Budget Planning and Management Commission Report

By the Senate majority and House minority members

November 30, 2010

HB 1 of the 128th General Assembly, Ohio's biennial operating budget, created the Budget Planning and Management Commission (BPMC). The commission's stated goal is to present a menu of items detailing options for balancing the state's FY 12 – FY 13 budget. The language creating the commission is shown below:

> SECTION 509.10. (A) There is hereby created the Budget Planning and Management Commission, consisting of six members. The Speaker of the House of Representatives shall appoint three members of the House of Representatives, not more than two of whom shall be members of the same political party, and the President of the Senate shall appoint three members of the Senate, not more than two of whom shall be members of the same political party. The initial appointments shall be made not later than ninety days after the effective date of this section. Vacancies shall be filled in the manner provided for original appointments.
> (B) The commission shall complete a study and make recommendations that are designed to provide relief to the state during the current difficult fiscal and economic period. In developing the recommendations, the commission shall develop a strategy for balancing the state budget for fiscal years 2012 and 2013.
> (C) The commission shall appoint two of its members to serve as co-chairpersons for the commission. One co-chairperson shall be a member of the majority party of the House of Representatives, and one co-chairperson shall be a member of the majority party of the Senate. Commission meetings shall take place at the call of the co-chairpersons of the commission. The commission shall conduct meetings during the period of July 1, 2009, through November 30, 2010.
> (D) Not later than November 30, 2010, the commission shall submit a written report of its recommendations to the Speaker of the House of Representatives, the President of the Senate, and the Governor. The commission ceases to exist upon submission of its report.
> Am. Sub. H. B. No. 1 128th G.A.
> 3001
> (E) The Legislative Service Commission shall provide technical, professional, and clerical support necessary for the Budget Planning and Management Commission to perform its duties.

The commission members are:

Representative Vernon Sykes, (D-Akron), Co-Chair	Senator Shannon Jones, (R-Springboro), Co-Chair
Representative Ron Amstutz (R-Wooster)	Senator Dale Miller (D-Cleveland)
Representative Jay Goyal (D-Mansfield)	Senator Chris Widener (R-Springfield)

Rationale Leading to the Creation of the BPMC

A primary rationale for the creation of the BPMC was the use of non-recurring, one-time revenues to support ongoing expenses in the operating budget. The concern amongst legislators was that natural growth in state revenues due to increased economic activity would be insufficient in the FY 12 – FY 13 biennium to replace the one-time revenues used in HB 1 (and later in HB 318). While the original version of the BPMC language was drafted to have the panel compile a menu of options which would prevent tax increases, the final version omitted that prohibition. It has become clear, however, that the new administration intends to craft a balanced budget without tax increases, so this report will not contain tax increases as an option.

On June 29th 2010, the BPMC held its first meeting. Along with Governor-elect Kasich's announcement that tax increases will not be proposed, both co-chairs Sykes and Jones expressed their intentions during the hearing that tax increases should be avoided, especially in a recessionary economic climate. Therefore, this report will contain a menu of non-tax options for Governor-elect Kasich and 129th General Assembly to consider during the crafting of a biennial budget plan for Ohio.

Structural Deficit Looking Ahead

Discussions have been occurring across Ohio about the state's FY 12 – FY 13 budget 'shortfall.' At the moment, that is not an accurate description of the circumstances. Until a spending plan for the upcoming biennium is completed and measured against revenues available to support that plan, there is no surplus or shortfall. The measure that has been used by executive and legislative staffers instead attempts to quantify how much of Ohio's current operating budget is being funded by one-time revenues to see, upon depletion of those non-recurring sources, how much of the spending plan could no longer be supported. This represents Ohio's structural imbalance.

The biennial estimates of one-time money have been somewhat contentious. Co-chairman Sykes pegged the number at approximately $4 billion; Co-chairwoman Jones stated a number closer to $8 billion. Those June estimates likely need to be increased due to the federal government's award of eFMAP funding ($518.6 million in September) and "Ed Jobs" funding ($361.2 million) in September of 2010. The Office of Budget and Management's estimate released following the passage of HB 1 is that the one-time resources equal $4.9 billion plus $1.9 billion in non-GRF Medicaid funds (approximately $6.8 billion over the biennium). The Senate majority caucus' spreadsheet of one-time funds, which has been updated throughout FY 10, shows nearly $8.7 billion.

