COVID-19 & Ohio's K-12 Budget

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This OESCA Members Only Brief was created to provide the OESCA membership and educational stakeholders with some background and context on the broader economic and budgetary challenges related to the COVID-19 pandemic and its potential impact on state and local government and, in particular, primary and secondary education in Ohio. This brief is written in an abbreviated, bulleted fashion to provide a bottom-line oriented, *preliminary* analysis based on the latest publicly available data and will continue to evolve and be refined as more information become available.

Overview

In the past 3 weeks, the national and state economies have been put in an economic "time out" to combat the COVID-19 global pandemic and slow the spread of the virus. The effect has been an economic recoiling unlike anything previously experienced in both depth and breadth, which may have long lasting fiscal and psychological effects on Ohio and the nation. In just three weeks Ohio has lost more than 600,000 jobs – twice the amount lost over two years during the Great Recession. Early estimates suggest as much as a 30% contraction of the national economy in the second quarter of 2020 (April – June) accompanied by a 13% unemployment rate.

The duration of the current conditions, however, remains an open and critical question that hinges on the natural progress of COVID-19 and in containing and treating the virus. A premature re-opening of the economy before the pandemic has ended could exacerbate and thus extend the health crisis, but a delay beyond some critical point could risk permanent damage to the national and state economies, as businesses that once provided jobs may no longer exist to provide jobs for which former workers could return. Fortunately, according to the April 10, 2020, OBM monthly report, forecasters currently project an explosive rebound in the economy in the second half 2020 but still a large decline in real state GDP for the year.

Forecaster	Real GDP, annualized % change					
	20Q1	20Q2	20Q3	20Q4	2020 Q4/Q4	2021 Q4/Q4
IHS Markit (4/3)	-3.5%	-26.5%	-0.4%	+6.0%	-7.0%	+10.1%
CNBC Survey (4/6)	-5.0%	-27.0%	+14.0%	+10.0%	-3.4%	
Morgan Stanley (4/3)	-3.4%	-38.0%	+20.7%	+15.8%	-4.3%	+4.8%

OBM March 2020 Preliminary Revenue Estimates

The Office of Budget and Management released March 2020 revenue data on April 10, 2020.

- Total General Revenue Fund tax receipts finished the month $159.4 million (-10.5%) below estimate.
- Total fiscal-year-to-date tax receipts through March exceed estimate by $89.5 million (0.5%) and are $362.0 million (2.2%) over total tax receipts through the same period last fiscal year.
- March sales and use tax revenues missed estimates by 8.3 percent ($68.0 million, split between non-auto sales and use taxes which were $66.6 million below estimate and auto sales and use taxes which were $1.4 million below estimate). Because both sales tax categories performed above estimate through the end of February, fiscal year-to-date sales tax receipts continue to exceed fiscal year-to-date estimates by $77.4 million (1.0%).
- March income tax revenues missed estimates by 5.1 percent ($22.3 million). Fiscal year-to-date income tax receipts are below estimate by $39.9 million (-0.7%). Given the movement of the April 15 income tax filing deadline to July 15, OBM anticipates that April income tax revenues will miss the April estimates by a significant margin.

How Ohio Compares to Other States

So, how do Ohio's revenue numbers compare to other states? Looking at the *State Budget Watch Special Series* from the Center for Budget Policy Priorities, the 12 states reviewed anticipate total tax collection declines on average of 8% - 13%, with Michigan and New York anticipating losses of 16% and 17% in FY 2021 (on the high end). The impact for the remaining quarter of state fiscal year 2020 is more conservative (1-20%, average of 8%).

