Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE JANUARY, 1997

FISCAL OVERVIEW

— Frederick Church

Tax revenues were $21.4 million over estimate last month, despite a big shortfall in the corporate franchise tax. The $45.2 million overage in the personal income tax was by far the biggest variance in December, and it pushed year-to-date revenues back above the estimate. This strong showing in the income tax followed a disappointing November, and the monthly fluctuations in this tax throughout FY 1997 have made it difficult to get a handle on exactly where it is going. January is a hugely important month for the income tax: the final estimated payment against taxable year 1996 is due, and withholding in January is always very large due to such factors as the payment of year-end bonuses and the remittance of tax for Christmas season work. We should have a much clearer picture of how the income tax will end FY 1997 by next month.

The non-auto sales tax continues to do well, posting a string of small but steady overages. The tax was $6.2 million over estimate in December, boosting the year-to-date overage to $28.0 million. While the strength in the non-auto tax has seemed surprising in light of the weak national retail sales numbers, upward revisions to those numbers may remove some of the mystery. On the other hand, the auto sales tax fell below estimate in December, and seems to be trending downward. The December shortfall almost wiped out the accumulated year-to-date overage. The outlook for the auto sales tax looks considerably weaker than it did a couple of months ago.

It was apparent by early December that there would be a shortfall in the corporate franchise tax. Corporate franchise tax refunds against tax year 1996 payments, which OBM expected the state to pay in November, were instead paid in December. Despite the December shortfall, for the two months combined receipts were actually $3.9 million over estimate. For the year-to-date, franchise tax revenues are $6.6 million over the estimate, but the three major payments against taxable year 1996 are all still to come

Most of the smaller taxes are very close to the year-to-date estimate. An exception, the cigarette tax continues to outperform the forecast, having grown 3.4 percent rather than declining 2 percent as predicted.

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STATUS OF THE GRF

QUARTERLY LOTTERY REPORTS

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OHIO FACTS EXTRA!

The January GSTN video tape has not yet been received by LBO. As such, the summary index of this month's tape will be in the February issue of *Budget Footnotes*.

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
General Revenue Fund
Simplified Cash Statement
($ in millions)

	Month of December	Fiscal Year 1997 to Date	Last Year	Difference
Beginning Cash Balance	($497.8)	$1,138.5		
Revenue + Transfers	$1,224.4	$7,665.4		
Available Resources	$726.5	$8,803.9		
Disbursements + Transfers	$1,292.3	$9,369.7		
Ending Cash Balances	**($565.7)**	**($565.7)**	**($742.0)**	**$176.2**
Encumbrances and Accts. Payable		$401.5	$373.7	$27.8
Unobligated Balance		**($967.2)**	**($1,115.7)**	**$148.4**
BSF Balance		$828.3	$828.3	
Combined GRF and BSF Balance		**($138.9)**	**($287.4)**	**$148.4**

On the non-tax side, federal grants continue to fall short of the estimate. December's reimbursement was $9.1 million below the forecast, and the year-to-date shortfall is now $88.4 million - roughly what one would expect given the underspending in Medicaid and the other welfare programs that draw federal matching money.

For the year, tax revenues are $83.5 million over estimate — a variance of 1.5 percent — with growth of 6.8 percent from last year. The December surge in the income tax is responsible for almost half of this overage. Whether or not the GRF performs this well in the second half of the fiscal year seems to be riding primarily on the income tax: the outlook for the other major taxes seems clearer at this point.

Disbursements from the GRF in November were $101.4 million below estimate, despite overages in both K-12 education spending and higher education spending. The main factor was underspending of $58.9 million in property tax relief. Tax relief had been running far above estimate for the year (the only category to do so), but this was simply due to earlier payouts to the counties than expected. The estimate caught up with payments in December: for the first half of the year, payouts are actually slightly below forecast. Although it is not foolproof, the half-year variance for property tax relief is generally a pretty good predictor of the full-year variance.

Although K-12 education spending was over the estimate in December, the it remains well below estimate for the year. Most of the underspending is in the Foundation line items, and it seems that use of the old ADM figures may once again be the culprit. The Department of Education will begin using updated ADM figures in January (first full-month impact should be in February) and it will be interesting to see how quickly spending begins to catch up to the estimates.

For the year, disbursements are $353.0 million below estimate, although the overage in the other transfers category keeps the variance in total outlays down to $311.4 million. Spending excluding transfers has grown by only 3.9 percent. Most spending categories are below estimate, with human services leading the way. Medicaid spending is more than $110 million below the estimate and its growth from last year is less than 1 percent.

Much of this underspending can be traced to the HMO category, which is also about $110 million below estimate. Both lower than estimated caseloads and capitation rates are responsible. Lower than estimated HMO caseloads may be due to the decline in ADC recipients, particularly in the urban counties that have mandatory HMO enrollment requirements for ADC Medicaid eligible persons.

The other major component of welfare spending, ADC/TANF, is also well below estimate. While it is difficult at present for LBO to tell exactly where TANF is relative to the estimate due to the switch in accounting from the old ADC program, all evidence points to TANF, like ADC, being well below estimate. It would not be surprising to find that ADC/TANF spending is actually below last year's pending for the old ADC program at the halfway point of the fiscal year.[1]

A quick look at Table 1 will reveal that the impact of continued large underspending has been to keep unobligated GRF balances well above where they were last year (which was itself healthy). The GRF balance and the combined GRF and BSF (Rainy Day Fund) balance is $148.4 million above last year's level. In broad terms, the outlook for the second half of the fiscal year is roughly the same as for the first half. While education spending may catch up with the forecasts, welfare spending is expected to continue to be far below estimate, barring some unforeseen economic downturn of major proportions. Although the picture for the income tax is somewhat uncertain, the other taxes seem on track with the estimates, and it is unlikely that the income tax would experience a shortfall so big as to offset the underspending in welfare. If in fact year-end GRF balances are bigger than expected, by law the surplus would have to be used for another income tax rate cut for tax year 1997, similar to the one already in effect for tax year 1996. ❑

TRACKING THE ECONOMY

— Frederick Church

There are now several indicators that suggest that, after slowing in the third quarter, the U.S. economy picked up steam in the just-completed fourth quarter. Real GDP growth for the third quarter was only 2.0 percent, but many economists now believe that fourth quarter growth will exceed 3 percent. Despite this stronger growth, inflation seems to be still in check. The first part of calendar year (CY) 197 could also be stronger than expected.