The OBM one-time revenue sheet may be viewed at http://obm.ohio.gov/SectionPages/Budget/FY1011/EstimatedOneTimeRevenueSource.aspx LSC drafted a memo for the BPMC on August 11th which summarized the OBM and Senate one-time documents that were available at that time. The Senate Majority Caucus' one-time revenue sheet is on the next page.

	biennial total	source of number
revenue		
Ohio School Facilities Commission 'loan'	$250,000,000	OBM Budget Highlights document
Rotary transfers (portion which OBM deems non-recurring only)	$45,000,000	OBM Budget Highlights document
Fund 4K9 transfer from Board & Commission funds	$30,000,000	OBM Budget Highlights document
Human Resource Savings from non-GRF sources	$142,000,000	OBM Budget Highlights document
Human Resource Savings from GRF sources	$130,000,000	OBM Budget Highlights document
Tobacco Interest from Bond Fund	$65,000,000	OBM Budget Highlights document
Public Library Fund temporary reduction	$84,317,620	OBM Budget Highlights document
Temporary income tax rate 'freeze'	$844,000,000	OBM HB 318 testimony Oct. 19, 2009
Unclaimed Funds transfer (portion deemed non-recurring by OBM)	$335,000,000	OBM Budget Highlights document
Federal stimulus for Education in GRF	$1,463,709,963	OBM Budget Highlights document
Federal stimulus for government services in GRF	$325,666,520	OBM Budget Highlights document
Enhanced Federal Medicaid Assistance Percentage (eFMAP) in GRF	$488,764,741	OBM Budget Highlights document
Enhanced Federal Medicaid Assistance Percentage (eFMAP) in non-GRF	$1,890,000,000	OBM Budget Highlights footnote
Prior fiscal year 'roll-forward' balances	$364,300,000	OBM Budget Highlights document
Assumed spending lapses	$428,185,965	OBM Budget Highlights document
Medicare Part D excess federal payment/"clawback"	$151,000,000	Gov's Office e-mail of May 6, 2010
Tobacco Master Settlement funding redirected for human services	$257,600,000	OBM e-mail of Aug. 11, 2009
Federal funds drawn down from the tobacco master settlement funding	$369,000,000	JFS e-mail of Apr. 9, 2010
eFMAP extension by feds for JFS Medicaid program spending*	$150,000,000	Gov's office press release Sept. 2, 2010
eFMAP extension by feds for Mental Health programs	$32,600,000	Gov's office press release Sept. 2, 2010
eFMAP extension by feds for Ryan White drug assistance program	$12,800,000	Gov's office press release Sept. 2, 2010
eFMAP extension by feds for ODADAS, EDU, Aging, DDD, and MH	$73,300,000	Gov's office press release Sept. 2, 2010
eFMAP extension by feds for Medicare Part D	$24,700,000	Gov's office press release Sept. 2, 2010
Debt Restructuring	$735,900,000	OBM Budget Highlights document
subtotal	$8,692,844,809	

Ohio is constitutionally prohibited from having annual budget deficits (Article VIII, Section 3 and Article XII, Section 4). In the case where revenues fall short during a fiscal year, the legislature may take additional actions or the Governor is required to order spending reductions to prevent a deficit under 126.05 of the Ohio Revised Code. However, in many instances Ohio has balanced its budgets with the use of non-recurring revenue to support appropriations.

Structural Deficits Looking Back

In November of 2003, the Cleveland-based Federation for Community Planning (now called the Center for Community Solutions) produced a report entitled "Ohio Structural Deficit Reaches Record Levels." According to the report, the budget of Governor Taft and the 125th General Assembly contained $3.8 billion in "one-time monies" for the FY 04 – FY 05 budget. The primary sources: federal fiscal relief, a temporary tax source, borrowing from the tobacco settlement, and a local government fund formula freeze. These sources comprise most of Governor Strickland's & the 128th General Assembly's HB 1/HB 318 non-recurring revenues.