	FY 2020				FY 2021			
	Low Estimate		High Estimate		Low Estimate		High Estimate	
	$	%	$	%	$	%	$	%
Arkansas	$ 353,000,000.00	6%	$ 353,000,000.00	6%				
Colorado	$ 396,000,000.00	3%	$ 396,000,000.00	3%				
Michigan	**$ 1,000,000,000.00**	**4%**	**$ 3,000,000,000.00**	**12%**	**$ 1,000,000,000.00**	**4%**	**$ 4,000,000,000.00**	**16%**
Oklahoma	$ 219,000,000.00	3%	$ 219,000,000.00	3%	$ 250,000,000.00	4%	$ 500,000,000.00	7%
Vermont	$ 224,000,000.00	14%	$ 224,000,000.00	14%				
Alaska	$ 600,000,000.00	20%	$ 600,000,000.00	20%				
Colorado	$ 750,000,000.00	6%	$ 1,800,000,000.00	13%				
Hawaii	$ 319,000,000.00	4%	$ 319,000,000.00	4%				
Kentucky	$ 115,000,000.00	1%	$ 115,000,000.00	1%				
New Mexico					$ 1,500,000,000.00	20%	$ 2,000,000,000.00	27%
New York - Comptroller					**$ 4,000,000,000.00**	**5%**	**$ 7,000,000,000.00**	**8%**
New York - Budget Director					**$ 9,000,000,000.00**	**9%**	**$ 15,000,000,000.00**	**17%**
Virgina					$ 1,000,000,000.00	4%	$ 1,000,000,000.00	4%
Min	$ 115,000,000.00	1%	$ 115,000,000.00	1%	$ 250,000,000.00	4%	$ 500,000,000.00	4%
Max	$ 1,000,000,000.00	20%	$ 3,000,000,000.00	20%	$ 9,000,000,000.00	20%	$ 15,000,000,000.00	27%
Mean	**$ 441,777,777.78**	**7%**	**$ 780,666,666.67**	**8%**	**$ 2,791,666,666.67**	**8%**	**$ 4,916,666,666.67**	**13%**
Median	$ 353,000,000.00	4%	$ 353,000,000.00	6%	$ 1,250,000,000.00	5%	$ 3,000,000,000.00	12%

Conversations with educational service agency representatives in other states reveal similar patterns.

<u>What Can We Learn from the Past?</u>

While we are in unchartered territories, it may be worth also looking back on previous recessionary periods to get a sense of perspective. To follow are a few data points from the Great Recession:

- State sales tax collections went down in 2009 by -6.83%.
- State personal income tax receipts dropped by -15.48% (the overall 2-year decline was -19.92% comparing 2008-2010).
- The sales tax only had an initial 1-year decline and then began to go back up.
- Income tax collections dropped again in 2010 before beginning to rise again.
- Sales tax collections were back to 2008 pre-recession levels by 2012, 1 year before overall tax collections.
- The unemployment rate, which hit its peak at 10.3% in October 2009, was finally back to 2007 pre-recession highs by 2014.

<u>FY 2020 – FY 2021 Revenue Estimates: How big might the budget hole be?</u>

Based on early revenue estimate projections, Governor DeWine ordered state agency directors to review their agency budgets and provide recommendations for cuts of up to 20% for both 4th quarter FY 2020 and for FY 2021. To get a sense of perspective on what a 20% decline in state revenue would approximate and how the state might fill that gap with 20% cuts, it is a helpful to look at estimated tax receipts for FY 2020-2021.

- According to the LSC Budget in Brief, estimated GRF Tax Receipts for FY 2020 were $23,725,900,000.00.
    - That leaves an estimated $5,931,475 remaining in the fourth quarter. ***A 20% decline in revenue from GRF tax receipts would equal approximately $1,186,295,000.***

- Estimated GRF tax receipts for FY 2021 were $24,326,300,000.00.
    - ***A 20% decline in FY 2021 tax receipts would results in a loss of $4,865,260,000.00 or $1,216,315,000.00 per quarter.***

- ***A 20% reduction of GRF tax receipts in both the 4th quarter of FY 2020 and in the 1st quarter of FY 2021 combined would equal a loss of approximately $2,402,610,000 through the next two quarters.***

Given that the forecasts referenced above anticipate signs of economic recovery beginning in the third quarter of calendar year 2020, ***this analysis assumes a state budget hole of approximately $2.4 billion***. This does not account for losses to local governments as a result of decline in local tax revenue collections. Assuming a lagging economic recovery through the fourth quarter of calendar year 2020, this number is likely to grow.

Possible Budget Balancing Tools/Scenarios

Closing the projected budget gap will minimally require a combination of budget cuts and transferring funding from the state budget stabilization fund. A review of this follows below.

- The Budget Stabilization Fund or "Rainy Day Fund" currently stands at ***$2,691,554,191***. H.B. 197, Section 36, allows the Director of OBM to request approval from Controlling Board for a transfer of cash from the Rainy Day Fund to the GRF to ensure available revenue balances are not less than expenditures for FY 2020.

