Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE — MARCH, 1998

FISCAL OVERVIEW

— Frederick Church

February brought another round of revenue overages — in everything but federal grant money, that is. The sales tax and the income tax exceeded the estimate, and although the corporate franchise tax fell short, combined January and February collections of the first estimated payment were above the estimate by $1.7 million (the other two estimated payments are due at the end of March and May). The public utility excise tax also posted an overage in February. The biggest disappointment was the foreign (meaning out of state) insurance premium tax, which was $13.2 million below estimate. While there are still additional payments to be processed in March (the tax is not actually due until March 1) it seems unlikely that all of the shortfall will be made up next month.

Transfers into the GRF were $237.4 million above estimate, because the movement of money from the Income Tax Reduction Fund (ITRF) to the GRF that was scheduled for January was not actually made until February. This transfer is intended to reimburse the GRF for the 4.0 percent income tax rate cut that resulted from the budget surplus in the prior fiscal year (FY 1997).

For the year to date, tax revenues are $174.4 million above the estimate. The income tax and the sales tax account for $172.6 million. Income tax revenue is $141.4 million above the estimate, and growth is 8.7 percent, well above the estimated 4.8 percent. February's overage was largely the result of lower than expected refunds, which may be a timing issue. Sales and use tax revenue has grown by 5.1 percent from last year, with the non-auto portion of the tax growing somewhat faster. While month to month sales tax results have been erratic, the overall trend leads us to expect an overage by year's end.

Spending was actually over the estimate by $44.3 million in February. Three large spending categories partially or completely caught up to the estimate, wiping out prior underspending that was partly the result of timing factors. In higher education and the aggregate human services category, February overages wiped out prior underspending and left spending above estimate for the year. Of course, in higher education underspending may return, since the February overage was due in part to earlier than expected debt service payments due to bond refinancing. This should lead to lower debt service payments later in the year. In primary and secondary education, even after the $54.2 million overage in February, year-to-date spending is still $65.6 million below estimate.

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

Budget Footnotes examines the fiscal position of the state GRF on a monthly basis. Each issue also 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 February	Fiscal Year 1998 to Date	Last Year	Difference
Beginning Cash Balance	($107.7)	$1,367.7		
Revenue + Transfers	$1,536.1	$11,355.3		
Available Resources	$1,428.4	$12,723.0		
Disbursements + Transfers	$1,307.6	$12,602.2		
Ending Cash Balances	**$120.9**	**$120.9**	**$510.4**	**($389.5)**
Encumbrances and Accts. Payable		$449.3	$336.1	$113.2
Unobligated Balance		**($328.4)**	**$174.4**	**($502.7)**
BSF Balance		$862.7	$828.3	
Combined GRF and BSF Balance		**$534.3**	**$1,002.7**	**($468.3)**

For the year-to-date, GRF spending excluding transfers is $416.8 million below estimate, on growth of 5.0 percent. A little less than 3/4 of the underspending, or $297.1 million, is in human services programs. Surprisingly, the shortfall in federal grant money received, at $337.1 million, is actually quite a bit larger than the human services underspending (about $40 million). We know that the Department of Human Services has been spending state TANF dollars in order to meet the Maintenance of Effort (MOE) requirements, and therefore holding federal dollars in reserve. However, it is not clear how that can cause the federal revenue shortfall to exceed the combined state and federal underspending in Medicaid, TANF, and other human services programs.

Human services underspending is still being driven primarily by low caseloads, although there are also other factors at work. TANF spending is $157.4 million below estimate, a variance of more than 20 percent. The number of cash assistance recipients is still declining: another 7,500 dropped off in February, bringing the total below 380,000. In Medicaid, year-to-date spending is $121.7 million below estimate, despite the fact that services to the elderly are far above estimate. Payments for nursing home care and prescription drugs are about $73 million over estimate. However, hospital spending is $44 million below estimate, and HMO spending shows a huge $77.7 million negative variance.

Simplified Summary of Current-Year Revenues and Spending

Non-Federal Revenue, Excluding Transfers Other Than Liquor Profits	$201.6
State Spending, Net of Federal Dollars and Transfers	$79.7
Current Year State Surplus Relative to Forecast	$281.3

Questions directed at the LBO in recent months have made it clear to us that not everyone reading this report is able to sort through the welter of numbers to get a "quick read" on the state's fiscal condition for the current year. While Table 1 paints a picture of the overall cash position of the GRF, it is not easy to extract a summary of year-to-date spending and revenue relative to expectation from that data. The simplified table above presents a summary of current year revenues and spending that shows that the state is doing about $280 million better than expected at the beginning of the year. We have excluded most transfers from the calculation so that the results will not be affected by such transitory phenomena as transfers to and from bond funds, which by year's end should net out or be one-time occurrences that do not speak to the ongoing fiscal health of the GRF. ❑

The Ongoing Saga of Internet Commerce and State Sales Tax

— Frederick Church

> *All government — indeed, every human benefit and enjoyment, every virtue and every prudent act,— is founded on compromise and barter.*
> — Edmund Burke, *Speech on the Conciliation of America. Vol. ii.*

Last month's issue of ***Budget Footnotes*** contained a brief overview of the issue of state and local taxes and Internet commerce, with an emphasis on sales and use taxes. In that overview we discussed the Internet Tax Freedom Act, separate bills in the U.S. House and Senate sponsored by Representative Chris Cox (R-California) and Senator Ron Wyden (D-Oregon) respectively. We mentioned that the bill seemed to be stalled and that the National Governor's Association (NGA) had just endorsed an effort led by Colorado Gov. Roy Romer to tax merchandise sold via the Internet, proposing a single Internet sales tax rate for each state and a number of provisions to bring uniformity and simplicity to tax collection. The latest news is that a compromise was reached between the NGA, the National Conference of State Legislatures (NCSL, led by Ohio's own Senator Finan), and Representative Cox. The new bill contains significant concessions to state and local governments — enough that Senator Wyden apparently feels that he cannot support it. The outlook for the bill is still problematic in the Senate.

