THE BUCKEYE INSTITUTE

Ohio's Biennial Budget:
Opportunity to Adopt Bold Reforms

Interested Party Testimony
Ohio Senate Finance Committee
House Bill 110

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May 18, 2021

As Prepared for Delivery

Chair Dolan, Vice Chair Gavarone, Ranking Member Sykes, and members of the Committee, thank you for the opportunity to testify today regarding House Bill 110 and Ohio's operating budget.

My name is Greg R. Lawson. I am the research fellow at **The Buckeye Institute**, an independent research and educational institution—a think tank—whose mission is to advance free-market public policy in the states.

The COVID-19 pandemic has created new challenges and new opportunities for you in drafting the state's biennial operating budget. Balancing the public's health and safety, the economic needs of struggling small businesses, and maintaining a sustainable long-term budget that does not hinder growth will be no small feat. But this difficult task can be accomplished even while adequately funding critical priorities such as vaccine distribution and maintaining a sound public infrastructure. Adhering to fundamental economic principles, re-prioritizing spending, curbing spending growth rates, and trimming government waste during this biennial budget process, will help fight the urge to turn one-time pandemic-recovery spending and money from Washington into ongoing, unsustainable spending obligations.

A well-drafted, sustainable budget can also address some important long-standing issues, including empowering families to get the individualized educational resources they need with flexible K-12 funding; making Ohio's tax code more competitive; investing in 21st century infrastructure; aligning higher education funding with educational, employment, and workforce needs; and targeting criminal justice resources to better deal with low-level offenders.

Budget Overview

The current version of **House Bill 110** includes appropriations of $162.8 billion in all funds over the biennium and $74.7 billion in general revenue funds (GRF). Approximately half of the proposed GRF increase stems from the state covering a larger share of Medicaid costs in Fiscal Year 2023 as temporary federal Medicaid resources wind down. But as Medicaid Director Maureen Corcoran has **indicated**, Medicaid eligibility redeterminations will not happen until next year and the overall caseload will likely remain above the pre-pandemic number through the biennium. And as with other recent Ohio budgets, more than two-thirds of **state-only spending** will pay for K-12 education, Medicaid, and criminal justice.

State tax revenues have remained **strong** despite the pandemic, providing adequate resources for ongoing, regular and non-COVID-19 related expenses. Ohio is also receiving up to **$17 billion** in federal funds under the latest COVID-19 relief package, which will tempt the General Assembly to create unsustainable spending programs that will outlast the initial federal funding. That temptation must be resisted and the federal dollars strategically spent.

The Buckeye Institute's most recent ***Piglet Book*** urges state policymakers to follow sound spending principles, remain focused on providing core government services, and supporting businesses recovering from the pandemic without establishing an unsustainable baseline for future spending that will inevitably require tax increases.

How to Spend in a Pandemic Recovery

Prioritize Government Spending

During the pandemic, policymakers should prioritize government spending to provide core government services and enhance public health and safety. Such priorities include procuring and distributing COVID-19 vaccines, and maintaining sound public infrastructures. Spending on programs and projects that fall beyond these immediate priorities should be eliminated or delayed.

With so many businesses struggling to survive the pandemic, the House has taken some positive steps by placing additional guardrails on H2Ohio. Governor Mike DeWine and the General Assembly rightly seek to ensure clean water in Lake Erie and protect against toxic algae blooms, but in difficult times like these when Ohio families have sacrificed and postponed even worthwhile objectives—their government should, too. As critical as H2Ohio may be, the initiative should be scaled-back temporarily. Although the House took a partial step in this direction by compelling the administration to seek Controlling Board authorization before transferring unencumbered GRF into H2Ohio, a better solution would firmly scale-back the program until Ohio has fully emerged from the pandemic.

