board, the National Academy of Public Administration, and the American Society for Public Administration, encouraging governments to utilize performance measurement and reporting systems. The GPRA was amended in 2010 to require agencies to publish their strategic plans and reports in machine-readable formats.

In the 1990s, results-based budgeting became viewed as one component of a total results-based system, the components of which are shown in Table 1-2.

**Table 1-2: Results-based Management Components**

STRATEGIC PLANNING	ESTABLISHING PERFORMANCE GOALS
Performance Measurement	A government jurisdiction quantifies how efficiently and cost effectively it has used its resources in delivering public services using a baseline (standard, norm, or criterion) against which to assess performance in programs or services.
Benchmarking	Identifying, analyzing, adopting, and adapting the high-performance processes of other organizations that excel at a particular activity.
Managerial Accounting	Consists of (1) accumulating and reporting the cost of activities on a regular basis for management information purposes, (2) matching costs with outputs, (3) determining the full cost of government goods and services, (4) recognizing the cost of goods and services provided among governmental entities, and (5) using appropriate costing methodologies to accumulate and assign the cost to outputs. <sup>6</sup>
Results-based Budgeting	Utilizing a budgeting system that allocates resources according to results and holds agencies responsible for budgetary outcomes, as defined internally or externally.

Results-based budgeting is linked to a strategic planning process in which agencies determine the goals and objectives for each program they administer. Performance measures are then developed for those programs to assess how likely the allocation of resources is to achieve the desired outcome. In results-based budgeting and managerial systems, the focus is on outcomes, not outputs.

**Ohio and Results-based Budgeting.** During the 1990s, Governor George Voinovich made a commitment to results-based management, incorporating performance measurement principles into his budgeting process. The state legislature authorized the central budget office, the Office of Budget and Management, to begin conducting performance reviews of selected state programs during the FY 1996–1997 biennium. The Office of Budget and Management worked with selected state agencies in the development of program goals, in setting measurable objectives to determine if desired outcomes were being achieved, and in establishing data collection procedures and capabilities necessary to measure the objectives. For the FY 1998–1999 budget, six major state agencies submitted performance review reports along with their budget requests and these were incorporated into the Executive Budget Request.

As with previously employed performance budgeting approaches, Ohio’s attempt at objectifying or rationalizing the budget process was of more use to the executive branch than the legislature, which continued to appropriate funds by line item and by agency; although over the years, the level of line item detail has shrunk. This is largely due to the fact that the predominant interest of the executive branch is on planning while the legislative focus is primarily on control. These different philosophies are the natural outcome of different institutional roles and serve to shape the budgetary dynamics of the appropriations process.

More recently, the legislature has shown interest in improving agency and program performance through a renewed emphasis on audits. Examples include House Bill 166 of the 127th General As-

sembly, which created an Office of Internal Audit within the Office of Budget and Management, and Senate Bill 4 of the 129th General Assembly, which subjected at least four programs or agencies each biennium to performance audits by the Auditor of State. The first four departments receiving a performance audit were the Ohio Department of Education, the Ohio Department of Job and Family Services, the Ohio Department of Transportation, and the Ohio Housing Finance Agency. However, it does not appear that any significant budgetary implications resulted from any of these or subsequent performance audits.

**Blended Budgeting.** For lack of a better term, the form that Ohio's budgeting process takes can be called a blended system. It combines elements of a number of the reforms since the 1950s but changes its emphasis depending on forecasted economic conditions and the managerial style of the incumbent governor. When economic times are bad, the central budget office is likely to greatly restrict the amounts agencies can request because of the political difficulties caused by budget requests, which far exceed estimated available resources. There is no point in raising the hopes of legislators, constituents, and interest groups on expanded and new programs when the political will to raise the revenues to support them will not be there. In contrast, in good economic times or with a governor willing to take a leadership role in raising taxes, free-ranging agency budget requests are desirable, since they enable the governor to gain needed public support for spending available revenues or for raising additional resources.

## How a Budget Process Evolves

### Budget Format

The arrangement, or format, of information provided in an agency budget request, and in the Executive Budget Request presented by the governor, determine the lines of inquiry about the request. If detailed line-item information is provided, the inquiry can be expected to focus on questions such as, "How many new employees are you planning to hire?" If performance data is included, the inquiry will more likely be about whether an agency's program is cost effective or whether there are other more cost-effective ways of accomplishing the program's mission.

Individual legislators cannot be expected to perform the kind of in-depth analyses contemplated by more sophisticated budgeting formats. Thus, the legislature relies on partisan fiscal experts as well as the budget and fiscal professionals in the Legislative Service Commission to perform such analyses. The Legislative Service Commission prepares "Redbooks" on each agency's budget request. These analyses, which can be viewed at [www.lsc.ohio.gov](http://www.lsc.ohio.gov), are thorough and assist legislators in framing program and performance questions to ask of agencies. The Legislative Service Commission also produces "Greenbooks" following the enactment of the operating budget analyzing the final version of agency budgets.