The original Cox bill had a six-year moratorium on "new and discriminatory" taxes on the Internet. As we indicated in last month's review, it is hard to see how the state sales and use tax could be characterized as "new" or "discriminatory". In fact, many vendors argued that the discrimination was in favor of electronic commerce and against traditional vendors who had nexus (stores, employees, etc.) in various states and therefore had to collect the tax. The case for various state and local taxes on Internet access is much less clear and in fact dealing with those issues will be an important part of the new Cox bill. In any case, the new bill:

- Limits the moratorium to no more than 3 years
- Clearly defines the type of taxes to be included in the moratorium. For example, taxes on Internet access charges are prohibited (but see the next bullet for exceptions). Also, taxes like the "bit tax" (being debated in Europe) or taxes on Internet-unique services like e-mail are prohibited.
- Protects state and local taxes on Internet commerce that were in place by March 1, 1998.
- Explicitly provides that sales over the Internet are to be treated the same as catalog or mail-order sales, subject to the same tests of *nexus* for sellers.
- Prohibits double-taxing of the same electronic commerce transaction by multiple states or jurisdictions, in the same way that non-Internet sales are protected.
- Establishes a Commission on Internet Commerce, composed of state, local, federal, consumer, and industry representatives, charged with submitting model legislation to Congress in two years. The legislation is supposed to: (1) define siting *nexus* for remote sales; (2) provide uniform definitions for sales and services; (3) establish one tax rate per state for remote sellers, with a distribution mechanism for local governments; (4) simplify administration and third-party collections. The guidelines developed are really supposed to apply to both Internet and mail-order purchases.

It is worth noting that, as with mail-order sales, there are divisions even among the vendors about the compromise bill. Vendors that already have nexus in a number of states can support bills like ITFA, and/or the Voluntary Collection Agreement (VCA) discussed last month. They already collect a lot of state and local sales tax and are mainly seeking uniformity and simplification. Some vendors with nexus in several states also can support ITFA or the VCA for essentially the same reasons. However, there are vendors with very limited nexus who seem to be interested primarily in blocking any sales tax collection agreements. How the disagreement between these industry groups will be resolved is an open question in this process.

Besides NSCL and NGA, the new Cox bill also has the support of the National League of Cities, the U.S. Conference of Mayors, and the National Association of Counties. President Clinton has praised the compromise bill, although the White House has not officially endorsed it. Representative Cox has stated that he hopes the House will pass the bill before Easter recess. In the Senate, the bill faces slower going. Senate Majority Leader Trent Lott has indicated that the Senate may take up the bill in May. ❑

Status of the General Revenue Fund

REVENUES

— Frederick Church

The income tax overage continues to dominate the revenue story. Through February, GRF income tax collections are $141.4 million over estimate, have grown by 8.7 percent from last year, and are 3.7 percent above the forecast. By far the bulk of the overage is in withholding, with quarterly estimated payments running a distant second. Withholding growth is 8.7 percent, a full three percentage points higher than the year-to-date estimate.

The other major overage is in the sales and use tax. As we had expected, the January shortfall in the non-auto tax was followed by an overage in February. The non-auto tax has grown 5.3 percent so far this year, while the auto tax has grown 3.7 percent. The non-auto revenue growth is faster than what one would expect based on national retail sales, while the auto revenue growth is somewhat slower. This is probably partly due to an old standard explanation of ours, the Ohio treatment of auto leasing tax payments as "non-auto" tax revenue. Not all of the growth differential can be explained that way, though.[1]

Table 2
General Revenue Fund Income
Actual vs. Estimate
Month of February, 1998
($ in thousands)

REVENUE SOURCE	Actual	Estimate*	Variance
TAX INCOME			
Auto Sales	$40,132	$43,218	($3,086)
Non-Auto Sales & Use	297,708	286,950	10,758
Total Sales	$337,840	$330,168	$7,672
Personal Income	$355,048	$328,014	$27,034
Corporate Franchise	221,737	229,140	(7,403)
Public Utility	10,892	4,845	6,047
Total Major Taxes	**$925,518**	**$892,167**	**$33,351**
Foreign Insurance	$77,015	$90,251	($13,236)
Domestic Insurance	239	0	239
Business & Property	4	324	(320)
Cigarette	20,889	21,557	(668)
Soft Drink	0	0	0
Alcoholic Beverage	4,347	4,141	206
Liquor Gallonage	2,058	2,025	33
Estate	104	0	104
Racing	0	0	0
Total Other Taxes	$104,657	$118,299	($13,642)
Total Taxes	**$1,030,175**	**$1,010,465**	**$19,710**
NON-TAX INCOME			
Earnings on Investments	$0	$0	$0
Licenses and Fees	3,049	6,057	(3,008)
Other Income	5,285	2,487	2,798
Non-Tax Receipts	$8,334	$8,544	($210)
TRANSFERS			
Liquor Transfers	$6,000	$5,000	$1,000
Budget Stabilization	0	0	0
Other Transfers In	236,376	0	236,376
Total Transfers In	$242,376	$5,000	$237,376
TOTAL INCOME less Federal Grants	**$1,280,885**	**$1,024,009**	**$256,876**
Federal Grants	$255,250	$323,661	($68,411)
TOTAL GRF INCOME	**$1,536,135**	**$1,347,670**	**$188,465**

* July, 1997 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

Most of the other taxes are relatively close to the estimates. The corporate franchise tax is $13.2 million below estimate, due to the first six months of the year. In the July through December period, revenues were $14.9 million below estimate. Collections during that time are based on audit findings and late payments from prior years, and not on activity in the most recent taxable year. Payments against taxable year 1997 liability are made at the end of January, March, and May in 1998. The January payment, whose revenues were spread across January and February, was $1.7 million over estimate. Since the first of the three payments is generally a pretty good predictor of the next two, LBO expects small overages in the second and third payments, but they may not be enough to wipe out the year-to-date shortfall.

