# Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE — OCTOBER, 1996

*Volume 29, Number 3*

*STATUS OF THE GRF*



*(continued on next page)*

## *FISCAL OVERVIEW*

*— Frederick Church*

After the August shortfall, tax revenues bounced back in September, finishing the month $32.6 million above estimate.[1] This put first quarter taxes $28.1 million over estimate, and up 6.1 percent from last year. Readers with long memories may recall that last year's first quarter performance was much weaker, with tax revenue growth of only 4.4 percent, and a small shortfall from the estimate. The first quarter this year was a marked improvement.

To what can the state attribute its good fortune? The two taxes that had the biggest shortfalls through August — the personal income tax and the non-auto sales and use tax — posted the biggest overages in September. The income tax was $21.1 million over estimate, and the non-auto sales tax was $10.1 million over estimate. The income tax now has the biggest year-to-date overage, at $16.9 million.

On the non-tax revenue side, there are two developments of interest. Investment earnings are $5.6 million above estimate after one quarter. Even after the transfer of GRF money to the Income Tax Reduction Fund (ITRF) to pay for income tax rate reduction, GRF balances have been somewhat higher than even the revised estimate anticipated (see Table 1, below, for the difference in unobligated balances from last year). Interest rates have also been somewhat higher than the admittedly conservative forecast. On the down side, federal reimbursement is $58.9 million below estimate. The shortfall is still a little bigger than the underspending on welfare programs would lead one to expect. Part of the explanation is that OBM reduced its estimate of welfare spending slightly, but did not reduce the federal reimbursement estimate correspondingly. However, there may also be other factors at work.

Spending in September was well below estimate, as it has been for the first quarter. Year to date disbursements are now $151.3 million bellow estimate (excluding transfers). Almost every category of expenditure is below estimate; if not for a big overage in property tax relief ($58.9 million), the spending variance would be huge. The aggregated categories — welfare, education, government operations — are all below estimate by 4 percent to 7.4 percent. Aggregate spending growth (again excluding inter-fund transfers) is only 2.0 percent, well below the budgeted 5.3 percent.

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Budget Footnotes is issued monthly by the Legislative Budget Office (LBO), a non-partisan fiscal research agency serving the Ohio General Assembly.

Budget Footnotes examines the fiscal position of the state GRF on a monthly basis. Each issue also cotains summaries of Controlling Board actions that have policy implications, and articles on fiscal issues of current interest.



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**TABLE 1**

| | Month of September | Fiscal Year 1997 to Date | Last Year | Difference |
|---|---|---|---|---|
| Beginning Cash Balance | $38.9 | $1,138.5 | | |
| Revenue + Transfers | $1,349.4 | $3,653.2 | | |
| Available Resources | $1,388.3 | $4,791.7 | | |
| Disbursements + Transfers | $1,723.1 | $5,126.5 | | |
| **Ending Cash Balances** | **($334.8)** | **($334.8)** | **($538.0)** | **$203.3** |
| Encumbrances and Accts. Payable | | $517.3 | $508.4 | $8.8 |
| **Unobligated Balance** | | **($852.1)** | **($1,046.5)** | **$194.4** |
| BSF Balance | | $828.3 | $828.3 | |
| **Combined GRF and BSF Balance** | | **($23.8)** | **($218.2)** | **$194.4** |

Looking at total outlays, the biggest difference between FY 1997 and last year is in transfers out of the GRF. Last year, the GRF made $858.2 million in transfers in July: $535.2 million to the Budget Stabilization Fund (BSF) to meet the 5 percent balance target, and $311.0 million to a variety of other purposes. This year, the GRF transfers have been reduced by over $300 million. Last year's big surplus went to beefing up the BSF and helping school districts; this year's surplus was used to provide a big personal income tax cut to Ohio taxpayers. Of the $405.2 million transferred out of the GRF in July, $400.8 million went to the newly created Income Tax Reduction Fund (ITRF). Almost all of the $131.5 million transfer last month was for SchoolNet Plus ($100 million) and the State Infrastructure Bank ($30 million), as authorized in the recent budget correction bill (S.B. 310 of the 121st General Assembly).

Owing to the fact that fewer transfers have been made from the GRF this year, the unobligated GRF balance is $194.4 million larger this year. Since the BSF is unchanged — no new transfers, and its interest earnings are being diverted elsewhere — the change in the combined GRF and BSF balance is identical to the change in the GRF balance. "

# TRACKING THE ECONOMY

*— Frederick Church*

U.S. economic growth in the second quarter was revised downward slightly, from 4.8 percent to 4.7 percent. More importantly, the current data seem to show that the Federal Reserve may have guessed right on their forecasts for real growth and inflation. Real growth in the third quarter has slowed, and there doesn't seem to be an increase in inflation or in inflationary pressure. The U.S. unemployment rate rose slightly in September, increasing from 5.1 percent to 5.2 percent, and payroll employment actually fell by 40,000 jobs. Consumer spending was weak in the third quarter, as retail sales increased by only 0.1 percent, after an increase of 1.2 percent in the second quarter. September sales increased sharply, rising 0.7 percent, with auto sales leading the way (non-auto sales increased by 0.4 percent), but August sales were revised downward. After the initial report showed a 0.2 percent increase in August, the revised report showed a 0.2 percent decrease.

On the price front, the producer price index (PPI) rose by only 0.2 percent in September, down slightly from the 0.3 percent increase in August. Price increases for both finished goods and intermediate goods continued to be restrained. Finally, the Consumer Price Index (CPI) increased by only 0.3 percent in September. For the 12 month period ending in September, the CPI increased by 3.0 percent; excluding food and energy (the so-called core rate) the increase was only 2.7 percent.

The one ominous bit of news that we have found on the inflation front comes from the Cleveland Federal Reserve Bank. While acknowledging that inflation has slowed in the last few months after accelerating for the first five months of CY 1996, the Cleveland Fed finds that inflationary expectations of households are beginning to rise.[2] If greater inflationary expectations lead to higher wage demands, higher enough that unit labor costs rise, then there will be additional upward pressure on retail prices, and output price inflation could accelerate. Interestingly, retail price inflation, as measured by the CPI, has been running ahead of wholesale price inflation, as measured by the PPI, by about one percent for CY 1996 to date.

### *NAIRU News*

Over the last few months, LBO has devoted a lot of space in this report to discussions of unemployment, wage inflation, and price inflation, with an emphasis on where the U.S. unemployment rate is with respect to the NAIRU and what implications that has. (The NAIRU, or "non-accelerating inflation rate of unemployment," is also known as the natural rate of unemployment, or full employment.) This month, we take a brief detour and examine some relatively recent labor market studies, and then speculate briefly about what their results might indicate about the NAIRU and the current U.S. unemployment rate.

A recent Urban Institute study using the Panel Study of Income Dynamics (PSID), which tracks a sample (or panel) of individuals over time, found that job security in the U.S. has declined somewhat in recent years (unfortunately, their data only goes through 1993). Specifically, the Urban Institute researchers found that[3]:

1. The rate of permanent job loss in 1993 was much higher than one would have predicted from its historical relationship with the unemployment rate, where the historical comparison begins in 1968;

2. A much higher proportion of the increase in unemployment in the early 1990s was due to permanent job loss, as compared to the previous two decades. In the three major recessions from 1970 to 1989, increases in the number of permanent job losers accounted for an average of 46 percent of the overall increases in the national unemployment rate. In the 1990-1991 recession, increases in permanent job loss accounted for 70 percent of the increase in the unemployment rate.

3. There has been a slow upward movement in the rate of permanent job loss. In 1993, permanent job losers were just under 3 percent of the labor force[4]. The rate of loss has increased by 0.1 percent every five years, holding the unemployment rate constant.

The study says that the upward trend in permanent job loss is relatively recent, but if continued, "would suggest that there has ... been some structural change in the labor market."

Another recent study by Henry Farber (Princeton University economist) using data from the Current Population Survey (CPS) Dislocated Workers Supplement finds that the overall rate of job displacement — involuntary job loss due to plant closing, elimination of shifts or positions, etc. — is slightly higher in the 1990s even than it was in the deep recession of the early 1980s. Furthermore, the study finds that, although the rate of displacement is still higher among less educated, blue-collar workers, job displacement has been rising among better educated, older, white-collar workers. The gap between blue-collar workers and white-collar workers narrowed in the 10 years between 1981-82 and 1991-92.

Has there been a structural change in the labor market? The reflex response might be that increases in permanent job loss would increase the structural unemployment rate, and thus increase the NAIRU. This would make the current U.S. experience with low unemployment rates and no outward signs of accelerating inflation even more puzzling. However, a closer look at other studies suggests that the reflex response would be misleading.

First, a study by Jennifer Gardner of the U.S. Bureau of Labor Statistics (BLS) finds that, although the rate of permanent job loss or job displacement has increased in the early 1990s, the rate of re-employment of displaced workers has also increased.[5] This may be tied to the fact that displacement has increased among better educated, white-collar workers, who have more flexible skills that can be more easily adapted to changing jobs and careers than less educated, blue-collar workers. This point is reinforced by recent analysis done by the Cleveland Federal Reserve Bank. The studies referred to earlier did not have access to the 1996 Displaced Worker Survey, covering 1993-1995. The Cleveland Fed work does have access to that survey, and it found "the highest re-employment rates since the survey began." [6]

Another study released this April by the President's Council of Economic Advisors makes a somewhat different point.[7] Because the most recent Displaced Worker Survey was from 1994, covering data from 1991-1993, there were no official displacement statistics after 1993 to show whether job loss was slowing down with better economic conditions. As a proxy for displacement, the Council used CPS data on recently unemployed job losers: persons unemployed less than 5 weeks, unemployed due to job loss (as opposed to voluntary quits or new labor market entrants), and not on temporary layoff. The Council then computed the ratio of job loss to total employment over the entire 1976-1996 period. Like the displacement data, this ratio shows a spike in the early 1990s (although unlike the displacement data, it does not show the job loss rate as being as high as in the early 1980s). However, this measure of job loss falls continuously after 1992. If this measure is accurate, then instead of a permanent structural change in the labor market, the experience of the early 1990s may have been just a one-time restructuring.

So what? Despite the fact that the data on worker displacement may at first glance suggest structural labor market changes in the 1990s that would point toward a higher NAIRU, a closer examination of the data casts doubt on that interpretation. While this says nothing about where the NAIRU currently is, it weakens the argument of some analysts that the NAIRU must be higher than the current unemployment rate because of the structural unemployment in the U.S. that is the result of industry restructuring.

One more point remains to made about the relationship between the NAIRU and inflation. There are models of price inflation that define the acceleration of inflation (the rate of change of the rate of change of prices) as a function of the gap between the NAIRU and the current unemployment rate and how long that gap persists (DRI has such a model). A recent paper by Staiger, Stock, and Watson (SSW) casts some doubt on this type of model, or at least on a forecaster's ability to use such a model to predict future inflation.[8] SSW find that all the usual methods of estimating the NAIRU, with extensions, show that the NAIRU is very imprecisely estimated: a 95 percent confidence interval can be as big as 2 to 3 percentage points. A model that predicts changes in the inflation rate based on the difference between the NAIRU and the current unemployment rate will produce very different results if the NAIRU is 5 percent as opposed to 7 percent. If the NAIRU is 5 percent, then the current unemployment rate is above the NAIRU, and inflation should remain constant or fall. If the NAIRU is 7 percent, then the current unemployment rate is much lower, and inflation can be expected to shoot upward. The SSW finding is that a 95 percent confidence interval for the NAIRU covers the range from 5 percent to 7 percent, so that any model that predicted inflation based on the "NAIRU gap" would really be unable to predict the direction of inflation at this time. Of course, since DRI is using a point estimate of the NAIRU rather than the whole confidence interval, they are able to generate predictions, but these predictions are subject to very large uncertainty.

# Status of the General Revenue Fund

## REVENUES

— Frederick Church

Tax revenue was $32.6 million over estimate in September, erasing the existing year-to-date shortfall and leaving a $28.1 million overage in its place. The taxes that were farthest below estimate after the end of August, the personal income tax and the non-auto sales and use tax, had the biggest overages in September. As a result, the income tax now has the biggest overage for the year, at $16.9 million.

Although the non-auto tax had a big overage in September, the auto sales tax still has a bigger overage for the first quarter. The outlook for the auto sales tax is still good. The performance of the non-auto tax is rather surprising given the weak national retail sales and consumer spending numbers for the third quarter.

The cigarette tax has picked back up: the first quarter overage was $5.3 million, and growth from last year topped 10 percent. Ohio may still be picking up cross-border sales from Michigan. The overage in the foreign insurance tax and the shortfall in the estate tax are probably strictly timing matters.