The FY 08 - FY 09 budget (HB 119) and the FY 10 – FY 11 budget (HB 1) expanded the uses of one-time revenue. The HB 1 one-time revenues have been detailed above, but it is useful to look at HB 119, as well. HB 119 securitized the Tobacco Master Settlement Agreement (MSA), effectively selling the revenue stream to bondholders via a Buckeye Tobacco Settlement Financing Authority (BTSFA) for a period of several decades. Some of the bonds could still be outstanding in FY 45. For this long-term assignment of assets, the state received gross proceeds of $5.465 billion. Those proceeds were used to cover what would have been debt-financed school and higher education expenses. The budget briefing document (OBM – March 2007) stated:

> "The Administration proposes to securitize Ohio's tobacco revenues from the MSA and use the GRF freed up through the proceeds to finance a 20 year expansion of Ohio's homestead exemption for senior citizens and the disabled, as well as to complete the construction commitments of the Ohio School Facilities Commission, rebuilding every school building in the state."

Effectively, a one-time revenue source was programmed by law to pay in perpetuity for the expansion of the homestead exemption entitlement, estimated to exceed $250 million per fiscal year. The General Assembly, in an attempt to mitigate the non-recurring funds being used for ongoing purposes, put language into HB 119 that would have set a lower debt ceiling for the state in statute so that future debt issuances would not "run the state's credit card back up" after the securitization proceeds were used. That language was line-item vetoed by Governor Strickland. {On a separate note, the proceeds did not "complete" the SFC building commitments. HB 462 of the 128th GA included $525 million of new debt appropriations for school facility projects, and it is expected that billions more will be needed to finish the list in subsequent biennia.}

The state's Budget Stabilization Fund (BSF), colloquially known as the rainy day fund, held a balance of $1,012,289,234.89 when HB 119 was drawing to a close, but due to declining revenues, the state needed to use nearly this entire fund to keep the budget in balance at the end of FY 09. As of November 2010, the BSF has a balance of eighty-nine cents.

End of the Road

To summarize, the state's usage of non-recurring revenues has occurred frequently over the past decade, with Governors and legislators of both parties affirming the practice through budget enactments. However, the base of state appropriations and the likely revenue totals for the next biennium will not permit this type of budget to recur. The divide between the appropriations and the revenues has simply gotten too large to manage with stopgap, one-time measures. It appears unlikely that the federal government will provide stimulus funding at anywhere near the amount provided in the current biennium, and while other securitization measures may be available, policymakers will need to make very difficult decisions about how to balance the budget and help move the state back towards fiscal stability. The next budget will undoubtedly contain some one-time funding, but it will (and should) be significantly less than the amount contained in HB 1.

While the task is daunting, the rewards are many: the state will be on a better fiscal footing, workers and employers in Ohio will have more certainty, and the state will be able to avoid operating on a crisis-to-crisis schedule. Additionally, Ohio's bond rating, which two of the three major ratings firms lowered in June of 2009, could stabilize.

Strategy for Balance – no tax increases

The BPMC in its hearings has continued to express support for fiscal restraint being the preferred methodology for balancing the next budget. As a consequence of that being the preference, this report will provide options to help produce an FY 12 – FY 13 budget that do not require additional revenue from tax increases. As of the date of this report being written, the BPMC has not received revenue estimates for the FY 12 – FY 13 biennium.

Ohio has budgeted in an incremental fashion – gradually increasing spending – for decades. The budget was generally created by determining what appropriation levels should be, followed by adjusting revenue sources to fund those levels of spending. *For FY 12 and FY 13, the Governor and General Assembly need to review the revenues available to them, and create a budget from those available resources.*

The BPMC recommends that the budget be developed without any tax increases. By planning appropriations within available resources, the pressures will be to reduce outlay while improving efficiencies, just as taxpayers, households, and businesses have had to do throughout the economic downturn. If, during the budget development process, policymakers determine that increased non-tax revenues will be utilized, steps should be taken to avoid using one-time monies for ongoing purposes.

