

## CHAPTER 9:

# The Evolution of Modern Budgeting, 1910-1974

**T**he budget process in Ohio continues to evolve. From its origins in 1910 to the present, a number of procedural and substantive milestones have had a long-lasting impact on budget writing. These significant events in Ohio's history of state budgeting are highlighted in order to provide a better understanding of why things are done as they are and in recognition of the fact that the state budget is not only about numbers but it is also about people and power. Understanding this history provides the key to understanding state budgeting in Ohio.

Budgeting is about allocating and spending the revenues that governments receive in order to provide services that the citizenry would otherwise have to provide for itself. Budgeting has evolved into a highly formalized process designed to bring rationality to what would otherwise be an irrational process punctuated by backroom wheeling and dealing, exchanges of favors, and corruption. Indeed, these were the kinds of conditions that prevailed before the modern budget process was born.

## Before Modern Budgeting

Modern budgeting is a remarkably recent phenomenon, beginning in municipalities at the turn of the 20th century in response to Progressive Era reforms that exposed political machines and called for the elimination of governmental waste and corruption. A major tenet of the movement was the recognition of the need for improved financial management systems, particularly an executive budget, at all levels of government. Before modern budget systems were established, government spending was chaotic, without regard to the total amount of money available. Departmental requests for appropriations were not itemized and could not be compared to expenditures of the past. In New York City, appropriations were made without even checking to see if enough money was available in the treasury to cover them. If funds ran out, the Board of Estimate simply issued revenue bonds to make up the difference.

Budget reforms that began in municipalities culminated in the passage of the federal Budget and Accounting Act in 1921, credited with eliminating the practice of independent federal agency fiefdoms. Prior to this, agencies would present their budget requests directly to their Congressional oversight committee, without any review by the president or any effort to tie the request to national policy. Besides requiring that there be a single spending plan based on agency requests and submitted by the chief executive, the act addressed concerns that citizens needed a more direct and meaningful voice in determining expenditures and in shaping public policies. Thus, governments made public hearings a routine part of budget preparation and adoption after 1921.<sup>1</sup>

In 1910, Ohio, was the first state to enact a law empowering the governor to prepare and submit an executive budget. Other states more slowly accepted formal budgeting systems. By 1929, all states had established a central executive budget office. Since that time, the budget process has been continually evolving nationally and in Ohio, where significant milestones have shaped the current process and the state’s fiscal policy.<sup>2</sup>

### The Evolution of State Budgeting, 1910–1970

EARLY STATE FISCAL MILESTONES				
Early 1900s	1917	1935	1959	1963
Institution of biennial budgeting	Creation of Controlling Board	<ul style="list-style-type: none"> <li>• Enactment of state sales tax</li> <li>• Creation of Local Government Fund</li> </ul>	Governor's tenure established at two, four-year terms	<ul style="list-style-type: none"> <li>• Enactment of revenue bonds</li> <li>• Creation of Ohio Board of Regents</li> </ul>

**Timing of Appropriations.** Ohio appropriates operating moneys for the state in two-year periods beginning on July 1 and ending on June 30 of odd-numbered years. Appropriations for capital improvements are usually made for two-year periods in even-numbered years on the same calendar. Biennial legislative sessions began in the early 1900s, when it was difficult to convene the legislators and when the legislative workload was comparatively light. The General Assembly had a full year, though usually a limited number of working legislative days, to enact a budget. During the second year of the biennium, the legislators generally met only for a special session, and legislative responsibilities could easily be handled on a part-time basis.

Today, with a very complex and diverse economy, ease of travel, and more government involvement in the affairs of society, the responsibilities of the legislature have become full time. Most states, including Ohio, have now adopted annual legislative sessions. Accordingly, most states have also adopted annual budgets, although Ohio continues to budget biennially.

There is no constitutional or statutory requirement that Ohio budget biennially. Other than changing a handful of statutory references to “biennium,” only a policy decision would be needed to adopt a 12-month budget. Advantages of switching to an annual budget would include providing legislators with greater flexibility to address emerging fiscal problems, more legislative oversight, and perhaps most importantly, greater accuracy in forecasting. The fast-paced changes in today’s economy make forecasting a dynamic art. Small variances in trend lines at the outset of a biennium can yield major differences from the original expectations 24 months later.