### Balance of Power

While the budget format sets the parameters of the budget process, it is also a visible representation of the underlying budgetary power struggle between the executive and legislative branches of government. As discussed, some types of budgeting formats are more useful to one branch than the other.

As a result, the evolution of budgeting practices has coincided with shifts in the balance of power between the legislative and executive branches of government. Early state constitutions provided for strong legislative bodies and weak executives. In a few states, the chief executive was actually appointed by the legislature. Over time, the executive gained power and the legislature weakened as governmental services expanded and the bureaucracy grew. During the 1970s when the Ohio legislature became full-time with very little turnover, especially with respect to legislative leadership, and became professionally staffed, the balance of power shifted briefly back to the legislative branch. However, in more recent times, with the impact of term limits and increased legislative turnover, including legislative staff, the executive branch has again gained in relative strength, and this has aided the evolution of the budget process.

## Stages of Budget Development

The eight distinct phases in the development of the state budget are (1) the issuance of budget guidelines to state agencies, including the governor’s policy priorities; (2) evaluation of agency budget requests by the central budget office, the Office of Budget and Management; (3) The Office of Budget and Management recommendations concerning the agencies requests submitted to the governor; (4) public release of the governor’s Executive Budget Request, or “Blue Book;” (5) legislative review of the Executive Budget Request leading to the recommendation of appropriations by the Ohio House of Representatives; (6) legislative review and recommendation of appropriations by the Ohio Senate; (7) Conference Committee negotiations leading to the enactment of final legislative appropriations; and the (8) governor’s signing of the enacted budget, usually line-item vetoing some matters. The timeline for these stages of state budget development in Ohio is shown in Table 1-3, which depicts the typical calendar for the main operating appropriations bill in a legislative session with an incumbent governor. In a year with a newly elected governor, as in the case of the FY 2020–2021 budget, the Executive Budget Request does not need to be unveiled until March 15.

**Table 1-3: Budget Calendar for the Main Operating Appropriations Bill**

June–July	The Office of Budget and Management (OBM) distributes budget guidelines to agencies, including assumptions for budget development and budget request forms.
September–November	Agencies submit budget requests (and spending forecasts as appropriate) to OBM. Budget submissions are reviewed for technical accuracy and additional data is sought from agencies as necessary.
October–January	OBM prepares revenue and Medicaid spending forecasts for the upcoming biennium. Recommendations are made to the governor on funding priorities within established revenue and spending projections. The Legislative Service Commission (LSC) independently prepares revenue and Medicaid spending forecasts.
January	The new General Assembly is seated in odd-numbered years. Except in the case of a new governor, the Executive Budget Request is released four weeks after the legislature convenes. LSC prepares the budget bill based on the governor’s recommendations.
February–April	The budget bill is introduced and referred to the House Finance Committee. OBM and LSC present their independent revenue and Medicaid spending forecasts to the committee. Subcommittees of the House Finance Committee review the budget bill and recommend changes to the full committee. LSC staffs the committee and subcommittees.

April–May	The House Finance Committee acts on subcommittee recommendations and amends the budget bill. LSC drafts both permanent and temporary law amendments. The House passes the amended bill and sends it to the Senate.
April–June	Subcommittees of the Senate Finance Committee review the agency budget requests and recommend changes to the full committee. The Senate Finance Committee acts on the subcommittee recommendations and amends the budget bill. LSC, which staffs the committee and subcommittees, drafts both permanent and temporary law amendments.
June	The Senate passes the bill with changes, and it is sent to a conference committee of the House and Senate. OBM and LSC provide updated revenue and Medicaid spending forecasts. LSC produces budget analyses comparing the House and Senate changes to the appropriations bill. The conference committee works out differences between the House- and Senate-passed versions of the bill. The House and Senate vote on the conference committee report, which is not subject to amendment. The governor signs the budget bill by June 30, usually line-item vetoing several matters.

Note: Newly elected governors are not required to introduce the Executive Budget Request until March 15, necessarily delaying House of Representatives action on the bill.

The budget chronology references the “budget bill,” whereas current practice is actually for the legislature to enact separate appropriations bills in odd-numbered years for (1) transportation, the operations of the Department of Public Safety and for operating and capital spending of the Ohio Department of Transportation, other than aviation, railroads, and mass transit; (2) the workers’ compensation system, the operations of the Bureau of Workers’ Compensation and the Ohio Industrial Commission, usually in separate bills; and (3) the main operating appropriations bill, or what is sometimes called the omnibus operating appropriations bill, for all other governmental operations.

In addition, in even-numbered years, two additional appropriations bills are usually passed: one for new capital improvements and a second to re-appropriate any amounts unexpended or unobligated from previously authorized capital improvements projects. Finally, one, and sometimes more, “Budget Corrections” bills are also regularly passed following the approval of the main operating appropriations act. Governor John Kasich labeled his budget corrections bills the “Mid-Biennium Review,” or MBR, to indicate a more strategic focus. Far more than corrective in scope, the MBR was intended as a sequel to the budget, a second wave of policy changes or reforms designed to transform Ohio for growth. It is a term that may well continue in future administrations for the much more positive direction it connotes. The General Assembly has subsequently broken the MBRs into multiple, more manageable components.

