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Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE JUNE, 1998

FISCAL OVERVIEW

— Frederick Church

After the stunning income tax overage in April, the big question was how much, if any, was due to accelerated processing. Would we lose some of the overage in May? Would refunds suddenly skyrocket, and annual returns dry up? The answers to those questions are, in order: no, no, and no. The income tax posted another small overage in May ($9.8 million). Refunds were right around the original estimate, and although annual returns did fall a little short, that shortfall was more than offset by an overage in quarterly estimated payments. So, as of the end of May, income tax revenues are still $465.8 million above the estimate (9.1 percent), and have increased by 14.3 percent from last year. It looks like this will end up being the strongest growth year for the income tax since FY 1987. It is not coincidental that FY 1987 was a year with strong employment growth, low inflation, a stock market boom and a change in the federal tax treatment of capital gains.

Compared to the garish colors of the income tax, the other revenue news in May was muted. The non-auto sales tax, foreign insurance premium tax, and corporate franchise tax all finished a little short. (LBO expects those tax sources to rebound with overages in June.) The auto sales tax, estate tax, and public utility excise tax all finished slightly above the estimate. Total tax revenues for the month were $3.8 million above the forecast, an estimating error of about 0.3 percent.

In non-tax revenue, liquor profits posted an $8 million overage, continuing what has been a very strong year. Federal grant receipts continued to fall, dropping $44.6 million below estimate in May. For the year, GRF federal receipts are $450.2 million (12.9 percent) below the estimate, and have fallen by 8.8 percent from last year. Predictions that some of the federal grants shortfall would be erased toward the year's end as federal TANF money was drawn down have not yet been realized although TANF disbursements saw a rare small monthly overage.

For the year, total tax revenues are $568.3 million above the estimate, on growth of 8.7 percent from last year. Non-tax revenues are $39.4 million above estimate, and transfers are $49.8 million above estimate (although $35 million of that amount is in temporary transfers into the GRF that are offset by transfers out). Total non-federal revenue is $657.5 million above the estimate, although the federal shortfall reduces the total GRF overage to only $207.3 million.

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STATUS OF THE GRF

ISSUES OF INTEREST

OHIO FACTS EXTRA!

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 May	Fiscal Year 1998 to Date	Last Year	Difference
Beginning Cash Balance	$835.3	$1,367.7		
Revenue + Transfers	$1,481.1	$16,225.5		
Available Resources	$2,316.4	$17,593.2		
Disbursements + Transfers	$1,475.6	$16,752.5		
Ending Cash Balances	**$840.8**	**$840.8**	**$778.4**	**$62.4**
Encumbrances and Accts. Payable		$347.1	$261.6	$85.5
Unobligated Balance		**$493.7**	**$516.8**	**($23.1)**
BSF Balance		$862.7	$828.3	
Combined GRF and BSF Balance		**$1,356.4**	**$1,345.1**	**$11.3**

May was also comparatively quiet on the disbursement side. There were three major stories:

(i) property tax relief finally caught up to the estimate (or more precisely, eclipsed most of the timing-driven gap);
(ii) the aggregated human services category, which includes mental health and developmental disability services, and the "other human services" caught up to and slightly surpassed the estimate, and;
(iii) Medicaid resumed its pattern of underspending, falling $23.1 million below the estimate.

May's underspending in Medicaid was largely the result of prescription drug rebates being posted to the accounting system in May rather than in April. For the year, Medicaid spending is $132.2 million, or 2.7 percent, below the original forecast. Medicaid spending has grown by only 3.4 percent from last year. The explanations are the same as they have been all year: declining TANF caseloads, slower growth in the aged, blind, and disabled (ABD) caseloads, and lower than estimated HMO spending (although this last presumably translates into higher spending in other service categories).

There were also some things on the disbursement side that were notable without there being a big May overage or shortfall. Primary and secondary education spending hit the estimate but did not wipe out any of the accumulated year-to-date underspending. Higher education spending dropped further below the estimate. While the month's underspending may have been the result of timing of processing for Ohio Instructional Grant (OIG) payments, it nevertheless appears unlikely that spending will catch up by year's end. Of course, in the OIG and other student assistance line items, it is difficult to identify spending lapses even once the year is over because the reconciliation process between the Board of Regents (BOR) and the campuses for Spring semesters or quarters spills over into July and thus into the next fiscal year.

Although TANF spending exceeded the estimate by $10.9 million in May, this barely made a dent in the year-to-date variance. State TANF spending is still $218.5 million below estimate for the year. Caseloads fell by another 13,000 from April to May, and have declined by 141,000 over the last 12 months (caseloads here are measured in terms of people, not assistance groups). It should be noted that although Ohio has finally finished spending state GRF dollars, since the FY 1998 maintenance of effort (MOE) requirement has been met, the move to drawing federal dollars seemed to have a "fly on an elephant" impact on total GRF receipts of federal money, which fell below estimate again in May (see above).

Simplified Summary of Current-Year Revenues and Spending

Non-Federal Revenue, Excluding Transfers Other Than Liquor Profits	$622.2
State Spending, Net of Federal Dollars and Transfers	$118.6
Current Year State Surplus Relative to Forecast	$740.8

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 above presents a summary of current year revenues and spending that shows that the state is doing about $740.8 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.

With the work on H.B. 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 H.B. 650) it now appears that the tax year 1998 income tax cut will be quite large. The tax cut could be 7.5 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 wish to note that two figures that have appeared in the press, an unobligated surplus of $550 million and a tax cut of about 8 percent, are not synonymous. A surplus of $550 million would translate into a tax cut of slightly less than 8 percent given the original forecast of FY 1999 income tax receipts. However, the forecast of FY 1999 income tax revenues will be revised upward by OBM and LBO at some point: what is unknown is how large the revision will be. This will increase the denominator of the fraction that determines the cut in tax year 1998 tax rates. So, an unobligated surplus of $550 million would probably result in a tax cut closer to 7.5 percent. On the other side, the unobligated surplus could exceed $550 million by year's end, so that the tax cut could still be 8 percent, or larger. ❑

Status of the General Revenue Fund

REVENUES

— *Frederick Church*

As we have already noted in the fiscal overview, not only did the GRF not lose some of the extraordinary April income tax overage in May, it actually added to it. May income tax revenues were $9.8 million above the estimate, as the overage in quarterly estimated payments more than made up for the shortfall in annual return payments. So, as of the end of May, income tax revenues are $465.8 million above the estimate (9.1 percent) , and have increased by 14.3 percent from last year. If the strong May estimated payments and very early June results are indicative of the June estimated payment, that overage could grow even larger by year's end. To reiterate a point made earlier, it looks like the best year for the Ohio income tax since FY 1987, when the federal Tax Reform Act of 1986 (TRA 86) and the stock market boom led to big state windfalls.

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

REVENUE SOURCE			
TAX INCOME	Actual	Estimate*	Variance
Auto Sales	$64,346	$61,054	$3,292
Non-Auto Sales & Use	357,996	367,655	(9,659)
Total Sales	$422,342	$428,709	($6,367)
Personal Income	$524,977	$515,164	$9,813
Corporate Franchise	140,448	145,025	(4,577)
Public Utility	9,261	4,951	4,310
Total Major Taxes	**$1,097,028**	**$1,093,849**	**$3,179**
Foreign Insurance	($10,947)	($2,642)	($8,305)
Domestic Insurance	60,545	55,313	5,232
Business & Property	5,551	5,487	64
Cigarette	37,272	38,389	(1,117)
Soft Drink	0	0	0
Alcoholic Beverage	4,622	4,293	329
Liquor Gallonage	2,169	2,079	90
Estate	18,434	14,069	4,365
Racing	0	0	0
Total Other Taxes	$117,646	$116,989	$657
Total Taxes	**$1,214,674**	**$1,210,837**	**$3,837**
NON-TAX INCOME			
Earnings on Investments	$0	$0	$0
Licenses and Fees	738	2,692	(1,954)
Other Income	4,673	5,360	(687)
Non-Tax Receipts	$5,411	$8,052	($2,641)
TRANSFERS			
Liquor Transfers	$14,000	$6,000	$8,000
Budget Stabilization	0	0	0
Other Transfers In	3	5,000	(4,997)
Total Transfers In	$14,003	$11,000	$3,003
TOTAL INCOME less Federal Grants	**$1,234,088**	**$1,229,889**	**$4,199**
Federal Grants	$247,028	$291,671	($44,643)
TOTAL GRF INCOME	**$1,481,116**	**$1,521,560**	**($40,444)**

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

Detail may not add to total due to rounding.

The non-auto sales and use tax fell short in May despite generally strong sales data for April (May non-auto collections reflect April retail activity). May collections were up only 2.5 percent from last year, whereas the forecast had been for 5.2 percent growth. On the other side, the auto sales tax was $3.3 million over the estimate, up 13.4 percent from the same month last year. This is consistent with data that LBO has seen on both national and regional auto sales.

The corporate franchise tax fell $4.6 million below estimate in May, but once again the distribution of revenues between May and June from the May 31st payment is unpredictable. LBO expects a June overage in this tax that will at least offset the May shortfall.

The foreign insurance tax and the domestic insurance tax are going in different directions, with the foreign (out-of-state) premium tax falling short of expectations and the domestic (in-state) premium tax exceeding expectations. The shortfall in the foreign premium tax is larger than the domestic premium tax overage. As a side note, this adds some uncertainty to LBO's and OBM's projections of the revenue impact from the insurance tax reforms in the last budget bill, since our assumptions of the baseline tax amounts for FY 1999 will probably be somewhat off.

On the non-tax side, after the April liquor profits transfer was skipped, the agency made a double transfer in May, and continued the trend of doing better than the forecast. Liquor profit transfers are now a bigger source of GRF revenue than the GRF taxes on spirituous liquor and other alcoholic beverages combined.

Federal revenues to the GRF continue to free fall. May revenues were $44.6 million below the estimate, making the year-to-date shortfall $450.2 million. Revenues have dropped 8.8 percent from last year and are 12.9 percent below the estimate. Federal grant receipts are $450.2 million below estimate despite the fact that underspending on all human services programs is only $382.6 million. It is unclear whether part of this shortfall will be erased after the state FY 1998 is over but the federal fiscal year (FFY) 1998 still has three months to run.

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

	Actual	Estimate	Variance	Yr-Over-Yr Growth
Employer withhholding	$5,179.8	$5,033.4	$146.4	8.5%
Quarterly estimated payments	$1,119.1	$979.2	$139.9	19.2%
Annual Tax Payments	$652.9	$452.9	$200.0	49.2%
Refunds	($721.7)	($756.4)	$34.7	16.7%
Total Major Components	$6,230.2	$5,709.1	$521.1	
Total All Components	$6,267.9	$5,742.5	$525.4	14.2%
Total GRF Amount	$5,605.4	$5,139.5	$465.9	14.2%

Personal Income Tax

With May finished, we essentially know the annual return results for the year (only $15 million in annual return payments is estimated for June). As of the end of the month, annual return payments (also known as tax due payments) are $200 million over the estimate and have increased by 49.2 percent from last year. Even if we didn't get another dollar in tax due payments in June, we would end up with a huge overage and growth of 40 percent.

