State Budgeting Matters

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

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

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

Fiscal Year 2008 Ends While Fiscal Woes Worsen

In June, 2007, the state enacted Amended Substitute House Bill 119, the main appropriations bill for the two ensuing years. It provided for a modest spending increase—3.6 percent (excluding federally-matched Medicaid) increase compared to the previous biennium. State-only General Revenue Fund (GRF) receipts were projected to be $21,185 million for Fiscal Year (FY) 2008 (a 3.1 percent increase over FY 2007) and to increase only slightly to $21,227 million for FY 2009, which began on July 1, 2008. The economic forecast on which those revenue estimates were based soon proved to be too optimistic, and so, seven months into the new biennium the Office of Budget and Management (OBM) re-examined its revenue forecasts and decided that they were too high. In February, 2008, out of three new projected economic scenarios (low growth, no growth, and a recession) the administration chose to assume state revenues would continue with lower growth, which meant a reduction in estimated state GRF receipts of $173 million for FY 2008 and $385 million for FY 2009.

In addition to the revenue problem, the administration determined that it had underestimated how much money would be needed to continue the state's medical program for needy persons (Medicaid). For FY 2008, it was estimated that additional state and federal matching appropriations of $91 million would be needed, and another $271 million for FY 2009. Most of the increase is fueled by Medicaid caseloads exceeding original estimates and a failure to realize projected savings from cost containment strategies.

Under the revised low growth scenario, the administration postulated a $733 million biennial budget problem (which would be $1,299 million under the zero growth scenario and $1,884 million under the recession scenario). In order to solve the problem, the administration announced $439.9 million in budget cuts, another $181.1 million in expected additional lapses from unspent GRF money, $50.3 million in transfers from other funds (including $25 million in tobacco securitization interest income), and $73 million from starting a new Keno gambling game. Implementation of several elements of the administration's budget re-balancing plan required legislative action. The changes the legislature agreed to became part of the state's capital construction budget bill, Amended Substitute House Bill 562, which was signed (after several vetoes) on June 24, 2008.

Now FY 2008 has ended and it appears that the state's biennial budget will face new problems in FY 2009. This is what has happened to further challenge those responsible for keeping the state ledgers in the black:

- State GRF revenues for FY 2008, excluding federal grants and transfers, have come in at $19,784 million, which is $120.7 million below the revised revenue estimates.
- The state legislature refused to appropriate the full amount of additional state GRF, one that the administration maintains is needed to continue operating the Medicaid program without cuts.
- The legislature made additional GRF appropriations for the current biennium.
- The legislature failed to approve several important components of the administration's budget re-balancing plan.
- The economy continues to worsen, making it far more likely that the the state's budget problem will be closer to the recession scenario, with a projected deficit of $1,884 million,

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rather than the $733 million which the state continues to try to solve.

Making matters worse, actions taken by the legislature in the enactment of the capital construction bill, as well as some provisions of the so-called Economic Stimulus Bill (Amended Substitute House Bill 554) will require additional GRF spending in the next biennium, the budget proposal for which is currently in preparation by the administration.

FY 2008 Revenues

The negative effects of the poor economy are shown in the fact that during FY 2008 every one of the state's major GRF taxes came in below estimates and, importantly, all of the shortfalls have occurred during the second half of the fiscal year. This suggests a pattern of shortfalls continuing throughout FY 2009.

Non-auto sales tax receipts were only $25.7 million below estimates for the year. However, during the first seven months of the year that revenue source was enjoying large surpluses and the collections for the last five months of the year wiped them out, as well as developing an actual deficit. According to the Department of Taxation, food and fuel price increases accounted for about $8 to $12 million of the monthly shortfall.

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No one will be surprised to learn that sales taxes on autos were $40.8 million, or 4.1 percent, below the fiscal year estimate. OBM notes that, "The surprise is that tax revenues were not worse, given that for FY 2008, U.S. light vehicle sales were 15.3 million units, down 1 million units, or 6.2% from FY 2007."