With the exception of Texas, Ohio is the largest government to continue using a biennial budget. Advantages of staying with a biennial budget are that it allows more time to study complex fiscal matters as well as address the many important issues facing state government that are outside the fiscal domain.

Governor John Kasich's Mid-Biennium Review process effectively split the difference between annual and biennial budgeting. It maintained budgeting on a biennial basis for most purposes, while formalizing the annual review of important policy matters.

From time to time, the federal government has considered proposals to move from annual to biennial budgeting, largely because of its continued inability to make timely appropriations. Presumably, Congress could begin the process of considering a budget earlier if it only had to do so once every two years. The difficulties that Congress faces annually in adopting, or more often than not failing to adopt, a budget should give Ohio pause in considering a similar path.

What enables Ohio to function effectively with a biennial budget are the powers the state has granted to a joint executive-legislative entity called the Controlling Board.

**Controlling Board.** The Controlling Board is composed of six legislative leaders and a designee of the director of the governor's Office of Budget and Management, who acts as president of the board. Recreated through temporary law in each biennial budget since 1917, the board was made permanent in 1975.<sup>3</sup>

The Controlling Board was originally created to deal with fiscal matters that needed legislative attention when the part-time legislature, which met for only a few months each year, was not in session. However, when the legislature became a full-time body, the Controlling Board's powers were expanded, not contracted. The legislative leadership realized it had more influence over the few legislative members of the board than over the entire body. For this reason, as well as the force of tradition, the board continues to operate with far-reaching powers that have caused many to consider it a "super-legislature."<sup>4</sup> Its current powers include approving General Revenue Fund (GRF) transfers between fiscal years and between appropriated line items, increasing appropriation authority in non-GRF funds, authorizing contracts without competitive bidding under certain circumstances, and releasing funds appropriated to it for special and general purposes.

The Controlling Board's vast powers ensures that it touches virtually all major state agencies and critical issues. Notably, it was used in 2013 to circumvent the legislature in order to authorize funding authority necessary to expand Medicaid under the provisions of the federal Affordable Care Act. This action foreshadowed a veto override in 2017 by a later General Assembly to limit the Controlling Board's authority by placing a dollar limit on what it can approve. Ironically, another veto override in 2017 granted the Controlling Board an additional power by requiring the administration to obtain board approval before spending the state share of Medicaid expansion funding.

Because it does interface with most important state policy concerns, the Controlling Board acts less formally as the legislature's primary fiscal watchdog on executive spending. The legislative oversight function that it performs is at least as important as its more formal powers. The operation of the Controlling Board in Ohio's fiscal processes is unique among all 50 states.

**Sales Tax and Revenue Sharing.** The Great Depression of 1929 left many homeowners unable to pay

their real property taxes. That year, the General Assembly proposed a constitutional amendment to impose a 15-mill limit on unvoted property taxes, and the voters approved the amendment. As the depression worsened, an initiative petition in 1933 rolled the limit back further to the present-day 10 mills.<sup>5</sup> However, the resultant loss in revenues, particularly to local governments, made it impossible for them to maintain essential services and also to provide for requisite “poor relief,” as income maintenance was then called. After having proposed and defeated it five times between January and November 1934, the General Assembly, on December 6, 1934, enacted the Ohio Retail Sales Tax law, becoming the 16th state to adopt a general sales tax. It became effective on January 1, 1935, and was levied at a rate of 3 percent. The Use Tax was enacted one year later. The Sales Tax was raised to 4 percent in 1967, to five percent in 1981, to 5.5 percent in 2005, and to 5.75 percent in 2013. A constitutional amendment in 1936 exempted all carryout food from the sales tax.<sup>6</sup>

The original purpose of the sales tax was spelled out in legislation that provided that after administrative costs and specific appropriations for emergency poor relief and other purposes 60 percent of the remainder was to be distributed to the state public school fund and the remaining 40 percent to a newly created “local government fund.” The moneys in this fund were allocated to county auditors who provided them to a County Budget Commission in each county that then distributed the funds by formula to county and other local governments.

