Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE MAY/JUNE, 1997

FISCAL OVERVIEW

— Frederick Church

April tax revenues were $46.4 million over estimate. The news from the income tax and the sales tax was good; the news from the corporate tax was not. The income tax was $22.3 million over estimate and the sales and use tax was $11.7 million over. The income tax overage was once again based on very strong results in quarterly estimated payments, which more than offset low withholding. In the sales tax, both the auto and non-auto components outpaced the forecast.

The corporate tax was $7.0 million below estimate. The combined March-April receipts from the second of three annual payments were $3.4 million short. While this is not a big shortfall, it is disappointing in light of the fact that OBM and LBO had hoped that the corporate tax would actually do better than the estimate for FY 1997. However, the fact that the first two payments have come in low does not guarantee that the third one will also. The first two payments showed growth of 2.7 percent from last year, but this was lower than OBM's estimate. For whatever reason, OBM has estimated that the third payment will be lower than last year's by 2 percent. If growth continues as it has, the third payment would exceed the estimate and the tax would post a small overage for the year.

In the minor taxes, the cigarette and estate taxes both had significant overages. While some of the estate tax surplus was due to timing, it now appears that the tax will end the year well above the estimate.

In non-tax revenue, liquor profits continued their strong performance. Profit transfers to the GRF through the end of April are almost equal to the original forecast for the entire fiscal year. In the continuing saga of federal reimbursement, April receipts were a relatively modest $20.4 million below the estimate, pushing the year-to-date shortfall to $233 million.

Overall tax receipts are now $272.4 million above estimate for the year — a variance of 2.7 percent — with growth of 4.1 percent from last year. The income tax is responsible for 80 percent of that overage ($217.7 million). The non-auto sales tax is responsible for another 13.3 percent ($36.2 million). Thanks to strong investment earnings, liquor profits, and some unanticipated temporary transfers, the overage in non-federal revenue stands at $353.6 million. The huge shortfall in federal reimbursement, which stems from underspending on welfare programs that draw federal matching money,

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STATUS OF THE GRF

ISSUES OF INTEREST

OHIO FACTS EXTRA!

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Budget Footnotes examines the fiscal position of the state GRF on a monthly basis. Each issue also contains 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 April	Fiscal Year 1997 to Date	Last Year	Difference
Beginning Cash Balance	$505.3	$1,138.5		
Revenue + Transfers	$1,526.7	$14,150.6		
Available Resources	$2,032.0	$15,289.1		
Disbursements + Transfers	$1,383.5	$14,640.6		
Ending Cash Balances	**$648.5**	**$648.5**	**$205.4**	**$443.1**
Encumbrances and Accts. Payable		$302.5	$265.2	$37.4
Unobligated Balance		**$346.0**	**($59.8)**	**$405.7**
BSF Balance		$828.3	$828.3	
Combined GRF and BSF Balance		**$1,174.3**	**$768.6**	**$405.7**

has held the total GRF overage down to $120.6 million.

Disbursements crashed back to Earth in April after taking flight the prior month. March's $34.6 million overage was followed by a $154.7 million negative variance (including transfers, the variance was only $119.6 million). Medicaid was $69.5 million bellow estimate, pushing year-to-date underspending back up to $276.9 million. Year-over-year spending growth is once again negative. The overage in ADC/TANF and underspending in Other Welfare roughly cancelled each other out, but the aggregated human services category was $10.9 million below estimate. Finally, there was significant underspending in both K-12 education and higher education. Despite all the talk about coming closer to the estimate by year's end, K-12 spending continues to lag far behind. After 10 months, spending is $108.9 million below the estimate.

For the year, spending excluding transfers is $640.4 million below the estimate. A brief search of historical data did not uncover another year when spending was so far below the forecast. Even last year, spending through April was $315.9 million below estimate, and finished the year $437.5 million below. While education spending will probably do some of its promised catching up in the last two months, the trends in human services outlays are expected to continue. The state could end the year with a very large surplus, fueled by this low spending growth.

A quick look at Table 1 will reveal that the impact of revenue overages and continued underspending — mostly underspending — has been to keep unobligated GRF balances well above where they were last year. The unobligated GRF balance is $405.7 million ahead of last year's figure at the end of April. Even after one adjusts this figure for the portion of the transfer from the Income Tax Reduction Fund (ITRF) to the GRF that has not yet been given back to taxpayers in the form of refunds or lower tax due, the fund balance is still well ahead of last year's level.[1] The recently-passed Senate operating budget was predicated, in part, on an assumption that the ending unobligated GRF fund balance would be approximately $766 million. It now appears that the ending fund balance could be even larger. Under the Senate budget, any additional budget surplus would lead to additional money being put into school building assistance (see the article on budget highlights later in this issue).[2] Whether this will be part of the final budget agreement is, of course, not yet known. ❑

TRACKING THE ECONOMY

— Frederick Church

The U.S. economy posted a number of results that were "bests" in the first several months of 1997. Real Gross Domestic Product (real GDP) increased by 5.6 percent in the first quarter, the best quarterly growth in nine years. The U.S. unemployment rate hit 4.9 percent in April, the best rate since 1973, and then followed that with an even better mark of 4.8 percent in May. April's nonfarm employment gain was revised upward from 142,000 jobs to 323,000, and the March figure was also revised upward from 139,000 jobs to 182,000.

Meanwhile, consumer confidence soared to its highest level in either 10, 28, or 32 years, depending on whose survey one believes. The latest Money Magazine/ABC News poll showed consumer confidence at its highest level since 1986. The Consumer Comfort Index measures Americans' confidence in three areas: the national economy, their own finances, and their willingness to spend money. All three were very strong, and the ratings of the national economy were the highest ever. Of particular interest to Ohio was the fact that Midwest residents were the most optimistic of any region. The Conference Board's consumer confidence index hit a 28 year high in May, with both feelings about the current state of the economy and expectations about the future soaring upward from their already high April levels. The University of Michigan's Index of Consumer Sentiment hit 101.4 in April, the highest level since 1965.

Reflecting the increase in consumer confidence and the good news in the labor market, consumer spending in the first quarter increased by 6.4 percent, the biggest increase in 10 years. Most categories of goods and services showed strong growth. If the surveys are right about consumer confidence, spending should stay strong in the second quarter also.

All these "bests" have led a number of economists to call this economy the best in a generation. To the surprise of many, all this has been achieved without increases in inflation. Add one more "best" – the core inflation rate (the CPI excluding food and energy costs) is running at 2.5 percent, the lowest rate since 1965. The slow increases in the CPI have been accompanied by even slower increases in the Producer Price Index (PPI), indicating that there is little inflationary pressure from increases in the prices of inputs.

The lack of inflation led the Federal Reserve to stand pat at its May 20th meeting, after increasing rates by a quarter point in March. With the PPI rising so slowly, the greatest risk of inflation is from increases in wages. Wage inflation has begun slowly accelerating, but so far it remains below the level that would lead to pressure on output prices. Slow increases in benefit costs have also helped to hold down overall labor costs and reduce pressure on prices. While the employment cost index (ECI) shows that private sector wage and salary increases have accelerated from 2.6 percent to 3.3 percent (measured in quarterly year-over-year changes), benefit costs rose by only 2.0 percent in the first quarter.

The U.S. economy is in very good shape. Reflecting this, the Governor's Council of Economic Advisors, at its May meeting, predicted continuing growth over the upcoming biennium, for the U.S. and Ohio. The question is, how strong will that growth be, and what are the risks to the forecast?

Potential GDP Growth

The long run growth potential of a country's economy can be mathematically broken down into two components: growth in the labor force and growth in the productivity of the labor force. Everyone agrees that the U.S. growth over the last couple of years has been buoyed by surprisingly strong labor force growth. In the last 12 months, U.S. employment has grown by 2.7 million jobs, while Census estimates of the working-age population have increased by only 1.9 million persons. If labor force participation rates had been constant over the last 12 months, employment would have increased by only 1.5 million jobs.

Labor force participation has increased markedly in four demographic groups: teenagers, black females, older workers (those aged 55-64), and Hispanics. The increase in the labor force participation of older workers may be the best indicator of how strong this economy really is. The participation rate for this group had been falling for 20 years: between 1974 and 1994, the participation rate for older males fell by 12 percentage points. Some workers who had "retired" due to corporate downsizing and the drop in earnings potential for older workers have unretired now that more jobs are available. Also, the cohort of workers who are aged 55 to 64 is significantly different than prior cohorts in that age range. The wrenching restructurings that the U.S. endured in the mid 1970s and the early 1980s made the skills of many older workers essentially obsolete. Today's older workers (who were 31-40 in 1973) are more flexible and less tied to traditional manufacturing occupations.

Optimists believe that potential GDP growth may be more like 3 percent annually, instead of the 2.2 percent to 2.5 percent that most economists have declared. Since population is unlikely to increase much faster (birth rates are low and legal immigration is unlikely to increase beyond its already high levels), labor force participation must continue to increase if the optimists are to be proven right (or productivity must rise).

While everyone agrees that labor force growth has been surprisingly strong, there is much less consensus on the other factor driving potential GDP, labor productivity. Economists bemoan the fact that despite the anecdotal evidence that productivity growth is strong, the U.S. statistics don't show it. This has led to a sharp disagreement between optimists who believe that the official statistics are no good and productivity growth is much stronger than the GDP accounts show, and pessimists who believe that the income numbers are overstated and that they will be revised downward, and that consumer spending will slow sharply in the near future.

There is not enough room here to review all the aspects of the productivity debate. To give an idea of the magnitude of the problem, the discrepancy between the income and expenditure sides of the NIPA accounts hit $98.7 billion in the third quarter of 1996, the highest level ever. Theoretically, the Commerce Department could solve this discrepancy by either reducing the estimates of personal and corporate income, or increasing the expenditure estimates.

The optimists, arguing that productivity and GDP are both being understated, have some ammunition on their side. The U.S. has seen an investment boom, with high spending on all sorts of capital goods, but particularly on communications equipment, computers, and software. If businesses aren't getting productivity gains, why are they spending the money? Second, productivity growth in manufacturing has been strong, but service-sector productivity growth, as measured by the official statistics, has been weak. However, this is precisely the area where government economists admit they have the hardest time measuring output and productivity. Finally, the official numbers show productivity growth in this expansion as much weaker than in other postwar expansions. If the output and productivity numbers were adjusted upward, then this expansion's productivity growth would fit the norm.

DRI has gone out on a limb and predicted that the Commerce Department will both raise output estimates and reduce income estimates in its July revisions. The crucial question is, how much? The importance of the answer cannot be overemphasized. If productivity growth is faster than the statistics show, then long-run potential GDP growth may be faster than believed, and the Federal Reserve would be less likely to make "pre-emptive strikes" in raising short-term interest rates when they felt that real economic growth was too fast and that excess demand was about to trigger price increases.

Inflation

Most economists are surprised that the U.S. has had such strong real growth with low inflation. However, there are some (including analysts at the Cleveland Federal Reserve Bank) who believe that observers have got the relationship turned around: the fact that the U.S. has had low and stable inflation rates is one of the main reasons that the U.S. has been able to sustain six years of economic growth.