In non-tax income, investment earnings continue above estimate (by $23.1 million) despite the fact

Table 3
General Revenue Fund Income
Actual vs. Estimate
Fiscal Year-to-Date 1998
($ in thousands)

REVENUE SOURCE *TAX INCOME*	Actual	Estimate*	Variance	FY 1997	Percent Change
Auto Sales	$447,745	$439,726	$8,019	$431,798	3.69%
Non-Auto Sales & Use	3,080,996	3,057,816	23,180	2,925,033	5.33%
Total Sales	$3,528,741	$3,497,542	$31,199	$3,356,831	5.12%
Personal Income	$3,973,644	$3,832,288	**$141,356**	$3,656,965	**8.66%**
Corporate Franchise	410,267	423,474	(13,207)	419,199	-2.13%
Public Utility	240,486	218,888	21,598	217,971	10.33%
Total Major Taxes	$8,153,138	$7,972,192	$180,946	$7,650,966	6.56%
Foreign Insurance	$223,924	$237,893	($13,969)	$230,795	-2.98%
Domestic Insurance	678	440	238	224	202.50%
Business & Property	485	1,396	(911)	1,094	-55.71%
Cigarette	181,718	181,035	683	184,349	-1.43%
Soft Drink	0	0	0	18	-100.00%
Alcoholic Beverage	34,606	33,296	1,310	34,435	0.50%
Liquor Gallonage	18,753	18,461	292	18,539	1.15%
Estate	51,912	46,078	5,834	46,117	12.56%
Racing	0	0	0	0	#N/A
Total Other Taxes	$512,075	$518,600	($6,525)	$515,572	-0.68%
Total Taxes	**$8,665,212**	**$8,490,791**	**$174,421**	**$8,166,538**	**6.11%**
NON -TAX INCOME					
Earnings on Investments	$65,400	$42,319	$23,081	$50,989	28.27%
Licenses and Fees	24,520	52,275	(27,755)	50,988	-51.91%
Other Income	68,501	48,158	20,343	56,946	20.29%
Non-Tax Receipts	$158,421	$142,752	$15,669	$158,923	-0.32%
TRANSFERS					
Liquor Transfers	$56,000	$44,500	$11,500	$41,500	34.94%
Budget Stabilization	0	0	0	$0	#N/A
Other Transfers In	269,308	235,300	34,008	398,780	-32.47%
Total Transfers In	$325,308	$279,800	$45,508	$440,280	-26.11%
TOTAL INCOME less Federal Grants	**$9,148,942**	**$8,913,343**	**$235,599**	**$8,765,741**	**4.37%**
Federal Grants	$2,206,357	$2,543,440	($337,083)	2,460,572	-10.33%
TOTAL GRF INCOME	**$11,355,299**	**$11,456,783**	**($101,484)**	**$11,226,313**	**1.15%**

* July, 1997 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

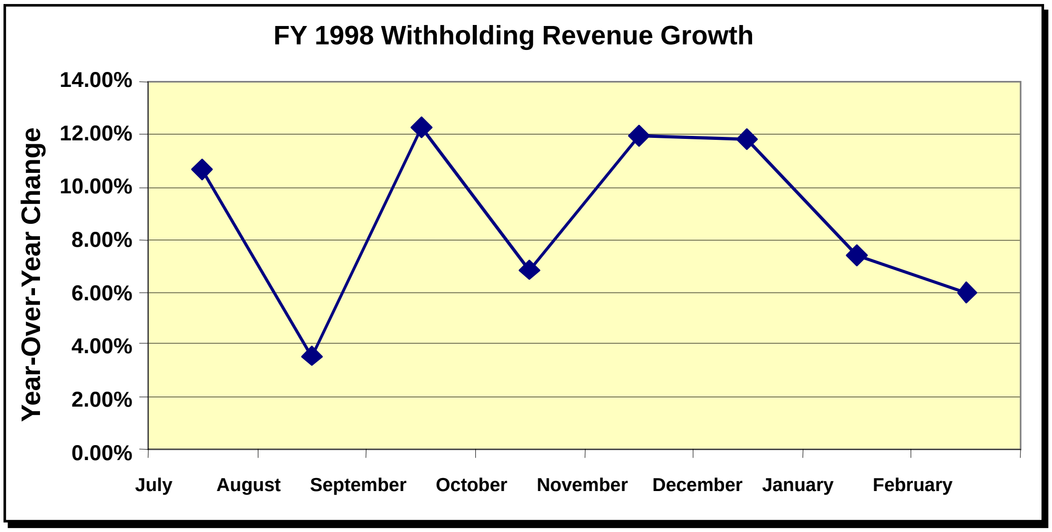
that the unobligated GRF fund balance has dipped so far below last year's level. Liquor profit transfers also show a $11.5 million overage. License and fee income is far below estimate, but this is still thought to be a timing problem that will be corrected by year's end. Federal grants received are even further below estimate than one would expect based on the underspending in welfare and human services programs — in fact, the federal dollar shortfall is greater than the total underspending in human services programs. LBO is still trying to determine exactly what is happening in federal grants revenue.

Personal Income Tax

The income tax component with the biggest overage is still employer withholding, now $106.9 million over the estimate. Year-over-year growth has finally begun moderating, as the following chart illustrates. Growth through February is 8.7 percent.

Regular readers of this report may recall graphic illustrations of the relationship between the quarterly growth rates of withholding , nonfarm employment, and wages (manufacturing hourly earnings).

While quarterly growth rates in these variables show a rough



correlation, we have been rather hard put to explain all of the jump in withholding revenue through wage and employment growth. One possible explanation is stock option income. For many executives and employees, gains through exercising stock options are treated as ordinary income rather than capital gains, and so are reflected in increased withholding payments rather than in quarterly estimated payments. LBO does not yet have a guess at the magnitude of this effect, but the explanation has promise. Late-year employee bonuses may also be a factor in explaining the very high withholding growth in November and December.

In the last issue of ***Budget Footnotes*** we mentioned that the January 1998 estimated payment was well above the estimate and so we expected a strong filing season this Spring. It is too early to tell whether that expectation is being realized. Refunds were below the forecast in February, but so many timing factors can affect refunds that it will not be clear for awhile what the cause actually was.