**Table 2**
General Revenue Fund Income
Actual vs. Estimate

**Month of September, 1996**
($ in thousands)

| REVENUE SOURCE | | | |
|---|---|---|---|
| *TAX INCOME* | Actual | Estimate* | Variance |
| Auto Sales | $55,818 | $55,662 | $156 |
| Non-Auto Sales & Use | 351,022 | 340,920 | 10,102 |
| Total Sales | $406,840 | $396,582 | $10,258 |
| Personal Income | $526,995 | $505,900 | $21,095 |
| Corporate Franchise | 8,971 | 7,994 | 977 |
| Public Utility | 13 | 0 | 13 |
| **Total Major Taxes** | **$942,819** | **$910,476** | **$32,343** |
| Foreign Insurance | $7,131 | $1,595 | $5,536 |
| Domestic Insurance | 0 | 0 | 0 |
| Business & Property | 48 | 90 | (42) |
| Cigarette | 25,884 | 23,320 | 2,564 |
| Soft Drink | 0 | 0 | 0 |
| Alcoholic Beverage | 4,430 | 4,317 | 112 |
| Liquor Gallonage | 2,372 | 2,255 | 117 |
| Estate | 0 | 8,075 | (8,075) |
| Racing | 0 | 0 | 0 |
| Total Other Taxes | $39,865 | $39,652 | $212 |
| **Total Taxes** | **$982,683** | **$950,128** | **$32,555** |
| *NON-TAX INCOME* | | | |
| Earnings on Investments | $30,019 | $24,375 | $5,644 |
| Licenses and Fees | 1,285 | 1,950 | (665) |
| Other Income | 6,727 | 6,825 | (98) |
| Non-Tax Receipts | $38,032 | $33,150 | $4,882 |
| *TRANSFERS* | | | |
| Liquor Transfers | $6,000 | $5,000 | $1,000 |
| Budget Stabilization | 0 | 0 | 0 |
| Other Transfers In | 0 | 0 | 0 |
| Total Transfers In | $6,000 | $5,000 | $1,000 |
| **TOTAL INCOME less Federal Grants** | **$1,026,715** | **$988,278** | **$38,437** |
| Federal Grants | $322,670 | $317,917 | $4,753 |
| **TOTAL GRF INCOME** | **$1,349,386** | **$1,306,195** | **$43,191** |

* July, 1996 estimates of the Office of Budget and Management.

*Detail may not add to total due to rounding.*

On the non-tax side, the first quarter overage in investment earnings just offsets the shortfalls in licenses and fees and other income. Although federal reimbursement was over estimate in September, it still shows a big shortfall ($58.9 million) for the year. The September overage was due to a one-time reimbursement under the disproportionate share hospital program (the old HCAP program). The payment was to public psychiatric hospitals, for indigent care services.

### *Sales and Use Tax*

After falling slightly below the estimate in the first two months of FY 1997, the non-auto sales tax roared back in September. Not only was revenue $10.1 million above estimate, but it was also up 6.9 percent from the same month last year. However, for the first quarter as a whole, non-auto tax collections are very close to the mark, at $3.7 million over estimate (a forecast error of only 0.3 percent). Growth for the first quarter is a very modest 4.2 percent.

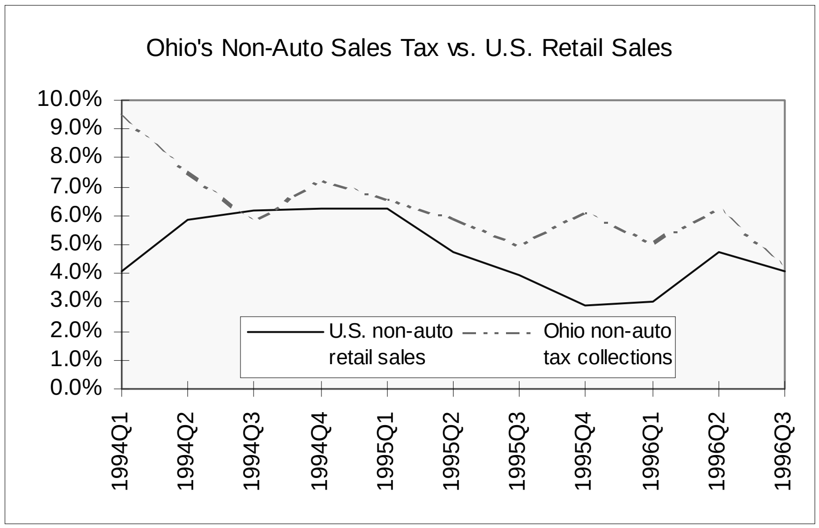
Basically, when one looks at the quarterly data, instead of the monthly data, Ohio's non-auto sales and use tax performance for the third quarter of 1996 (in terms of year -over-year growth) fits very closely with the U.S. non-auto retail sales data. This should be clear from the chart above, which compares Ohio non-auto sales tax growth with U.S. retail sales growth over the last 11 quarters. U.S. retail sales are lagged one month to account for the fact that monthly Ohio non-auto tax collections are based on prior month retail activity.

Unfortunately, LBO doesn't have much regional information that is different than in last month's report. The next Federal Reserve System ***Beige Book*** summary is not due out until October 30th.

The auto sales tax continues to hum along. The tax is $5.1 million over estimate, and up 7.6 percent

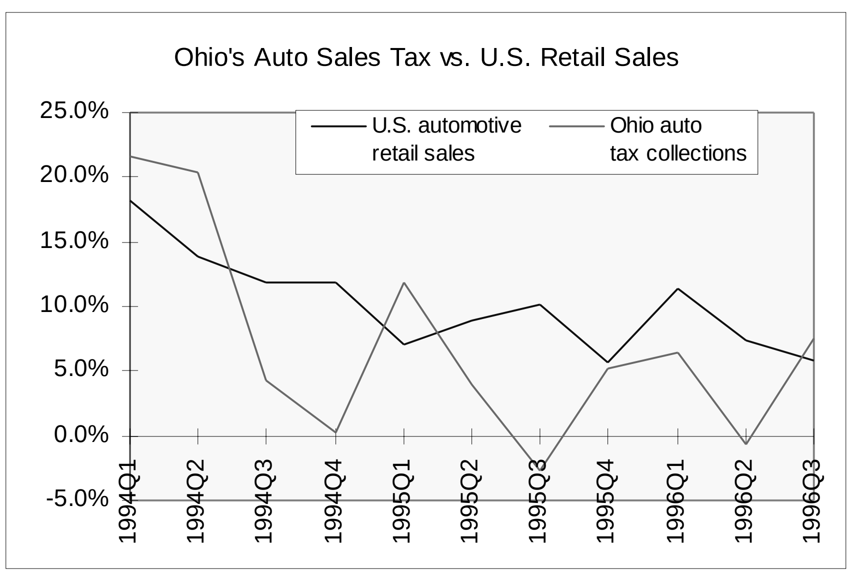
Comparison of U.S. Retail Sales With Ohio Tax Collections, by Quarter
*Year-Over-Year Changes*

| | U.S. non-auto retail sales | Ohio non-auto tax collections |
|---|---|---|
| 1994Q1 | 4.1% | 9.5% |
| 1994Q2 | 5.9% | 7.5% |
| 1994Q3 | 6.2% | 5.8% |
| 1994Q4 | 6.3% | 7.2% |
| 1995Q1 | 6.2% | 6.6% |
| 1995Q2 | 4.8% | 5.9% |
| 1995Q3 | 4.0% | 5.0% |
| 1995Q4 | 2.9% | 6.1% |
| 1996Q1 | 3.0% | 5.0% |
| 1996Q2 | 4.7% | 6.3% |
| 1996Q3 | 4.0% | 4.2% |




Comparison of U.S. Retail Sales With Ohio Tax Collections, by Quarter
*Year-Over-Year Changes*

| | U.S. automotive retail sales | Ohio auto tax collections |
|---|---|---|
| 1994Q1 | 18.2% | 21.6% |
| 1994Q2 | 13.9% | 20.4% |
| 1994Q3 | 11.9% | 4.2% |
| 1994Q4 | 11.8% | 0.3% |
| 1995Q1 | 7.1% | 11.9% |
| 1995Q2 | 9.0% | 3.9% |
| 1995Q3 | 10.1% | -2.6% |
| 1995Q4 | 5.7% | 5.2% |
| 1996Q1 | 11.4% | 6.5% |
| 1996Q2 | 7.4% | -0.7% |
| 1996Q3 | 5.8% | 7.6% |



from last year (fiscal year). U.S. auto sales through September (calendar year) were 11.58 million units, up 3.2 percent from last year. At this rate, auto sales for CY 1996 will finish at around 15.1 million units, up from CY 1995's 14.75 million. At the beginning of the year, many analysts had expected flat sales in CY 1996, so it looks like sales will easily beat that forecast. Most forecasts of CY 1997 sales are slightly weaker, around 14.9 million units. Nevertheless, if these forecasts hold, Ohio should be able to meet the auto sales tax estimate, since even OBM's revised estimate only calls for 1.5 percent growth (the original estimate actually allowed for a 0.7 percent decrease).

As one can see from the chart on the previous page (Ohio's Auto Sales Tax vs. U.S. Retail Sales), over the last 11 quarters Ohio auto sales tax growth has been much more volatile than non-auto sales tax growth, as one would expect given the nature of durable goods generally and automobiles in particular. Also, the correspondence between growth in the auto sales tax and growth in U.S. retail sales has been much weaker than on the non-auto side. Ohio may have simply diverged from the nation in its auto purchasing patterns, but this may also be partly the result of timing problems in county remittances of auto sales tax to the state. The fact that auto leasing is counted in the non-auto sales tax is also probably a factor in explaining why Ohio auto tax growth was less than one would expect based on U.S. sales data from 1995:2 through 1996:2, while over the same period Ohio non-auto tax growth was more than the sales data would suggest.

**Table 3**
General Revenue Fund Income
Actual vs. Estimate

**Fiscal Year-to-Date 1997**
($ in thousands)

| **REVENUE SOURCE** | | | | | |
|---|---|---|---|---|---|
| *TAX INCOME* | Actual | Estimate* | Variance | FY 1996 | Percent Change |
| Auto Sales | $187,669 | $182,597 | **$5,072** | $174,444 | 7.58% |
| Non-Auto Sales & Use | 1,069,048 | 1,065,375 | **3,673** | 1,025,552 | 4.24% |
| Total Sales | $1,256,717 | $1,247,972 | **$8,746** | $1,199,996 | 4.73% |
| Personal Income | $1,292,004 | $1,275,100 | $16,904 | $1,198,456 | 7.81% |
| Corporate Franchise | 19,594 | 21,127 | (1,533) | 20,334 | -3.64% |
| Public Utility | 37 | 0 | 37 | 2 | 1750.00% |
| Total Major Taxes | $2,568,352 | $2,544,199 | $24,154 | $2,418,788 | 6.18% |
| Foreign Insurance | $7,413 | $1,595 | $5,818 | $464 | 1497.53% |
| Domestic Insurance | 200 | 0 | 200 | 74 | 170.27% |
| Business & Property | 891 | 1,305 | (414) | 1,631 | -45.37% |
| Cigarette | 65,657 | 60,341 | 5,316 | 59,240 | 10.83% |
| Soft Drink | 0 | 0 | 0 | 1 | -76.92% |
| Alcoholic Beverage | 14,571 | 13,805 | 767 | 14,057 | 3.66% |
| Liquor Gallonage | 6,764 | 6,738 | 26 | 6,703 | 0.91% |
| Estate | 309 | 8,075 | (7,767) | 9,932 | -96.89% |
| Racing | 0 | 0 | 0 | 0 | #N/A |
| Total Other Taxes | $95,804 | $91,858 | $3,946 | $92,101 | 4.02% |
| **Total Taxes** | **$2,664,157** | **$2,636,057** | **$28,100** | **$2,510,890** | **6.10%** |
| *NON -TAX INCOME* | | | | | |
| Earnings on Investments | $30,019 | $24,375 | $5,644 | $23,204 | 29.37% |
| Licenses and Fees | 9,056 | 10,075 | (1,019) | 9,017 | 0.44% |
| Other Income | 19,025 | 23,625 | (4,600) | 28,024 | -32.11% |
| Non-Tax Receipts | $58,101 | $58,075 | $26 | $60,245 | -3.56% |
| *TRANSFERS* | | | | | |
| Liquor Transfers | $12,500 | $10,000 | $2,500 | $9,500 | 31.58% |
| Budget Stabilization | 0 | 0 | 0 | 0 | #N/A |
| Other Transfers In | 64 | 0 | 64 | 0 | #N/A |
| Total Transfers In | $12,564 | $10,000 | $2,564 | $9,500 | 32.25% |
| **TOTAL INCOME less Federal Grants** | **$2,734,821** | **$2,704,132** | **$30,689** | **$2,580,635** | **5.97%** |
| Federal Grants | $918,352 | $977,300 | ($58,948) | 928,481 | -1.09% |
| **TOTAL GRF INCOME** | **$3,653,173** | **$3,681,432** | **($28,260)** | **$3,509,116** | **4.11%** |

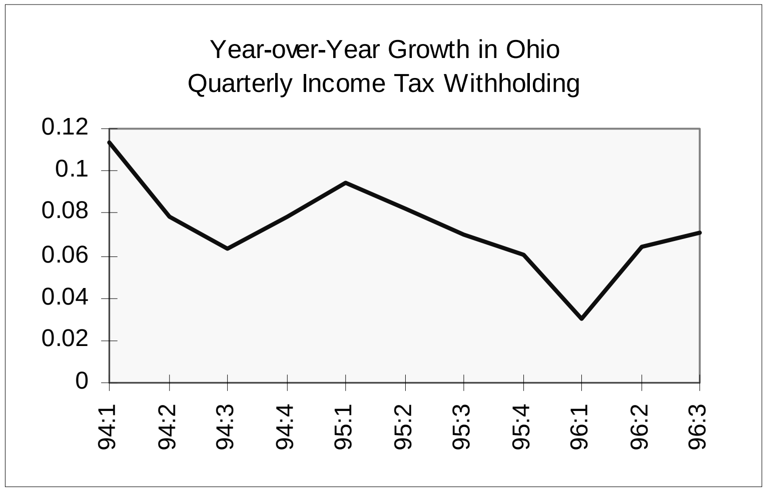
* July, 1996 estimates of the Office of Budget and Management.