Readers of this report are aware of our fascination with the theoretical debate over where the "non-accelerating inflation rate of unemployment" or NAIRU is for the U.S. economy, and what it means for inflation. The conventional wisdom is that inflation accelerates as the unemployment rate falls. The theory implies that there is an unemployment rate at which inflation is stable. So far during the 1990s, the unemployment rate has fallen from a high of 7.8% in June 1992 to 4.8% in May of this year without any acceleration in consumer price inflation. However, NAIRU theory really postulates a relationship between the unemployment rate and ***wage*** inflation. Wage inflation has accelerated somewhat as the unemployment rate has fallen, but by much less than most of the NAIRU models predicted. Why?

A couple of explanations are possible. The NAIRU is not necessarily fixed over time. Changes in the U.S. economy, including a better-educated and more flexible workforce, may have acted to push down the "natural" rate of unemployment. Estimates of the NAIRU are also notorious for having very wide confidence intervals. Some econometricians found that models that yielded point estimates of the NAIRU around 6 percent (where a lot of economists thought U.S. unemployment had to stay to avoid inflation until the last couple of years) had confidence intervals so large the NAIRU could actually be anywhere from greater than 7 percent to less than 5 percent. Finally, some economists express doubt that there even is a national NAIRU. Alan Greenspan himself has hypothesized that thinking about a national NAIRU may not be useful. Instead, it may be more helpful to think of the U.S. as a number of regional labor markets, each with its own unemployment-inflation tradeoffs.

What all this means is that analysts aren't sure exactly what lies ahead for inflation. Most seem to feel that the unemployment rate is so low that wage inflation must accelerate fairly soon, and that eventually this will lead to the Federal Reserve raising short term interest rates enough to slow down real economic growth and keep output price inflation from accelerating. When and how much interest rates need to rise is an open question.

Risks to the Forecast

The major risk that all the big forecasting firms are pointing to is the Federal Reserve making a mistake in reacting to price data. If the Fed leaves rates unchanged for too long, the economy grows too quickly, and excess demand pushes up price inflation, then the Fed will have to raise rates sharply and growth will be choked off, possibly leading to recession. The WEFA Group believes that the probability of this sort of boom-bust recession in the second half of CY 1998 (Ohio's FY 1999) is now 30 percent (they also believe that the recovery would be fast, as soon as rates came down). On the other hand, if the Fed raises short-term interest rates pre-emptively when inflation is in fact not accelerating, then the economy will grow at a needlessly slow rate.

There is another risk to the long-run forecast that has received much less attention. A WEFA analysis of the corporate profits boom of the 1990s finds that, although holding down compensation costs has helped profits, the biggest factor has been corporate interest payments. More use of equity financing instead of debt financing, and lower interest rates have combined to push down corporate interest payments and increase corporate profits. If inflation increases, and long-term interest rates rise in response, profits may be sharply reduced. This in turn could reduce stock prices, reduce household wealth, and cause a drop in consumer spending. Without an increase in inflation, improvement in the economies of Europe and Japan could still push up worldwide real interest rates by increasing the global competition for capital.

The size and timing of the stock market drop under this scenario, and the impact on U.S. consumption are, of course, unknown. ❑

As stated in the Overview, tax revenues were $46.4 million over estimate in April, with the income tax

Status of the General Revenue Fund

REVENUES

— Frederick Church

accounting for almost half the overage. For the year, tax revenues are now $272.4 million over the estimate, and 4.1 percent over last year's collections. The reason that such seemingly weak revenue growth can lead to such a big overage is, of course, the income tax rate cut. Overall GRF revenue growth through April was expected to be less than 2 percent, and income tax collections were expected to decline, because of the 6.6 cut in income tax rates. Instead, income tax growth has continued despite the tax cut, and GRF revenues have surged past the estimate.

After the $217.7 million overage in the income tax, the best news and the biggest overage are in the non-auto sales and use tax. The non-auto tax is $36.2 million over the estimate, and has had solid 6 percent growth from last year. Strong consumer spending and retail sales (regionally and at the national level) seem to be driving tax revenue growth. Furthermore, collections beat the estimate in April despite the fact that the estimates had already built in healthy percentage increases from last year.

Among the other major taxes, the auto sales tax and the corporate franchise tax are disappointments, but relatively minor ones. Shortfalls in the two taxes combined are only $3.1 million. The corporate tax shortfall continues to be something of a puzzle in light of strong earnings reports from U.S. companies, but the puzzle is not limited to Ohio. A number of other states are also experiencing shortages in corporate tax collections. Is it possible that business restructuring is partly to blame? (This is discussed in some detail below.)

In the minor taxes, there are three significant variances. The cigarette tax has a $9.5 million overage that may grow slightly by year's end. The foreign insurance tax is $8.5 million below the estimate and unlikely to catch up over the last two months. Finally, the estate tax has a $19.4 million overage. While part of this is due to timing and will disappear in the next month or two, part of it is real and will cause the tax to finish the year with a surplus.

Non-tax revenue is dominated, as always, by the $233 million shortfall in federal reimbursements. Federal money should continue to come in below the estimate as human services spending is depressed due to low welfare caseloads. All other non-tax revenues are above the estimate. Investment earnings are $19.4 million over the forecast, fueled by large GRF cash balances and higher than expected interest rates. Liquor profits are $11.5 million over estimate. Since liquor taxes are very close to the forecast, we surmise that high profits are due to cost savings and not sales volume. Finally, "other transfers" are $44.0 million above estimate. This overage is more than offset by unanticipated transfers out of the GRF on the expenditure side, so it represents no net improvement in state finances.

Total non-federal revenues are $353.6 million over estimate for the year-to-date, although the federal reimbursement shortfall holds the total GRF overage down to $120.6 million.

Sales and Use Tax

The stunning 6.4 percent growth in overall U.S. consumer spending in the first quarter was almost matched by a 6.2 percent increase in non-auto retail sales. This was easily the best quarterly increase since the beginning of 1990. Ohio clearly benefited from the strong sales trend. Over the February through April period state non-auto tax collections increased by 6.5 percent from a year ago (non-auto sales tax collections are based on prior month activity), slightly outpacing national sales activity. However, the drop in national sales in April means that May's non-auto tax collections may not be so strong.

The Federal Reserve's ***Beige Book*** report from early May states retailing conditions in the Fourth District remain mixed. Sales of furniture and consumer electronics remain weak, but computers and appliances are picking up, and apparel has been strong all year. In addition, new retailing outlets are being added in the Columbus and Dayton areas. The ***Beige Book*** also reports that Internet retail sales are growing very rapidly in the region. Of course, since these sales are rarely taxed, this does not help state and local sales tax revenues (although it may help employment).

The auto sales tax rebounded with a small ($1.8 million) overage in April after a big March shortfall ($7.3 million). Recent auto sales tax revenue performance does not appear to be very closely linked to economic data. There was no national or regional data that explained why Ohio's sales were so poor in March. The ***Beige Book*** actually reported that Fourth District car sales were strong in March and early April. While national data show automotive retail sales had better year-over-year growth in April than in March, the change was not big enough to explain why Ohio's March tax collections dropped by 14.5 percent, but April collections rose by 5.4 percent. Given the month-to-month volatility in this tax, it is hard to predict what the final two months of this fiscal year will bring. It would not be surprising to see the auto tax end the year with a small shortfall.

Personal Income Tax

As expected, after an inflated March, employer withholding growth dropped sharply in April. March withholding was $24.9 million over the estimate and up 12.4 perfect from FY 1996; April withholding was $15.6 million below estimate and grew by only 1.8 percent from last year. Unexplained timing factors have made monthly withholding behave erratically all year. One has to look to the quarterly data for trends. The important fact at this point is that, even after the April shortfall, withholding is still $19.3 million over estimate for the year, and year-over-year growth is 6.4 percent.

Although Ohio employment growth is still expected to slow somewhat over the upcoming biennium, the slowdown has not occurred yet. Establishment survey data shows that Ohio nonfarm employment (seasonally adjusted) increased by 1.4 percent from the first quarter of 1996 to the first quarter this year, while U.S. nonfarm employment in-creased by only 0.6 percent. This con-tinued labor market strength makes us hopeful that, despite the April shortfall, withholding will turn in good results in May and June, and finish the year with an overage in

Table 2
General Revenue Fund Income
Actual vs. Estimate
Month of April, 1997
($ in thousands)

REVENUE SOURCE			
TAX INCOME	Actual	Estimate*	Variance
Auto Sales	$66,287	$64,486	$1,801
Non-Auto Sales & Use	367,882	357,966	9,916
Total Sales	$434,169	$422,452	$11,717
Personal Income	$551,140	$528,800	$22,340
Corporate Franchise	118,596	125,620	(7,024)
Public Utility	(184)	0	(184)
Total Major Taxes	**$1,103,721**	**$1,076,872**	**$26,849**
Foreign Insurance	$46	$0	$46
Domestic Insurance	0	0	0
Business & Property	447	180	267
Cigarette	26,481	23,612	2,870
Soft Drink	0	0	0
Alcoholic Beverage	4,303	4,267	36
Liquor Gallonage	2,119	2,200	(81)
Estate	36,829	20,400	16,429
Racing	0	0	0
Total Other Taxes	$70,225	$50,659	$19,566
Total Taxes	**$1,173,946**	**$1,127,531**	**$46,415**
NON-TAX INCOME			
Earnings on Investments	$0	$0	$0
Licenses and Fees	3,843	4,550	(707)
Other Income	6,139	6,450	(311)
Non-Tax Receipts	$9,982	$11,000	($1,018)
TRANSFERS			
Liquor Transfers	$6,000	$4,000	$2,000
Budget Stabilization	0	0	0
Other Transfers In	3,936	0	3,936
Total Transfers In	$9,936	$4,000	$5,936
TOTAL INCOME less Federal Grants	**$1,193,864**	**$1,142,531**	**0**
Federal Grants	$332,857	$353,241	($20,384)
TOTAL GRF INCOME	**$1,526,721**	**$1,495,772**	**$30,949**

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

Detail may not add to total due to rounding.

the $25 million to $30 million range.

Quarterly estimated payments posted a $31.9 million overage in April, and are now $138.8 million above the forecast for the year.[3] Estimated payments have grown by 12.3 percent rather than falling by 4.7 percent as the Tax Department had predicted (interestingly, estimated payments last year grew by an almost identical 12.4 percent). The decline was supposed to be the result of two factors: behavioral responses to the tax rate cuts and an artificially inflated 1996 base due to one-time factors such as high capital gains realizations. It now appears that the strong economy has offset some of the losses from the rate cuts, and that much of last year's estimated payments bonanza was not one-time money.

