Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE MAY, 1998

FISCAL OVERVIEW

— *Frederick Church*

The three biggest stories in April were the income tax, the income tax, and the income tax. The numbers are mind-boggling. GRF income tax receipts were $290.3 million above the estimate in April. This pushed the year-to-date overage to $456.0 million. Year-to-date collections are almost 10 percent over the estimate, and year-over-year growth is 15.2 percent. All components of the income tax show strong to phenomenal growth (employer withholding has grown by 9 percent, while annual payments of tax due are up 90 percent from last year). The first reaction from OBM and LBO was stunned disbelief. The second reaction was: "it must be timing — somehow the refunds all got held up, or all the tax due payments were processed early, or both." However, a closer analysis of the April data, in combination with preliminary May data, suggests that this is not true. The third reaction has been a frantic scurrying about for explanations. We obviously don't completely understand what has happened. Other states are in the same situation, and also are trying to figure out exactly where their windfall revenue comes from, how much is temporary, and how much is permanent.

The other state fiscal news in April was also good, although of course it was eclipsed by what happened in the income tax. The sales tax continued its string of steady overages, finishing $20.8 million above the estimate. Both the auto and the non-auto components of the tax outperformed the estimate in April. For the year, collections are $77.3 million above the estimate. The corporate franchise tax was $18.5 million short, but the combined March-April collections for the year's second payment were $12.2 million over the estimate. Year-to-date collections are within $1 million of the estimate, and it appears likely that there will be a small overage in the third payment, and thus a small overage for the year. The public utility excise tax has maintained its $21.4 million overage.

There was not much action in non-tax income in April, outside of federal grants. GRF federal revenues were $51.1 million below estimate, bringing the year-to-date shortfall to $405.5 million. The shortfall continues to exceed total human services underspending, which continues to strike us at the LBO as counterintuitive, although few seem to agree with us. TANF alone accounts for about $217 million of the foregone federal revenue, as Ohio has spent state GRF money and child support money to meet its maintenance of effort (MOE) requirements. In May and June, the state will go back to drawing federal money for TANF, and may actually spend more than the estimated amounts. Whether that will eat into the federal revenue shortfall is unclear.

Volume 21, Number 8

STATUS OF THE GRF

Revenues 189
- State surplus $752 million better than originally forecasted
- Income tax overage grows to mind boggling $456 million
- Sales tax overage makes some noise, now up to $77 million
- Federal grant and reimbursement money continues to free fall

Disbursements 193
- Reality Stomps April Estimate
- Underspending Balloons, But Caution in the Air
- Conventional Wisdom: Underspending Spells Less Federal Revenue . . . Well Not Quite
- Tax Relief's Oversized Load Can't Negotiate Exit Ramp
- Old K-12 Money Gathers Dust?

ISSUES OF INTEREST

TANF Reserve Funds.......... 201

LBO, Sampling, and Statistical Inference 206

OHIO FACTS EXTRA!

First Edition Copies Still Available............................. 207

Virtually LBO 208

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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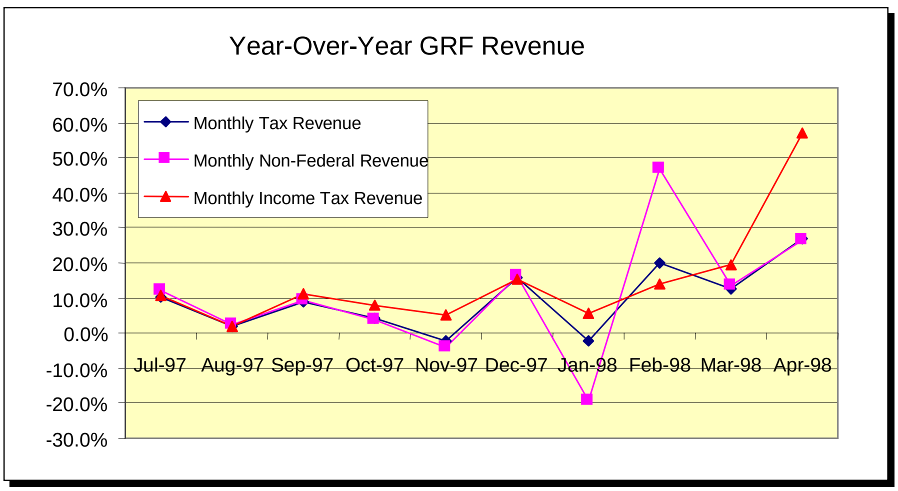
TABLE 1
General Revenue Fund
Simplified Cash Statement
($ in millions)

	Month of April	Fiscal Year 1998 to Date	Last Year	Difference
Beginning Cash Balance	$383.1	$1,367.7		
Revenue + Transfers	$1,787.4	$14,744.4		
Available Resources	$2,170.5	$16,112.1		
Disbursements + Transfers	$1,335.2	$15,276.8		
Ending Cash Balances	**$835.3**	**$835.3**	**$648.5**	**$186.8**
Encumbrances and Accts. Payable		$387.8	$302.5	$85.3
Unobligated Balance		**$447.5**	**$346.0**	**$101.5**
BSF Balance		$862.7	$828.3	
Combined GRF and BSF Balance		**$1,310.2**	**$1,174.3**	**$135.9**

Thanks to the huge growth in the income tax, tax revenues are $564.5 million over the estimate. Growth from last year is 9.2 percent. Total non-federal revenue is $653.3 million over the estimate, with growth of 7.7 percent. In spite of the massive shortfall in federal grants, total GRF revenue is $247.7 million above the estimate, and has grown by 4.2 percent from last year. To get an idea of how much of an outlier the April result is, the graph below shows year-over-year growth of income tax revenue, total tax revenue, and total non-federal revenue for each month of fiscal year 1998.



On the spending side, there were four categories that were significantly below the estimate in April. First, TANF was $51.7 million below estimate, as the Department of Human Services (HUM) spent state GRF dollars and child support collection dollars to meet the MOE for FY 1998. The April underspending pushed year-to-date TANF disbursements $229.5 million below the estimate. Now that the state has spent its MOE requirement, it can resume drawing federal grant money for the last two months of FY 1998. Although caseloads are still declining, HUM is estimating that spending will actually exceed the estimate in May, and perhaps in June as well. This appears to be the result of the estimates for May and June being rather low (the estimates of cash assistance spending are approximately $41 million and $32 million, respectively, rather than the $67.5 million that the state has been averaging over the first 10 months. The year-to-date shortfall will shrink this some, but the year end balance will depend on the department's programming and reserving decisions.

The aggregated human services category, containing Mental Health (MH), Mental Retardation and Developmental Disabilities (MR), and "Other Human Services" was $30.4 million below estimate in April. Almost all of the underspending was in MH/MR, and seems to be the result of late subsidy payments to community mental health centers and late payments for community residential services.

Higher education spending was $29.0 million below estimate. The official word on this variance is that it is a timing matter, in which Ohio Instructional Grant (OIG) payments have been delayed. This may be so, but the cash flow does not seem to have been straightened out in the first part of May.

Finally, rather than catching up to the estimate, property tax relief fell even further behind in April. The $69.8 million underspending for the month pushed the year-to-date underspending total to $143.7 million. Disbursements through both the education (distributions to school districts) and taxation (distributions to local governments) line items are well below the estimate. Interestingly, the Department of Education received an audit finding in August, which stated that the department should be verifying the numbers the county auditors are forwarding for the property tax rollbacks. Since then, education gets a certification of the numbers from the tax department and then the education department processes the paper. An education department spokesperson stated that the department is current on all certifications passed to them from the tax department, so the holdup seems to be on the tax department or local county side. LBO does not know whether there has been some delay within the tax department or in the submission of paperwork by the counties.

For the year, four categories make up approximately 80 percent of the underspending: TANF, Medicaid, property tax relief, and primary and secondary education. These four spending categories account for almost $551 million of the $688 million in underspending (excluding transfers). We still expect property tax relief to come close to the estimate by year's end. The variances in the other three programs are not timing matters. As stated above, TANF spending is expected to exceed the estimate in the last two months and shrink the variance somewhat, but it will probably still end up around $200 million under. Medicaid spending has been very close to the estimate for the last two months, but the $109 million year-to-date variance may increase some more by year's end, helped by prescription drug rebates and continued low HMO utilization.

LBO has been speculating over the past several months about how much of the primary and secondary education variance is timing. As the year draws toward a close and the underspending stays in the $65 million to $70 million range, the answer appears to be that very little is timing. Most of the underspending (about $40 million) is in special education and vocational education. The department of education's estimates of salary increases per unit turned out to be somewhat high. In past years, rather than lapsing dollars, the department would often encumber unspent special education and vocational education money for possible contingencies on unit approvals, which sometimes meant that then the next year's appropriations would go partially unspent and there would be a sort of rolling lapse of funds. In this case, the surpluses may be too large to fully encumber for contingencies.

Previous issues of this report have emphasized the size of the unspent TANF money — the reserve held with the federal government. The point was to illustrate that Ohio has reserves in addition to those in the Budget Stabilization Fund (BSF). However, this should not be interpreted as meaning that the TANF reserve is free money that can be used for any purpose. The money is clearly reserved for TANF eligibles, and the services that can be provided (e.g. in education of disadvantaged children) are restricted. In addition, the reserve is likely to get somewhat smaller in the wake of the Governor's announcement of the TANF Employment and Training program (which is being developed in lieu of accepting a Welfare-to-Work grant from the federal government). An article later in this report has a detailed analysis of the TANF reserve funds and the revised Human Services budget plan. Among other things, this article shows that the size of the reserve is not "excessive" in the sense that an average recession could boost caseloads enough, over an extended period, to eat up the available money.