Sales and Use Tax

The sales and use tax is over estimate by $31.2 million. As expected, the non-auto tax exceeded the estimate in February, although the auto tax fell short. In general, the outlook for the remainder of the year remains solid, with the expectation of continuing small overages. The Federal Reserve's most recent ***Beige Book*** sheds some light on regional consumption trends. The analysis for the Fourth District, which includes Ohio, reports that most retailers expect CY 1998 to be stronger than CY 1997. Retail sales in the district were far above the expectation in January (helping to explain the February overage in Ohio's non-auto tax) but only slightly above the forecast in February. As a result, LBO expects that March tax collections should be around the estimate. The strongest sales growth has been in apparel and wireless communications.

In the auto market, January and February sales were strong for minivans, sport utility vehicles, and trucks, but passenger car sales were flat. Heavy inventory buildup in the slow months before the holidays has led to dealers having a large supply of cars now. Used vehicle prices are being pushed down by all the 1996 cars and trucks being returned from lease agreements.

Consumer loan demand has weakened slightly, but home mortgage refinancing is still very robust, making homeowners feel richer and boosting spending. In general, the strong economy, with low unemployment, solid wage growth, and low inflation continues to spur consumer confidence and should lead to steady consumption increases in the coming months. ❑

[1] LBO also believes that the auto tax shortfall in February was partly a timing issue, and we expect revenue to rebound in March

DISBURSEMENTS

— Jeffrey E. Golon*

Let's not mince words. Our running commentary on the state's underspending parade struck an abrupt, but not unexpected, $44.1 million positive reversal of what had been a negative year-to-date story. (This number solely reflects total program disbursements and excludes any fund transfers.) Two critical ingredients powered this 180-degree course correction. First, Medicaid disbursements were absolutely Houdini-like with virtually no monthly variance. This first ingredient essentially stabilized the state's fiscal stew. The second ingredient — distribution of some $80 million in previously delayed education and human services funding — finished the job. Together, these ingredients concocted only the second negative monthly disbursement variance seen this fiscal year in these them there parts.

Then, where does that leave us? Well, excluding GRF transfers, state spending closed the month of February $416.8 million under estimate year-to-date, thus dropping us from the FY 1998 high water mark for underspending — $460.9 million — set just last month.

Table 4
General Revenue Fund Disbursements
Actual vs. Estimate
Month of February, 1998
($ in thousands)

USE OF FUNDS			
PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$371,584	$317,348	$54,236
Higher Education	179,401	169,111	10,290
Total Education	$550,985	$486,459	$64,526
Health Care	$442,708	$442,656	$52
Temporary Aid to Needy Families	66,734	103,412	(36,678)
General Assistance/Disability Assistance	4,031	5,174	(1,143)
Other Welfare	16,904	20,641	(3,737)
Human Services (2)	94,702	66,743	27,959
Total Welfare & Human Services	$625,078	$638,626	($13,548)
Justice & Corrections	$96,089	$100,160	($4,071)
Environment & Natural Resources	6,532	7,151	(619)
Transportation	3,061	2,654	407
Development	7,361	7,115	246
Other Government (3)	16,025	18,641	(2,616)
Capital	280	402	(122)
Total Government Operations	$129,348	$136,122	($6,774)
Property Tax Relief (4)	($17)	$0	($17)
Debt Service	2,083	2,113	(30)
Total Program Payments	**$1,307,477**	**$1,263,321**	**$44,156**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	114	0	114
Total Transfers Out	$114	$0	$114
TOTAL GRF USES	**$1,307,591**	**$1,263,321**	**$44,270**

(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, 1997 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

Also, keep in mind our usual admonition regarding a chunk of federal funds that are drawn down to support the state's welfare and human services program spending; the most notable of which are Temporary Assistance to Needy Families (TANF) and Medicaid. Although technically-speaking this is federal money, the reality is that the state budgets and tracks it as GRF appropriations. Knowing that, the reader should also be aware that, of the just-posted $416.8 million negative year-to-date GRF disbursement variance, $174.9 million, or 42.0 percent, has really to be viewed as federal, and not, state money. Once that federal money is backed out, the year-to-date underspending of non-federal state money is reduced to more like $241.9 million.

At this juncture, we feel compelled to launch into a short sidebar to further underscore the importance of this federal money and its relation to state GRF disbursements. The state closed last month with around 27 percent, or $126.7 million, of the year-to-date underspending attributable to federal money. A month later, the amount of year-to-date un-derspending had been reduced by

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
Fiscal Year-to-Date 1998
($ in thousands)

USE OF FUNDS PROGRAM	Actual	Estimate*	Variance	FY 1997	Percent Change
Primary & Secondary Education (1)	$3,077,369	$3,142,946	($65,577)	$2,835,128	8.54%
Higher Education	1,487,225	1,483,399	3,826	1,375,624	8.11%
Total Education	$4,564,594	$4,626,345	($61,751)	4,210,752	8.40%
Health Care	$3,426,842	$3,548,497	($121,655)	$3,267,955	4.86%
Temporary Aid to Needy Families	613,301	770,688	(157,386)	690,784	-11.22%
General Assistance/Disability Assistance	38,478	43,825	(5,347)	104	36,897.90%
Other Welfare	289,108	303,969	(14,861)	379,392	-23.80%
Human Services (2)	817,173	815,029	2,144	762,567	7.16%
Total Welfare & Human Services	$5,184,902	$5,482,008	($297,106)	$5,100,802	1.65%
Justice & Corrections	$1,033,971	$1,040,931	($6,960)	$951,647	8.65%
Environment & Natural Resources	94,641	88,765	5,876	83,284	13.64%
Transportation	17,205	25,379	(8,174)	17,308	-0.60%
Development	80,442	94,562	(14,120)	86,200	-6.68%
Other Government (3)	241,980	272,616	(30,636)	237,310	1.97%
Capital	3,053	6,126	(3,073)	5,482	-44.32%
Total Government Operations	$1,471,292	$1,528,380	($57,088)	$1,381,232	6.52%
Property Tax Relief (4)	$515,545	$516,897	($1,352)	$489,942	5.23%
Debt Service	102,138	101,594	544	93,765	8.93%
Total Program Payments	**$11,838,472**	**$12,255,225**	**($416,753)**	**$11,276,492**	**4.98%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$0	—
Budget Stabilization	34,400	34,000	400	0	—
Other Transfers Out	729,351	686,766	42,585	577,913	26.20%
Total Transfers Out	$763,751	$720,766	$42,985	$577,913	32.16%
TOTAL GRF USES	**$12,602,223**	**$12,975,991**	**($373,768)**	**$11,854,405**	**6.31%**

