School funding outlook in the next biennium

Dr. Howard Fleeter, Education Tax Policy Institute consultant

The fiscal year (FY) 2012-13 state budget enacted significant changes in funding for schools and other local governments in Ohio. Reductions in distributions to the Local Government Fund (LGF) and Public Library Fund (PLF), coupled with a phase out of replacement payments for the loss of business tangible personal property (TPP) tax and public utility tangible personal property (PUTPP) tax, were implemented as part of the administration's and legislature's strategies for restoring structural balance to the state budget.

In addition, while Ohio K-12 public schools did receive a small increase in their funding appropriation in FY '12 and FY '13, these increases were not sufficient to offset the loss of $457 million in federal American Recovery and Reinvestment Act stimulus dollars from the State Fiscal Stabilization Funding (SFSF) program and the changes to the TPP and PUTPP tax reimbursements.

Table 1 provides a summary of these changes in funding.

The data in Table 1 show that total state support for K-12 education in FY '12 was $240 million less than in FY '11. This reduction was entirely due to the $485 million reduction in TPP tax replacement payments, as all other categories of revenue showed increases. When the loss of the $457 million in federal SFSF stimulus is taken into account, the reduction in general purpose funding for Ohio's school districts from FY '11 to FY '12 amounts to $697 million. (The SFSF revenue went to the state's General Revenue Fund (GRF) and was available for general purpose expenditures. In contrast, most federal aid does not go to the GRF, and school districts must spend it for specific purposes mandated by the federal government.)

Table 1: HB 153 as-enacted appropriations for K-12 education, FY '11 through FY '13

Revenue category	**FY '11**	**FY '12**	**FY '13**
State GRF K-12	$6,264	$6,453	$6,533
State GRF rollback	$1,051	$1,086	$1,095
State feneral services & special revenue	$83	$97	$97
State lottery Profits	$711	$718	$681
Property tax replacement (TPP & PUTPP)	$1,241	$756	$505
Subtotal — state (GRF)	**$9,350**	**$9,110**	**$8,911**
Change in state revenue vs. FY '11		**-$240**	**-$439**
Federal SFSF foundation stimulus (GRF)	$457	$0	$0
State + SFSF change in revenue vs. FY '11		**-$697**	**-$896**
Federal stimulus non-foundation (non-GRF)	$482	$101	$40
Federal other (non-GRF)	$2,291	$2,209	$1,971
Subtotal — non-GRF federal revenue	**$2,773**	**$2,310**	**$2,011**
Change in non-GRF fed. revenue vs. FY '11		**-$463**	**-$762**

Figures shown are in millions
Source: House Bill (HB) 153 for FY '12 and FY '13; Budget Blue Book for FY '11

Similar calculations for FY '13 show that state funding for K-12 education was reduced by $439 million compared to FY '11 (again due almost entirely to further reductions in TPP and PUTPP tax replacement payments), with the total reduction coming to $896 million when the lost SFSF funding available for GRF purposes is included. This brings total reductions in state and SFSF stimulus funding to K-12 school districts during the FY 2012-13 biennium to $1.593 billion compared to the funding level of FY '11. In essence, this figure shows that Ohio schools had nearly $1.6 billion less in funding than they would have had if the FY '11 funding levels had continued throughout the current biennium.

While some may argue that it was not the state's responsibility to replace the SFSF stimulus funds, it is imperative to understand that the explicit purpose of the Federal Fiscal Stabilization funding stream was to preserve basic state and local programs during the recession and its aftermath. Because the $457 million in SFSF stimulus was delivered to Ohio school districts to allow them to preserve existing educational programs, it is entirely appropriate to include its elimination in the calculations above.

Finally, Table 1 shows that Ohio's school districts lost an additional $463 million in other federal funding from FY '11 to FY '12, with the total loss growing to $762 million in FY '13, as compared to FY '11. Some of this loss in federal funds occurred in the form of federal stimulus programs earmarked for specific purposes. Other losses occurred in non-stimulus federal funds. Unlike the SFSF stimulus money that was intended for general educational purposes at the local level, these funds were intended to fund specific categorical programs. As a result, they never appeared as part of the state's GRF support for schools.

The state's bottom line for FY '12

FY '12 ended up being a better year fiscally for Ohio than state budget and policymakers anticipated. On the revenue side of the ledger, GRF taxes exceeded estimates by $399 million in FY '12. Federal grants (primarily relating to Medicaid expenditures) were $240 million less than estimates, and "other receipts" came in $578 million under estimates (primarily due to the failure to receive an estimated $600 million payment from JobsOhio derived from the leasing of the state liquor business). The net result was that total GRF receipts were $419 million under estimates for the year.

Fortunately for the state, total GRF expenditures in FY '12 came in $809 million under estimates (in large part because $535 million less than anticipated was spent on public assistance and Medicaid), resulting in a net bottom line savings of $391 million compared to what was budgeted. Table 2 provides a summary of these figures.

Table 2: General Revenue Fund: Final fiscal year 2012 receipts and spending

Category	Actual	Estimate	Difference
Total GRF taxes	$19,005	$18,606	$399
Federal grants	$7,363	$7,603	**-$240**
Other receipts	$235	$813	**-$578**
Total receipts	**$26,603**	**$27,022**	**-$419**
Total expenditures	**$26,395**	**$27,204**	**-$809**
FY '12 budget bottom line			**$391**

Figures shown are in millions
Source: Office of Budget and Management
July 10, 2012, Monthly Financial Report

On July 3, 2012, the state deposited $235 million into the Budget Stabilization Fund, also known as the "rainy day" fund. This brought the total in the rainy day fund to $482 million (roughly 1.8% of FY '12 GRF revenues). The state deposited $247 million in the Budget Stabilization Fund at the end of FY '11.