Simplified Summary of Current-Year Revenues and Spending

Non-Federal Revenue, Excluding Transfers Other Than Liquor Profits	$613.0
State Spending, Net of Federal Dollars and Transfers	$282.6
Adjustment for Property Tax Relief	($143.7)
Current Year State Surplus Relative to Forecast	$751.9

Questions directed at the LBO in recent months have indicated that some readers of this report would prefer 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 below presents a summary of current year revenues and spending that shows that the state is doing about $751.9 million better than expected at the beginning of the year. Just two months ago, this figure was only $280 million.

With the work on HB 770, the education and budget corrective bill, completed without any diversion of ending FY 1998 GRF surplus to school buildings (nothing in addition to the $200 million for buildings and solvency assistance already in HB 650) it now appears that the tax year 1998 income tax cut will be quite large. The tax cut could be 8 percent or more. There is an interesting symmetry to this year's results, then, as the unexpected income tax windfall will lead to a large income tax cut for the following 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. ❑

Status of the General Revenue Fund

REVENUES

— *Frederick Church*

As the fiscal overview should have made clear, the income tax overage dominates the revenue news. The income tax was $290.3 million over the estimate in April, as all components of the tax came in far above the forecast. For the year, the income tax is $456.0 million above the estimate. Year-over-year growth in the tax is 15.2 percent. Collections are 9.9 percent over the estimate, meaning that the percentage forecast error is larger than the raw growth number for the other tax sources. This is truly an exceptional occurrence.

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

REVENUE SOURCE			
TAX INCOME	Actual	Estimate*	Variance
Auto Sales	$68,506	$65,170	$3,336
Non-Auto Sales & Use	394,052	376,622	17,430
Total Sales	$462,558	$441,792	$20,766
Personal Income	$865,320	$575,037	$290,283
Corporate Franchise	103,319	121,821	(18,502)
Public Utility	(433)	0	(433)
Total Major Taxes	**$1,430,764**	**$1,138,650**	**$292,114**
Foreign Insurance	$120	$0	$120
Domestic Insurance	0	0	0
Business & Property	37	465	(428)
Cigarette	25,757	26,282	(525)
Soft Drink	0	0	0
Alcoholic Beverage	4,318	4,343	(25)
Liquor Gallonage	2,126	2,160	(34)
Estate	28,608	30,318	(1,710)
Racing	0	0	0
Total Other Taxes	$60,966	$63,569	($2,603)
Total Taxes	**$1,491,730**	**$1,202,218**	**$289,512**
NON-TAX INCOME			
Earnings on Investments	$0	$0	$0
Licenses and Fees	3,502	4,038	(536)
Other Income	7,694	2,873	4,821
Non-Tax Receipts	$11,196	$6,911	$4,285
TRANSFERS			
Liquor Transfers	$0	$5,000	($5,000)
Budget Stabilization	0	0	0
Other Transfers In	6,307	0	6,307
Total Transfers In	$6,307	$5,000	$1,307
TOTAL INCOME less Federal Grants	**$1,509,233**	**$1,214,129**	**$295,104**
Federal Grants	$278,163	$329,306	($51,143)
TOTAL GRF INCOME	**$1,787,396**	**$1,543,435**	**$243,961**

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

Detail may not add to total due to rounding.

LBO now forecasts that by year's end, growth will have subsided somewhat from the current 15.2 percent pace. Year-end collections will probably end up being 13.5 percent to 14.0 percent above FY 1997. To put this in perspective, since FY 1984, when the last major legislated increases in the income tax had played out, and the high inflation of the 1970s had been mostly wrung out of the economy, there have been only two fiscal years where income tax revenue growth exceeded 13 percent. In FY 1989, income tax revenue growth was 13.2 percent. Growth was somewhat inflated that year by the implementation of an accelerated withholding schedule. In FY 1987, income tax growth was 15.9 percent. Growth that year was largely the result of the Federal Tax Reform Act of 1986 (TRA 86), which cut federal tax rates but also broadened the base. In tax year 1986 there were huge realizations of capital gains as taxpayers scrambled to take stock market profits before the 50 percent exclusion was eliminated and the federal tax rate for most taxpayers with gains rose from 20 percent to 28 percent. The tax base grew by so much that Ohio realized big gains in spite of the fact that state tax rates were cut in anticipation of the federal windfall.

The FY 1998 result does not look exactly like either FY 1987 or FY 1989. Like FY 1987, this year's result is partly the result of federal tax changes, although in this case

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	$584,412	$559,776	$24,636	$551,865	5.90%
Non-Auto Sales & Use	3,778,540	3,725,872	52,668	3,568,984	5.87%
Total Sales	$4,362,952	$4,285,648	$77,304	$4,120,849	5.88%
Personal Income	$5,080,385	$4,624,360	**$456,025**	$4,410,076	**15.20%**
Corporate Franchise	822,773	823,743	(970)	815,492	0.89%
Public Utility	451,824	430,453	21,371	426,714	5.88%
Total Major Taxes	$10,717,934	$10,164,204	$553,730	$9,773,131	9.67%
Foreign Insurance	$290,693	$295,126	($4,433)	$285,172	1.94%
Domestic Insurance	678	440	238	224	202.77%
Business & Property	522	1,954	(1,432)	1,582	-67.03%
Cigarette	233,735	231,236	2,499	233,963	-0.10%
Soft Drink	0	0	0	19	-100.00%
Alcoholic Beverage	43,001	41,326	1,675	42,519	1.13%
Liquor Gallonage	22,861	22,565	296	22,615	1.09%
Estate	91,710	79,819	11,891	86,520	6.00%
Racing	0	0	0	0	#N/A
Total Other Taxes	$683,199	$672,467	$10,732	$672,615	1.57%
Total Taxes	**$11,401,133**	**$10,836,670**	**$564,463**	**$10,445,746**	**9.15%**
NON -TAX INCOME					
Earnings on Investments	$99,333	$58,660	$40,673	$71,943	38.07%
Licenses and Fees	33,474	61,917	(28,443)	61,847	-45.88%
Other Income	83,695	53,923	29,772	68,499	22.18%
Non-Tax Receipts	$216,502	$174,500	$42,002	$202,289	7.03%
TRANSFERS					
Liquor Transfers	$64,000	$57,500	$6,500	$55,500	15.32%
Budget Stabilization	0	0	0	$0	#N/A
Other Transfers In	275,615	235,300	40,315	402,716	-31.56%
Total Transfers In	$339,615	$292,800	$46,815	$458,216	-25.88%
TOTAL INCOME less Federal Grants	**$11,957,251**	**$11,303,970**	**$653,281**	**$11,106,250**	**7.66%**
Federal Grants	$2,787,111	$3,192,644	($405,533)	3,044,323	-8.45%
TOTAL GRF INCOME	**$14,744,361**	**$14,496,614**	**$247,747**	**$14,150,573**	**4.20%**

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

Detail may not add to total due to rounding.

federal tax rates on capital gains were cut rather than increased. Unlike FY 1987, when employer withholding grew by 3.9 percent, withholding growth in FY 1998 is very strong. Through April, withholding was up 9.0 percent from last year. FY 1998 looks more like FY 1989 in that growth in the components of the income tax — estimated payments, annual returns, employer withholding — is more uniform. A more detailed analysis of the income tax is contained in the next section.

The performance of the sales and use tax has been less spectacular, but by year's end there will be a significant overage accumulated there as well. Through April the sales and use tax was $77.3 million over estimate. Both the auto and non-auto components of the tax are doing well, with growth at 5.9 percent in both components (don't expect that kind of symmetry again any time soon). The tax's performance has picked up over the last couple of months, buoyed by a strong economy — particularly a strong labor market — and by extra discretionary cash for consumers due to mortgage refinancings. With consumer confidence dipping slightly from its historic high levels, sales may slow somewhat in the last month or two, but LBO expects that the sales tax will still make the estimate in those months, so that the year-end overage will end up in the $75 million to $80 million range.

There is little new to report in the other taxes, or in non-tax income, since last month. Federal grant and reimbursement money continues to free-fall, and it seems unlikely that the switching of TANF spending to drawing federal dollars in the last two months will have much impact on the shortfall, which stands at $405.5 million and may hit the $450 million to $500 million range by year's end.

Personal Income Tax

Withholding is no longer the star income tax component: annual tax payments now have far and away the biggest overage. The table below shows each of the key components of the income tax through April.

FY 1998 Year-to-Date Income Tax Collections, by Component
amounts in milions of dollars

	Actual	Estimate	Variance	Yr-Over-Yr Growth
Employer withhholding	$4,737.8	$4,592.7	$145.1	9.0%
Quarterly estimated payments	$1,068.4	$955.7	$112.7	16.6%
Annual Tax Payments	$459.3	$245.0	$214.3	90.3%
Refunds	($620.1)	($656.1)	$36.0	0.3%
Total Major Components	$5,645.4	$5,137.3	$508.1	
Total All Components	$5,681.1	$5,166.9	$514.2	15.2%
Total GRF Amount	$5,080.4	$4,624.4	$456.0	15.2%

At this point we still cannot explain the growth in withholding through growth in employment and wages. As in prior issues of this report, we can only offer hypotheses that growth in stock option compensation might be a contributing factor, since the receipt of options (as distinct from their exercise) is treated as ordinary income rather than capital gains, and so are reflected in increased withholding payments rather than in quarterly estimated payments. Late-year employee bonuses may also be factor in explaining the very high withholding growth in November and December, but cannot explain the double-digit growth in March and April.