*Detail may not add to total due to rounding.*

### *Personal Income Tax*

It isn't worth paying too close attention to the monthly numbers. After being over estimate in July, and below estimate in August, employer withholding bounced back strongly in September, finishing $12.9 million over estimate. The monthly data seems to be too noisy to draw many conclusions. For the first quarter of FY 1997, withholding was $8.7 million above estimate, and up 7.1 percent from last year. This is above both the estimated year-to-date growth of 6.4 percent, and the estimated full year growth of 5.9 percent. As shown in the chart below, the slowdown in withholding growth seems to have been reversed in the last two quarters. At this point, without a sharp slowdown in the national economy, it seems that withholding stands a fairly good chance of hitting the estimate in FY 1997.

The other component of the income tax that is well above estimate is quarterly estimated payments. Estimated payments are $15.6 million over estimate and up 13.4 percent from last year. Most of the overage came in September, which was the first test of estimated payments in FY 1997. The third payment against taxable year 1996 liability was due September 15th, and since it was the first payment following the passage of the 6.6 percent income tax rate reduction for 1996, the Tax Department had estimated that some taxpayers would begin reducing their estimated payments in response. Either this adjustment did not occur, or did not occur to the extent anticipated, or payments without the adjustment would have shown an even bigger increase. Obviously, the real test of these competing hypotheses will come in January, when the final estimated payments against taxable year 1996 liability are due.




The only real negative in the income tax at this point is in refund payouts, which are $7.4 million higher than estimated, reducing net collections relative to the estimate by that amount. “

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[1] Recall that both LBO and OBM are using revised FY 1997 revenue and disbursement estimates. See last month’s issue of Budget Footnotes for a full explanation.

[2] *Economic Trends*, Federal Reserve Bank of Cleveland, October 1996, p. 8.

[3] A summary of the full research paper by Isabel Sawhill and Daniel McMurrer can be found in “Are Jobs Less Secure Today,” *The Urban Institute Policy and Research Report,* Vol. 26, No. 1, Spring 1996.

[4] The Displaced Worker Survey gives the rate of displacement for 1991-92 as 3.8 percent. This is the percentage of displaced workers with three or more years of tenure at their current job.

[5] “Worker Displacement: A Decade of Change,” Jennifer Garber, *Monthly Labor Review,* Vol. 118, No. 4, April 1995, pp. 45-57. This article also has interesting information about regional displacement effects. In the early 1980s, displacement rates were highest in the Midwest. In the early 1990s, the midwest had the lowest rates, while the northeast and west were highest.

[6] One interesting side point that the Cleveland Fed also makes in its report is that the 1996 Displaced Worker survey shows that while younger and less-educated workers are much more likely to be jobless, they also tend to be out of work for a shorter time than older, more educated workers. See *Economic Trends,* Federal Reserve Bank of Cleveland, September 1996, pp. 12-14.

[7] “Job Creation and Employment Opportunities: The United States Labor Market, 1993-1996,” Report by the Council of Economic Advisors with the U.S. Department of Labor, Office of the Chief Economist, April 23, 1996.

[8] See Douglas Staiger, James Stock, and Mark Watson, “How Precise Are Estimates of the Natural Rate of Unemployment?” *National Bureau of Economic Research,* Working Paper Number 5477, March 1996.

# DISBURSEMENTS

— Chris Whistler

Program spending of $1,591.6 million, coupled with transfers of $131.5 million, left total GRF uses under estimate by $75.8 million in September. This monthly variance left year-to-date underspending nearly twice as large as it was through August: total GRF uses of $5,126.5 million through September were below estimate by $149.8 million. The underspending has occurred in nearly every major program area, with the exception of **Property Tax Relief**, which was over estimate by $58.9 million through September.

**Table 4**
General Revenue Fund Disbursements
Actual vs. Estimate
**Month of September, 1996**
($ in thousands)

| USE OF FUNDS | | | |
|---|---|---|---|
| PROGRAM | Actual | Estimate* | Variance |
| Primary & Secondary Education (1) | $392,267 | $444,573 | ($52,307) |
| Higher Education | 130,692 | 171,133 | (40,441) |
| **Total Education** | $522,959 | $615,706 | ($92,748) |
| Health Care | $474,641 | $442,349 | $32,291 |
| Aid to Dependent Children | 70,942 | 75,555 | (4,613) |
| General Assistance | 38 | 0 | 38 |
| Other Welfare | 58,226 | 59,075 | (849) |
| Human Services (2) | 63,212 | 82,598 | (19,386) |
| **Total Welfare & Human Services** | $667,059 | $659,578 | $7,481 |
| Justice & Corrections | $146,073 | $153,446 | ($7,373) |
| Environment & Natural Resources | 14,182 | 10,315 | 3,867 |
| Transportation | 1,353 | 2,247 | (894) |
| Development | 11,026 | 16,234 | (5,208) |
| Other Government (3) | 53,319 | 68,606 | (15,287) |
| Capital | 314 | 388 | (74) |
| **Total Government Operations** | $226,268 | $251,235 | ($24,968) |
| Property Tax Relief (4) | $171,205 | $138,287 | $32,918 |
| Debt Service | 4,114 | 4,109 | 6 |
| **Total Program Payments** | **$1,591,605** | **$1,668,915** | **($77,310)** |
| TRANSFERS | | | |
| Capital Reserve | $0 | $0 | $0 |
| Budget Stabilization | 0 | 0 | 0 |
| Other Transfers Out | 131,499 | 130,000 | 1,499 |
| **Total Transfers Out** | $131,499 | $130,000 | $1,499 |
| **TOTAL GRF USES** | **$1,723,105** | **$1,798,915** | **($75,810)** |

(1) Includes Primary, Secondary, and Other Education

(2) Includes Mental Health, Mental Retardation and Developmental Disabilities, Other Human Services

(3) Includes Regulatory and Nonregulatory agencies, Pension Subsidies, and Reissued Warrants.

(4) Includes property tax rollbacks, homestead exemption, and tangible property tax exemption.

* August, 1996 estimates of the Office of Budget and Management.

*Detail may not add to total due to rounding.*

**Primary and Secondary Education** (including Other Education) spending for the month of September was $52.3 million below the estimate of $444.6 million. The primary reason for the underspending was that the payment of the nonpublic administrative cost reimbursement subsidy (line item 200-532), the bulk of which was scheduled to be disbursed in September, did not occur. At issue may have been uncertainty about obtaining Controlling Board approval to transfer $4.4 million of the FY 1996 appropriation for this line item to FY 1997.

The transfer request resulted from the fact that the Department of Education was not able to spend $4.4 million of the $34.9 million appropriation for nonpublic administrative cost reimbursement in FY 1996. The State Superintendent of Public Instruction is required to reimburse each chartered nonpublic school annually for the "actual mandated service administrative and clerical costs incurred" by the nonpublic school in doing things such as filing required reports and maintaining records. Prior to the enactment of the current main appropriations act, reimbursement could not exceed $100 per pupil enrolled in a nonpublic school. Beginning in FY 1996, the reimbursement rate was increased to $150 per pupil, which in turn led to a higher appropriation. However, some nonpublic schools were not able to justify expenditures up to $150 per pupil. Additionally, nonpublic enrollment declined in fiscal year 1996. To enable the department to disburse the entire appropriation (including some nonpublic schools that could justify expenditures in excess of $150 per pupil) the corrective bill (S.B. 310) further increased the reimbursement rate to $250 per pupil. (Approval for this transfer did in fact occur at the

Controlling Board's October 7 meeting, and OBM now predicts that spending of the entire line item will be fully complete by the end of November.)

Underspending for the month in **Primary and Secondary Education** also occurred in the following line items: Education Management Information System (200-446), by $4.4 million; Special Education (200-504), by $2.1 million; Vocational Education (200-507), by $1.3 million; Post-Secondary/Adult Vocational Education (200-514), by $2.1 million; Professional Development (200-417), by $ 2.3 million; and Educational Excellence and Competency (200-524), by $3.1 million.

In terms of first quarter spending, the department is remarkably on track, except for the nonpublic administrative cost reimbursement line item (discussed above) and the public preschool line item (200-408), which is $5.2 million under projected estimates for the quarter. For all of the SF-12 (foundation) line items (Basic Aid, Vocational, Special, and Gifted Education, Transportation, and DPIA), spending is very close to OBM estimates. The following chart summarizes first quarter estimates and actual disbursements (amounts expressed in millions).

**Department of Education — Foundation Spending (1st Quarter)***

| Line Item No. | Line Item Name | Estimate | Actual | Variance |
|---|---|---|---|---|
| 200-501 | Basic Aid | $533.7 | $536.0 | -$2.3 |
| 200-502 | Transportation | $ 31.6 | $ 33.9 | $2.3 |
| 200-504 | Special Ed. | $128.9 | $127.1 | $1.8 |
| 200-507 | Vocational Ed. | $ 70.8 | $ 71.6 | -$0.8 |
| 200-520 | DPIA | $ 69.9 | $ 68.4 | $1.5 |
| 200-521 | Gifted Education | $ 6.4 | $ 6.4 | -- |
| Total | Foundation | $841.3 | $843.4 | -$ 2.1 |

**$ in millions.*

The other component of the **Education** category, **Higher Education**, was also under estimate in September. The $40.4 million variance (23.6 percent) was due to the timing of Ohio Instructional Grants (line item 235-503), which were originally scheduled for September but will be made in October.

When the year-to-date underspending in **Higher Education** of $41.7 million (which is nearly identical to the September variance) is combined with the **Primary and Secondary Education** variance of $33.5 million, total first quarter spending in the **Education** category was $75.2 million below estimate.

For the first quarter of FY 1997, **Aid to Dependent Children** spending was approximately $20.5 million under the Department of Human Services' revised estimate. (FY 1997 estimates were revised downward following lower-than-expected caseloads in FY 1996.) Below estimate caseloads in the first quarter kept both cash assistance (400-503) and day care (400-536) expenditures under estimate.

September not only marked the close of the first quarter of FY 1997 (and the close of federal FY 1996) — it marked the end of the **Aid to Dependent Children** (ADC) program. However, this does not mean that Ohio's impoverished will be left without assistance. In fact, **ADC's** replacement, Temporary Assistance to Needy Families (TANF), has the potential to make public assistance recipients better off — the winners and losers are yet to be determined.

The TANF program will be funded through new line items that were created through Controlling Board action on October 7, 1996. Although the disbursement pattern of TANF moneys across the new line items had not been determined by the department prior to our going to press, aggregate monthly spending estimates will likely be similar to those under **ADC** since the TANF program will operate in a similar fashion to the **ADC** program until policymakers determine how to design a new welfare system. (Many of TANF's provisions closely mirror last year's welfare reform legislation, H.B. 167 of the 121st General Assembly.) We will provide information regarding how TANF moneys will be disbursed during the remainder of FY 1996 as it becomes available from the department. (For a summary of the Controlling Board's actions relating to TANF, see the "Issues of Interest" section of this issue of ***Budget Footnotes***.)