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	$551,865	$553,900	**($2,035)**	$548,680	0.58%
Non-Auto Sales & Use	3,568,984	3,532,784	**36,201**	3,366,841	6.00%
Total Sales	$4,120,849	$4,086,684	**$34,166**	$3,915,520	5.24%
Personal Income	$4,410,076	$4,192,400	$217,676	$4,278,171	3.08%
Corporate Franchise	815,492	816,530	(1,038)	782,065	4.27%
Public Utility	426,714	424,960	1,754	409,883	4.11%
Total Major Taxes	$9,773,131	$9,520,574	$252,558	$9,385,640	4.13%
Foreign Insurance	$285,172	$293,625	($8,453)	$279,841	1.90%
Domestic Insurance	224	580	(356)	621	-63.93%
Business & Property	1,582	2,880	(1,298)	2,347	-32.58%
Cigarette	233,963	224,461	9,502	230,995	1.29%
Soft Drink	19	0	19	4	348.84%
Alcoholic Beverage	42,519	41,057	1,462	41,698	1.97%
Liquor Gallonage	22,615	22,996	(381)	22,792	-0.78%
Estate	86,520	67,150	19,370	66,937	29.26%
Racing	0	0	0	0	#N/A
Total Other Taxes	$672,615	$652,749	$19,865	$645,235	4.24%
Total Taxes	**$10,445,745**	**$10,173,323**	**$272,422**	**$10,030,875**	**4.14%**
NON-TAX INCOME					
Earnings on Investments	$71,943	$52,500	$19,443	$54,272	32.56%
Licenses and Fees	61,847	59,150	2,697	60,412	2.37%
Other Income	68,499	65,025	3,474	74,071	-7.52%
Non-Tax Receipts	$202,289	$176,675	$25,614	$188,755	7.17%
TRANSFERS					
Liquor Transfers	$55,500	$44,000	$11,500	$51,000	8.82%
Budget Stabilization	0	0	0	0	#N/A
Other Transfers In	402,716	358,700	44,016	26,150	1440.02%
Total Transfers In	$458,216	$402,700	$55,516	$77,150	493.93%
TOTAL INCOME less Federal Grants	**$11,106,249**	**$10,752,698**	**$353,551**	**$10,296,781**	**7.86%**
Federal Grants	$3,044,323	$3,277,292	($232,968)	3,082,049	-1.22%
TOTAL GRF INCOME	**$14,150,572**	**$14,029,990**	**$120,582**	**$13,378,829**	**5.77%**

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

Detail may not add to total due to rounding.

While the timing of capital gains realizations is often cited as reason for state and federal income tax fluctuations, federal tax data shows that individual capital gains (as opposed to business gains) in Ohio are generally not large enough to cause major income tax swings. It is possible that capital gains by unincorporated businesses are large enough to cause big increases or decreases in tax revenue, but it seems that high unincorporated business income generally, not just capital gains, may be driving the big overages in estimated payments. This may also explain some of the corporate tax shortfall. When the state passed legislation allowing limited liability companies (LLCs) several years ago, LBO expected that LLCs and unincorporated businesses generally would account for an ever-increasing share of new business formations. The tax advantages provided by the LLC, S-corporation, and partnership form of organization are too tempting to ignore, especially for new businesses (there are transition costs for existing businesses). In support of this hypothesis, the Secretary of State's office reports that in the first quarter of 1997, the largest year-over-year increase in business filings was in LLCs. However, while LBO expected businesses to switch from C-corporations that pay the corporate tax to "flow-through" entities that pay the personal income tax, the switch may be happening faster than we expected.

Rounding out the income tax picture, annual return payments are higher than forecasted, and refunds are still significantly lower. While we still expect refunds to come closer to the estimate, it no longer seems clear that they will catch up all the way. Again, it looks like stronger than expected employment and income growth may have offset some of the impact of the 1996 tax rate cuts. Annual returns seem like they will finish the year well above estimate. Unfortunately, tax return processing has been held up enough that we will not know much more about refunds in May. The final numbers will not be clear until close to year's end.

Corporate Franchise Tax

The first two FY 1997 franchise tax payments against taxable year 1996 liability were a combined $7.7 million below estimate (1 percent). Because payments over the first six months (against taxable years prior to 1996) were $6.7 million over estimate, the shortfall for the year is only $1.0 million. Because of an unusual pattern in the monthly forecasts, it is possible that the third payment will exceed the estimate and the tax will still finish with a surplus.

Revenues from the first two major payments of FY 1997 have grown by 2.7 percent from FY 1996. The shortfall is due to the fact that OBM had forecasted 3.6 percent growth. However, OBM also forecasted a third payment that was 2 percent below the third payment last year. If the third payment grows by 2.7 percent, it will be $15 million over the estimate, more than enough to erase the year-to-date shortfall. Looked at a slightly different way, the third payment needs to grow by only 0.4 percent from last year to offset the shortfall in the first two payments. Thus, there is still a good chance that the franchise tax will catch up to the estimate by year's end.

Even if the franchise tax does catch up to the estimate, there will still be the question of why growth in FY 1997 was so anemic. If growth stays at 2.7 percent, it will still be well below the 6.8 percent increase in U.S. before-tax profits for CY 1996. Longtime readers of this report are probably familiar with the litany of reasons why Ohio franchise tax revenues do not correlate all that well with U.S. corporate profits: differing taxable years, the dual net worth-net income tax base, the separate treatment of financial institutions, net operating loss carryovers, etc. However, in this instance, none of these factors looks like a particularly likely candidate for explaining the weak revenue growth.

Many other states are also experiencing weak corporate tax revenue growth. However, the experience is not uniform across states or regions. Of the 45 states that report corporate tax revenue, 11 had double-digit increases in the fourth quarter of 1996 (first quarter 1997 data is still not widely available). On the other hand, 24 states had decreases in corporate tax revenue. Two of these were due to tax cuts, but the other 22 were not caused by legislative changes.

What are the common factors behind weak state corporate tax revenue growth? One intriguing hypothesis is that one of the factors behind weak corporate tax growth is also a factor behind strong personal income tax growth. Growth in quarterly estimated income tax payments has outstripped growth in employer withholding in a number of states, not just Ohio. Some analysts attribute much of this to capital gains income. While this is probably part of the explanation, in Ohio and other states individual capital gains realizations are not large enough to swing income tax numbers as much as we have seen. Besides, if capital gains are so strong for individuals, why aren't corporate capital gains higher also?

An alternative explanation is that the income of unincorporated businesses (including capital gains income) is driving much of the personal income tax overage in Ohio and in other states. The owners of all types of businesses other than regular "C" corporations — proprietorships, partnerships, S-corporations, LLCs, etc. - pay the personal income tax rather than the franchise tax. If a large number of businesses are choosing to organize as unincorporated businesses like LLCs, rather than as C corporations, that would give an extra kick to the income tax while slowing down growth in the franchise tax.

Elegant as this explanation may be, at present it is essentially speculation: we do not have solid data to back it up. Data on the comparative growth in number of tax returns by C-corporations and other forms of business would not be conclusive, but would be very helpful. Unfortunately at this point LBO does not have this data for Ohio or for other states. There is also a theoretical problem in that there are disincentives in the federal tax code to switching from C-corporation status to S-corporation or unincorporated status. This means that the increases in LLC and partnership filings that we have seen may be more from new businesses than existing businesses, and new businesses typically take time before they start turning a profit. ❑

DISBURSEMENTS

— Chris Whistler

For those of you keeping score at home, one thing should be becoming clearer: there is likely to be a little spending underage this year. Actually, it could be pretty big — total GRF uses were already under estimate by $560.0 million through April — but a so-called economist must be noncommittal.

April's program payments were $154.7 million under estimate; when $35.0 million in transfers out of the GRF for flood relief are included, total uses were $119.6 million below estimate.

Almost 60 percent of the monthly program payment variance

Table 4
General Revenue Fund Disbursements
Actual vs. Estimate
Month of April, 1997
($ in thousands)

USE OF FUNDS			
PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$296,462	$331,039	($34,577)
Higher Education	203,683	213,627	(9,944)
Total Education	$500,145	$544,666	($44,521)
Health Care	$373,174	$442,716	($69,542)
ADC/TANF	67,324	43,945	23,379
General Assistance	0	6,179	(6,179)
Other Welfare	43,638	70,521	(26,883)
Human Services (2)	75,492	86,393	(10,901)
Total Welfare & Human Services	$559,628	$649,754	($90,126)
Justice & Corrections	$122,635	$122,897	($262)
Environment & Natural Resources	4,954	5,696	(742)
Transportation	1,471	1,429	42
Development	7,847	9,567	(1,720)
Other Government (3)	21,988	20,716	1,272
Capital	844	491	353
Total Government Operations	$159,739	$160,797	($1,058)
Property Tax Relief (4)	$129,041	$147,942	($18,901)
Debt Service	(64)	0	(64)
Total Program Payments	**$1,348,490**	**$1,503,159**	**($154,669)**
TRANSFERS			
Capital Reserve	$0	$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	35,042	0	35,042
Total Transfers Out	$35,042	$0	$35,042
TOTAL GRF USES	**$1,383,532**	**$1,503,159**	**($119,627)**

(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.

[1] It is necessary to adjust for the ITRF transfer because, while the GRF has received that money to offset the revenue loss from the 1996 rate cut, only part of that revenue loss has already been felt yet, with more yet to come.

[2] The Senate budget caps the taxable year 1997 income tax cut, funded out of FY 1997 GRF surplus, at $285.7 million. This was the number originally estimated by OBM when the Governor's budget was introduced.

[3] We do not yet know how much of the April payment was money paid with annual return filing extension requests, and how much was "true" estimated payments.

in April was in the **Welfare and Human Services** spending category, which is actually a little lower than its year-to-date contribution of over 75 percent. **Health Care** (Medicaid) spending represents over half of the year-to-date variance, with underspending reaching $276.9 million. The **TANF/Other Welfare** combination is responsible for $186.9 million, and timing factors in the departments of Mental Health (DMH) and Mental Retardation and Developmental Disabilities (DMR) each contribute about $10.1 million toward the $23.9 million negative variance in **Human Services**.

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)	$3,431,894	$3,540,772	($108,878)	$3,250,956	5.57%
Higher Education	1,746,362	1,756,118	(9,756)	1,663,042	5.01%
Total Education	$5,178,256	$5,296,890	($118,634)	4,913,998	5.38%
Health Care	$4,124,527	$4,401,465	($276,938)	$4,155,722	-0.75%
ADC/TANF	$824,553	846,398	(21,845)	800,066	3.06%
General Assistance	112	6,179	(6,067)	9,773	-98.85%
Other Welfare	$451,113	616,130	(165,017)	521,994	-13.58%
Human Services (2)	886,777	910,700	(23,923)	857,424	3.42%
Total Welfare & Human Services	$6,287,082	$6,780,872	($493,790)	$6,344,977	-0.91%
Justice & Corrections	$1,202,594	$1,199,112	$3,482	$1,070,527	12.34%
Environment & Natural Resources	94,071	94,689	(618)	90,782	3.62%
Transportation	24,731	34,051	(9,319)	34,621	-28.57%
Development	104,580	108,236	(3,656)	92,076	13.58%
Other Government (3)	306,745	336,019	(29,274)	291,822	5.11%
Capital	6,863	5,051	1,812	3,037	125.96%
Total Government Operations	$1,739,585	$1,777,159	($37,574)	$1,582,865	9.90%
Property Tax Relief (4)	$725,116	$714,697	$10,419	$660,350	9.81%
Debt Service	94,883	95,708	(825)	95,175	-0.31%
Total Program Payments	**$14,024,921**	**$14,665,325**	**($640,404)**	**$13,597,366**	**3.14%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$12,000	-100.00%
Budget Stabilization	0	0	0	535,214	-100.00%
Other Transfers Out	615,673	535,237	80,436	341,076	80.51%
Total Transfers Out	$615,673	$535,237	$80,436	$888,290	-30.69%
TOTAL GRF USES	**$14,640,594**	**$15,200,562**	**($559,968)**	**$14,485,655**	**1.07%**

(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.

