Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE AUGUST, 1997

FISCAL OVERVIEW

— *Frederick Church*

Why, man, he doth bestride the narrow world
Like a Colossus, and we petty men
Walk under his huge legs and peep about
To find ourselves dishonourable graves.

William Shakespeare
Julius Caesar, Act I, Scene 2

The aftermath of the *DeRolph* school funding decision bestrides Ohio government like a Colossus: one hardly hears of anything else. Clearly, it is the biggest issue facing the state, a decision of the same magnitude as the adoption of the income tax in 1971 or the increase in the income tax in 1982. Not coincidentally, although the 1982 increase came about partly as the result of a deep recession, both changes were sold largely on the basis of providing additional funding for primary and secondary education. Lost in all the debate about finding more money for schools is the fact that, were it not for this problem, the state's finances would be hailed as being in very good shape (granted that this reminds one of the joke about how Mrs. Lincoln enjoyed the play). FY 1997 offered a virtual replay of FY 1996, with revenues outperforming the forecasts and spending growth under control. In fact, both the revenue overages and underspending totals were bigger in FY 1997 than in FY 1996.[1]

Tax revenues finished $334.3 million above estimate, or 2.65 percent greater than forecast. Most of the overage was in the personal income tax, which enjoyed a banner year despite the rate cut that resulted from the FY 1996 budget surplus. The income tax was $280 million, or 5.5 percent, above the estimate. Collections grew by 2.3 percent even though marginal rates were reduced by 6.6 percent. Every component of the income tax finished above estimate, although the greatest overage was in quarterly estimated payments. Strong growth in non-wage income again seems to have been the driving force.

The other significant overages were in the non-auto sales tax ($33.8 million), the estate tax ($17.0 million), the corporate franchise tax ($8.8 million), and the tobacco tax ($6.9 million). These other overages were relatively small in percentage terms, except for the estate tax, which was

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QUARTERLY LOTTERY REPORTS

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ISSUES OF INTEREST

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

Budget Footnotes examines the fiscal position of the state GRF on a monthly basis. Each issue also 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 June	Fiscal Year 1997 Final	Last Year	Difference
Beginning Cash Balance	$778.4	$1,138.5		
Revenue + Transfers	$1,633.2	$17,253.9		
Available Resources	$2,411.6	$18,392.4		
Disbursements + Transfers	$1,043.9	$17,024.7		
Ending Cash Balances	**$1,367.7**	**$1,367.7**	**$1,138.5**	**$229.1**
Encumbrances and Accts. Payable		$532.8	$357.2	$175.6
Unobligated Balance		**$834.9**	**$781.3**	**$53.5**
BSF Balance		$828.3	$828.3	
Combined GRF and BSF Balance		**$1,663.2**	**$1,609.6**	**$53.5**

a whopping 20 percent over the forecast. The only shortfalls worth noting were in the auto sales tax ($5.1 million) and the insurance taxes ($8.1 million for the foreign and domestic combined). Broadly speaking, the overages in the income, sales, and franchise taxes were all the result of a continued strong economy. Obviously, there were special factors responsible for the income tax's results, but strong employment and income growth (broadly construed to include corporate earnings) drove the performance of the "Big Three" Ohio taxes.

In non-tax revenue, liquor profits continued their strong performance. Driven by higher prices and wider profit margins, profit transfers to the GRF were $10.5 million above the original estimate. Extremely high average daily GRF cash balances also led to a big overage in investment earnings ($27.5 million, or 36.7 percent). Total non-federal revenues finished the year with an overage of $436.8 million, or 3.3 percent.

Despite all the good news, total GRF income was only $43.5 million over estimate, due to a massive shortfall in federal reimbursement. Federal matching money was $393.3 million below estimate, down 4.6 percent from last year, and 10 percent below the estimate. For the most part, this was due to lower than estimated spending on human services programs such as Medicaid, which draw federal funds. Whether there were other factors involved in the shortfall is not yet clear.

Disbursements were a record $811.8 million (4.7 percent) less than the estimates.[2] The bottom line GRF variance was reduced somewhat by the fact that several unanticipated transfers (mostly temporary) caused transfers to other funds to exceed the estimate by $85.4 million. Even so, total GRF outlays were below estimate by $726.4 million, or 4.1 percent. However, to get a truer picture of state spending, one must factor in the amount of state "encumbrances," which are commitments or obligations to spend money that for a variety of reasons did not lead to checks actually being written in FY 1997. Encumbrances this year were $532.8 million, far more than the $357.2 million at the end of FY 1996. While it is generally true that encumbrances are higher in the second year of a biennium, the increase from FY 1996 is still surprising (one of the encumbrances was a pure timing issue: see the discussion of Medicaid that follows).

In general, agency year-end encumbrances have been rising, both in raw dollars and as a percentage of disbursements. As recently as FY 1992, encumbrances were less than 2 percent of agency disbursements, while FY 1997's figure was 3.2 percent. The reason for this trend is unclear. It is also unclear how much of the encumbered money is actually being spent in succeeding years (some encumbrances are cancelled by OBM partway through the fiscal year), and for what purposes.

Once again, the biggest underspending was in the welfare and human services programs (given the nature of entitlement programs, unless they are forecasted extremely well or other spending is forecasted very poorly, the biggest variances will be there). Welfare and human services were $666.4 million below estimate. Medicaid alone was responsible for almost 2/3 of that variance. Medicaid spending was $426 million, or 8.0 percent, below the estimate, and actually declined by 0.9 percent from the prior year. However, once one adds the $76.1 million payment scheduled to be made the last week of FY 1997 but encumbered and paid in July instead, the Medicaid variance is reduced to "only" $349.9 million. Adjusted Medicaid spending turns out to have increased very slightly from FY 1996 (0.7 percent).

As with strong tax revenues, much of the welfare underspending can be traced to a strong economy. In welfare spending, the driving force has been declining caseloads for the former ADC (now TANF) program. Most categories of Medicaid spending were below estimate, and in most of those categories low usage by ADC eligibles was largely responsible. (Contrary to a long term trend, caseloads among non-ADC eligibles like the Aged, Blind, and Disabled are also declining or levelling off.) As one would expect, low ADC/TANF caseloads also drove cash assistance payments in the ADC/TANF and Other Welfare categories far below estimate. The combined underspending here was about $245 million.

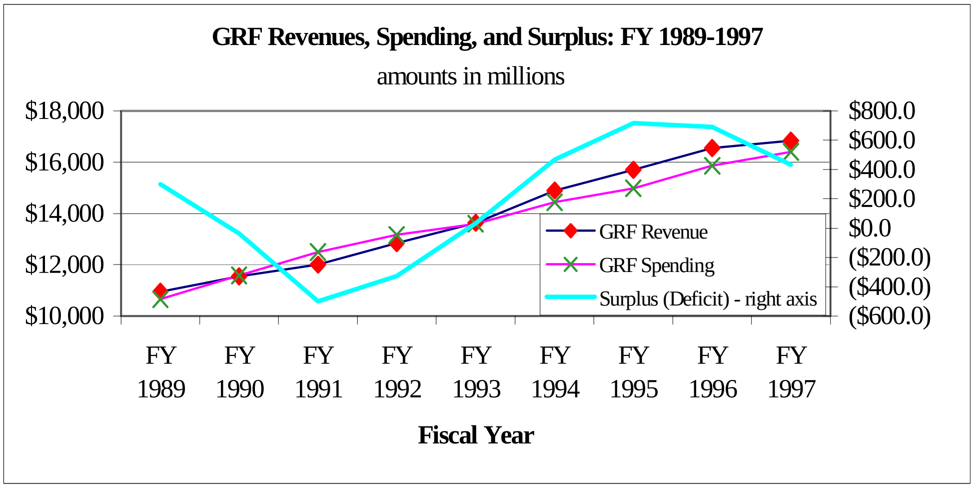
Ironically enough, while the debate rages on about how to put more money into primary and secondary education, FY 1997 spending in that category showed the biggest negative variance outside of welfare. Total K-12 spending was $108.1 million below estimate. Low ADC/TANF caseloads actually affected this category too, by causing an $11 million lapse in Disadvantaged Pupil Impact Aid (DPIA). However, basic aid and the other SF-12 funding components were responsible for the largest part of the spending variance. Most of the non-DPIA $97 million in underspending was encumbered ($79.7 million). However, based on historical experience, it appears unlikely that all this encumbered money will actually be spent.

The year-end budget surplus was not as big as it might have been, due to the encumbrances mentioned above, but it was still larger than in FY 1996. Most of the $834.9 million surplus was spent on transfers from the GRF to other funds for education-related purposes. After the transfers and the necessary carryover balance for FY 1998, enough money was left for a tax cut of $262.9 million, or approximately 4 percent. This rate cut will be applied to taxable year 1997 income, and will

HB 215 FY 1997 Transfers

amounts in millions of $	Amount
Ending GRF Balance	$834.9
School Building Assistance	($250.0)
SchoolNet Plus	($94.4)
Textbooks and Materials	($35.0)
Distance Learning	($9.2)
Subtotal School Transfers	($388.6)
BSF Transfer	($34.4)
Capital Reserve	($7.2)
Reserve Against 1996 Income Tax Rate Cut	($55.5)
Necessary 0.5% GRF Carryover	($86.3)
Total All Transfers	($572.0)
Amount Left for 1997 Tax Cut	$262.9

	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997	FY 1998
GRF Revenue	$10,957.6	$11,547.4	$12,001.5	$12,842.4	$13,634.8	$14,901.3	$15,695.6	$16,548.0	$16,836.2	$17,758.0
GRF Spending	$10,656.4	$11,585.7	$12,501.1	$13,169.5	$13,600.2	$14,433.2	$14,978.6	$15,858.1	$16,404.1	
Surplus (Deficit)	$301.2	($38.3)	($499.6)	($327.1)	$34.6	$468.1	$717.0	$689.9	$432.1	



affect returns filed in 1998 (due to the timing of receipts, revenues will be reduced in both FY 1998 and FY 1999). In contrast, the 1996 tax cut was $400.8 million, leading to a 6.6 percent reduction in marginal rates).[3]

It is worth noting that, of the $388.6 million transferred for education spending, most will be spent on relatively long-lived assets: buildings, computers, books, etc. The additional spending can be thought of as having been deferred from the last capital bill. At that time it did not seem like the state would have enough near-term cash to fund all the education projects the legislature wanted, but the FY 1997 surplus provided the means.