On the other side of the coin from the huge surplus in annual return payments, there is a smaller but still significant negative variance in refunds paid out. Through May, refunds were $34.7 million less than the estimate, which of course makes net collections higher than estimated. While there is still a possibility that there will be some unexpected refunds in June that will shrink the income tax overage, we do not view that as likely. One piece of evidence against such a scenario is that the *counts* of the number of annual returns with tax due are up significantly from last year. That means that, unless there is a big (and unexplained) increase in the number of filers, the count of returns with refunds must fall. If the number of returns with refunds falls, so should the dollar amount, unless there is a big increase in the average refund.[1]

The focus on annual returns should not distract us from the fact that employer withholding and quarterly estimated payments also have huge year-to-date overages. The position of the various components of the income tax relative to the estimate are summarized in the table above.

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

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	$648,759	$620,830	$27,929	$608,586	6.60%
Non-Auto Sales & Use	4,136,536	4,093,527	43,009	3,918,375	5.57%
Total Sales	$4,785,295	$4,714,357	$70,938	$4,526,961	5.71%
Personal Income	$5,605,362	$5,139,524	**$465,838**	$4,905,708	**14.26%**
Corporate Franchise	963,221	968,768	(5,547)	962,349	0.09%
Public Utility	461,085	435,404	25,681	431,557	6.84%
Total Major Taxes	$11,814,963	$11,258,053	$556,910	$10,826,575	9.13%
Foreign Insurance	$279,746	$292,484	($12,738)	$282,819	-1.09%
Domestic Insurance	61,223	55,753	5,470	54,769	11.78%
Business & Property	6,073	7,441	(1,368)	6,603	-8.04%
Cigarette	271,007	269,625	1,382	272,760	-0.64%
Soft Drink	0	0	0	20	-100.00%
Alcoholic Beverage	47,622	45,619	2,003	46,816	1.72%
Liquor Gallonage	25,030	24,644	386	24,740	1.17%
Estate	110,144	93,888	16,256	96,743	13.85%
Racing	0	0	0	0	#N/A
Total Other Taxes	$800,844	$789,455	$11,389	$785,271	1.98%
Total Taxes	**$12,615,807**	**$12,047,507**	**$568,300**	**$11,611,846**	**8.65%**
NON -TAX INCOME					
Earnings on Investments	$99,333	$58,660	$40,673	$71,943	38.07%
Licenses and Fees	34,212	64,609	(30,397)	64,021	-46.56%
Other Income	88,368	59,283	29,085	79,840	10.68%
Non-Tax Receipts	$221,913	$182,552	$39,361	$215,804	2.83%
TRANSFERS					
Liquor Transfers	$78,000	$63,500	$14,500	$62,500	24.80%
Budget Stabilization	0	0	0	$0	#N/A
Other Transfers In	275,618	240,300	35,318	402,716	-31.56%
Total Transfers In	$353,618	$303,800	$49,818	$465,216	-23.99%
TOTAL INCOME less Federal Grants	**$13,191,339**	**$12,533,859**	**$657,480**	**$12,292,865**	**7.31%**
Federal Grants	$3,034,139	$3,484,315	($450,176)	3,327,840	-8.83%
TOTAL GRF INCOME	**$16,225,477**	**$16,018,174**	**$207,303**	**$15,620,705**	**3.87%**

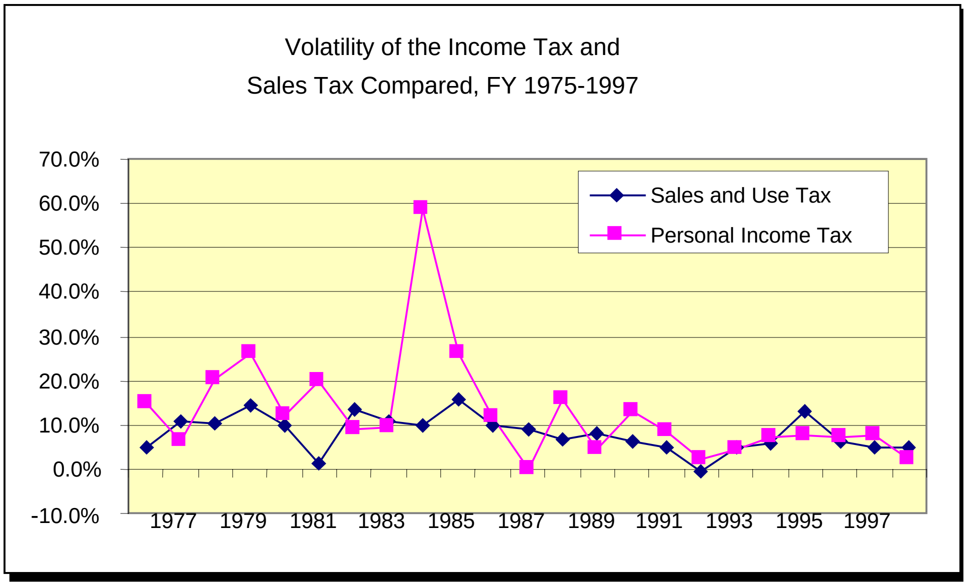
* July, 1997 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

1989. Like FY 1987, this year's result is partly the result of federal tax changes, although in this case 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 May, withholding was up 8.5 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.

Sales and Use Tax

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. Currently the sales and use tax is $70.9 million over estimate, and LBO expects that figure to hit at least $80 million by year's end. In May non-auto collections fell below the estimate, so that the cumulative overage in that category fell from $52.7 million to $43.0 million. However, national and regional economic conditions are so strong that we expect at least a small overage in June.



In the auto tax, May collections were $3.3 million over the estimate, pushing the year-to-date overage up to $27.9 million. The auto tax experience fit better with the national data, which showed a strong resurgence in unit car sales. Total light vehicle sales (in units) were up 12.0 percent in May over last year.

At the regional level, the latest Federal Reserve ***Beige Book*** (released on June 17th) said that 4th District sales of new vehicles have picked up in the last two months and were especially strong in May. There has also been a rise in used car sales. Dealers are anticipating continued strong sales through the end of the model year, and inventory stockpiling is reported. All these factors point toward another overage in tax collections in June.

It is unclear at this point how much of a wrench the General Motors strike will throw into auto sales, and thus into FY 1999 auto tax collections. GM's light vehicle sales in May were up 13.0 percent from last year, and the company's growth was pulling the overall industry growth number upward. It may be that much of GM's lost sales will be made up by other companies, or perhaps GM inventory is high enough that the sales impact will not be that large.

In general , both components of the tax are doing well, with the auto tax having grown 6.6 percent and the non-auto tax having grown 5.6 percent. The underlying economic fundamentals are very strong — Federal Reserve Chairman Greenspan stated that they were the best he has seen in his nearly 50 years of tracking the U.S. economy — and one would expect the sales tax to do well.2 In addition to the continuing boom in the labor market, low long-term interest rates have saved homebuyers and homeowners quite a bit of money, and some of that extra discretionary cash has gone toward consumption.

In fact, one might wonder why the sales and use tax hasn't grown even faster, given the strong growth in personal income and the explosion in income tax revenues. Consumer behavior may give us some indication of what taxpayers think about how much of the current boom is permanent and how much is transitory. It may also be the case that some of the stock market gains that are resulting in more income tax are being put back into financial investments and purchases that are not subject to the sales tax (e.g. homes).

The historical data shows that it is not unusual for the sales tax to grow more slowly than the income tax — in general, the sales tax grows more slowly and avoids the wild year-to-year swings that characterize the income tax. This is due to several factors, but one of them is that taxpayers base their consumption behavior on estimates of their long-run income (the permanent income hypothesis and life-cycle hypothesis are complementary theories of long-run consumer behavior) and fluctuations in income that are perceived as transitory are largely ignored. The graph of Ohio sales and income tax collections over the FY 1975 to FY 1997 period supports this idea. ❑

1 One would expect some increase in the average refund, due to the following logic. As increases in income push up taxpayer liability, and that extra liability is not absorbed by increased withholding or extra estimated payments, some taxpayers who formerly were getting refunds will be pushed into the category of owing tax. Those taxpayers still left in the refund group will probably have a higher average refund, even if their refunds shrink somewhat from the prior year due to higher (and higher than expected) liability.

2 Jacob M. Sclesinger, "Greenspan Suggests: No Rate Rise Soon," ***The Wall Street Journal***, June 11, 1998.

DISBURSEMENTS

— *Jeffrey E. Golon**

May rose from the canvas, dusted off, and then unleashed a powerful overage aimed straight at the state's fiscal belly. Ringside witnesses, who clearly had been seasoned to expect the unexpected, calmly placed the size of the monthly overage at $119.4 million. As a result of this pounding, excluding GRF transfers, year-to-date underspending, which had just fattened itself up to an all-time high of $688.1 million after a round of April disbursements, was only temporarily stunned and still managed to land at $568.8 million. June, the lone contender remaining for FY 1998, was in the audience, but remained close-mouthed as to its game plan.

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

USE OF FUNDS

PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$341,796	$340,036	$1,760
Higher Education	205,614	212,267	(6,653)
Total Education	$547,410	$552,302	($4,892)
Health Care	$357,581	$380,687	($23,106)
Temporary Aid to Needy Families	51,768	40,830	10,938
General Assistance/Disability Assistance	4,269	5,188	(919)
Other Welfare	18,360	27,929	(9,569)
Human Services (2)	115,633	87,340	28,293
Total Welfare & Human Services	$547,611	$541,974	$5,637
Justice & Corrections	$97,069	$99,906	($2,837)
Environment & Natural Resources	10,104	14,935	(4,831)
Transportation	2,075	5,667	(3,592)
Development	5,972	8,059	(2,087)
Other Government (3)	17,024	21,654	(4,630)
Capital	190	492	(302)
Total Government Operations	$132,434	$150,712	($18,278)
Property Tax Relief (4)	$243,904	$107,005	$136,899
Debt Service	0	0	0
Total Program Payments	**$1,471,359**	**$1,351,994**	**$119,365**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	4,290	0	4,290
Total Transfers Out	$4,290	$0	$4,290
TOTAL GRF USES	**$1,475,649**	**$1,351,994**	**$123,655**

(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.

May. The $119.4 million overage turned in by the month of May was only the third positive monthly disbursement variance posted this fiscal year. The first two showed up in December and February and carried considerably less powerful punches at $36.9 million and $44.2 million, respectively. Driving the May overage was Property Tax Relief, which weighed in with a positive disbursement variance of $136.9 million. This program category was basically making up for lost time, meaning that substantial property tax relief distributions delayed from the months of March and April occurred in May. Also adding to the monthly overage was: $20 million-plus of community mental health subsidy funding as a result of timing; and $10.9 million from the Temporary Assistance to Needy Families/TANF program. The latter was not a surprise as it had been predicted that a pile of TANF money would charge out the door in the last few months of the fiscal year, causing actual spending to run well past estimates.