One of the strongest indicators of a U.S. rebound in the fourth quarter is the Federal Reserve Board's index of industrial production, which rose 0.8 percent in December, the second straight month of solid gains for the index. November's gain was also 0.8 percent, and the increase for CY 1996 as a whole was 3.2 percent. In general, November's and December's gains have been strongest in manufacturing, particularly in durable goods such as cars, appliances, and computers.

The same Federal Reserve report also offered support for the hypothesis that inflation pressures are still under control. The capacity utilization rate was estimated to be 83.8%, up from a revised 83.4% in November, but below the 85% level at which many economists fear that bottlenecks and shortages can emerge.

On a seasonally adjusted basis, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.3 percent in December, the same as in each of the three preceding months. However, the increase in the CPI-U excluding food and energy, also known as the "core CPI" has been slower. It rose only 0.1 percent in December, following increases of 0.2 percent in each of the preceding two months. The core CPI is considered to be a better measure of underlying inflation pressures in the economy because food and energy prices are subject to relatively large short-term swings that have less to do with the overall economy than with conditions particular to those markets.

For all of 1996, the CPI-U rose 3.0 percent from 1995, making 1996 the fifth consecutive year that this measure of inflation has been 3 percent or less.[2] Also, despite the fact that overall inflation accelerated somewhat, from 2.8 percent in 1995 to 3.0 percent in 1996, core inflation actually declined from 3.0 percent to 2.7 percent, the lowest mark over the five year low-inflation period. Wages also outpaced inflation in CY 1996: over the past year, average hourly earnings rose by 3.8 percent, while average weekly earnings increased by 5.3 percent.

In other labor market news, January statistics both painted a rosy picture of CY 1996 and suggested a fourth quarter rebound. First, total nonfarm payroll employment (establishment survey data) increased by 262,000 in December to 120.7 million, after seasonal adjustment, and rose by 2.6 million over the year. (about 2.2 percent). The private sector added 231,000 jobs in December, and private sector job growth during the fourth quarter averaged 218,000 per month, well above the third-quarter average of 147,000. Meanwhile, the household survey also showed employment increasing by about 2.2 percent in CY 1996, and the December unemployment rate stayed at 5.3 percent.

In the week ending Jan. 11, the advance figure for seasonally adjusted initial claims for state unemployment insurance was 323,000, a decrease of 32,000 from the previous week's revised figure of 355,000, and the biggest drop in almost six months, according to the U.S. Department of Labor. The four-week moving average of claims, considered to be a better indicator of labor-market health, fell 6,750 to 348,750 although it remains high relative to last year's level. Generally, claims have been trending upward since August. While one week of data does not constitute a new trend, it is possible that the labor market "loosening" that analysts had predicted might not be here yet.

Finally, despite the complaints of retailers (particularly large chain stores) the preliminary retail sales report for December showed total sales rising about 4.5 percent from the same month last year, with both automotive sales and non-auto sales rising by the same amount. While this is not spectacular growth, it is within the 4 percent to 5 percent range that most analysts had originally expected, before anecdotal reports about "disappointing Christmas sales" started coming in. November retail sales were also revised upward somewhat. In fact, sales growth for the Christmas season this year was stronger than it was in 1995.

For all of CY 1996, total U.S. retail sales grew 5.0 percent from CY 1995 - non-auto sales grew by 4.2 percent, while auto sales grew by 7.5 percent. All these figures were down slightly from CY 1995. Unfortunately, Ohio retail sales data reporting is several months behind the national total, so LBO does not have current Ohio figures. However, it would not be surprising if Ohio's retail sales growth had outpaced the nation's, as it has been since the last recession. When one examines annual retail sales totals over the 1990-1995 period, Ohio grew by 43.2 percent, while the nation grew by 27.0 percent. Ohio's growth was about 1.5 times the national increase over that 5 year period.[3] ❑

Status of the General Revenue Fund

REVENUES

— *Frederick Church*

Tax revenue was $21.4 million over estimate in December, increasing the year-to-date overage to $83.5 million. The largest overage is in the personal income tax, where the December windfall pushed revenue to $38.0 million over estimate. The non-auto sales tax is $28.0 million over estimate, and the cigarette tax is $7.4 million over estimate. On the non-tax side, investment earnings are $8.6 million above estimate, and licenses and fees are $4.1 million over estimate, but federal reimbursement shows an $88.4 million shortfall. This shortfall is about what one would expect given the roughly $260 million underspending in human services programs.

Table 2
General Revenue Fund Income
Actual vs. Estimate
Month of December, 1996
($ in thousands)

REVENUE SOURCE	Actual	Estimate*	Variance
TAX INCOME			
Auto Sales	$45,427	$50,231	($4,804)
Non-Auto Sales & Use	364,185	357,966	6,219
Total Sales	$409,612	$408,197	$1,415
Personal Income	$459,152	$414,000	$45,152
Corporate Franchise	(19,729)	(4,568)	(15,161)
Public Utility	(156)	0	(156)
Total Major Taxes	**$848,879**	**$817,629**	**$31,250**
Foreign Insurance	$0	$0	$0
Domestic Insurance	0	0	0
Business & Property	29	135	(106)
Cigarette	26,278	24,778	1,500
Soft Drink	0	0	0
Alcoholic Beverage	3,862	3,916	(54)
Liquor gallonage	2,363	3,300	(937)
Estate	3,388	13,600	(10,212)
Racing	0	0	0
Total Other Taxes	$35,920	$45,728	($9,809)
Total Taxes	**$884,799**	**$863,357**	**$21,441**
NON-TAX INCOME			
Earnings on Investments	$20,968	$18,000	$2,968
Licenses and Fees	2,689	3,900	(1,211)
Other Income	8,843	5,925	2,918
Non-Tax Receipts	$32,500	$27,825	$4,675
TRANSFERS			
Liquor Transfers	$10,000	$12,000	($2,000)
Budget Stabilization	0	0	0
Other Transfers In	0	0	0
Total Transfers In	$10,000	$12,000	($2,000)
TOTAL INCOME less Federal Grants	**$927,299**	**$903,182**	**0**
Federal Grants	$297,062	$306,142	($9,080)
TOTAL GRF INCOME	**$1,224,361**	**$1,209,324**	**$15,036**

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

Detail may not add to total due to rounding.

