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R-126-3047

## MEMORANDUM

To: Senator Eric Fingerhut  
From: Steve Mansfield, Chief of Fiscal Analysis  
Date: March 22, 2006  
Subject: Impact of proposed tax expenditure limitation amendment

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This memorandum responds to your request for a fiscal impact analysis of the proposed tax expenditure limitation (TEL) amendment that may appear on Ohio's ballot this coming November. Your request was for an analysis of the potential impact on overall state and local government spending, without going into specific impacts on state programs or on specific local government entities. The enclosed spreadsheet compares actual state and local government spending for FYs 1994 to 2002 to what those expenditures would be under the operation of the TEL amendment if it had been in place at the time.

Two typical obstacles confront such an analysis. First is the availability of reliable and timely data. Second is the availability of sufficient information about the data so that it can be categorized in the same terms as the proposed changes.

Both of these obstacles can be overcome to a large degree with the use of U.S. Census Bureau data on State and Local Government Finances. The Census Bureau has online state and local government expenditure and revenue data for FYs 1992 through 2002, but only state level data for FY 2001. This is the only source of data for both state and local government expenditures and revenues.

### Reliability of the data

Is the data reliable? The annual "Budgetary Financial Report" from the Ohio Office of Budget and Management (OBM) also provides data on state expenditures and revenues, which can be used as a check on the general accuracy of the Census Bureau

data. For the eight years where the Census Bureau and the Office of Budget and Management both had data, the differences that resulted when calculating state expenditures subject to the proposed TEL ranged from 0.23% to 3.54%. Confidence in the results of this analysis is enhanced by the relatively small degree of differences between these data, although that degree of imprecision will have some effect on the results of calculations based on the data.

**Matching data categories and the terms of the amendment**

What are the specific terms of the proposed amendment? As you know, the proposed TEL amendment puts limits on aggregate state expenditures and on each political subdivision's aggregate expenditures. Included in the definition of "aggregate state expenditures" are all state expenditures except expenditures from money "(a) received from a revenue source other than taxes, licenses, permits, fees or sales, (b) received from the federal government, (c) for refunds of any kind, or (d) made pursuant to a bill which . . . authorizes temporary expenditures for the sole purpose of providing relief directly related to an emergency . . . and which receives an affirmative vote of not less than three-fifths of the members of each house of the general assembly."

Similarly, but with differences, "aggregate local government expenditures" is defined as all expenditures by a political subdivision except from money "(a) received from the federal or state government, (b) for refunds of any kind, (c) received as grants, gifts, donations or bequests . . . or (d) made pursuant to an ordinance or resolution which . . . authorizes temporary expenditures for the sole purpose of providing relief related to an emergency" and which "receives an affirmative vote of not less than three-fifths of the members of the legislative authority of that political subdivision."

The Census Bureau data reports the "direct expenditures" of state and local governments and includes detail on intergovernmental revenues, interest earnings, and expenditures from insurance trust funds (e.g., custodial employee retirement, workers' compensation, and unemployment insurance trust funds). On the basis of my interpretation of the amendment, adjustments were made from direct expenditures to establish state or local expenditures that are roughly in line with what would be included under the terms of the TEL amendment. Initial deductions were made from state government direct expenditures to account for intergovernmental revenues from the federal government and from local government. Similar deductions were made from local government direct expenditures to account for intergovernmental revenues from the federal government and from the state government. Revenues that the state government provided to local government were added back in, as were those from local government to state government. Data from OBM were also used to deduct expenditures that came from Tobacco Settlement funds. Further, a deduction was also made for state, but not local, expenditures from interest earnings, as this appears to be outside the definition of

"aggregate state expenditures." Tax relief payments from the state to local governments have not been excluded since they appear to be intergovernmental expenditures that provide local governments with an alternative source of revenue and thus reduce the level of local government tax levies. Assumptions such as these are necessary to developing a simulation analysis. If the proposed TEL amendment is adopted, some of its terms may need to be more precisely defined.

The proposed TEL amendment limits the growth in state and local government spending by the greater of (1) 3.5% or (2) the rate of inflation during the preceding calendar year (as measured by the consumer price index) plus the rate of population change during the preceding calendar year in the state or the political subdivision, respectively. If the rate of population change in the political subdivision is unavailable, the rate of population change in the county would be used.

Applying the terms of the proposed TEL amendment to calculate the "allowable rate" for state government beginning with the FY 1994-1995 biennium, the "allowable rate" would be 3.63% for FY 1994 but only 3.5% for FY 1995. This is because even though the sum of the rate of change for the CPI and for the state population change is 3.507% in 1994 this fact was unknown and could not be taken into consideration in the winter and spring of FY 1993 when the budget for FY 1995 was being prepared. This would also be the case for FY 2001: the 3.653% sum of the changes in the CPI and in population would not be known at budget time. Because local governments prepare their budgets on an annual basis, they would not be affected by this problem.