## Principles of Budgeting

There are a number of constitutional provisions, and judicial interpretations of those provisions, which set limits on state taxing and spending. Federal and state laws frequently restrict how revenues can be used. Political processes also exert a number of very real constraints on the General Assembly and the governor as they appropriate and implement the state budget. These provisions are described as they affect (1) public debt, (2) the power to tax, and (3) the power to appropriate.

## Provisions that Govern Public Debt

Most states have at least some procedural restrictions on how debt may be incurred. Constitutional and statutory limits on how debt may be incurred as well as the amount of that debt vary considerably across the states. Ohio is very restrictive about public debt.

**Basic Principle.** Article VIII, Section 1 of the Ohio Constitution authorizes debts “to supply casual deficits or failures in revenues, or to meet expenses not otherwise provided for,” but it limits the total amount of that debt to \$750,000. This is, of course, virtually nothing in terms of the state’s current multi-billion-dollar annual expenditures. This section of the Constitution, adopted in 1851, was probably intended to deal with short-term cash-flow problems. Additional debt may be authorized only by amendment of Article VIII, Section 2, which specifies that debt may be incurred “to repel invasion, suppress insurrection, defend the State in war, or to redeem the present outstanding indebtedness of the State....” There is no evidence, however, that the General Assembly has ever used this provision to issue debt. Public indebtedness has been incurred only through constitutional amendments that have been adopted through the years as Article VIII, Sections 2a through 2s.

**Public Debt Defined.** There is an open question as to what constitutes public debt within the meaning of the Constitution. Article VIII, Section 3 provides that “Except the debts above specified in sections one and two of this article, no debt whatever shall hereafter be created by, or on behalf of the State.” However, when the state signs a contract with a private party to manage state-owned lodges within state parks or to run state prisons, does this create an obligation that is a public debt? These obligations are long term, but only by virtue of renewal clauses divided into two-year periods. There is a dearth of judicial opinion on questions such as these and the relevant constitutional provisions.

One form of public indebtedness that is permissible both by U.S. Code and the Ohio Revised Code is applying for an advance to the Unemployment Compensation Fund and to do all things necessary to repay such an advance. Bonds may be issued for this purpose, provided that they both satisfy federal requirements for how a state system must be established for employers and fall under the state constitutional exceptions against creating debt that exceeds \$750,000.<sup>7</sup>

**Self-Generating Revenues.** One court case holds that Sections 2 and 3 of Article VIII do not apply to indebtedness incurred in procuring property or erecting buildings or structures for the state’s use if the property or building will be paid for out of revenues or income generated by its use.<sup>8</sup> However, in that case, the revenue bonds issued were determined to be void because repayment was to be made out of rental charges to be paid by the Ohio Department of Public Welfare (now Job and Family Services). Since the revenues amounted to one state department owing another, this created unconstitutional state indebtedness. The state has financed the construction of parking garages associated with state buildings, using revenue bonds, under this interpretation of the constitutional provision, because they are paid for by parking fees, not tax receipts.

**Installment Contracts.** In another particular instance, a question was raised about a state agency’s ability to contract to lease or purchase equipment in eight annual payments, with those payments being applied toward the purchase price of the equipment. Even though the state reserved the right to cancel the contract or to exercise an option to purchase it on any anniversary date of the agreement, the Ohio Attorney General argued that this constituted an installment purchase contract prohibited by law under the constitutional provisions on public debt.<sup>9</sup>

**Certificates of Participation.** State agencies may enter into lease-purchase agreements to finance capital improvements or equipment. Certificates of Participation (COPs) are issued with terms from seven to 20 years, representing fractionalized interests in or payable from state payments made under those agreements. COPs were issued by the Ohio Department of Administrative Services to finance the acquisition and installation of two information technology systems, the Ohio Administrative Knowledge System (OAKS) and the State Taxation Accounting and Revenue System (STARS).<sup>10</sup>

**Lending Credit and Assuming Debt.** Article VIII, Section 4 provides in part that “The credit of the State shall not, in any manner, be given or loaned to, or in aid of, any individual association or corporation whatever; nor shall the state ever hereafter become a joint owner, or stockholder, in any company or association in this state, or elsewhere, formed for any purpose whatever.” The word “credit” has been interpreted judicially to include (1) a loan of money and (2) the ability to borrow, that is, the ability to acquire something tangible in exchange for a promise to pay for it.<sup>11</sup> It has also been held not to prohibit giving or loaning the state’s credit to or in aid of a public organization that is created for a public purpose.<sup>12</sup> In 2005, Ohio voters authorized setting this constitutional provision aside to enable the state to aid private businesses using voter-authorized moneys, when giving approval to Governor Bob Taft’s “Third Frontier” initiative. Governor James Rhodes opened the door 40 years earlier to this idea with his successful constitutional amendment to guarantee loans for industrial development.