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)	$4,093,939	$4,160,557	($66,617)	$3,740,589	9.45%
Higher Education	2,059,451	2,086,234	(26,783)	1,949,174	5.66%
Total Education	$6,153,390	$6,246,791	($93,401)	5,689,763	8.15%
Health Care/Medicaid	$4,683,312	$4,815,477	($132,165)	$4,528,272	3.42%
Temporary Assistance to Needy Families	762,410	980,960	(218,549)	865,046	-11.86%
General Assistance/Disability Assistance	53,702	60,034	(6,332)	114	47007.34%
Other Welfare	358,777	389,310	(30,533)	484,198	-25.90%
Human Services (2)	1,035,449	1,030,436	5,013	992,787	4.30%
Total Welfare & Human Services	$6,893,651	$7,276,218	($382,567)	$6,870,417	0.34%
Justice & Corrections	$1,398,718	$1,415,907	($17,189)	$1,297,955	7.76%
Environment & Natural Resources	118,345	116,542	1,803	108,643	8.93%
Transportation	28,357	38,186	(9,829)	30,609	-7.36%
Development	103,484	121,513	(18,029)	112,311	-7.86%
Other Government (3)	319,535	362,452	(42,917)	326,083	-2.01%
Capital	3,986	7,856	(3,870)	7,215	-44.76%
Total Government Operations	$1,972,425	$2,062,458	($90,033)	$1,882,817	4.76%
Property Tax Relief (4)	$857,358	$864,163	($6,805)	$827,237	3.64%
Debt Service	106,594	102,560	4,034	94,883	12.34%
Total Program Payments	**$15,983,419**	**$16,552,190**	**($568,772)**	**$15,365,116**	**4.02%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$0	—
Budget Stabilization	34,400	34,000	400	0	—
Other Transfers Out	734,633	686,766	47,867	615,673	19.32%
Total Transfers Out	$769,033	$720,766	$48,267	$615,673	24.91%
TOTAL GRF USES	**$16,752,452**	**$17,272,956**	**($520,505)**	**$15,980,789**	**4.83%**

(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.

Monthly underages in more than a half dozen or so other state program categories combined to shrink the size of the May overage from what it would otherwise have been. The Healthcare/Medicaid program provided the most punch with underspending that totaled $23.1 million. The remainder of the program category underages were relatively small in the scheme of things, but in tandem constrained spending at the bottomline.

Year-to-Date. At May's end, the four major players in the $568.8 million negative year-to-date disbursement variance were: Temporary Assistance to Needy Families/TANF ($218.5 million), Health Care/Medicaid ($132.2 million), the Department of Education ($66.3 million), and the Nonregulatory agency component of the Other Government program category ($42.2 million). The first two programs have been major participants in the state's underspending all year long as the size of the TANF caseload has spiraled downward and held spending in check. The Department of Education has carried a rather healthy and persistent underage as well, with the timing of various subsidy payments to school districts believed afoot. A pile of this unspent money will no doubt be on the move during the month of June and in the end most of it will be disbursed, vouchered, or encumbered by the close of FY 1998. The last player, Nonregulatory agencies, has slowly built its way into the big picture, primarily as a result of underspending emanating from the Department of Administrative Services. Rent and operating expenses for certain state-owned buildings and slower than expected spending on computing and communications services to other state agencies, in particular the Year 2000 and MARCS projects, have helped generate a negative year-to-date departmental disbursement variance of $29.6 million.

Federal Money. Of the year-to-date underspending in the TANF and Medicaid programs combined ($350.7 million), 81 percent, or $283.6 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 — $206.3 million — was exclusively attributable to TANF. 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 $285.2 million.

At year's end, any unspent federal TANF money really represents money the state will have earned by meeting its required maintenance of effort (MOE). On the other hand, an underage in Medicaid really signals a loss of anticipated revenue since the state will not have spent the money necessary to earn financial reimbursement from the federal government.

With one-month left on the state's fiscal calendar, here's some of what caught our attention during a review of May disbursements.

Primary and Secondary Education

NET. The Office of Information, Learning, and Technology Services (NET) — a previously independent agency within the Department of Education charged with the administration of all programs for the provision of assistance to school districts and other educational institutions for the acquisition and utilization of educational technology — posted a $3.8 million disbursement overage for the month of May. This was not an unexpected or dramatic discovery as prior issues of ***Budget Footnotes*** (October, 1997 and March, 1998) had noted a build-up in NET's year-to-date underspending that would eventually correct itself. That some technology initiatives were running behind "schedule" was not all that surprising, given disbursement estimates tied to the design and implementation of such endeavors, while exuding the appearance of precision and certainty, in reality have great difficulty incorporating the unknowns that can snag programs and thus delay spending.

Despite the May overage, NET still closed the month with a year-to-date underage totaling $5.7 million, entirely driven by line item 228-404, SchoolNet, which is used to make grants to qualifying schools and entities for the provision of hardware, software, telecommunications services, and staff professional development to support educational use of technology in the classroom.

Virtually all of the SchoolNet line item's $17.2 million FY 1998 appropriation is expected to have been disbursed by the end of the fiscal year. The remainder, anticipated to be $1.9 million, is tied to two slower-moving technology initiatives. These funds will be encumbered for disbursement in FY 1999. The first project involves 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. The second project is part of an Education Management Information System (EMIS) initiative undertaken by the Department of Education to procure or develop common EMIS software for use by school districts and data acquisition sites.

On the flip side, by the end of May, all of the FY 1998 appropriations for NET's two other GRF line items — 228-539, Education Technology, and 228-559, Interactive Parenting Program — had been disbursed. The Education Technology line item received a $6.6 million FY 1998 appropriation to provide funding to suppliers of information services to school districts and to support assistive technology for children and youth with disabilities. NET was required to use $5.6 million to contract with instructional television and the remainder to contract with education media centers.

The Interactive Parenting Program line item received $1.7 million in each fiscal year to fund a grant to RISE, Inc. as partial support in a program to educate preschool staff members and providers on developmentally appropriate teaching methods and to involve parents more closely in the education and development of their children. The intent was that, over the course of the current biennium, NET, in concert with RISE, Inc., would develop and implement this program, perhaps in conjunction with other state supported technology programs, to include an interactive instructional program, teleconferences, and training sessions. Upon completion of each of the school years for which these grant moneys were made, RISE Inc. is required to issue a report that discusses the program's goals, objectives, activities, progress, and outcomes.

Health Care/Medicaid

With only one month of somewhat unpredictable healthcare payment events left in FY 1998, Medicaid spending continued its salutary contribution to the state's fiscal picture by chipping in another round of underspending in May. For the month, Medicaid spending totaled $357.6 million, falling short of the estimate by $23.1 million, or 6.1 percent. This negative monthly disbursement variance in turn boosted Medicaid's year-to-date underspending to $132.2 million, which was 2.7 percent below the estimate. (For more detail on monthly and year-to-date Medicaid spending, see table 6.)

Before our usual selective monthly look-see at some of the service categories hidden below Medicaid's bottomline, we'd liked to offer two broad observations. First, the decline in TANF related, and to a lesser degree Aged, Blind and Disabled, caseloads continued to constrain Medicaid spending. Thus, the building of year-to-date underages in certain service categories depicted in Table 6 was not, and should not have been, a surprise. Second, although there were relatively large monthly disbursement variances in certain service categories, they appeared, at least based on our current programmatic knowledge, to carry no discernible significance at this time. This very qualified way of speaking is intended to send a clear signal to the reader that a judgement of an event's significance, especially if a program is not rich with timely data, may only be rendered retrospectively and not prospectively.

That said, let's turn then to monthly spending.

Prescription Drugs. The most positive fiscal news for the month was probably the safe arrival of

Table 6

FY 1998 Medicaid Spending (Line Item 400-525)

	May '98				Year-to Date Spending			
Service Category	**Actual**	**Estimate**	**Variance**	**Percent Variance**	**Actual** thru' May**	**Estimate** thru' May**	**Variance**	**Percent Variance**
Nursing Homes	$150,491,453	$158,803,181	($8,311,728)	-5.2%	$1,736,688,767	$1,697,726,777	$38,961,990	2.3%
ICF/MR	$27,182,388	$27,893,525	($711,137)	-2.5%	$311,296,660	$313,277,112	($1,980,452)	-0.6%
Hospitals	$84,422,734	$85,913,200	($1,490,466)	-1.7%	$1,047,130,628	$1,073,428,120	($26,297,492)	-2.4%
Inpatient Hospitals	$66,198,870	$67,470,079	($1,271,209)	-1.9%	$812,567,537	$833,619,364	($21,051,827)	-2.5%
Outpatient Hospitals	$18,223,864	$18,443,121	($219,257)	-1.2%	$234,563,091	$239,808,756	($5,245,665)	-2.2%
Physicians	$20,368,695	$21,319,794	($951,099)	-4.5%	$253,875,674	$258,290,905	($4,415,231)	-1.7%
Prescription Drugs	$28,215,474	$43,111,205	($14,895,731)	-34.6%	$464,838,786	$417,342,493	$47,496,293	11.4%
Payments	$51,182,118	$53,889,006	($2,706,888)	-5.0%	$572,136,966	$534,057,494	$38,079,472	7.1%
Rebates	$22,966,644	$1,088,515	$21,878,129	2009.9%	$107,298,180	$107,025,714	$272,466	0.3%
HMO[2]	$194,809	$0	$194,809	na	$432,728,120	$558,010,289	($125,282,169)	-22.5%
Medicare Buy-In	$20,587,144	$10,217,442	$10,369,702	101.5%	$122,407,389	$118,889,791	$3,517,598	3.0%
All Other***	$26,069,341	$33,429,080	($7,359,739)	-22.0%	$313,532,313	$378,503,891	($64,971,578)	-17.2%
TOTAL	$357,532,039	$380,687,427	($23,155,388)	-6.1%	$4,682,498,337	$4,815,469,378	($132,971,041)	-2.8%
CAS	$357,581,197		($23,106,230)	-6.1%	$4,683,313,346		($132,156,032)	-2.7%
Est. Federal Share	$207,949,860	$221,417,631	($13,467,771)		$2,723,643,100	$2,800,982,533	($77,339,433)	
Est. State Share	$149,582,179	$159,269,796	($9,687,617)	-6.1%	$1,958,855,237	$2,014,486,845	($55,631,608)	-2.8%

* 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.

2. HMO payment made from IMD/DSH monies ($34,387,151.7), Funds 5C9 & 3F0, ALI 400 - 672 & 623.

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

previously delayed Prescription Drug rebate money, which we had noted in last month's ***Budget Footnotes***. Rebates worth $22.9 million hit the system in May and reversed the April shortfall. Monthly Medicaid spending took an interesting reversal of fortunes once one factored out the estimated $19.0 million rebate amount that was expected in April. When we performed that calculation, Medicaid's total monthly spending rose to $376.5 million, and was only $4.2 million, or 1.1 percent, below the monthly estimate. Furthermore, had this $19.0 million been properly reflected in April spending, Prescription Drug spending in May would have been increased from $28.2 million to around $47.2 million. This would have transposed the $14.9 million monthly underage in that service category into a $4.1 million overage.

Nursing Homes. For the month, Nursing Home services payments were $8.3 million, or 5.2 percent, below the estimate, thus reducing the year-to-date overage to $38.9 million. As regular readers of ***Budget Footnotes*** may have noticed over the course of FY 1998, this service category has exhibited a fluctuating mix of monthly overages and underages. The lack of timely information about recipients for whom claims were paid has made, and continues to make, analyzing monthly gyrations in the Nursing Home service category exceedingly problematic.

Buy-In. The Medicare Buy-in payment registered $20.6 million, which was roughly double the monthly estimate and essentially represented two months worth of payments in May. We have been led to believe that this payment included the June as well as the May Buy-In payment.