The personal income tax produced $31.8 million less than estimated, which was very close to the estimate. That occurred even after the effects of the third of five annual 4.2 percent rate cuts.

Corporate franchise tax receipts were 9.5 percent ($79.3 million) below FY 2008 estimates. The Commercial Activity Tax, which is replacing the tangible personal property tax and corporate franchise tax, was also $31.3 million below estimates. As businesses continue to struggle in this economy more bad news can be expected.

FY 2008 Spending

Budget cuts, euphemistically called "recalibrations" by the administration, were made selectively to GRF appropriations for both FY 2008 and FY 2009, to address what is still being viewed as a modest budget gap of $733 million for the biennium. For FY 2008, those cuts totaled $227.5 million, most of which fell to higher education ($90.4 million) and primary and secondary education ($51.8 million). Nineteen other state agencies also had their appropriations reduced. Now that FY 2008 has ended, it can be determined whether those reductions had their intended effects. Here's what happened to spending areas that were subjected to budget cuts:

- Spending on primary and secondary education was $166.1 million below the estimate, not so much because of appropriations reductions, as by the fact that student enrollments were lower than the budget anticipated.
- Planned underspending resulted in higher education disbursements being $96.8 million below estimates.
- Medicaid disbursements should have been $87 million over estimates, but because the administration was not given the appropriation authority it requested for FY 2008, it chose to move the June disbursements into July and, therefore, into the next fiscal year.
- Non-Medicaid spending by the Department of Job and Family Services was below estimates by $72.4 million, $30.3 million of which resulted from forced budget cuts.
- Cuts in the budget of the Department of Mental Health accounting for $7.1 million of the $9.3 million of spending below appropriations levels.
- Cuts in the budget of the Department of Mental Retardation and Developmental Disabilities accounted for $4.3 million of the $6.5 million in departmental FY 2008 underspending.
- Because of budget cuts, the Department of Aging disbursed $17.6 million less than was budgeted.
- The Department of Natural Resources spent $8.2 million less than appropriated due to budget cuts.
- Budget cuts accounted for $2.6 million of the $21.9 million in lower disbursements by the Department of Transportation.
- Spending by "general government" agencies were $24.2 million below estimates.

But not all agencies met their targeted budget reductions:

- The Department of Public Safety lapsed less than $100,000 in GRF appropriations.
- The Department of Rehabilitation and Correction actually disbursed $8 million more than was budgeted. They were scheduled to make $4.1 million in cuts, but that was reduced to $727,113 (after a settlement of $3.4 million in the Department's favor).
- The Department of Youth Services disbursed $200,000 more than estimated (it was exempted from budget reductions due to a class-action lawsuit).

Also problematic is the fact that tax relief payments, supported by a combination of lapses in debt service made possible by tobacco securitization and excess interest earnings on the securitization proceeds, exceeded estimates by $111.1 million in FY 2008. At the same time, total debt service on state general obligation bonds came in $37.9 million under estimates.

The Medicaid Problem

The state spends more in state and federal dollars for Medicaid than any other public purpose. Appropriations for the program are almost as much as the state spends on public education, including primary, secondary, and higher education. And, it is the program whose expenditures the state finds most difficult to control.

When the state adopted its current biennial budget, it appropriated $8.8 billion to the program for FY 2008, assuming that with a number of cost containment measures it could hold spending down by 4.8 percent below FY 2007. The following table shows the seven cost containment initiatives in the Medicaid program that were supposed to save $108.8 million in FY 2008 and $173.4 million in FY 2009, but which are now expected to produce only $16 million in FY 2008 and $55 million in FY 2009. Besides not being able to contain costs by the measures assumed in the preparation of the current budget, the legislature approved a number of caseload expansions, provider rate changes, and service expansions, all of which were to add to the costs of the program. In February, the state revised its estimates of the costs of these various policy changes and concluded that the state needed to appropriate another $91,415,633 to the program for FY 2008 and an additional $271,322,344 to the program for FY 2009. The state share of the total needed was estimated to be $215 million. The legislature, however, refused to appropriate the full amount requested, and they made other changes that could result in even further overspending of current Medicaid appropriations.