Until 2008, the Local Government Fund (LGF) was comprised in statute as 4.2 percent of the state sales, and use, individual income, public utility, and corporate franchise tax collections. An additional fund, the State and Local Government Revenue Assistance Fund, was created in 1989 to distribute another 0.6 percent of the collections of the same taxes to each county based on the county’s population compared to the total population of the state. As a result of the initial agreement to share the proceeds of the state sales tax with local governments, which enabled the General Assembly to muster the votes necessary to enact it, the state has had one of the largest general revenue-sharing programs in the nation, and it has significantly impacted state fiscal policy and the budget process. Accordingly, beginning in FY 2001, the legislature found it necessary to freeze or reduce the amounts that were distributed to local governments over the next several biennial budgets because of ongoing fiscal crises.

Effective in 2008, the State and Local Government Revenue Assistance Fund was consolidated into the LGF, and distributions ceased. At this time, a new funding mechanism was instituted for the LGF in which the fund received 3.68 percent of total GRF tax receipts. The FY 2012–2013 budget subsequently replaced this “percentage of revenue” methodology with a “base year” funding methodology. The LGF received a designated percentage of fixed FY 2011 total GRF revenues, the “base year.” This change dramatically reduced LGF revenues from that which was received in FY 2011, by 25 percent in FY 2012 and 50 percent in FY 2013. The “percentage of revenue” methodology returned in the FY 2014–2015 budget and thereafter at a fixed 1.66 percent. The FY 2018–2019 budget further redirected \$17.65 million annually in LGF funds to address the opioid crisis confronting the state.

**Gubernatorial Term Limits.** Until 1959, when Governor Michael DiSalle took office, a governor was elected for unlimited two-year terms in even-numbered years. At that time, a 1954 amendment took effect, mandating that a governor could not serve more than two consecutive four-year terms. The ability to affect two state budgets, without facing re-election, had as much of a positive effect on strengthening the Office of Governor as did the establishment of the executive budget. Since 1959, every governor except Michael DiSalle, John Gilligan, and Ted Strickland, all Democrats, has served for eight years. Governor James Rhodes twice served two consecutive four-year terms, one before and

one after Governor Gilligan's single four-year term. This continuity has permitted governors to exercise strong budget leadership and allowed them sufficient time to affect the direction of state fiscal policy, regarding spending, taxing, and borrowing.

**Capital Construction.** Upon taking office in 1963, Governor James Rhodes worked to gain legislative and voter approval for a plan to issue revenue bonds to pay for a massive state building program to support the state's economic development effort. Primarily, these took the form of a good transportation system to take advantage of Ohio's favorable geographical position for moving manufactured goods, and a system of community colleges and career-technical education centers easily accessible to businesses in need of a good labor supply.

The Ohio Constitution restricts the issuance of debt to \$750,000, an insignificant amount in terms of the state's multibillion budget.<sup>7</sup> Thus, in order to undertake the kind of building program he sought, Governor Rhodes proposed a constitutional amendment, which voters approved in 1963.<sup>8</sup> The amendment allowed the issuance of general obligations bonds, but only for projects that would create jobs, enhance employment opportunities, and improve the economic welfare of the people of the state. Issuance of revenue bonds was also authorized for capital improvements for mental health and developmental disabilities, parks and recreation, and institutions of higher education.

To this day, this bond authority, reinterpreted to permit the state to construct prisons and state office buildings with revenue bonds, even though they generate no real revenues to support the repayment of the bonds, has served as the foundation for the capital budget in Ohio. Without the artifice of bonds supported by either non-existent or inadequate revenues generated by the facilities built, Ohio would have no state capital building program, because Ohio voters have repeatedly rejected, as recently as 1998, constitutional amendments to give the state the authority to issue general obligation bonds for construction beyond those authorized in 1963.<sup>9</sup> However, in 2005, voters did approve a 10-year, \$650 million general obligation bond issue to finance the Ohio Third Frontier program to nurture high technology business development. A four-year, \$700 million program extension was approved in 2010.