(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, 1997 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

$44.1 million. Obviously, spending in the aggregate exceeded estimates for the month. However, for the month of February, contrast this with the percentage of year-to-date underspending attributable to federal money; that did not drop, it actually grew quite dramatically by $48.2 million. Our expectation is that the amount of federal underspending will continue to grow in the months ahead as the state furiously spends its required maintenance of effort funding for the TANF program and stockpiles federal dollars for future use. The ultimate outcome is that a progressively smaller proportion of the underspending will be available state GRF dollars.

Over 80 percent of the year-to-date underspending was directly attributable to three areas of state government — TANF ($157.4 million), Medicaid ($121.7 million), and the Department of Education ($65.6 million). Declining human services caseloads have held TANF and Medicaid spending handily in check for the fiscal year so far. (Don't forget that although Medicaid produced a virtually imperceptible February disbursement variance, its contribution to year-to-date underspending remained quite significant.) Although the Department of Education's underspending still loomed large, it actually had taken a $55.6 million nosedive from last month when the department's year-to-date negative disbursement variance registered $121.2 million. As we had suggested would occur, a $48-plus million distribution of Auxiliary Services funding originally scheduled for January was released a month later.

Other notable matters lurking somewhat further in the disbursement background were related to community subsidy funding and general government operations. Throughout the fiscal year, timing issues have periodically dogged the funding distributions made to local boards and service providers by the departments of Mental Health and Mental Retardation and Developmental Disabilities. Some of this state fiscal assistance has been released ahead of schedule, while other pieces intermittently have fallen behind schedule. Nothing notably problematic seems afoot here, with timing as the apparent culprit.

Elsewhere, in the area of general government operations, the principal player — the Department of Administrative Services — has built itself a comfortable year-to-date pile of underspending totaling $23.1 million. Disbursements on debt service payments as well as computer services — Year 2000 compliance assistance, SOMACS, Strategic Technology, and MARCS — have both been lower than was originally assumed. The former was not all that surprising as favorable market conditions these days frequently reduce bond servicing costs below what was expected. The sluggish pace in computer-related spending, on the other hand, has been a relentless source of surprise, with the forces behind that underspending still unclear to us.

And now, for something completely different. How about a selective turn through the disbursement matters that happened to capture our attention whilst some of us desperately fought off the winter blues with visions of barbecuing and baseball dancing in the head?

Primary and Secondary Education

Department of Education. By far and away, the primary driver behind the state's total $44.1 million monthly overage — only the second such total overage posted by the state this fiscal year, the first having been registered in December — was the Department of Education's $55.6 million positive disbursement variance. The disbursement of a previously delayed distribution of $48.2 million in Auxiliary Services funding (line item 200-511) fueled the department's monthly overage. As noted in the previous issue of ***Budget Footnotes***, this subsidy distribution was expected to hit the streets in January. That did not happen. And, as expected, the Controlling Board released the money a month later.

This Auxiliary Services subsidy is distributed to the state's chartered nonpublic elementary and secondary schools — numbering around 890 and serving in the neighborhood of 240,000 students statewide — for the provision of secular services and materials, including textbooks, health services, programs for the handicapped, and transportation to services offered off-site.

NET. Year-to-date disbursements of the Office of Information, Learning, and Technology Services were $7.2 million under estimate through the month of February. Timing, the apparent obstacle, is expected to sort itself out in the remaining months of the fiscal year, which certainly should mean a quickening in the pace of NET's disbursements between now and then. NET carries a $25 million annual GRF budget and is responsible for directing all technology-related programs for the provision of financial and other assistance to school districts and other educational institutions. This assistance covers the acquisition and utilization of educational technology, including SchoolNet, SchoolNet Plus, Ohio SchoolNet Telecommunity, and Interactive Video Distance Learning.

Almost all of NET's underspending was concentrated in line item 228-404, SchoolNet, which is used to make grants to qualifying schools for the provision of hardware, software, telecommunications services, and staff development to support educational uses of technology in the classroom. Various projects slated to receive funding from this line item during FY 1998 have moved more slowly than expected, the largest involving a $3.3 million set-aside for a technology equity project. The budget bill earmarks that amount in each fiscal year to be distributed to low-wealth districts or consortia including low-wealth districts. To date, only $142,000 has been distributed, primarily due to a changed grant distribution process. For the first time, eligible districts have been asked to report accountability information (such as the history of prior grant spending, results of past spending, and future grant spending plans) before actually receiving grants. The reporting deadline is May 1, 1998. The technology equity grants will be fully disbursed once eligible districts report the required information.

Other notable projects or events that also contributed to the line item's year-to-date underspending included: a $1.1 million amount targeted for two professional development projects, yet only $400,000 has been disbursed to date; a $360,000 statewide conference on professional development postponed from January to May; and a FY 1998 earmark in the budget bill of up to $250,000 for the development of educational materials related to the restoration of the Statehouse and its role in Ohio government. With regard to the latter, as a contract to perform that task is still under negotiation, a mere $82 of the permissive budgetary earmark has been disbursed so far.

Higher Education

Board of Regents. For the month of February, the Board of Regents' (BOR) disbursements were $10.3 million, or 6.1 percent, above estimate. As we expected circling through the 60-plus line items buried in BOR's GRF budget, there was a mix of positive and negative disbursement variances littered throughout the February spending. The notable participant in the monthly overage was an unscheduled $16.9 million debt service payment (line item 235-401). Apparently, favorable winds in the market prompted some bond refinancing. As a result of this financial maneuver, debt service payments scheduled to occur later in April and May of this year should be lower than the originally estimated total for that two-month period — $136.0 million. Also contributing to the monthly overage was the Ohio Instructional Grant (OIG) Program, which registered a positive disbursement variance of some $3.0 million (line item 235-503).