In the text and tables above, we have taken the term “surplus” to mean essentially excess cash. This includes both revenue overages and underspending from the current year and balances carried forward in some fashion from prior years. A slight refinement in our thinking leads us to think of the GRF surplus in annual terms: that is, how much the GRF has taken in above spending on an annual basis. Although there are many adjustments possible to arrive at a “true” surplus figure, we have taken only the simple step of excluding transfers to and from the GRF. Thus, transfers to and from the Budget Stabilization Fund (BSF) and the Income Tax Reduction Fund (ITRF), which can cloud the picture, have been omitted. The same is true for GRF transfers of what is assumed to be “one-time” revenue to other funds for spending (there have been a lot of such transfers in the past two years). Liquor profit transfers, which are a continuing source of revenue, are included in revenue. The result is presented in the graph above.

The operating surplus seems to have peaked in FY 1995, and is now trending downward, although the FY 1997 surplus is still quite sizable. For fiscal years 1997 and onward, the income tax cut mechanism which gives back part of the GRF surplus to taxpayers, can be expected to restrict the operating surplus. Thus, it acts as a kind of built-in stabilizer to restrict the size of the surplus.

The table and graph provide at least a rough answer to what can be expected to happen to state finances in recessionary times. The economic slowdown in 1989-1990, followed by the relatively mild recession of 1990-91, took the state from a $300 million surplus in FY 1989 to three years of deficits, with the FY 1991 deficit running at $500 million. The size of the FY 1991-92 budget hole was about $827 million, or 3.3 percent of revenue.[4] An equivalent percentage deficit over the FY 1998-99 biennium would be about $1.2 billion. In fact, the FY 1991-92 deficit would have been even larger if not for spending cuts that held expenditures below the original appropriation amounts, so the $1.2 billion figure is somewhat conservative. Also, a longer or more pronounced downturn than the 1990-91 recession could produce a bigger gap, although this is mitigated by the fact that there is some conservatism already built into the FY 1998-99 forecasts.

None of this implies in any way that LBO predicts a deficit in the upcoming biennium: we are on record as saying that we forecast continued growth. This is intended as a theoretical exercise to give a rough idea of the magnitudes involved.❑

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[1] This is not surprising. If one forecasts moderate growth for both years of a biennium (FY 1996-1997) and growth outperforms expectations, estimating errors will accumulate and the second year will be even farther off.

[2] Of course, savings to the state do not equal the entire $811.8 million. Given that federal reimbursement was $393.3 million below estimate, the net savings to the state was about $418.5 million. The foregone federal money can be viewed as a contribution by Ohio (albeit small) to reducing the federal deficit for FFY 1997.

[3] The order of the transfers, which fixed all the dollar amounts except for the income tax cut, which was allowed to float based on the ending fund balance, was established in temporary law in the budget act for FY 1998-1999 (Am. Sub. H.B. 215 of the 122nd General Assembly).

[4] The rebound in FY 1993 is partly the result of an improving economy, but also partly the result of budget cuts and tax increases made in H.B. 904 of the 119th G.A., which took effect partway through the fiscal year.

Status of the General Revenue Fund

REVENUES

— Frederick Church

Tax revenues finished the year $334.3 million above estimate, a variance of 2.65 percent. The income tax alone was over estimate by $280 million, or 5.5 percent. Because of the impact of the 6.6 percent income tax rate cut, income tax revenue growth was only 2.3 percent, and overall tax revenue growth was 3.4 percent. However, LBO estimates that without the rate cut, income tax revenue growth would have been around 10 percent, and overall tax revenue growth would have been 6.6 percent or more.

The all funds overage in the income tax (local government funds included) was $318.5 million. Almost half was from quarterly estimated payments, driven by much higher than expected amounts of non-wage income. However, all components of the income tax were over estimate. Annual returns posted a strong overage, and refunds were smaller than anticipated (which contributes to the overage in net collections). Since January, the administration had been waiting for the rate cut impact to cut down annual returns and push refunds up toward the estimate. It finally became apparent in May that, while the rate cut had an undeniable impact on both components, the rate cut was going to be swamped by the impact of income growth, and the only question was how big the income tax overage would get.

Although there were five tax sources that were below estimate, the shortfalls were all relatively minor. There were two variances worth noting: the foreign insurance tax was $6.5 million below estimate, and the auto sales tax was $5.1million short.

On the plus side, there were four categories other than the income tax with notable overages: the non-auto sales and use tax ($33.8 million), the estate tax ($17.0 million), the corporate franchise tax ($8.8 million), and the cigarette tax ($6.9 million). All in all, it was a solid but unspectacular year for revenues, except for the income tax.

On the non-tax side, investment earnings and liquor profits both posted sizable overages. Investment earnings were $27.5 million over estimate, despite a modest rate of return on the Treasurer's portfolio. Huge GRF average daily cash balances drove overall earnings. The overage in transfers to the GRF was mostly due to temporary transfers such as repayments of transfers from the GRF to bond funds. As a result, the transfers overage has little impact on the bottom-line status of the GRF.

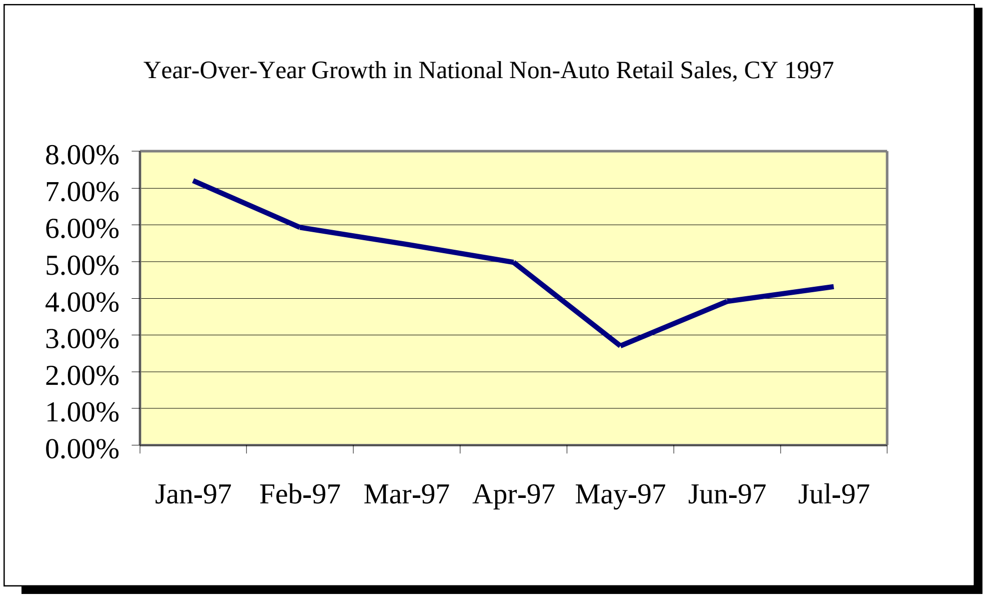
Federal reimbursement was under by a stunning $393.3 million, or 10 percent. Federal funds dropped by 4.6 percent from a year ago. Most of this shortfall is due to underspending in welfare programs that draw federal money, and thus is actually good news. In fact,

Comparison of National Retail Sales and Ohio Tax Collections, Automobiles
Growth Rates for Ohio Fiscal Years 1994-1997

	1994	1995	1996	1997	1993-1997 average
National Retail Sales, Autos	15.0%	9.0%	7.3%	5.4%	9.1%
Ohio Sales Tax Collections, Autos	21.8%	4.7%	1.7%	0.7%	6.9%

despite the low federal funds total, it appears from the Medicaid data that health care spending was so low that the effective federal match rate was quite high, hitting almost 61 percent.

Total non-federal revenues were $436.8 million over estimate for the year (3.3 percent), although the federal reimbursement shortfall held the total GRF overage down to $43.5 million.



Sales and Use Tax

The auto sales tax needed only growth of 1.5 percent to hit the FY 1997 target, but it still fell short. The auto tax finished $5.1 million below estimate, with growth of only 0.7 percent. This low growth came in spite of the fact that the U.S. Department of Commerce reported that retail sales of vehicles (in dollars, not units) increased by 5.4 percent nationally over the July 1996 through June 1997 period. Ohio auto sales tax collections greatly lagged national results.

This is nothing new. In FY 1996, Ohio auto sales tax collections increased by only 1.7 percent, despite the fact that Department of Commerce data reported national auto sales growing by 7.3 percent over the same period. The question is, why are Ohio auto sales tax collections lagging behind what one would predict based on national data?

Comparison of National Retail Sales and Ohio Tax Collections, Automobiles

One of our standard explanations to fall back on is the increased percentage of the automotive market accounted for by leasing. Auto leasing sales taxes are paid monthly, along with the lease payments, rather than up front. More importantly, under Ohio's peculiar system of accounting, auto leasing tax payments are counted as non-auto sales taxes, rather than auto sales taxes. This distorts the data in several ways:

1. Auto sales tax collections are artificially depressed, and non-auto collections are artificially inflated.

2. Relative growth rates for any given year or period are distorted to the extent that leasing's share of the market changes over that period.

3. Non-auto sales tax growth rates are artificially "smoothed out," and disconnected from current activity. At any given time, the non-auto sales tax is reflecting a fairly substantial amount of collections that are based on leases actually entered into 2, 3, or 4 years ago. The plus side of this is that it buffers sales tax collections somewhat against downturns. The down side is that statistically, it is harder to relate non-auto sales tax activity to current consumption figures.

The Federal Reserve's Beige Book report from early August showed auto sales in the Fourth District (Ohio, northern Kentucky, western Pennsylvania) have slowed, but offered no explanations why. It appears that sales in the Fourth District may have slowed a little more than the national average, but it is hard to be precise based on the anecdotal accounts therein.

National data on unit sales show a clear slowdown in the first half of CY 1997, which hurt Ohio tax collections in the last half of FY 1997. National unit sales over the January through June period dropped by 2.0 percent. Continuing a trend of recent years that favors light trucks, truck sales are still edging up, but car sales are falling. Imports are beginning to recapture some of the market share they have lost in recent years.