The lack of authority to issue general obligation bonds did not deter the state's economic efforts for long. Just two years after the 1963 Constitutional amendment, Governor Rhodes proposed an additional amendment to the Constitution to further spur the state's economic development effort. Ohio voters approved Section 13 of Article VIII, which provided for the guarantee of loans for industrial development without requiring the use of tax revenue. The use of revenue bonds effectively circumvented the 1851 constitutional provision that prohibited the state and its political subdivisions from lending aid and credit to private enterprises.<sup>10</sup>

**Ohio Board of Regents.** The Ohio Board of Regents has been responsible for overseeing higher education in Ohio since its creation in 1963. Prior to this time, each individual institution sought its appropriations independently through currying the favor of its local legislators. This approach, though certainly not ideal, was nevertheless manageable, as there were only six public institutions of higher education in Ohio before 1963.<sup>11</sup> The method would have inevitably broken down without a state higher education board, given the explosion in the number of public universities and community colleges in Ohio in the 1960s and 1970s. With the creation of the Ohio Board of Regents, individual two- and four-year institutions presented unified operating and capital appropriations requests to the General Assembly. The abolition of the former practice permitted the creation of a more objective formula approach to funding higher education instruction.

The establishment of the nine-member Board of Regents had the somewhat perverse effect of removing the budget for higher education, accounting for more than 10 percent of the state's General Revenue Fund, out of effective executive control. The Board of Regents actively lobbied for their original budget request to the governor, regardless of what the governor proposed for them in the Executive Budget Request. Members of the Board of Regents could do so because, although initially appointed by the governor, they were not under direct control of the executive, since they served for fixed, overlapping terms of nine years. Because the terms were overlapping, it took a new governor a full four-year term before he was able to appoint sufficient new members, even indirectly, to have some control by having a majority of the members as his appointees. This system existed until 2007, when Governor Ted Strickland sought and obtained legislation establishing the Ohio Board of Regents, subsequently renamed the Ohio Department of Higher Education, as a Cabinet-level agency with a gubernatorial-appointed Chancellor. The Board itself became advisory in function.

### John Gilligan, 1971-1975

FISCAL MILESTONES OF THE GILLIGAN ADMINISTRATION	
1971	1973
Enactment of individual income and corporate franchise taxes	<ul style="list-style-type: none"> <li>• Enactment of Budget and Accounting Act</li> <li>• Establishment of Legislative Budget Office</li> <li>• Creation of State Lottery</li> </ul>

**State Income Tax.** By 1970, Ohio's tax structure was clearly inadequate to support burgeoning higher education enrollments that resulted from the Baby Boom generation moving through the school system, federal mandates such as the Medicaid program established in 1965, and other non-discretionary commitments. It fell to Democrat Governor John Gilligan to convince a conservative Republican legislature to institute the state's first individual and corporate income tax.

After unsuccessfully attempting to force the issue by closing state parks in the middle of the summer, threatening school closures, and proposing other heavy-handed assertive tactics, Governor Gilligan was able to gain approval of the tax increase by a majority of the Republican-controlled House. He did so by forging an alliance with Charles Kurfess, the powerful, long-time Speaker of the Ohio House of Representatives. Speaker Kurfess managed to obtain House approval of a budget bill that was \$1.5 billion higher than the previous one, an increase that could not be supported with a simple one-cent sales tax increase. The Senate would not agree and the state approved an interim budget.

On July 14, 1971, the House passed a tax package that included a graduated state income tax.<sup>12</sup> Two months later, the Senate passed a budget cutting \$500 million of the House-approved budget increase and providing for a one-and-a-half-cent increase in the sales tax to finance it. Continued interim budgets threatened public assistance payments and state employees' paychecks and, finally, when legislators' paychecks went unissued, on December 9, the fourth conference committee reported a budget bill that included the imposition of an income tax.

The rancor in the General Assembly leading to the enactment of the state's first income tax had further repercussions. Voter ill will as a result of that action was a big contributor to Governor Gilligan's defeat in his bid for re-election three years later. However, the institution of the income tax created

a progressive tax structure for the state, and a decade later would replace the sales tax as the major source of state General Revenue Fund (GRF) receipts. In FY 1973, the first full year of collections, the income tax generated \$1.3 billion. Thirty-five years later, FY 2008, it generated \$9.8 billion. However, after years of rapid growth, the combined impact of 2005 rate reductions and the Great Recession saw income tax revenues dip significantly to \$7.9 billion in FY 2010. By FY 2014, the less progressive, consumption-based sales tax had once again eclipsed the income tax as the largest source of GRF receipts as a result of additional income tax reductions coupled with a modest sales tax increase.