In the budget corrections bill, Am. Sub. H.B. 562, the legislature chose to make no additional appropriations to Medicaid for FY 2008 and to appropriate only an additional $70 million for FY 2009. In addition, a provision was added to permit the administration, with Controlling Board approval, to transfer up to $63,333,420 in FY 2009 from the Budget Stabilization (Rainy Day) Fund to the GRF, if additional appropriations are needed to fund the program. Even if that transfer is eventually made, the state is $82 million short of the appropriation authority it needs to pay for its February, 2008, revised spending requirements estimate.

In Am. Sub. H.B. 562, the legislature made a number of other changes in the Medicaid program with fiscal

Cost Containment Initiative	Revised All Fund Savings FY 2008 (in millions of $)	Revised All Funds Savings FY 2009 (in millions of $)
Improved TPL Management	16	45
Improve Medicare Enrollment	0	0
Claims Editing	0	0
Expedite Managed Care Enrollment	0	0
Re-Approve Psych Drugs	0	0
Increase Medical Support Collections	0	0
Proposed Savings By Agency	10	0

implications, one of which the governor vetoed. These include:

- Prohibiting the Medicaid reimbursement rates that apply to durable medical equipment providers until July 1, 2009, and requiring beginning on that date the rates be established based on the providers' costs. This would have negated savings the administration expects to realize from negotiating competitive contracts with individual vendors and the governor vetoed the provision.
- Specifying the FY 2009 Medicaid rate for type G nursing facilities, this may result in increased payments to a small number of nursing facilities according to the Legislative Service Commission.
- Permitting information the state receives for the purpose of establishing third-party liability under the Medicaid program to also be used for purposes directly connected to the state's child support enforcement program. The Legislative Service Commission estimates the change to save approximately $680,000 in FY 2009 GRF funds.
- Lowering the minimum countable income that an individual may have to qualify for the Children's Buy-In Program from 300 percent to 250 percent of the federal poverty guidelines, which OBM estimates will cost $10 million in FY 2009.

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At the end of FY 2008, the Medicaid line item had expended $10,762.2 million, not including money that should have been disbursed in FY 2008, but which the administration, lacking sufficient appropriations authority to make the disbursements, moved into FY 2009 for payment in that year. (See "Commentary" section of this article for further details.)

The failure of the legislature to appropriate the full amount of the additional Medicaid monies the administration felt was needed, as well as the potential for even larger Medicaid caseloads considering the continued deterioration of the economy and the increased number of jobless, may well add to the state's growing FY 2009 problem.

The Economy and FY 2009

Based on the continued deterioration of the national and state economies, it seems almost certain that the rest of this calendar year, and the first half of 2009, which constitute State Fiscal Year (SFY) 2009, will be worse than FY 2008 has been. This is born out by the Ohio Governor's Council of Economic Advisors, which met on June 26, and made a number of significant reductions in their previous (April) forecasts. Among the significant changes they foresee are these:

- The consumer price index (a measure of inflation) will rise by 3.5 percent compared to the earlier estimate of 2.6 percent.
- The Ohio unemployment rate will be 6.1 percent compared to a national rate of 5.7 percent, which is now 0.1 percent higher than previously estimated.
- While U.S. personal income is projected to rise by 0.2 percent to 4.4 percent, Ohio's personal income is set to remain below the national average at 3.1 percent.
- Ohio housing starts, which were projected at 36.9 thousand units when the current budget was set, are now projected at less than half that number (17.5 thousand units).
- Ohio vehicle registrations have been lowered from a May, 2007, estimate of 624,000 units to 502,000 units.
- Ohio's real gross state product is projected to remain virtually stagnant increasing by only 0.2 percent.