In contrast to the auto sales tax, the non-auto sales tax outperformed

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

REVENUE SOURCE			
TAX INCOME	Actual	Estimate*	Variance
Auto Sales	$65,130	$61,092	$4,038
Non-Auto Sales & Use	376,904	366,489	10,415
Total Sales	$442,034	$427,581	$14,453
Personal Income	$476,556	$474,800	$1,756
Corporate Franchise	188,409	199,850	(11,441)
Public Utility	208,203	205,440	2,763
Total Major Taxes	**$1,315,202**	**$1,307,671**	**$7,531**
Foreign Insurance	$712	$725	($13)
Domestic Insurance	1,600	26,100	(24,500)
Business & Property	2,327	1,080	1,247
Cigarette	25,646	26,235	(589)
Soft Drink	0	0	0
Alcoholic Beverage	5,106	4,719	387
Liquor Gallonage	2,401	2,365	36
Estate	5,225	850	4,375
Racing	0	0	0
Total Other Taxes	$43,017	$62,074	($19,057)
Total Taxes	**$1,358,219**	**$1,369,745**	**($11,526)**
NON-TAX INCOME			
Earnings on Investments	$30,596	$22,500	$8,096
Licenses and Fees	2,182	2,925	(743)
Other Income	19,482	14,550	4,932
Non-Tax Receipts	$52,260	$39,975	$12,285
TRANSFERS			
Liquor Transfers	$4,000	$6,000	($2,000)
Budget Stabilization	0	0	0
Other Transfers In	15,000	0	15,000
Total Transfers In	$19,000	$6,000	$13,000
TOTAL INCOME less Federal Grants	**$1,429,480**	**$1,415,720**	**$13,760**
Federal Grants	$203,721	$321,842	($118,121)
TOTAL GRF INCOME	**$1,633,201**	**$1,737,562**	**($104,361)**

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

Detail may not add to total due to rounding.

the level predicted by national sales figures. Ohio non-auto tax collections finished the year $33.8 million above estimate, with growth of 5.5 percent. National non-auto retail sales, adjusted for the one-month lag in collections (Ohio sales tax revenue is based on prior month activity) grew by only 4.7 percent over the same period. Once again, presumably some of this disparity is due to the auto leasing phenomenon, which inflates Ohio's non-auto sales tax collections.

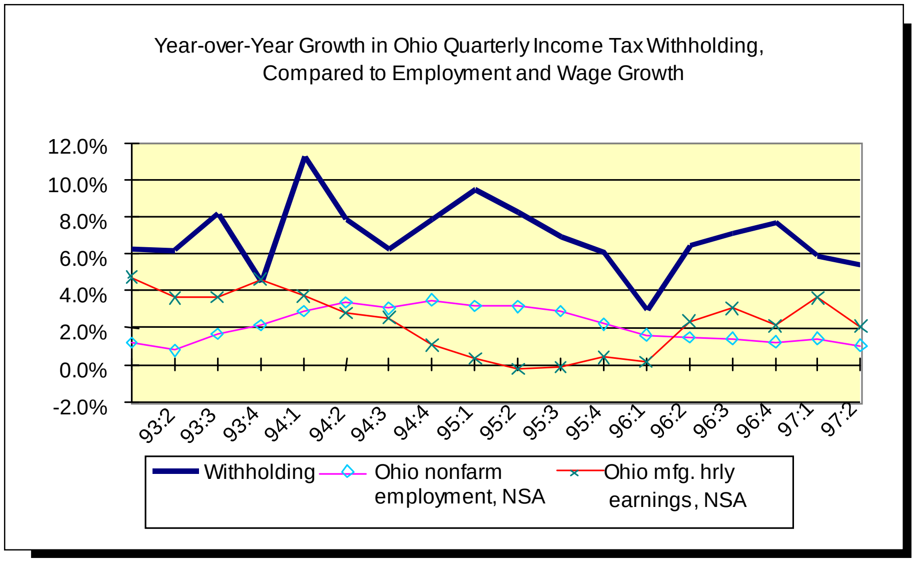
The Federal Reserve's August Beige Book did not have much to say about Fourth District retailing, except to note that the cool, wet Spring had dampened sales. However, district retailers reported better results in June, which should help Ohio's July tax collections.

Nationally, one can see a sharp slowdown in year-over-year growth in non-auto retail sales from the beginning of the calendar year through May. Clearly, the 6.4 percent growth in U.S. consumption spending and 6.2 percent increase in non-auto retail sales from the first quarter (the strongest quarterly growth since the beginning of 1990) could not be expected to continue. However, sales growth has begun to pick up again in June and July, promising a better start to FY 1998.

Personal Income Tax

While the GRF income tax overage was $280 million, the all funds (including the three local government funds) overage was $318.5 million. Quarterly estimated payments were responsible for $149.4 million, not far from half the total. Estimated payments grew by 10.5 percent rather than falling by 4.0 percent as the Tax Department had predicted. There were a couple of reasons why the Tax Department had thought that estimated payments might decline. First, it was expected that not all of the adjustment to the 6.6 percent rate cut would come in annual returns or refunds. It was assumed that taxpayers would also reduce their estimated payments in response to lower rates. Second, there was a feeling that the 1996 base was artificially inflated due to one-time factors such as high capital gains realizations.

It is probably true that taxpayers did factor in lower rates in calculating their estimated payments, but nonwage income growth was simply so strong that it swamped the impact of the rate cuts. With regard to the "one-time money" argument, we would tentatively advance a twofold response. First, although some of the money in FY 1996 was due to capital gains, it is probably not reasonable to look at this revenue as a one-year phenomenon. Roger Brinner and David Wyss of DRI argue persuasively in the August 1997 U.S. Forecast Summary that the stock market's performance over the past three years (doubling in value since 1997, or an increase of $3 trillion in market capitalization) will increase taxpayers' capital gains for a number of years. They point out that most stock options do not expire for 10 years, and that holders of options are encouraged to retain them until they mature. Even beyond the exercise of options, taxpayers naturally take the gains at different times, depending on their particular financial needs. A large amount of paper gains have not yet been realized but probably will be realized over the next several years. DRI has built in increased federal taxes from capital gains for several years into the future, and this same reasoning should apply to state income taxes as well.



Are capital gains realizations of Ohio taxpayers big enough to drive the overage in estimated payments that we have seen? They explain some of the overage, although exactly how much is unclear. LBO has 1994 federal tax data on capital gains realizations of Ohioans by federal adjusted gross income (FAGI) class. Based on that data, LBO estimates that Ohio would have received about $235 million in state tax revenue from capital gains income in FY 1995. If the stock market were to roughly double in value, capital gains realizations might double also, although as noted above, the time period for those realizations probably extends over several years (it is generally difficult to predict flow variables due to sudden changes in stock variables, as in this case). Federal tax data indicates that Ohio capital gains realizations have swung by as much as 40 percent in a given year, even before the latest stock market runup. An increase of 50 percent in realizations could increase Ohio tax revenues by $118 million, or almost the whole amount of the overage, even without including gains from nonresidents, who are subject to tax on their Ohio income but not counted as Ohioans in the federal data.

In past months, we have also advanced the hypothesis that growth in income from unincorporated businesses is also a reason for increased quarterly estimated payments. We have not completely dropped this explanation. We advance it in tandem with the capital gains hypothesis. As big an impact as capital gains are surely having on federal and state taxes, federal tax data from 1994 shows that income from "flow-through" businesses (partnerships, S-corporations, proprietorships, limited liability companies) was more than twice the amount of net capital gain income. Strong business earnings have boosted this income, as well as regular corporate income, and have no doubt contributed to the surge in total nonwage income and in estimated tax payments. At this point, LBO cannot guess at the size of the contribution to the tax overage from capital gains vs. flow-through income.

Annual returns and refunds (collectively, net settlements of tax liability) were $121.9 million more than estimated (actually, refunds were lower than estimate, but this terminology often confuses readers). Annual return revenue plunged by 12.0 percent from the prior year, and refunds increased by 42.1 percent, but these changes were much less severe than the Tax Department had feared based on their modelling of the 6.6 percent rate cut. The FY 1997 estimates had built in a 24.5 percent drop in annual return revenue and a 52.0 percent increase in refunds. Once again, the hypothesis is that strong growth in nonwage income (capital gains and flow through business income) offset quite a bit of the rate cut impact.

Finally, employer withholding also finished with a solid $30.4 million overage. Withholding growth was 6.5 percent in FY 1997, significantly higher than the estimated 5.9 percent. Ohio employment growth was about what was expected, but wage growth was higher (as a proxy for overall wage growth, the graph above shows year-over-year growth in manufacturing hourly earnings). Unfortunately, it is not easy to extrapolate any forecast for the near future from recent months. Unexplained timing factors have continued to make the monthly collections behave erratically, and even the quarterly data has been affected. A quick look at the graph below would seem to show a slowing trend in quarterly withholding, as measured on a year-over-year basis (this also fits the Ohio employment growth data). However, what the graph conceals is that withholding collections were far over estimate in March, and then sharply under estimate in April. If timing caused some of the expected April revenues to be pulled into March, then possibly the adjusted data would show an increase in withholding growth in the second quarter.

However one divides the data between quarters, they definitely show slowing growth in the last half of FY 1997. Most of the forecasts that LBO has seen project that Ohio employment growth will pick back up from the anemic 1.0 percent second quarter figure. Ohio employment growth for the upcoming biennium is expected to move back up to around 1.4 percent, which is roughly what it was over the five quarters prior to the second quarter of CY 1997. If Ohio wage growth gets back up toward 3 percent, which is fairly likely given how low the unemployment rate is, then withholding growth should move back to exceeding 6 percent.

Corporate Franchise Tax

Despite the fact that the first two FY 1997 franchise tax payments

Table 3
General Revenue Fund Income
Actual vs. Estimate
Final Results, Fiscal Year 1997
($ in thousands)

REVENUE SOURCE *TAX INCOME*	Actual	Estimate*	Variance	FY 1996	Percent Change
Auto Sales	$673,715	$678,800	**($5,084)**	$668,807	0.73%
Non-Auto Sales & Use	4,295,279	4,261,500	**33,779**	4,070,668	5.52%
Total Sales	$4,968,994	$4,940,300	**$28,695**	$4,739,475	4.84%
Personal Income	$5,382,264	$5,102,300	$279,964	$5,262,838	2.27%
Corporate Franchise	1,150,758	1,142,000	8,758	1,114,013	3.30%
Public Utility	639,760	640,000	(240)	621,609	2.92%
Total Major Taxes	$12,141,776	$11,824,600	$317,177	$11,737,935	3.44%
Foreign Insurance	$283,533	$290,000	($6,467)	$276,105	2.69%
Domestic Insurance	56,369	58,000	(1,631)	55,268	1.99%
Business & Property	8,930	9,000	(70)	9,090	-1.76%
Cigarette	298,407	291,508	6,899	294,460	1.34%
Soft Drink	19	0	19	5	310.64%
Alcoholic Beverage	51,922	50,192	1,731	50,757	2.30%
Liquor Gallonage	27,141	27,508	(367)	27,280	-0.51%
Estate	101,967	85,000	16,967	89,947	13.36%
Racing	0	0	0	0	#N/A
Total Other Taxes	$828,288	$811,208	$17,080	$802,913	3.16%
Total Taxes	**$12,970,063**	**$12,635,807**	**$334,256**	**$12,540,848**	**3.42%**
NON-TAX INCOME					
Earnings on Investments	$102,539	$75,000	$27,539	$76,629	33.81%
Licenses and Fees	66,203	65,000	1,203	65,023	1.81%
Other Income	99,322	90,000	9,322	101,045	-1.70%
Non-Tax Receipts	$268,064	$230,000	$38,064	$242,697	10.45%
TRANSFERS					
Liquor Transfers	$66,500	$56,000	$10,500	$61,000	9.02%
Budget Stabilization	0	0	0	0	#N/A
Other Transfers In	417,716	363,700	54,016	27,054	1444.01%
Total Transfers In	$484,216	$419,700	$64,516	$88,054	449.91%
TOTAL INCOME less Federal Grants	**$13,722,342**	**$13,285,507**	**$436,835**	**$12,871,599**	**6.61%**
Federal Grants	$3,531,562	$3,924,900	($393,338)	3,703,502	-4.64%
TOTAL GRF INCOME	**$17,253,904**	**$17,210,408**	**$43,496**	**$16,575,101**	**4.10%**

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

Detail may not add to total due to rounding.

against taxable year 1996 liability were a combined $7.7 million below estimate, by year's end revenues caught up to and surpassed the estimate. This is what we had predicted on the basis of the fact that the first two payments, while below estimate, had grown by 2.7 percent from last year. The third payment showed only 1.0 percent growth, but that was enough to put the sum of the three payments $2.1 million over estimate. Because payments over the first six months (against taxable years prior to 1996) were $6.7 million over estimate, the total fiscal year overage was $8.8 million.