**Legislative Budget Office.** Until FY 1973, the preparation and execution of the state budget was in the hands of the Ohio Department of Finance, which managed all state purchasing, accounting, data processing, and budgeting. The legislature was totally dependent on the governor and the Department of Finance for fiscal information to use in appropriating state funds. The Department of Finance even provided staff to the House and Senate Finance Committees. This dependence changed when the legislature created its own Legislative Budget Office in 1973. Although nominally part of the Legislative Service Commission at the time, the Legislative Budget Office was, for many purposes, a separate entity.

In the mid-1960s, the Legislative Service Commission, the research and bill-drafting arm of the General Assembly, issued a report identifying the need for its own legislative fiscal staff. The report noted that neither the Executive Budget Request nor the information derived during legislative budget hearings was adequate for well-informed legislative decision-making. The pressures of the session and the demands of other legislative activities made it virtually impossible for legislators to familiarize themselves with the detailed fiscal information presented to them by agencies and outside interests in support of their appropriations requests. The report recommended that full-time legislative fiscal staff should be hired to work directly with legislators. As a result, two fiscal positions were created in the Legislative Service Commission, one to serve the majority party and another to serve the minority.

In 1972, another report, this one prepared by an outside body, the Ohio Citizens' Committee on the State Legislature, recommended that the General Assembly establish four partisan, full-time fiscal officer positions, one each for the majority and minority members of each house. These were to supplant the partisan fiscal staff (the Legislative Service Commission provided) that, the committee felt, "somewhat dilutes the strict nonpartisan position which the Service Commission staff arm rightly should reflect." In addition, two nonpartisan fiscal staff members were to be retained in the Legislative Service Commission to provide technical assistance to individual legislators and to other standing committees.

One year later, a newly Democrat-controlled General Assembly, distrustful of the Legislative Service Commission, which had been under the control of Republicans for 13 years, and also distrustful of the governor's fiscal advisors, decided to create its own fully staffed Legislative Budget Office under the supervision of a 12-member bipartisan Legislative Budget Committee. The four partisan fiscal staff and the two Legislative Service Commission fiscal staff were transferred to the newly created Legislative Budget Office and placed under the direction of Richard G. Sheridan, who recently held a similar position in Washington state.<sup>13</sup> Additional staff was authorized to be hired as needed.

The creation of the Legislative Budget Office signaled the beginning of the legislature's fiscal independence from the executive branch and made it a more equal partner in the budgetary process. However, in 2000, for reasons that have never been fully explained, the Legislative Budget Office was wholly subsumed under the Legislative Service Commission. Today, legislative budget and fiscal functions

remain organizationally under the control of the Legislative Service Commission.

**The Budget and Accounting Act of 1973.** While the legislature was reorganizing its fiscal operations, Governor John Gilligan chose to reorganize those of the executive branch. In order to strengthen the budgeting function, it was removed from the Ohio Department of Finance in 1973 and transferred to a new, separate Ohio Office of Budget and Management created within the Office of the Governor. All other fiscal functions, except data processing and accounting, which were later also transferred, were lodged in a new cabinet-level Ohio Department of Administrative Services. Warrant writing, the process of paying the state's bills, was transferred to the independently elected Auditor of State. In 2007, this function was transferred to the Office of Budget and Management.

Along with this reorganization came a change in the way the budget was viewed. Until 1973, the state used line-item budgeting with its emphasis on strict budgetary control of each separate line item of expenditure, such as personal services, telephones, postage, stationery, and travel. During both executive and legislative budget hearings, agencies provided detailed justifications for the amounts of money they wished to spend on each object of expenditure. When the legislature was satisfied with the explanations, appropriations were enacted, and the executive officials then kept strict account of spending from each object to ensure that the authorized amounts were not exceeded.

Governor Gilligan argued that these kinds of controls hampered his ability to manage government. He suggested that if the legislature was unhappy with how its policies were translated into action, it would have to free his hands from the bonds of accounting for line-item appropriations. Thus, under Governor Gilligan, Ohio moved to the lump-sum method of appropriations, emphasizing the organizational unit instead of the expenditure object. Little by little, restrictions on spending for individual items were removed. Statutes were changed to allow funds to move between expenditure items and between divisions within executive agencies. The executive power over the budget was enhanced, since the legislature did not have to be consulted for these changes, and movement away from line-item budgeting had begun.