Sales and Use Tax

The non-auto tax has grown by 5.5 percent over the first half of FY 1997, almost a point higher than the 4.6 percent increase in U.S. non-auto retail sales over the same period.[4] Tax revenue growth is also well ahead of the estimate, which for the first six months of the year was 4.2 percent.

It will not be quite as easy to achieve non-auto tax overages in the second half of FY 1997. OBM estimated only 4.2 percent growth for the first half of the year, but estimated growth for the second half is a full point higher, at 5.2 percent (estimated growth for the whole fiscal year is 4.7 percent). If the non-auto tax keeps growing at 5.5 percent, as it did in the first half of the year, it will still exceed the forecast. However, since U.S. retail sales are projected by most analysts to keep growing in the 4 to 5 percent range, Ohio tax revenue growth will have to keep outstripping national sales growth.

OBM projected that January non-auto revenues would increase 5.8 percent from last year. Initially this seems rather steep given that national non-auto retail sales for December increased by only 4.5 percent. However, if Ohio sales are still outperforming the nation, and special factors like Ohio's accounting for auto lease revenue as non-auto taxes are still having an impact, then this target is reachable.

Ohio's auto sales tax is starting to see-saw like the income tax. Over the last three months, revenues were weak in October, bounced back in November, and then fell flat again in December. After half of the fiscal year, the auto sales tax is $0.7 million over estimate, but growth is only 2.6 percent, compared to U.S. automotive retail sales growth of 5.6 percent. The story in the auto sales tax is the opposite of the non-auto tax: Ohio is underperforming the national figures in auto sales. (As mentioned above, this is partly a result of the way Ohio accounts for the sales tax on auto leasing transactions.)

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	$342,858	$342,115	**$743**	$334,224	2.58%
Non-Auto Sales & Use	2,154,492	2,126,489	**28,004**	2,041,737	5.52%
Total Sales	$2,497,350	$2,468,603	**$28,747**	$2,375,962	5.11%
Personal Income	$2,521,377	$2,483,400	$37,977	$2,325,073	8.44%
Corporate Franchise	23,753	17,130	6,623	10,782	120.30%
Public Utility	212,134	209,920	2,214	197,178	7.58%
Total Major Taxes	$5,254,614	$5,179,053	$75,560	$4,908,996	7.04%
Foreign Insurance	$143,256	$144,275	($1,019)	$136,496	4.95%
Domestic Insurance	200	0	200	79	153.16%
Business & Property	985	1,935	(950)	2,152	-54.25%
Cigarette	140,006	132,635	7,372	135,370	3.42%
Soft Drink	17	0	17	4	302.33%
Alcoholic Beverage	26,692	25,700	992	26,571	0.45%
Liquor gallonage	13,411	14,467	(1,056)	14,419	-6.99%
Estate	45,321	42,925	2,396	41,835	8.33%
Racing	0	0	0	0	#N/A
Total Other Taxes	$369,888	$361,937	$7,951	$356,926	3.63%
Total Taxes	**$5,624,503**	**$5,540,990**	**$83,513**	**$5,265,921**	**6.81%**
NON-TAX INCOME					
Earnings on Investments	$50,988	$42,375	$8,613	$51,028	-0.08%
Licenses and Fees	43,390	39,325	4,065	41,754	3.92%
Other Income	42,838	41,400	1,438	45,505	-5.86%
Non-Tax Receipts	$137,216	$123,100	$14,116	$138,287	-0.78%
TRANSFERS					
Liquor Transfers	$33,500	$31,500	$2,000	$32,000	4.69%
Budget Stabilization	0	0	0	0	#N/A
Other Transfers In	64	0	64	10,150	-99.37%
Total Transfers In	$33,564	$31,500	$2,064	$42,150	-20.37%
TOTAL INCOME less Federal Grants	**$5,795,282**	**$5,695,590**	**$99,693**	**$5,446,359**	**6.41%**
Federal Grants	$1,870,156	$1,958,525	($88,369)	1,845,208	1.35%
TOTAL GRF INCOME	**$7,665,438**	**$7,654,115**	**$11,323**	**$7,291,566**	**5.13%**

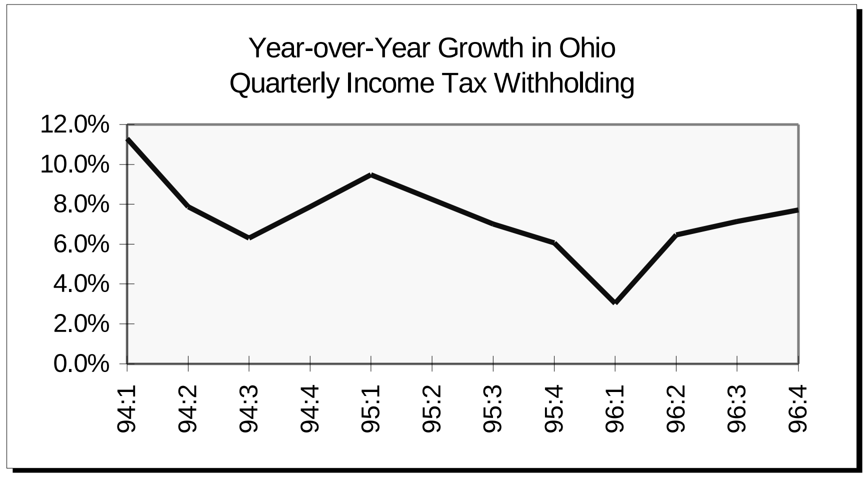
* July, 1996 estimates of the Office of Budget and Management.