In some sense we actually have two anomalies to explain in withholding. In FY 1996 and FY 1997 Ohio withholding growth was less than one would have expected given the underlying labor market numbers. The concern was that in such good economic times, we had withholding growth of only 5.5 percent in FY 1996 and 6.5 percent in FY 1997. Now, the rebound has come, but rather than returning to the 8.0 percent growth of FY 1994 and FY 1995, we have returned to a growth path that is a full percentage point higher. Since withholding represents more than 80 percent of Ohio income tax collections, despite the fact that there is more "splash" associated with the lumpier estimated payment and annual tax payment streams, this is a very important puzzle to solve in the coming months.

At this point we do not have that much to say about the phenomenal April result in annual tax payments. First, we believe that the overage is real: it is not going to be partially offset by a significant shortfall in May or June. Second, Ohio has company in that other states are reporting similar "off the charts" revenue growth in April (next month LBO will have some additional information on other states). Third, we have the usual menu of explanations: bonuses, realization of capital gains through mergers and acquisitions, changes in business structure from Subchapter C corporations (which pay the Ohio franchise tax) to LLCs, partnerships, and S-corporations that pay the income tax, and individual realization of capital gains. Essentially, all the revenue analysts in all the states have the same roster of explanations, but all of them also are unable to quantify how much of the revenue overage comes from which component.

LBO is often hesitant to use the capital gains explanation for swings in Ohio revenues, since federal tax data shows that capital gains have historically represented only about 2.5 percent to 3.0 percent of Ohio federal adjusted gross income (FAGI).[1] However, in this instance we would say that the following facts are at least suggestive:

1. Taxpayers have been waiting years — ever since TRA 86 in some cases — for a federal cut in the capital gains tax.
2. In the interim, while taxpayers were waiting for a cut, the stock market had huge increases in value. Many areas in the country have also had strong increases in real estate values.

3. The switch from C-corporation status to unincorporated business organization means that many business capital gains will now show up as gains to individuals paying the income tax.

4. More and more employees are taking at least part of their compensation in the form of stock options or stock distributions.

When these factors are examined together, it appears that capital gains realizations have to be acknowledged as at least the preliminary front-runner as the explanation for the increase in Ohio income tax collections. In the coming months, as more information becomes available from the federal government and from other states, we hope to be able to speak more definitively about what has happened in the past, and thus have a better grasp of what is likely to happen in the future.

Finally, the quarterly estimated payment for April was $70 million over the estimate. Since this was actually the first estimated payment against tax year 1998 liability, this indicates that taxpayers seem to feel that their liability in tax year 1998 will also be high. While it is very early to make pronouncements about FY 1999, this seems to bode well for FY 1999 collections, barring a year-end surprise when taxpayers discover that they have overestimated their liability and overpaid on their quarterly estimates.

Sales and Use Tax

The national and regional evidence on what to expect in the sales tax in the coming months are somewhat mixed. LBO has been bullish in previous issues of this report, citing the obvious factors: a very strong labor market with growth in employment and wages, low unemployment rates and a stronger feeling of job security than workers have had in the last several years, low and stable inflation, relatively low interest rates, mortgage refinancing putting additional money in consumers pockets, booming financial markets increasing consumers' wealth. There are a host of factors that argue that consumption growth and sales tax growth should continue to be strong. A small note of pessimism has crept in over the last month. Major Asian economies are in trouble, the financial markets have been fluctuating since the FOMC minutes were released, and consumer confidence has finally dipped. This brings a note of caution to the retail sales outlook.

However, the Federal Reserve's most recent ***Beige Book*** (released May 6th) for the Fourth District reveals that district retailers have become quite optimistic. March and April sales were much better than they had expected, and for the April — June quarter projections for growth range from 2.5 percent all the way up to 10 percent. The biggest gainers are expected to be discount stores, because consumers are still very price conscious. A contributing factor in retail optimism is the fact that prices from suppliers are not rising (the Producer Price Index (PPI) data shows this), and inventory levels are thought to be about right. At the national level, there was some inventory buildup that contributed to the high first quarter GDP growth, but it appears that most of that additional inventory is being held at the manufacturer level. Interestingly, some economic forecasting firms are predicting that inventory growth should moderate in the remainder of CY 1998 but then surge again in CY 1999, as manufacturers and retailers stockpile some inputs and goods as a hedge against possible supply problems due to the "Year 2000 problem."

In the auto market, Ohio's sales tax rebounded with a big overage in March and a smaller overage in April despite fairly weak national sales figures. Correspondingly, district retailers report that vehicle sales in Ohio and other parts of the district were strong in March and April, showing sizable year-over-year growth. Most dealers expect sales in the coming months to be up significantly from last year. ❑

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[1] This is somewhat misleading because the IRS data is for Ohio residents, while Ohio's income tax also applies to nonresidents, many of whom pay the tax because they are investors in Ohio businesses. These taxpayers tend to have high income and large capital gain realizations.

DISBURSEMENTS

— *Jeffrey E. Golon**

Reality stomped on last month's tennis analogy with a vengeance as the month of April streaked to the net and hammered a huge ball of underspending into our analytic forehead. Ouch! Game, set, match, end of analogy. Quite simply, a four-month volley of overages and underages came to a screeching stop with an enormous $189.9 million negative disbursement variance for the month of April. As a result of this very large underage, excluding GRF transfers, FY 1998's year-to-date underspending ballooned all the way up to $688.1 million, easily eclipsing the year's previous high water mark for underspending set just last month — $498.2 million.

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

USE OF FUNDS			
PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$334,430	$332,066	$2,364
Higher Education	217,864	246,815	(28,951)
Total Education	$552,294	$578,881	($26,587)
Health Care	$417,881	$422,246	($4,365)
Temporary Assistance to Needy Families	26,129	77,855	(51,726)
General Assistance/Disability Assistance	5,270	5,183	87
Other Welfare	31,939	36,265	(4,326)
Human Services (2)	51,661	82,067	(30,406)
Total Welfare & Human Services	$532,880	$623,614	($90,734)
Justice & Corrections	$130,852	$138,903	($8,051)
Environment & Natural Resources	6,687	6,013	674
Transportation	4,584	1,319	3,265
Development	5,612	8,310	(2,698)
Other Government (3)	22,626	17,972	4,654
Capital	184	776	(592)
Total Government Operations	$170,545	$173,293	($2,748)
Property Tax Relief (4)	$79,476	$149,299	($69,823)
Debt Service	0	0	0
Total Program Payments	**$1,335,195**	**$1,525,087**	**($189,892)**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	0	0	0
Total Transfers Out	$0	$0	$0
TOTAL GRF USES	**$1,335,195**	**$1,525,087**	**($189,892)**

(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 rollbacls, 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.

Year-to-Date. Seventy per-cent of the $688.1 million year-to-date negative disbursement variance was traceable to three state programs: Temporary Assistance to Needy Families/ TANF ($229.5 million), Property Tax Relief ($143.7 million), and Health Care/ Medicaid ($109.0 million). Two facets of this underspending were most notable. First, property tax relief distributions planned for the months of March and April appeared to be nothing more than victims of timing, with the result being actual disbursements that were dramatically lower than estimates. An identical scenario sorted itself out last fall, and we would fully expect the current delay to resolve with time as well.

Second, of the year-to-date underspending in TANF and Medicaid programs combined ($338.5 million), 83 percent, or $280.7 million, was in the federal share of these two human services programs that are jointly funded by the state and federal government. Furthermore, a substantial portion of this underspending in the federal share — $216.8 million — was exclusively attributable to TANF.

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)	$3,752,143	$3,820,521	($68,378)	$3,431,894	9.33%
Higher Education	1,853,837	1,873,968	(20,131)	1,746,362	6.15%
Total Education	$5,605,980	$5,694,489	($88,508)	5,178,256	8.26%
Health Care	$4,325,731	$4,434,789	($109,057)	$4,124,527	4.88%
Temporary Assistance to Needy Families	710,642	940,130	(229,488)	824,553	-13.81%
General Assistance/Disability Assistance	49,433	54,846	(5,413)	112	44036.94%
Other Welfare	340,417	361,381	(20,963)	451,113	-24.54%
Human Services (2)	919,816	943,095	(23,280)	886,777	3.73%
Total Welfare & Human Services	$6,346,040	$6,734,243	($388,203)	$6,287,082	0.94%
Justice & Corrections	$1,301,649	$1,316,001	($14,352)	$1,202,594	8.24%
Environment & Natural Resources	108,241	101,607	6,634	94,071	15.06%
Transportation	26,281	32,519	(6,238)	24,731	6.27%
Development	97,512	113,454	(15,942)	104,580	-6.76%
Other Government (3)	302,511	340,799	(38,288)	306,745	-1.38%
Capital	3,796	7,364	(3,569)	6,863	-44.70%
Total Government Operations	$1,839,991	$1,911,746	($71,755)	$1,739,585	5.77%
Property Tax Relief (4)	$613,455	$757,158	($143,703)	$725,116	-15.40%
Debt Service	106,594	102,560	4,034	94,883	12.34%
Total Program Payments	**$14,512,061**	**$15,200,196**	**($688,135)**	**$14,024,921**	**3.47%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$0	—
Budget Stabilization	34,400	34,000	400	0	—
Other Transfers Out	730,343	686,766	43,577	615,673	18.63%
Total Transfers Out	$764,743	$720,766	$43,977	$615,673	24.21%
TOTAL GRF USES	**$15,276,804**	**$15,920,962**	**($644,158)**	**$14,640,594**	**4.35%**

(1) Includes Primary, Secondary, and Other Education
(2) Includes Mental Health, Mental Retardation and Developmental Disabilities, and Other Human Services
(3) Includes Regulatory and Nonregulatory agencies, Pension Subsidies, and Reissued Warrants.
(4) Includes property tax rollbacls, 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.