The general consensus among the BPMC members is that tax increases would be counterproductive in the present economic environment. In August of 2010, BPMC staff had the Legislative Services Commission detail what certain taxes would generate if increased. At that time, the estimates were:

- A one-cent (5.5% to 6.5%) increase in the state sales & use tax would increase GRF tax receipts by $1.19 billion.
- Increasing the Commercial Activities Tax from 0.26% to 0.27% (and presumably directing the revenue into the GRF) would produce $54 million.
- Increasing the state personal income tax rates by 1% in all brackets would increase GRF tax receipts by approximately $84 million.
- Increasing the cigarette tax from its current level of $1.25 per pack by 1 cent would increase GRF tax receipts by $5.8 million. This figure includes the 'floor tax' on current inventory.

The BPMC would not advocate for any of these methods to be utilized, but for the sake of the report, felt that the information was useful for review. The projected structural imbalance is so large that any tax increase or combination of tax increases sought to close the gap would be very onerous to Ohio's citizens and employers.

It is worth noting that a **review of the state's tax expenditures** (detailed in OBM's executive budget 'book II') should be vigorously undertaken on a biennial basis. While the BPMC would not suggest eliminating a tax expenditure that is pending for any taxpayer, prospective actions could be taken to reform or eliminate tax expenditures that no longer serve their intended purpose or fail to assist in the creation of private sector jobs.

Menu of Options

- **Reductions in state spending.** Each board, commission, agency, and subdivision of the state is already responsible for elimination of waste, fraud, and abuse. Additionally, managers must ensure efficient use of funds. Even with safeguards in place and improved management functions, the state will need to reduce its appropriations. Policymakers should decide on which method or combination of methods to employ.
    - **Proportional** – By reviewing how much each category of state government costs, one could establish a budget by proportionally reducing each of those categories to fit within available revenue.
    - **Program specific** – A variant of what some would term "zero-base budgeting," a program specific budget review would incorporate a complete review of all of the spending, revenue-sharing, and transfers the state does to determine what should be trimmed or eliminated and could even produce suggestions for programs that should be bolstered or initiated. (ORC 126.02 already requires incorporation of zero-based budgeting principles into budget preparation.)
    - **Prior-year as base-year** – Upon receiving revenue estimates, policymakers could review actual spending from past fiscal years to see if a framework exists for a lower spending base. While this would not work for all appropriations (debt service, entitlements, formulaic pass-throughs), it would provide a reasonable starting point for review.
    - **Across-the-board** – This method, used many times over the past few decades, reduces the vast majority of line items by a set percentage or range of percentages to achieve budget balance. Exemptions for certain purposes such as primary & secondary education and debt service are generally employed, but the more that is exempted will require larger reductions to the non-exempt line items.

  The BPMC would recommend using "program specific" as the primary method for paring the spending. If, after careful review of spending cuts and non-tax revenue options, it becomes clear that additional reductions are needed, a modest "across-the-board" reduction could be used to get to the final balance.
- **Medicaid Reforms**
    - *Opting out of Medicaid?* – To be clear, Ohio should NOT opt out of the Medicaid program. The loss of the assumed 64-cent federal draw down for each dollar spent would significantly reduce Ohio's medical service purchasing ability and would have a severe negative effect on both recipients and providers. The state should carefully watch developments across the country with regards to states opting out, though. As of late November 2010, Washington, Texas, South Carolina, Wyoming, and Nevada officials have publicly discussed opting out. The federal government could enact significant changes or even a repeal to the

unfunded or underfunded portions of health reform if state governments articulately express their cost concerns.