It's now safe to say that the **Medicaid** variance will exceed $300 million by the end of the fiscal year. The low growth — likely to be around one percent over FY 1996 — has been driven primarily by an extraordinary decline in eligibility. Total eligibility is expected to fall by over 4 percent this fiscal year, which is similar to the decline in FY 1996. As was the case last year, most of the decrease again stems from a decline in the **TANF/ADC** cash assistance caseload. However, that's not the big story.

While the cash assistance caseload decline is significant, the most notable eligibility category will likely increase in FY 1997. The Aged, Blind, and Disabled (ABD) eligibility group is far and away the most expensive Medicaid category to cover. So when growth in ABD eligibility is less than one percent, a low-growth year in total **Medicaid** spending should follow in turn. If you look only to FY 1996 when ABD growth was four percent, the FY 1997 growth doesn't seem so remarkable. However, when you consider that the average annual growth rate between FY 1990 and FY 1995 was 7.6 percent, the fiscal significance of this occurrence cannot be overstated.

Payments to health maintenance organizations (HMOs) continue to generate the largest variance of all the **Medicaid** spending categories. Total payments to HMOs will probably reach $450 million this fiscal year, but they won't approach the estimate of $761.1 million. The reasons for the variance deal with both rates and enrollees. In terms of rates, FY 1997 HMO reimbursement rates were set assuming a "six percent managed care savings" relative to fee-for-service costs. This was not assumed in the last budget bill. As for enrollees, the decline in eligibles coupled with a lower-than-anticipated rate of enrollment of

TANF/ADC and Healthy Start eligibles in HMOs, has left actual enrollment approximately 31 percent below estimate. (It should be noted that, in general, the costs not borne in the HMO category because of the lower-than-expected enrollment rate are realized in the other acute care categories on a fee-for-service basis.)

Within the **TANF/Other Welfare** category, Disability Assistance (400-511) continues to generate the largest variance. Through April the program is $41.2 million, or 44 percent, under the year-to-date spending estimate of $92.7 million. In addition to DA and the historically low **TANF/ADC** cash assistance caseload, various line items, such as Computer Projects (400-416) — which is under estimate by $4.5 million — also contribute to the variance.

To a large extent, the $118.6 million variance in the **Education** category is due to timing issues. However, when the timing issues in Head Start, Basic Aid, Vocational Education, and Desegregation are worked out, the negative variance in **Primary and Secondary Education** should move from the year-to-date amount of $108.9 million toward the Department of Education's projected lapse of $30 million. **Higher Education** was under estimate by $9.8 million through April, all of which came in that month.

Government Operations spending was below estimate by $1.1 million in April, which pulled year-to-date spending to a negative $37.6 million variance. Within the $29.3 million negative variance in the **Other Government** component, spending by the Department of Administrative Services was under estimate by $20.7 million through April. Aside from the **Other Government** component, **Transportation** and **Development** are under estimate for the year by $9.3 and $3.7 million, respectively.

One additional disbursement area worth mentioning is **Property Tax Relief**. Payments were below estimate by $18.9 million in April, which reduced the year-to-date overage to $10.4 million — approximately the year-end lapse we projected in last month's issue. ❑

ISSUES OF INTEREST

GOING, GOING, GONE: THE CONVEYANCE OF THE VETERANS' CHILDREN'S HOME

JEFFREY M. ROSA

Although the last student left the Ohio Veterans' Children's Home (OVCH) on June 30, 1995, as of May 1997, the OVCH property was still in state hands. Am. Sub. H.B. 117 of the 121st General Assembly directed the discontinuance of programs and services at the OVCH with a skeletal staff to maintain and protect the assets until the official disposal of the property. By the end of FY 1997, there will be approximately 22.5 full-time equivalent positions[1] held by state employees.

Substitute Senate Bill 7, which passed the Senate on April 29, authorizes the conveyance of the property known as the OVCH to the Board of Greene County Commissioners. Greene County will make three annual payments of $435,956 to the State, totaling $1,307,868. Proceeds from the sale will be deposited into Fund 4Z0, Veterans' Plaza Fund.

History and Value of the Property

The OVCH is located on approximately 440 acres in Greene County. The property is divided into three parcels. The first parcel, on which the campus of the Home is located, is 156.84 acres. Parcel two, which is mainly agricultural, measures 117.19 acres. The final parcel, which lies south of U.S. Route 35, between Union Road and State Route 380, measures 165 acres. This parcel is also agricultural, but does have two family residences located on the property. The exact acreage of each parcel is based on courthouse records before the construction of U.S. Route 35.

The total campus of the OVCH was acquired over a period of more than 150 years through various methods, including purchases and bequests. The standards used to convey property during this period did not meet the specific standards of the 1990s. In an agreement with Greene County, the Department of Administrative Services (DAS) will transfer to Greene County a single deed that will include a legal description of the property and make reference to all previous deeds that reference the boundaries of the property. The deed will then make note of the acres subtracted from the total property for roads, State Highway Patrol, and Department of Transportation uses, among other things.

This deed of consolidation is comprehensive enough to allow the county to legally accept the transfer of the property. If Greene County officials, including the County Recorder, feel that a more formal survey is needed, one will be performed at the county's expense. Since Greene County has the staff and resources needed for this survey, it will be cheaper than the original estimate of $50,000 - $75,000 for DAS to contract with people to perform the survey.

DAS appraised the value of the three parcels in November 1996 at $4.91 million. The appraised value of parcel one, which has the 38 buildings of the Veterans' Children's Home, is four million dollars. The second and third parcels are valued at $350,000 and $560,000, respectfully. Any asbestos abatement costs will lessen the value of the $4 million parcel. DAS originally estimated that addressing the asbestos problem would cost approximately $2.7 million. The county's original environmental abatement costs differed from those of the state. The selling price of $1,307,868 was determined after the state and county agreed upon environmental abatement costs.

Potential State Costs in FY 1998

The majority of the property known as the OVCH is empty farmland. On the 150 acre campus, there are 38 buildings in a varied state of repair. Most of the buildings have problems with asbestos and lead paint. Additionally, the campus has an old hot water/steam boiler system that is running at 20% efficiency. Action at the April 8, 1997 Controlling Board meeting released $16,116.16 in capital funds for an emergency repair of a Deaerator Feedwater Heater. Estimated costs for keeping the Home viable top $1.5 million annually. OVCH staff projects that unemployment and early retirement costs could total approximately $277,700[2]. The net savings to the state if the property is conveyed before FY 1998 is approximately $1.2 million.

Under Sub. S.B. 7, if the OVCH property is still in state control starting in FY 1998, DAS will assume the business and financial functions of the Home, including any business commenced but not completed by the Home that relates to the closing and disposal of the property. DAS shall also assume responsibility related to the layoff of state employees and the final disbursement of wages and salaries. Officials from DAS estimate that the department would incur costs of approximately $100,000 per month if it needs to carry-out the tasks outlined in the bill.

Currently, the state and county are working on an "Early Occupancy Agreement." Under this plan, Greene County would assume responsibility for the property known as the OVCH after June 7, 1997. Under the emergency provision included in the bill, the deed can be given to the county immediately on or after June 7 with the passage of Sub. S.B. 7 and a signed early occupancy agreement. If the agreement is signed, no state employees would work at the Home as of June 7. The early occupancy plan would prevent DAS from using its resources to run the Home, which could total several million dollars in FY 1998 if the sale and transfer do not occur promptly. The county prefers the agreement, as well, because it will allow enough time for renovation work that would allow the property to be in shape to be used next season.

Veterans' Plaza

Sub. S.B. 7 would amend Section 139. of Am. Sub. H.B. 117 of the 121st General Assembly. The current language states that $1,000,000 of the proceeds from the sale of the OVCH property is to be deposited into State Special Revenue Fund 4Z0, the Veterans' Plaza Fund. The new language will cause all proceeds (approximately $1.3 million) from the sale of the property to be deposited into Fund 4Z0. According to Sub. S.B. 7, Greene County will make three equal payments of $435,956 to start immediately upon passage of Sub. S.B. 7.

Greene County's Plans for the Property

Although Greene County will gain an asset on the books, there are expenses involved to make the property usable. According to Greene County officials, asbestos removal in all 38 buildings would run about $2 million. Additional costs arise from the need to encapsulate lead paint in these buildings. The county could save a portion of these costs by sealing off the asbestos in certain cases. Demolition of buildings could possibly pose additional expenses if hazardous waste is exposed. The county will be required to remove any environmental hazards. Another immediate cost for the county involves shutting down the current heating system. There will be costs involved in abandoning the current system and building a new system.

Following conveyance of the Home, Greene County will form a task force to create a long-term plan for the property. Under earlier versions of S.B. 7, the county was required to use the property to provide children and family services programs. Under the version of the bill passed by the Senate, this restriction was removed because the property is now being sold to the county. The county's master plan for the property envisions a long period in which programs will be phased in. The county wants to put two projects currently being planned at the OVCH. The first project is a juvenile court justice center, which will include rehabilitation and detention wings. The other program involves the expansion of an MR/DD sponsored school.

The county's plan may recommend the demolition of some of the buildings on the campus. Additionally, the county may lease any building or other structure located on the property to persons or entities to permit those persons or entities to run programs, which will increase potential revenues by an indeterminate amount. Potential program expenditures will also decrease if the county contracts some program administration out to third parties. Exact costs and revenues cannot be determined until after the task force has resolved exactly how many buildings will be kept and what types of programs will be undertaken. Long term upkeep of the property is estimated at $1 million or more, annually.❑

[1] Ohio Veterans' Children's Home Proposed Biennium Budget for Fiscal Years 1998-1999, Core Budget Level Narrative; Section 4, Page 1.

[2] Ohio Veterans' Children's Home Proposed Biennium Budget for Fiscal Years 1998-1999, Core Budget Level Narrative; Section 4, Page 7.

SPOTLIGHT ON THE BUDGET

Introduction

As Sub. H.B. 215, the 1997-1999 budget bill, heads to conference committee, Budget Footnotes provides an abbreviated look at some of the significant temporary and permanent law changes that have been proposed. The changes are grouped according to agency and recap the differences between the Executive, House Passed and Senate Passed versions of the budget bill.