Despite the fact that the franchise tax eventually caught up to the estimate, FY 1997 growth was quite anemic. Franchise tax revenues based on the most recent liability year (the three payments in January through June) grew by only 2.2 percent. Even if one includes revenues from the July through December period, growth was only 3.3 percent. In contrast, U.S. before-tax corporate profits grew by 6.8 percent in 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, although the experience is not uniform across states or regions. 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 probably 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 both contributing to pushing up the personal income tax in Ohio and in other states, and also reducing corporate tax revenue. 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 flow through 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.

As we stated last month, we have no hard data to support this hypothesis. 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.

Insurance Taxes

The insurance taxes were collectively $8.1 million below estimate. The foreign insurance tax fell $6.5 million short, with growth of 2.7 percent. The domestic insurance tax fell $1.6 million short, on growth of 2.0 percent.

Growth in the foreign insurance tax has been slowing over the past few years. Since FY 1991, four of the six years have had growth between 1.9 percent and 3.5 percent. Fortunately, in simulating the impact of the budget act's changes in the insurance tax, all parties involved agreed that baseline revenue estimates should incorporate only 3 percent annual growth in premiums (for more information on the insurance tax changes, please see the Budget Highlights in this issue).

The low growth in the domestic insurance tax was not as expected, since growth had been high in the previous two years. The domestic tax is harder to predict, since like the franchise tax it is levied on two bases, although in this case the tax is based on the lesser of 2.5 percent of premiums or 0.6 percent of capital and surplus. This will change, since the budget act eliminates the capital and surplus base ("domestic preference tax") and switches domestic companies to a premium tax, although the change takes place over a 5 year phase-in beginning with FY 1999.

Cigarette Tax

The cigarette tax – actually the tobacco tax since products such as cigars and pipe tobacco are now taxed – finished the year $6.9 million over estimate, with growth of 1.3 percent from last year. LBO does not yet have the FY 1997 breakout between revenue from cigarettes and revenue from other tobacco products. However, it appears at this time that, surprisingly, there was growth in both components of the tax last year. LBO had expected the cigarette tax to continue declining, as it did in FY 1996, after the one-time consumption shift that appears to have resulted when Michigan raised its tax from 25 cents to 75 cents.

Unfortunately, the U.S. consumption and sales data is not current, so we cannot compare current Ohio tobacco tax revenues with national sales or consumption figures. Interestingly, the latest data available show per-capita cigarette consumption decreasing in 1994 and 1995, but at a much slower rate than in the prior few years. Domestic per-capita cigarette sales, which are compiled differently and never exactly agree with consumption data, actually show an increase in CY 1994.

For the future, LBO expects domestic cigarette sales and consumption to resume decreasing at the long-term trend rate. Revenues from other tobacco products are expected to grow somewhat, although it is unclear how long the boom in cigar sales will continue.

Other Revenues

The estate tax finished the year $17.0 million over estimate, with growth of 13.4 percent. On a year-to-year basis, the estate tax is rather unpredictable. Over the six years since FY 1991, the estate tax has grown by an average of 9.2 percent per year, or an aggregate of 70 percent.[1] The increases in Ohio estate tax revenues correlate fairly well with the increase in wealth of older Americans. More than half of all wealth in the U.S. is held by people over 55 years of age. Economists predict continued large bequests by the current group of older Americans over the next 25 years, which should mean higher estate tax revenues, unless federal tax changes counteract that trend.[2]

Finally, liquor profits were $10.5 million over estimate. Although U.S. consumption of spirituous liquor has been declining, and presumably Ohio consumption has also, profits are increasing. Two factors are helping to keep profits up: overall prices have been increasing, and Ohio liquor agencies have been selling more high-price, high-margin liquor. Profits are expected to increase in the next biennium, also, although not at the 9.0 percent rate from FY 1997. ❑

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[1] The annual average is calculated through the geometric mean, not the arithmetic mean.

[2] The Survey of Consumer Finances shows an increase of almost 20 percent in the mean net worth of families where the head is 75 or older between 1992 and 1995. See “Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances,” Arthur Kennickell, Martha Starr-McCluer, and Annika E. Sunden, ***Federal Reserve Bulletin***, vol.83 (January 1997), pp. 1-24.

DISBURSEMENTS

*— Chris Whistler**

*(*Contributions to this article were made by Ogbe Aideyman, Clarence Campbell, Jeff Golon, Rick Graycarek, Grant Paullo, Chuck Phillips, Roberta Ryan, and Wendy Zhan).*

June disbursements reinforced the trend we had seen all of FY 1997 – that of significant underspending. Spending (including transfers) for the month contributed another $114.5 million to the FY 1997 variance, which grew to $726.5 million by year's end. The variance could have been much larger had unbudgeted transfers out of the GRF totaling $85.4 million not mitigated the program payment negative variance of $811.8 million.

While encumbrances totaling $532.8 million ate up much of the variance, significant lapses still occurred. (For a more detailed discussion of the year-end fiscal health of the state, please see the "Fiscal Overview" in this issue.) One wonders if a strong economy will continue to outperform even the most optimistic forecasts in the FY 1998-99 biennium, again holding the human services programs such as Medicaid and Disability Assistance below estimate.

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

USE OF FUNDS			
PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$216,548	$211,923	$4,625
Higher Education	135,570	132,337	3,233
Total Education	$352,118	$344,260	$7,858
Health Care	$368,913	$484,802	($115,889)
ADC/TANF	16,044	17,210	(1,166)
General Assistance	2	0	2
Other Welfare	26,772	49,557	(22,785)
Human Services (2)	50,811	40,444	10,367
Total Welfare & Human Services	$462,542	$592,013	($129,471)
Justice & Corrections	$95,130	$90,196	$4,934
Environment & Natural Resources	3,493	3,068	425
Transportation	5,911	2,175	3,736
Development	8,796	6,106	2,690
Other Government (3)	22,675	28,984	(6,309)
Capital	380	337	43
Total Government Operations	$136,385	$130,868	$5,517
Property Tax Relief (4)	$87,893	$91,203	($3,310)
Debt Service	0	0	0
Total Program Payments	**$1,038,938**	**$1,158,343**	**($119,405)**
TRANSFERS			
Capital Reserve		$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	4,938	0	4,938
Total Transfers Out	$4,938	$0	$4,938
TOTAL GRF USES	**$1,043,877**	**$1,158,343**	**($114,466)**

(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.

Since Primary and Secondary Education is the hot topic these days we begin with a discussion of K-12 spending. The Department of Education finished the year $108.1 million under the Office of Budget and Management's (OBM) August 1996 estimate. Of that amount, the department encumbered $79.7 million. Like a beagle for a bone, this begs the question: Will the department be able to spend this amount? If prior years' encumbrances are any indication, it may be unlikely. From all prior years, a total of $107.1 million was encumbered by the department going into fiscal year 1997; $64.3 million or 67 percent was actually disbursed this year. This underspending significantly affects the overall K-12 variance.

Total encumbrances by the Department of Education at the end of FY 1997 were $171.9 million: $92.2 million were projected in OBM's initial estimates and $79.9 million were unanticipated (as discussed above). Of the total amount, $106 million was encumbered in the main SF-12 items (basic aid, special, vocational, and gifted education, and Disadvantaged Pupil Impact Aid). Of that amount, $56.7 million was encumbered in basic aid alone. The encumbered funds will be used to pay for set-asides that have not yet been paid and for special and vocational recomputation (The department projected that the cost of recomputation would be $35 million). The encumbered funds for the other SF-12 items will be used to pay for set-asides that have not yet paid and for unallocated special, vocational, and gifted units (including preschool special education units).

The department's most significant lapse was in DPIA ($11 million), which was the result of lower-than-projected ADC eligible students. Debt service and special education also lapsed more than was projected by $6.5 million and $3.6 million, respectively.

Higher Education spending was under OBM estimates by about $24 million in FY 1997. The estimates assumed that spending would be $8 million below current year appropriations, and $20 million below total appropriations[1] for the higher education category, which includes the Board of Regents (BOR), the Student Aid Commission (SLC), and the Board of Proprietary Schools (SCR). Actual spending by BOR was $2.0 billion, SLC's spending was $57.6 million, and SCR spent $450,000.

Spending reports show the following peculiarities: BOR exceeded estimates by approximately $60.5 million; SCR was under estimate by approximately $132,000; and spending by the SLC was under estimate by $84.5 million dollars, or nearly 60 percent. But, unusual circumstances adequately explain away this seemingly odd, accounting situation.

SLC ceased to exist as an agency at the end of FY 1997 and some of its programs and spending were transferred into BOR during the fiscal year. Thus a significant portion of the student aid spending that had been expected out of SLC actually is accounted for in the state accounting system as BOR's spending. State spending on student financial aid is actually $11.1 million less than what the appropriation authority for FY 1997 and prior years would have allowed. (This situation is discussed further below and shown in the table.)

A provision was inserted in H.B. 215 permitting OBM to spend remaining SLC funds to meet SLC obligations. There is $885,000 remaining in SLC's administrative budget and none of it is encumbered at this time.

Turning specifically to BOR's budget, the Board encumbered about $17.8 million in FY 1997 funds to be spent during the beginning of FY 1998. This compares with encumbrances of $12.4 million in FY 1996. The FY 1997 encumbrances include the following: $6.5 million from Ohio Instructional Grants (235-503); $3 million from Performance Funding (235-512); $3 million from Family Practice (235-519); $500,000 from Geriatric Medicine (235-525); $1.4 million Primary Care Residency (235-526) and $700,000 from Student Choice (235-531). Other, "small ticket" encumbrances make up the remaining, approximately $2 million of the $17.8 million total encumbrances. Historically, agencies rarely spend all encumbered funds which means that lapses are likely to be higher when encumbrance issues are resolved.