The outlook for the rest of FY 1997 does not look as clear as it was. Many economic analysts still see increasing light vehicle sales for the long term, but some of them have reduced their forecasts for CY 1997. For example, DRI is now forecasting a drop in unit sales of light vehicles from 15.1 million in CY 1996 to 14.8 million in CY 1997, although sales are then forecast to rise to 15.7 million units by 2001. In dollar terms, DRI expects inflation-adjusted consumer spending on autos to decline this coming year. Auto forecasts from the WEFA Group predict a similar decline in CY 1997. The good news is that OBM's estimated growth for the last six months of FY 1997 is only 0.6 percent. Despite the auto slowdown, tax revenues may be able to hit this low target.

Personal Income Tax

Apparently the monthly numbers cannot be relied on at all. After a disappointing October and November, employer withholding shot up $46.3 million above the estimate in December (the income tax as a whole was $45.2 million above estimate). After posting a year-over-year gain of 6.0 percent in October, and a 1.8 percent decline in November, withholding was up 19.3 percent in December. The $20.8 million year-to-date withholding shortfall was turned into a $25.6 million overage, just like that. The income tax overall has bounced back from a deficit to a $38.0 million overage.

Whatever the reason for the wild month-to-month fluctuations, the quarterly data is much better behaved. Withholding for the October through December quarter was $16.9 million over estimate (1.3 percent), and up 7.7 percent from the fourth quarter last year. As the graph below illustrates, quarterly withholding growth is still on an upward trend, although it is starting to flatten out.



The state is not out of the woods yet. January is the crucial month for employer withholding, the time when payments of year-end bonuses and high payrolls for additional Christmas season workers show up in tax remittances. If revenues hit the estimate in January, the outlook for the year as a whole will look very rosy. Estimated growth over the February through June period is not very high, and if labor markets continue to show the same strength, collections should hit or exceed the target. If revenues fall short in January, recent history suggests that one will have to wait until February to get an idea of whether there is really a shortfall or if instead some unforeseen timing quirks have temporarily produced a variance.

The other very important factor in January is quarterly estimated payments. The January payment is the last payment against tax year 1996 liability, and so it may follow the pattern of prior years where it acts as a "reconciliation" payment. That is, taxpayers who make estimated payments do a rough calculation of the tax they actually owe against 1996 and compare that amount to their estimated payments. If the tax owed is higher than expected, they make a big "catch-up" payment in January; if the tax owed is lower than expected, they cut their January payment. Thus, the January payment acts as an advance indicator for the whole filing season's refunds and tax payments. So far, preliminary evidence indicates that January estimated payments may be a little better than expected, suggesting that the filing season may also be stronger than anticipated.

Cigarette Tax

The cigarette tax continues to exceed expectations. The tax is growing rather than declining - it has increased 3.4 percent so far in FY 1997, rather than falling 2.0 percent as predicted. Alert readers will recall that the recent history of this tax has been for revenues to outperform the forecasts. In FY 1996, cigarette tax revenue fell by 0.4 percent, but this was significantly better than the estimated decline of 4 percent. In FY 1995, tax revenue grew by 3 percent.[5] Why is this tax growing, in defiance of the conventional wisdom that U.S. cigarette consumption is declining?

The answer has at least two parts. First, while Ohio's tobacco taxes are higher than those of Indiana or Kentucky, they are lower than those in Pennsylvania and much lower than in Michigan. Ever since Michigan increased it's tax per pack from 25 to 75 cents, Ohio has reaped some benefits from cross-border sales. Cigarette bootlegging is no longer a one-way street in Ohio: Ohioans may want cheap cigarettes from Kentucky, but Michiganders want cheap cigarettes from Ohio.[6]

A second factor that may be at work is Ohio's addition of non-cigarette tobacco products to its tax base in 1992. While the use of such products as snuff and cigars has not been studied as extensively as cigarette consumption, it may be that the downward trend in cigarette consumption is not present in these other products. The anecdotal evidence is that cigar sales are booming nationwide: while LBO is not sure how big a share of Ohio's tobacco taxes they represent, the growth there must be offsetting the decline in some other tobacco items. ❑

[1] As mentioned in prior issues of this report, the change from the ADC program to the TANF program has caused spending to be reclassified across GAAP categories, making ADC spending look much lower and boosting "Other Welfare" spending. Since the monthly spending estimates for FY 1997 were done without this change in mind, ADC spending will be far below estimate and Other Welfare spending will be far over estimate for the remainder of the year, unless OBM and LBO restructure their estimates.

[2] These calculations are based on annual averages of the monthly index numbers; some analysts report percentage changes on the December-over-December basis, which show slightly higher inflation for CYC 1996.

[3] These numbers should be taken with at least a grain of salt. Retail trade economists have remarked on more than one occasion that it is hard to match up the state retail sales numbers with tax collections or other measures of a state's economy. However, the presence of such a large and persistent difference as we have seen over the last five years suggests that there is something real happening that requires explanation.

[4] Actually, retail sales are lagged one month because the Ohio non-auto tax is based on prior month sales activity.

[5] There is revenue growth in prior years also, but it is largely due to law changes such as increases in tax per pack and the imposition of a tax on other tobacco products, which are lumped together with the cigarette tax.

[6] Michigan's cigarette tax increase was part of its property tax reduction and education finance reform package. For a rough estimate of how much tax revenue Ohio may be gaining from cross-border sales, please see the February 1996 issue of ***Budget Footnotes***.