HMOs. Stop the presses we cried. Not only did the May HMO payments total a paltry $194,809, but no such payments were even built into the monthly estimate. By gosh, we got us a story right here in River City. Well, as it turned out, we'd probably not read the FY 1998 script closely enough. The truth of the matter was that May's HMO payments actually totaled $34.6 million, with only $195,000 being paid from Medicaid's lone GRF line item 400-525. The balance of the payments, $34.4 million, was covered using a mix of state and federal reimbursement moneys earned from the state's IMD/DSH (Institutions for Mental Disease Disproportionate Share) program. This payment method reflected the change in the executive branch's original plan which was to use these funds for the transfer of certain Medicaid service payment activities to the departments of Mental Health and Alcohol and Drug Addiction Services, an administrative plan that was not implemented. A similar payment mechanism will be employed for the month of June. (Next month, we plan to get into a more detailed discussion of the state's IMD/DSH program.)

Medicaid's negative year-to-date disbursement variance has been driven principally by underages in the HMO service category. Spending for HMO coverage of TANF eligibles has been suppressed due to the continued decline in TANF cash assistance caseloads. In addition, HMO enrollment rates of TANF eligibles have declined as well. HMO penetration rates have fallen from a fiscal year high of 54.4 percent in December 1997 to 49.5 percent in the month of May.

TANF

TANF (Temporary Assistance to Needy Families) program spending finally made its anticipated course reversal by posting a $10.9 million May overage, thus breaking ten consecutive months of underspending that featured a low of $12.4 million last September and a high of $51.7 million just last month. However, this positive monthly variance did little to dent TANF's year-to-date underspending, which still stood at a rather sizeable $218.5 million, or 22.3 percent, below where the estimate assumed we would be at this point in the fiscal year.

Glancing over the status of the various TANF components, as well as the state's maintenance of effort requirement (MOE), year-to-date at the close of May produced the following spending picture: the Child Support Collections (Fund 4A8) contribution to the MOE had been met, TANF Day Care (GRF line item 400-413) had been nearly 100 percent disbursed, the state TANF MOE (GRF line item 400-410) stood at 98 percent disbursed, and the TANF Federal Block Grant (GRF line item 400-411) had been 64 percent disbursed.

Looking ahead to June, we will probably witness the year-to-date underage shrinking considerably. Cash benefits alone should easily exceed the relatively low original estimate for the month — $31.6 million. There will also be disbursements for the Prevention, Retention, and Contingency program, county administration, and other expenses. In addition, funds for the newly created TANF Employment and Training program will be made available to the counties during June. Nevertheless, when all is said and done, it seems likely that actual FY 1998 TANF disbursements will be substantially under the original annual estimate. The actual size of that underspending will depend on programmatic decisions made by the Ohio Department of Human Services, but seems likely, in our view, to exceed $100 million, all in GRF line item 400-411 (TANF Federal Block Grant).

And lastly, the ongoing drop in the TANF caseload marched forward with 13,000 fewer recipients in May than there were in April.

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) edged down in the month of May. Likewise, DA disbursements were below estimate by a little over $900,000, or 17.7 percent. As a result of continued declines in the caseload, year-to-date, DA disbursements were $6.3 million, or 10.5 percent, below estimate.

Other Human Services

Health. On first blush, an aura of tranquility oozed from the Department of Health's disbursement variance at May's end, suggesting not much of note was afoot. However, from amongst the department's 25-plus GRF line items, we found five with disbursement variances worth noting.

First, within the department's health care policy and data program, the Ohio Health Care Data System line item (440-413) was carrying a negative disbursement variance of close to $900,000, with only 55 percent of its $2.9 million FY 1998 appropriation having been spent. Further investigation suggested that the line item's appropriation — which funds a statewide, uniform electronic claims system that collects information on all recipients of publicly funded health care — has historically exceeded the effort's true need and that a lapse of $900,000 or so would not be surprising.

Second, within the department's disease prevention program, the Immunizations line item (440-418) — used to purchase vaccines to prevent the occurrence and transmission of infectious diseases — had unexpectedly disbursed over 80 percent of its $6.9 million FY 1998 appropriation, especially in light of the expectation that approximately $3.2 million would be encumbered for disbursement in FY 1999. This outcome was simply another reminder that there are line items in the state budget, this being one of them, for which generating reasonably accurate spending estimates can be somewhat of a lost cause.

Third, within the department's quality assurance program, the Nursing Home Survey and Certification line item (440-439), carrying a $3.3 million FY 1998 appropriation as the state's match for its role in the surveying and certification of nursing homes for Medicaid, was running a year-to-date underage of almost $800,000. As the department's recent quality assurance efforts have been directed more into areas associated with the federal Medicare program, less of this matching Medicaid money has been spent. This raised the possibility that around $750,000 of the line item's FY 1998 appropriation may lapse, and that in the future the department may need to budget more GRF matching funds in favor of its Medicare quality assurance responsibilities and less for its Medicaid efforts.

Fourth, again within the department's disease prevention program, line item 440-451, Prevention, displayed a negative year-to-date disbursement variance in excess of $1.0 million, a considerable amount of which will most likely lapse at the close of FY 1998. This line item's $5.1 million appropriation represents about one-third of the state's FY 1998 GRF commitment to the disease prevention program and is used essentially to cover a host of operating expenses related, but not limited to, infectious disease control, health promotion and risk reduction, environmental health and toxicology, and laboratory testing.

Fifth, again within the department's quality assurance program, of the $3.9 million in FY 1998 subsidy funds to aid local health departments in the inspection and/or licensure of swimming pools, manufactured home parks, food services, and wastewater and sewer services, absolutely no money has been disbursed (line item 440-501). This was not all that surprising as local health departments have some statutorily required reporting requirements to fulfill prior to the release of these state subsidy funds. The entire FY 1998 appropriation has been encumbered and will most likely be released as one or two large lump sum payments early on in FY 1999. These subsidy funds are distributed according to a formula developed by the Public Health Council, with local health departments being given a base amount plus additional funds according to population. Subsidy funding could be enhanced even further if a local health department meets optimal public health standards.

A last note on the Department of Health's disbursements before we move on to other matters. The department is also one of those state agencies — of which the Department of Natural Resources and the Ohio Environmental Protection Agency jump readily to mind — that maintains a chargeback or indirect cost recovery system under which GRF accounts with an operating component are required to make payments that in turn support central office's administrative expenses. Two months of those indirect cost payments are expected to post in June, which will reduce the department's total GRF lapse from what we might otherwise have expected by just looking at the May numbers.

Mental Retardation. As more of a prelude to our next disbursement discussion covering June and the close of FY 1998, we'd like to emphasize three matters with respect to FY 1998 funding lapses and the Department of Mental Retardation and Developmental Disabilities. And by lapsing, we are referring to the accounting rule that state agencies with GRF appropriations not expended or encumbered prior to the start of FY 1999 essentially lose control of those amounts as they, in theory at least, revert back to the state's GRF cash balance and are available for other purposes.

First, the department is in the rare position of having some statutory protection from the lapsing of GRF appropriations. How can that be? Well, just check out section 5123.352 of the Revised Code, which was created by Am. Sub. S.B. 21 of the 120th General Assembly. Under that provision of state law, the director of the department is required, not later than 60 days after the end of each fiscal year, to certify to the Office of Budget and Management (OBM) the amount of all the unexpended, unencumbered balances of GRF appropriations made to the department for the fiscal year, excluding debt service appropriations. On receipt of the certification, OBM must transfer that amount to the Community Mental Retardation and Developmental Disabilities Trust Fund. All moneys credited to the trust fund must be used to provide temporary funding to county boards of mental retardation and developmental disabilities and to pay the expenses of members of the trust fund's advisory board.

Second, as just noted the lone exception to the department's statutory GRF lapse protection is money appropriated for debt service payments. The equivalent of this in the department's budget is GRF line item 320-415, Rent Payments-OPFC. This line item carries a FY 1998 appropriation totaling $41.9 million, of which $1.2 million will not be needed. Thus, this $1.2 million will in fact lapse and not qualify for transfer to the trust fund.

And third, at the close of FY 1998, it would not surprise us if the largest line item in the department's $340-plus million FY 1998 budget — 322-413, Residential and Support Services — was still holding around $17.0 million of its $128.2 million FY 1998 appropriation. This line item is used to fund community residential and other support services for individuals with mental retardation or other developmental disabilities through: state contracted Purchase of Service (POS) homes; supported living services contracted by county boards; and the state's home and community based Medicaid waiver programs — Individual Options (IO) and Omnibus Budget Reconciliation Acts (OBRA). Any money left unexpended in the line item after June is expected to be encumbered for disbursement later in FY 1999, which means that none of it would be available to be certified for transfer to the credit of the trust fund.

Minority Health Commission. Last month, the commission — created in 1987 to promote health awareness and disease prevention among members of economically disadvantaged populations — was highlighted in these pages as the result of our uncovering a relatively substantial monthly overage and then dismissed as largely a matter of nothing more than timing. This month we turned our attention to the commission's $200,000-plus year-to-date underage, driven by a mix of line items 149-501, Minority Health Grants, and 149-502, Lupus Programs. Most notable was the latter line item, which, with only June remaining, had disbursed only 24 percent of its $180,000 FY 1998 appropriation.

The Lupus Program is a grant-making activity that the commission inherited from the Department of Health at the start of FY 1994. Temporary law in place ever since stipulates that funds appropriated to this line item be used to provide grants for programs in patient, public, and professional education on the subject of Systemic Lupus Erythemtosus; to encourage and develop local centers on Lupus information gathering and screening; and to provide outreach to minority women.

Since taking over the Lupus Program, the commission has employed a variety of approaches in deciding how to distribute this grant money. The commission has only recently settled on the awarding of FY 1998 grants, which will include moneys for the Lupus Foundation of America and the Arthritis Foundation. With these grant awards, the commission's intent is to provide programs that serve all of Ohio's eighty-eight counties in one way or another, although it does appear at this time that no arrangement has been formalized to serve Franklin County. All of the FY 1998 Lupus money will either be expended by the end of June or encumbered for disbursement in FY 1999.

It is likely that an arrangement to serve Franklin County may not be in place until FY 1999, which itself may be negatively affected by the 1.0 percent budget cut that the commission was required to take pursuant to Am. Sub. H.B. 650 of the 122nd General Assembly. As a result of that budget trimming, the original FY 1999 Lupus Program appropriation of $180,000 was reduced to $178,200. Given the potential that FY 1999 Lupus Program grant moneys have already been promised to existing service providers, and no grant agreement currently exists to serve Franklin County, it is certainly likely that there will be less grant money available to serve Franklin County, once an arrangement is formalized, than would otherwise have been the case.

Rehabilitation Services. Over the course of FY 1998, we have remarked repeatedly about the persistence of the Rehabilitation Services Commission's (RSC) negative year-to-date disbursement variance and almost in the same breath asserted that it would eventually disappear. In fact, the last time we uttered that mantra was the March issue of ***Budget Footnotes***. So, it was with almost a sigh of relief that our belief seemed well on its way to confirmation following May's disbursements. RSC closed the month with a $1.1 million overage and had reduced a year-to-date underage that had been scraping $4.0 million only a month or two ago down to roughly $1.0 million. The dominant force in RSC's GRF disbursements continued to be the roughly $11 million line item 415-506, Case Services for People with Disabilities, which virtually represents one-half of their total FY 1998 GRF appropriations.

If we can be allowed to mouth our mantra one more time, the remaining underage should have largely evaporated when the June numbers are in, realizing of course that any activities tied to federal programs, which RSC's are, create some amount of uncertainty in the art of estimating the amount of state versus federal money that might be spent at any particular point in time.