Once the federal money associated with TANF and Medicaid was backed out, the year-to-date underspending in non-federal state money was reduced to $407.4 million.

And to complicate one's thinking a little more, between the federal underspending in the TANF and Medicaid programs lies a key difference. By year's end, any unspent federal TANF money really represents money the state will have earned by meeting its required maintenance of effort (MOE). This is money that the state can essentially bank for future use on TANF-related activities. On the other hand, Medicaid is a reimbursement program in which the federal government pays the state back for a portion of actual costs incurred. In this case, the state must spend a $1 of its own money to earn generally around $0.58 in federal financial reimbursement. Critical to remember on this point as well is that an underage in Medicaid expenditures also translates into a revenue underage as less federal money is gained than was originally assumed.

April. Turning to the month just completed, its rather sizeable $189.9 million underage was largely driven by two state programs: Property Tax Relief ($69.8 million) and TANF ($51.7 million). These two programs were already identified as two of the three primary culprits behind year-to-date underspending as well. Together, the two state programs consumed 64 percent of April's negative disbursement variance. With regard to property tax relief, timing struck hard for the second month in a row, but as this money constitutes state compensation to local governments, including school districts, for lost tax revenue it will eventually be distributed. In the matter of TANF, all of the monthly underspending was located in the program's federal component, as the state has been focused on meeting its required maintenance of effort (MOE). By the close of April, the state had largely met its MOE, which meant that we should witness a pile of federal TANF money flowing out the door in May and June.

Although a recent intense flurry of pre-summer legislative activity consumed much of our collective body and spirit, we did still manage to uncover some disbursement material worthy of comment. So read on.

Primary and Secondary Education

Department of Education. Monthly spending for the Department of Education was $6.1 million, or 1.9 percent, over the estimate. Notable in their contributions to this overspending were: 1) $5.7 million in Head Start — due to timing; 2) $2.2 million in Public Preschool — due to timing; 3) $5.1 million in basic aid from current FY 1998 appropriations — also due to timing and partially offsetting earlier underspending; 4) $2.4 million in Vocational Education — due to timing; and 5) $3.2 million in Desegregation Costs — again due to timing.

Obviously, if one were to do the math, the above-noted line item overages totaled around $19 million, while the departmental overage was a much smaller $6.1 million. Clearly then, other line items had to have underspent relative to estimates, thus driving the size of the departmental overage down. Notable in their contributions to offsetting the total departmental overage for the month were: 1) $1.1 million in Teacher Recruitment — also due to timing; 2) $1.8 million in Student Proficiency — timing; 3) $1.4 million in EMIS, — timing; 4) $3.7 million in basic aid from previous years' encumbrances — in part timing, but may also reflect potential non-spending; 5) $1.5 million in bus purchases — timing; and 6) $3.5 million in special education — timing.

Also inside the Primary and Secondary Education program category, one state agency in particular — the Office of Information, Learning, and Technology Services — underspent for the month to the tune of $2.96 million, which softened the department's monthly overage and cut the program category's monthly overage down to $3.1 million.

Year-to-date, the Primary and Secondary Education program category was under estimate by $67.4 million, with the Department of Education's underage in the clear lead at $65.2 million. However, the major part of this underspending (nearly $60 million) was due to prior fiscal years' encumbrances that have yet to be disbursed. In other words, the department has a chunk of unspent GRF money on the books that it was allowed to carry forward from previous fiscal years with the intent that those moneys be disbursed in FY 1998. If the department were to lapse any GRF money at the end of FY 1998, it will most likely come from these prior fiscal years' encumbrances that, for whatever reason, can't seem to find the door. The spending of current fiscal year appropriations (FY 1998) was only a minor player in this year-to-date disbursement story.

Although final computations have not yet been made, the department is expecting balances of approximately $20 million each in the Special Education (200-504) and Vocational Education (200-507) line items. The department expects to go to the Controlling Board to ask that these anticipated excess funds be transferred to the Basic Aid line item (200-501), to be used for two purposes: 1) special and vocational education recomputation; and 2) paying for the Section 3317.026 adjustment. Special and vocational education recomputation is a calculation made by the department to ensure that districts are not penalized financially for counting special and vocational education students in units rather than as a part of a district's average daily membership. The Section 3317.026 adjustment allows school districts to receive payments based on the recalculation of the foundation formula taking into account refunds of tangible personal property taxes. The department is not yet sure how much this adjustment will cost, but reports that approximately 25 districts are eligible for the payment.

The department also reports that

instead of the amounts that would have been distributed through formula, the amounts distributed for Pupil Transportation (line item 200-502) and Disadvantaged Pupil Impact Aid (line item 200-520, DPIA) were reduced so that the expenditures would stay within appropriations. The department also plans to ask the Controlling Board for authority to use the available balances in other departmental line items to make the full transportation and DPIA payments.

Health Care/Medicaid

While the clock, as well as life itself for most of us, sprang forward during April, Medicaid spending fell backward into more familiar territory by posting a negative disbursement variance, though it must be noted that a $4.4 million underage in the face of monthly Medicaid spending that totaled $417.9 million is pretty small potatoes in the scheme of things. This negative monthly disbursement variance reversed two previous months of unexpected overages and drove Medicaid's year-to-date underspending up to $109.0 million, which was 2.5 percent below the year-to-date disbursement estimate. (For more detail on monthly and year-to-date Medicaid spending, see Table 6.)

Although Medicaid's total underspending for the month was relatively small, it in fact masked more significant variances that occurred among the program's varied service categories. That said, payments for HMO services for TANF eligibles continued its fiscal year pattern of underspending to the tune of $23.8 million in April. Spending on Hospitals also fell short of the estimate by $5.4 million, with inpatient and outpatient hospital care accounting for $3.4 million and $2.0 million of the underspending, respectively.

Meanwhile, on the other side of the spending ledger, disbursements for Prescription Drugs posted an overage in April, exceeding their monthly estimate by $26.7 million. On the surface, total spending on Prescription Drugs (Payments minus Rebates) seemed significantly out of line for the month of April, but a closer look at the two prescription drugs subcategories — Payments

Table 6

Medicaid (400-525) Spending in FY 1998

	April '98				Year-to Date Spending			
Service Category	**Actual**	**Estimate**	**Variance**	**Percent Variance**	**Actual** thru' April**	**Estimate** thru' April**	**Variance**	**Percent Variance**
Nursing Homes	$171,909,636	$164,096,620	$7,813,016	4.8%	$1,586,197,314	$1,538,923,596	$47,273,718	3.1%
ICF/MR	$28,498,173	$28,823,309	($325,136)	-1.1%	$284,114,272	$285,383,587	($1,269,315)	-0.4%
Hospitals	$80,539,539	$85,913,200	($5,373,661)	-6.3%	$962,707,894	$987,514,920	($24,807,026)	-2.5%
Inpatient Hospitals	$64,116,622	$67,470,079	($3,353,457)	-5.0%	$746,368,667	$766,149,285	($19,780,618)	-2.6%
Outpatient Hospitals	$16,422,917	$18,443,121	($2,020,204)	-11.0%	$216,339,227	$221,365,635	($5,026,408)	-2.3%
Physicians	$20,429,894	$21,319,794	($889,900)	-4.2%	$233,506,979	$236,971,111	($3,464,132)	-1.5%
Prescription Drugs	$45,181,782	$18,496,259	$26,685,523	144.3%	$436,623,311	$374,231,288	$62,392,023	16.7%
Payments	$51,712,379	$43,532,096	$8,180,284	18.8%	$520,954,847	$480,168,488	$40,786,360	8.5%
Rebates	$6,530,598	$25,035,837	($18,505,239)	-73.9%	$84,331,536	$105,937,200	($21,605,664)	-20.4%
HMO	$36,187,633	$59,997,554	($23,809,921)	-39.7%	$432,533,311	$558,010,289	($125,476,978)	-22.5%
Medicare Buy-In	$10,169,788	$10,169,788	$0	0.0%	$101,820,245	$108,672,349	($6,852,104)	-6.3%
All Other***	$25,185,793	$33,429,080	($8,243,287)	-24.7%	$287,462,972	$345,074,811	($57,611,839)	-16.7%
TOTAL	$418,102,237	$422,245,604	($4,143,367)	-1.0%	$4,324,966,298	$4,434,781,951	($109,815,653)	-2.5%
CAS	$417,881,369		($4,364,235)	-1.0%	$4,325,732,149		($109,049,802)	-2.5%
Est. Federal Share	$243,179,050	$245,588,939	($2,409,889)		$2,515,693,240	$2,579,564,902	($63,871,662)	
Est. State Share	$174,923,187	$176,656,665	($1,733,478)	-1.0%	$1,809,273,058	$1,855,217,049	($45,943,991)	-2.5%

* 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.

and Rebates — led us to conclude otherwise. We sensed that the element of timing was afoot here. As stated in earlier publications of ***Budget Footnotes***, for every $1 spent on prescription drugs, the Medicaid program is rebated about $0.20 from drug manufacturers. Usually, the majority of the rebates arrive in the first month of the quarter, but for April (the first month of fourth quarter FY 1998) rebates were abnormally low.

We estimate that about $19.0 million in anticipated rebates for the month of April did not hit the system, and, as a result, would expect these rebates to arrive a month later than was originally assumed. Under normal circumstances, May rebates would amount to about $1.0 million or less.

Had this $19.0 million in rebate moneys landed as expected, April's total Prescription Drugs spending would have been reduced from $45.2 million to around $26.2 million. (Remember that rebates in effect serve as a form of credit against payments, thus cutting actual monthly spending.) This would have knocked the monthly overage in Prescription Drugs spending from $26.7 million down to $7.7 million. That result would have driven the year-to-date underspending in Medicaid well past $109.0 million to a much larger $128.8 million.