Department of Administrative Services

Exempt Employee Pay Raise

The Senate recommended pay raises of 3% each year at the beginning of fiscal years 1998, 1999, and 2000 to exempt state employees. Including benefits, this change will cost roughly $20 million in FY 1998, $41 million in FY 1999, and $62.5 million in FY 2000 (compared to current law). About 11,700 employees are covered by this estimate which includes all funds and all state agencies (including DOT, BWC, and OIC). Neither the Executive nor the House included this provision.

Department of Commerce

Credit Card, Debit Card and Gift Certificates for Spirituous Liquor Sales

The Senate inserted permanent law language that would allow agency liquor stores to engage in the sale of spirituous liquor through credit cards, debit cards or gift certificates. (Under the Executive and House versions, no provision existed.) It is not clear what effect this change will have on the sale of spirituous liquor. However, it does provide agency liquor stores and consumers, respectively, an additional avenue for selling and purchasing spirituous liquor.

Department of Development

Low and Moderate Income Housing Trust Fund

The budget submitted by the Governor increased certain county recorder fees by 50 percent to provide a permanent funding source for the Low and Moderate Income Housing Trust Fund, line item 195-638. It was projected that this fee increase would generate $16.875 million in fiscal year 1998 and $22.5 million in fiscal year 1999. In addition, the budget as it was introduced, transferred $5.5 million in interest income from the Human Services Stabilization Fund (HSSF) in each fiscal year of the biennium to the Housing Trust Fund. Total appropriations equaled $25,375,000 in fiscal year 1998 and $31,000,000 in fiscal year 1999.

Department of Development						
Revenue	**Executive**		**House**		**Senate**	
	FY 98	FY 99	FY 98	FY 99	FY 98	FY 99
50% fee inc.	16,875,000	22,500,000	$0	$0	$0	$0
HSSF interest	5,500,000	5,500,000	10,500,000	11,400,000	10,500,000	11,400,000
GRF, 195-441	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Total	**$25,375,000**	**$31,000,000**	**$13,500,000**	**$14,400,000**	**$13,500,000**	**$14,400,000**

The House, in its subcommittee report, removed the fifty percent fee increase and chose to use interest income from the HSSF as a temporary funding source. This change was retained in the As Passed by the House version. In the beginning of fiscal year 1998, $11.7 million in interest income from the HSSF will be transferred to the Housing Trust Fund. Only $10.5 million would be available in fiscal year 1998. The other $1.2 million would be available in fiscal year 1999. The House also provided for quarterly transfers of interest income in fiscal year 1999 from the HSSF to the Housing Trust Fund. Total appropriations for the Low and Moderate Income Housing Trust Fund are $13.5 and $14.4 million in fiscal year 1998 and 1999, respectively. The Senate retained these provisions.

Both the House and the Senate retained the $3 million in GRF appropriations located in line item 195-441, Low and Moderate Income Housing, for the Housing Trust Fund.

Department of Development

Facilities Establishment Fund Programs

The governor's recommended budget includes funding for two new programs within the Facilities Establishment Fund Group. Port Authority Bond Reserves (item 195-649) is proposed at $2.5 million per year and Urban Redevelopment Loans (item 195-650) is proposed at $10.0 million in FY 1998 and $20.0 million in FY 1999. Earmarking language for the Facilities Establishment Fund specifies that the Director of Development would be responsible for developing program guidelines for the transfer and release of funds, subject to Controlling Board approval. Appropriation levels in line item 195-615, Facilities Establishment, are decreased to reflect funding support for these new line items.

While the House budget makes no changes to these provisions, the Senate budget creates a third new program within the Facilities Establishment Fund Group called Technology Action Loan. Recommended funding of $2.5 million per year would be used by the Governor's Science Advisor in consultation with the Ohio Science and Technology Council and the Director of Development, for the purposes of securing high priority technology initiatives. As with the other new programs proposed by the governor, earmarking language for the Facilities Establishment Fund specifies that the director of development would be responsible for developing program guidelines for the transfer and release of funds, subject to Controlling Board approval. Appropriation levels in line item 195-615, Facilities Establishment, are again decreased to reflect funding support for this new line item.

International Trade

Though silent on this issue, the executive budget includes increased appropriations of approximately $200,000 per year (line item 195-432, International Trade) to open another off shore trade office. Deliberations in the House revealed the department's intent to open an office on the continent of Africa, but the date and location for the opening remains undetermined. The House budget adds temporary language that requires "no less than $200,000" in each fiscal year shall be used to establish a full-service trade office in Africa. Furthermore, the Director of Development must report on the progress of this initiative to the Speaker and Minority Leader of the House of Representatives, the President and Minority Leader of the Senate, and the Controlling Board on or before June 15, 1998.

The Senate budget adjusts the House earmarking language by eliminating the requirement of using "no less than $200,000" in each fiscal year for this purpose. While a lesser amount of funds could be used, the department would still be required to establish a full-service trade office in Africa and would be required to report on the status of this office on or before June 15, 1998.

Department of Education

Primary and Secondary Education Funding

Basic Aid: The House made two major changes to the basic aid formula. The first change involves the treatment of the income factor in the basic aid formula, and the second change involves total assessed valuation.

a) *Income Factor.* The executive budget continued the phase-in of the income factor begun in Am. Sub. H.B. 152, at a phase-in ratio of 3/15ths in FY 1998 and 4/15ths in FY 1999. The House froze the phase-in at a 2/15ths ratio for districts with an income factor greater than one, while continuing the phase-in of 3/15ths and 4/15ths for districts with an income factor less than one. The Senate retained the House treatment of the income factor.

What does this mean? The income factor adjusts the total assessed value of a district to account for the income wealth of residents of the district compared to the statewide median income. Districts with an income factor less than one (districts whose residents are income poor) benefit or receive more basic aid as a result of the income factor than they otherwise would have. Districts with an income factor greater than one (districts whose residents are income rich) are hurt or receive less basic aid as a result of the operation of the income factor.

By freezing the income factor at 2/15ths for districts with an income factor greater than one, these districts receive more in basic aid than they otherwise would have had their valuations been adjusted at a ratio of 3/15ths and 4/15ths. It costs approximately $9 million each year to freeze the income factor at 2/15ths. This is money that would have otherwise been available to distribute to all districts.

b) *Total Assessed Valuation.* Under the executive budget, total real and tangible personal property valuation as reported by each county auditor is multiplied by 23 mills to determine the district's local share of the basic aid formula. Under the House budget, growth in the value of existing property is capped at the percentage increase of the foundation level. In non-reappraisal or update years, when growth for existing property is usually small, some growth above the previous cap can be counted to reach the new cap for that year. For districts with rapidly appreciating property, some growth could exceed the annual cap level for an indefinite period. The Senate restored the executive version of real and tangible personal property valuation.

Equity Aid

The executive budget appropriated $104 million in FY 1998 and $109.1 million in FY 1999 for equity aid. The equity aid formula in the executive proposal was designed to provide aid to 292 school districts. The House increased appropriations to $109.4 million in FY 1998 and to $113.2 million in FY 1999. Under the House budget, 292 districts would receive aid at a "strength level" of 13 mills. The Senate retained the House provisions.

Special Education, Vocational Education, and Gifted Education

The executive, House and Senate all added additional dollars to increase unit funding reimbursement. All of the new dollars were added to the supplemental unit allowance, which equalizes dollars according to the property wealth of the district. The chart below shows current average unit funding reimbursement amounts, and projected reimbursement for a unit under the various versions of the budget.

Textbooks

The House appropriated $20 million in FY 1998 and $30 million

Department of Education

	FY 1997	Executive98	House98	Senate98
Vocational Education	$ 39,609	$ 40,144	$ 41,834	$ 44,179
Special Education*	$ 37,340	$ 38,894	$ 39,351	$ 41,441
Gifted Education	$ 33,642	$ 33,584	$ 33,884	$ 35,054

**The average reimbursement for special education is an average of classroom and supervisory unit reimbursements.*

in FY 1999 from the Lottery Profits Education Fund for textbooks and instructional materials. The moneys were to be distributed on a per pupil basis to all city, exempted village and local school districts for textbooks and instructional materials for core subjects.

The Senate appropriated $25 million in GRF money in FY 1998 only for the same purpose — textbooks and instructional materials. The only difference between the House and Senate proposals was that in the Senate budget, districts with valuations in excess of $200,000 per pupil were not included in the funding distribution.

Head Start

The House made little change in the Head Start program except that it earmarks $150,000 in FY 1998 for the Marotta Montessori School and reduces Head Start appropriations by $1 million in FY 1998 and by $ 2 million in FY 1999. The Senate removes the set-aside for the Marotta Montessori School, restores the $1 million appropriations cut made by the House in FY 1998, and sets aside $1.5 million in each fiscal year for the Department of Education to assist programs with the costs associated with implementing corrective plans. The Senate also makes several other changes to the program.

To determine the number and percent of eligible children served in each county, the executive proposal requires the Department of Education to use TANF, Food Stamp, and Healthy Start (EPSDT) enrollment data provided by the Department of Human Services. The Senate emphasizes that the Department of Education should use an unduplicated count of these data provided by the Department of Human Services as of the first full week of December divided into the actual number of children receiving Head Start services as of the first full week of December.

The executive proposal sets aside one percent of the appropriation for administration and another one percent for management assistance. The Senate combines these two set-asides into two percent of the appropriation for administration and management assistance.

Under the executive proposal, continuation grants are to be distributed based on the amount received by each grantee in the previous year. The Senate requires the continuation grant to be distributed based on the actual enrollment as reported during the first full week of December. The Department of Education is permitted to redistribute the dollars to programs demonstrating an unmet need based on updated assessments of family needs and community resources.

Expansion grants, under the executive proposal, are to be distributed based on the percentage of unserved economically disadvantaged children in the applicant's service area, the agency's record, and the agency's plan to serve Head Start eligible children in child care centers. The Senate establishes the following two priorities for distributing continuation grants:

a) Priority One: Head Start/ Early Childhood Partnership. Increases services through collaborative funding or service models designed to meet the needs of families who are employed, entering the workforce, or participating in TANF-related education and training activities.

b) Priority Two: Center-Based, Home-Based, and Other Programs. Service additional children in part-day or full-day center-based programs, home-based programs, or combination option programs in accordance with current Head Start standards. Programs should also take into account the projected impact of welfare reform on the families to be served.

Office of Information, Learning and Technology Services

Senate Bill 230 of the 121st General Assembly replaced the original SchoolNet office with the Office of Information, Learning and Technology Services, a semi-autonomous office within the Department of Education. It also created a Technology Advisory Committee to develop policies for the office and to oversee the implementation of SchoolNet and SchoolNet Plus.

The House budget proposal establishes the office as a totally independent agency and creates the Information, Learning and Technology Authority to replace the Technology Advisory Committee. The House transfers most of the technology related line items from the Department of Education into the office. The Senate proposal returns four of those line items (Ohio Educational Computer Network, Educational Management Information System, Education Technology, and Computer Services) to the department. The office's independent agency status has remained unchanged. It will assume authority over SchoolNet,

SchoolNet Plus, Interactive Parenting, SchoolNet Telecommunity, Distance Learning, SchoolNet Electrical Infrastructure, and Interactive Video Distance Learning programs.