The state is prohibited from assuming “the debts of any county, city, town, or township, or of any corporation whatever, unless such debts shall have been created to repel invasion, suppress insurrection, or defend the State in war” by Article VIII, Section 5. The legislature can provide direct state grants to public organizations, as it did to assist the City of Cleveland from defaulting on its bonds in 1975, but it cannot take on a local debt.

Article III, Section 4 and Article III, Section 5 both came into discussion during a lawsuit over the constitutionality of Governor John Kasich’s JobsOhio initiative. The lawsuit, which was dismissed in June 2012 because of a lack of standing on the part of the plaintiffs, questioned whether the state was extending its credit to invest in JobsOhio as a joint venture and whether JobsOhio could discharge its liabilities to the state within its contract. Before the lawsuit was dismissed, Governor Kasich responded by modifying the statute to more specifically delineate the limitation on JobsOhio’s assignment of liabilities to the state, narrowing the original intentions he had for the organization. The matter highlights how restrictive the state constitution is on debt assumption.

**Higher Education Loan Guarantees.** In 1965, Ohio voters approved a constitutional amendment that has become Section 5 of Article VI. It authorizes the legislature to pass laws permitting state guarantees for repayment of higher education loans, “including the payment, when required, of any such guarantee from moneys available for such payment after first providing the moneys necessary to meet the requirements of any bonds or other obligations heretofore or hereafter authorized by any section of the Constitution.” The purpose of the provision was to ratify legislation enacted in 1961 and 1963 of which constitutionality was questioned. This provision was used in 1989 to establish Ohio’s Internal Revenue Service Section 529 prepaid higher education tuition program.

**Debt for Internal Improvement.** Article XII, Section 6 provides that “Except as otherwise provided in this constitution the state shall never contract any debt for purposes of internal improvement.” The courts have not interpreted this provision, which was adopted in 1912.

**Payment of Debt.** Article XII, Section 11 specifically requires that the legislation establishing or renewing state bonded indebtedness must include provision “for levying and collecting annually by taxation an amount sufficient to pay the interest on said bonds, and to provide a sinking fund for their final redemption at maturity.” A sinking fund is a debt service or bond retirement fund established by the voters to reserve money to guarantee the repayment of a bond.

## Taxing Power

All governments have the power to tax. Taxes are the main source of government income to support government spending. However, while Ohio’s Constitution grants the General Assembly the power to tax, it also places limits on that power.

**Obligation to Tax.** The General Assembly’s power to tax is found in Article XII, Section 4 as an obligation: “The General Assembly shall provide for raising revenue, sufficient to defray the expenses of the state, for each year, and also a sufficient sum to pay principal and interest as they become due on the state debt.”

**No Referendum.** Neither “laws providing for tax levies, [nor] appropriations for the current expenses of state government and state institutions” may be subject to a referendum vote of the people, according to Article II, Section 1d. This means that the legislature cannot shirk its responsibility by seeking voter approval of a tax increase and thus avoid the political fallout from such a decision. However, legislators were able to place a one-cent sales tax increase on the fall 1998 ballot, using a legal interpretation provided by the legislature’s attorneys. They noted that Section 26 of Article II provides that “all laws of a general nature, shall have a uniform operation throughout the state; nor shall any act, *except such as relates to public schools*, be passed, to take effect upon the approval of any other authority than the general assembly, except as otherwise provided in this constitution [emphasis added].” Because the tax increase was specifically to be used for public schools, it was argued that the tax increase on the 1998 ballot placed it in a uniquely privileged category.<sup>13</sup> Since the measure failed, no one challenged its constitutionality, and therefore the Ohio Supreme Court has not directly ruled on this issue. See Chapter 10.

While tax increases, with the exception of those for public schools, cannot be subject to a vote, it appears that, through judicial interpretation, tax decreases or exemptions could be referred to voters since they *concern* taxes but do not actually *levy* a tax. The Ohio Supreme Court has determined that “laws providing for tax levies” are limited to an actual self-executing levy of taxes and are not synonymous with laws “relating” to, “pertaining” to, or “concerning” tax levies or any agency or method provided for a tax levy by any local subdivision or authority.<sup>14</sup>

**Specific Taxes.** Article XII, Section 3 specifically permits the state legislature to impose (1) taxes on estates;<sup>15</sup> (2) taxes on income that “may be either uniform or graduated, and may be applied to such incomes and with such exemptions as may be provided by law;” (3) excise and franchise taxes; and (4) taxes on the production of coal, oil, gas, and other minerals. However, the Ohio Constitution specifically prohibits taxing “the sale or purchase of food for human consumption off the premises where sold.” In other words, retail food sellers do not pay a tax on the food items they sell.