DISBURSEMENTS

— *Chris Whistler**

Disbursements for FY 1997 fell even further below estimate in December. The $101.4 million variance for the month pulled total year-to-date GRF uses to $311.4 million under estimate. Total program payments (total GRF uses less transfers) were even further below estimate through December, ending the month $353.0 million under for the year-to-date. (As discussed in the last issue of ***Budget Footnotes***, $40.0 million of the difference is due to temporary transfers out of the GRF which are expected to be replenished in January, 1997 — which will bring the total uses variance closer to that of program payments.)

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

USE OF FUNDS			
PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$361,111	$345,477	$15,634
Higher Education	137,536	131,200	6,336
Total Education	$498,648	$476,677	$21,971
Health Care	$441,539	$466,817	($25,278)
Aid to Dependent Children	(1,306)	86,542	(87,848)
General Assistance	6	0	6
Other Welfare	126,409	54,561	71,848
Human Services (2)	63,834	81,511	(17,677)
Total Welfare & Human Services	$630,482	$689,431	($58,949)
Justice & Corrections	$85,985	$84,471	$1,514
Environment & Natural Resources	6,489	6,613	(124)
Transportation	3,027	6,201	(3,175)
Development	14,266	12,140	2,126
Other Government (3)	17,618	24,268	(6,650)
Capital	1,487	698	790
Total Government Operations	$128,871	$134,390	($5,519)
Property Tax Relief (4)	$34,276	$93,200	($58,923)
Debt Service	0	0	0
Total Program Payments	**$1,292,277**	**$1,393,698**	**($101,421)**
TRANSFERS			
Capital Reserve	$0	$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	0	0	0
Total Transfers Out	$0	$0	$0
TOTAL GRF USES	**$1,292,277**	**$1,393,698**	**($101,421)**

(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.

The big story in December was the fact that **Property Tax Relief**, which had been the only category running consistently over estimate this fiscal year, was $58.9 million below estimate. This reconciliation of timing issues throughout the first half of FY 1997 left the category only $3.4 million under estimate for the year-to-date through December.

In the past, the variance at the end of December has been a good indicator of the year-end variance. If that holds true, **Property Tax Relief** should end the year with a variance of less than one percent. Generally, all tangible tax relief is paid during the October through December time period — so the variance for that component has already run its course. Real property tax relief, however, usually has a more even disbursement pattern between the first and second halves of the fiscal year. Property tax relief disbursed in the first half of the fiscal year can be paid any time over the September through November period. County auditors usually settle up with local taxing districts over the distribution of the June real property tax payment in August. They then submit requests to the state for reimbursement of the 10 percent and 2.5 percent rollbacks, and the homestead exemption. This year, requests were processed and payments were made earlier than OBM had expected, resulting in a big overage by the end of November. However, there was much less to be paid out in December than originally anticipated, so December disbursements were much lower than expected and year-to-date payments are now actually slightly below estimate.

Foundation Spending, FY 1997 YTD
(in thousands)

Line Item	Actual	Estimate	Variance
Basic Aid	$1,023,733	$1,040,400	($16,667)
Transportation	$85,672	$85,532	$140
Special Education	$247,197	$250,408	($3,211)
Vocational Education	$138,778	$139,782	($1,004)
DPIA	$138,247	$144,242	($1,004
Gifted Education	$12,854	$11,771	$1,083
TOTAL	$1,646,481	$1,672,135	($25,654)

Primary and Secondary Education spending for the month of December was $15.6 million over the estimate of $345.5 million. Considering the fact that the category was $45.5 million under estimate through November, the overage seems to be a move in the right direction. However, the overage was not due to spending in the foundation line items, which were on track at the end of the first quarter but have now slipped to $25.7 million under estimate for the first half of the fiscal year. Most of the overage for the month can be attributed to overspending of $12.6 million in the 200-406, Head Start, line item that apparently occurred earlier than had been anticipated, and a $4.3 million overage in the 200-534, Desegregation Costs, line item that corrected previous underspending.

Once again, LBO will be looking closely at spending in both January and February to see what effect updated ADM figures will have on spending in the 200-501, School Foundation - Basic Allowance, line item. The updated figures will be used by the Department of Education beginning with the second foundation payment in January, and will be fully incorporated in both foundation payments in February.

Although we still have not received revised spending estimates from the Department of Human Services or the Office of Budget and Management (OBM) to account for line item changes resulting from the new Temporary Assistance for Needy Families (TANF) block grant, the combined variance of the **ADC** and **Other Welfare** spending components suggests that cash assistance caseloads continue to run well below revised estimates. (In August, 1996, following a lapse of over $100 million in FY 1996, OBM revised FY 1997 spending estimates in the 400-503, ADC, line item downward from the appropriation by $40.0 million.) The two-category combined negative variances of $16.0 million in December and of $100.5 million for the fiscal year-to-date, as well as knowledge of the spending patterns of other programs within the two components, seem to indicate that the largest component, TANF, is below estimate.

Lower-than-expected cash assistance caseloads have had a tremendous impact on spending in the **Health Care** (Medicaid) program this fiscal year. As discussed in previous issues of ***Budget Footnotes***, the declining caseload has had the most noticeable effect in the health maintenance organization (HMO) spending category in the 400-525, Health Care/Medicaid, line item. Spending in the HMO category was about $110 million under estimate through December — about two-thirds of which can be attributed to caseloads. The remaining one-third has been due to below estimate capitation rates, which, in part, can be attributed to the six percent “managed care savings” incorporated into the FY 1997 capitation rates, which was not accounted for in the estimates. Although fee-for-service spending categories also have been affected by the declining welfare caseloads, there is a possibility that the decline has been most significant in the more urban counties, seven of which have mandatory HMO enrollment for ADC and Healthy Start Medicaid eligibles.