Despite **ADC** underspending for the month, **Health Care** (Medicaid) spending was over estimate by $32.3 million in September. According to the Office of Budget and Management (OBM), the **Medicaid** variance was driven by two factors: the timing of the receipt of prescription drug rebates and a high inpatient hospital services payment. Although the below estimate drug rebates in September can be attributed to above estimate receipts earlier in the quarter, the cause of the inpatient hospital services overage is unclear. However, the year-to-date underspending (negative variance of $11.1 million) can clearly be attributed to lower-than-expected

**ADC** caseloads and below estimate capitation rates in the health maintenance organization spending category. (For a detailed explanation of the capitation rate variance, see the "Disbursements" section of the August issue of ***Budget Footnotes***.)

The $0.8 million negative variance in **Other Welfare** in September actually understates the "true" underspending in September, according to OBM. Second quarter children's services payments were disbursed early, driving spending in the category closer to estimate. Thus, the $18.0 million variance for the year-to-date is also an understatement. As in FY 1996, the variance can be attributed to below estimate Disability Assistance caseloads and underspending on computer projects.

September timing issues drove spending in the **Human Services** component $19.4 million under estimate in September and in turn, $36.6 million under through the first quarter. The largest variance, that of the Department of Mental Health ($4.7 million under), was largely due to the timing of subsidy draw-downs by the community mental health centers. Other **Human Services** agencies with under-spending in September include the following: the Bureau of Employment Services, $4.3 million under; the Department of Aging, $3.3 million below estimate; the Department of Mental Retardation and Developmental Disabilities, $3.2 million under; the Rehabilitation Services Commission, $2.3 million under; and the Department of Health, $1.0 million under estimate.

The **Justice and Corrections** program category posted a negative monthly disbursement variance of $7.4 million, which in turn pushed the category's total year-to-date underspending up to $15.0 million. Not surprisingly, the Department of Rehabilitation and Correction (DRC) is the primary culprit behind this underspending relative to OBM's July, 1996, disbursement estimates. In fact, $14.5 million of the category's negative $15.0 million year-to-date variance was in DRC's budget. In the case of the $7.4 million negative monthly variance, DRC's underspending (by $10.2 million) was much larger than the total negative variance for the entire program category. DRC's rather sizable underspending was partially offset by the Public Defender Commission (PUB), which managed to push $2.3 million more in indigent defense subsidy reimbursements out the door — best seen as a timing issue and no more — than was originally expected.

DRC's negative monthly and year-to-date variances are being fueled by two areas of spending: debt service payments and operating expenses. Relative to the former, it seems that favorable market conditions prompted the Ohio Building Authority to refinance or refund some existing "adult corrections" bonds, thus producing what looks like a $2.1 million minimum savings in September. Operating expenses continue to present a more tangled picture of underspending involving current fiscal year appropriations, as well as FY 1996 encumbrances. As far as we can tell, some of this underspending is the result of procurement delays for hardware related to a large-scale management information system upgrade currently underway at DRC.

Hidden within the **Justice and Corrections** spending component is a $1.0 million overage (9.8 percent) by the Office of the Attorney General through the first quarter of the fiscal year. Higher spending in the 055-321, Operating Expenses, line item, represents 98 percent of the overage. Part of the overage was set in motion through early FY 1997 Controlling Board actions which transferred $725,000 into the 055-321 line item — because these transfers were not included in OBM's original disbursement estimates, some overage was expected in the line item. Specifically, $125,000 was transferred from the Controlling Board's 911-401, Emergency Purposes, line item, in July for the purpose of paying the legal expenses associated with the Thomas Ferguson/State Auditor investigation and prosecution; and, $600,000 was transferred from the Controlling Board's 911-427, DNA Laboratory, line item, to pay start-up costs related to the establishment of a DNA facility.

The majority of the overage is attributed to a combination of disbursing the additional Controlling Board moneys, FY 1996 encumbrances paid at the beginning of FY 1997, and payroll timing issues (i.e. three pay periods in one month). However, do not expect the AG to fall back within their disbursement estimates any time soon. The remainder of the extra spending is attributed to equipment purchases and new staff. Equipment purchases relating to implementing an automated ballistics identification system (Drugfire), the automated fingerprint identification system (AFIS), which came on-line this month, and other technology updates have been somewhat higher than expected. Also, additional investigators have been hired by the Bureau of Criminal Identification and Investigation, increasing operation costs associated with personnel. Although the additional spending for technology and personnel is minimal on a monthly basis, it will likely keep the AG at an overage for the remainder of the fiscal year and on track to exhaust their appropriation authority in the line item. Some future expenses in the line item will likely be paid by revenue in non-GRF funds such as Fund 419, Claims Section, which is also used for the AG's operating expenses. Relief from other funds combined with payroll turnover, that usually comes closer to the end of the fiscal year, should keep the AG within their appropriation authority.

Another AG line item worth noting is the Community Police Officers line item, 055-406. As you may recall from the July issue of ***Budget Footnotes***, the Controlling Board forwarded approximately $2.9 million from the line item's FY 1996 appropriation to be used in FY 1997. This line item is used by the AG for providing up to 10 percent of the required match (25 percent) necessary to draw-down federal grants for additional law enforcement officers to counties, townships, municipalities, and so forth. For several reasons outlined in the July issue, the AG has had difficulty distributing these funds. Thus far $424,000, or 14.4 percent, of the $2.9 million has been disbursed. What may be more interesting is the fact that another $4.6 million, appropriated for FY 1997 for the same purposes, awaits release from the Controlling Board's 911-402, Community Police Officers, line item. It is quite possible that the 1997 revenue may sit idle for the remainder of the fiscal year.

**Table 5**
General Revenue Fund Disbursements
Actual vs. Estimate
**Fiscal Year-to-Date 1997**
($ in thousands)

| USE OF FUNDS PROGRAM | Actual | Estimate* | Variance | FY 1996 | Percent Change |
|---|---|---|---|---|---|
| Primary & Secondary Education (1) | $1,184,160 | $1,217,694 | ($33,534) | $1,096,948 | 7.95% |
| Higher Education | 423,199 | 464,888 | (41,689) | 449,570 | -5.87% |
| **Total Education** | $1,607,359 | $1,682,582 | ($75,223) | 1,546,518 | 3.93% |
| Health Care | $1,274,846 | $1,285,992 | ($11,146) | $1,382,984 | -7.82% |
| Aid to Dependent Children | 273,023 | 293,683 | (20,660) | 292,213 | -6.57% |
| General Assistance | 72 | 0 | 72 | 8,353 | -99.14% |
| Other Welfare | 186,218 | 204,219 | (18,001) | 159,345 | 16.86% |
| Human Services (2) | 303,881 | 340,508 | (36,627) | 294,351 | 3.24% |
| **Total Welfare & Human Services** | $2,038,040 | $2,124,401 | ($86,361) | $2,137,246 | -4.64% |
| Justice & Corrections | $388,010 | $403,013 | ($15,002) | $357,827 | 8.44% |
| Environment & Natural Resources | 40,355 | 40,544 | (189) | 38,558 | 4.66% |
| Transportation | 3,930 | 4,690 | (759) | 5,183 | -24.17% |
| Development | 36,734 | 41,003 | (4,269) | 31,765 | 15.64% |
| Other Government (3) | 126,598 | 152,851 | (26,253) | 128,519 | -1.49% |
| Capital | 498 | 1,771 | (1,273) | 1,583 | -68.55% |
| **Total Government Operations** | $596,126 | $643,872 | ($47,746) | $563,435 | 5.80% |
| Property Tax Relief (4) | $273,391 | $214,535 | $58,857 | $180,214 | 51.70% |
| Debt Service | 74,793 | 75,655 | (862) | 73,450 | 1.83% |
| **Total Program Payments** | **$4,589,709** | **$4,741,044** | **($151,336)** | **$4,500,864** | **1.97%** |
| TRANSFERS | | | | | |
| Capital Reserve | $0 | $0 | $0 | $12,000 | -100.00% |
| Budget Stabilization | 0 | 0 | 0 | 535,214 | -100.00% |
| Other Transfers Out | 536,752 | 535,237 | 1,515 | 311,418 | 72.36% |
| **Total Transfers Out** | $536,752 | $535,237 | $1,515 | $858,632 | -37.49% |
| **TOTAL GRF USES** | **$5,126,460** | **$5,276,280** | **($149,821)** | **$5,359,496** | **-4.35%** |

(1) Includes Primary, Secondary, and Other Education

(2) Includes Mental Health, Mental Retardation and Developmental Disabilities, and Other Human Services

(3) Includes Regulatory and Nonregulatory agencies, Pension Subsidies, and Reissued Warrants.

(4) Includes property tax rollbacks, homestead exemption, and tangible property tax exemption.

* August, 1996 estimates of the Office of Budget and Management.

*Detail may not add to total due to rounding.*

Disbursements from the **Other Government** spending component were under estimate by $15.3 million for the month of September and by $26.3 million for the fiscal year-to-date. The largest contributor to this negative variance was disbursements from the Department of Administrative Services' (DAS) 100-448, Office Building Operating Payments, line item, which have been $5.3 million below the year-to-date estimate. Other major causes of lower-than-estimated spending within DAS have been delays in the implementation of the contract with Ameritech for the fiber optic backbone of the State of Ohio Multi-Agency high-speed fiber Communication System (SOMACS) and delays in the negotiation of security and maintenance contracts for the State of Ohio Computer Center (SOCC).

**Contributions were made to this article by Jeff Golon, Grant Paullo, Debra Pelley, Mike Toman, and Deborah Zadzi.*

# Lottery Profits Quarterly Report

## LOTTERY TICKET SALES AND PROFITS TRANSFERS FIRST QUARTER, FY 1997

— *Allan Lundell*

Quarterly ticket sales decreased for the first time in over two years. Total sales for the first quarter of FY 1997 were $578.59 million, down from $626.58 million for the fourth quarter of FY 1996. Sales decreased steadily throughout the quarter; by 6.1 percent in July, 5.5 percent in August, and 4.8 percent in September. Despite the decrease from the previous quarter, sales remained higher than first quarter FY 1996 levels.

The decreases in sales did not result in decreases in transfers to the Lottery Profits Education Fund. First quarter transfers were $184.47 million, $19.61 million above projection and $3.85 million above first quarter FY 1996. The average monthly transfer has been $61.49 million. The projected transfer for FY 1997 is $661.20 million. In order to meet projections, monthly transfers will need to average $52.97 million for the remainder of the fiscal year.

Total sales decreased 7.95 percent from fourth quarter FY 1996 levels. Sales of all games decreased. The largest decrease, 23.47 percent, was for Super Lotto. The smallest decrease, 1.66 percent, was for Pick 4. The large decrease in Super Lotto sales was not a surprise. Super Lotto sales reached a record high in the fourth quarter of FY 1996 due to jackpot rollovers. Super Lotto sales are primarily a function of the jackpot level, and such a high level of sales could not be maintained. Although sales of Instant Tickets decreased by 2.58 percent from fourth quarter FY 1996 levels, they still accounted for over 50 percent of total lottery sales.

For the first quarter of FY 1997 prize awards totaled $293 million, slightly more than 50 percent of ticket sales. In addition to the amount awarded as prizes, $35.36 million was transferred to the Deferred Prize Trust Fund, $6.51 million was transferred to the Unclaimed Prize Fund, and $14.34 million in free tickets were given out. Including these amounts reveals that overall prize related expenses and transfers totaled $349.21 million, or over 60 percent of ticket sales. Combining this amount with the transfer to the Lottery Profits Education Fund reveals that over 90 percent of sales is returned to the public in one form or another.

**Table 1, FY 1997 Lottery Ticket Sales and Transfers to LPEF, millions of current dollars**

| | *Actual Transfers* | *Projected Transfers* | *Dollars Variance* | *Percentage Variance* | *Ticket Sales* | *Transfers as a Percentage of Sales* |
|---|---|---|---|---|---|---|
| July | $ 69.46 | $ 57.01 | $12.45 | 21.84 | $203.40 | 34.15 |
| August | 56.42 | 53.41 | 3.01 | 5.64 | 192.18 | 29.36 |
| September | 58.59 | 54.44 | 4.14 | 7.60 | 183.01 | 32.01 |
| **Total** | **$184.47** | **$164.86** | **$19.61** | **11.89** | **$578.59** | **31.88** |

**Table 2, FY 1997 Lottery Ticket Sales by Game, millions of current dollars**

| | *Pick 3* | *Pick 4* | *Buckeye 5* | *Kicker* | *Super Lotto* | *Instant Tickets* | *Total Sales* |
|---|---|---|---|---|---|---|---|
| July | $ 37.48 | $ 9.07 | $ 6.91 | $ 6.47 | $ 46.71 | $ 96.76 | $203.40 |
| August | 37.91 | 9.40 | 6.94 | 5.01 | 31.52 | 101.41 | 192.18 |
| September | 34.18 | 8.70 | 6.44 | 4.61 | 29.48 | 99.61 | 183.01 |
| **Total** | **$109.57** | **$27.17** | **$20.29** | **$16.09** | **$107.71** | **$297.77** | **$578.59** |

# LOTTERY PROFITS EDUCATION FUND DISBURSEMENTS

## DISBURSEMENT OF FISCAL YEAR 1996 PROFITS

— *Deborah Zadzi*

Lottery Profits Education Fund (LPEF) disbursements in fiscal year 1997 (year-to-date) total $102.7 million. Disbursements to date consist of payments for three major education subsidy line items (200-670, School Foundation Basic Allowance; 200-671, Special Education; and 200-672, Vocational Education). Table 4 shows fiscal year 1997 appropriations, disbursements, and available appropriation balances for each account in the LPEF as of September 30, 1996.

