THE WALL STREET JOURNAL.
WSJ.com

REVIEW & OUTLOOK
JULY 7, 2011

The Buckeye Budget Lesson

Ohio cuts spending and taxes—and still balances the books.

The reform-minded GOP Governors across the upper Midwest have sustained a lot of political damage lately, but at least they're delivering on their campaign promises and will be judged on the results. The latest is Ohio's John Kasich, who signed an ambitious budget late last week that will help the Buckeye State's economy and finances.

Mr. Kasich took office this year facing the largest deficit in Ohio history, close to $7.7 billion. His predecessor, Democrat Ted Strickland, had avoided any serious reform in advance of the 2010 election, despite a shrinking economy and tax base, and had concealed fiscal holes with federal stimulus dollars that have now run out. To close the gap with revenue alone, the Ohio tax department estimated that income rates for the average family would need to rise 56%.

Mr. Kasich's budget is bringing Ohio's finances into balance by cutting spending while also cutting taxes, which ought to be a lesson for Washington. The $55.8 billion two-year budget pares from nearly every state program and agency, and it privatizes some of them, including some prisons and maybe even the Ohio Turnpike, if the legislature approves. It restores a scheduled cut in the top income tax rate to 5.9% from 6.2%—part of a larger across-the-board cut over five years that Mr. Strickland deferred. And it eliminates Ohio's estate tax and cuts property taxes by $1.7 billion.

A particular achievement is reforming Medicaid, which covers one of seven Ohioans and makes up nearly a third of state spending. The stimulus and ObamaCare imposed severe "maintenance of effort" mandates on states that make the program far less flexible, but Mr. Kasich's plan will slow the program's projected 8% spending growth to 4%, well below the national average. Major savings come from redirecting subsidies to community-based care from the nursing home industry, which is politically powerful in Columbus.

Over the last decade only Michigan and California have lost more jobs than Ohio, party because of manufacturing decline but also because of a tax code that promotes capital (and investor) flight. The budget includes a tax credit equal to 10% of long-term investments in Ohio-based small businesses, those below $50 million in assets or $10 million in sales. Mr. Kasich's budget director Tim Keen describes this "Invest Ohio" fillip as an interim measure to end a capital strike amid a larger effort to reduce business costs and government drag on the economy.

Reductions in the overall tax burden would be cleaner and more efficient, and one challenge for Mr. Kasich will be bringing down Ohio's top marginal, corporate and local rates, which still add up to a much higher tax burden than surrounding states like Indiana, Kentucky and even Michigan. Still, it wouldn't be the worst thing if regional governors like the Wolverine State's Rick Snyder and Wisconsin's Scott Walker got into a jobs race akin to this year's collective bargaining reforms.

Mr. Kasich's approval ratings have fallen sharply as he's pursued budget and labor change, though challenging the status quo is always disruptive. On the other hand, voters didn't reward Mr. Strickland for making the problem worse by doing nothing.