All of this should serve as a reminder once again that when it comes to making sense of Medicaid spending time is well spent in trolling through the details that lie below the surface of things.

TANF

The disbursement variance in the TANF (Temporary Assistance to Needy Families) program for April was a perplexingly large $51.7 million, or 66.4 percent, under estimate. The negative monthly disbursement variance pushed TANF's year-to-date underspending to $229.5 million, or 24.4 percent, below where the estimate assumed we would be at this point in the fiscal year. Actual monthly TANF disbursements were: $0.5 million from line item 400-410 (State TANF MOE) and $25.6 million from line item 400-411 (TANF Federal Block Grant). Given that monthly cash benefits have been averaging around $45 million for the last several months, this was, at least on first glance, a surprising and puzzling variance.

However, one of the component's of the state's TANF maintenance of effort (MOE) requirement of $411 million per year is $53.0 million that is required to be spent from the department's non-GRF Fund 4A8, Child Support Collections (line item 400-658). In April, $45.1 million was disbursed from this fund for TANF purposes. Thus, when these non-GRF disbursements were rolled in, TANF disbursements for the month were actually in excess of $70 million. In addition to cash benefits, this $70 million included funds for county administration, the PRC (Prevention, Retention, and Contingency) program, and computer upgrade projects.

Summing up the status of the various TANF components year-to-date: the Child Support Collections component (Fund 4A8) of the MOE has been met, TANF Day Care (GRF line item 400-413) has been nearly 100 percent disbursed, the state TANF MOE (line item 400-410) stands at 98 percent disbursed, and the TANF Federal Block Grant (line item 400-411) has been 56 percent disbursed. By a process of elimination over the last several months, federal funds make up almost all of the remaining available funds for TANF spending that will take place in May and June. Furthermore, we fully expect total monthly cash benefit payments alone will exceed original disbursement estimates for those two remaining months, thus producing relatively substantial overages in federal TANF spending. If that were to be the case, then a ten-month pattern of negative monthly disbursement variances will have been reversed, which will effectively reduce year-to-date underspending from its current high water mark of $229.5 million.

Another development in April that will have a significant impact on disbursements is the fact that the executive branch withdrew its plan for a Welfare-to-Work matching grant from the federal government. In its place, the executive branch announced the creation of the TANF Employment and Training program that will be funded out of unobligated federal TANF funds. Out of these funds a reserve of $88 million will be established. From this reserve, $22 million will be made available to counties in the current fiscal year.

The Department of Human Services now has reserve funds for caseload contingencies, county incentives, disaster relief, staff training, welfare-to-work programs, and the early start program. Through the end of federal FY 1997, Ohio's reserve of "unliquidated obligations" held at the federal level was $273.8 million. Measuring the size of Ohio's reserve in terms of dollars held by the federal government, at the end of federal FY 1997, Ohio ranked second, behind California.

Measuring the size of the reserve as a percentage of the grant award, Ohio ranked fourteenth. (For more information on this subject, see the piece by Steve Mansfield entitled "TANF Reserve Funds" in this issue of ***Budget Footnotes***.)

The decline in the TANF caseload continued with 5,445 fewer recipients in April than there were in March.

General Assistance/Disability Assistance

The number of recipients in the Disability Assistance (DA) program (a state- and county-funded effort which provides cash and/or medical assistance to persons ineligible for public assistance programs that are supported in whole or in part by federal funds) has been fairly stable over the last few months, hence so have DA disbursements. In fact, DA disbursements for April checked in at slightly over estimate—the first such occurrence since July of last year. Year-to-date, however, DA disbursements remain $5.4 million below estimate, largely because of earlier declines in the caseload.

Other Human Services

Health. Probably lost to most that have taken a wander through the 1,300-plus pages of Am. Sub. H.B. 215 — the main appropriations act of the 122nd General Assembly — was a small budgetary initiative calling for the establishment of an osteoporosis awareness program by the Department of Health. To support this initiative, $100,000 of GRF money was appropriated in each of FYs 1998 and 1999 (line item 440-402, Osteoporosis Awareness). As of the close of April, only $5,753 of the $100,000 FY 1998 Osteoporosis Awareness appropriation had been disbursed, with an additional $30,218 having been encumbered. What was behind this sluggish spending pace?

According to the department, several projects are actually in operation under the aegis of the Osteoporosis Awareness Program. However, since the department had yet to receive project invoices requesting payment for expenses incurred, funding had not been disbursed.

One such project involves a research contract under which Wright State University is conducting a data and literature review of osteoporosis in Ohio. Currently, much of the information available on osteoporosis tends to be very general in nature and utilizes national data. At a minimum, Wright State's research is expected to provide a baseline of the extent of osteoporosis in Ohio. The department is hopeful that this work, which is expected to cost approximately $30,000, will be concluded by the end of June.

A second project undertaken is the Netwellness website (http://www.netwellness.org). This site is a collaboration between the University of Cincinnati, The Ohio State University, and Case Western Reserve University. It provides a variety of information on various health-related topics. The Osteoporosis Awareness Program will provide moneys enabling Netwellness to provide information and resources on osteoporosis.

Finally, the department is working on a county-by-county resource guide on osteoporosis. Although this document is currently in the developmental stage, ultimately it will provide location-specific information on where women can go to find information and receive osteoporosis diagnoses and treatment. This project is being undertaken in collaboration with the Central Ohio Arthritis Foundation.

Minority Health Commission. Whilst moseying through April's human services spending, we happened upon a state agency whose monthly disbursement variance captured our attention. For starters, the monthly totals we hit looked like this: an estimated disbursement of $78,511, an actual disbursement of $372,522, ergo an overage of $294,011. The state agency in question was the Ohio Commission on Minority Health, a 7-person operation with an annual GRF budget of about $1.7 million whose mission since its creation in 1987 has been to promote health awareness and disease prevention among members of economically disadvantaged minority populations. What was the story with the commission's disbursements?

Well, since the commission only has three GRF line items, it took only a few moments to uncover the two that were the source of the monthly overage — 149-501, Minority Health Grants, and 149-321, Operating Expenses.

Roughly three-quarters of the monthly overage emanated from the Minority Health Grants line item, which carries a $1.0 million FY 1998 appropriation for the purpose of awarding grants to community-based organizations. The original OBM estimates assumed that these grant moneys would be disbursed evenly over a 12-month period, when in fact, these grant payments are largely processed on a quarterly basis and are generally reimbursements for actual reported expenditures, with the third and fourth quarters of the fiscal year being peak points for the distribution of money to grant recipients. Thus, timing was the real culprit here.

The remainder of the commission's monthly overage was attributable to the Operating Expenses line item, which checked with an actual disbursement amount of $73,000 that was almost double the original estimate of $37,147. As April has historically been designated Minority Health Month, a 30-day period in which the commission conducts a wellness campaign that features lectures, workshops, and health fairs, as well as a community recognition and awards dinner, this elevated level of monthly spending was not all that surprising. The original monthly disbursement estimate simply failed to reflect that reality.

Justice & Corrections

Attorney General. We thought that this was as an appropriate time as any to review the status of a GRF line item in the Attorney General's budget that had a rocky time of it prior to the current biennium — line item 055-406, Community Police Match and Law Enforcement Assistance. When first created in FY 1995, the line item was actually named Community Police Officers, reflecting a much narrower scope or purpose than is currently the case. At that time, temporary language attached to the money restricted its use to providing subsidies, principally to counties, municipalities, and townships, to assist those local entities in satisfying the 25 percent matching requirement necessary to access federal funds under the Community Oriented Policing (COPS) program for the purpose of hiring additional law enforcement officers. Specifically, under the program, the state provided up to 10 percent of the required match, thereby leaving the localities to come up with the remaining 15 percent.

Over the three-year period covering FYs 1995-1997, a total $18.20 million was earmarked in the Controlling Board's budget (line item 911-422) for transfer to the Attorney General to assist localities in meeting the required federal matching requirement. Of that earmarked amount, only $6.05 million was actually transferred to the Attorney General, $4.21 million of which was disbursed and $1.84 million lapsed. This meant that $12.15 million, or two-thirds, of the total $18.20 million earmark over the three fiscal years was never tapped.

Why was this earmark never fully utilized? Two factors jumped readily to mind.

First, the initial earmark in FY 1995 — $9.1 million — was probably a case of the cliched "putting the cart before the horse." The final form of the federal program itself was uncertain. Following that, the Attorney General had to put an administrative mechanism into place that could manage the money, including the processing of grant applications, and promote the grant program. And until all of those matters were resolved, there was not really anything for the local law enforcement community to apply for.

Second, once the federal and state programs were ready to go, the response from portions of the local law enforcement community was, let's just say, less than enthusiastic. Some localities simply chose not to participate in the law enforcement hiring assistance program, at least partly because they would have to assume 100 percent of the fiscal burden for these new hires once the federal grant money ran out. For localities that actually participated in the federal grant program, it appeared that some were not interested in the state's grant program. Perhaps they did not want to bother with the paperwork required to secure a state grant, while others may have found the amount of the potential state grant not worth the time and effort.

A widening in the permissible uses of this line item's funding was initiated in FY 1998, a policy change that had to have been at least somewhat motivated by the less than overwhelming response to the federal and state law enforcement hiring assistance programs. Although no explicit language in the budget bill governs this line item any longer, its purpose has been expanded by the Attorney General to allow for technology and equipment grants to state and local law enforcement, including the Ohio Organized Crime Investigations Commission for the purchase of specialized equipment. The commission, which was established in the Office of the Attorney General in 1986, assists local law enforcement agencies in the investigation of organized crime activity, including the formation and support of task forces and the loaning of sophisticated surveillance and communications equipment.