- The OIG encumbrance can be explained as a means of addressing cash-flow issues in the OIG program. After July 1, 1997, BOR continues to disburse FY 1997 funds to campuses claiming grant funds to pay for their OIG-eligible students from the 1996-97 academic year, which falls in the state's 1997 fiscal year. At the same time, BOR receives refunds from campuses whose grant recipients do not complete spring quarter. Since the outflow and inflow of funds are not coordinated, BOR needs to "hold on" to FY 1997 cash until it can close the books on FY 1997, which occurs after July 1, 1997. Lapse from this encumbrance is virtually guaranteed to occur because the purpose of this encumbrance is more "security" than a budgeted need. Instructional grants are provided to colleges and universities to assist their economically disadvantaged students with tuition and fees.

- The explanation of the Performance Funding encumbrance is the timing of BOR's decision for allocating these funds to the 2-year institutions that compete for them. The Board voted on the allocation plan in June 1997, shortly before the end of the fiscal year. Funds were disbursed during July. The Performance Funding item was the precursor to the Performance Challenge item funded in FY 1998 and FY 1999, and rewards 2-year campuses for meeting their Service Expectations.

- Encumbrances in the health education subsidy items [$3 million from Family Practice (235-519); $500,000 from Geriatric Medicine (235-525); $1.4 million Primary Care Residency (235-526)] are again related to June approval of plans to allocate funds to the eligible institutions by the Board of Regents. The Board is discussing adding a competitive element to the allocation plans for these items, and this seems to have delayed the Board's approval of the FY 1997 allocation. Funds were disbursed in July.

The current projection for funds BOR will lapse is approximately $27 million. The lion's share is $17.8 million in debt service (appropriation item 235-401, Ohio Public Facilities Commission), and the rest is from the following lines: Ohio Instructional Grants (235-503), projected lapse of $7.7 million; War Orphans Scholarships (235-504), projected lapse $700,000; and Student Choice Grants (235-531), projected lapse $300,000.

- Some portion of the debt service lapse is built-in security for bond sales. OBM must estimate the debt service levels needed to finance the next capital bill in the current operating budget bill, which at that time is at least 1 to 1.5 years away. Other estimated factors encouraging conservatism (defined here as some amount of over-appropriation) are the unknown speed of spending on the current capital bill which affects the rate at which debt service funds are spent, and the uncertainty of future interest rates. This year's lapse is especially high due to the favorable economy and low interest rates.

- Lapses in the student aid items appear to be due to overestimation of demand, most significantly in the OIG item. Due to greatly increased grant amounts in the FY 1998-99 OIG grant tables – approximately 17 percent across the biennium, BOR believes the significant lapses in this item at the end of FY 1997 will not be repeated in the FY 1998-99 biennium.

The table below shows the variance between actual FY 1997 spending and OBM estimated spending for the main student financial aid and scholarship line items. Despite a very slight overage in the Part-Time Student Instructional Grants item ($3,328 above estimate) and no variance in Academic Scholarships, total spending was considerably lower than anticipated, by $11.1 million. Negative variances in Ohio Instructional Grants ($10.1 million below estimate), Student Choice Grants ($526,953 under), and the War Orphans Scholarships ($498,617 below estimate) drove the aggregate underspending.

If the aggregate Education variance of $127.1 million got your attention, then the Welfare and Human Services negative variance of $666.4 million might feel like a giant thump on the head. The categorical variance represents 82 percent of the program payment variance, or 92 percent of the total variance after transfers.

Spending in Health Care (Medicaid) is largely responsible for the variance. However, while the $426.0 million variance in Medicaid represents 64 percent of

ALI Title	FY 97 Appropriation	Total Authority	Estimated Spending	FY 97 Spending	Variance
OHIO INSTRUCTIONAL GRANTS	$91,294,283	$91,294,283	$86,364,000	$76,254,428	($10,109,572)
WAR ORPHANS' SCHOLARSHIPS	$3,624,060	$3,624,060	$3,340,000	$2,841,383	($498,617)
ACADEMIC SCHOLARSHIPS	$6,000,000	$6,000,000	$6,000,000	$6,000,000	$0
STUDENT CHOICE GRANTS	$34,232,347	$34,232,347	$33,991,000	$33,464,047	($526,953)
PART-TIME Student INSTRUCTIONAL GRANTS	$10,949,539	$10,949,539	$11,094,000	$11,097,328	$3,328
				TOTAL	($11,131,814)

Medicaid (400-525) Spending vs. Estimates

	Adjusted Actual*	Original (8/97) Estimate	Variance
Nursing Homes	$2,077,371,731	$2,143,157,821	($65,786,090)
Nursing Facilities	$1,753,733,743	$1,795,060,317	($41,326,574)
ICFs for the Mentally Retarded	$323,637,989	$348,097,504	($24,459,515)
Hospitals	$1,231,314,664	$1,246,893,830	($15,579,166)
Inpatient Hospitals	$941,208,082	$957,844,967	($16,636,885)
Outpatient Hospitals	$290,106,582	$289,048,863	$1,057,719
Physicians	$301,336,863	$302,736,953	($1,400,090)
Prescription Drugs	$458,002,877	$391,667,225	$66,335,652
Payments	$562,887,487	$489,584,031	$73,303,456
Rebates	($104,884,610)	($97,916,806)	($6,967,804)
HMO	$427,293,011	$761,081,305	($333,788,294)
Medicare Buy-In	$119,846,473	$153,018,954	($33,172,481)
All Other Care*	$358,164,947	$324,643,106	$33,521,841
TOTAL	$4,973,330,566	$5,323,199,194	($349,868,628)

* FY 1997 disbursements have been adjusted by adding spending from FY 1997 encumbrances that occurred in early FY 1998. This adjustment is made to show the "true" variance (i.e. what would have occurred if the final week's payment were released on time. Note that additional expenditures may occur as FY 1997 encumbrances are still open.

the categorical variance, the “true” amount of underspending is overstated. The final weekly payment of FY 1997 was not released prior to the close of the fiscal year, and the amount was encumbered. Thus, a more accurate assessment of the “true” variance can be calculated by adding the spending against FY 1997 encumbered amounts that occurred early in FY 1998. (Almost $78.5 million was encumbered in the 400-525 line item, of which $76.1 million has been spent.) Such a calculation yields a variance of $349.9 million. The following table shows a breakdown of the line item variance by spending component after the encumbrance adjustment was made.

The table confirms what we have been reporting all year. The declining Aid to Dependent Children (ADC)/Temporary Assistance for Needy Families (TANF) caseload has held spending in most of the categories under estimate, most noticeably health maintenance organizations (HMOs). The $333.8 million variance in the HMO component can be further attributed to a lower-than-expected enrollment rate of ADC/TANF and Healthy Start eligibles in HMOs and the unbudgeted “six percent managed care savings” incorporated in the FY 1997 capitation rates.

Also of note is the $66.3 million overage in the prescription drugs component. The variance, which blatantly defies the trends of the other spending components, can likely be attributed to higher-than-expected utilization rates by Aged, Blind, and Disabled eligibles and to higher costs-per-claim by all eligibility groups. Such increases were accounted for when setting FY 1998-99 appropriations.

The restructuring of line items in response to federal welfare reform has created the need for the ADC/TANF and Other Welfare components to be combined for FY 1997 spending analyses in order to obtain a more useful representation of public assistance spending. Combined spending in the two components was $245.4 million below estimate.

Approximately $111 million of the variance can be attributed to spending in the TANF/ADC program. Within this spending category, 100 percent of the moneys for child care services were disbursed. Therefore, the entire variance from estimate is due to a lower-than-expected caseload, accompanied by below estimate expenditures in the job training programs.

The Disability Assistance (DA) program finished the year approximately $42 million under estimate. This is primarily due to a miscalculation of the number of people that would be affected by eliminating cash benefits to persons who were eligible for DA only because they were classified as medication dependent. The estimated number was significantly smaller than the actual number of persons who lost benefits due to this policy change. In addition, it would appear that these individuals quit coming to the county welfare office for DA medical benefits; when this policy change was implemented, there was a drop in the expenditures for the medical component of the DA program as well. There were no cost savings estimated for the medical component because it was assumed that the people that lost cash benefits would continue to receive medical benefits since the eligibility for medical benefits were not affected by this policy change.

Aside from TANF/ADC and DA, the other area of this combined welfare component that accounts for the major underspending is line item 400-416 Computer Projects. Spending for this line fell below estimates all year long. The variance between actual spending and estimated spending for this line item amounts to $20.7 million. However, $18.1 million of this variance was encumbered for the fulfillment of contracts or equipment purchases for various computer projects.

The general Human Services component finished the year $11.1 million over estimate as a result of a $10.4 million monthly variance in June. The largest dollar variance was in the budget of the Bureau of Employment Services (BES). The Bureau's $8.0 million overage was due basically to line item 795-407, OBES Operations. In fiscal year 1996, $7.1 million was appropriated to this line item. However, the Bureau did not spend any of this money and was able to transfer the appropriation to fiscal year 1997. This accounts for a significant portion of the overage.

Line item 795-407 provides money to help BES maintain the operation of local offices, including unemployment insurance and employment service staff because federal funding for these programs is less than optimal. The Bureau likely erred in its decision to use money from their Unemployment Compensation Special Administrative Fund (Fund 4A9) rather than the GRF appropriation in FY 1996. (Fund 4A9 contains fine revenues, forfeitures, and interest income collected from employers on delinquent employer unemployment compensation contributions.) Because of this decision, a Controlling Board request approved on November 18, 1996 permitted the Bureau to transfer the unspent FY 1996 GRF appropriation ($7.1 million) to fiscal year 1997. Total expenditures for line item 795-407 in FY 1997, therefore, reflect appropriation amounts from two fiscal years and account for the significant overage portrayed in the spending reports.

The Department of Mental Health (DMH) had the next biggest variance in the spending component. Spending by the agency was over estimate by $6.8 million, or 1.4 percent. What is most notable about spending by the department is not the overage – but that the department disbursed 100 percent of its funding in nearly all of its major program areas.

The Department of Mental Retardation and Developmental Disabilities (DMR) also disbursed 100 percent of its funding in all of its major program areas, yet the department finished the year $3.5 million, or 1.0 percent under estimate. Part of the reason for the small variance seems to be that the line item consolidations have provided funding flexibility. In particular, the 322-413 line item allows the department to shift funds between Purchase of Service, Supported Living, and the Individual Options Medicaid Waiver program.