**One-Percent Limitation.** Article XII, Section 2 prohibits taxes on property to be issued in excess of 1 percent of the true or market value of the property without the approval of the voters in the taxing

district voting on the issue. Statutes clarify the provision to mean that only 10 mills of unvoted taxes may be levied by the state against any taxable property in the state. (With regard to property tax, one mill is equivalent to one dollar in property tax levied per every \$1,000 of a property's taxable value. The property tax levied on a property equals the millage rate multiplied by its taxable value divided by \$1,000. Ten mills on a residence with a taxable value of \$120,000 would thus yield a tax obligation of \$1,200.)<sup>16</sup>

The provision limits the imposition of property taxes to 1 percent of true value “for all state and local purposes....” Property taxes levied within the 1 percent limit, usually called “inside millage” because it is levied “inside” the constitutional limitation, are all currently utilized by local units of government. Additional voter-approved millage is logically called “outside millage.” This means that the General Assembly cannot impose a statewide property tax on its own authority to the extent that the tax would cause total unvoted taxes on property to exceed the constitutional restriction. However, under another interpretation, the state could levy a state property tax.

**State Property Tax Permitted.** Ohio actually assesses real property at a fraction of its market value. Applying the 1 percent limitation to property would permit an unvoted tax up to 28.5 mills. Using an assessment rate of 35 percent on real property, a tax rate of 28.5 mills equates to 1 percent. Hypothetically, it could be argued that the General Assembly could levy an additional 18.5 unvoted mills through a state tax on real property. However, it is hard to imagine such a tax ever being approved by Ohio voters. Using the same reasoning, the 25 percent assessment rate on most business personal property would permit up to 40 unvoted mills on that class of property.<sup>17</sup>

**Uniform Rule.** Another provision of Article XII, Section 2 is that “land and improvements thereon shall be taxed by uniform rule, although Ohio voters did approve a constitutional amendment in 1973 permitting the valuation of agricultural property based upon current use. This provision means that the legislature is prevented from treating business real property differently from residential property for tax purposes. It also has the effect of preventing the pooling of commercial real property for purposes of a statewide tax while reserving residential property for local taxes only.

**Stated Purpose of Tax.** Article XII, Section 5 requires that every law imposing a tax must state the purpose for the tax, and that the revenues derived from that tax be applied only to its stated purpose. Under this provision, the General Assembly is prevented from redirecting the taxes levied by the voters in one taxing district to some other purpose.

**Highway Revenues.** Article XII, Section 5a provides that any “moneys derived from fees, excises, or license taxes relating to registration, operation, or use of vehicles on public highways, or to fuels used for propelling such vehicles” can only be used for highway and bridge construction and maintenance and repair and for the “expense of state enforcement of traffic laws, and expenditures authorized for hospitalization of indigent persons injured in motor vehicle accidents on the public highways.”

**Gambling Revenues.** Article XV, Section 6 specifies that net state lottery proceeds be used solely for the support of primary and secondary education programs. It further requires that tax collected on gross casino revenues be distributed according to a prescribed formula.

**Interest Revenues.** Before 1968, it was the practice of the state to credit interest earned on all idle funds to the state General Revenue Fund (GRF). Section 135.14 of the Revised Code, enacted in 1968,

provided that henceforth all interest should be credited to “the proper fund of the state or subdivision.” The state continued to deposit interest earned into the GRF, assuming it to be the “proper” fund. However, a series of court decisions challenging that interpretation have led the state to credit interest earnings to the funds that have earned them. For example, interest earned on the Wildlife Fund is deposited into that fund and no other. Except for the case of highway funds, which are constitutionally protected, enabling legislation is now required for the state to return to the prior practice of crediting interest from any other state fund to the GRF if economic circumstances should justify it. An exception is the interest earned on advanced federal funds, which must be returned to the federal government.

**Fifty-Percent Rule.** Article XII, Section 9 requires that “not less than 50 percent of the income, estate, and inheritance taxes that may be collected by the state shall be returned to the county, school district, city, village, or township in which said income, estate, or inheritance tax originates, or to any of the same, as may be provided by law.” In fact, the state does not automatically credit those proceeds; instead it uses its general revenue-sharing program and other appropriations made to local governments to satisfy the requirement. The Auditor of State simply certifies each year that the General Assembly has appropriated a sum equal to 50 percent of the revenues collected by the state from the noted taxes generated in a given area for use by the units of local government listed. Those amounts have always exceeded the 50 percent requirement.

**Other Limitations.** Article XII, Section 1 prohibits the state from levying a poll tax, a provision found in many state constitutions after the abolition of slavery, to prevent persons from being denied the right to vote. Article XII, Section 5 provides that taxes can be levied only according to law, and laws imposing taxes must clearly state the object to be taxed and that the tax shall be applied only to that object.

## The Nature of Appropriations

**Legal Basis.** In Article II, Section 22, the Ohio Constitution provides that “No money shall be drawn from the treasury, except in pursuance of a specific appropriation, made by law; and no appropriation shall be made for a longer period than two years.” Under this provision, it is established that (1) appropriations made by the General Assembly constitute the only legal basis for disbursing money from the state treasury; (2) no appropriation may be for longer than two years; and (3) an appropriation must be specific. An appropriation by the General Assembly is the only legal basis for disbursing any money from the state treasury, whether its origin is agency-generated receipts, state tax collections, or federal receipts.