As reported in previous issues of this report, most lottery moneys blend with General Revenue Fund (GRF) moneys to fund certain education subsidies. The following programs are funded with a combination of GRF and LPEF moneys as shown in the first table below.

An exception to the above is the lottery money used for debt service. Instead of combining with General Revenue Fund moneys, these moneys are transferred to the General Revenue Fund to pay debt service on bonds issued for the School Building Assistance Program. Thus, even though these appropriations appear in the Department of Education's budget for lease rental payments in both the General Revenue Fund and the Lottery Profits Education Fund, the total amount for this purpose does not equal the sum of the two amounts.“

**Table 3, Combined General Revenue Fund and Lottery Profits Education Fund Appropriations for Basic Aid, Special Education and Vocational Education, FY 1997**

| *Program* | *GRF Appropriations* | *Lottery Appropriations* | *Total Appropriations* |
|---|---|---|---|
| Basic Aid | $2,024,719,369 | $ 579,770,000 | $2,604,489,369 |
| Special Education | $ 496,725,784 | $ 44,000,000 | $ 540,725,784 |
| Vocational Education | $ 285,344,510 | $ 30,000,000 | $ 315,344,510 |
| **Total** | **$2,806,789,663** | **$ 653,770,000** | **$3,145,215,153** |

**General Revenue Fund and Lottery Profits Education Fund Appropriations for Lease Purchase Payments, FY 1997**

| *Program* | *GRF Appropriations* | *Lottery Appropriations* | *Total Appropriations* |
|---|---|---|---|
| Lease Rental Payments (Debt Service) | $20,430,000 | $20,430,000 (transfer to GRF) | $20,430,000 |

**Table 4, LPEF Appropriation/Disbursement Summary**

| | *FY 1997 Appropriations* | *FY 1997 Disbursements (through Sept. 30,1996)* | *Appropriation Balance* |
|---|---|---|---|
| LPEF | | | |
| 670 Basic Aid | $579,770,000 | $91,069,809 | $488,700,191 |
| 671 Special Ed | $44,000,000 | $6,908,419 | $37,091,581 |
| 672 Vocational Ed | $30,000,000 | $4,710,286 | $25,289,714 |
| 682 Lease Rental Payment | $20,430,000 | $0 | $20,430,000 |
| **Total LPEF** | **$674,200,000** | **$102,688,514** | **$571,511,486** |

# ISSUES OF INTEREST

## BLOCK GRANTING, CONTROLLING BOARD STYLE:
### HUMAN SERVICES' FUNDING FOR NEW WELFARE PROGRAMS

BY GRANT PAULLO*

In August of 1996 Congress passed and the President signed the Personal Responsibility and Work Opportunity Act (PRWOA). Title I of this Act eliminated the Aid to Families with Dependent Children program (AFDC, in Ohio known as ADC), the Job Opportunity and Basic Skills program (JOBS), and the Emergency Assistance program (EA, in Ohio known as FEA). Replacing these programs is the Temporary Assistance for Needy Families block grant (TANF). The TANF block grant provides federal funding based upon historical spending on the ADC, JOBS, and FEA programs. For Ohio the block grant amounts to approximately $728 million. In order to receive the entire block grant, Ohio is required to maintain a level of spending equivalent to 80 percent of the amount the state spent on the eliminated programs in federal FY 1994. This amount is referred to as the state's maintenance of effort (MOE).

The Governor has designated the Department of Human Services as the administering agency for the TANF block grant. This requires the department to submit a state plan for the TANF moneys. The plan already submitted will allow the department to administer the TANF program as the ADC program has been administered, pursuant to H.B. 167 of the 121st General Assembly, until the department can come before the legislature with changes. In order to spend TANF moneys the department requested and was granted by the Controlling Board a transfer of appropriation authority from the JOBS, ADC, and FEA line items to new line items that will fund the TANF programs. In addition, the JOBS and IM Direct Services line item, which is the department's primary funding source for county departments of human services, was reduced to reflect the elimination of the ADC, JOBS and the FEA programs. Moneys for counties to administer the TANF program will come from the new line items created to administer the TANF block grant. The department will not be changing any of the requirements of the ADC, JOBS, or FEA programs immediately; however, the department has indicated that changes will be necessary in the future to meet the new goals and requirements of TANF.

This Controlling Board eliminated three line items. The largest line item eliminated was 400-503, the ADC line item. The department is requesting the transfer of $620,321,181 from the ADC line item to the following line items: the new 400-410, TANF Maintenance of Effort; the existing 400-408, Child and Family Service Activities and the renamed 400-511, Disability and Other Assistance.

Line item 400-415, JOBS, which currently provides funding for the state administered JOBS programs, will also be eliminated. The Controlling Board transferred: (1) the administration moneys to 400-100, Personal Services; (2) the funding for the Food Stamp Employment Training (FSET) participant allowance to 400-511, Disability and Other Assistance; and (3) the funding for work related activities to 400-410, TANF Maintenance of Effort.

As previously stated, 400-504, JOBS and IM Direct Services, was reduced by $87,598,553 in FY 1997. This reduction reflects the JOBS and ADC related moneys that would have been sent to the county departments of human services. The state share of these funds was transferred to 400-410, which will be used to distribute funds from the TANF MOE to the counties. The counties will be allocated money based upon the same methodology as the current ADC program until the TANF state plan is changed.

The Family Emergency Assistance program has been combined into the TANF block grant at the federal level. Therefore, the department, with Controlling Board approval, eliminated 400-505, Family Emergency Assistance. The moneys from this line item were transferred to the TANF Maintenance of Effort line item.

In addition to the three line items that were eliminated, two line items were created. These are 400-410, TANF Maintenance of Effort, and 400-411, TANF Block Grant. The 400-410 line item will be used to meet the maintenance of effort (MOE) requirement of the TANF block grant. As previously stated, the MOE must be at least 80 percent of the amount the state expended on the eliminated program in federal FY 1994. If the state spends less than 80 percent, the federal government will reduce the TANF block grant by one dollar for each dollar under 80 percent. Line item 400-411 will receive the TANF block grant allocation. These funds will be used to support any activities of the state designed TANF program. Currently, the state is planning to administer the TANF program in the same manner as it currently administers the ADC program.

In a related Controlling Board request, the Department of Human Services received approval of a contract with Anderson Consulting to aid the department in developing a plan to transform the delivery of welfare and related programs. The contract runs for nine months at a cost of $1,130,000. This contract would be funded through the new 400-410 line item, TANF Maintenance of Effort (see agenda number 58 for a description of this line item).

The department is contracting with Anderson for development of a plan to implement welfare reform that would integrate all agencies and programs that will be affected by the program changes. Anderson would identify all agencies that will need to be involved with revamping the delivery of human services programs. The consultant would identify the responsibilities of all affected parties, as well as develop a strategic plan to implement the recommended changes.

The request for this contract arises from the rigorous analysis that the department believes is needed to develop this plan. Anderson will provide econometric models evaluating alternative reform approaches that departmental staff could not perform adequately. The department selected Anderson because it has gained the specialized experience of developing a plan to completely redesign the delivery of human services programs through aiding a Canadian province in its welfare reform efforts.

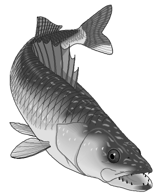
The contract is broken down into three phases. In Phase One, the consultant, with the assistance of the Department's contract manager, will develop a project work plan to establish a structure, process, and time line — which ultimately would result in a recommended "master plan." This initial work plan will be delivered within the first three weeks of the contract. Phase One would be billed at $165,000.

In Phase Two, the contractor will conduct various analytical assignments specified in the work plan developed under Phase One. Phase Two will be completed in eight weeks time, with an initial maximum cost estimate of $430,000.

Phase Three will involve the construction of the "master plan," which would include the following: identification of resource requirements associated with the policy options; a cost analysis of the options; and funding strategies, including revenue enhancement alternatives. The final deliverable from this phase is intended to be used as a part of the 1998-99 biennial budget process and/or part of a separate piece of legislation addressing only welfare reform. The conclusion of Phase 3 will be targeted for completion prior to June 30, 1997. The initial cost estimate of Phase Three of the contract is $535,000. It should be noted that the initial cost estimate of Phases Two and Three may be reallocated across the two phases.

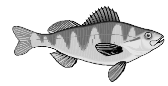
With the approval of the Department of Human Service's request for restructuring of the funding of welfare programs and the approval of the contract with Anderson for development of a "aster plan" of a redesigned human services system, the Controlling Board has given the department the green light to begin planning for the future delivery of welfare programs. The department has indicated that the new welfare system will be unveiled during the upcoming budget deliberations, as part of the budget or a stand alone bill. Only time will tell what form Ohio's welfare reform will take."

**Contributions were made to this article by Chris Whistler.*



# THE BIG CATCH:
## DNR CONTRACTS FOR NEW RESEARCH VESSEL FOR LAKE ERIE

BY JONI LEONE



On September 16, 1996, the Department of Natural Resources/ Division of Wildlife 'caught' the approval of the Controlling Board for its request to build a new research vessel for use on Lake Erie. The new vessel, as yet unnamed, will replace the 15-year-old 43-foot "Explorer." The new 53-foot vessel project is being managed by the Napier Company of Arbroath, Scotland, and will be built by Vinette Boatworks of Port of Escanaba, Michigan for $545,032. Funds from the Division's Wildlife Conservation line item are being 'hooked' to purchase the vessel. This fund's 'diet' consists of revenue from hunting and fishing license fees. The Division is projecting a July, 1997 date for the vessel to arrive at its new berth. Its home port will be the Sandusky Fish Research Station. The new vessel will be used for annual trawling and gill net surveys in western Lake Erie as well as various other research projects. The Division of Wildlife's other research vessel, the 47-foot "Grandon," was designed by the Napier Company and built by Washburn and Doughty in East Boothbay Harbor, Maine in 1989-90 for $650,000.[1] The "Grandon" is based out of the Fairport Harbor Fish Research Station and is used for similar net surveys, but it is better suited to the deep central basin waters of Lake Erie due to its displacement-type hull. Some of the current research projects for which these vessels are used on Lake Erie include the status of round goby in Ohio waters of Lake Erie, the state of forage fish in the central basin of Lake Erie, the relative abundance of select fish species, and the growth and maturity rates of select fish species.

According to the Division of Wildlife's March 1996 report,[2] a number of different methods were used to gather data about the Lake Erie fisheries. A creel[3] survey was conducted at thirty-eight major boat departure sites along Ohio's portion of the Lake Erie shoreline from Toledo to Conneaut. Monthly catch reports were submitted by licensed commercial operators and were summarized to determine harvest (in pounds) and fishing effort for all species by month, statistical grid, and district. Wildlife's research vessels were used for experimental trawl and gill net surveys which were conducted in the Ohio waters of Lake Erie to ascertain the relative abundance of walleye, gizzard shad, alewife, white and yellow perch, and white bass, as well as growth and maturity rates of the major predator and forage fish species such as walleye, white and yellow perch, white bass, and smallmouth bass.

The division's current projects include walleye tagging, development of management recommendations for Sandusky River walleye, steelhead trout stocking evaluation, restoration of lake sturgeon in Ohio, central basin trawl variation research, and central basin walleye diet analysis. There are also a number of cooperative research initiatives taking place with the Ohio State University, Michigan State University and Case Western Reserve University. Subjects planned for future research include the current status of white bass and development of appropriate rehabilitative strategies, current status of small mouth bass and development of appropriate modifications to sampling programs to acquire additional data where required, changes in lake productivity and their effects on fisheries and forage populations, and development of a tactical plan for Sandusky Bay."

[1] The "Grandon" was contracted through the Research Foundation at Ohio State University.