The lack of disbursements from the 322-414, Sermak Class Services, line item is worth noting. The line is used to implement the requirements of the consent decree in the case of Sermak vs. Manuel. Only 27 percent of the funds from this GRF account were disbursed in FY 1997. (The total appropriation for FY 1997 was $2.0 million.) These moneys are used to pay for OBRA Waiver costs associated with providing care to individuals identified as Sermak class who are scheduled to be moved from a nursing home to an alternative care setting. Originally, there were about 50 OBRA Waiver slots that were to be filled with Sermak class individuals. However, the number has decreased to about 30 due to death, and some individuals deciding that they will remain in the nursing home. Apparently, there are numerous hold-ups (mainly legal) preventing these people from being moved. Consequently, the only funds that are being expended for this purpose are for items such as wheelchairs and ramps.

The departments of Aging and Health also had year-end variances. Health was over estimate by $3.5 million, and Aging was under by $2.3 million.

FY 1997 spending in the Government Operations category was only $25.3 million under estimate, but as always, the relatively small categorical variance masks some interesting spending activities. The total variance can loosely be described as the net effect of a $10.9 million overage in Justice and Corrections and a $35.2 million underage in Other Government. Each component will be discussed in turn.

Perhaps the most notable highlight of the Department of Rehabilitation and Correction's (DRC) FY 1997 spending is that it marks the first time that the department's total annual GRF obligations (disbursements + requisitions and encumbrances) crossed into the territory of $1 billion. For watchers of the world of criminal justice, hitting this historic marker was simply a matter a time. After all, DRC runs a large, geographically far-flung system of twenty-nine correctional institutions that house somewhere in the neighborhood of 47,000 inmates and employ around 14,000 staff, more than 7,000 of who are correction officers. Of the 65,000 or so persons on state payroll, this means 2 out of 10 work for DRC and 1 out of 10 are correction officers.

Relative to DRC's total FY 1997 GRF appropriation of $1.02 billion, around 5.0 percent (or $51.2 million) had not been disbursed by the close of the fiscal year. Of these unspent moneys, $34.5 million have been allocated to cover various requisitions and encumbrances, meaning that they will most likely be spent sometime in the next five months of FY 1998. This means that the remainder, $16.79 million, has in effect lapsed.

If one were to simply look inside DRC's lapsed FY 1997 amounts, two line items would attract the most attention – debt service and parole operations. Debt service payments provided the biggest chunk of this lapsed amount. Of DRC's $106-plus million FY 1997 debt service appropriation, $14.0 million lapsed. This is not surprising. For various reasons, OBM has historically built cash cushions into debt service appropriations – thus providing more money than would most likely be necessary – plus when market conditions are right, bonds are refinanced which further reduces the amount needed to cover debt service payments.

Parole operations contributes the other significant feature of DRC's FY 1997 lapse picture, around $1.0 million. This represents an intentional lapse by DRC to identify GRF funding that was budgeted for the electronically monitored early release program, but not spent. As the reader may be aware, this program generated some amount of controversy during legislative deliberations over the main appropriations act of the 122nd General Assembly, Am. Sub. H.B. 215. There are no offenders participating in the electronically monitored early release program. To date, problematic contracting language has blocked DRC from implementing that program; thus it is not operational.

The department is seeking a legislative solution to this problem via S.B. 111, which is currently working its way through the 122nd General Assembly. The bill will repeal three existing prison release programs – furlough education and work release, conditional release, and electronically monitored early release – and essentially consolidate them under a new program termed "transitional control." Under this new program, eligible prisoners could be transferred to community supervision during the final 180 days of their confinement. Community supervision would include confinement in a halfway house, electronic monitoring in a residence, or conceivably, some mix of both.

As with DMR above, spending that did not occur is also worth mentioning. Readers may recall that both the main appropriations act of the 121st General Assembly, Am. Sub. H.B. 117, as well as Am. Sub. S.B. 2 of the 121st General Assembly, legislation that fundamentally restructured the state's felony sentencing framework, contained temporary law describing the conditions for the creation and subsequent distribution of $1.6 million in supplemental FY 1997 community subsidy funding. Its purpose was to provide more state assistance to local governments if the number of offenders that were diverted from prison and into community controls exceeded departmental estimates. That never happened; thus, this $1.6 million pool of contingency funds was never tapped.

Lastly, buried in DRC's FY 1996-97 biennial budget was $27.08 million in new GRF money to continue the fueling of institutional growth by opening the medium security Noble Correctional Institution and a 186-bed minimum security camp located adjacent to the 500-bed "supermax" institution currently under construction in Youngstown. The Noble Correctional Institution began receiving inmates in the fall of calendar year 1996 and is now fully operational. The minimum security camp, on the other hand, has not come online. Inmates were to have started arriving around December 1996. It now looks like inmates may not arrive until December 1997 or later.

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)	$3,957,137	$4,060,156	($103,020)	$3,543,069	11.69%
Higher Education	2,084,744	2,108,787	(24,043)	2,003,453	4.06%
Total Education	$6,041,881	$6,168,944	($127,063)	5,546,522	8.93%
Health Care	$4,897,185	$5,323,199	($426,014)	$4,941,254	-0.89%
ADC/TANF	$881,090	918,218	(37,128)	802,318	9.82%
General Assistance	115	6,179	(6,064)	9,865	-98.83%
Other Welfare	$510,968	719,227	(208,259)	602,744	-15.23%
Human Services (2)	1,043,597	1,032,521	11,076	985,700	5.87%
Total Welfare & Human Services	$7,332,955	$7,999,345	($666,390)	$7,341,880	-0.12%
Justice & Corrections	$1,393,085	$1,382,181	$10,905	$1,236,118	12.70%
Environment & Natural Resources	112,136	111,552	584	107,383	4.43%
Transportation	36,520	38,094	(1,574)	38,541	-5.24%
Development	121,104	122,976	(1,872)	104,426	15.97%
Other Government (3)	348,759	383,970	(35,211)	329,440	5.86%
Capital	7,595	5,700	1,895	3,290	130.83%
Total Government Operations	$2,019,201	$2,044,472	($25,271)	$1,819,199	10.99%
Property Tax Relief (4)	$915,129	$907,400	$7,729	$856,672	6.82%
Debt Service	94,883	95,708	(825)	95,175	-0.31%
Total Program Payments	**$16,404,048**	**$17,215,869**	**($811,821)**	**$15,659,448**	**4.75%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$12,000	-100.00%
Budget Stabilization	0	0	0	535,214	-100.00%
Other Transfers Out	620,611	535,237	85,374	343,484	80.68%
Total Transfers Out	$620,611	$535,237	$85,374	$890,698	-30.32%
TOTAL GRF USES	**$17,024,659**	**$17,751,105**	**($726,446)**	**$16,550,145**	**2.87%**

(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.

Getting to the point, DRC's plans for bringing new correctional facilities online are quite fluid. DRC has become particularly adept at manipulating construction completion dates and bed activation schedules so as to meet the ever-changing needs and demands generated by the very large residential complex for criminals that it owns and operates. That said, the department's GRF budget covering FY 1998 and FY 1999 provides $71.3 million in new money for the activation and opening of four full-service prisons and three correctional camps, carrying a total 5,400 or so new beds. Two years or so from now, it should be interesting to see how those facility and bed activation plans have panned out.

Although the Department of Youth Services' FY 1997 disbursements shadowed planned expenditures, two points of interest in the department's budget should be noted. First, nearly $8.0 million has been encumbered against FY 1997 to cover June 1997 Reclaim payments ($4.1 million), subsidies to county youth facilities ($1.0 million), and community program services ($0.8 million), among others. Second, Reclaim payments of $19.5 million were $1.6 million higher than the $17.9 million estimated at the start of the fiscal year. This higher than anticipated payment to counties under the Reclaim program indicates that counties have significantly improved their ability to adequately program rehabilitation systems for at risk youths in their communities. However, a few counties, have not been able to realize financial benefits from the program. (For additional information, please see "Missed Opportunities and Ohio's Juvenile Courts" in this issue.)

Although the variance is larger, the underspending by $35.2 million in the Other Government component is somewhat less exciting than that of Justice and Corrections. Most of the variance can be attributed to underspending by two agencies, the Department of Administrative Services (DAS) and the Auditor of State (AUD). The

$20.0 million negative variance by DAS can largely be attributed to the timing of building rent (100-447) and operating (100-448) payments, and the $7.5 million negative variance by AUD is mainly due to a $5.7 million variance in their 070-321, Operating Expenses, line item.

So ends another fiscal year. Tune in during the FY 1998-99 biennium to see if GRF disbursements will again be characterized by enormous underspending. Or, have the appropriations been tightened such that estimates and actuals will be nearly one-in-the-same? Or, did we tighten too far? Only time will tell.❑

[1] Total appropriations differ from current year appropriations because agencies can receive authority to spend funds originally appropriated in previous fiscal years. This is spending “carried-over” funds. The higher education category’s total spending authority for fiscal year 1997 is approximately $12.4 million higher than its fiscal year 1997 appropriation due to the carry over of prior years’ spending authority.

Lottery Profits Quarterly Report

LOTTERY TICKET SALES AND PROFITS TRANSFERS FOURTH QUARTER, FY 1997

— *Allan Lundell*

Total ticket sales for the fourth quarter were $577.5 million, up 4.56 percent from third quarter sales of $552.3 million. However, sales were 5.20 percent less than second quarter sales of $609.2 million and 8.13 percent less than fourth quarter FY 1996 sales of $628.6 million. Total sales for FY 1997 were $2,303.9 million, down $49.3 million (2.09 percent) from FY 1996 sales of $2,352.5 million.

Fourth quarter transfers to the Lottery Profits Education Fund (LPEF) were $177.1 million, $10.8 million greater than projected transfers of $166.3 million. Total transfers for FY 1997 were $710.5 million, $49.3 million greater than projected transfers of $661.2 million. Although FY 1997 transfers were greater than projected, they were $3.0 million less than FY 1996 transfers.

Sales by game are presented in table 2. For the fourth quarter, Pick 3, Pick 4, Super Lotto, and the Kicker all experienced increases in sales from the previous quarter. Super Lotto sales were helped by a jackpot that grew to $35 million during May and June. The increase in Super Lotto sales caused Kicker sales to also increase. Sales of instant Tickets fell, possibly due to shifting as consumers purchased Super Lotto tickets due to the high jackpot. However, this was the second consecutive quarter of declining Instant Ticket sales. This had never happened in the 1990's. Buckeye Five sales continued their four year decline.