A small group of GRF line items combined to produce approximately $10 million in underspending, effectively halving what the size of the BOR monthly overage would otherwise have been. Two of BOR's five performance-based line items — 235-418, Access Challenge, and 235-420, Success Challenge — together provided the largest negative disbursement variance at $3.5 million. Rather than being disbursed in four monthly payments over the fiscal year as had been originally assumed, the entire FY 1998 appropriation for each line item was shipped out the door last September. A total of $14.0 million was distributed at that time, $12.0 million in Access Challenge funding used to restrain tuition growth and $2.0 million in Success Challenge funding used to promote degree completion of "at-risk" students.

A medical support subsidy — line item 235-519, Family Practice — chipped in another $1.5 million worth of underspending as a scheduled quarterly payment was not made. (Look for this payment to be made in March instead.) BOR's medical support program consists of nine state subsidies totaling $68.7 million in FY 1998 that generally support the medical education functions that take place outside of the classroom and laboratory. The family practice medicine subsidy ($5.96 million in FY 1998) supports the family practice programs within each Ohio medical college, including Case Western Reserve University, for the provision of education and training to medical students and residents in family practice.

One of BOR's 14 financial aid programs, the Dayton Area Graduate Studies Institute (line item 235-553), provided the last notable area of underspending. The line item's FY 1998 appropriation of $2.9 million was planned for distribution in three payments. The second payment of $725,000 was made in January rather than in February, as originally assumed. The Institute is a not-for-profit consortium of five Ohio graduate engineering schools: The Ohio State University, the University of Cincinnati, the Air Force Institute of Technology, the University of Dayton, and Wright State University. This state financial assistance supports approximately 150 masters- and doctoral-level engineering scholarships at a rate of $14,000 per full-time equivalent student.

Health Care/Medicaid

Medicaid spending, in an unexpected role as a ski jumper in search of highly touted Olympic Gold, landed squarely on target in February, leaving a microscopic overage of only $52,060 in its wake. Not bad for a $5-plus billion program. This subatomic-like monthly disbursement variance meant year-to-date Medicaid underspending was virtually unchanged from whence it stood at the end of January — $121.6 million, or 3.4 percent, below estimate. And in fact, if one were

Table 6
Medicaid (400-525) Spending in FY 1998

Service Category	February '98 Actual	February '98 Estimate	February '98 Variance	February '98 Percent Variance	Year-to Date Spending Actual** thru' Feb.	Year-to Date Spending Estimate** thru' Feb.	Year-to Date Spending Variance	Year-to Date Spending Percent Variance
Nursing Homes	$160,191,501	$162,442,648	($2,251,147)	-1.4%	$1,272,189,241	$1,228,104,585	$44,084,656	3.5%
ICF/MR	$29,789,437	$29,471,220	$318,217	1.1%	$228,825,641	$229,941,111	($1,115,470)	-0.5%
Hospitals	$93,905,059	$85,178,680	$8,726,379	9.3%	$750,754,945	$794,840,030	($44,085,085)	-5.9%
Inpatient Hospitals	$73,369,909	$66,932,572	$6,437,337	8.8%	$581,822,797	$614,720,431	($32,897,634)	-5.7%
Outpatient Hospitals	$20,535,150	$18,246,108	$2,289,042	11.1%	$168,932,148	$180,119,599	($11,187,451)	-6.6%
Physicians	$21,671,525	$20,588,190	$1,083,335	5.0%	$180,641,591	$189,921,252	($9,279,661)	-5.1%
Prescription Drugs	$51,712,114	$40,970,861	$10,741,253	20.8%	$330,742,845	$301,673,085	$29,069,760	8.8%
Payments	$52,874,480	$43,104,130	$9,770,349	18.5%	$408,048,155	$378,611,555	$29,436,601	7.2%
Rebates	$1,162,366	$2,133,269	($970,904)	-83.5%	$77,305,310	$76,938,470	$366,841	0.5%
HMO	$37,282,484	$60,473,458	($23,190,974)	-62.2%	$359,749,548	$437,418,675	($77,669,127)	-21.6%
Medicare Buy-In	$10,009,622	$10,101,372	($91,750)	-0.9%	$81,469,096	$88,376,595	($6,907,499)	-8.5%
All Other***	$38,216,184	$33,429,080	$4,787,104	12.5%	$221,281,340	$278,216,651	($56,935,311)	-25.7%
TOTAL	$442,777,924	$442,655,509	$122,415	0.0%	$3,425,654,247	$3,548,491,984	($122,837,737)	-3.5%
CAS	$442,707,569		$52,060	0.0%	$3,426,842,161		($121,649,823)	-3.4%
Estimated Federal Share	$257,531,066	$257,459,866	$71,200		$1,992,630,145	$2,064,075,787	($71,445,642)	
Estimated State Share	$185,246,858	$185,195,643	$51,215	0.0%	$1,433,024,102	$1,484,416,197	($51,392,095)	-3.5%

* This table only includes Medicaid spending through Human Services' 400-525 line item.

** Includes spending from FY 1997 encumbrances in service categories for July & in the All Other category for August & September.

*** All Other, includes all other health services funded by 400-525.

Source: BOMC 8300-R001 Reports, Ohio Department of Human Services.

to factor out a previously missed Medicare "Buy-in" payment that ultimately will occur, year-to-date underspending would be reduced to around $111.6 million. (For more detail on monthly and year-to-date Medicaid spending, as well as a comparison to FY 1997 spending, see Tables 6 and 7, respectively.)

As many readers are doubtless aware, the Medicaid program is composed of a multitude of service categories and recipient types. This means that one has to look underneath the monthly or year-to-date bottom line and check out the mix of negative and positive disbursement variances that inevitably lie below the surface to uncover what is really going on. Performing that operation for the month of February reveals that there were actually some relatively significant disbursement variances that were, in effect, masked. Specifically, payments for HMO coverage of eligible recipients fell short of anticipated levels by $23.2 million, while payments for acute care (hospitals) and prescription drugs exceeded estimates by $8.7 million and $10.7 million, respectively. The overages in acute care and prescription drug spending were due primarily to higher than expected service utilization across all eligibility categories for which claims were paid in February.