- An across the board 20% cut would generate approximately $1.197 billion savings in the remaining quarter of FY 2020. A 20% across the board cut for FY 2021 would produce $4.947 billion ($1.236 billion per quarter). However, this is unlikely and ignores practical and political realities. More targeted funding cuts are the realistic approach. And, perhaps, the complete elimination or zeroing out of non-essential earmarks.

- The likelihood is that ***certain budgetary priorities will likely either be exempt from cuts or cut at a lesser rate***. After certain exemptions (see below), A 1% cut to FY 2020 GRF appropriations generates approximately $88.80 million ($22.2 million in the 4th quarter). Likewise, a 1% cut to FY 2021 GRF appropriations generates approximately ***$90.67 million***. These numbers are after exempting the appropriation areas below. ***A 20% reduction in non-exempt areas would produce $444,000,000 in FY 2020 and $1,813,400,000 in FY 2021*** *(approx. $453,350,000 per quarter)**.***
  - Property Tax Reimbursement
  - Debt Service
  - Foundation Aid
  - Student Wellness and Success funding
  - Medicaid
  - TANF/Cash Assistance
  - Local Government Fund
  - Department of Health (though probably not necessary to spare entire DOH budget)

In order to meet anticipated needs, and not completely deplete the state's rainy-day fund, it is likely that ***a state response will include both rainy day fund transfers and budget cuts***. It may likely also necessitate otherwise unpopular ***tax increases***. While this reality may be politically unpopular it may be unavoidable. Additionally, consideration may be given to ***statewide bond initiatives and infrastructure projects*** like water, sewers, and highways aimed at getting people back to work; policy makers will have to weigh these options against raising the state's debt limit that currently stands at 3.98% (Ohio has a 5% constitutional debt ceiling (percent of GRF revenues and net lottery profits)). Lastly, the states will need to seek ***continued and increased federal assistance***. Each of these strategies could be implemented in a ***staged approach through multiple budget corrective measures with targeted cuts*** – perhaps even quarterly - as the coronavirus and related economic outcomes continue to evolve and reveal themselves. Other states are exploring, for example, a 6-month budget that might allow for one or both of the following: 1) buying some time to realize the true fiscal impact of the pandemic so they can come back in the fall and adjust; and/or 2) passing tax increases after the November election during the lame duck session if necessary. The longer the state waits to make budget adjustments the deeper and more painful the cuts will be on an annualized basis to meet the balanced budget requirement in the state constitution. State budget officials will need to consider the efficacy of this approach.

CARES Act

To date, Congress has passed three stimulus packages to address the pandemic. The largest of these efforts was the $2.3 Trillion Coronavirus Aid, Relief and Economic Security (CARES) Act. The CARES Act should not be thought of as fiscal stimulus but rather as an economic stabilization package. Most of the provisions of the Acts were designed to prevent the private sector from unraveling. More is likely needed to assist state and local governments.

- Ohio is set to receive a total of ***$6,642,141,000*** in stimulus funding. There are specific conditions to these funds to address disruptions specific the COVID-19 virus. They are not designed to replace lost revenue as a result of declines in state revenue.
    - Funding for the Coronavirus Relief fund equals $4,532,572,911.85.
        - $155,829,856.71 will go to the city of Columbus.
        - The remaining $***4,376,743,055*** goes to the state for the remaining local political subdivisions. Guidance has not yet been released.
    - ***$105,212,000*** goes to the Governor's Fund for Education
    - ***$489,205,000*** goes to a K-12 education fund and is distributed using the Title 1 formula allocation
        - Recipients must continue to pay employees and contractors during the period of any disruptions or closures related to coronavirus, if possible.
        - States receiving the Governor's or K-12 funds must maintain funding for elementary and secondary and higher education programs at least at the average of the state's funding in the last three years.
    - $404,422,000 goes to higher education
        - Can be used for costs associated with significant changes to the delivery of instruction due to the coronavirus. At least 50% to provide emergency financial aid grants to students for expenses related t to the disruption of campus operations (food, housing, healthcare, childcare)

Sec.18006 of the federal CARES Act (H.R. 748) requires LEAs to, *the greatest extent practicable*, continue to pay employees and contractors like ESCs and other educational service providers. This goal of maintaining continuity of service and stability for employees is also echoed in agency guidance like the federal Office of Head Start that has directed programs to "*continue to pay wages and provide benefits for staff unable to report to work during center closures necessary to address COVID-19.…This additional emergency response flexibility is important to ensure critical grants management activities can continue during closures. It will help ensure staff are ready and able to return to work as soon as it is possible to resume operations."* This is consistent with state law including but not limited to 3319.08(B) and 3319.081(G) of the Ohio Revised Code.