Total sales for FY 1997 were $49.3 million (2.09 percent) lower than sales for FY 1996. Pick 3 sales were $15.0 million (3.34 percent) lower. Buckeye Five sales were $8.5

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

	Ticket Sales	*Actual Transfers*	*Projected Transfers*	*Dollars Variance*	*Percentage Variance*	*Transfers as a Percentage of Sales*
July	$ 198.57	$ 69.46	$ 57.01	$ 12.45	21.84	34.98
August	187.19	56.42	53.41	3.01	5.64	30.14
September	179.14	58.59	54.44	4.14	7.60	32.71
Q1	**564.90**	**184.47**	**164.86**	**19.61**	**11.89**	**32.66**
October	194.76	56.84	55.46	1.38	2.49	29.18
November	187.48	55.44	53.06	2.38	4.48	29.55
December	226.94	58.09	56.34	1.75	3.11	25.60
Q2	**609.18**	**170.37**	**164.86**	**5.51**	**3.34**	**27.96**
January	189.05	61.64	53.67	7.96	14.83	32.61
February	171.41	57.48	54.18	3.31	6.11	33.53
March	191.85	59.48	57.31	2.18	3.80	31.01
Q3	**552.30**	**178.60**	**165.16**	**13.45**	**8.14**	**32.34**
April	185.51	55.62	55.37	0.25	0.45	29.98
May	202.95	61.57	55.90	5.67	10.14	30.34
June	189.04	59.91	55.05	4.86	8.83	31.69
Q4	**577.50**	**177.09**	**166.31**	**10.78**	**6.48**	**30.66**
FY 1997 Total	**$ 2,303.88**	**$ 710.54**	**$ 661.20**	**$ 49.34**	**7.46**	**30.84**

Table 2, FY 1997 Lottery Ticket Sales by Game, in millions of dollars								
Month	*Pick 3*	*Pick 4*	*Buckeye Five*	*Super Lotto*	*Kicker*	*On-Line*	*Instants*	*Total*
July	37.48	9.07	6.91	46.71	6.47	106.64	91.93	198.57
August	37.91	9.40	6.94	31.52	5.01	90.77	96.42	187.19
September	34.18	8.70	6.44	29.48	4.61	83.41	95.74	179.14
Q1	**109.58**	**27.17**	**20.29**	**107.71**	**16.08**	**280.82**	**284.08**	**564.90**
October	37.03	9.74	6.83	36.61	5.58	95.79	98.97	194.76
November	37.21	9.64	6.37	28.90	4.78	86.90	100.58	187.48
December	36.82	9.79	6.76	40.82	5.92	100.11	126.84	226.94
Q2	**111.06**	**29.17**	**19.96**	**106.32**	**16.28**	**282.80**	**326.38**	**609.18**
January	36.45	9.97	6.85	33.47	5.29	92.03	97.02	189.05
February	33.26	9.03	6.20	22.81	3.99	75.30	96.11	171.41
March	36.23	10.11	6.49	29.43	4.91	87.16	104.69	191.85
Q3	**105.94**	**29.11**	**19.55**	**85.71**	**14.19**	**254.49**	**297.81**	**552.30**
April	37.16	10.44	6.38	28.47	4.77	87.23	98.29	185.51
May	37.49	10.63	6.58	41.70	6.25	102.65	100.29	202.95
June	34.41	10.02	5.99	40.68	5.87	96.97	92.07	189.04
Q4	**109.05**	**31.09**	**18.96**	**110.85**	**16.90**	**286.85**	**290.65**	**577.50**
TOTAL	**435.63**	**116.54**	**78.75**	**410.59**	**63.45**	**1,104.96**	**1,198.92**	**2,303.88**

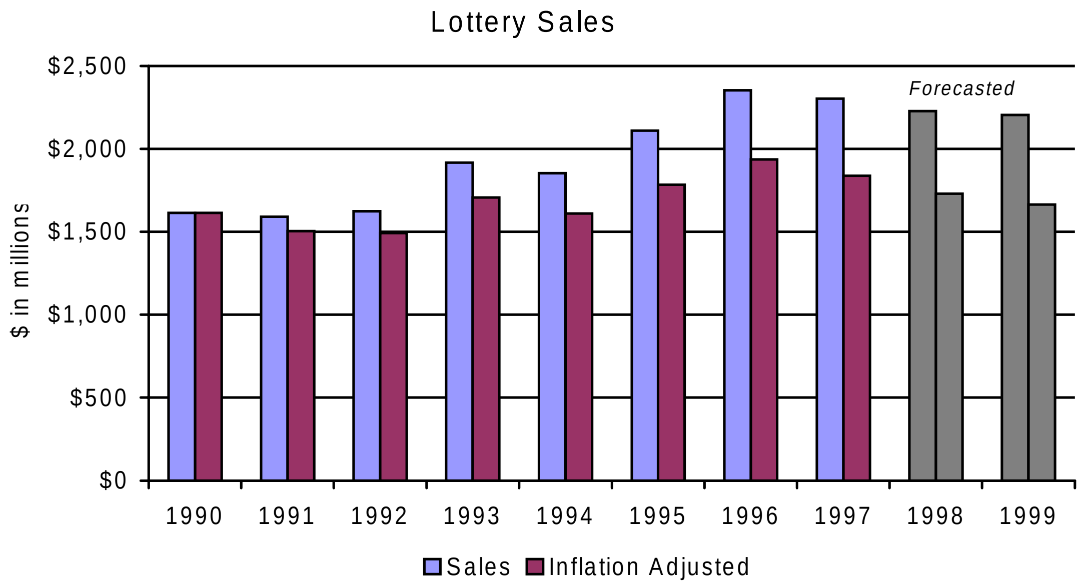
million (9.75 percent) lower. Super Lotto sales were $45.2 million (9.92 percent) lower. Kicker sales were $3.3 million (4.89 percent) lower. The only games with increased sales were Pick 4 and Instant Tickets. Instant Ticket sales were $14.4 million (1.21 percent) higher and Pick 4 sales were $8.4 million (7.72 percent) higher. Decreased sales lead to decreased transfers to the LPEF. Transfers were $3.0 million (0.42 percent) lower in FY 1997 than in FY 1996.

The following charts provide a picture of changes in total lottery sales and transfers throughout the 1990's. Sales increased from $1,613.8 million in FY 1990 to $2,352.4 million in FY 1996 and decreased to $2,303.9 million in FY 1997. Transfers increased from $616.5 million in FY 1990 to $713.5 million in FY 1996 and decreased to $710.5 million in FY 1999.

Total sales have increased 42.76 percent throughout the 1990's. Adjusting for inflation reveals that the purchasing power of the amount spent on lottery tickets has increased 13.90 percent during this time period. Transfers have increased 15.26 percent during the 1990's. Adjusting for inflation reveals that the purchasing power of transfers has fallen by 8.04 percent. Table 3 presents a history of sales and transfers in the 1990's. Forecasts are used for FY's 1998 and 1999. All dollar amounts are in millions of dollars. "Real" figures have been adjusted for inflation and "Ratio" is transfers as a percentage of sales.

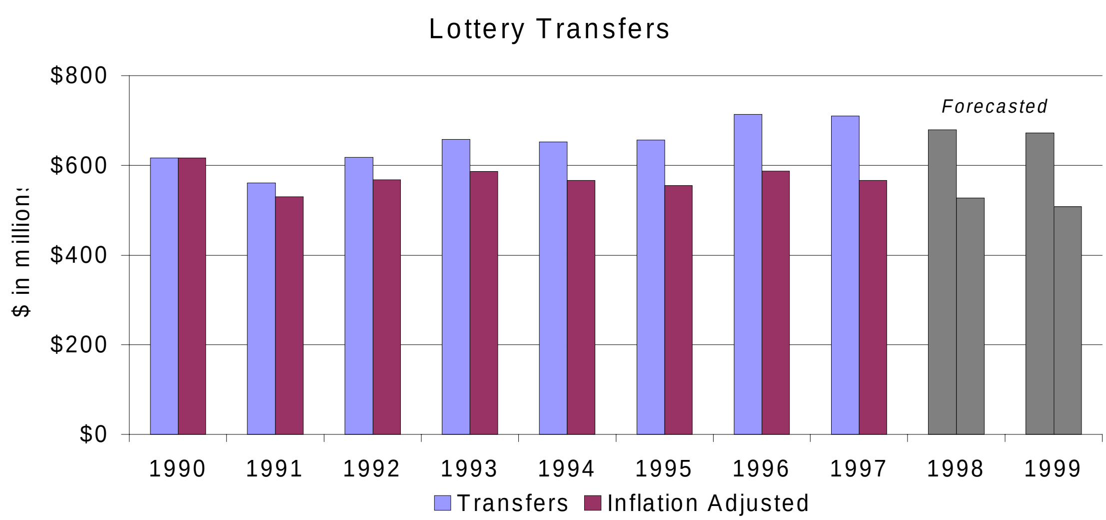
Transfers grew at a lower rate than sales because the major cause of overall sales growth has been a tremendous increase in the sales of instant tickets. Instant tickets have higher payout rates than other lottery games. This contributes to their popularity, but

Table 3, History of Lottery Sales and Transfers to Education										
Fiscal Year	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Sales	$1,613.8	$1,591.0	$1,625.4	$1,917.2	$1,853.9	$2,110.0	$2,353.2	$2,303.9	$2,227.0	$2,204.0
Real Sales	1,613.8	1,503.3	1,493.5	1,708.4	1,610.1	1,738.7	1,937.6	1,838.2	1,729.3	1,664.8
Transfers	616.5	561.0	618.4	658.4	652.3	656.4	713.5	710.5	679.4	672.6
Real Transfers	616.5	530.1	568.2	586.7	566.5	554.9	587.5	566.9	527.6	508.1
Ratio	38.20	35.26	38.05	34.34	35.18	31.11	30.32	30.84	30.51	30.52



means they have a lower profit margin. The lower profit margins of instant tickets and the rise in instant ticket sales have also made it more difficult for the lottery to meet the "30 percent requirement" for transfers. Transfers as a percentage of sales have fallen from over 38 percent in FY 1990 to just over 30 percent forecasted for the current budget biennium.

Lottery sales are forecasted to be $2,227 million in FY 1998 and $2,204 million in FY 1999. Theseare less than sales for the most recent biennium, $2,353 million in FY 1996 and $2,303 million in FY 1997. Transfers are forecasted to be $679.4 million in FY 1998 and $672.6 million in FY 1999. These are less than transfers for the most recent biennium, $713.5 million in FY 1996 and $710.5 million in FY 1997. Although it may be beneficial to be conservative when forecasting, decreasing forecasts may indicate that the Ohio Lottery is a "mature" lottery that may find it difficult to maintain sales and transfers at current levels. When the decreased forecasts are adjusted for inflation, the forecasted purchasing power of lottery transfers falls even more and raises questions about relying on lottery transfers to fund primary and secondary education.❑



MISSED OPPORTUNITIES AND OHIO'S JUVENILE COURTS

OGBE O. AIDEYMAN

As the RECLAIM Ohio Program marches towards maturity at the start of the fifth year since introduction, several counties have managed to miss the RECLAIM revenue train. In fiscal year 1995, the first full year of statewide implementation, the Department of Youth Services (DYS) recognized the problem and established the RECLAIM Ohio Challenge Grant Program to help remedy the situation. RECLAIM to some might conjure a crusade to redirect lost souls, to others, inner city redevelopment might spring to the mind. For DYS, it represents an innovative partnership between state youth corrections programs and local juvenile courts.