Ohio Veterans' Home. The Home produced a negative May disbursement variance of 21 percent, which in turn cut their year-to-date overage down to $429,800 with just one month left in the fiscal year. As we had noted in the March issue of ***Budget Footnotes***, the Home's GRF spending on payroll and maintenance was on a collision course with fiscal reality, meaning that spending was running dangerously close to appropriations, a problematic cash flow trend that could not possibly continue. Thus, an underage in May was not surprising, nor would one be in June either.

How then has the Home managed to extricate itself from this fiscal quandary, particularly in light of the fact that over 90 percent of what we term their 100 (personal services) and 200 (maintenance) GRF money had been disbursed by the close of May?

Very simply, some payroll and maintenance expenses have been shifted to various non-GRF accounts. A specific manifestation of this maneuver, a standard operating practice for state agencies when GRF money is tight, will most likely occur in June when the Home approaches the Controlling Board for an increase in the FY 1998 appropriation authority of a non-GRF operating account or two to cover payroll expenses that have been transferred in anticipation of a shortfall in available GRF funds. Secondarily, one suspects that, to the extent possible, some maintenance spending slated to happen in FY 1998 was postponed until FY 1999.

Environment & Natural Resources

Ohio EPA. The Ohio Environmental Protection Agency closed May having disbursed all but $1.3 million of its total $25.5 million GRF budget, which included less than $200,000 in funds encumbered from prior fiscal years. Eighty-one percent of the GRF budget is devoted to the operating expenses of various divisions, with the remainder, around $4.8 million, allocated to subsidies for local air agencies, a science advisory program, and a unique, one-time $3.0 million earmark to address problems with a wastewater system serving Rocky Fork State Park in Highland County. Almost all of the GRF funds unexpended to date will either be disbursed or encumbered by the end of June.

The notable lapse expected to occur is in line item 715-503, Science Advisory Program, a newly created program for the purpose of supporting research on environmental regulation and its effects on the environment, health, and the economy. In each year of the biennium, the budget bill provided a $500,000 appropriation. Through May, absolutely none of the FY 1998 appropriation had been disbursed, although a small amount of funds had been encumbered. This new program had obviously gotten off to a much slower start than had been anticipated. A lapse of up to $300,000 is a very real possibility.

Natural Resources. The Department of Natural Resources' FY 1998 GRF budget totals almost $100.0 million, which includes around $1.6 million in funds encumbered from prior fiscal years. Virtually that entire GRF budget is allocated for various divisional operating expenses and annual debt service obligations, with the most noticeable exception being $8.9 million in subsidy funding for county soil and water conservation districts.

Of the total $100.0 million, at May's end, almost $94.0 million, or 94.0 percent, had been disbursed, leaving only around $6.0 million with a month to go in the fiscal year. All of these unspent funds will most likely be disbursed or encumbered by the end of June.

The only line item expected to produce much of a lapse is 725-413, OPFC Rental Payments, which contains a $16.3 million appropriation that finances debt retirement of revenue bonds issued for various parks and recreation capital projects. Around $900,000 or so remains unspent and will lapse. This lapsing of GRF funds appropriated for debt service payments would not be a new, nor surprising, fiscal phenomenon to seasoned followers of the state budget. In recent years, appropriations beefed-up to reassure bond markets in tandem with a healthy economy have combined to conserve debt service spending and produce funding lapses.

Other Government

Administrative Services. With a $1.9 million negative May disbursement variance, the Department of Administrative Services continued its flirtation with the $30.0 million mark in year-to-date underspending. Year-to-date underspending actually hit $29.6 million, driven there by a blend of lower than expected payments for rent and operating costs on certain state-owned buildings and slower than expected disbursements on computing and communications services to other state agencies.

A total of $106.2 million was appropriated in FY 1998 to provide payment of rent and operating expenses for state agencies that occupy space in various state-owned buildings, including the State of Ohio Computer Center. A load of that money, $71.8 million, was for the purpose of making debt service payments to the Ohio Building Authority who financed the construction of those state-owned buildings. As actual rent and operating costs have been less than the amount of funds available, a lapse of $12.5 million is a very real possibility.

The other major source of the department's underspending has been its computer and communications services program, the second leading piece of the FY 1998 GRF budget with appropriations totaling in excess of $22.0 million. Two components of the program continued to stand out with very sluggish disbursement patterns — the Year 2000 Competency Center and the Multi-Agency Radio Communication System (MARCS) project.

The budget bill created a new line item (100-430) to provide the department with the necessary resources to lead, support, and facilitate achievement of Year 2000 compliance throughout state government, the purpose of which is to ensure that computer systems can recognize century dates. At month's end, only $1.2 million, or 15.0 percent, of the $8.0 million appropriated for FY 1998 had been disbursed, with another $800,000 or so vouchered or encumbered. This left an available fund balance of about $6.0 million, with $5.0 million of that amount scheduled to be transferred into FY 1999 subsequent to approval of the Controlling Board sometime in June.

The MARCS project was established in 1994 for the purpose of developing a statewide mobile radio system that would provide voice and data communication and feature computer aided dispatch, automatic vehicle location, and telephone interconnect. Of the $3.4 million appropriated to assist with ongoing management and operation of the system under development (line item 100-417, MARCS), just over 25 percent had been disbursed at the end of May, another $100,000 or so was vouchered or encumbered, and roughly $2.4 million was left in available funding with one month left in the fiscal year. So far, it has appeared that concerns with the price tag associated with the construction of MARCS, as well as uncertainties surrounding the availability of any new capital money, have exerted a serious dragging effect on where many would have expected the project to be at this point in time. As a result, a lapse on the order of $1.0 million or even $2.0 million or so has become a real possibility. ❑

**LBO colleagues developing the material that anchored this issue include, in alphabetical order, Ogbe Aideyman, Laura Bickle, Erica Burnett, Sybil Haney, Steve Mansfield, Jeffrey M. Rosa, and Wendy Zhan.*

Issues of Interest

Evolution of State Assistance for Local Law Enforcement:

The Attorney General's Community Police Match and Law Enforcement Line Item

Jeff Newman

Of the many policy changes ushered in with Am. Sub. H.B. 215 of the 122nd General Assembly (the general operating budget bill), one of the less heralded was a provision expanding the authority of the Attorney General to provide subsidy moneys to county, municipal, township, and state assisted or state supported institutions of higher education law enforcement operations. This authority permitted the Attorney General to increase state assistance by reducing restrictions on the use of moneys from the 055-406 (Community Police Match and Law Enforcement Assistance) line item. Prior to the passage of the budget bill, funds appropriated for the 406 line item were restricted solely for the purpose of aiding localities in meeting the 25 percent requirement for matching funds in order to draw down federal funds available through the various Community Oriented Policing (COPS) programs. This change opened up the potential uses by local entities for these dollars.

Created as part of the federal Violent Crime Control and Law Enforcement Act of 1994, and offering funding for a variety of law enforcement purposes, COPS had as its most publicized goal the provision of federal assistance in putting 100,000 additional police officers on the street by the year 2000. While the offering up of additional federal funding was obviously attractive to localities, it carried with it potential future fiscal burdens and created a dilemma whereby localities which took the money and hired the additional officers knew that there would be only three years of federal funding. Despite the presence of the dilemma however, many Ohio localities applied for and received the federal assistance, which according to the United States Department of Justice has amounted to $87.2 million provided to Ohio since the beginning of calendar year 1996.

State Assistance in Meeting the Matching Requirement

To assist localities in accessing this new source of federal dollars, the state began in fiscal year 1995 to provide assistance to localities in the form of subsidy moneys. While these funds provided 10 of the 25 percent federal matching requirement (leaving localities to provide the remaining 15 percent), many localities choosing to seek the federal dollars, chose not to take advantage of the state matching assistance. The choice of localities not to take advantage of the state dollars is reflected in the performance of Community Police Match line item (055-406) during fiscal years 1996 and 1997 as it lapsed $2.9 million and $351,000 of the respective appropriations. While no empirical study has been conducted to determine why localities are opting not to pursue the state matching assistance, possible explanations may be tied to a desire to avoid an extra layer of required paperwork or the view that the amount of state assistance was not worth the effort. While the amount of the appropriations that lapsed seems minor in relation to the overall state budget, appropriation levels alone do not reflect the additional moneys appropriated for that purpose through the Controlling Board but never released to the Attorney General. Specifically, when we look at total state appropriations between 1995 and 1997, $12.15 million of the $18.2 million earmarked went untapped. Considering that Ohio localities received a total of $87.2 in federal COPS moneys since the beginning of calendar year 1996, without the benefit of all the available state dollars, the need for the amounts of state assistance offered comes into question.

Increased Flexibility in Am. Sub. H.B. 215

In an attempt to make greater use of available resources and to assist local law enforcement officials, the budget bill loosened restrictions on the use of the 406 line item. These changes, which among other things, amended the title of the line item to Community Police Match and Local Law Enforcement Assistance (from Community Police Match) and expanded the authority of the Attorney General to disburse moneys for uses other than simply meeting federal grant matching requirements. Specifically, the Attorney General's authority was expanded to permit grants to local law enforcement for the purposes of improving technology and equipment, as well as providing support for local organized crime task forces. However, despite the permitted expansion of the use of moneys in the 406 line item, the direct state assistance for additional purposes could only be secured after funds were allocated for requested matching purposes.

The Effects of Policy Changes and Future Issues

As previously discussed, while the funding to assist localities solely for the purpose of meeting the federal matching requirement in fiscal years 1995 through 1997 resulted in available funding not being fully utilized, it appears that the opposite may be true for both fiscal years 1998 and 1999. According to representatives of the Attorney General, despite sizable funding increases of 19.9 percent in fiscal year 1998 and 5.0 percent in fiscal year 1999, little money should lapse either this year or next as assistance to local law enforcement increases by as much as $700,000 to $800,000 annually. However, with appropriation increases of $600,000 during the current biennium and at least a short term move toward the seeking of equipment grants, it has been unclear as to the extent or nature in which increased state assistance is meeting local law enforcement needs.

While the language authorizing the change in policy expanded the use of 406 moneys to assist local law enforcement in improving technology and equipment and to provide support to the organized crime task forces, anecdotal evidence indicates most of the funding was used to support the purchase of computer equipment. While much of the equipment was purchased directly by the localities upon receipt of state assistance, some of these moneys were used at the state level to purchase specialized equipment for the Organized Crime Investigations Commission which is then loaned to local organized crime task forces on an as needed basis.

Based on projections through the first three quarters of fiscal year 1998, it appears that the increase in state expenditures has been successful in assisting localities in securing ongoing levels of federal funding as well as providing an additional $800,000 (25.8 percent of the total appropriation) in direct state assistance. Within this broader picture however, it appears that there has also been at least a short-term move away from matching assistance as state expenditures used to assist localities for this purpose shrink from $2.55 (87.8 percent) to $2.3 (74.8 percent) of the total appropriation. Whether the decrease expected in fiscal year 1998 is an anomaly or the beginning of a trend brought about by the combination of expanded use of state funds is unclear and muddled further by the uncertainty of whether Congress will reauthorize the COPS program once it expires in 2000. Since current language permits the expenditure of all appropriations remaining after the awarding of matching moneys, a decision not to reauthorize at the federal level would at least in theory, create a situation in which the state appropriation could be used only as direct assistance to local law enforcement. As a result of the above uncertainties and the possibility that state budgetary priorities will most likely need to be set prior to a federal decision on reauthorization, it will be interesting to see how this line item evolves in the upcoming biennium. ❑

Benchmarking: A More Productive Way of Measuring an Agency's Performance?

Nelson Fox

There was a time when dogs wandering city parks were the only experts on "benchmarking".