Maintain a Sustainable Budget

With federal financial aid flowing from Washington, state policymakers must resist the temptation to create long-term programs with one-time federal funding. As The Buckeye Institute recently explained in ***How to Spend Federal Stimulus Money Wisely***, there are wise ways and wrong ways to spend excess federal funding. Extravagant public spending—even when governments can afford it—establishes higher budget baselines and creates the unrealistic expectation that government largesse will continue indefinitely. Those higher baselines and expectations inevitably lead to painful spending cuts and economically harmful tax increases. All of the funding coming from Washington should have separate budget line items to ensure public transparency and curb co-mingling of funds that might later justify higher permanent spending. For all of these reasons, the creation of the Joint Legislative Oversight and Review Committee of Federal COVID Relief is a smart move. The joint committee can rigorously oversee how these dollars are spent to maximize Ohio's post-COVID recovery while ensuring that these one-time funds do not tie the fiscal hands of future General Assemblies.

One strategic use of those federal dollars would be to **pay back the federal funds** that Ohio borrowed to pay unemployment benefits during the pandemic. Paying back those loans would avoid the difficulties imposed on Ohio employers after the Great Recession. In the wake of that recession, the state did not quickly repay its federal loans and higher interest costs were then passed along to Ohio employers. A second strategic use of the federal funds would replenish Ohio's unemployment fund to the pre-COVID-19 level. Doing so will help policymakers resolve the ongoing systemic state fund issues that predated the pandemic.

Peg Public Spending Growth Rates to Inflation

Where legally permissible, non-COVID related spending growth should track inflation and population growth rates. The Congressional Budget Office's most recent **10-year economic forecast** projects inflation (as defined in the Consumer Price Index) of 1.9 percent in 2021 and 2.2 percent in 2022. Ohio's population growth remains negligible, so actual inflation may prove far below Ohio's **statutory appropriation limit** that allows for 3.5 percent growth in GRF spending each fiscal year.

Eliminate Corporate Welfare

Governments should not pick economic winners and losers by redistributing taxpayer dollars to their favorite companies. This includes industry-specific state-backed marketing campaigns—like the **one** for Ohio wines funded by a five cents per gallon tax on consumers. Winemakers can find ways to market their own products without using the state's taxing authority to charge consumers more for it.

End Government Philanthropy and Advocacy

Governments are poor philanthropists. Philanthropists and charities—not politicians or bureaucrats—should direct voluntary contributions to support worthy programs and causes like the Ohio Arts Council, for example. When governments attempt "philanthropy" to support politically preferred causes using money that taxpayers are compelled to give, altruism turns to political advocacy and **crowds out** the voluntary efforts of the people, leaving them with less money to donate.

Eliminate Earmarks

Government funding through grants and direct aid should only flow through a transparent, competitive process in which all eligible entities may compete. Earmarks subvert that process and erode the public's faith in good government. Budget line items for Ohio History Connection programs and subsidies for specified universities beyond the State Share of Instruction subsidy should be eliminated. And the House's budget line-item giving a $150,000 grant for a "Uniform to Unions" to the Ohio State Building and Construction Trades Council apprenticeship program should be removed. Apprenticeships are worthwhile, but direct earmarks—even small ones—to particular groups are the wrong way to support them. Likewise, the House's earmarks for specific university programs dealing with public affairs can and should be supported by other higher education line items.

Addressing Long-Term Budget and Policy Issues

Taking a Student-First Approach and How to Fund It

The House's school funding plan provides a cornerstone for more education-funding reform—reform that is overdue and sorely needed. Unfortunately, even under the House's new funding proposal, Ohio will continue to fund public school districts before funding students, putting the interests of districts ahead of the students they are asked to teach. But just as the pandemic has led families to take a **hard look** at their educational preferences, priorities, and alternatives, so should the state. It is time for Ohio to take a student-first approach to funding K-12 education.

Public school districts moved to online and hybrid learning environments to cope with COVID-19 concerns, but as the pandemic persisted families confronted technical difficulties, equipment failures, and the unexpected need for expensive tutoring. The most vulnerable groups of students, including minorities and those from lower-income households, have suffered significant academic **setbacks**. To help, Ohio should move beyond its one-size-fits-all education system that prioritizes funding school districts over students, and instead help parents afford critical education resources and offer the flexibility necessary to help students succeed.

Education savings accounts—or ESAs—provide a bipartisan funding solution to this recurring problem by helping parents afford critical education resources and the flexibility needed for student success. As The Buckeye Institute has **shown**, ESAs can also help close some of the opportunity gaps and make the transition to new curricula easier and less expensive for families. In addition to traditional tuition expenses, ESAs can be used to purchase laptops or other technology for distance learning, tutoring services, or supplemental learning material.