The pessimism now being expressed in this forecast reflects the financial problems that have resulted from the rising price of oil, the national mortgage mess, the national credit crunch, reduced consumer spending, devaluation of the dollar, the decline in the value of stocks and bonds, lack of consumer confidence in the economy, and overall economic malaise. All this bodes ill for the state and suggests that far more severe actions will be needed by Ohio if it is to keep its FY 2009 budget in balance.

FY 2009 in Other States

Most states that budget on an annual, rather than biennial basis, have completed action on their FY 2009 budgets and they have had to address the same kind of serious budget problems that Ohio faces. According to the National Conference of State Legislatures, at least 16 states needed to patch $12 billion in budget gaps in their FY 2008 budgets and the Center on Budget and Policy Priorities estimated that at least 29 states are facing budget shortfalls of $48 billion in their FY 2009 budgets. For the 30 states with annual budgets that just completed action on their FY 2009 budgets, none has chosen to increase general taxes as a way of closing their budget gaps. Instead, what many have done is increase fees or make changes in various taxes directed at select taxpayers. For example:

- "Minnesota drivers will pay 8.5 cents more for every gallon of gas they put in their car, thanks for a higher state gas tax.
- New York smokers will pay an extra $1.25 on each pack of cigarettes now that state lawmakers raised the state tax to $2.75 a pack, the highest in the country.
- Marylanders who earn a million dollars are getting slapped with a new tax rate of 6.25 percent, up from 5.5 percent. The tax replaces a computer-services tax what lawmakers approved in 2007 but repealed this year after widespread criticism that the tax would force tech businesses out of the state.
- In Maine, beer and wine drinkers and soda fans will have a bigger tab now that lawmakers more than doubled excise taxes on those items, with the money directed to the state's health insurance program.
- Illinois increased the sales tax by a quarter percent in Chicago and surrounding counties to avoid cuts and fare increases in public transportation.
- New York also became the first to require online retailers such as Amazon that do not have a physical presence in the state to collect sales taxes on purchases New Yorkers make."[1]

And:

- Indiana increased its sales tax by up to 1 percent using the money to cut property taxes.
- In November, Florida voters will be given the same option.
- Virginia lawmakers are in special session to consider raising $1 billion in tax and fee increases to support transportation projects.
- Arizona voters may be asked to approve a one cent sales tax with the proceeds going for transportation projects.
- California Governor Arnold Schwarzenegger wants to borrow against $15 billion in future lottery profits.
- Pennsylvania Governor Ed Rendell wants to lease the Pennsylvania Turnpike for $12.8 billion.
- Maine is considering whether to add slots to race tracks.[2]

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A number of states are still wrestling with their serious FY 2009 budget problems. What they all have in common is a determination to avoid a general tax increase. Instead, a combination of budget cuts and selling off of government-owned assets, like toll roads (a throwback to the Thatcher years in Great Britain). Reportedly, the governors of both Illinois and Missouri have been looking into auctioning off student loan portfolios and some governors are also considering leasing their state lotteries. More and more, states are also turning to new forms of legalized gambling to raise needed revenues without adjusting taxes. As the recession deepens, these methods will be exhausted and, by the next biennium, it is likely that tax increases will be the only reasonable way that states like Ohio will be able to adopt a balanced budget.

Commentary

The first fiscal year of the biennium has ended, the numbers are in, and it appears that the actions taken by the administration, with the help of the legislature, have avoided what could have been a contentious redrawing of the FY 2008 spending plan.

The state ended the fiscal year with an $801.8 million GRF balance, almost exactly on target with the February, 2008, revised estimated unobligated balance. But even with all that positive news there are some important cautions.