An examination of the performance of the line item's disbursements thus far in FY 1998 indicates that this widening of purpose has definitely produced at least one noticeable effect — accelerated spending. Year-to-date, not only has a higher percentage of this FY 1998 law enforcement assistance appropriation been disbursed when compared to the same point in time for FY 1997, but actual year-to-date disbursements have already exceeded FY 1997's by more than $600,000.

Property Tax Relief

For the second month in a row, the Property Tax Relief program category threw in another monster, though only slightly less Godzilla-like, negative monthly disbursement variance, this one totaling $69.8 million. A monthly distribution totaling $149.3 million in real property tax relief from the departments of Education and Taxation budgets (line items 200-901 and 110-901, respectively) was originally assumed would take place in April. Well, a monthly property tax relief distribution clearly transpired, but it was also clearly well under estimate, again. The word "timing" jumped to our lips, suggesting as always whenever that disbursement term is deployed that a matter will simply sort itself out.

The Property Tax Relief program category consists of state payments to local governments as compensation for credits or exemptions provided to taxpayers in state law. Two important facts about GRF tax relief: much more of the payments are for real property tax relief than for tangible tax relief, and about 70 percent of all tax relief (real and tangible) goes to school districts, due to their heavy reliance on the property tax. Real property relief tax relief is distributed through two line items: 200-901 in the Department of Education's budget reimburses school districts, and 100-901 in the Department of Taxation's budget reimburses counties, municipalities, townships, and other special taxing districts. ❑

**LBO colleagues who provided important fuel in the development of this issue included, in alphabetical order, Ogbe Aideyman, Laura Bickle, Deborah Gavlik, Steve Mansfield, Jeff Newman, and Jeffrey M. Rosa.*

Issues of Interest

TANF Reserve Funds

STEVE MANSFIELD

The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996 dramatically altered the funding relationship between the federal government and the states. Prior to the PRWORA, under the Aid to Families with Dependent Children (AFDC) program, the federal government provided states with open-ended matching funds for cash welfare payments to all families who qualified. Cash benefits were an "entitlement" and had no time limit. Under an entitlement, qualified recipients have a "right" to receive benefits and appropriations must be provided in case of a shortfall. In the old AFDC program the federal government reimbursed states for welfare spending by 50 percent to 80 percent, depending on per capita income. During the 1990's, Ohio's ADC reimbursement level was approximately 60 percent.

The PRWORA eliminated the AFDC program as well as related programs which served the AFDC population: the Job Opportunity and Basic Skills (JOBS) program, Emergency Assistance (in Ohio known as FEA), and Title IV-A day care. These four programs were replaced by two block grants: (1) the Temporary Assistance for Needy Families (TANF) Block Grant; and (2) the Child Care Development Block Grant (CCDBG).

The TANF program establishes a flat block grant to the states for five years, beginning in October 1997. Ohio's annual TANF block grant award of approximately $728 million is based on the amount of federal funds expended in federal fiscal year 1994 for the three eliminated programs, AFDC, JOBS, and FEA. Ohio is required to meet a maintenance of effort (MOE) requirement of 80 percent of what it spent in FFY 94 on the three eliminated programs (approximately $411 million), through FFY 2002. If the State fails to meet the MOE, its TANF grant for the next FFY will be reduced by the amount of the deficit, and the state will be required to increase its TANF spending by an amount equal to the penalty.

Clearly, the TANF funding system represents a fundamental shift away from an open-ended reimbursement to a flat block grant. This shift introduces the need to manage reserves for future needs. It also shifts a substantial portion of the burden and risk of increasing caseloads in periods of economic recession to the states.

In case of economic recession and climbing caseloads, there are some additional forms of federal assistance. There is a contingency fund of $2 billion in federal matching funds for the period of FFY 1997-2001. As well, there is a federal "rainy day loan fund" that would enable a state to borrow a maximum of 10% of a state's grant, for up to 3 years. However, to access any additional funding sources, a state must have met a 100% MOE level of state spending in the year(s) a state uses the funds. Use of the contingency fund cannot exceed 20% of the state's total block grant in a fiscal year. While these funds are available, it is unlike the open-ended funding system of AFDC in that the block grant will not change automatically when a state's assistance spending increases or decreases.

Fortunately, caseloads have been going down during the current period of transition to the new TANF program. As a result, Ohio and all other states but one are experiencing substantial declines in the TANF caseload. Because TANF is flat funded, Ohio, along with most other states, has received more federal money than it would have under the old funding system. Thus more money per recipient family is available for more intensive services to support recipients trying to find jobs.

In Ohio, the build-up of available TANF funds has recently received significant media attention. A study called "Tracking Ohio's Welfare Spending: Before and After Reform," was recently released by the consulting firm of Levin & Driscoll. The study was commissioned by the Federation for Community Planning, a non-profit organization based in Cleveland.

According to the Levin & Driscoll study, over $500 million intended for Ohio's TANF program will go unspent by the end of the current fiscal year, and the reserve will build further to $660 million by the end of fiscal year 1999. The study's calculations are based on a budget plan prepared by the Department of Human Services in February. However, in April, prior to the release of the study, the Department released a revised budget plan for fiscal years 1998 and 1999. The revised budget plan was necessitated primarily by the need to take account of changes resulting from the Executive's announcement of the TANF Employment and Training program (which is being developed in lieu of accepting a Welfare-to-Work grant from the federal government). This new program is to be funded out of existing reserves. The Levin & Driscoll study did not take these changes into account. The revised projection of the reserve will be discussed shortly, but first let us consider how Ohio's reserves compare to other states.

Is Ohio's TANF reserve the largest in the country? Data from the Administration for Children and Families, the federal agency within the Department of Health and Human Services which maintains administrative oversight of the TANF program, reveal that at the end of FFY 1997, Ohio ranks second behind California in terms of money held on reserve at the federal level, and ranks fourteenth in terms of the percentage that reserves compose of the total amount of the state's award. The top five states in terms of dollar amounts of reserve for federal fiscal year 1997 are:

1. California	$762,843,217
2. **Ohio**	**$273,788,340**
3. Florida	$206,830,009
4. New Jersey	$148,006,322
5. Wisconsin	$132,556,008

In terms of the percentage of their annual awards that have been left on reserve with the federal government, the average for FFY 97 for all states and the District of Columbia is 27.6 percent. Ohio's FFY 97 reserve as a percentage of its annual award is 37.6 percent. The top fifteen states according to the size of their reserves as a percentage of the annual grant award are:

1. Idaho	91.2%
2. Wyoming	83.2%
3. North Dakota	63.3%
4. Indiana	61.9%
5. Minnesota	57.1%
6. Louisiana	53.3%
7. New Jersey	50.5%
8. Colorado	47.6%
9. Maryland	42.5%
10. Dist. of Columbia	42.0%
11. Wisconsin	41.7%
12. Nebraska	41.1%
13. Oklahoma	38.2%
14. **Ohio**	**37.6%**
15. South Dakota	37.1%

While among the largest, by either measure Ohio's reserve is not the largest in the country for federal fiscal year 1997, the latest point at which such a measurement is published.

A second and larger question that ought to be considered is the characterizations of the reserve funds as "excess," or "surplus."

The federal Administration for Children and Families divides unspent reserves into two categories: "unliquidated obligations" and "unobligated balance." All of Ohio's reserve funds fell into "unliquidated obligations" in FFY 1997. Why is this?

The Ohio Department of Human Services has established seven specific reserve funds; each is derived from federal funds, held at the federal level, and earmarked for specific spending purposes in current and future fiscal years. These are:

- ***The Caseload Contingency Reserve*** – Under the PRWORA a state may reserve and carryover funds for the purpose of providing assistance in future years under the TANF Block Grant. Under the block grant system, Ohio has chosen to leave $75 million per year "on account" with the federal government.
- ***The New County Incentive Reserve*** – Counties entering a partnership agreement with the state will be offered a set of performance-based financial incentives to be awarded in future years to encourage increased work participation rates, reduced out-of-wedlock pregnancy, increased duration of post-assistance employment, and other performance measures. $45 million has been set aside.
- ***The Caseload Reduction Incentive Reserve*** – Another

Table 1
TANF Reserve Funds
From Department of Human Services Budget Plan, April 28, 1998

Obligated Reserve Funds	FY 97 Reserve	FY 98 Activity	FY 98 Reserve	FY 99 Activity	FY 99 Reserve
Caseload Contingency	75,000,000	75,000,000	150,000,000	75,000,000	225,000,000
New County Incentive	45,000,000		45,000,000	-15,000,000	30,000,000
Caseload Reduction Incentive	60,000,000	-15,000,000	45,000,000	-15,000,000	30,000,000
Training Reserve	8,000,000	-2,000,000	6,000,000	-2,000,000	4,000,000
Disaster Reserve	20,000,000	-5,000,000	15,000,000	-5,000,000	10,000,000
WtW Reserve	0	88,000,000	88,000,000	0	88,000,000
WtW Expenditures		-22,000,000	-22,000,000	-55,000,000	-77,000,000
Early Start Reserve	20,000,000		20,000,000	-20,000,000	0
Obligated Reserves for FY	228,000,000		347,000,000		310,000,000
Human Services Stabilization Fund	100,000,000		100,000,000		100,000,000
Cumulative Obligated Reserves	328,000,000		447,000,000		410,000,000
Cumulative Unobligated Reserve	**45,179,920**		**44,315,566**		**142,052,682**

incentive for counties will be based on reductions in cash assistance. Those counties which have already entered into a partnership agreement with the state will share the reserve amount set aside for a particular fiscal year according to their percentage of the overall reduction in expenditures among those participating counties. $60 million has been set aside.