FY '12 also saw $53 million in lottery profits generated above the estimated amount for the year. Combined with $67 million in excess lottery profits from previous years, the state's Lottery Profits Education Fund (LPEF) currently has a balance of $120 million. Because lottery profits are deposited directly into the LPEF, they are not included in the state's GRF revenues.

Outlook for FY '13 and beyond

The FY 2014-15 biennial budget process will begin in January 2013. Given the reduction of $700 million in funding in FY '12 and another $900 million in funding in FY '13 (compared to FY '11 funding levels), it is only natural that school districts may look to the next budget with trepidation. Over the same period, non-school local governments lost $409 million in state revenue from FY '11 to FY '12 and $740 million from FY '11 to FY '13, for a total loss in the biennium of $1.15 billion.

However, there are some signs that the state may not feel the need to make further reductions in funding, and in fact may have the resources available to offset all or part of the cuts that have been made to schools and other local governments in the current biennium.

First, a large chunk of the $120 million in the LPEF could be directed to school districts to offset the impact of the reductions in TPP and PUTPP tax replacement payments and the loss of the SFSF stimulus. Second, the $399 million excess of GRF tax revenues over estimates in FY '12 suggests that Ohio's economy is stronger than was anticipated. The Office of Budget and Management (OBM) has, in fact, updated its estimate of FY '13 GRF taxes, but only by $5 million over the initial conference committee figure. Thus, it seems possible that the FY ’13 GRF taxes also may come in over estimates, presuming there is not a significant national economic downturn.

Third, the economic viability of shale drilling (often referred to as “fracking”) to access previously unattainable reserves of oil, natural gas and other valuable petrochemicals contained in the state’s two large shale deposits offers a unique opportunity for augmenting state revenues without typical concerns for diminishing economic activity. As Gov. **John Kasich** has frequently explained, Ohio currently taxes crude oil at a mere 20 cents per barrel. This rate is far lower than that of other oil-producing states. Similarly, Ohio’s current tax rate on natural gas also is lower than other nearby and high-production states.

While these relatively low tax rates may not have mattered much given Ohio’s prior low levels of oil and natural gas production, the viability of extracting these resources from the vast Utica and Marcellus shale deposits changes the calculus significantly. The state’s underground shale deposits represent a vast, yet finite, natural resource. Once the petrochemical products are extracted, the resource will be gone forever. The state has an obligation to its 11 million residents to extract fair payment from the private companies that will profit from the development of these resources.

Furthermore, unlike the situation where one state tried to induce a company to locate a factory or corporate headquarters in its environs instead of in another state, there is no aspect of interstate competition with the shale deposits. If oil, natural gas and chemical companies would like to consume our resource, they must come to Ohio to do so. Both Kasich and OBM Director **Tim Keen** have made this point in the course of explaining the governor’s proposal to increase taxes on both natural gas and crude oil derived from shale drilling.

Kasich’s proposal entails raising the tax rates on crude oil and natural gas, and using the proceeds to fund a decrease in the state’s income tax. Because of the uncertainty of projecting the pace at which shale drilling will accelerate in Ohio, the governor’s proposal creates a fund where revenues will be deposited and income tax cuts will then occur in accordance with collected revenue levels.

Initial estimates by the governor’s office indicated that an income tax cut of $500 million would be possible in 2016. This suggests that higher taxes on shale drilling would generate this much revenue by then. Analysis by both the Education Tax Policy Institute and Policy Matters Ohio finds that even the higher tax rates proposed by the governor are still low relative to other states.

Thus, it seems clear that shale drilling represents a viable way for the state to increase revenues and use the proceeds to offset the current biennial budget’s cuts in school and local government funding, either by reducing or eliminating the proposed income tax reduction or by increasing the proposed tax rates.

Conclusion

From FY ’06 through FY ’08, Ohio’s GRF tax revenues were relatively flat at roughly $19.5 billion annually. This was largely due to the tax restructuring in 2005’s HB 66. However, as a result of the national recession, GRF tax revenue fell $2.3 billion from FY ’08 to FY ’09, and another $860 million from FY ’09 to FY ’10. While tax revenue grew by nearly $1.5 billion from FY ’10 to FY ’11, GRF taxes in FY ’11 were still lower than they were in FY ’04, which demonstrates how significant the recession was.

The combination of state revenue reductions from HB 66 and the devastating effects of the recession required using several billion dollars of “one-time” funds to balance the FY 2010-11 budget. In light of this, the primary objective of the state for the FY 2012-13 biennium was to restore structural balance to the budget by curtailing the use of one-time money. While a small amount of one-time funding is still in place in FY ’13, the state has largely achieved its objective, and done so without raising state taxes.

However, schools and local governments in Ohio bore the brunt of the budget balancing through the policy changes leading to the reduction in state funding for personal property tax replacement and local government funds. As the state’s economy continues to recover and the prospect of generating significant new revenue through increased taxes on shale drilling looms, Ohio’s schools and local governments can question whether the policy changes that were necessary in the current biennium must continue in the future. ■