**Two-year Limit.** An appropriation cannot be made for a period of longer than two years, but there is no restriction on when the two-year period is to begin. Appropriations for current expenses go into effect immediately, instead of the usual 90 days after the governor has filed a bill with the Secretary of State. Capital appropriations for new construction are subject to the 90-day delay, but it is not clear whether other capital appropriations would go into effect immediately or after the requisite 90 days. The Ohio Supreme Court has ruled that all sections of an act containing an appropriation for current expenses go into effect immediately, if the appropriation has a conditional influence on the rest of the act.

**Specificity.** An appropriation must be specific. Re-appropriating moneys that have been encumbered but not spent from a previous fiscal period is sufficiently specific to satisfy the constitutional requirement.<sup>18</sup> In addition, the legislature makes limited appropriations to the Controlling Board, a

seven-member joint executive-legislative body, for “Emergency Purposes,” allowing the Board to later allocate those funds for specific public purposes. This exception has not been judicially challenged as an unlawful delegation of legislative appropriations power. Chapter 7 includes a complete listing of the Controlling Board’s numerous and varied powers.

**“Un-appropriating.”** When the governor, not the legislature, determines that state revenue collections are insufficient to support legislative appropriations, the governor may issue an executive order to spending units declaring a “fiscal emergency” to prevent them from expending or incurring obligations that will exceed the amount of revenue available.<sup>19</sup>

**Encumbrances.** When moneys that have been appropriated are not expended at the end of a fiscal period, they remain available to the agency until it has satisfied any obligations legally incurred against that appropriation.<sup>20</sup> In Ohio, unencumbered, unexpended funds remaining in the first year of the biennium do not lapse back to their fund of origin until the end of the second year.

**Transfers.** The state Controlling Board, consisting of six legislators and the governor’s designee, which meets about every two weeks, can authorize the transfer of appropriated moneys between fiscal years within the same agency and between line items within the same agency. However, only the General Assembly can authorize the transfer of moneys between agencies.

**Balanced Budget.** Article VIII, Section 1 limits the amount of debt the state can incur to \$750,000, thereby establishing the principle that Ohio’s budget must be balanced with current expenses not to exceed current revenues. This principle is more complicated than it might appear. The state uses fund accounting and therefore at the end of the fiscal biennium must balance each separate fund. See Chapter 3. During the fiscal biennium, however, a fund may be negative. To meet ongoing obligations, there must always be cash available for disbursement. Setting aside a portion of an allocation so as not to spend it is one way to assure that funds remain available for future disbursement. The state also relies on working capital, a planned average positive balance in the state’s funds. Knowing what this planned average balance is enables cash managers to plan disbursements and expenditures to maintain a positive cash position. The lower this average is, the more difficult it becomes to keep a positive balance on a day-to-day basis when income is low.

Though Ohio uses fund accounting for cash purposes and to reduce the amount of working capital needed in each separate fund, the state pools the cash of several of its funds into what is called the “Total Operating Fund.”<sup>21</sup> The principle Ohio uses in maintaining a balanced budget is that unappropriated cash should approximate outstanding encumbrances, the obligations that have not been liquidated, at the end of a fiscal period.

**State Appropriation Limit.** In 2006, a proposal for a constitutional amendment to put limits on the state legislature’s constitutional responsibility to determine appropriations levels was certified to be placed on the November ballot. The amendment would have placed similar limits on the legislative bodies of all local governments in the state. The ballot measure was similar to provisions adopted in other states intended to limit how much state and local governments can spend. Facing stiff opposition, petitioners who initiated the constitutional amendment agreed to withdraw it if the legislature would enact a similar statutory limitation applied only to the state legislature. Senate Bill 321 of the 126th General Assembly was passed in May 2006 and requires the governor to calculate a state appropriation limit (SAL) for the General Revenue Fund for each fiscal year of every biennium and

obligates the General Assembly to comply with the limitation.

The intent of the SAL is to limit the power of the state General Assembly to a growth factor that limits increases in spending to either 3.5 percent or the sum of the inflation rate and the rate of Ohio's population change, whichever figure is larger. There are a number of exceptions to the limitation provided in the legislation. A simple legislative majority vote can circumvent it. Given low inflation rates and low revenue growth, as a result of both a sluggish Ohio economy and the impact of state tax law changes since 2005, the SAL has not yet been imposed.

Since the SAL is not a constitutional provision, it cannot be enforced according to a 2006 Legislative Service Commission research memorandum. That memorandum states that "because the SAL limits a duty that is purely legislative in character and over which the General Assembly has exclusive control, the duty to enact appropriations, and because the Ohio Constitution does not impose the SAL on the General Assembly, the constitutional doctrine of separation of powers likely makes the General Assembly's failure to follow it non-justifiable. In that case, no court would have authority to enforce General Assembly compliance with the SAL." In addition, the SAL itself contains no provision permitting enforcement against the General Assembly, so it becomes solely an unenforceable declaration of legislative intent. Nonetheless, any budget proposal that would exceed the limits specified in the SAL would likely encounter some major political, if not legal, obstacles.