[2] Department of Natural Resources, Division of Wildlife, "Ohio Lake Erie Fisheries 1995," prepared in March 1996. Work for this report was completed under Federal Aid in Sport Fish Restoration Project F-69-P, *Fish Management in Ohio.*

[3] A creel survey checks the catches of anglers and the amount of time spent fishing as they return from their outings.

# TORT REFORM: FISCAL IMPLICATIONS OF H.B. 350 ON STATE AND LOCAL GOVERNMENTS

BY MICHAEL R. TOMAN

After eighteen months of hearings, amendments, testimony from varying interests, and long-debated floor sessions, Ohio has passed House Bill 350, better known as "Tort Reform." Generally the bill is aimed at restricting how civil lawsuits are handled in terms of when they can be filed and how much damages can be recovered. How will the bill's 250 pages of legal verbiage fiscally affect Ohio's state and local governments? The dynamics of the court system and tort law make estimating the fiscal effects of H.B. 350 virtually impossible. This article does not offer figures estimating the bill's fiscal impact, but serves as a discussion of the bill's implications on political subdivisions,

**What is In the Tort Reform Bill?**
**Table 1: Provisions of H.B. 350**

- Sets an award cap on non-economic damages (i.e. pain and suffering) of $250,000 or three times the amount of economic damages (i.e., actual losses; wages, medical expenses) in less severe cases. In the most severe cases, the award is capped at $1 million, or $35,000 times the number of year's of a victim's life expectancy.

- Sets an award cap on punitive damages, or penalty money awarded to victims when a company has been found guilty of intentional neglect. Companies with 25 employees or less: awards are limited to three times the total of economic and non-economic damages or $100,000, whichever is less. Companies with more than 25 employees: awards are limited to three times the total of economic and non-economic damages, or $250,000, whichever is greater. These caps could not be exceeded no matter how many times a company is sued over the same course of conduct. In other words, the company pays up to the cap amount once per course of conduct, despite the number of lawsuits filed. In addition, victims seeking punitive damages could only do so via a separate lawsuit from that of economic and non-economic damages.

- Establishes statutes of repose, or time limits in which a suit can be filed. Product liability suits and suits against persons who performed services for the improvement of real property such as designers, planners, and supervisors of construction, can not be filed after 15 years from the date the product was delivered or service was rendered. There is a 6 year statute of repose on medical, dental, optometric, and chiropractic claims.

- Amends joint and several liability. Under the bill, defendants have to be found at least 50 percent liable before being jointly and several liable for economic losses. In regard to damages for non-economic loss, defendants are only responsible for their proportionate share of negligence.

- Amends several areas of the Political Subdivision Sovereign Immunity Law (PSSI).

- The bill also contains the following: product liability provisions including new standards of proof regarding seat belts, alcohol and drug abuse, exposure to hazardous or toxic substances, and recall notifications; medical claim provisions including new standards for evidence against hospitals, expert witnesses, and incident and risk management reports; includes new immunities for charitable volunteers, athletic coaches or officials, and sponsors of teams or programs; and contains changes regarding suits arising from sale of securities, tort actions filed by persons engaged in unlawful activity, and actions regarding the picking of agricultural produce.

particularly its effect on Ohio's court system, political subdivision sovereign immunity laws, insurance premiums, and health care costs.

### *Are Tort Actions Clogging up Ohio's Courts?*

One of the most prevalent themes heard throughout the hearings on H.B. 350 was the claim that tort actions have increased dramatically and are clogging court dockets. Available data indicates that this is not correct as the total number of torts in Ohio decreased from 1990 to 1994 (see Table 2).

The tort cases most affected by the bill are heard in the courts of common pleas, which generally hear most professional tort, product liability actions, and other tort actions. Civil actions with damages of up to $15,000 are also heard in county and municipal courts. The following bullets represent the caseload percentage of tort actions in Ohio's courts.

- Less than 1 percent of the total new cases filed in all of Ohio's courts are professional tort, product liability cases, or other tort cases; and
- Less than 5 percent of the total new cases filed in Ohio's courts of common pleas are professional tort, product liability cases, or other tort cases.

Although available tort caseload data suggests that the statement that tort actions have increased dramatically is false, it does not invalidate the complaint that some problems with rising caseloads and costs exist. Take for example professional tort actions. While the number of total tort actions and civil actions have continued to decrease in the last four years, professional tort actions have increased approximately 17 percent in Ohio, suggesting there may very well be a problem in this area. Also, a cost element not reflected with simple caseload data is how fast these tort actions are being disposed of. Professional tort actions such as medical malpractice claims generally have the longest disposition period due to their often complex nature. A study conducted by the Bureau of Justice Statistics, *Civil Justice Survey of State Courts, 1992*, examined tort cases in the nation's 75 largest counties, which included Ohio's Cuyahoga and Franklin counties. The study indicated that the median length for product liability cases was seventeen months, medical malpractice — twenty months, and other tort actions — fourteen months. Coupled with the increase in professional tort actions, is an increase in the number of those actions reaching jury trials. A review of the Supreme Court's *Ohio Courts Summary 1990 to 1994* indicates the number of professional tort cases reaching a jury trial in 1994 has increased approximately 64 percent (about 80 cases) over the 1990 figure, while product liability and other civil and tort actions have remained relatively the same over the same four years. For a number of reasons the costs for cases disposed of by jury trials are significantly higher than cases settled before they reach trial. Another element not reflected in court caseload information is the number of cases that are settled out of court before they are filed. Although there is no data on the number of instances in which parties settle before filing a tort action in court, it appears that many parties named as defendants in a lawsuit, especially businesses and insurers, simply settle rather than undergo expensive and timely

**Table 2: Ohio Tort Caseloads from 1990-1994**
**(Source: Supreme Court of Ohio, Ohio Courts Summary, 1990-1994)**

| Type | 1990 | 1991 | 1992 | 1993 | 1994 | % Change '90-'94 |
|---|---|---|---|---|---|---|
| Professional Tort | 2,211 | 2,164 | 2,329 | 2,333 | 2,587 | 17.0% |
| Product Liability | 1,036 | 929 | 872 | 829 | 671 | -35.2% |
| Other Tort | 27,978 | 26,503 | 26,714 | 24,454 | 24,679 | -11.8% |
| Total New Tort Cases Filed | 31,225 | 29,596 | 29,915 | 27,616 | 27,937 | -10.5% |
| Total Cases Filed in Common Pleas Crts | 607,472 (5.1%)* | 616,662 (4.8%)* | 614,865 (4.7%)* | 578,679 (4.8%)* | 600,293 (4.7%)* | -1.2% |
| Total Cases Filed in all of Ohio's Crts | 3,138,368 (.99%)* | 3,137,022 (.94%)* | 3,014,577 (.99%)* | 2,945,809 (.93%)* | 2,984,439 (.94)* | -4.9% |

*Indicates percentage of tort cases within common pleas total caseload.
**Indicates percentage of tort cases within the total of all court caseloads.

litigation. In fact, throughout the hearings on Sub. H.B. 350 many business owners testified that the number of cases (including frivolous cases) they are settling out of court has increased.

We do not know to what degree the increases in professional tort actions, jury trials, and the number of cases being settled out of court have contributed to the belief that tort actions and their costs have increased dramatically. The fact that tort actions filed in Ohio's courts have decreased provides some evidence that dockets are no more clogged than they were in the past. However, as indicated above, assumptions that aggregate caseload information can be used as a lone indicator to prove or disprove claims of rising tort actions or costs is problematic.

***Will Tort Reform Reduce the Current Costs of Operating Ohio's Courts?***

No, the bill's provisions will not reduce the current tort caseload to the degree necessary for a reduction in court expenditures to be realized. Recall that the percentage of tort actions in courts of common pleas as less than 5 percent of the total caseload; with torts representing such a small percentage of the common pleas caseload, even a large reduction in caseloads could not reduce fixed costs significantly. Hence H.B. 350 is unlikely to require layoffs in Ohio's common pleas courts nor will any court rooms become vacant. However, the bill does remove certain "incentives" that could, under current law, make lawsuits more attractive for some plaintiffs. It eliminates high awards by placing caps on non-economic and punitive damages and reduces plaintiff's ability to search for the "deepest pocket" to sue by changing the joint and several liability laws. Although the bill may reduce some incentives for filing a lawsuit, most of the bill's major provisions will have little effect on alleviating court dockets and operating costs. The bill places caps on punitive damages as well as non-economic damages that are higher than most awards currently won in Ohio. In addition, there have been few cases relative to the total number of tort cases where punitive damages have actually been awarded. A 1990 study by a Suffolk University law professor found punitive damages were only awarded in approximately 355 cases nationwide and testimony given by both proponents and opponents of H.B. 350 suggests the number of awards in Ohio is less than a dozen annually.

Two of tort reform's major provisions, the fifteen year statute of repose or time limit placed on product liability suits and the six year statute of repose placed on medical malpractice claims, will also only affect a relatively small number of cases. Again the small number of cases affected by these provisions limits the potential for courts to save money. Under existing law the majority of product liability and medical malpractice claims are already filed within the established statute of repose periods. Testimony from both opponents and proponents of the bill suggested that as many as 99 percent of all tort actions are filed within ten years of the "harm" which is the basis of the claim. "Statutes of repose" establish a limited time period for which a person may sue for a "harm;" the period begins when the "harm" occurs, as opposed to when the "harm" was discovered, which is generally the case with "statutes of limitations."

The tort reform bill also provides some additional safeguards against the filing of "frivolous" lawsuits, including "loser pays" provisions, which in theory should deter such suits from being filed. Since the "frivolity" of a lawsuit can be a matter of personal opinion, the number of cases filed may not decline as much as some proponents of tort reform hope. What one person deems frivolous another believes is legitimate; the "loser pays" provisions will not deter those who feel their case is legitimate. Furthermore, many would argue that current law already offers adequate procedures to deal with frivolous conduct.

The most promising provisions of the bill that may reduce common pleas court dockets are the provisions on alternative dispute resolution (ADR). The bill requests the Supreme Court to continue to expand its efforts to establish and promote the use of ADR mechanisms and authorizes each municipal court, county court, probate court, juvenile court, and courts of common pleas to establish ADR procedures for the purpose of settling disputes between parties more efficiently. The programs have been very successful at settling cases before they are filed or go to trial, reducing judges dockets and decreasing expenditures. However, the bill does not provide any additional funding for ADR programs and establishing programs is permissive upon the court. Thus, the fiscal impact of these provisions will likely be minimal.

In summary, this bill is unlikely to dramatically reduce court caseloads or operating costs. Beyond the specifics discussed above, it is important to remember that many court costs are paid by the litigants engaged in a lawsuit. It is a court's "fixed" operation costs such as the salaries of judges and court employees, debt service payments on court buildings, and so forth, that represent the majority of a court's annual operation costs. A small reduction in the tort caseload will only affect "marginal" costs, such as employee overtime, while having little or no affect on "fixed" costs.

It should be noted that at least one provision of the bill, the one which requires plaintiffs who are seeking punitive damages to file separate lawsuits for those damages, could actually minimally increase the tort caseload. Under current law, punitive damages are awarded along with economic and non-economic damages at one trial.

### *Will the Bill Affect Monetary Settlements Against Political Subdivisions?*

As stated above, the bill's provisions will do little to decrease tort caseloads and their costs in Ohio's courts. However, several provisions of the bill could directly affect monetary settlements against political subdivisions, thus saving the subdivisions money.

The Bureau of Justice Statistics study of tort cases in the nation's 75 largest counties indicated that approximately 5 percent of the tort cases named some form of government entity (state agencies, counties, municipalities, and so forth.) as the defendant. In Ohio, tort actions filed against the state are generally filed with and heard by the Court of Claims, whereas those filed against local political subdivisions are generally heard in the courts of common pleas, county, and municipal courts. Under current law, political subdivisions already have certain protections from lawsuits via the Political Subdivision Sovereign Immunity (PSSI) laws. Because current laws, such as the PSSI laws, regulate how political subdivisions can be sued, many of the bill's major provisions will have little direct effect. For instance, political subdivisions are protected from punitive damage awards, collateral benefits are currently taken into account in civil actions filed against political subdivisions, and there are caps on non-economic damages in wrongful death cases filed against political subdivisions.

Although many of the bill's provisions do not affect actions filed against political subdivisions, there are some provisions which do. The bill expands several sovereign immunity provisions in existing PSSI law including: changing liability standards regarding guard rails and embankments, amending political subdivisions liability of care for public roads, amending the provisions surrounding political subdivisions liability for injuries on their property, and amending political subdivisions' liability for an employee's breach of duty. The bill, among other changes, bars the recovery of damages for harm or injury to any person who has been convicted of or pleaded guilty to a felony offense arising out of criminal conduct that was a proximate cause of that harm or injury. According to county representatives, current laws for guard rails and public roads leave counties and other political subdivisions vulnerable to being named in lawsuits. The bill's changes should decrease such actions filed against political subdivisions, simultaneously decreasing political subdivisions' expenses for defending tort actions and reducing the number of settlements paid out.