SchoolNet Plus and SchoolNet Electrical Infrastructure

The FY 1996-FY 1997 main operating appropriations bill made a $400 million commitment and appropriated $125 million to start the SchoolNet Plus program. The FY 1997-FY 1998 capital appropriations bill appropriated another $150 million for this initiative. This leaves an unfilled commitment of $125 million to round out the $400 million program.

The thinking of the executive budget proposal is to fulfill this last $125 million commitment during the FY 1998-FY 1999 capital appropriations process. The House authorizes the issuance of up to $125 million in bonds after January 1, 1998, to pay for the completion of the program. To apply for additional SchoolNet Plus moneys, districts must first certify that they had used all previously distributed SchoolNet Plus moneys to actually purchase and install computers in grades K-4. The Senate eliminates the bond issuance provision and appropriates $125 million in General Revenue Fund moneys to complete the program. Under the Senate proposal, $94.4 million cash in FY 1998 and $30.6 million cash in FY 1999 would be transferred from the General Revenue Fund to the SchoolNet Plus Fund.

Under the original SchoolNet Plus program, 459 targeted districts would receive a total $700 per K-4 ADM in state subsidies and the other 152 non-targeted districts would receive $188 per K-4 ADM. The House proposes to transfer $28 million in cash in FY 1998 from the General Revenue Fund and $3,664,253 from the Lottery Commission's Unclaimed Prizes Fund to the SchoolNet Plus Fund. These moneys are to be distributed to non-targeted districts to bring their total SchoolNet Plus payments up to $350 per K-4 ADM. This provision has remained unchanged under the Senate budget proposal.

The need for electrical upgrades has been identified as the most pervasive obstacle for implementing SchoolNet and SchoolNet Plus initiatives. Many classrooms and school buildings currently do not have adequate electrical service to support computer workstations and other devices. While school districts are allowed to use up to 10 percent of their SchoolNet Plus subsidies for electrical upgrades, the problem is more costly than this for many school districts. As another step toward resolving the problem, the executive budget proposal earmarks $30 million in projected FY 1997 excess lottery profits for electrical service upgrades. This provision has remained essentially unchanged under the House and Senate proposals. However, the House earmarks $2.8 million for the University of Akron to complete the Medina Achievement Center/ Medina Educational Support Center link-up project.

Interactive Video Distance Learning

The Senate establishes the interactive video distance learning program and appropriates to the program $9.2 million in General Revenue Fund moneys in FY 1998. (There is no provision under the executive and the House budget proposals.) Funding priority is to be given to a consortia of schools that are geographically dispersed around the state. The office would calculate a maximum grant amount for each approved school district or consortium. The percentage of the maximum grant amount awarded to school districts or consortia would be greater for lower property wealth districts and less for higher property wealth districts. School districts or consortia of districts whose per pupil valuation for the average of the preceding two years exceed 60 percent of the statewide median valuation per pupil would be eligible for funds only if they commit to provide programming without charge or at minimal cost to districts whose valuation is below the statewide median valuation per pupil.

Department of Human Services

400,525, Health Care/Medicaid, Appropriation Decrease

The Senate used LBO's baseline (February 1997) spending forecasts (with the Executive's adjustments for policy initiatives) to set appropriations in the major Medicaid program line item, 400-525, Health Care/Medicaid. The Senate appropriations thus are set at $5,267.7 million ($2,197.1 million state share) in FY 1998 and $5,534.0 million ($2,344.4 million state share) in FY 1999. This contrasts with the Executive's estimates of $5,361.8 million ($2,236.9 million state share) in FY 1998 and $5,651.8 million ($2,394.1 million state share) in FY 1999 that were used in the "as introduced" version of the budget bill. The House used funding levels the "split the difference" between the LBO and executive estimates.

The Senate's decrease in appropriations in the 400-525 line item simply completed what the House started when it split the difference between the Executive and LBO's estimates. Thus, each chamber decreased the preceding appropriations by $47.0 million ($19.9 million state share) in FY 1998 and by $58.9 million ($24.8 million state share) in FY 1999. The decrease in the Senate from the House appropriations simply represents the second half of the difference between the Executive recommendations and LBO's Medicaid forecasts.

Adult Protective Services

The Executive had collapsed adult protective services into County Social Services, with no temporary language. The House earmarks at least $3,022,000 of the 400-552, County Social Services, line item in fiscal years 1998 and 1999 to be spent in each year for adult protective services. The Senate removes this earmark and restores the 400-534, Adult Protective Services, line item.

Child Protective Services Information System

The Executive makes no specific mention of this item, however, the House requires the Department of Human Services to expend from appropriation line item 400-416, Computer Projects, $3,500,000 in fiscal year 1998 and $4,000,000 in fiscal year 1999 to implement a statewide automated child welfare information system (SACWIS) to be used by the 88 county public children service agencies. It also stipulates what the department must do to implement such a system.

The Senate increases the earmark in the 400-416, Computer Projects, line item from $3.5 million to $6 million in FY 1998 and from $4 million to $6 million in FY 1999. These funds are still to be used to implement a statewide-automated child welfare information system to be used by the 88 county public children services agencies. It mandates that SACWIS must be fully operational in all 88 counties by June 30, 1999 and that it must be capable of interfacing with the existing SETS and CRIS-E informational systems.

Human Services Staff Reduction

The House provides temporary law that requires Human Services to reduce its staff by 150 positions over fiscal years 1998 and 1999. Appropriation line items 400-100 Personal Services and 400-200 Maintenance are reduced to reflect this decrease.

The Senate modified the temporary law section governing the staff reduction by clarifying that it must be measured from the staffing levels that existed on January 1, 1997.

Funding for Food Banks

Neither the Executive nor the House provide for food banks. The Senate grants the Department of Human Services permissive authority to provide finding to local food banks from presumably unused funding that becomes available throughout the 1997-1999 biennium.

TANF Day Care

The Executive recommended setting aside money from the TANF program for day care. The recommendations were for $29.4 million in FY 1998 and $49.9 million in FY 1999. The governor's Blue Book referenced these amounts; however, the introduced version of H.B. 215 contained no language earmarking these dollars.

The House earmarks the $29.4 million in FY 1998 and $49.9 million in FY 1999 for day care. This earmark is from the 400-410, TANF State, and the 400-411, TANF Federal, line items. This simply reflects what was referenced in the Blue Book. The Senate retained this language.

Day Care

In current permanent law only families not receiving public assistance must pay fees for child care. In addition, eligibility for subsidized care is determined by rule. The House stipulated that all users of subsidized child care shall pay a fee, based on a sliding fee scale to be adopted in rules, and allowed families to receive such care until their incomes reach 150 percent of the federal poverty level, so long as funds are available. The Senate concurred on this language.

HCAP Appropriation Increases

The Senate increased the appropriations for the Hospital Care Assurance Program by $64.6 million in FY 1998 and by $66.7 million in FY 1999. This increase came through appropriation changes from the Executive/House levels in two line items. The 400-650, Hospital Care Assurance Assessment Match Fund, line item (Fund 3F0 of the Federal Special Revenue Fund Group) was increased from $301.9 million to $340.2 million in FY 1998 and from $301.4 million to $340.2 million in FY 1999. Appropriations in the 400-649, Hospital Care Assurance Program Fund, line item (Fund 651 of the State Special Revenue Fund Group) were increased from $207.4 million to $233.7 million in FY 1998 and from $217.0 million to $245.0 million in FY 1999. The latter line, 400-649, was increased by the amounts necessary to generate the specified HCAP federal match contained in 400-650.

Ohio has two hospital disproportionate share (DSH) programs. Under the Hospital Care Assurance Program (HCAP), Ohio makes assessments on general hospitals (based upon their total facility costs) and receives federal match on the amounts collected. The entire pot of money (roughly a 60/40 federal/state split) is redistributed to the hospitals based upon their relative uncompensated care. Under the Institutions for Mental Disease DSH program (IMD/DSH), the state receives a federal match for the amount of uncompensated care it claims in public psychiatric hospitals. However, the federal funds are not distributed to the public hospitals (a relatively small portion, however, is distributed to private IMDs). In the proposed budget the IMD/DSH federal match funds are used to expand Medicaid eligibility to children, increase waiver slots, and provide seed money for the transfer of special health-related services to the respective departments. This increase in HCAP appropriations directly affects the HCAP program, but can indirectly affect the IMD/DSH program as noted below.

The federal government has set a cap on the total amount of a state's Medicaid spending that can be DSH related. (In fact, the current federal budget agreement further reduces total DSH payments to all states.) Essentially, this provision increases the size of the Hospital Care Assurance Program (HCAP) in order to raise total appropriations for Ohio's DSH programs to a more recent estimate of the federally imposed ceiling (i.e. and draw the maximum federal funds). The IMD/DSH program size remains constant. (Note that in the past, Ohio has not claimed all of its uncompensated care in psychiatric hospitals because of the overall federal DSH limit).

The Department of Human Services administers the program and will not allow a larger HCAP than is allowable under federal law or than would allow for the IMD/DSH draw-down to fund the Administration's proposed Medicaid program expansions. The higher spending authority can only be achieved if the funds are determined to be available for HCAP.

IMD/DSH Fund Transfers

Fund 3P8 of the State Special Revenue Fund Group received earned federal reimbursement in FY 1996 for the IMD/DSH program. The original plan was to use the $56 million received in FY 1996 for the purpose of funding the start-up costs of OhioCare, but full implementation of the OhioCare waiver program was never achieved. It is for this reason that the majority of the funds remain.

Of the initial $56 million, around $41 million remains in the fund. The Department of Human Services ran the program again in FY 1997, but because OhioCare was pared back, the $51 million received by the state was deposited directly into the GRF.

The department intends to continue to run the program in FY 1998 and FY 1999, but the appropriations from Fund 5C9 of the General Services Fund Group (to which monies from Fund 3P8 will be transferred and new IMD/DSH monies will be received next biennium) do not tap the existing $41 million fund balance. The anticipated new revenue of $150 million will be used as the state share for the following purposes: to expand Medicaid coverage for children; to increase the number of slots in the Medicaid waiver programs; to fund Medicaid covered mental health services that are currently paid through the 400-525, Health Care/Medicaid, line item but will be transferred to the Department of Mental Health after FY 1997 (transfer services); and, to pay Medicaid mental health claims for services provided prior to the transfer for which reimbursement has not been made (pipeline).

Although it would appear that the $41 million is unallocated, there are intended uses for some of the funds. The Administration has indicated that approximately $25 million of the funds will be needed (for the transfer services and the pipeline) to prevent a cash flow problem prior to the receipt of the federal FY 1997 monies, which won't reach the state until late September 1997. However, those funds will be replaced when the federal funds are received. Aside from the cash flow situation, the Department of Mental Health will receive transfers totaling $3 million across the biennium for MACSIS.