  - *Managed Care Expansion* – Enrolling more of the existing caseload into a managed care setting could improve health outcomes and reduce costs for the program.
  - *Re-aligning Ohio's Long-Term Care Spending* – As testimony before the BPMC detailed, Ohio's spending on long-term care is not aligned with national spending trends. As consumers demand different options and providers change delivery models to reduce costs while improving care, our Medicaid system must change, too. An evaluation and modernization of how Ohio pays for long-term care services should be pursued, while ensuring a quality continuum of care.
  - *Block Grant* – Ohio should review those states which have applied for block grant Medicaid funding rather than the traditional match methodology. The flexibility is desirable, but it must be weighed against the longer-term spending reductions that are necessary in block grant scenarios. Generally, block granting results in capped funding (much like when TANF was implemented).
  - *Seek Federal Reimbursement for Prisoner In-Patient Health Services* – The state and local political subdivisions pay the medical expenses of Ohio's incarcerated population. For Medicaid eligible populations, this could be a significant cost-savings for both the state and local governments.
  - *Review Ohio Commission to Reform Medicaid Report* - http://ohiomedicaidreform.gov/
    Reviewing recommendations of this report that was released at the end of 2004 would be very worthwhile.

- **Federal Assistance**
  - *Medicaid funding* – The recently enacted federal health care law will significantly increase Ohio's costs. Even with the feds paying for newly eligible people, JFS estimated in April that 279,000 of the 554,000 new enrollees are currently eligible people that the state will need to cover. The federal government should pick up the costs for any enrollee who signs up for Medicaid due to the passage of the health reform act. The Kaiser Foundation put out this useful memo with regards to additional costs due to the passage of the health reform act: http://www.kff.org/healthreform/upload/7952-03.pdf
  - *Medicaid relief* – If the so-called enhanced FMAP funding is not continued, the feds should grant states the ability to limit eligibility to levels lower than those mandated by the health reform act.
  - *Unemployment Compensation fund* – Ohio's negative balance exceeds $2.3 billion. OBM estimated in a BPMC hearing that the interest alone on this borrowing may cost the state over $290 million in the 12-13 biennium. Congress should be asked to extend the waiver of interest payments. The latest figures for Ohio's borrowed balance can be seen at: http://workforcesecurity.doleta.gov/unemploy/budget.asp

    - *Ensure maximization of federal match* – For all programs run by the state that draw a federal match, Ohio must ensure that every dollar it expends that is eligible for match is being matched.
- **Privatization of Services/Administration** – The state should review all of the services it performs to see if the private sector could provide the service at a comparable level and at a lower cost. In addition, management of certain state functions could be turned over to private sector vendors to maximize efficiencies and reduce overhead costs. Some other states have proposed allowing private-sector vendors run their lotteries, for example. Ohio currently has two privately run prisons which, by statute, must provide services at costs below public-sector facilities. These types of management functions could be expanded.
- **Collective Bargaining Reform** – Ohio's collective bargaining statute, in place since 1983, must be reviewed. The state and its political subdivisions need flexibility to deal with personnel expenses, and workers should have the ability to be promoted/retained based upon their work product. This review of Ohio's laws and policies regarding bargaining is long overdue.
- **Continuation of Furloughs** – The Strickland administration proposed mandatory furlough days for state employees, sometimes termed "cost savings days." If necessary, these furloughs could be repeated in the FY 12 – FY 13 biennium. As these have the effect of being nonrecurring savings, though, it would presumably be better to use this option only after ongoing overhead cost reductions are put into place.
- **Securitization of Assets/Lease-Back Proposals** – As in HB 119 (127th General Assembly) when the state's tobacco master settlement revenue stream was securitized, the state could consider going further. Some assets that have been securitized by other states: roadways, concession sales, lotteries, revenue streams (fees and taxes), and even long-term leases of state-owned buildings and lands. (Lease rights could be extended to state-owned equipment, too. Placement of private company equipment on state-owned lands or towers could provide a non-GRF revenue stream.) As noted above, however, these types of arrangements produce a large up front payment of one-time funds. Great caution should be taken to ensure, if any of these methods are used, that these one-time moneys are not used for ongoing purposes.
- **Mineral Extraction/Oil Drilling on State-owned Lands** – Discussed for several biennia, it would be worthwhile to explore creating a new revenue stream from what has been called "drilling on state lands." Any funds collected from these endeavors could be used to offset GRF appropriations for ODNR.
- **Pension Reform** – The goal here should be to achieve two ends: maintain solvency in all of the public retirement systems and ensure that taxpayers and public employers are not unduly burdened by the costs of the systems. Each system has recommended reforms that need to be reviewed. These suggested changes are on the Ohio Retirement Study Council's website:
  http://www.orsc.org/uploadpdf/Updated_Comparative_Summary3.pdf
  In addition, the state needs to see how many public entities pay portions of the 'employee share' and consider prohibiting that practice.