- ***The Disaster Fund Reserve*** – This is an element of the Prevention, Retention, and Contingency program, setting aside funds to be allocated to counties declared to be disaster areas by the Governor. Counties will determine eligibility for assistance. $20 million has been set aside.
- ***The Training Reserve*** – A reserve for staff training during the transition process has been established. $8 million has been set aside.
- ***The Welfare To Work Reserve*** – This reserve was established to fund the TANF Employment & Training (TANF E & T) program. $88 million has been set aside.
- ***The Early Start Statewide Reserve*** – This reserve was established to expand the Ohio Early Start Program to provide services to children aged birth to thee years who are identified with or at risk of developmental difficulties, abuse or neglect. The Ohio Early Start program is administered by the Department of Health. $20 million has been set aside.

In addition, the state maintains a Human Services Stabilization Fund (HSSF). This fund was set up out of the General Revenue Fund, and does not count toward the TANF MOE. At the present there is about $104.9 million in this fund. Of that amount, only the $100 million in principal is unobligated. HB 215 earmarks the interest earned on the HSSF for the Low and Moderate Income Housing Trust Fund. While not limited to being spent only within OWF, under state law, the principal in the HSSF can only be used for human services purposes: higher caseloads, federal funding changes, and unforeseen costs due to significant state policy changes.

As the above description of the program and the reserve funds makes clear, along with increased responsibility for dealing with economic contingencies and for managing their programs designed to meet their own needs, state governments have been given a great deal of leeway in the use of federal funds. In order to meet those responsibilities prudently, Ohio has reserved some of the available money to set up contingency funds that can be drawn on in time of economic need or natural disaster. In fiscal year 1998, approximately 56 percent of the total amount reserved (including the HSSF) is earmarked for contingencies that could result from economic downturn, natural disaster, or significant policy changes. An additional 34.4 percent of the remainder of the total amount reserved is earmarked for incentive funds, special training needs, the TANF E & T program, and the Early Start program — each of which will have expenses in FY 1999. The remainder of the FY 1998 funds — $44.3 million, or 9.4 percent — remains unobligated at the time of this writing. Table 1, above, presents the reserves component of the current Department of Human Services TANF budget plan.

Since Ohio will bear a large part of the burden of increased welfare costs during periods of recession, setting up such contingency reserves seems very prudent. The present situation of what seems to be rather ample funding could shift rapidly in the event of an economic downturn, an increased need to provide job training and child care services, or other factors that could increase either costs or needs. An economic downturn, in particular, could result in a sharp increase in families applying for assistance.

In the relatively mild recession of 1990-1992, Ohio's unemployment rate climbed from an average of 5.5 percent in 1989, to 7.4 percent in June 1992, and did not return to the pre-recession rate until August 1994. In July 1989 the number of ADC recipients was 619,553. By March of 1992, the number of recipients had peaked at 748,717, a 20.8 percent increase. To calculate the cost of this recession in terms of additional cash benefits, we could total cumulative spending beyond the 1989 level for the 5 fiscal years 1990-1994. This would yield a conservative estimate of the cost since it would not include the costs incurred beyond June 1994.[1] While there also may have been other factors beside the recession contributing to the increased costs during this time period, the largest factor contributing to costs was the recession. Limiting the time period to five years would produce an estimate that makes an allowance for the costs of other unknown factors. Spending in Ohio's ADC program for each of those years was as follows:

FY 1989	$777,816,806
FY 1990	$826,036,908
FY 1991	$869,840,252
FY 1992	$952,807,544
FY 1993	$939,188,568
FY 1994	$918,487,945

The cumulative amount beyond the FY 1989 spending level comes to $617.3 million, approximately 85 percent of the current annual federal grant. By adding $75 million each year to a caseload contingency reserve, this portion of Ohio's reserves will total $375 million after five years. However, this amount of reserve would not fully meet the additional costs that were imposed during the 1990-1992 recession. Although we would be starting from a smaller base, an economic downturn as severe as the recession of the early 90s could easily exhaust the caseload contingency reserve now being established. Prudence would seem to support keeping this reserve at least at its planned level.

Ohio's state-funded HSSF is also a very prudent precaution since it could be applied to meeting the state's MOE requirement of $411.2 million. This fund exists to relieve some of the budgetary pressures likely to be encountered during a recession.

A third and final question to be considered is the future "up side" risks concerning estimations of Ohio's TANF reserves. Because of declining caseloads, the Department of Human Services has already revised downward it estimate of expenditures in fiscal years 1998 and 1999 for TANF cash benefits. Comparing the October to April budget plans prepared by the Department shows a reduction for FY 1998 from $678.9 million to $565.9 million for cash benefits — a 16.6 percent reduction. The FY 1999 projection of cash benefits is revised down from $668.2 million to $532.7 million, a 20.3 percent reduction.

In light of the current caseload and the trend in caseload decline, how accurate are these projections? Two possible scenarios worth considering are: 1) the number of TANF recipients will remain at the current level; or 2) the number of TANF recipients will continue to decline by approximately 5,000 per month, which has been the average rate since July 1996.

The amount of $565.9 million, which is projected for cash benefits for FY 1998, would provide an average monthly cash benefit of $116 (the current average benefit level) to 406,500 recipients. The average number of monthly recipients so far this fiscal year now stands at about 407,500. The projected amount of cash benefits is thus not far off the mark. If the number of recipients continues to decline for May and June at the same rate that has been experienced since July 1996, the cash benefit expenditures would fall below the estimate by only about $1.5 million.

For FY 1999, however, there is a greater likelihood that these scenarios would result in significantly lower than anticipated expenditures for cash benefits. If we were to assume that the number of recipients remained unchanged throughout FY 1999 at its current April, 1998 level of about 366,800 and that the average monthly benefit per recipient remains at $116, cash benefits would total $510.6 million for the year. In this scenario total expenditures for cash benefits would be $22 million below the projected amount. If, instead, the number of recipients continued to decline throughout FY 1999 at a rate of 5,000 per month, actual spending would be $45.2 million lower that the static scenario just considered, for a total of $67.2 million below the estimate. In this continued decline scenario, Ohio's unobligated reserve for FY 1999 would increase to a total of $209.3 million.

Of course, these are only two possible scenarios. Unemployment rates are at a historic low, and it would seem that it would be difficult for them to go lower. Job creation looks as if it will remain strong for the next several months, thus helping to hold unemployment at its current low rate. Still, a cyclical downturn remains a possibility, and could easily push caseloads and cash benefits up. However, according to the WEFA Group, one of the most widely subscribed economic forecasting services, the risk of a cyclical downturn during the next twelve months is only 15 percent.[2] There is a strong possibility, therefore, that Ohio's FY 1999 TANF reserve will be significantly larger than the amount currently estimated.

Another risk to consider is the possible consequences of leaving reserves at the federal level. Despite the fact that the federal legislation says explicitly that "a State may reserve amounts paid to the State … for any fiscal year for the purpose of providing, without fiscal year limitation, assistance under the State program" there is the danger that the federal government seeing these funds going unspent could cut the TANF grants or require that the states spend them for other purposes. Providing explicit earmarks for reserved funds, as Ohio has done, could discourage federal attempts to reduce or take back TANF allocations.

Conclusion

A close examination of the Department of Human Services' budget plan for the TANF program reveals that, rather than being awash in surplus or excess funds that can either be spent on new initiatives or sent back to the federal government, the department has built reserve funds that are earmarked or obligated for specific uses and purposes. A significant portion of this reserve is prudently earmarked for caseload contingency, disaster relief, or significant policy changes. While Ohio ranks high in terms of the size of its reserve, especially when compared to other large industrial states, the size of its reserve in neither the largest nor does it seem inordinate. Unlike the old AFDC system of funding, under TANF the states bear much of the risk for future contingencies and hence need to plan accordingly. Much of Ohio's TANF reserves are dedicated to that purpose. Because of the administrative role of counties in delivering TANF services, Ohio has also introduced a performance management system. A large portion of the TANF reserves also serves that purpose. ❑

[1] A recently released study by Stapleton, Livermore, and Tucker of the Lewin Group, "Determinants of AFDC Caseload Growth," commissioned by the Department of Health and Human Services, found that "a current increase in the unemployment rate affects caseload growth for the next 14 quarters (3.5 years)." The study also calculates that a one percent increase in the unemployment rate, which then held constant for the next 14 quarters, would produce a total caseload growth of six percent.

[2] The WEFA Group, Executive Summary, May 8, 1998.

LBO, SAMPLING, AND STATISTICAL INFERENCE

FREDERICK CHURCH

As part of our effort to upgrade our services and better serve the General Assembly and the citizens of Ohio, the Legislative Budget Office (LBO) is undertaking a comprehensive review of our sampling procedures. In the course of our work, we frequently sample local governments (including school districts) in order to ascertain the impact of proposed legislation. Depending on the number and the quality of responses, we may or may not make inferences from the sample or samples to regions or to the entire state. Less frequently, LBO also uses samples of taxpayers or households, whether these samples are drawn by us or passed along to us from another state agency or a non-state entity.

As part of our internal quality-control procedures, we are reviewing our use of samples and our procedures for making inferences from samples to populations. This also involves carefully distinguishing between instances where sample results may be generalized to a population, and instances where due to small sample size or possible bias the sample may be good for illustrative purposes but cannot be used to make inferences about population parameters. Our proposed internal guidelines will be subjected to outside review by statistical and sampling professionals before formally becoming part of our standard operating procedure. LBO will complete this process within this calendar year.