The plan of the Administration was to hold the remaining $38 million balance as a contingency for the estimated state share spending of $150 million, in case the estimates of mental health spending and the costs of expanding eligibility are inaccurate. The House, however, transferred $9.9 million to the Department of Health, and the Senate increased the transfer to $14.8 million. The Senate transfers bring the contingency down to $23 million (or about 15 percent of the appropriations from Fund 5C9). In addition to the decrease in the contingency, it should be noted that the recent federal budget agreement reduces federal dollars for DSH programs, which may result in the need to use the remaining contingency to cover revenue shortfalls relative to the initial estimates.

Department of Natural Resources

Natural Areas and Preserves Permanent Language Change

Under current law, the tax checkoff monies for Natural Areas and Preserves can be used for the identification, protection, conservation, and management of endangered plants and for the identification, acquisition, and management of natural areas, wild, scenic, and recreational river areas, and endangered species habitat. These monies are not intended to replace other moneys appropriated for these purposes. All investment earnings of the fund are credited to the fund.

Permanent law was changed in the House version of the bill to identify the following specific purposes for which these monies can be used: the acquisition of new or expanded natural areas, nature preserves, and wild, scenic, and recreational river areas; facility development in natural areas, nature preserves, and wild, scenic, and recreational river areas; and special projects, including, but not limited to, biological inventories, research grants, and the production of interpretive material related to natural areas, nature preserves, and wild, scenic, and recreational river areas. Additional language was added which states that these monies cannot be used to fund salaries, administrative costs, or routine maintenance. Investment earnings are still credited to the fund. The Senate let stand the changes made in the House.

The Ohio Board of Regents and State-Assisted Higher Education

House and Senate plans for higher education are quite different — both in funds appropriated and law passed, and both chambers differ from the Executive's As Introduced bill in many areas. More details can be found in the LBO Fiscal Comparison Document, but here are some highlights.

GRF funding

The Executive proposed GRF funding of $2.17 billion in fiscal year 1998 and $2.25 billion in fiscal year 1999 for Regents. The House Passed GRF budget was $2.18 billion and $2.25 billion, respectively. The Senate Passed GRF budget was $2.22 billion and $2.31 billion, respectively. The biggest increase in Senate funding, $30 million in 1998 and $40 million in 1999, was used to increase funding for the Instructional Subsidy, guaranteeing each institution a 3% increase from fiscal years 1997 to 1998 and from 1998 to 1999.

Challenge funding

This is a first, major step toward diversifying Ohio's state higher education funding away from its current heavy reliance on the instructional subsidy formula, which is based primarily on student enrollment, and toward financial rewards for institutional attainment in specified areas. The Executive introduced seven new challenge items, and funded all nine items at $17.08 million in fiscal year 1998 and $38.22 in fiscal year 1999. The House Passed funding levels were $34.57 million and $50.65 million, respectively. The Senate totals were $29.18 million and $36.53 million, respectively.

The new Challenge items are JOBS, Technology, Access, School, Success, and Productivity Improvement. The House funded all items but School Challenge, while the Senate eliminated funding for the following items: Higher Education Efficiency, JOBS, Technology, and Success. The Senate agreed with the Executive to fund School Challenge in fiscal year 1999, and funds it at a higher amount: $3 million versus the Executive's $1.93 million. The House eliminated funding for School Challenge entirely. Appropriations levels for the other challenges differ as well. Performance Challenge and Research Challenge are not new, being funded in the 1996-7 biennium as well as in Sub. H.B. 215.

Instructional Subsidy

This is the BOR workhorse for delivering funds to state-assisted higher education institutions. Executive funding level was $1.47 billion in fiscal year 1998, and $1.51 billion in fiscal year 1999. House funding was about $6.4 million less both years, rounding to: $1.47 billion, and $1.50 billion. Senate: $1.50 billion, and $1.55 billion, respectively. The big changes in 235-501, Instructional Subsidy, are the Senate's additional funding, mentioned above, and the movement of Central State University funding described below.

Ohio Instructional Grants (OIGs)

OIGs are need-based financial aid to students enrolled in public and private higher education, including proprietary schools. Funding levels were Executive: $89.10 million and $91.77 million; House: $93.60 million and $96.27 million; Senate: $93.60 million and $96.27 million. The Executive introduced substantially increased awards, but did not change the range of eligible incomes — up to $30,000. The House increased appropriations by $4.5 million both years of the biennium, and expanded eligibility by increasing the maximum allowable income to $31,000, and raising the threshold of the maximum grant to $11,000 from $10,000. The As Introduced grant amounts were left unchanged. The Senate maintained the higher appropriations but returned to the Executive's tables, reducing the number of eligible students, and the size grants that some students will receive. With the "excess" funds the Senate created a merit scholarship for OIG students who pass all of the 12th grade proficiency test. The Senate also required BOR to prepare a report for folding the part-time OIG program and funding into the main (full-time) OIG program and appropriation item.

Central State & Fiscal Exigency

Total funding doesn't change from As Introduced through House Passed. The Senate reduced total appropriations by $190,350 by reducing 235-595, International Water Resources, by that amount. Whichever way CSU is funded, the dollars total approximately $28 million over the biennium.

The Executive and the Senate both fund CSU via the existing appropriation items: 235-514, Central State Supplement; 235-595, International Water Resources Development; and 235-501, Instructional Subsidy. The Senate's 3% increase in Instructional Subsidy for all institutions also increases CSU's share of Instructional Subsidy, however, this increase is offset by a reduced appropriation in the Central State Supplement item. The House eliminated all funding in these Regents' items and created new items and governing temporary law in the Controlling Board (CEB). The House's temporary law specifies that any funds to be released to Central State would be released after Controlling Board approval was sought and obtained by the Office of Budget and Management.

The Senate developed a set of procedures to govern institutions in financial crisis, called "fiscal exigency", specifying what they may and may not spend state funds on, and accounting standards which must be implemented, among other requirements. CSU's current state of fiscal exigency is declared by law to continue through 1998-99, and the institution will be closed if it fails to meet conditions specified for institutions in fiscal exigency (section 3345.70) and for CSU in particular (section 98.16).

Tuition Cap

The issue is limits on the increases in undergraduate instructional and general fees. The Executive proposed 4% limits; the House maintained the 4% limits but permitted certain exemptions based on freshman retention rates, graduation rates, and percentage of student population which are Ohio residents. The Senate eliminated the caps, but required that any increase beyond 8% be used for undergraduate student financial aid.

Department of Rehabilitation and Correction

GRF Appropriations

The House and Senate versions of the budget both cut total annual GRF funding for the Department of Rehabilitation and Correction from what was recommended by the executive, with the House proposing somewhat deeper cuts in the second fiscal year of the next biennium than the Senate. Inside the total GRF bottom line, both legislative chambers reduce the overall amount of money committed to prison operations through various line items in the executive budget and then move some of those savings to increase funding for community corrections.

Privately-Operated Prison

The Senate version of the budget added temporary law instructing the Department of Rehabilitation and Correction to take all necessary steps to ensure that the prison currently under construction in Conneaut (Ashtabula County) be completed and then promptly turned over to a private vendor for management and operation during fiscal year 1999. The executive and House versions of the budget contain no such requirement.

Professional Services Contract Review Committee

A free-standing temporary law section added in the Senate version of the budget (Section 162) creates the short-lived, ten-member Professional Services Contract Review Committee, to be assisted by staff of the Legislative Budget Office and the Department of Rehabilitation and Correction. The committee is tasked with performing a cost-benefit analysis of all fiscal year 1996 and 1997 professional services contracts entered into by the departments of Rehabilitation and Correction, Mental Health, Mental Retardation and Developmental Disabilities, and Youth Services, and then delivering a report of findings and recommendations no later than June 30, 1998. The executive and House versions of the budget contain no such provision.

Department of Taxation

Cap on the Income Tax Reduction Fund (ITRF)

The executive budget made the tax cut mechanism adopted in S.B. 310 (the latest budget corrective bill) permanent. As originally adopted in S.B. 310, the tax cut formula would have been in place only for two taxable years, 1996 and 1997, although the state would have felt the revenue impact in three fiscal years, 1997 through 1999. The income tax cut formula gives back unanticipated budget surpluses to taxpayers in the form of across-the-board tax rate reductions.

When the executive budget was introduced, OBM estimated that the tax cut for taxable year 1997 would be $285.7 million, or about 4.5 percent (the cut for taxable year 1996 was $400.8 million, or 6.6 percent). The House split the difference between OBM's revenue and caseload forecasts and LBO's more optimistic forecasts. This resulted in a larger estimated ending GRF fund balance for FY 1997 ($564.5 million), and consequently a larger tax cut, of $374.1 million or 5.9 percent. The Senate decided to use straight LBO forecasts and thus the estimated ending GRF fund balance for FY 1997 grew larger still ($766.9 million). Without other Senate action, the tax cut would have risen to $539.3 million, or 8.4 percent — even larger than the 1996 rate cut.

Seeing the need for additional state funding for K-12 education in the wake of the recent *DeRolph v. State* decision, the Senate decided to cap the transfer from the GRF to the Income Tax Reduction Fund (ITRF) after the end of FY 1997, which caps the income tax rate cut for taxable year 1997. The Senate bill limits the transfer from the GRF to the ITRF to $285.7 million, the amount identified in the Governor's budget. The other $253.6 million is used for four specific purposes, all of which provide additional money for primary and secondary education. These four transfers are listed below:

(i) The first $94.4 million is transferred from the GRF to Fund 4Y4, SchoolNet Plus. When combined with the $30.6 million transfer from the GRF in FY 1999 (already in the House bill), this provides the $125 million in cash necessary to complete the SchoolNet Plus program. (The legislature provided $125 million in Am. Sub. H.B. 117 of the 121st General Assembly, with intent language to provide another $275 million. The $150 million from Am. H.B. 748 (the latest capital bill) and the $125 million in this bill fulfill the requirement.) Unlike the House bill, no bonding authority or debt service appropriations are needed.

(ii) The next $25 million is transferred from the GRF to Fund 5F8, the Instructional Materials Education Fund (IMEF). The Senate bill removes the $50 million in biennial appropriations for this purpose that was in the House bill. Those appropriations were to be funded by lottery profits that current estimates indicate will not be realized.

(iii) The next $9.2 million is transferred from the GRF to the Distance Learning Fund newly created in this bill (Section 3317.51). The GRF transfer is to be combined with the PUCO — telephone company settlement moneys.

(iv) Finally, any remaining unobligated GRF fund balance money will be transferred from the GRF to Fund 021, School Building Assistance. Under LBO's latest estimates this amount will be $125 million. The money will be commingled with the $300 already appropriated in the recently-passed S.B. 102 of the 122nd General Assembly to provide a total of $425 million in new funds for school building construction or renovation for low-wealth school districts.