This all has changed since benchmarking made its way into the public sector. Ideally, benchmarking shifts policy makers' focus from measuring quantities of services delivered to the quality of service provided. A well conceived benchmarking system should enable policymakers to:

- evaluate an agency's current performance;
- forecast potential problems;
- alter policy before a crisis forces drastic action.

Ultimately, benchmarks should make public managers more accountable by assessing the strengths and weaknesses of agency services at frequent intervals.

BWC Benchmarks Replace Performance Measures

The Ohio Bureau of Workers' Compensation (BWC) will soon provide the results of its second benchmark report to the General Assembly, the Office of Budget and Management (OBM), the Legislative Budget Office (LBO), and the Workers' Compensation Oversight Commission. This reporting requirement was contained in a provision of H.B. 363, BWC's current budget bill.

What are BWC's benchmarks, and of what use are these data to policy makers and regulators as they attempt to assess the performance of Ohio's workers' compensation system?

Can policymakers use these benchmarks to make valid comparisons between the performance of Ohio's workers' compensation system and those in other states?

What are the limitations of these benchmark data?

The concise one-page benchmark report, which contains 13 indicators of performance, replaces a more detailed 17-point performance report that BWC was mandated to provide to the General Assembly under the agency's previous budget bill, H.B. 278 of the 121st General Assembly. That bill required the agency to gather data on myriad agency functions, pegging specific performance expectations to each of the 17 measures. BWC was required to submit the quarterly reports to the General Assembly, as well as OBM and LBO.

Although performance measures may yield insight into the efficiency of administration, they can also lead policymakers to simplistic judgements about agency performance that emphasize rates of output over quality of services delivered. For example, the H.B. 278 report required BWC to track its claims management performance, stipulating that the Bureau should make initial determinations on 100 percent of lost-time claims within 28 days. Quotas of this kind may well encourage speed of claims processing, but they can do so at the expense of fairness to injured workers who file these claims or their employers.

Benchmarks, BWC officials contend, shift policymakers' focus toward a more comprehensive analysis of agency services. Indeed, the semiannual benchmark report may allow the agency—and lawmakers—to make more informed policy decisions concerning workers' compensation issues. This means that policymakers need to analyze an array of interrelated performance data contained in the benchmark report, itself a complicated task.

Interpretation Is Sometimes Complicated

Especially in the case of workers' compensation, simple performance statistics can be misinterpreted when taken out of context. This is the case with injury rate data. Since higher injury rates drive up expenses throughout the workers' compensation system (and eventually premium costs) most workers' compensation jurisdictions monitor these data closely.

The injury rate reported for the December 1997 period illustrate the perils of misinterpreting this information. The table below shows Injury Rate per 1,000 workers recorded since December 1995, as reported on BWC's benchmark report.

Average Injury Rate/ 1,000 Workers	
Dec 1997	92.2
Jun 1997	86.3
Dec 1996	83.1
Jun 1996	84.9
Dec 1995	86.1
Jun 1995	87.9

Note that the injury rate appears to have increased substantially since December 1995. Does this trend suggest that BWC's workplace safety programs are not effective, and that administrators need to address the troubling increase in injury rates? Not necessarily.

There could be an alternative interpretation that explains why the rate of injury appears to be increasing. Perhaps employers and workers are simply more willing to report injuries to BWC promptly. In addition, this may indicate better coordination between the Bureau and the various managed care organizations handling medical claims.

Far from detecting something amiss, then, the increase in reported injuries could actually be a positive outcome. Indeed, in the long run early medical intervention tends to reduce lost time and medical benefits costs. In turn, reduced claims costs leads to reduced premiums.

Comparisons to Other States Difficult

The extraordinary variation in bureaucratic processes among workers' compensation systems complicates what might seem to be an exercise in simple comparison. Nevertheless, a few nationally recognized workers' compensation think tanks have realized the value of such comparisons and have undertaken benchmarking initiatives that might yield more straightforward—and valid—comparisons.

One such initiative is a benchmarking program spear-headed by the International Association of Industrial Accident Boards and Commissions (IAIABC).[1] In its interim report, the IAIABC has pointed to a number of concerns which made state-by-state comparisons of workers' compensation programs very difficult. Most of the problems stem from 1) the vast differences in size of programs, and 2) the lack of common terminology among workers' compensation systems.

This means that policy-makers should make state-by-state comparisons very carefully. One way to surmount this difficulty is to group workers' compensation systems by size and type. Even this method poses problems.

For example, while five other states maintain exclusive state funds, Ohio's system is by far the largest. This means that generally there are few measures by which policymakers can compare Ohio's workers' compensation system to those in other states.

Explaining Deviations

Although benchmark reports can condense performance indicators into a straightforward document, they also tend to omit key information that helps explain the data. BWC's "Direct Loss Ratio" benchmark is an example of how important detail should be included in such performance reports. The Direct Loss Ratio is simply a percentage derived from dividing the medical and indemnity claims paid by premium by the assessment income received over the same period. Data from the period December 1995 through December 1997 for this indicator are displayed below.

Direct Loss Ratio	
Dec. 1997	199.3%
Jun 1997	93.1%
Dec 1996	80.9%
Jun 1996	76.6%
Dec 1995	74.4%
Jun 1995	76.2%

The December 1997 result for the "Direct Loss Ratio"—almost 200 percent—appears to be far out of line with previous results in the 75 to 95 percent range. A footnote appearing in the benchmark report puts this apparent spike in context by citing recent premium cuts and dividends announced late last year. These actions reduced premium and assessment income while claims costs remained fairly constant. Since claims costs remained steady most of the period, this caused the direct loss ratio to soar.

While too much detail can overwhelm policymakers and hinder effective policy evaluation,

BWC Benchmark Results, June 1995 to December 1997

Benchmark	Dec 1997	Jun 1997	Dec 1996	Jun 1996	Dec 1995	Jun 1995
Premium Cost per State Fund Worker Premium and Assessment income from State Fund employers divided by workers employed by State Fund employers	$511	$555	$645	$667	$678	$661
Claim Cost per State Fund Worker Indemnity and Medical Costs Paid from State Fund divided by workers employed by State Fund employers	$500	$497	$511	$512	$502	$498
Administrative Cost per Claim Total State Fund Administrative Costs divided by Number of Active Claims	$324	$343	$317	$280	$295	$283
Return on Investments State Fund investment return	19.5%	18.6%	9.4%	13.3%	29.4%	17.9%
Direct Loss Ratio Premium and Assessment income divided by indemnity and medical costs paid; expressed as percentage	199.3%	93.1%	80.9%	76.6%	74.4%	76.2%
Customer Service Index An index derived from survey results from workers with medical and lost time claims	7.0	7.1	NA			
HPP Performance Index Not yet developed	NA					
Avg. Injury Rate per 1,000 Workers State Fund claims filed divided by State Fund employment	92.2	86.3	83.1	84.9	86.1	87.9
Avg. Days to Adjudicate Medical Bills Average number of days BWC takes to pay all medical bills received	13.5	13.8	12.5	13.6	15.9	16.4
% Injured Workers returning to Work Injured workers eligible for return to work divided by number of injured workers with stable return to work	NA	91.4%	89.5%	88.3%	86.1%	84.1%
Avg. Days to report Injury Average lag time between injury and report to BWC for lost time and medical claims	43.7	57.3	63.9	65.4	66.3	69
% Claims Adjudicated Within 14 Days Percentage of lost time and medical claims determined by BWC within 14 days	9.6%	2.1%	1.4%	1.2%	1.2%	1.0%
% Claims Contested to Industrial Commission Percentage of determinations subsequently appealed to the Industrial Commission	10%	NA				

benchmark data should include 1) definitions of the indicators used, and 2) summaries that explain any anomalous data.

Conclusion

From a management perspective, the BWC benchmarks appear to shift the emphasis of agency performance away from sheer quantity of output and toward service outcomes. Administrators will need to interpret a combination of data to conduct a proper analysis and to make informed policy changes.

Benchmarks can also play an equally important role in legislative oversight of the state's workers' compensation system. Both legislators and legislative staff could make use of information related to the benchmarks. This suggests that BWC's benchmark report could be enhanced by defining the indicators used and providing capsule summaries for each of them, especially when there are noteworthy statistical aberrations. The benchmark report could then become an innovative and effective way to ensure administrative and legislative accountability for Ohio's workers' compensation system. ❑

1 "'Comment Draft: Benchmarking' the Administration of Workers' Compensation Systems." The International Association of Industrial Accident Boards and Commissions. http://iaiabc.org/committee activity/benchmarking taskforce. July 1, 1997.

STUDENT LOANS ON THE AUCTION BLOCK? THE DEBATE OVER STUDENT LOAN INTEREST RATES

FREDERICK CHURCH

This article is part of a continuing series — appearing at irregular intervals — on the practical application of economic analysis to federal, state, and local public finance issues.

Congress has adopted a temporary fix to the problem of what to do about student loan interest rates, but the issue still lacks a long-term resolution. The federal transportation act that President Clinton recently signed contained a 3-month delay in resetting interest rates. By delaying the change in the interest rate calculation from July 1 to October 1, the loan process for the coming school year is subjected to minimal disruption while a longer-term fix is sought as part of the reauthorization of the federal Higher Education Act.

The debate over interest rates stems from the 1993 law that created the Federal Direct Loan Program (FDLP) to compete with the existing bank-lending program (the Federal Family Education Loan Program, or FFELP).[1] Besides creating a new direct loan program that eliminated the middleman, the 1993 federal Student Loan Reform Act (SLRA 93) also included a change in the calculation of the interest rate on student loans made through banks. At the time that the law was passed, the calculation change would have had a minor impact. Now that long-term interest rates have fallen and the yield curve has flattened, the potential impact on lending banks and borrowers is huge. The executive and legislative branches of the federal government are thus considering various compromises that would water down the impact on lenders while still providing some interest savings to borrowers. There are also longer term proposals involving market-based auction mechanisms being offered.

The proposed interest rate change would have a large financial impact. The Congressional Budget Office (CBO) projects that new FFELP loans nationwide in FY 1998 will total $19.7 billion. The volume in Ohio is projected to be about $1 billion. About 6 million students receive financial assistance though FFELP loans. Federal subsidies to lenders and guarantee agencies totaled $6.4 billion in FY 1996. A 1 percent decrease in borrowing costs to students will mean large savings, although if the lenders are held harmless it could also mean a large increase in costs to the federal government.

This short paper essentially has three objectives: (1) to describe the proposed law change and its effect on banks and borrowers; (2) to provide a rough estimate of the impact of proposed changes on Ohio borrowers; (3) to discuss the potential impact of "market-based" loan alternatives.

Background on Student Loan Programs

In 1993, the federal Student Loan Reform Act (SLRA 93) created the Federal Direct Loan Program (FDLP) to compete with (and perhaps replace) the Federal Family Education Loan Program (FFELP). Under the FDLP the federal government makes loans directly to students and parents through their schools. Under the old FFELP private banks make the loans. The same types of loans are offered through both programs. The FDLP has not captured as large a share of the market as originally expected: nationwide, the FFELP is still the more popular program, chosen by the majority of colleges and universities. Spokespersons from state loan guaranty agencies estimated that about 70 percent of student loans nationwide were through the FFELP.[2] In Ohio, according to a spokesperson for the

Great Lakes Higher Education Guaranty Loan Corporation (GLHEGC) the volume of FDLP loans and FFELP loans is approximately equal.