What is RECLAIM Ohio you ask? The RECLAIM Ohio (Reasoned and Equitable Community and Local Alternatives to the Incarceration of Minors) program, initiated statewide in the latter half of the fiscal year 94-95 biennium, provides funding to juvenile courts to develop or purchase a range of community-based options to meet the needs of each juvenile offender. These funds may also be used to purchase a commitment from DYS or a Community Corrections Facility (CCF).

By placing the fiscal power in the hands of judges, they are freed to make presumably more appropriate treatment decisions, which are in the best interest of both the youth and community. In doing so, the program is intended to reduce the number of commitments to DYS institutions.

Funding is allocated to counties through a formula based upon the proportion of statewide felony delinquent adjudications coming from each county. Each month, counties are charged 75 percent against this allocation for youth placed in DYS institutions and 50 percent for youth placed in CCFs. Any funds remaining after deductions are remitted to the counties for juvenile court's use to develop and operate rehabilitation programs at the local level. Courts may use the funds to purchase or develop a broad-based spectrum of community-based programs for adjudicated delinquent youths who would otherwise have been committed to DYS. Such programs include day treatment, intensive probation, electronic monitoring, home-based services, residential treatment, reintegration, and transitional programs.

Contingency provisions in the program allow the courts to commit youth to DYS or CCFs even if a county has exhausted its allocation. In addition, the law provides for a category of commitments called "public safety beds" for which the counties are not charged. Public safety beds are provided for youth that are committed for very serious offenses such as aggravated murder, murder, kidnapping, rape, aggravated arson, and three-year gun specification for certain offenses. In addition, counties who adjudicate less than one-tenth of one percent of the state's total number of felony adjudications are not charged for commitments. Various safeguards are built into the system to ensure that the department will remain fiscally solvent and that counties will not be left out-of-pocket.

At a recent DYS-sponsored RECLAIM conference, the following observations about the strengths and weaknesses of RECLAIM Ohio were made. Strengths perceived by the courts and county officials included: (1) good funding source to expand services; (2) enhances community based services; (3) limited funding restrictions; (4) funding rolls over to the next year; (5) saves counties money that would otherwise be spent on more expensive state programming; (6) provides courts greater ability to work with other agencies; and (7) provides courts a greater ability to look at the underlying problems and needs of youths. The major weaknesses cited by local officials were: (1) penalizes counties that were already doing a good job of minimizing commitments to DYS; (2)

RECLAIM formula restrictive; (3) longer penalties required for certain offences; and (4) counties cannot control the number of youths coming to the attention of the juvenile court. The consensus was that the financial benefits of the program, with careful planning, outweighed its weaknesses.

During the first full year of implementation, Ohio's juvenile court judges received $17.6 million in RECLAIM funds and served approximately 8,600 youths in county programs. The average county RECLAIM revenue was $200,000. In fiscal year 1996, the juvenile courts collectively received $17.1 million (approximately 25 percent of county allocations) and served approximately 10,400 youth in community based programs, with an average county RECLAIM revenue of $194,000. County RECLAIM revenues improved to $19.5 million in fiscal year 1997, the largest ever payment by DYS since the RECLAIM program's inception, resulting in average county revenues of $221,000. County RECLAIM programs are projected to generate revenues of $20.1 million in fiscal year 1998, and $20.5 million in fiscal year 1999, assuming that counties continue on the success path achieved in fiscal year 1997.

Challenge Grants

The Challenge Grant program was established to target resources to those juvenile courts that have been unable to realize funding through RECLAIM Ohio, because their commitment costs exceed their allocations of state funding provided through DYS. Several reasons could be responsible for these higher commitment costs. The two most notable being a continued higher than expected number of felony adjudications, and the lack of local treatment alternatives. Thus, financial assistance is offered to eligible counties for support of community-based alternatives to state incarceration. Each juvenile court receiving a grant is required to contract with a consultant to assess the local juvenile justice system and develop a strategic plan to improve RECLAIM Ohio performance. Any funds remaining after the evaluation may be used to implement the plan.

In fiscal years 1996 and 1997, DYS distributed $1.18 million in Challenge Grants to 17 counties to improve their ability to obtain and utilize their RECLAIM allocations. Although there is no specific appropriation line item to support the Challenge Grant program, DYS has in the past financed these grants with GRF moneys transferred from its Youth Services subsidy (line item 470-510), to line item 470-405, County Program Development. These funds are encumbered in the fiscal year of transfer and then distributed in the first quarter of the following fiscal year. In May 1997, the Controlling Board approved the transfer of $350,000 from line item 470-510, Youth Services, to line item 470-405, County Program Development, to fund the Challenge Grant distribution planned for fiscal year 1998. It is highly probable that this funding mechanism will no longer be available in the future, due to the consolidation of DYS Youth Services subsidies. The recently enacted budget, Am. Sub. H.B. 215, merged the administration of the County Care and Custody (funded by line item 470-401), and Youth Subsidies programs to provide greater programming flexibility (allows funding to be used for juveniles who would be considered felons or misdemeanants if they were convicted as adults). This flexibility will provide counties an enhanced ability to design programs to influence the target population before they commit these offenses that would be considered felonies if they were committed by an adult. Translated, it would mean that counties with effective alternative programs to DYS incarceration would be better positioned to further improve on their ability to "earn revenues" from the RECLAIM program.

The attached table shows the counties that received these grants in fiscal year 1996 and fiscal year 1997, as well as the amounts of RECLAIM revenues received by these counties in the year preceding and immediately following a Challenge Grant Award.

Evaluating the ability of counties that have received challenge grants to generate RECLAIM revenues in the years following grant receipts produces mixed results. Of the 10 counties receiving grants in fiscal year 1996, based on poor revenue performance in fiscal year 1995, 3 counties (Fayette, Medina and Trumbull) generated appreciable gains in RECLAIM revenue in FY 1996. Medina County went from $8,586 in FY 1995 to $232,355 in fiscal year 1997, more than triple its FY 1996 revenue of $73,058, and surpassing the statewide average of $221,000 in fiscal year 1997. Trumbull County on the other hand, after showing a good come back in fiscal year 1996 with revenues of $201,036, slipped in fiscal year 1997 to $164,150.

In the second year (fiscal year 1997) of the grant, 11 counties received grants. Of these 11

Challenge Grant Awards and Reclaim Revenues

County	Reclaim Revenue FY 1995	Challenge Grant Awards FY 1996	Reclaim Revenue FY 1996	Challenge Grant Awards FY 1997	Reclaim Revenue FY 1997	Total Grant Awards To Date
Allen*	$0	$14,000	$0	$0	$0	$14,000
Ashtabula	$32,966	$0	$19,725	$50,000	$0	$50,000
Belmont	$3,148	$0	$14,694	$10,000	$0	$10,000
Brown	$0	$25,000	$0	$0	$6,722	$25,000
Butler*	$154,157	$0	$70,002	$50,000	$0	$50,000
Clark	$0	$77,700	$0	$0	$46,563	$77,700
Fayette*	$0	$25,000	$9,953	$0	$0	$25,000
Franklin	$397,260	$0	$685,922	$14,725	$1,446,906	$14,725
Guernsey	$0	$25,000	$0	$0	$0	$25,000
Madison	$21,289	$0	$6,272	$25,000	$14,426	$25,000
Mahoning	$0	$74,400	$0	$150,000	$0	$224,400
Medina	$8,586	$33,200	$73,058	$108,975	$232,355	$142,175
Montgomery	$68,289	$82,000	$26,139	$200,000	$0	$282,000
Ottawa	$0	$6,000	$0	$75,800	$19,915	$81,800
Perry	$28,617	$0	$0	$19,500	$38,792	$19,500
Sandusky	$41,407	$0	$14,915	$36,000	$140,105	$36,000
Trumbull	$0	$77,700	$201,036	$0	$164,150	$77,700
Total	$755,719	$440,000	$1,121,716	$740,000	$2,109,934	$1,180,000
Total 88 County- Revenue	$17,600,000		$17,100,000		$19,498,000	

**** Counties eligible for FY 1997 Grants (disbursed in FY 1998) amongs others.***

counties, 2 counties (Franklin and Sandusky) realized immediate results. Sandusky's revenues grew from $14,915 in fiscal year 1996 to $140,105 in FY 1997, while Franklin County's revenues improved 111 percent from $686,922 in fiscal year 1996 to $1,446,902 in fiscal year 1997. On the down side, however, are Mahoning and Montgomery Counties, which have received grants totaling $224,400 and $282,000 respectively, but still appear unable to unlock the doors of the revenue train in the RECLAIM program as of the end of fiscal year 1997. DYS, however, notes that the programs implemented, as a result of the grants to these two counties, will begin to yield results in fiscal year 1998.

In fiscal year 1997, the Challenge Grant program was divided into two categories. Category One includes funds to allow for the development of the strategic plan which will identify problems, assess needs, and support local planning efforts in those counties currently not receiving RECLAIM funds and which have not had an assessment completed using previous Challenge Grants. Category two grants are designed for the implementation of the developed plans, to support direct services to juvenile felony offenders who would otherwise be committed to DYS, and to evaluate the effectiveness of the proposed approaches. Thus, only counties that previously received development funds under category one are eligible for category two implementation grants.

In the third (fiscal year 1998) and current grant year, DYS determined that the following counties were eligible for Category One Challenge Grants: **Coshocton**, Defiance, **Fayette**, Hancock, **Hardin**, Henry, **Lawrence**, **Licking**, **Lucas**, Morrow, **Muskingum**, **Pike**, Scioto, **Stark** and Washington. Each of the juvenile courts in the bolded counties above will receive $10,000 in FY 1998, except Lucas and Stark, which will each receive $15,000. The other counties did not apply for the grant. DYS believes that these counties opted not to apply because they are comfortable with their programs for rehabilitation of offending youth, and thus feel no program assessments are necessary. Category two Challenge Grant funds which will be used to expand or develop the local community corrections infrastructure, built on the results of the strategic plans, were awarded to two counties, Allen and Butler, and will each receive $130,000.

DYS, in its effort to reduce institutional commitments and enhance local juvenile treatment programs, continues to strive for counties to maximize RECLAIM revenues. What is not clear however, are the policy options that will be available to DYS if these counties continue in their inability to generate RECLAIM revenues.❑