Indexing the Personal Exemption

Beginning in taxable year 2000, the bill annually indexes the state income tax personal exemption for inflation. Beginning in taxable year 1999, past legislated increases in the personal exemption will have been fully phased in, and exemptions for taxpayer, spouse, and dependents will all be equalized at $1,050. Starting in 2000, the $1,050 amount is indexed according to July through June changes in the Gross Domestic Product (GDP) implicit deflator. The indexing adjustment *always rounds upward* to the

Rail Development Fund Transfers							
	Actual	Actual	Estimated	HB 117 (121st)/ HB 210 (122nd)		HB 215	
	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 1998	FY 1999
RDF	$4.1	$4.3	$4.3	$6.45*	$6.45*	$4.3	$4.3
*Slightly over the original estimate of $6.1 million.							

nearest $50. As an example, if the GDP deflator increases by only 2.0 percent, the unrounded exemption would increase to $1,071. Rounding to the nearest $50 would hold the exemption at $1,050, but the bill language specifies that the exemption will be rounded *up* to $1,100. In the short run this will probably not make much difference, but in the long run, as the base exemption steadily increases, this method of rounding will overcompensate for annual inflation.

An increase in the exemption from $1,050 to $1,100 is projected to reduce income tax revenues by approximately $20 million in FY 2001. The GRF would bear $17.9 million of this loss, with the other $2.1 million falling on the three local government funds (LGFs). Losses for the next few years are expected to stay around $20 million annually.

Department of Transportation/ Rail Development Commission

Rail Development Fund

4981.09 Rail Development Fund

An August 1991 ruling, *Cuyahoga Valley Rail, et al. vs. Limbach* made it clear that railroad companies would no longer pay the public utility excise tax (gross receipts tax), but, instead, would be taxed as ordinary businesses. Am. Sub. H.B. 152 of the 120th G.A. (biennial appropriations act) explicitly subjected railroad companies to the corporate franchise tax. Much discussion ensued over the distribution of this revenue when Am. Sub. H.B. 790 of the 120th G.A. (capital act) credited fifty percent of the tax to the Rail Development Fund in FY 1995. The Rail Development Fund was previously created (without an appropriation) for the purpose of acquiring, rehabilitating, and developing rail service through grants, loans, and leases. In Am. Sub. H.B. 117 of the 121st G.A. (biennial appropriations act), the share was increased to 75 percent in permanent law. However, temporary law in the act maintained the 50 percent transfer for fiscal years 1996 and 1997, thereby, delaying the increase until FY 1998. Due to changes in the transfer date in Am. Sub. H.B. 210 of the 122nd G.A. (transportation appropriations act) to eliminate a delay in receiving the cash, temporary law in this act clarified that the 75 percent increase was to take effect July 1997 (FY 1998). Therefore, appropriations in the Fund for the 1997-1999 biennium are based upon this 75 percent transfer. The bill reduces the portion back to 50 percent and repeals the temporary law so that the 75 percent increase never takes place, yet it does not amend H.B. 210 to reduce the appropriation.

When it was first determined that the Rail Development Fund (RDF) would receive 50 percent of the corporate franchise tax, the Department of Taxation estimated that total collections would be about $12.2 million annually. Therefore, it was anticipated that the Fund would receive about $6.1 million. However, FY 1995 collections totaled $8.2 million, which provided only $4.1 million to the Fund. In FY 1996, total collections were $8.6 million ($4.3 million to the Fund). The increase to 75 percent is estimated to generate an additional $2.15 million which would make up the difference between what was originally estimated to be generated and what is actually generated. The transfer amounts to the Rail Development Fund under current law and the bill are shown in the table above.

Utility Radiological Safety Board

As Introduced by the Executive

The Executive budget continues the funding mechanism and structure of the Utility Radiological Safety Board, as found in current law. Money appropriated to fund duties of the Utility Radiological Safety Board would be deposited in the Public Utility Commission's Fund 664, 870-613 Radiological Preparedness Board. These moneys would then be disbursed to the appropriate line item with the Department of Agriculture, Emergency Management Agency, Department of Health and the Environmental Protection Agency to fund activities related to utility radiological safety. The Public Utilities Commission would also retain a portion of the money for their role in utility radiological safety.

Executive	FY 1998	FY 1999
DEPARTMENT OF AGRICULTURE		
Fund 4E4, Radiological Safety	$95,552	$97,958
DEPARTMENT OF HEALTH		
Fund 610, Radiation Emergency Response	$420,040	$430,541
EMERGENCY MANAGEMENT AGENCY		
Fund 657, Utility Radiological Safety	$385,502	$395,140
ENVIRONMENTAL PROTECTION AGENCY		
Fund 644, ER Radiological Safety	$198,095	$190,451
TOTALS	***$1,099,189***	***$1,114,090***

Senate	FY 1998	FY 1999
DEPARTMENT OF AGRICULTURE		
Fund 4E4, Radiological Safety	$95,552	$97,958
DEPARTMENT OF HEALTH		
Fund 610, Radiation Emergency Response	$752,788	$771,275
EMERGENCY MANAGEMENT AGENCY		
Fund 657, Utility Radiological Safety	$744,361	$764,459
ENVIRONMENTAL PROTECTION AGENCY		
Fund 644, ER Radiological Safety	$198,095	$190,451
TOTALS	***$1,790,796***	***$1,824,143***

Because the total appropriation to the PUCO's Fund 664 was to be $1,443,941 in fiscal year 1998 and $1,467,577 fiscal year 1999, the PUCO would retain $344,752 in fiscal year 1998 and $353,487 in fiscal year 1999.

As Passed by the House

The House cut funding to PUCO's Fund 664 in half in fiscal year 1998 and by three-fourths in fiscal year 1999, reducing the effective appropriation to the PUCO for this line (i.e., the appropriation authority remaining after the required transfers are made). It did not reduce the appropriation to the affected lines in the other agencies' budgets. Although revenues obtained via the PUCO would be reduced, the other agencies would be able to make up the difference by means of grants from the affected utilities. The House also required the URSB to sunset at the end of fiscal year 1999.

As Passed by the Senate

The Senate appropriated $50,000 in fiscal year 1998 and $0 in fiscal year 1999 in PUCO's Fund 644, thus phasing out its involvement in the Utility Radiological Safety Board by FY 1999. However, the URSB does not sunset at the end of fiscal year 1999. Additionally, all temporary language regarding the PUCO's Radiological Preparedness Board is deleted. Therefore, instead of the PUCO transferring a portion of their appropriation to the Department of Health, Department of Agriculture, Emergency Management Agency, and Environmental Protection Agency, these agencies will negotiate grants with the nuclear utilities to fund their statutory duties related to nuclear safety, the Utility Radiological Safety Board and/or agreements with the Nuclear Regulatory Commission.

The Senate specifies the maximum amount that each agency of the Utility Radiological Safety Board may receive from the nuclear electric utilities. The maximum amount for each agencies' radiological safety fund is as follows.

If any member agency disagrees with the grant amount offered from the nuclear electric utilities, the agency shall make a written directive to the Utility Radiological Safety Board for an assessment against the nuclear electric utility for the grant amount the agency has requested, and notify the Controlling Board, the Director of Budget and Management and the nuclear electric utilities of the written directive. If the grant amount that is offered by the nuclear electric utilities does not exceed 75 percent of the maximum amount specified above, the Utility Radiological Safety Board shall assess the specified amount against the nuclear electric utility, as long as that assessment does not exceed the maximum amount specified above. If the grant amount does exceed 75 percent of the maximum amount specified above, the agency may request the Controlling Board to approve an assessment against the nuclear electric utilities for the specified amounts, as long as that assessment does not exceed the specified above. If the member agencies and the nuclear electric utilities agree to the grant amount, the Utility Radiological Safety Board shall not make an assessment against the nuclear electric utilities. All revenues received as grants or assessments are deposited into each member agencies' appropriate nuclear safety fund. ❑

Contributions to this article were provided by Linda Bailiff Piar, Clarence Campbell, Fred Church, Jeff Golon, Rick Graycarek, Sybil Haney, Joni Leone, Doris Mahaffey, Grant Paullo, David Price, Roberta Ryan, Kathy Schill, Chris Whistler, Deborah Zadzi, and Wendy Zhan.

The Legislative Budget Office produces numerous documents conveying information to the General Assembly regarding the main operating budget bill. The following documents are available to the general public:

Budget Spreadsheet: This document provides an agency-by-agency breakdown of line items. Total appropriations and changes for an agency are provided.

Local Impact Statement: This document provides a detailed look at local fiscal effects. The document relates this information by agency. Both local costs and revenues are covered.

Fiscal Comparison Document: This document provides a review of most temporary and permanent law changes. Temporary law changes associated with agency appropriation sections or that have fiscal effects, as well as, permanent law changes with fiscal effects are covered.

OHIO FACTS EXTRA!

The Ohio Facts Extra! section grew out of the booklet, Ohio Facts, a publication developed by LBO to provide a broad overview of public finance in Ohio. Each month in Budget Footnotes, a different area of interest will be presented in graphics and text.

Relief for the Elderly: Homestead Exemptions

— *Barbara Mattei Smith*

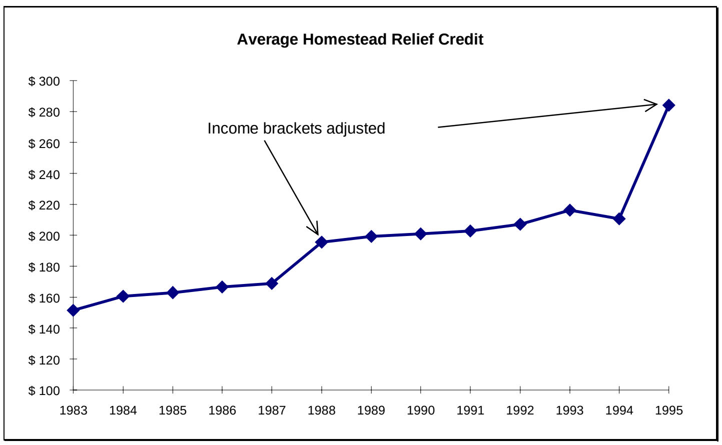
Current Homestead Exemption Income Brackets

Income	Reduction in Taxable Value - The Lesser of:
$0-$10,800	$5,000 or 75% of assessed value
$10,800-$15,800	$3,000 or 60% of assessed value
$15,800-$20,800	$1,000 or 25% of assessed value
over $20,800	Zero

- The homestead exemption program provides property tax relief for low income senior citizens and the permanently disabled by reducing the taxable value of the homestead. The amount of the reduction in taxable value is determined by income level as outlined in the table above.

- In tax year 1995, the state reimbursed local taxing authorities $69.8 million to provide relief to approximately 250,000 households.

- Adjustments to the income brackets are seen as sudden upward shifts. The latest adjustments were made in the biennial budget bill of the 121st General Assembly, resulting in an increase in average relief from $211 to $286.



Government Services Television Network Index
By Joshua N. Slen

Due to recent changes in the format of programs we will no longer be providing a monthly review of materials from GSTN. However, we will continue to have access to videos containing news segments and training programs on various topics. If you are curious about the types of programs available please stop by the LSC Library on the 9th Floor of the Vern Riffe Center for Government & the Arts and ask to see the most recent GSTN video tape.