Beyond the changes in the sovereign immunity statutes, the bill's changes in joint and several liability will also directly affect political subdivisions. Because political subdivisions under existing law can be named as the "deep pocket" defendant, the changes in joint and several liability could potentially decrease settlements against political subdivisions significantly, decreasing expenditures associated with lawsuits.

### *Will the Bill Lower the Cost of Liability Insurance?*

A goal of H.B. 350, by means of caps and statutes of repose, is to provide some predictability in awards for insurance companies with hopes of decreasing insurance losses and reducing rates for consumers. An indirect effect of reduced losses by insurance companies could be lower liability premiums for political subdivisions. Whether or not the bill will reduce losses and premiums in the insurance industry is yet another element that is difficult, if not impossible, to measure. There seem to be few studies available that point to actual reductions in premiums as a result of tort reform. Furthermore there are few studies that are not arguably biased (i.e. the studies were conducted by the insurance industry,

| Table 3: Effects of 1986 Tort Reform on Insurance Losses and Premiums from 1986-1988 | | | | | | |
|---|---|---|---|---|---|---|
| **Type of Insurance** | **Actual Change in Losses** | **Est. Change in Losses w/o Tort Reform** | **Est. Decrease in Losses as a Result of Tort Reform** | **Actual Change in Premiums** | **Est. Change in Premiums w/o Tort Reform** | **Est. Decrease in Premiums as a Result of Tort Reform** |
| General Liability Insurance | Increased by 4.1% | Increased by 12.5% | 8.4% reduction or $1.1 billion in savings | Increased by 80% | Increased by 91.6% | 11.6% reduction or $1.6 billion in savings. |
| Medical Malpractice Insurance | Increased by 7.3% | Increased by 26.8% | 19.5% reduction or $692 million in savings | Increased by 53.4% | Increased by 70% | 16.6% reduction or $589 million in savings. |
| Automobile Insurance | Increased by 32.6% | Increased by 34.2% | 1.6% reduction or $734 million in savings | Increased by 59.4% | Increased by 60.5% | 1.1% reduction or $505 million in savings |

they were dependent on the insurance industry for their data, or simply were statistically unreliable). Thus, any study used in this article should be used with caution, keeping in mind certain potential biases.

A study conducted by Blackmon and Zeckhauser, *State Tort Reform Legislation: Assessing Our Control of Risks*[1], monitored 41 states that enacted tort reform laws and other legislation in 1986 aimed at slowing the increase in insurance rates and costs. Generally the study measured actual losses and actual premium changes, estimated what changes in losses and premiums would have occurred without the legislation, and estimated the decreases in losses and premiums the states had resulting from the legislation. Because Ohio did not pass any major tort legislation until 1987 (enacted in 1988), the study does not include Ohio's prior tort reform legislation.

Table 3 provides a summary of the study's findings regarding losses and premiums.

The study found that, although losses and premiums increased, they would have increased more dramatically without the legislation. The legislation, according to the study, reduced losses and premium growth. The study suggested the most effective changes in tort reform entailed joint and several liability and restrictions on non-economic and punitive damages. Some of the potential biases of the study range from statistical validity to the influence of the insurance industry data. The confidence intervals in the study ranged from 70 percent to 99 percent. To be statistically reliable, confidence intervals should be at least 90 percent.

Taking into account the biases above, it is assumed that tort reform can reduce insurer losses and potentially reduce premiums. Before concluding that Ohio's tort reform legislation will reduce losses and premiums paid by government entities, other factors should be considered, the first being the fact that a decrease in losses does not necessarily mean reduced premiums. Although the bill may cause a reduction in losses, premiums may still increase, but their growth may decrease. Thus, a "real" premium reduction may not be realized. Furthermore the study's findings, which estimated a total decrease in losses of $2.6 billion and decrease in premiums of $2.7 billion, were measured in the aggregate of 41 states; small states and large states, as well as states with large reform efforts and some with small efforts. Reform affected states differently; each state did not have the percentage reductions in losses and premiums that was realized in the aggregate. In fact, some states did not experience any conclusive reductions at all. Premium reductions depend upon more than just decreased losses; there is also a large element of human and business behavior. According to the study, one such behavior affecting the success of tort reform is the overall incentive for consumers, manufacturers, patients, physicians, and others to be more efficiently safe and to be efficiently unsafe when rewards exceed the cost of the risks. However, the behavior that most affects premiums is whether a decrease in insurer's losses will be realized as profits by the insurer or used to adjust premiums accordingly.

Throughout the hearings on H.B. 350 the insurance industry remained quiet on the issue of potentially reducing premiums, while bill opponents wanted the bill to include provisions which "guaranteed" premium reductions. If insurance premiums are reduced, as a result of tort reform, whether in "real" dollar amounts, or a reduction in their percentage growth, political subdivisions stand to gain, as their expenditures for liability premiums would be reduced. The bill requires the Department of Insurance to conduct a preliminary study to determine the effects of tort reform on insurance premiums, the availability of insurance, and other aspects of the insurance industry by December 31, 1998 and to produce a final report as soon as it is feasible thereafter.

### *How Will the Bill Affect Health Care Costs?*

Lawsuits regarding medical malpractice arguably increase insurance premiums for hospitals, doctors, and so forth, thus increasing health care costs. H.B. 350 contains several provisions aimed at reducing medical malpractice claims. A reduction in medical malpractice claims combined with a subsequent decrease in health care costs via lower medical insurance premiums, decreases in defensive medicine, lower Medicaid costs, and so forth, would have a positive effect on political subdivisions. However similar to insurance studies, there seem to be few unbiased heath care analyses available that point to actual reductions in health care costs as a result of tort reform.

The most recent study that was conducted on the effects the liability system has on health care costs was a U.S. General Accounting Office (GAO) study. The September, 1995 study, *Medical Liability; Impact on Hospital and Physician Costs Extends Beyond Insurance*, identified the various types of medical liability costs, interviewed and collected data from a number of health care associations, insurance companies, and reviewed recent professional and academic journals. The GAO study was performed from January 1995 through April 1995. The study identified three other studies that estimate certain hospital and physician medical liability costs. These studies were prepared by the GAO,[2] the Congressional Budget Office (CBO),[3] and the Office of Technology Assessment (OTA).[4] The CBO study reported that the cost of purchased malpractice insurance in 1990, which totaled $5 billion, represented 0.74 percent of the national health care expenditures. The OTA study measured purchased insurance and self-insurance costs in 1991 and reported that purchased insurance totaled $4.86 billion, or 0.66 percent of the national health care expenditures. The OTA study also estimated self-insurance costs at 20 percent to 30 percent of premiums, which would mean that purchased insurance and self-insurance amounted to between $5.8 billion and $6.3 billion in 1991, less than 1 percent of national health care expenditures. Other studies that measured purchased insurance and self-insurance for the same periods studied by CBO and OTA estimated costs to be higher. Tillinghast, an actuarial and consulting firm, estimated malpractice insurance costs in 1990 over $8.2 billion[5] while another consulting firm, Lewin-VHI, Inc., estimated costs to be $9.2 billion in 1991.[6] A 1986 GAO study estimated that malpractice insurance costs for self-employed physicians averaged 9 percent of their total professional expenses in 1984, while malpractice insurance costs for hospitals accounted for 1 percent of their average inpatient per-day expense in 1985.

While there are several studies related to the liability system's effects on health care costs, namely malpractice premiums, there are few beyond the Blackmon and Zechhauser insurance study above that suggest tort reform has either reduced medical malpractice premiums or insurer's losses. Tort reform, including caps on damage awards, in California and Ohio reportedly reduced the states' percentage of the nation's medical liability awards. However, there are many factors which can influence awards, so too much weight should not be placed on these results. Ohio previously had a $200,000 cap on general damages for certain medical claims ruled unconstitutional in 1985, *Morris v. Savoy*.

Beyond the studies on the costs of insurance are those that make an effort at estimating the costs of defensive medicine. Defensive medicine costs can be defined as liability-induced changes in medical practice that entail costs in excess of benefits and that would not have occurred in the absence of the liability system. There are both positive defensive practices, such as ordering additional tests, and negative defensive practices, such as refusing care. Defensive medicine has been associated with rising costs of Medicaid and other health care costs.

A study completed by the American Medical Association (AMA) estimated defensive costs at between $9 billion and $10.6 billion in 1984, while a Lewin-VHI study estimated defensive medical costs at between $4.2 billion and $12.7 billion in 1991. A study included in the 1992 CBO report concluded defensive medical costs amounted to $15.1 billion in 1989.[7] These studies, according to the 1995 GAO report, had methodological limitations as they were based partly on the results of physician surveys. Another study, a Hudson Briefing Paper[8], *The High Cost of Medical Liability*, conducted in an Indiana hospital, suggests that legal liability added $450 in costs per patient admitted to the hospital, thus increasing medical costs at the hospital by 5.3 percent. An estimated $327 of the cost per patient was for defensive medicine and the remaining $123 of the cost per patient was for direct costs such as payments to patients, attorney's fees, and costs of litigation. While there are other studies related to the costs of defensive medicine caused by the liability system, it seems there are no reliable studies of reductions in defensive medicine as a result of tort reform. It is particularly difficult to accurately measure any potential cost savings in the area of defensive medicine. What one person terms as defensive medicine another may term necessary medicine. As stated above there is both positive and negative defensive medicine; while a reduction in positive defensive medicine may decrease medical expenditures, a reduction in negative defensive medicine may increase medical expenditures.

Whether any of these studies are reflective of the true costs of medical liability premiums, defensive medicine, or other liability costs is merely anecdotal. The point to be taken is that there are at least some additional medical costs being incurred as a result of the liability system. Thus, it can be assumed that the health care system may potentially experience a decrease in health care expenditures as a result of tort reform. How tort reform will affect those health care expenditures in Ohio, particularly costs incurred by state and local political subdivisions, such as the costs of Medicaid, the costs of providing employees with health care coverage, and the costs of various retirement systems, is uncertain. While the actual decreases in health care costs as a result of the bill may be indeterminate, any decrease for political subdivisions will likely be insignificant.

### *Could Tort Reform Decrease the Costs of Goods and Services for Political Subdivisions?*

The 1992 study conducted by the Bureau of Justice Statistics on tort cases in the nation's 75 largest counties indicated that approximately 40 percent of the tort cases named a business as the defendant. Several business owners and groups testified in subcommittee hearings on the bill to the costs they annually incur defending and settling tort actions and paying insurance liability premiums. Clearly some of these expenses are passed along in the costs of their products and services. The bill creates the possibility of lower costs by placing caps on non-economic damages, establishing statutes of repose, changing joint and several liability, and so forth. If the potential liability for insurers decreased and if insurers lowered business liability premiums as a result, businesses may realize these savings in the price of their products and services. Thus, the costs for political subdivisions to obtain products and services could be reduced. Keep in mind that businesses, like insurance companies, may choose to recognize savings as increased profits rather than passing on the savings to consumers such as political subdivisions.

### *Tort Reforms Effect on Political Subdivision in Review*

The preceding discussion points to the lack of data, biases, and general unpredictability in the tort system. Can tort reform have a positive fiscal effect for political subdivisions? The tort caseload is relatively small enough that even a large decrease as a result of tort reform is unlikely to affect court operation costs significantly; amendments to the political subdivision sovereign immunity laws will likely reduce some settlements and litigation expenses for political subdivisions, but to what degree is uncertain; political subdivisions could benefit from potential savings by the insurance industry; and, health care and business communities would benefit if decreases in liability and lawsuit expenditures were recognized not as profits, but as savings for recipients of their goods and services. To the question of whether H.B. 350 will positively affect political subdivisions, the answer is yes, with a lot of "ifs," "ands," and "buts" attached. One such "if" not discussed in this article but key to the effects of H.B. 350, is if the provisions of the bill will stand up to judicial scrutiny by the Supreme Court of Ohio. The jury is still out.“

[1] Glenn Blackmon and Richard Zeckhauser, two Harvard professors, conducted this study. The study was published as a chapter of Peter H. Schuck's book, *Tort Law and the Public Interest*, a compilation of several authors writing on issues regarding tort law.

[2] *Medical Malpractice: Insurance Costs Increased but Varied Among Physicians and Hospitals*, (GAO/HRD-86-112, September 15, 1986).