Although **Medicaid** spending was under estimate by $25.3 million in December, which contributed to the $111.5 million year-to-date variance, an overage within the 400-525 line is worth noting. Medicaid spending on prescription drugs has been one of the fastest growing service categories. The decline in the growth rate of long-term care spending has allowed the spotlight to shift to this smaller, yet similarly explosive category. Prescription drug spending increased by 10.9 percent from FY 1994 to FY 1995, and then by 13.5 percent in FY 1996. It is clear from the table entitled “Medicaid Prescription Drug Spending” that aged, blind, and disabled (ABD) Medicaid eligibles account for the largest share of drug spending, comprising 82.5 percent of the total spending during the July through December time period in FY 1996 and 86.9 percent in FY 1997.

The growth in prescription drug spending was expected to slow during this biennium for three reasons: drug inflation had been moving closer to the inflation rate of all other items, the ABD population was not expected to grow

Medicaid Prescription Drug Spending*

	FY 1997 YTD	FY 1996 YTD	% Change
Total Dollars	$269,183,819	$254,229,012	5.9%
ABD	$233,832,529	$209,628,377	11.5%
ADC	$29,220,342	$36,363,471	(19.6%)
ADC-Other	$6,164,804	$8,218,711	(25.0%)
Adjustments	($33,856)	$18,453	
Total Recipients	2,061,310	2,305,092	(10.6%)
ABD	1,312,271	1,287,193	1.9%
ADC	634,739	844,746	(24.9%)
ADC-Other	114,300	173,153	(34.0%)

* Amounts do not account for drug rebates, which equal about 20 percent of total spending
Recipient numbers include multiple visits
ABD: aged, blind, and disabled Medicaid eligibles
ADC: recipients of ADC cash assistance and Healthy Start eligibles
ADC-Other: recipients of Title-IV-E, adoption assistance, and other ADC-related programs
(Source: BOMM1420-R004 Report, Ohio Department of Human Services)

as rapidly, and ADC fee-for-service drug claims were expected to decline as managed care enrollment increased. All three things have occurred.

So why then is spending on prescription drugs over estimate by 11.1 percent, or $21.5 million this fiscal year? The first part of the answer stems from spending in the last fiscal year. Prescription drug spending in FY 1996 was $38.0 million over estimate. Since the same time last fiscal year, drug spending has increased by 5.9 percent, which is not far off of the anticipated increase of 4.9 percent from FY 1996 to FY 1997 used to set appropriations in the budget bill. However, the overage in FY 1996 drove the base for the FY 1997 increase upward — so even though prescription drug spending is increasing at a rate very similar to what was expected this fiscal year, the actual amount of spending in FY 1996 necessitated a 4.8 percent decline in FY 1997 to hold the latter year to the estimate.

The second part of the answer is not quite as clear. At first glance, it would be easy to attribute the big increase in FY 1996 to the payment of outstanding claims for drugs that were received in previous years in which there were more eligibles than the current number; but, that would not explain the continued growth in FY 1997. The table entitled "Medicaid Prescription Drug Variance" reveals that the actual number of drug claims in FY 1997 is only over estimate by 1.8 percent, whereas the cost-per-claim is over estimate by 9.1 percent — thus, the majority of the total variance can be attributed to a higher-than-expected average cost-per-claim. The higher cost-per-claim is likely due to the higher ratio of more costly ABD recipients to ADC/ADC-Other recipients (as illustrated in the "Medicaid Prescription Drug Spending" table). However, the drop in ADC/ADC-Other eligibles is not the only thing driving this ratio upward. The utilization rate (the number of claims per eligible), and in turn the number of recipients, of prescription drugs among the ABD eligibility group has been increasing rapidly — relative to movements in other service categories — in recent years. So, the unanticipated increase in the utilization rate by ABD eligibles led to a greater number of more costly claims, while the extreme decline in the ADC caseload led to fewer, less costly claims. The net result has been a higher-than-expected average cost-per-claim.

Despite overages totaling $14.2 million by the Department of Alcohol and Drug Addiction Services (ADA) and the Department of Mental Health (DMH), December **Human Services** spending was under estimate by $17.7 million. Simply put, big timing issues outweighed smaller ones as a negative variance of $29.4 million by the Department of Mental Retardation and Developmental Disabilities (DMR) had greater pull than the overages of $6.2 million and $8.0 million by ADA and DMH, respectively. Almost all of the variance by DMR can be attributed to line items 322-

Medicaid Prescription Drug Variance
FY 1997 Year-to-Date Actuals vs. Estimates

	Actuals YTD*	Estimates YTD	% Variance
Total Spending	$269,183,819	$242,361,863	11.1%
Rebates	$53,836,764	$48,472,373	11.1%
Net Spending	$215,347,055	$193,889,490	11.1%
Claims	9,787,437	9,609,921	1.8%
Cost/Claim	$22.00	$20.18	9.1%

* FY 1997 "actual" rebates estimated as 20 percent of total spending

413, Residential Services, and 322-501, County Subsidy. According to OBM, the semi-annual payment for Supported Living (out of the 322-413 line) and the subsidy for day programs (out of the 322-501 line item) did not go out by the end of the month as planned. The payments are expected to be released in January.

The monthly variances by ADA and DMH also can be easily explained. The $6.2 million overage by the Department of Alcohol and Drug Addiction Services resulted from the reconciliation of a timing issue in November caused by a delay in processing county subsidies. For DMH, almost all of the $8.0 overage can be attributed the timing of county draw-downs from line items 334-408, Community Mental Health and Hospital Services, and 335-508, Services for Severely Mentally Disabled Persons.