1 Pamela M. Prah, "Tax Hikes Rare Among States—So Far," *Stateline*, June 12, 2008.

2 *Ibid.*

One is the fact that GRF tax revenues are actually $107.8 million lower than expected in the February, 2008, budget revision. And another, is the fact that the state was only able to show an $801.8 million ending fund balance by pushing $433.2 million of money that should have been paid out in FY 2008 into the next fiscal year. So, all is not as rosy as it might otherwise appear. And that means that bringing the budget back in balance in FY 2009 will be no small task. And it also means that preparing and adopting a balanced budget for FY 2010-2011 will tax the financial and negotiating skills of all who are involved in the process including, of course, interest groups and their representatives.

Solving the continuing state budget problems will not be easy. Most of the nation's states are in similar straits as Ohio and they, too, have chosen to make budget cuts; increase non-general taxes, licenses, and fees; and utilize various creative financing options rather than raise general taxes. Budgets for FY 2009 are going to be especially lean according to the The Fiscal Survey of States which was released in June. They found that general fund spending is expected to increase by only 1 percent in governors' recommended budgets which is less than one-sixth of the historical average of 6.7 percent. And those lean budgets are likely to continue for at least another biennium since, if the past is any guide, it takes states several years to recover after a recession.

The state's FY 2009 budget will soon need to be rebalanced once again and bringing it back in balance will require the state to use some or all of its accumulated Rainy Day Funds. It is important that decision-makers reflect on the fact that the Rainy Day Fund was created for just this purpose, and not to build new public works. In good times, reserves are set aside in the fund to be used when revenues fail to meet expectations due to cyclical economic downturns. And while the FY 2009 budget is being re-balanced, the governor will be proceeding to prepare the next biennial budget which will be released in just six more months. That budget will challenge the state to maintain essential governmental services, rebuild the state's Rainy Day Fund, and not raise general taxes (or eliminate scheduled tax reductions). That may well prove to be an impossible task.

Commentary on Fiscal Management

Governor Strickland and his Budget Director, J. Pari Sabety, have thus far earned a well-deserved "A+" when it comes to financial management.

His first budget was enacted on time and with almost unanimous bipartisan support—a feat which none of the last six governors were able to achieve. The budget provided for the smallest increase in GRF spending in half a century and continued the phased-in tax reductions enacted just before Governor Taft left office. When it became clear that GRF revenues were not going to meet expectations for the biennium, swift action was taken to make targeted reductions in authorized appropriations. An easier course of action, and one frequently taken in the past, would have been to simply order an "across-the-board" percentage decrease in all budget constitutionally-protected spending objects. Instead each separate line item—not just agency—was scrutinized and cuts ordered based on the continuation of state spending priorities. In addition, an agreement was reached with the legislature to enact most of the other legislation the administration needed to bring the biennial budget in line with its conservative estimate of a biennial shortfall of $733 million.

But tempering these accolades is an important caveat.

For reasons that are less than clear, the legislature did not provide additional requested appropriation authority to pay for the costs of the Medicaid program in FY 2008. Instead of returning to the legislature to seek legal appropriation authority to pay Medicaid bills owed in FY 2008, the administration chose to hold those bills and pay providers the day after the fiscal year ended. That action had several negative effects.

First, it inflated the FY 2008 unobligated balance by that amount, making FY 2008 appear far better than it was. Second, it will improperly inflate spending in FY 2009. And third, it sets a dangerous precedent violating the cardinal budgeting principle that, by definition, an appropriation sets the maximum amount of money that can be disbursed for a defined governmental purpose.

To the credit of OBM, the June monthly report clearly and openly states what they did. Although it would be difficult to prove, the same kind of thing has probably happened in the past—but without being so openly revealed. Nonetheless, such action of questionable legality serves as a blemish on what is otherwise a remarkable record of financial management by the Strickland administration.

Do You Have Questions about Ohio's Budget?

E-mail your questions to budget expert Richard Sheridan at

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