[3] *A CBO Study: Economic Implications of Rising Health Care Costs*, CBO (October 1992), and *Statement of Robert Reischauer*, CBO, before the Committee on Ways and Means, U.S. House of Representatives, Appendix F, March 4, 1992.

[4] *Impact of Legal Reforms on Medical Malpractice Costs*, OTA (September 1993).

[5] Tillinghast, *Tort Cost Trends: An International Perspective*, 1992.

[6] Lewin-VHI, Inc., "Response to Medical Malpractice Article," memorandum to Jay Michael, President, Californians Allied for Patient Protection, April 15, 1994.

[7] Based on estimates in Roger A. Reynolds, John A. Rizzo, and Martin L. Gonzalez, "The Cost of Medical Professional Liability," Journal of the American Medical Association, vol. 257, no. 20 (May 22/29, 1987), pp.2776-2781.

[8] McIntosh, David M., and Murray, David C. *The High Cost of Medical Liability*, Hudson Briefing Paper, Number 163, April 1994.

# *Weights and Measures c Studies of Corporate Tax Burden and What They Tell Us*

By Barbara Mattei Smith

The question of determining a means to measure tax incidence on the business sector and the ability of states to compete in attracting new industry continues to reside in the forefront of state policy analysis. Attracting new business to local economies may mean the difference between growing economic wealth and stagnation or decline. Consequently, states have been reviewing their tax policies and have attempted to find a means to measure their ability to compete with other states for new industry. Measures of tax burden have generally attempted to view the tax climate in light of a businessman's decision making process. Some methods focus on the impact of taxes on capital investments and long range profits, other methods have focused on the impact of taxes on corporate expansion or relocation decisions. These methods may result in different measures of tax costs and uniformity of the tax structure.

Three papers researching tax competitiveness were presented at the Revenue Estimating and Tax Research Conference of the Federation of Tax Administrators in September. The Wisconsin and Washington Departments of Revenue presented the results of recently completed studies on corporate tax climate using a representative business model to compare the tax climates for several states. An economist from the Federal Reserve Bank of Chicago presented an alternative methodology by attempting to measure tax expenditures vis-a-vis the benefits received from the consumption of public services by a corporate entity. This article will focus on the results obtained by the Wisconsin study, which included Ohio as a comparison state, and will review the methodology of applying a cost benefit analysis to corporate tax burdens as presented at the conference.

The representative business model evaluates relative tax climates for businesses reviewing expansion and relocation decisions. Data is collected on firms in various industries within the state and sample financial statements are created for hypothetical firms within each industry. Using the sample financial statements, the hypothetical firms are located in many different states. Tax burdens are calculated for each firm and a comparison can then be made across state lines. Wisconsin developed financial statements for hypothetical firms representing seven major industries in the state (each industry has a major presence in Ohio also): paper products, fabricated metal products, machinery products, scientific instruments, food products, printing and publishing, and plastics products. State and local income, property, sales and franchise taxes for each firm were calculated for locations in nineteen states. The table[1] below summarizes the total tax liabilities for each firm in each state studied by type of tax.

This method of estimating tax burdens can be very useful when looking for broad measures of a state's tax climate. However, it does not provide for the dynamic nature of business activities and fails to account for intrastate differences in tax structures. Within Ohio, tax structures can be remarkably different: rural Ohio will generally have a lower tax burden than metropolitan areas due to relative differences in local property, sales, and income tax rates. Additionally, states that grant tax reductions for all new industry will show a lower tax rate even if this reduction is only for a few years. If tax breaks are granted on a case by case basis, these lower rates are excluded even if a substantial number of new firms will receive the breaks (which is common in Ohio.) Finally, tax burden is only one factor used by a business in decisions regarding site locations. This model fails to recognize the impact of such factors as infrastructure, educational assets, labor market characteristics, and proximity to suppliers. State government is limited in its ability

| *State* | *Sales Tax* | *Property Tax* | *Franchise Tax* | *Income Tax* | *Total Liability* | *Overall Ranking* |
|---|---|---|---|---|---|---|
| Alabama | $197,791 | $250,695 | $153,870 | $123,810 | $726,166 | 15 |
| Arizona | 197,596 | 856,616 | 315 | 270,284 | 1,324,811 | 4 |
| California | 374,323 | 253,513 | 35 | 343,107 | 970,978 | 10 |
| Colorado | 47,630 | 683,373 | 91 | 160,519 | 891,613 | 11 |
| Georgia | 317,021 | 543,644 | 9,605 | 202,667 | 1,072,937 | 6 |
| Illinois | 212,796 | 260,122 | 8,634 | 234,612 | 716,164 | 17 |
| Indiana | 33,782 | 896,618 | 70 | 385,258 | 1,315,728 | 5 |
| Iowa | 12,456 | 562,080 | 210 | 115,058 | 689,804 | 18 |
| Louisiana | 546,343 | 767,013 | 106,390 | 177,895 | 1,597,641 | 1 |
| Massachusetts | 33,782 | 247,342 | 98,866 | 336,206 | 716,196 | 16 |
| Michigan | 27,024 | 597,535 | 105 | 724,378 | 1,349,042 | 3 |
| Minnesota | 189,759 | 604,229 | 0 | 240,110 | 1,034,098 | 3 |
| Mississippi | 147,970 | 670,487 | 74,607 | 174,134 | 1,067,198 | 7 |
| New York | 48,981 | 278,669 | 0 | 345,939 | 673,589 | 19 |
| North Carolina | 131,069 | 311,838 | 65,709 | 250,621 | 759,237 | 12 |
| ***Ohio*** | ***40,535*** | ***801,049*** | ***70*** | ***216,939*** | ***1,058,593*** | ***8*** |
| Tennessee | 85,627 | 325,128 | 94,126 | 226,525 | 731,407 | 14 |
| Texas | 400,139 | 942,837 | 79,628 | 0 | 1,422,604 | 2 |
| Wisconsin | 167,197 | 424,751 | 175 | 150,394 | 742,518 | 13 |
| 19 State Average | $169,043<br>17.0% | $540,923<br>54.5% | $36,448<br>3.7% | $246,235<br>24.8% | $992,649<br>100% | |

to control many of these intangible factors but has a great deal of control over the tax climate. Therefore, this model can be employed as a useful policy tool when reviewing overall tax structure and the burdens these policies may place on businesses.

The Wisconsin study does point out the relative burden placed on corporations by the different forms of taxes imposed. It is interesting that, while Ohio's overall tax burden is fairly close to the study's average, a review of each form of taxation provides a more varied analysis. Ohio is considerably below average in sales and franchise tax burdens, close to the average in income tax burdens, and substantially over the average in property tax burdens. Thus, corporations in Ohio devote a larger share of their tax expenditures to the support of local governments than are provided in support of the state government. Since the largest portion of local taxes are collected by school districts, businesses in Ohio make most of their tax payments in support of K-12 education programs.

This view of Ohio's tax structure is particularly interesting when combined with the remarks of William Testa of the Federal Reserve Bank of Chicago[2]. Dr. Testa proposed that business taxes should be structured to recover the costs of the public goods provided to the business. It is not enough simply to measure the incidence of tax if no effort is made to compare the burden with the benefits received. If the tax climate in one state is more burdensome, and therefore less competitive, this can be offset if the state is seen as providing a higher level of public goods for consumption by the industrial sector. Dr. Testa's model reviewed state and local government expenditures by spending categories and prorated these expenditures to the business or household sectors based on an arbitrary proration system. Overall, households were seen as the only beneficiaries for expenditures made in the categories of education, health, welfare, fish and forestry natural resources, and housing and community development. Businesses were seen as the only beneficiaries of expenditures made in the categories of agriculture, other natural resources, and water transportation. Households and businesses were seen as sharing equally in the benefits from expenditures in the categories of transportation, parking, fire protection, police and corrections, judicial, protective inspection and regulation, sewage, and solid waste management. Using this method for states in the Federal Reserve Seventh District, 86.2% of state and local expenditures benefited households while only 13.8% of these expenditures benefited businesses. Dr. Testa concluded that household benefits are subsidized by the business tax.

Accepting this conclusion on face value is difficult. The proration of education expenditures can be used to question the validity of the approach applied. Without a properly educated workforce, finding workers to do the tasks necessary to remain in business is impossible for businesses. Likewise, state and local expenditures in support of agricultural activities will benefit households since they result in lower food prices. By definition, a public good is one that provides benefits to all members of society at a cost too prohibitive for any one member to bear alone. However, this analysis does allow policy makers to view taxation in a different light and may provide insight into ways that better balance the needs of its citizens, corporate and individual, with the costs they are asked to bear.

Considering the results obtained by the Wisconsin study, the structure of business taxes in Ohio merits further review. Is it appropriate for such a large share of corporate taxes to accrue to local governments? What responsibility do corporate citizens have for the education, health, and welfare of the workforce? What percentage of state revenues provide the appropriate climate for business activity and do corporations bear a fair share of this burden? Tax abatements aimed at reducing corporate property tax burdens imply a recognition of the uneven burdens placed upon corporations in Ohio. However, with such a large portion of corporate taxes controlled at the local level, are we encouraging a "dog-eat-dog" contest among local communities trying to attract new industry away from their neighboring communities? "

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[1] Braun, Yeang-Eng, "Measuring Tax Climate: A Representative Corporation Approach", Presented to the FTA Conference on Revenue Estimating and Tax Research, Boston, Massachusetts, September 8 - 11, 1996.

[2] Testa, William A., "State-Local Business Taxation and the Benefits Principle", Presented to the FTA Conference on Revenue Estimating and Tax Research, Boston, Massachusetts, September 8 - 11, 1996.

## *Government Services Television Network Index (cont'd.)*

**By Joshua N. Slen**

The Legislative Budget Office receives a monthly video tape which offers general training and information segments that are applicable to all levels of government. The video tapes are kept at the LSC library, which is located on the 9th floor of the Vern Riffe Center for Government & the Arts, and are available to all members of the General Assembly and their staff. If you have questions about the availability of one of the tapes please contact the LSC library at 466-5312. The programs/segments of the *September and October* editions of the GSTN video are outlined below.

***September***

| *Segment/Topic* | *Running Time* | *Content/Description* |
|---|---|---|
| GSTN Journal / Various newsworthy topics from around the country. | 9:45 | This month's journal includes segments on cable and telephone deregulation, smart highways, and EPA reimbursement for hazardous waste cleanup, among other topics. |
| Leadership Spotlight/ Surveying the Community, Part I | 10:15 | The first in a two part series, this segment details three different types of surveying methods. The program explains the pros and cons of utilizing telephone, direct mail, and personal interviews to survey the community. |
| Training Track/Ethics in the Workplace, Part 3 - Supervising for Ethics | 15:30 | This third segment is as well done as the first two in this series. The program discusses reasons why employees act unethically, gives some examples of major and minor infractions, and outlines how supervisors can help employees avoid ethical dilemmas. |
| Human Factor/Water Department Reorganization, Tonawanda, New York | 11:45 | This segment focuses on utilizing a team approach to redesigning an organization. The team approach allowed Tonawanda to consolidate and streamline operations in a nonthreatening atmosphere. |
| Money Watch/Competitive Service Delivery, Part I | 14:15 | This program begins an in-depth review of the common characteristics that public sector services which lend themselves most readily to private competition share. Five aspects of service delivery providers are examined. |

## Government Services Television Network Index (cont'd.)

### October

| Segment/Topic | Running Time | Content/Description |
|---|---|---|
| GSTN Journal/Various newsworthy topics from around the country | 9:25 | This month's journal includes segments on rising cable rates, background checks for volunteers working with children, and wireless modems, among other topics. |
| Leadership Spotlight/Surveying the Community, Part II | 10:45 | The second in a two part series, this concentrates on the importance of survey design, implementation, and interpretation. The report concludes by citing a special report titled "Citizen Surveys: How to do them, Ho to use them, and What they mean, and providing a toll free number for obtaining the report (1-800-745-8780). |
| Training Track/The Last Straw: A Guide to Manual Material Handling | 16:30 | The program discusses how to prevent bodily injuries in the workplace. Statistics for the number of back injuries are provided and the focus of the segment is on preventing injuries to your back. Lifting techniques are outlined and the dangers of repetitive actions are discussed. |
| Human Factor/Handling Difficult Public Meetings | 14:30 | This segment focuses on techniques for dealing with three types of people who disrupt meetings. The types of people identified are "the dominator, the hair splitter and the know-it-all." Different techniques for dealing with each type of individual are discussed. |
| Money Watch/Competitive Service Delivery, Part II | 11:45 | This program continues an in-depth review of the common characteristics that public sector services which lend themselves most readily to private competition share. This segment discusses some of the major external and internal factors that need to be considered when deciding whether to utilize competitive service delivery. |