TANF

The February variance in TANF disbursements loomed large at $36.7 million, or 35.5 percent, below estimate. However, more interesting than the mere size in the variance was its composition. The combined variance for the month in the state-funded GRF line items 400-410 (TANF State) and 400-413 (Day Care Match/MOE) was $11.6 million *above* estimate, while line item 400-411 (TANF Federal Block Grant) was $48.3 million *below* estimate.

This pattern is likely to continue through the end of the state's fiscal year; ending with all TANF state dollars expended, and any underage showing up in the TANF Federal Block Grant disbursements. This results from the necessity to spend all state GRF funds in order to meet the state's Maintenance of Effort (MOE) requirement. All federal dollars remaining at the end of the federal fiscal year are available to the state over the lifetime of the TANF program, as long as the MOE requirements are met.

The pace of the decline in the TANF caseload continues to be strong, although not matching the torrid pace set in earlier months. The total caseload declined in February by the comparatively moderate figure of 7,500 recipients.

General Assistance/Disability Assistance

The February disbursement for the Disability Assistance program (DA) was below estimate by about $1.1 million, or 22.1 percent, the second largest negative variance for the fiscal year. Year-to-date, the variance now stood at $5.3 million, or 12.2 percent, below estimate.

Cost savings resulting from the reduced caseload were the main reason for the variance. However,

Table 7
FY 1998 to FY 1997 Comparison* of Year-to-Date Spending

Service Category	FY 1998[1] Yr.-to-Date as of Feb. 98	FY 1997 Yr.-to-Date as of Feb. 97	Variance	Percent Variance
Nursing Homes	$1,272,189,241	$1,180,789,788	$91,399,453	7.2%
ICF/MR	$228,825,641	$217,582,461	$11,243,180	4.9%
Hospitals	$750,754,945	$795,124,509	($44,369,564)	-5.9%
Inpatient Hospitals	$581,822,797	$609,199,784	($27,376,987)	-4.7%
Outpatient Hospitals	$168,932,148	$185,924,725	($16,992,577)	-10.1%
Physicians	$180,641,591	$190,712,636	($10,071,045)	-5.6%
Prescription Drugs	$330,742,845	$279,472,447	$51,270,398	15.5%
Payments	$408,048,155	$356,618,037	$51,430,118	12.6%
Rebates	$77,305,310	$77,145,590	$159,720	0.2%
HMO	$359,749,548	$293,977,512	$65,772,036	18.3%
Medicare Buy-In	$81,469,096	$79,720,813	$1,748,283	2.1%
All Other***	$221,281,340	$230,622,641	($9,341,301)	-4.2%
TOTAL	$3,425,654,247	$3,268,002,807	$157,651,440	4.6%
Estimated Federal Share	$1,992,630,145	$1,928,121,656	$64,508,489	
Estimated State Share	$1,433,024,102	$1,339,881,151	$93,142,951	6.5%

* This table only includes Medicaid spending through Human Services' 400-525 line item.

1 . Includes FY 1997 encumbraces of $78.5 million.

while the caseload was down by 15.7 percent from the beginning of the fiscal year, February actually evidenced a small increase in caseload, thus bucking what had been a steady downward trend.

Other Human Services

Department of Aging. In previous months, we had noted that the Department of Aging was spending considerably more in nursing facility franchise fee revenues to fund PASSPORT — a program providing home health care to Medicaid eligible older persons — and less in GRF money than was originally assumed (line item 490-403). This trend, which continued through January (at which time year-to-date GRF disbursements for the program were approximately $7.6 million under estimate), appeared to reverse itself during the month of February. For the month, PASSPORT's GRF disbursements were approximately $2.1 million over estimate, forcing year-to-date underspending down to approximately $5.5 million. Over the reminder of FY 1998, we fully expect to witness more monthly overspending as actual year-to-date GRF disbursements with respect to PASSPORT move much closer to the estimate.

Rehabilitation Services. The major item of note relative to the Rehabilitation Services Commission (RSC) continued to be the persistence of its year-to-date negative disbursement variance, which has been circling around $3.0 million since the start of the fiscal year. At month's end, this negative year-to-date disbursement variance had even managed to creep its way up to $3.8 million, a fact largely attributable to the roughly $11 million line item 415-506, Case Services for People with Disabilities. Year-to-date, this line item — which funds vocational rehabilitation services that assist people in obtaining and maintaining competitive employment — has run itself to $3.1 million under estimate.

As RSC's vocational rehabilitation services are in general funded primarily through federal dollars with the required match generated largely by state GRF, it still seems reasonable to expect the money tap will open and this underage will largely evaporate by fiscal year's end. We have remarked upon this disbursement variance on at least two occasions in prior issues of ***Budget Footnotes***, and are somewhat surprised that it's still hanging around.

Ohio Veterans' Home. The Home's disbursement story was essentially one of exceeding expectations, with spending on payroll and maintenance needs having combined to pull year-to-date spending over estimate by around $600,000 or so. The prime culprit was payroll, which had effectively consumed 85 percent of the Home's FY 1998 personal services appropriation of $10.6 million by the end of February (line item 430-100, Personal Services). Put in perspective, if one were to assume that the Home's pattern of monthly payroll spending should look more or less even and steady over time, at that point in the fiscal year, we'd have thought the percentage of the FY 1998 appropriation spent to have been somewhere around 60 to 70 percent.

So, what's the point? The point is that there is no way that the Home will have enough available money to cover existing GRF-funded staff through the remainder of this fiscal year. This means that the Home will most likely do what other similarly situated state agencies would do, perform a short-term tap into non-GRF accounts. That said, it would not be a surprise if a Controlling Board item or two appeared in the next month or so requesting an increase in the FY 1998 appropriation authority of some non-GRF accounts so that the Home can cover its payroll needs for the next four months.