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)	$2,213,938	$2,243,844	($29,906)	$2,058,540	7.55%
Higher Education	1,076,958	1,088,509	(11,551)	1,024,283	5.14%
Total Education	$3,290,896	$3,332,353	($41,457)	3,082,823	6.75%
Health Care	$2,486,784	$2,598,266	($111,482)	$2,468,002	0.76%
Aid to Dependent Children	274,199	541,428	(267,230)	512,762	-46.53%
General Assistance	95	0	95	9,389	-98.99%
Other Welfare	553,919	387,158	166,761	320,082	73.06%
Human Services (2)	586,714	635,017	(48,303)	582,161	0.78%
Total Welfare & Human Services	$3,901,711	$4,161,868	($260,158)	$3,892,395	0.24%
Justice & Corrections	$696,492	$704,982	($8,490)	$627,055	11.07%
Environment & Natural Resources	68,358	67,748	611	64,760	5.56%
Transportation	8,992	13,590	(4,598)	14,234	-36.83%
Development	70,761	72,905	(2,144)	60,559	16.85%
Other Government (3)	188,124	220,739	(32,615)	187,412	0.38%
Capital	3,813	3,701	112	2,084	82.91%
Total Government Operations	$1,036,540	$1,083,664	($47,124)	$956,104	8.41%
Property Tax Relief (4)	$488,971	$492,341	($3,370)	$456,361	7.15%
Debt Service	74,793	75,655	(862)	73,445	1.84%
Total Program Payments	**$8,792,911**	**$9,145,880**	**($352,969)**	**$8,461,129**	**3.92%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$12,000	-100.00%
Budget Stabilization	0	0	0	535,214	-100.00%
Other Transfers Out	576,775	535,237	41,538	337,418	70.94%
Total Transfers Out	$576,775	$535,237	$41,538	$884,632	-34.80%
TOTAL GRF USES	**$9,369,686**	**$9,681,117**	**($311,431)**	**$9,345,761**	**0.26%**

(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.

The Department of Administrative Services (DAS) was the largest contributor to the $6.7 million negative variance in the **Other Government** spending component (within the **Government Operations** category) in December. The delay in the release of building operating payments by DAS caused the department to be under estimate $6.3 million. The payments were release in early January. ❑

Lottery Profits Quarterly Report

LOTTERY TICKET SALES AND PROFITS TRANSFERS SECOND QUARTER, FY 1997

— *Allan Lundell*

Total ticket sales for the second quarter were $609.34 million, 7.87 percent greater than first quarter sales, but still less than sales for the fourth quarter of fiscal year 1996. Ticket sales for the second quarter of FY 97 were 6.24 percent higher than second quarter sales for FY 96. This is the tenth consecutive quarter of positive annual growth. Sales for the first half of fiscal year 1997 are 3.3 percent greater than sales for the first half of fiscal year 1996.

Transfers to the Lottery Profits Education Fund decreased from first quarter levels, but were still greater than projected. A comparison with the first quarter may be a bit unfair. First quarter transfers were boosted by transfers from profits due to the $45 million Super Lotto jackpot that occurred at the end of fiscal year 1996 but could not be transferred at that time. The average monthly transfer for the second quarter was $56.79 million. The projected transfer for FY 1997 is $661.20 million. In order to meet projections, monthly transfers will need to average $51.06 million for the remainder of the year. For the quarter, transfers to the LPEF were 27.96 percent of sales, but year to date transfers remain above the 30 percent level at 30.22 percent.

Total sales increased 7.87 percent from first quarter FY 1997 levels. Unlike the first quarter, when sales of all games moved in the same direction, in the second quarter some games gained sales and others lost sales. Kicker sales increased by $0.19 million or 1.18 percent. Pick 3 sales increased by $1.49 million or 1.36 percent. Pick 4 sales increased by $2 million or 7.36 percent. Instant Ticket sales increased by $42.47 million or 14.95 percent. Super Lotto sales decreased

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	$ 198.57	34.98
August	56.42	53.41	3.01	5.64	187.19	30.14
September	58.59	54.44	4.14	7.60	179.14	32.71
Q1	**184.47**	**164.86**	**19.61**	**11.89**	**564.90**	**32.66**
October	56.84	55.46	1.38	2.49	194.76	29.18
November	55.44	53.06	2.38	4.48	187.64	29.55
December	58.09	56.34	1.75	3.11	226.94	25.60
Q2	**170.37**	**164.86**	**5.51**	**3.34**	**609.34**	**27.96**
Total	**$ 354.84**	**$ 329.73**	**$ 25.12**	**7.62**	**$1,174.24**	**30.22**

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	$ 91.92	$ 198.57
August	37.91	9.40	6.94	5.01	31.52	96.42	187.19
September	34.18	8.70	6.44	4.61	29.48	95.74	179.14
Q1	**109.57**	**27.17**	**20.29**	**16.09**	**107.71**	**284.08**	**564.90**
October	37.03	9.74	6.83	5.58	36.61	98.97	194.76
November	37.21	9.64	6.37	4.78	28.90	100.74	187.64
December	36.82	9.79	6.76	5.92	40.82	126.84	226.94
Q2	**111.06**	**29.17**	**19.96**	**16.28**	**106.32**	**326.55**	**609.34**
Total	**$220.64**	**$56.34**	**$40.25**	**$32.37**	**$214.03**	**$610.63**	**$1,174.24**

by $1.39 million or 1.29 percent. Buckeye Five sales decreased by $0.33 million or 1.63 percent.

Instant Tickets continued to dominate sales, accounting for 53.59 percent of total sales for the quarter. This share grew steadily throughout the quarter, from 50.82 percent in October to 53.69 percent in November to 55.89 percent in December. The popularity of Instant Tickets has been the major reason for the growth in Lottery sales and transfers to the LPEF. However, the higher payout percentages of Instant Tickets mean that as sales and profit transfers have increased, profit transfers as a percentage of sales has decreased. Both sales and profits could be increased even more by offering even higher payout percentages. Ironically, the requirement that profit transfers be at least 30 percent of sales actually acts to limit the amount of profits available to transfer. The issue of which is more important, the level of profits or profits as a percentage of sales, needs to be addressed. ❑