**Budget Reserves.** In addition to reserves maintained as working capital, Ohio establishes other reserves to protect against unforeseen events. In 1996, Ohio began to reserve \$75 million per year of Congress' Temporary Assistance to Needy Families (TANF) block grant, which replaced several human services entitlement programs. The reserve was established out of fear that the fixed nature of the block grant would make Ohio vulnerable to a downturn in the economy and an increase in human services caseloads. The accumulation of unexpended TANF funds brought this reserve to almost \$1 billion in 2000. It remained near that level until 2006, when the state began to release the accumulated reserve to be used for TANF-eligible services, although another TANF surplus would develop a decade later.

In 1996, the legislature set aside \$100 million in state General Revenue Fund (GRF) funds to help pay for Medicaid or other non-cash human services programs that would suffer in an economic recession. The FY 2012–2013 budget included a \$129.1 million Medicaid Reserve Fund to bridge the difference in health care caseload estimates between the Legislative Service Commission and the executive. A Health and Human Services Reserve was established in the FY 2016–2017 budget to pay for the state share of Medicaid expansion under the Affordable Care Act. However, the state met this obligation through existing Medicaid resources, avoiding the need to approach the Controlling Board to continue the initiative during that biennium.

These specific reserves are in addition to the more general Budget Stabilization Fund (BSF), or "Rainy Day Fund," that Ohio has maintained with varying balances since 1982. The fund grew to \$1 billion by 2000 and was almost depleted in the recessionary years that followed. By 2006 it had been rebuilt. By 2009, however, the fund was again depleted as a result of the Great Recession. The ensuing economic recovery allowed the fund to once again be rebuilt. It reached \$2 billion by FY 2015 and grew to nearly \$2.7 billion in FY 2019, putting it near the statutory maximum of 8.5 percent of the preceding fiscal year's GRF revenues. Previous to 2015, the goal was to maintain the BSF at 5 percent of the previous year's GRF revenues. Any excess balances generated by revenues exceeding estimates or

spending below appropriated levels is required to be returned to the voters in the form of a personal income tax rebate.<sup>22</sup>

As previously noted, the General Assembly also appropriates to the Controlling Board an amount that varies each biennium to be used for Emergency Purposes or other unforeseen contingencies, including the costs to local governments of natural disasters.

**Education.** Article VI, Section 2, requires the legislature to “make such provisions, by taxation, or otherwise, as...will secure a thorough and efficient system of common schools throughout the state.” This provision has been subject to considerable adjudication, as discussed in both Chapters 10 and 14.

**Mental Health Institutions.** Article VII, Section 1, provides that “institutions for the benefit of the insane, blind, and deaf and dumb, shall always be fostered and supported by the State...” It is worth noting that the state is committed to a policy of deinstitutionalizing the treatment of mental health and services for the developmentally disabled.

**Line-Item Veto.** Article II, Section 16, provides that “the governor may disapprove any item or items in any bill making an appropriation of money...” What constitutes an item has been judicially interpreted to be any provision that is “separate and distinct from other provisions in the same bill, insofar as the subject, purpose, or amount of the appropriation is concerned.”<sup>23</sup> However, since the legislature includes substantive provisions of law often unrelated to appropriations within appropriations bills, the judiciary has expressed concern over how an “item” should be defined. The judiciary has chosen to give the governor’s determination of what constitutes a separate item for the purposes of a veto a presumption of validity and permitted a line-item veto of a provision of substantive law included in an appropriations bill.<sup>24</sup> There are instances where the governor has vetoed not only complete paragraphs or sentences but also clauses, phrases, and even single words.

Appropriations can only be made by bills, not by joint resolutions, thereby ensuring that they will not become law without executive approval, except when the legislature overrides an executive veto by a three-fifths vote in each chamber or when the governor allows a bill to become law without his signature after letting it sit on his desk for 10 days. The Ohio Supreme Court has ruled that appropriating money in any bill makes that bill an appropriations bill, thereby subjecting the entire bill, including each of its substantive provisions, to the line-item veto.<sup>25</sup> This ruling has had important consequences for executive-legislative relations.

**Prior Commitments.** Although the Ohio Constitution prohibits one legislature from binding another, various provisions of substantive law, if not altered, do in fact bind succeeding legislatures to making appropriations because they amount to prior commitments. Construction of a new prison commits future legislatures to appropriate funds to operate it. Both the federal and state constitutions protect the “obligation of contracts,” and therefore payments must be made to service Ohio’s debts and pay for its pension programs since these are contractual obligations. In addition to these kinds of commitments, entitlements can further restrict a future state legislature.

**Retroactive Laws.** Article II, Section 28 prevents the General Assembly from passing retroactive laws. This prohibition means that the legislature cannot enact provisions that would change the terms or conditions of previously enacted budgetary, fiscal, or other provisions of law.

The state appropriation process is analyzed in depth in Chapter 5.

## Summary

The state budget has many functions. It is a means of controlling expenditures; it is a way of planning the use of resources; it is a document to express public policy; it is a public information and public relations tool; and it is the means of allocating resources. Yet, budgeting must proceed within the framework of rules established by the people as set forth in the Ohio Constitution, by previous legislatures in state statutes, and by federal law and judicial interpretations of state and federal law. These rules limit actions that can be taken on the budget. Limitations on the amount and kind of debt that may be issued by the state also restrain budget action, as do restrictions on the state's taxing powers. The reality of the uncontrollable nature of much state spending is another restraint, and politics and economics impose additional restraints.