It would be remiss of us, however, if we did not mention the fact that this is mostly a calculated shortfall. The Home is one of those state agencies that move payroll costs in and out of various accounts as a conscious act of cash flow management. Thus, one would suppose that the Home fully exploits available GRF money and then moves operating expenses to other non-GRF accounts as those resources dwindle.

On the matter of maintenance spending, the Home was also ahead of the year-to-date estimate by around $100,000. We performed a quick-and-dirty analysis of the Home's monthly maintenance disbursement pattern which suggested that their FY 1998 GRF maintenance appropriation (line item 430-200, Maintenance) of $4.7 million might be not only be thoroughly drained, but possibly short of money by $200,000 to $300,000.

So, why might this happen? Answer: Prescription drug spending. Our understanding is that, last December, the U.S. Department of Veteran Affairs' (VA) contract pharmacist was to have assumed responsibility for supplying the Home with prescription drugs, and that, as a result of that arrangement, the VA would end up paying the cost of those prescribed drugs. That arrangement has not been finalized. Thus, the Home has been absorbing a higher level of prescription drug expenses over the last few months than was originally assumed.

This does not end the Home's list of potential budgetary woes though. There are other concerns. First, in FY 1999, pursuant to Am. Sub. H.B. 650 of the 122nd General Assembly, certain GRF appropriations are targeted for reductions. Specifically, the Home's FY 1999 GRF budget will be cut by 1 percent, or roughly $160,000. This could affect a planned 52-bed nursing facility expansion. Second, the number of residents diagnosed with Alzheimer's and related dementia is on the rise, placing added strain on the Home's around-the-clock medical and nursing care staff. Presumably, at some point, if it has not already indeed happened, the extraordinary care these veterans require will necessitate the hiring of additional staff for the nursing home portion of the facility. Third, and last, the statutory authority that guides the allocation of resident assessment fees between the Home's operating expense and capital budgets is very inflexible. Current law restricts the ability of the Home to easily move funds between the two budgets as priorities and needs change.

Let's close this rare discussion of the Home's GRF disbursements by painting its broader picture. The Home is a residential medical and nursing care facility for Ohio veterans located in Sandusky (Erie County). It opened as the Ohio Soldiers and Sailors Home in 1888 to provide a home for the state's honorably discharged Civil War veterans who were disabled or unable to care for themselves and was subsequently renamed the Ohio Veterans' Home in 1979. The Home features a long-term care facility and an independent living-oriented domiciliary that together house close to 600 residents at any given time. Full- and part-time employees number well over 500, with close to 300 being nursing staff. Total annual appropriations run between $25 million to $27 million; 60 percent of that support comes from the GRF and another 25 percent or so is generated by fees charged to the residents. Federal VA funds fill the remainder. ❑

Numerous colleagues here at the LBO have contributed to the development of this issue, including, in alphabetical order, Ogbe Aideyman, Laura Bickle, Deborah Gavlik, Steve Mansfield, Chuck Phillips, Jeffrey M. Rosa, Roberta Ryan, and Wendy Zhan.

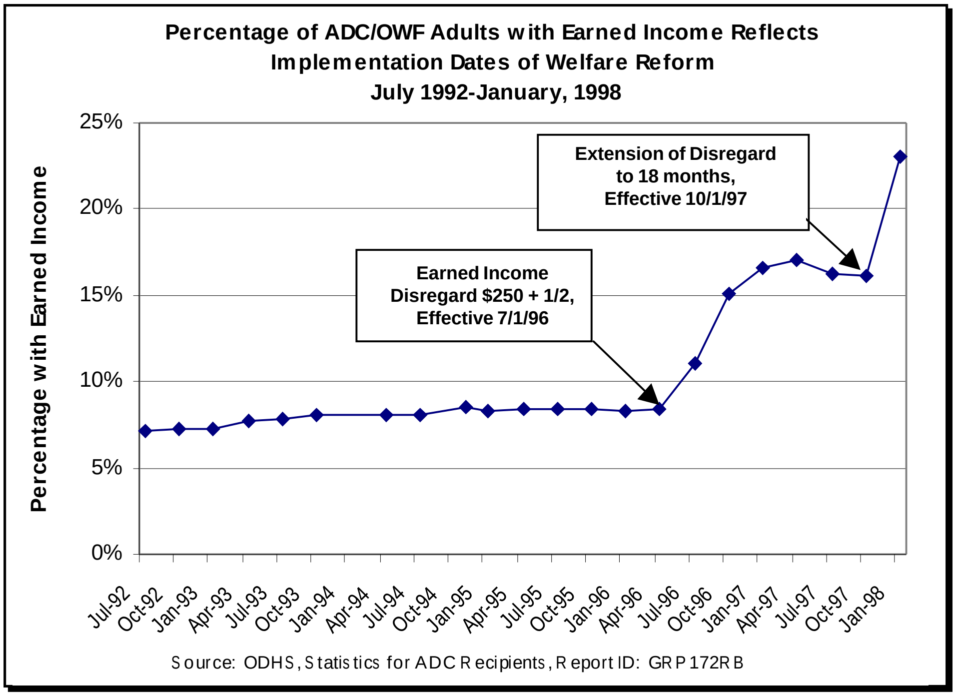
Ohio Facts Extra!

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.

Percentage of ADC/OWF Adults with Reported Earned Income Reflects Implementation Dates of Federal and State Welfare Reform

— *Steve Mansfield*

One of the key elements of welfare reform has been the introduction or enhancement of "income disregards" where after first qualifying to receive benefits, a recipient can go to work and keep part of their earned income without losing a corresponding amount of the welfare benefit. The accompanying chart illustrates a correspondence between the implementation dates of welfare reforms in Ohio and reports of earned income. Key points of reform are:



- The federal Family Support Act of 1988 provided for an earned income disregard of $90 per month for work expenses, the first $30 of income for 12 months, and 1/3 of remaining income for 4 months.
- Ohio H.B. 167 increased income disregards to the first $250 and 50 percent of the remaining income for 12 months, effective with Federal waiver July 1, 1996.
- Ohio H.B. 408 extended the $250 + 1/2 disregard from 12 to 18 months, effective October 1, 1997. ❑