LOTTERY PROFITS EDUCATION FUND DISBURSEMENTS
DISBURSEMENT OF FY 1997 PROFITS

— *Deborah Zadzi*

Table 3, LPEF and LPERF Appropriation/Disbursement Summary

LPEF	*FY 1997 Appropriations*	*FY 1997 Disbursements (through December 31, 1996)*	*Appropriation Balance*
670 Basic Aid	$579,770,000	$203,589,949	$376,180,051
671 Special Ed	$ 44,000,000	$ 38,979,181	$ 5,020,819
672 Vocational Ed	$ 30,000,000	$ 11,658,408	$ 18,341,592
682 Lease Rental	$ 20,000,000	$ 0	$ 20,000,000

Lottery profits Education Fund (LPEF) disbursements in fiscal year 1997 (year-to-date) total $254.2 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 3 shows fiscal year 1997 appropriations, disbursements, and available appropriation balances for each account in the LPEF as of December 31, 1996. ❑

Distribution of FY 1996 Excess Profits

Lottery profits in FY 1996 exceeded estimates by approximately $59.1 million. The funds are to be distributed as follows:

- $20 million ➪ Public School Building Fund
- $32.95 million ➪ Lottery Profits Education Reserve Fund (transferred only after the Superintendent of Public Instruction determines by January 15th, 1997 that the amount allocated to the Department of Education is sufficient to make all required school aid payments
- $6.05 million ➪ Public School Building Fund

Welcome to *Ohio Facts Extra!*, a new feature in *Budget Footnotes*. LBO recently presented to members of the Ohio General Assembly the first production of *Ohio Facts*, a booklet developed to provide a broad overview of public finance in Ohio. This section in *Budget Footnotes* grew out of that booklet. Each month, highlights from a different area of interest will be presented in graphics and text.

OHIO FACTS EXTRA!

Ohio's Public Employee Retirement Systems

—Debra Pelley

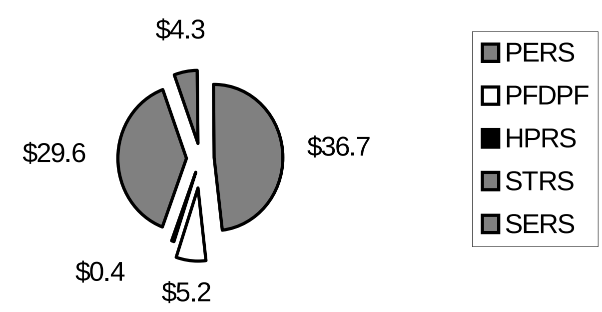
- Ohio has five statewide public employee retirement systems: the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Police and Firemen's Disability and Pension Fund (PFDPF), and the Highway Patrol Retirement System (HPRS).

Retirement System Members and Beneficiaries

System	*Active Members*	*Inactive Members*	*Beneficiaries*
PERS	365,383	127,491	116,705
STRS	166,623	116,177	83,136
SERS	100,784	58,935	52,413
PFDPF	24,583	1,184	19,522
HPRS	1,455	12	826
Total	658,828	303,799	272,602

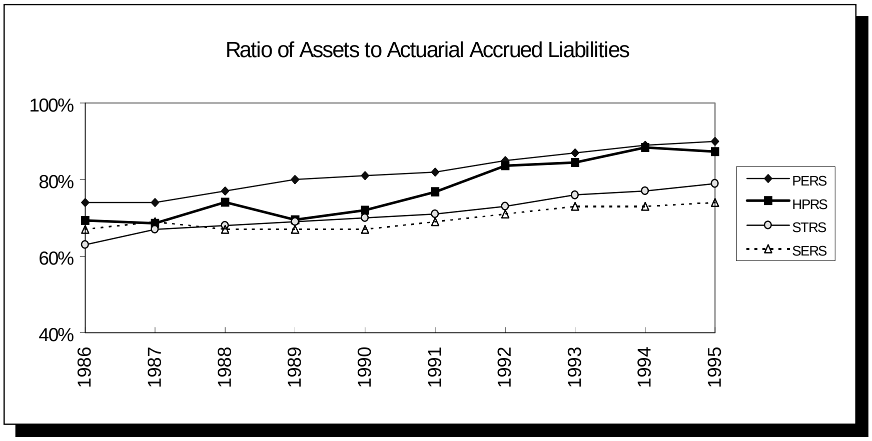
- The net assets of the state retirement systems available for benefit payments total over $76,251,400,000.

State Retirement System Assets (in billions)



- One way to evaluate the soundness of a retirement system is to examine trends over time in its ratio of assets to actuarial accrued liabilities. Actuarial accrued liability is liability for service already performed by former and present members of the system.

- The graph on the right shows that PERS, STRS, SERS, and HPRS have made gradual progress on this ratio since 1986. Although historical data for PFDPF is not comparable due to use of a different actuarial cost method, the PFDPF actuary calculated a ratio of 81.6% as of January 1, 1996 for that system using the same actuarial cost method used by the other funds. (These amounts do not includes assets or liabilities for post-employment health care benefits.)



Ratio of Assets to Actuarial Accrued Liabilities

- Although the primary responsibility of the state retirement systems is to provide pension (i.e., service retirement, disability, death, and survivor) benefits, the Revised Code also permits the systems to provide post-retirement health care benefits. As the table on the right shows, health care expenses make up a significant part of the systems' benefit payments. ❑

	Reporting Period	*Pension Benefits*	*Post-Retirement Health Benefits*
PERS	CY95	$1,102,183,479	$353,685,547
PFDPF	CY95	$339,273,131	$70,170,717
HPRS	CY95	$13,606,107	$1,959,225
STRS	FY95	$1,361,148,000	$165,767,000
SERS	FY95	$272,709,499	$88,340,780
Total		$3,088,920,216	$679,923,269

The Legislative Budget Office recently presented to the General Assembly the first production of *Ohio Facts*, a booklet developed to address frequently asked questions and to provide a broad overview of public finance in Ohio. If you would like an *Ohio Facts* booklet, please call LBO at 466-8734 to request a copy. The cost is $3.00 per booklet.

Budget Footnotes Quarterly Article Index

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