Through the FFELP, the federal government provides three incentives to lenders to make student loans:

(i) the government guarantees 98 percent of the principal amount of eligible loans;

(ii) the government sets the interest rate that lenders can earn on the loans;

(iii) the government establishes a ceiling on the interest rate that students pay — currently 8.25 percent.

When the interest rate that the lenders are allowed to charge exceeds the maximum interest rate that students are required to pay, the federal government makes up the difference through Special Allowance Payments (SAPs). SAPs also reimburse lenders on a quarterly basis for increases in interest rates during the year. On subsidized loans (based on financial need), the government also pays all interest during the time that borrowers are in school, during a grace period after they graduate, and during authorized deferment periods. On the unsubsidized loans (not based on need), borrowers are responsible for the interest payments, but they are frequently deferred until loan repayment begins. Most FFELP loans are for 10 years. There are annual and total caps on the amounts that students and/or parents can borrow.

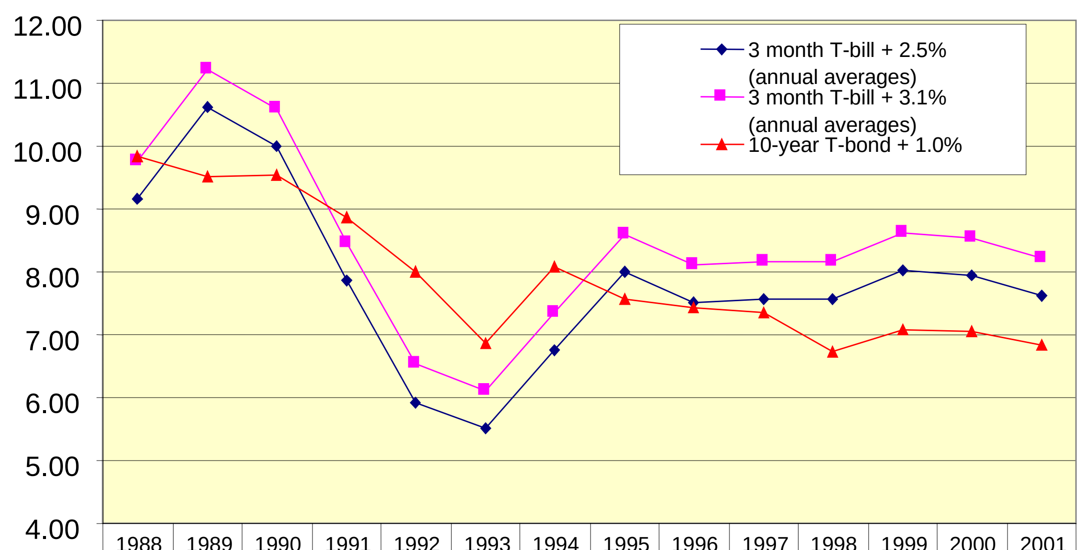
Besides the interest charges on the loans, there are also fees that borrowers pay. The FFELP authorizes lenders to collect an "origination fee" of 3 percent of the principal borrowed, which is then paid to the federal government. The origination fee is intended to offset the federal subsidy cost (this is essentially a form of risk pooling). There is also an insurance premium of up to 1 percent that is paid to a loan guaranty agency. The Clinton Administration's current budget proposal not only changes the interest rate calculation, it also changes the fee structure. Total origination fees plus insurance premiums would be capped at 3 percent, and origination fees would be eliminated for needy students.

The Interest Rate Calculation

The simplified version of the current and new interest rate calculations is provided below, followed by some discussion of the nuances of the formula and the implications for lenders and borrowers.

On federally guaranteed student loans made between July 1, 1994 and

Student Loan Interest Rate Differentials, Old and New



	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
3 month T-bill + 2.5%	9.17%	10.61%	9.99%	7.87%	5.93%	5.50%	6.75%	7.99%	7.51%	7.56%	7.57%	8.02%	7.95%	7.62%
3 month T-bill + 3.1%	9.77%	11.21%	10.59%	8.47%	6.53%	6.10%	7.35%	8.59%	8.11%	8.16%	8.17%	8.62%	8.55%	8.22%
10-year T-bond + 1.0%	9.85%	9.50%	9.55%	8.86%	8.01%	6.87%	8.08%	7.58%	7.44%	7.35%	6.74%	7.09%	7.05%	6.85%

October 1, 1998, the interest rate is the bond-equivalent yield (BEY) on three month Treasury bills (T-bills) plus 2.5 percent when borrowers are in school, in the grace period, or deferring repayment. The rate is BEY plus 3.1 percent when borrowers are repaying their loans. The rate earned by lenders is determined quarterly based on average T-bill rates on bills auctioned during the quarter. The loan rate paid by the students is reset annually and capped at 8.25 percent.

Old Formula: 3 month T-bill rate +2.5% or 3.1%. Rate reset quarterly. New formula: 10-year T-bond rate +1.0%

Beginning October 1, 1998, the rate earned by lenders is equal to the BEY of Treasury securities with a maturity comparable to FFELs (about 10 years) plus one percentage point. Most commentators have simplified this to be the yield on 10-year Treasury bonds (T-bonds) plus 1.0 percent. The rate would be reset every 12 months.

At certain times in history, such as when the FDLP program was created, the difference in these interest rate calculations was small. Now that the yield curve has flattened, so that short-term and long-term interest rates have become much closer, the savings to borrowers and reduction in profits to lenders from this change is quite substantial.

According to the U.S. Treasury Department's report on this issue, the motivation for going to the 10 year Treasury bond was twofold.[3] First, although the formula would have produced an increase in interest rates if it had gone into effect at the time that the law was passed, the federal government's economic projections assumed that short-term interest rates would rise by more than long-term rates, and so by the time the change took effect in 1998-99, students would pay about 0.6 percent less in interest (in fact, it looks like they would have paid 0.8 percent to 1.4 percent less — see the table). Second, the Treasury Department already charges the U.S. Department of Education a discount rate for budget scoring purposes that is tied to the 10 year Treasury bond rate.

As one can see from the chart and the table, beginning in 1995 the 10-year T-bond + 1.0 percent fell substantially below the T-bill rate plus either 2.5 percent or 3.1 percent. The gap narrowed somewhat in 1996 and 1997, but it has widened again in 1998, and is projected to remain substantial over the next several years.[4]

Impacts of the Change

The battle lines on this issue are fairly clearly drawn. Student groups want the SLRA 93 changes in the interest rate formula to stand, so that borrowers save money. Banks that make student loans under the FFEL Program want the change overturned, because it reduces their profits on lending.

The lenders in the program are subjected to several changes by the new law. The first and most obvious is that the interest rate is reduced. The second is that a timing mismatch is introduced between interest flows (now tied to a long-term rate) and financing costs. This results in additional risk for lenders, who generally raise funds to finance their student loan portfolio through short-term borrowing, or by securitizing their loans based on T-bill rates. Also, there is a smaller capital market for the 10-year Treasury note than for financial instruments with shorter duration, so some financial institutions may have trouble capitalizing their student loan portfolios and selling their loans on the secondary markets. This could mean a shortage of liquidity in the student loan program and might make some lenders reluctant to make federal student loans.

Because of the mismatch between bank borrowing terms and the 10 year T-bond, the Treasury analysis concluded that interest rates should be re-indexed to 3 month T-bills. Treasury estimated that to hold borrowers harmless for the 1998/1999 school year — no longer a concern due to the delay until October 1 — the interest rate should be reduced to the T-bill rate plus 1.7 percent - 2.0 percent. For the longer run, holding student borrowers harmless would require a premium of 1.8 percent to 2.1 percent on top of the T-bill rate. For lenders to make money, Treasury estimated that the new interest rate would have to be the T-bill rate plus 2.1 percent to 2.45 percent. Even this rate would be a savings relative to the current 2.5 percent / 3.1 percent markup (Treasury estimates that the weighted average markup is about 2.9 percent).

Treasury's analysis was the genesis of a Clinton Administration compromise proposal that would cut student loan interest rates to the T-bill rate plus 1.7 percent or 2.3 percent when students are repaying their loans. Essentially, this retains the old formula structure but cuts rates by 0.8 percent.

Summary of Student Loan Interest Rate Proposals

		Base		Lenders' Premium	Borrowers' Premium	Repricing
Current Law	In School, Grace Period, Deferral	3 month T-bill		2.5%	2.5%	quarterly
	During Repayment	3 month T-bill		3.1%	3.1%	quarterly
SLRA 93	In School, Grace Period, Deferral	10 year T-bond		1.0%	1.0%	annual
	During Repayment	10 year T-bond		1.0%	1.0%	annual
Administration	In School, Grace Period, Deferral	3 month T-bill		1.7%	1.7%	quarterly
	During Repayment	3 month T-bill		2.3%	2.3%	quarterly
House of Reps.	In School, Grace Period, Deferral	3 month T-bill	*	2.2%	1.7%	quarterly
	During Repayment	3 month T-bill	*	2.8%	2.3%	quarterly

* Difference of 0.5% to be made up by federal subsidy

CBO's own study of the proposed FFELP changes concluded that the Treasury analysis had given short shrift to lenders, and that cutting rates by 0.8 percent would not allow banks to earn an adequate rate of return.[5] Banks also responded with an outcry, claiming that they could not make money under the formula in SLRA 93 or under the Administration proposal. The banks claimed that so many lenders would exit the FFELP that students would have difficulty getting loans. [6]

Critics of the CBO study and the private bank studies have pointed out that the CBO drew rather sweeping conclusions from a small sample, and that furthermore student loans are not a generic commodity. There is a much higher loan volume taken by students of private 4-year colleges, where the profit margin is higher. These critics say that the most likely lender response would be to reduce lending to lowest-cost institutions, so that access to loans would be a particular problem for students attending community colleges and other 2-year institutions. However, critics of the bank studies also claim that state guarantee agencies could have accommodated most or all of these students through acting as a "lender of last resort" with federal money.

The various claims and counterclaims essentially point out that there is no consensus within the community about pricing these loans. In response to concerns from the banking community and the colleges themselves, the U.S. House modified the Administration proposal to a cut of 0.8 percent in the interest rate paid by students, but a cut of only 0.3 percent in the interest rate earned by lenders. The 0.5 percent gap would be paid to lenders as a federal subsidy.

The CBO study does not directly speak to whether cutting the rate to lenders by only 0.3 percent would allow them to be profitable, although it seems to suggest that it would. CBO estimated that the 0.5 percent subsidy would cost the government $1.2 billion over 5 years, while the Administration estimated the cost at $2.7 billion.

The key features of the various proposals are summarized in the table above.

The United States Student Association (USSA) estimates that the average undergraduate has about $15,000 in student loan debt by graduation time. Fairly simple math shows that a student paying the maximum 8.25 percent (this cap would be in effect assuming the T-bill rates + 3.1 percent listed in the table above) would save about $800 over a 10-year repayment if the rate were reduced by 0.8 percent. A graduate student with $80,000 in debt would save about $9,700 over a 20-year repayment period.

Using the numbers we have, we can generate a rough estimate of the potential savings to Ohio student borrowers from the Administration's interest rate proposal. The GLHEGC estimates that there is about $1 billion annually in new FFELP loans in Ohio. Using the Treasury's estimate that the weighted average of the existing 2.5 percent / 3.1 percent premium over the T-bill rate is about 2.9 percent, under the existing law Ohio students on average would pay an interest rate between 8.0 percent and the maximum 8.25 percent (see the table above). If the average repayment period is 10 years, then a reduction in the interest rate of 0.8 percent would cut annual interest payments by $53 million for the $1 billion in loans taken out in the first year. Second year savings would be $106 million, third year savings would be $159 million, etc., until by year 10 a peak annual savings of $530 million would be realized.