- **Study Creation of Charter Agencies** – A concept similar to that enacted in Iowa in 2003 by then-Governor Vilsack and reviewed by the Strickland administration in 2007, charter agencies agree to take budget cuts but are given significantly more administrative flexibility over personnel, procurement, and IT than traditional agencies. (The BPMC would not recommend the component allowing agencies to generate their own revenue without gubernatorial & legislative approval, however.) The National Governors' Association briefing on Iowa's experiment is available on the web: http://www.nga.org/Files/pdf/0511OMCTINNOVATIVESTRATEGIES.PDF Some 'flexible performance agreements' were pursued in Ohio over the last few years, but they were not given the same parameters as the charter agency concept. The results of those endeavors can be seen at: http://results.ohio.gov/ Elimination of bureaucracy in an effort to achieve better and lower cost results for citizens must always remain the goal of the state.
- **Regulatory/Mandate Relief** – In an era where public expenditures will not keep pace with requested demands, a reasonable alternative is to eliminate burdensome regulations and unfunded mandates across all sectors. The incoming administration and 129th General Assembly should continue efforts to identify and remove costly regulations and mandates as an alternative to increased appropriations.
- **Prison/Sentencing Reform** – To achieve cost savings in the corrections portion of the budget, and to not make the jobs of Ohio's excellent correctional officers any more difficult, sentencing reforms should be considered. The BPMC heard testimony from Sen. William Seitz advocating for the passage of SB 22 of the 128th General Assembly. When creating a unified corrections plan for the FY 12 – FY 13 budget, reforms should be considered as part of the budget.
- **Purchasing Consortia for Public Sector Entities/Procurement Reform** – The state should provide options, rather than mandates, which would allow for public sector purchasers to join together in the buying of goods and services. Any impediments in statute or rule to these types of arrangements should be eliminated. As a supplement to consortia, the incoming administration should review the Advantage Ohio report released in April of 2008 which outlined a procurement reform process which would streamline processes and potentially create significant savings. http://procure.ohio.gov/pdf/AdvantageOhio.pdf
- **Information Technology Sharing** – Advances in utilizing computer technologies, such as server virtualization, hold promise for lowering costs, while improving service levels, for many state agency, university and local governmental functions. Strategies should be pursued that could begin lowering state expenditures for information technology by employing shared, scalable computing services. Savings could be divided between budget balancing and re-investment for further deployment of more efficient technology platforms to generate further savings in the future. This approach would require strong leadership support to overcome natural turf barriers between entities performing compatible functions, or between entities with different functions, but that can still share computing and network resources.

- **Cross-entity Service Agreements** – Significant discussions, spawned in part by meetings of the BPMC, have been occurring around concepts that involve sharing management level and support services between governmental entities ranging from smaller school districts, townships, municipalities, counties and special districts to universities, state agencies and state boards and commissions. These concepts should be examined for opportunities to save public funds, improve service deliveries and absorb funding reductions in this next biennium. Additionally, opportunities to encourage entities to engage in longer-term shared projects should be considered. It would be appropriate to invest a portion of new one-time sources of revenue, should they occur, in establishing funding incentives and process improvement grants, perhaps through establishment of an institute, to governmental entities willing to commit to real cost-saving operational improvements.
- **Tax Amnesty –** This is a method to create nonrecurring revenue, so any proceeds of such should be used accordingly. Ohio has had two tax amnesty programs – one starting in October of 2001, the other in January of 2006. Revenue realized from an amnesty could be deposited into the unemployment compensation fund or be used to pay down state debt to reduce debt service costs.

To review the suggestions made by the public as well as to see copies of the testimony presented to the BPMC, please go to: https://bpmc.legislature.state.oh.us/