Nine other states have already pioneered successful ESA programs and Ohio should follow suit. Ohio could, for example, create an ESA program parallel to its EdChoice scholarship program.

As Buckeye's president and chief executive officer Robert Alt recently **explained**, "In the wake of this devastating once-in-a-lifetime pandemic, this biennial budget offers Ohio's General Assembly a corresponding once-in-a-lifetime opportunity. We must reassess K–12 education and carefully design and implement an ESA program, with guardrails to ensure that funds are easy to access and appropriately spent, but without onerous burdens or bureaucratic meddling."

Promises and Perils of Proposed School Funding Plan

Aside from the need to embrace a student-first mechanism of school funding, the House's school funding proposal offers the promise of improving the status quo and the perils of unanswered funding questions. To its credit, the House's school spending proposal calculates more transparently the actual costs to educate a student, and it moves away from the **caps and guarantees** for school districts that plague the current system. The House's effort takes a first step in the right direction, but the Senate must still address several significant concerns.

First, the new school funding plan ensures that the state's K-12 education costs—already one of the largest budget line items—will continue to rise as the plan is implemented. But these rising costs are not fully funded by the budget, implicitly assuming that future General Assemblies will act according to the plan. That dubious assumption leaves the plan vulnerable to litigation and unsustainability if a subsequent General Assembly fails to fund the system.

Second, the House underestimates the plan's base costs by using three-year old teacher salary data from Fiscal Year 2018. Teacher salaries are sure to rise over time, making the plan's true costs higher than advertised.

Third, the plan does not distinguish between base costs paid by the state and those paid locally. Without that distinction, local decisions to increase teacher salaries with locally raised dollars may then increase the state's costs, too, because the per-pupil base cost formula uses the *total* cost of teacher salaries to determine the state's share.

Fourth, some advocates tout the House plan's formula as moving beyond caps and guarantees—that is, "caps" that prevent growing districts from being fully funded and "guarantees" that prevent districts with declining student enrollments from losing commensurate funding. Unfortunately, the current proposal does not quite meet this objective because it retains funding amount guarantees—through "temporary" transitional funding—for districts that are losing students. Thus, many school districts will continue receiving funds for students that do not attend their schools.

Fifth, the proposed funding formula that determines each school district's local capacity will curb **open enrollment** and harm the **80,000** students that use it. The new school funding plan would reduce funding substantially for those districts and remove incentives for more districts to participate in open enrollment.

Finally, the new plan's direct-funding model improves the current approach, but charter schools remain vulnerable to line-item vetoes by future, anti-school choice governors and should be protected, as the Fordham Institute has **suggested**, with new provisions that parallel statutory language used to fund school districts and joint vocational districts.

Each of these concerns are problematic, but every one of them is fixable.

Tax Reform

Ohio tax revenues are coming in strong and ahead of earlier estimates, according to the **latest** Office of Budget and Management revenue summaries. Non-auto sales and use taxes are currently 6.3 percent ahead of estimates for this fiscal year. The proposed two percent income tax reduction in the House version is yet another small step forward on broader tax reform and should be commended. Given the positive state of revenues, the General Assembly can afford to be even bolder and make even deeper reductions. More than **$9 billion in tax expenditures** littered throughout the state tax code could be eliminated to facilitate an across-the-board personal income tax rate reduction as well. Pursuing even these modest steps will help make Ohio more economically competitive by reducing the **combined** state and local tax rate.

The General Assembly should not be intimidated by the unconstitutional federal tax mandate included in the American Rescue Plan Act, which attempts to restrict your authority to set Ohio's tax policy. Attorney General Dave Yost has wisely challenged this unconstitutional provision in federal court, asking the court for an injunction. The Buckeye Institute has filed an **amicus brief** supporting Ohio's case.

21st Century Infrastructure

Broadband has become all-but essential for 21st century life. Schools, businesses, households, and hospitals rely heavily on high-speed internet access. The COVID-19 pandemic has compounded that reliance with expanded use of telehealth, hybrid and online learning, web-based e-commerce, and telework all depending on consumer **access** to reliable broadband service.