Alternative Mechanisms – Markets and Auctions

Although the Treasury and CBO studies of student loan profitability differed, both included calls for "market-based mechanisms." CBO's report does not specify what that mechanism would be, although there is a key phrase that states that the competitive mechanism would be for "setting the yield lenders earn on FFELs." Treasury's study proposes something somewhat different, an auction mechanism.

One of the key, and controversial, points made by the Treasury study is that the current FFELP market is not competitive. While the legislated interest rate is a ceiling, in practice banks generally do not go below that rate to attract borrowers. Many schools have preferred provider lists of lenders to whom they steer students. The competition among lenders to be on the preferred provider list may take the form of competition in services provided to the colleges themselves rather than interest rate competition in the loans offered. This finding that the current market is not competitive is one of the driving forces behind the Treasury's auction recommendation.

The Treasury Department, of course, has vast experience with debt auctions — it auctions T-bills and T-bonds throughout the year. After the Salomon Brothers scandal of 1991, Treasury moved to a uniform price auction from the old sealed-bid, multiple-price auction it had used for decades. The Treasury report on student loans suggests a mechanism similar to the "Vickrey Auction" now used for Treasury securities.

The Treasury report takes the Health Education Assistance Loan (HEAL) program as a starting point. HEAL is a federally-insured loan program for graduate students in schools of medicine and the health professions. Interest rates on HEAL loans are capped at the 3 month T-bill rate plus 3.0 percent. The insurance authority for HEAL loans is auctioned and the spread over the T-bill rate has been below the 3.0 percent cap and declining. For the last auction in February 1997, the successful bid was the T-bill plus 1.5 percent.

What the Treasury report specifically recommends is that the banks be forced to make sealed bids for the right to make specified amounts of student loans. Bids would be accepted in order from highest price to lowest price (lowest to highest interest rate) until the total target quantity of student loans, as estimated by the U.S. Secretary of Education, had been reached. The maximum interest rate that all lenders could charge would be that of the last bid accepted. This is different than a pure Vickrey auction in that the bid accepted is not the second-highest. However, it is similar in that all successful bidders would offer one interest rate. A bank that bid 6 percent when the highest bid was 7 percent would clearly make out: presumably if they bid 6 percent it was because they could be profitable at that rate, but they are allowed to charge 7 percent. However, overall the auction mechanism should encourage fair bidding and keep interest rates down. The same bank would not want to bid 7.25 percent and try to make a killing, because it risks bidding so high that it does not get the right to make any loans at all.

Finally, the Treasury report itself states that the HEAL experience may not translate directly to the FFELP. The HEAL program is only about $85 million annually, compared to the $20 billion FFELP. Furthermore, successful HEAL bidders have mostly been nonprofit state guarantee agencies, who are not taxable and thus can borrow funds at lower rates than FFELP lenders.

The Consumer Bankers Association opposes the Treasury's auction proposal and disagrees with their view of the HEAL program.[7] Many medical colleges also don't like the HEAL program — it drove down student interest rates, but colleges couldn't choose the banks that they wanted to work with. A spokesperson for the Association of American Medical Colleges stated in writing that medical colleges had the following objections to the HEAL auction mechanism: it created year-to-year uncertainty; students lost track of their loans as banks in the program changed; because banks were unsure whether they would remain in the program for the long-term, their customer service declined.

The Clinton administration has responded that the program can be set up so that lenders bid for the right

Vickrey Auction

The Vickrey Auction is named for the economist William Vickrey, the 1996 Nobel Economics Prize winner, who formalized its structure in the 1960s (in the financial community this is sometimes called a Dutch auction, but that is actually a completely different type). It is also known as the “uniform second-price auction.” It is a sealed-bid auction where each bidder is supposed to not know the other bids, and the item being sold is awarded to the highest bidder at a price equal to the second-highest bid (or highest unsuccessful bid). In other words, a winner pays less than the highest bid. If, for example, Bank A bids $100, Bank B bids $110, and Bank C bids $120, Bank C would win, however he would only pay the price of the second-highest bid, namely $110.

The modified Vickrey auction used by the Treasury Department is more complicated than this. Treasury auctions multiple blocks of T-bills, and there is more than one winning bidder. In this case, all winning bidders pay for the bills at the same price, the highest losing price.

Why adopt such a mechanism? The old multiple-price sealed bid auction was a target for manipulation and collusion. The risk of bidding too high was great, and the reward for bidding low was great. Brokers tried to cheat and find out what other bidders were offering. They might also collude and agree that nobody would offer a fair price, making sure that an artificial ceiling was in place.

Real-world experiments have shown that in a Vickrey auction, bidders adjust upward. No one is deterred out of fear that he will pay too high a price. Aggressive bidders receive sure and certain awards but pay a price closer to market consensus. The price that winning bidder pays is determined by competitors' bids alone and does not depend upon any action the bidder himself undertakes. Less “bid shading” occurs because people don't fear the so-called “winner’s curse”, where the winner almost by definition pays more than anyone else thinks the item is worth (imagine how difficult this makes resale). In short, the Vickrey auction is a relatively simple but extremely clever way to get buyers to reveal their willingness to pay.

to serve specific colleges, and guarantee that they will hold the loans until the borrowers graduate. Presumably this could answer the primary medical college objections. However, the banker objections are another matter.

What lenders want is a system where the rates lenders earn and that students pay are both set by the free market (recall the phrase in the CBO study, quoted at the start of this section). Banks would somehow compete directly for borrowers on the basis of interest rates and loan servicing quality. LBO is not aware of any research on how exactly this would work and whether interest rates would be higher or lower than under the current program. It seems likely that interest rates would show a much wider variation, and that students in need who are poor credit risks might face high rates and thus have trouble getting access to loans without federal subsidies.

Congress is looking seriously at auction proposals. Senator Domenici wants to include in the Senate version of the Higher Education Act reauthorization a provision that would keep the House’s 0.8 percent / 0.3 percent rate cut compromise in place for 5 years and phase in a market-based system by 2003. The CBO, Treasury, and advisory groups would study possible models.

The Clinton Administration wants to test market-based approaches sooner. With administration urging, Senator Kennedy is expected to offer an amendment to the Senate version of the HEA reauthorization that would give the Education Secretary the authority to run a 2-year pilot program beginning in FFY 1999 that would apply to as much as 20 percent of FFELP volume.

The final form that the student loan program will take is still unclear, but given the dissatisfaction with the current rate-setting mechanism, it appears likely that a different structure will be in place in the future. It is possible that the outlines of the new structure may be visible by this Fall, if Congress continues on its current path. ❑

[1] Some members of the Democratic-led Congress that passed that act called for the direct loan program to completely replace the bank lending program.

[2] Some commentators feel that politics may have been involved. They believe that the direct loan program would have attained greater market share if the Republicans had not captured both chambers of Congress in 1995. See Stephen Burd, "Free Market Ideas Win Support for Overhaul of Student Loans," ***The Chronicle of Higher Education***, June 26, 1998.

[3] See "The Financial Viability of the Government-Guaranteed Student Loan Program," U.S. Department of the Treasury, Office of Public Affairs, February 25, 1998.

[4]WEFA's forecasts of spreads between the 3 month T-bill and the 10 year T-bond are somewhat smaller than the CBO or OMB projections, meaning that the savings to borrowers under the WEFA assumptions is somewhat larger. However, the forecasts are quite close given the uncertain nature of forecasting interest rates.

[5] "The Profitability of Federally Guaranteed Student Loans," Congressional Budget Office, March 30, 1998.

[6] "Administration Report on Student Loans Is Flawed and Would Create Major Loan Access Problems," Consumer Bankers Association News Release, March 5, 1998. Also see "Impact of 1998 Interest Rate Formula on Guaranteed Student Loans," Jonathan Gray, October 1997. Mr. Gray is an analyst for Sanford, Bernstein & Company.

[7] "An Auction in the FFEL Program Adversely Affects Student Loans, Schools, and Students," Consumer Bankers Association, June 4, 1998.

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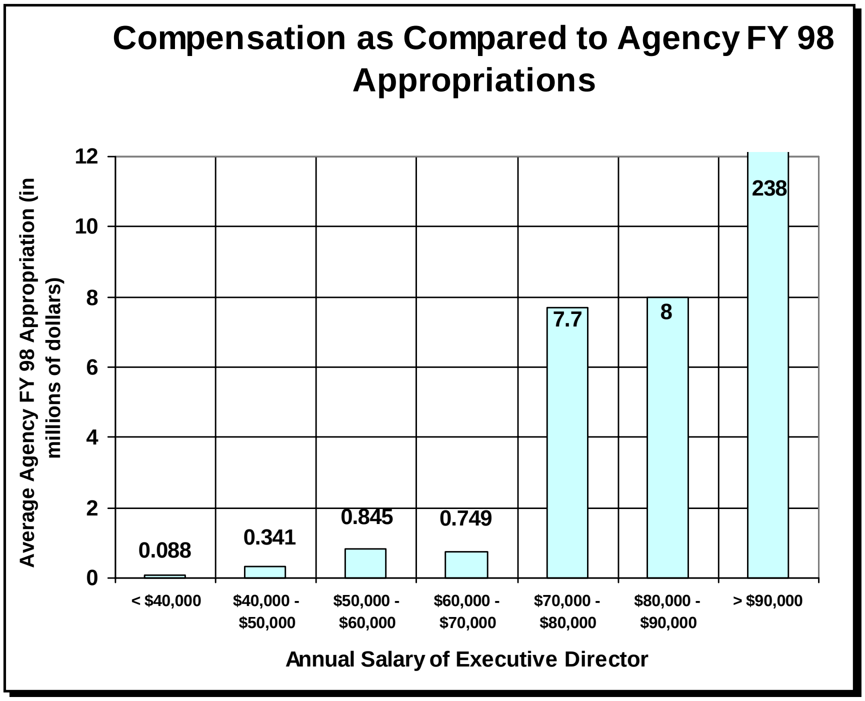
Ohio Facts Extra!

Board and Commission Salary Study Excerpts
— Jeffrey Rosa

Section 151 of Am. H.B. 215 of the 122nd General Assembly required the Legislative Budget Office to conduct a study of the salaries of executive directors and administrators of all the boards and commissions in Ohio whose operating expenses were appropriated in the FY 98-99 biennium. The following are excerpts from this study. The complete study is available online at http://lbo.state.oh.us/products/salarystudy.html. For further information, please contact Jeff Rosa.



- Compensation rates for directors and administrators vary greatly among the various boards and commissions in the state. Salaries range from approximately $36,000 to $102,000, while the majority fall within the $50,000 to $70,000 range.

- Directors and administrators also exhibit varying levels of educational attainment. Six boards and commissions are headed by individuals with high school diplomas, but most directors have a bachelor's degree and a significant number have masters degrees as well.

- The average tenure of directors and administrators is 6.5 years, although twelve individuals have headed a board or commission for at least ten years and two have been directors for more than twenty years.

- In FY 98 appropriations for boards and commissions ranged from $88,000 to $444,000,000.

- Survey results indicate a relationship between agency appropriations and the salary of the director. Any relationship between salary and education level or tenure and education level is less clear.