**State Lottery.** In 1973, Ohio joined the movement toward state-sponsored lotteries that was sweeping the nation during the 1960s and 1970s through the passage of a constitutional amendment authorizing certain kinds of gambling.<sup>14</sup> During the campaign for passage of the amendment, public school authorities and teacher organizations, who strongly advocated its passage, were led to believe that its profits would be used to support primary and secondary education and teacher salaries. This same argument was used in obtaining public support for the state's first income tax. In actuality, lottery proceeds were originally deposited into the General Revenue Fund, along with income tax, sales tax, and other receipts, and from these pooled resources appropriations were made.

Each time a local school district sought voter approval for a property tax levy, opponents argued that the state lottery was supposed to pay for education. It was difficult for legislators to explain how those proceeds did, in fact, support schools when they were pooled with other revenues. Finally, in 1988, voters, by an initiative sponsored and endorsed by the same public education authorities that advocated for the original proposal, approved a constitutional amendment requiring that lottery profits, which are expected to total \$1.04 billion in FY 2019, be used only for education.<sup>15</sup> A separate State Lottery Fund was created to receive and disburse the proceeds of lottery ticket sales.

For the purposes of state budgeting and fiscal policy, the passage of the lottery launched a fifth major

source of revenue, the first four being the sales, income, corporate franchise, and cigarette and other tobacco taxes, to support state programs and services.

## Summary

Ohio was the first state to adopt legislation empowering its governor to prepare and submit an executive budget. However, it can be said that modern budgeting did not really commence until more than 60 years later when a Republican legislature would reluctantly enact the state's first individual and business income taxes after a nearly year-long struggle with Democrat Governor John Gilligan. Greater rationality and professionalism was introduced into the process in both the executive and legislative branches at this time, replacing the legislative wheeling and dealing and the exchange of favors that characterized the earlier era. However, the long struggle to enact the income tax brought with it a partisan rancor that would only grow over the next decades as the Ohio economy experienced a veritable roller coaster of ups and downs.

## Endnotes

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- <sup>1</sup> Irene Rubin, "Who Invented Budgeting in the United States?" *Public Administration Review* 53 (September/October 1993).
- <sup>2</sup> There is room for disagreement on which events have had the greatest impact on state budgeting and fiscal policy. The choice of which events are milestones is subjective and based on the judgment and experience of the authors and editor.
- <sup>3</sup> Ohio Revised Code Section 127.11 ff.
- <sup>4</sup> Richard G. Sheridan, *Governing Ohio: The State Legislature*, Federation for Community Planning, Cleveland, Ohio, 1989.
- <sup>5</sup> Ohio Constitution, Article XII, Section 2.
- <sup>6</sup> Ohio Constitution, Article XII, Section 3.
- <sup>7</sup> Ohio Constitution, Article VIII, Section 1.
- <sup>8</sup> Ohio Constitution, Article VIII, Section 2i.
- <sup>9</sup> In 1999, the voters approved a constitutional amendment, Article VIII, Sections 2(n) and 17, permitting the state to issue general obligations bonds to finance public school construction and state-supported and state-assisted institutions of higher education. The same amendment limited the total amount of revenue that can be used for debt service for all obligations to a ceiling of 5 percent of total estimated revenues for the General Revenue Fund and net lottery proceeds during the fiscal year in which the particular obligations are to be issued, but this limitation can be waived by a vote of three-fifths of each house of the General Assembly.
- <sup>10</sup> Policy Matters Ohio, "Exploring the Third Frontier: Constitutional and Fiscal Limitations of Issue 1," Cleveland, Ohio, October 2003.
- <sup>11</sup> The state's only six public universities prior to 1963 were Bowling Green State University, Central State University, Kent State University, Miami University, The Ohio State University, and Ohio University.
- <sup>12</sup> In 1912, Ohio's Constitution was amended to authorize levying a state income tax, which was considered in 1933 and rejected in favor of a state sales tax.
- <sup>13</sup> Richard G. Sheridan was the founding director of the Legislative Budget Office of the Ohio Legislative Service Commission and remained in that post until 1982.
- <sup>14</sup> Ohio Constitution Article XV, Section 6.
- <sup>15</sup> Ohio Constitution Article XV, Section 6.