The proposed TEL amendment would also create a local government fund and requires the state government to appropriate to this fund a minimum of 5% of the aggregate state expenditures for the preceding year. These moneys would then be distributed to the state's political subdivisions. This provision seems to have no substantive effect on the amount of money the state transfers to its political subdivisions. As seen in the enclosed spreadsheet, the state government routinely provides revenue to local governments well in excess of 5%.

### **Comparison of actual expenditures to a TEL simulation**

In Tables 1 and 2, the comparison of actual state and local government expenditures from FYs 1992 through 2002 with simulated expenditures allowed under the limits of the proposed TEL amendment shows that the TEL amendment would restrict expenditures of both state and local governments by hundreds of millions of dollars in its first years of operation and by billions of dollars in subsequent years. In FY 2002 the difference between the actual expenditures and the simulated expenditures would have been \$5.6 billion for state government and \$4.4 billion for local governments. The cumulative impact on local government expenditures considered in the aggregate would

have been somewhat greater since aggregate local government expenditures had a slightly higher growth rate in the initial years under consideration.

**Table 1. Simulated Impact Of Proposed Tax Expenditure Limitation Amendment on Ohio State Government Expenditures\* (dollars in millions)**

Fiscal Year	State Government Expenditures Subject to TEL	Percentage increase in actual expenditures	Percentage increase in CPI + population	TEL allowable rate applied for biennial budgeting	Budget limit under TEL beginning FY 1994	Difference
1992	\$16,746.5		3.704%			
1993	\$16,920.9		3.630%			
1994	\$17,740.2	4.842%	3.507%	3.630%	\$17,535.1	\$205.1
1995	\$18,467.1	4.097%	3.518%	3.500%	\$18,148.9	\$318.3
1996	\$18,489.4	0.120%	3.551%	3.518%	\$18,787.3	-\$297.9
1997	\$20,047.8	8.429%	2.776%	3.500%	\$19,444.9	\$603.0
1998	\$21,660.8	8.045%	1.966%	3.500%	\$20,125.4	\$1,535.3
1999	\$22,898.2	5.713%	2.437%	3.500%	\$20,829.8	\$2,068.4
2000	\$24,542.2	7.179%	3.653%	3.500%	\$21,558.9	\$2,983.3
2001	\$25,771.2	5.008%	2.924%	3.500%	\$22,313.4	\$3,457.7
2002	\$28,647.5	11.161%	1.427%	3.500%	\$23,094.4	\$5,553.1
		<b>6.066%</b>		<b>3.516%</b>		<b>\$16,426.3</b>

\*See enclosed spreadsheet for data sources and explanatory footnotes.

**Table 2. Simulated Impact Of Proposed Tax Expenditure Limitation Amendment on Ohio Local Government Expenditures\* (dollars in millions)**

Fiscal Year	Local government Expenditures Subject to TEL	Percentage increase in actual expenditures	Percentage increase in CPI + population	TEL allowable rate applied for annual budgeting	Budget limit under TEL beginning FY 1994	Difference
1992	\$15,383.4		3.704%			
1993	\$16,298.2		3.630%			
1994	\$17,071.8	4.746%	3.507%	3.630%	\$16,889.8	\$181.9
1995	\$18,412.0	7.851%	3.518%	3.507%	\$17,482.2	\$929.8
1996	\$19,553.8	6.201%	3.551%	3.518%	\$18,097.2	\$1,456.6
1997	\$19,592.2	0.196%	2.776%	3.551%	\$18,739.8	\$852.4
1998	\$20,775.2	6.039%	1.966%	3.500%	\$19,395.7	\$1,379.6
1999	\$22,160.6	6.668%	2.437%	3.500%	\$20,074.5	\$2,086.1
2000	\$23,566.5	6.344%	3.653%	3.500%	\$20,777.1	\$2,789.4
2001	\$25,135.0	6.655%	2.924%	3.653%	\$21,536.2	\$3,598.8
2002	\$26,703.4	6.655%	1.427%	3.500%	\$22,290.0	\$4,413.5
		<b>5.706%</b>		<b>3.540%</b>		<b>\$17,688.0</b>

\*See enclosed spreadsheet for data sources and explanatory footnotes.

**Summary**

If the proposed TEL amendment had been in effect from 1994 to 2002 it would have limited the rate of growth of state and local government spending. The magnitude of the difference between the actual expenditures and the simulated expenditure limits of the TEL would have been in the hundreds of millions of dollars in the initial years and in the billions of dollars after that.

In addition to the analysis here, a broader analysis could consider such topics as why state and local government expenditures grew at a higher rate than the CPI during the given time period, what goods and services are provided by state and local governments and how the inflation rates in the prices for these goods and services differ from the market basket of goods that is the basis of the CPI, whether the growth rate of state and local government expenditures have been impacted by federal mandates or by rulings of the judiciary, or what new priorities, demographic changes, or other economic contingencies have influenced the growth rates of state and local government expenditures. I hope that you will find the provided information helpful. If I can be of further assistance on these questions, please feel free to call me at 728-4815.

Enclosure: Simulated Impact of Proposed Tax Expenditure Limitation Amendment