Again, it is important to look at previous federal responses to provide some context. ARRA Stimulus Funding during the Great Recession provide direct funding for Education of $77 Billion:

- $40 billion in state stabilization funds to help avert education cuts.
- $13 billion for Title I, including $3 billion for Title I school improvement programs.
- $12 billion for IDEA.
- $5 billion in incentive grants to be distributed on a competitive basis to states that most aggressively pursue higher standards, quality assessments, robust data systems and teacher quality initiatives.
- $5 billion for Early Childhood, including Head Start, early Head Start, childcare block grants, and programs for infants with disabilities (Includes HHS programs).
- $2 billion for other education investments, including pay for performance, data systems, teacher quality investments, technology grants, vocational rehab, work study, and Impact Aid.

Additional funding was provided in 2010 bringing total K-12 funding to approximately $100 Billion during the Great Recession. Congress is currently considering a "CARES 2" Act with an estimated $250 billion more in funding for state and local government including schools. National education organizations representing administrators and teachers are advocating for an additional $175 billion in funding for education. Likewise, the Nation's Governors led by Larry Hogan,

R-Md and Andre Cuomo, D-NY are calling for Congress to approve $500 billion in direct aid to states. Arguably, the federal government must do more to support state and local governments. How much, is the billion-dollar question. There will undoubtedly be disagreements between parties about what this looks like and concerns about how much more the federal government can borrow given the national debt now stands at approximately 113% of U.S. Gross Domestic Product (GDP).

Conclusion

This represents an initial overview and analysis of the broader, macro-level indicators that could impact the state of Ohio operating budget and related funding of state and local government activities including, but not limited to, primary and secondary education. The state fiscal situation will become clearer as the fourth quarter of state fiscal year 2020 evolves. Importantly, ***no cuts have yet to be announced at this time and organizational leaders should consider all relevant factors prior to make decisions up to and including state and federal funding guidelines***. Cuts are expected to be announced before the end of April.

It is important to note the state lawmakers have continued to emphasize the importance of protecting K-12 education to the degree possible. Additionally, school district leaders should recognize conditions for federal education funding create limitations on how much K-12 and higher education can be cut by states. Funding cannot be less than the average of the 3 previous years. In Ohio, that could mean ***K-12 would be reduced approximately 2.5% in FY 2020 and 2% in FY 2021 (based on a 3-year average of all K-12 funding less property tax rollbacks). However, if only looking at foundation aid (GRF, State Lottery Funds and Student Wellness and Success), funding could be reduced 5% in FY 2020 and 4% in FY 2021***. ***This latter methodology is consistent with the fact that 20% of remaining subsidy payments to Districts, ESCs and CTCs is just south of $ 500 million or, when annualized about, 4.5% of the line item appropriations. These limits can be overridden by a waiver from the U.S. Secretary of Education*** by application though such a move would undoubtedly be met with considerable public scrutiny. ***It is important to note that these ranges are approximate and based on certain assumptions using currently available information***; as such, they can be used to assist in planning but are somewhat speculative until final guidance is provided to the states.

Ultimately, the pandemic is forcing a difficult conversation among public health experts and economists and state budget analysts: how do we address the tradeoffs between promoting public safety and preventing mass unemployment? And what should we do if medical shortages arise and there isn't enough life-saving equipment to care for everyone who becomes sick? And, importantly, when is it safe to reopen our schools and to we continue to provide quality instructional and related support to all students in the interim and for the duration. These stark realities should put things into perspective for those effected by state budget decisions. And those conversations will begin sooner rather than later as Governor DeWine, aligned with the Trump Administration guidelines, announced on April 16, 2020, that business re-openings in Ohio will gradually begin with a phased-in approach starting May 1, 2020. What this means for K-12 education has yet to be announced.

OESCA will continue to monitor and report to the membership to support ESC decision making, operations and services to client school districts through the state of Ohio.

Sources:

- LSC Am. Sub. H.B. 166 (FY 2020-2021) Budget in Brief
- OBM Monthly Report, April 10, 2020
- Center on Budget and Policy Priorities, State Budget Watch Special Series
- Federal Funds Information for States, Budget Brief 20-14, April 9, 2020
- The American Recovery and Reinvestment Act of 2009: Education Jobs and Reform February 18, 2009, U.S. Department of Education