## Endnotes

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- <sup>1</sup> Adapted from Robert L. Bland and Irene S. Rubin, *Budgeting, A Guide for Local Governments*, International City/County Management Association, 1997, p. 4.
- <sup>2</sup> Aaron Wildavsky, *The Politics of the Budgetary Process*, Little, Brown & Company, Boston, 1964.
- <sup>3</sup> Prepared by Sydney Duncombe for Thomas D. Lynch, *Public Budgeting in America*, Prentice-Hall, Inc., Englewood Cliffs, New Jersey, 1979.
- <sup>4</sup> The fiscal year for the federal government runs from October 1 to September 30.
- <sup>5</sup> *Budget Processes in the States*, National Association of State Budget Officers, Spring 2015.
- <sup>6</sup> *Managerial Cost Accounting Concepts and Standards for the Federal Government*, Statement of Recommended Accounting Standards #4, U.S. Office of Management and Budget, Washington, D.C. 1997.
- <sup>7</sup> "Financing Unemployment Benefits—Federal Loans to Cover Shortfalls," Ohio Legislative Service Commission, *Members Only*, Volume 128, Issue 6, April 10, 2009.
- <sup>8</sup> *Kasch v. Miller, Supt. of Public Works*, 104 Ohio St. 281, 135 N.E. 818; *State ex rel. Public Institutional Building Authority v. Griffith*, 135 Ohio St. 604, 22 N.E. (2d) 200 (1939).
- <sup>9</sup> OAG 65–80.
- <sup>10</sup> Ohio Office of Budget and Management Website, 2012.
- <sup>11</sup> *Saxbe v. Brand*, 176 Ohio St. 44, 197 N.E. (2d) 328 (1964).
- <sup>12</sup> *State ex rel. Kauer v. Defenbacher*, 153 Ohio St. 268, 91 N.E. (2d) 512 (1950).
- <sup>13</sup> Jim Burley, Ohio Legislative Service Commission Memorandum, January 20, 1998.
- <sup>14</sup> *State v. Forney*, 108 Ohio St. 463, 141 N.E. 16 (1923).
- <sup>15</sup> The Ohio Estate Tax was repealed effective January 1, 2013.
- <sup>16</sup> Investopedia.com, September 2018.
- <sup>17</sup> Ted Sanders, Superintendent of Public Instruction, *Proposals for the Elimination of Wealth Based Disparities in Public Education*, Ohio Department of Education, Columbus, Ohio, June, 1995.
- <sup>18</sup> *State ex rel. Sceffler v. Griswold*, 35 App. 354, 172 N.E. 438 (1930).
- <sup>19</sup> Ohio Revised Code, Section 115.11 and *Cleveland Board of Education v. Gilligan*, 360 App.2nd 15 (Franklin City), 301 N.E. (2d) 911 (1973).
- <sup>20</sup> Ohio Revised Code, Section 131.33.

- <sup>21</sup> Ohio Revised Code Section 126.06 stipulates that “The total operating fund consists of all funds in the state treasury except the auto registration distribution fund, local motor vehicle license tax fund, development bond retirement fund, facilities establishment fund, gasoline excise tax fund, higher education improvement fund, highway improvement bond retirement fund, highway capital improvement fund, improvements bond retirement fund, mental health facilities improvement fund, parks and recreation improvement fund, public improvements bond retirement fund, school district income tax fund, state agency facilities improvement fund, state and local government highway distribution fund, state highway safety fund, Vietnam conflict compensation fund, any other fund determined by the director of budget and management to be a bond fund or bond retirement fund, and such portion of the highway operating fund as is determined by the director of budget and management and the director of transportation to be restricted by Section 5a of Article XII, Ohio Constitution.”
- <sup>22</sup> Although the Revised Code requires that first claim on budget surpluses goes to maintain the ending balance of the state’s General Revenue Fund at 0.5 percent of prior year’s revenue, second claim goes to bring the Budget Stabilization Fund up to 8.5 percent of prior years’ revenue and the remainder is to be used for personal income tax relief, the legislature may and has appropriated balances for other uses before those provisions go into effect. For example, in H.B. 650, the education funding bill for FY 1999, \$30 million of FY 1998 ending year fund balances were provided to the School District Solvency Fund and up to \$170 million to the School Building Assistance Fund.
- <sup>23</sup> *State ex rel. Brown v. Ferguson*, 32 Ohio St. 2d 245, 291 N.E. 2d 434, 1972.
- <sup>24</sup> *Elmhurst Convalescent Center v. Bates*, Franklin County Court of Appeals, 46 App 2d 106, 348 N.E. 2d 151, 1975.
- <sup>25</sup> *State ex rel. Akron Education Association v. Essex*, 47 Ohio St. 2d 47, 35 N.E. 2d 118, 1976.