As Ohio deploys broadband, using a mix of state and newly available COVID-19 related **federal dollars**, policymakers should keep three things in mind. First, given the billions of private investment dollars already at work, Ohio should utilize public-private partnerships in the field and avoid **government-owned broadband networks** (GONs) that can cost unsuspecting taxpayers dearly. It is my understanding that there is language being considered that would provide additional safeguards against an expensive expansion of GONs. Such safeguards would be prudent. Second, the state's new broadband funding should be spent in areas that are truly unserved and not in areas that already have access. And finally, with federal funding flowing into state coffers, Ohio must adopt procedural safeguards to protect taxpayers. Helping service providers reach unserved areas makes sense, double-dipping for redundant broadband expansion does not.

Higher Education

Ohio's higher education policy should continue to strive toward helping students get the skills they need to secure gainful employment quickly and pay down student loans. Community colleges can play a key role in accomplishing both of these goals. First, they provide workforce credentialing through direct training and hiring programs with businesses and **industry partnerships**. And second, they are generally less expensive than four-year universities, with three credit hours from Edison State, for example, **costing** students less than half of what the University of Toledo and The Ohio State University charge, and one-tenth of what the University of Dayton charges. Such reduced rates help students seeking a four-year college degree to earn transferable credits at a lower cost.

But community colleges receive less than $500 million of the approximately $2 billion in the State Share of Instruction line item—a line item that does not transparently delineate its funding for higher education. Such a significant line item bearing such a significant price tag should be more transparent and the House, to its credit, separated the amounts allocated for community colleges from funding for four-year schools in its initial take on the budget. Unfortunately, that break out was removed before the budget went to the House floor. The Senate should restore it.

Additionally, access to Ohio College Opportunity Grants (OCOG) for low-income students attending community colleges is practically non-existent, despite the success of community colleges in helping students gain in-demand job skills. Ohio's flawed "**Pell-first**" policy is responsible. This policy restricts OCOGs from being awarded to students when a Pell Grant covers anything beyond the cost of tuition. And because community college tuition is so affordable, students are nearly always ineligible for OCOGs. Unfortunately, this Pell-first requirement ignores the additional costs that often keep lower-income students from pursuing associate degrees. Additionally, OCOGs are unavailable to students earning required job training certificates for jobs such as automobile repair, information technology, supply chain management, and welding. And Pell Grants cannot be used to cover the costs of such certificates. Senator Rob Portman is **working** to fix this problem at the national level, and the General Assembly should follow his lead and eliminate the Pell-first requirement and open the OCOG program to students earning job training certificates.

Criminal Justice Reforms

Total state spending on criminal justice represents the third largest portion of the budget. The House has wisely chosen to continue pursuing policies like the successful **Targeted Community Alternatives to Prison** (T-CAP) program. T-CAP is designed to keep low-level non-violent criminal offenders from unnecessarily spending time in Ohio's overcrowded prisons. T-CAP provides participating counties with Ohio Department of Rehabilitation and Correction grant funding if the county agrees not to send fifth-degree felony offenders to prison and instead rehabilitates the offenders in the community. This worthwhile effort to keep low-level drug offenders out of state prisons that began as a pilot program in 2018, currently has 60 of Ohio's 88 counties participating. Over time, programs like T-CAP will **save the state money** on prisons and the costs of recidivism.

Conclusion

The biennial budget process can ensure that Ohio makes a solid economic recovery from the COVID-19 pandemic without jeopardizing its future growth prospects. But policymakers must adhere to sound spending principles and resist the understandable temptation to create long-term programs with short-term federal funding. Focusing on providing core government services, curbing public spending growth rates, making the tax code more competitive, and eliminating earmarks and corporate welfare will keep Ohio on course. And now is the time to pursue several key policy initiatives, including flexible K-12 funding for families; investing in expanding broadband access throughout the state; and reducing recidivism through T-CAP and other community-based criminal justice reforms. The current version of the budget makes progress in several of these areas, but more can and should be done to improve the bill and help Ohio recover from the pandemic.

Thank you for the opportunity to testify. I would be happy to answer any questions that the Committee may have.

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