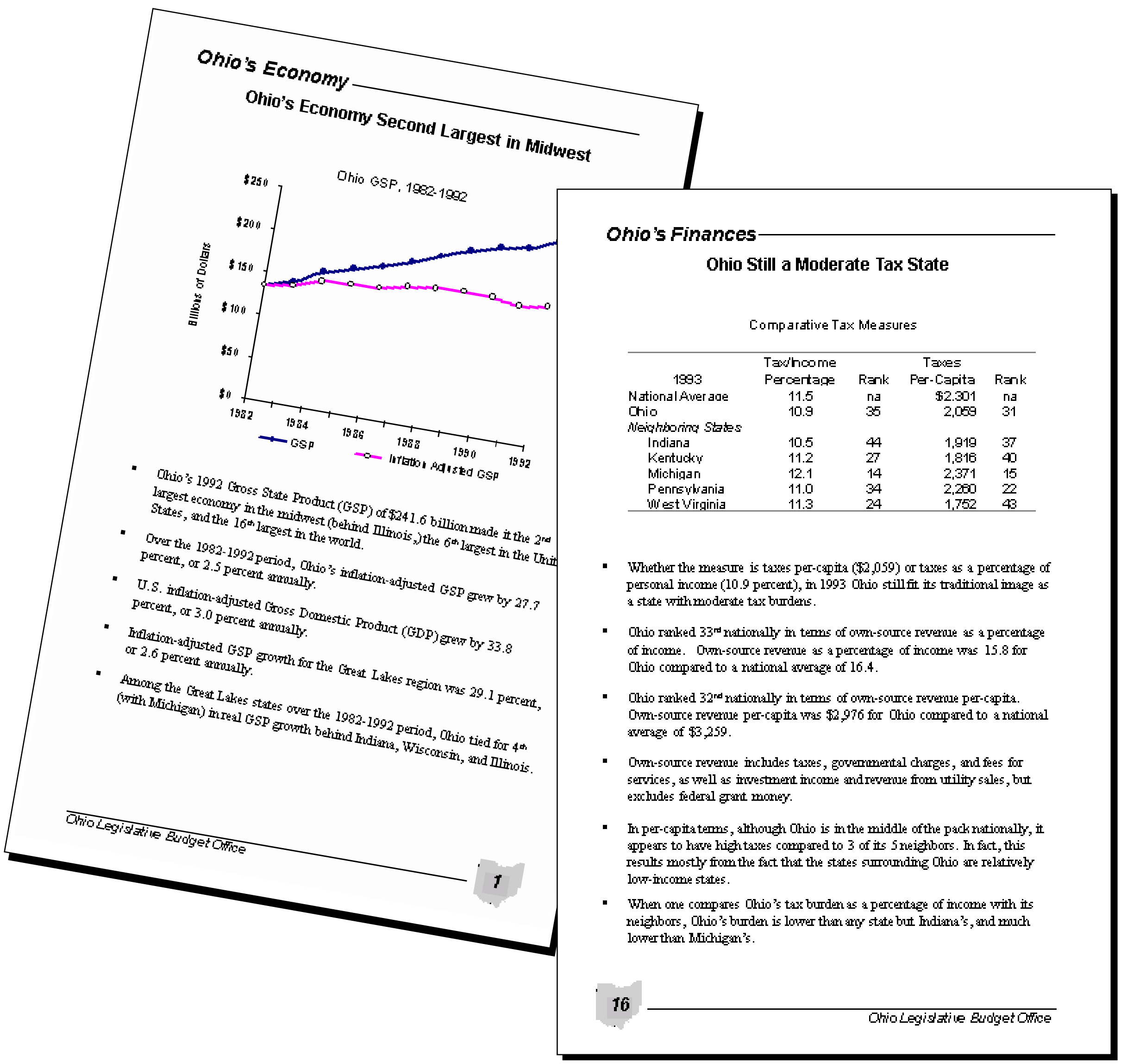
Upon completion of the review process, LBO will incorporate the guidelines as appropriate into LBO products, such as fiscal notes and research projects. Oftentimes, legislative timeframes do not lend themselves to extensive scientific research methods. Therefore, this review process will help to specify the appropriate research approach in different situations, depending on the nature of the research project and the information and time available.

LBO's review of sampling and statistical methods for Ohio policy research also has an external component. Many other entities — state agencies, advocacy groups, independent research bodies (think tanks) — do policy research that includes the use of case studies or probability samples. In the past, LBO has sometimes reviewed these studies in an informal way. Questions about method or suspicions of errors were usually filed away for our own usage, in the sense that we did our reviews for the purpose of identifying studies we should use or cite in the course of doing our own research, and which studies we should be cautious of using. The evaluation of outside research is also becoming a more formal process at the LBO, and we will become more active in our efforts to clear up questions of method or statistical validity earlier in the research process. We believe this to be of crucial importance in making sure that the Legislature receives the best possible information for making policy decisions. We hope to establish a close and productive working relationship with those state agencies and other groups doing policy research that that parallels or overlaps our own research for the legislature. ❑

Ohio Facts Extra!

First Edition Copies Still Available — *While They Last!*

Last year, LBO completed the first edition of ***Ohio Facts***, a booklet developed to provide a broad overview of public finance in Ohio. The booklet presents data covering a variety of subject areas: Ohio's economy, transportation, environment, education, and human services, among others. Shown below are sample pages from ***Ohio Facts***. What other information lays hidden in the pages of this little booklet? Find out . . . we have a limited supply of ***Ohio Facts*** still available for distribution — call LBO at 466-8734 to request a booklet.



Ohio's Economy

Ohio's Economy Second Largest in Midwest

- Ohio's 1992 Gross State Product (GSP) of $241.6 billion made it the 2nd largest economy in the midwest (behind Illinois,)the 6th largest in the Unit States, and the 16th largest in the world.
- Over the 1982-1992 period, Ohio's inflation-adjusted GSP grew by 27.7 percent, or 2.5 percent annually.
- U.S. inflation-adjusted Gross Domestic Product (GDP) grew by 33.8 percent, or 3.0 percent annually.
- Inflation-adjusted GSP growth for the Great Lakes region was 29.1 percent, or 2.6 percent annually.
- Among the Great Lakes states over the 1982-1992 period, Ohio tied for 4th (with Michigan) in real GSP growth behind Indiana, Wisconsin, and Illinois.

Ohio Legislative Budget Office 1

Ohio's Finances

Ohio Still a Moderate Tax State

Comparative Tax Measures

1993	Tax/Income Percentage	Rank	Taxes Per-Capita	Rank
National Average	11.5	na	$2,301	na
Ohio	10.9	35	2,059	31
Neighboring States				
Indiana	10.5	44	1,919	37
Kentucky	11.2	27	1,816	40
Michigan	12.1	14	2,371	15
Pennsylvania	11.0	34	2,260	22
West Virginia	11.3	24	1,752	43

- Whether the measure is taxes per-capita ($2,059) or taxes as a percentage of personal income (10.9 percent), in 1993 Ohio still fit its traditional image as a state with moderate tax burdens.
- Ohio ranked 33rd nationally in terms of own-source revenue as a percentage of income. Own-source revenue as a percentage of income was 15.8 for Ohio compared to a national average of 16.4.
- Ohio ranked 32nd nationally in terms of own-source revenue per-capita. Own-source revenue per-capita was $2,976 for Ohio compared to a national average of $3,259.
- Own-source revenue includes taxes, governmental charges, and fees for services, as well as investment income and revenue from utility sales, but excludes federal grant money.
- In per-capita terms, although Ohio is in the middle of the pack nationally, it appears to have high taxes compared to 3 of its 5 neighbors. In fact, this results mostly from the fact that the states surrounding Ohio are relatively low-income states.
- When one compares Ohio's tax burden as a percentage of income with its neighbors, Ohio's burden is lower than any state but Indiana's, and much lower than Michigan's.

16 Ohio Legislative Budget Office

Virtually LBO

This section in ***Budget Footnotes*** will reference material of topical interest available on LBO's web site. Since the inception of our web site in October, 1997, a number of changes have been made to ensure that it is more user friendly. If you haven't visited us lately, stop by at **http://www.lbo.state.oh.us**.

Available In our Virtual Office

✓ Most recently, the Ohio General Assemby completed work on the budget corrective bill, H.B. 770. To review LBO's fiscal analysis of the corrective bill, as passed by the General Assembly, go to **http://www.lbo.state.oh.us/products/forms/FN/hb0770ga.pdf**.

✓ LBO completes a fiscal note and a local impact statement for each bill at various points as the bill moves through the legislative process. Fiscal notes estimate the fiscal effects of proposed legislation on state and local government revenues and expenditures. **Newly completed fiscal notes** are added to our web site daily. To access our fiscal note database online, select this link: **http://www.lbo.state.oh.us/search/query.htm**.

✓ Issues of ***Budget Footnotes*** are online from the current issue back to Volume 20, Issue 1 (August, 1996). To access ***Budget Footnotes*** online, choose **http://www.lbo.state.oh.us/products/footnotes.html**.

✓ LBO is a fount of fiscal information for many folks, but we have resources of our own. Our web page provides links to several other budget-related departments, divisions, and agencies. Link up at **http://www.lbo.state.oh.us/links/Default.htm**.

Just a Reminder . . .

To those of you who opted for electronic delivery of ***Budget Footnotes***, next month will bring you the final **paper** copy of our newsletter. We hope you enjoy accessing ***Budget Footnotes*** on line. If, at any time, you need assistance or wish to be added as an electronic delivery subscriber, e-mail Cindy Murphy at **cmurphy@lbo.state.oh.us**. Thank you for joining us as we move towards the future.