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Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE

JUNE/JULY, 1999

FISCAL OVERVIEW

— *Frederick Church*

> *As long as we are lucky we attribute it to our smartness; our bad luck we give the gods credit for.*
> *— Josh Billings*

Last July's year-end issue of this report had considerable discussion of the size of the budget surplus in Ohio and other states. The feeling was that state and local governments were at the peak of a 5 year run of good economic and fiscal conditions. As it turns out, FY 1998 wasn't quite the peak. The National Conference of State Legislatures (NCSL) recently reported the results of its state budget survey for FY 1999. NCSL's general conclusion was that states are in "their best financial condition in decades." For the 44 states that responded to the survey, aggregate ending fund balances — combining the general fund and rainy day fund balances — were $33.4 billion, or 9.4 percent of FY 1999 general fund spending. This is the best figure since NCSL has been tracking state finances. Before this year, FY 1980 and FY 1998 (last year) had posted the highest ending balances, at 9.0 percent of spending. Just as in FY 1998, in FY 1999 17 states had combined ending fund balances in excess of 10 percent of general fund spending. Ohio was once again one of those 17 states, and was one of the 11 "billion dollar club" states, with year-end balances over $1 billion.

Ohio's year-end balances are not quite as high as at the end of FY 1998. Last year, Ohio's combined ending GRF and BSF balances amounted to $1,947.1 million, or 13.6 percent of GRF spending, excluding transfers and federal moneys (i.e. state dollars only), but including encumbrances. This year, the combined ending balances were $1,883.7 million, or 12.5 percent of state GRF spending plus encumbrances. So Ohio is still well ahead of the U.S. average of 9.4 percent. Ohio is also still ahead of all its

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STATUS OF THE GRF

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Note to our readers: This is Fred's swan song. After a 12 year stint with LBO, during which he wrote the Fiscal Overview, Tracking the Economy, and Revenue sections of this publication— in addition to forecasting the State's revenues— Fred has departed the capital grounds of Ohio for the scenic shores of Maryland. Thank you, Fred, for your many years of dedicated service to the state of Ohio. Your quick wit and contribution to the multitude of tax policy issues in Ohio will be sorely missed.

Fred is now the Assistant Director of the Bureau of Revenue Estimates in the Maryland Comptroller's Office. Good luck tracking and forecasting revenues in Maryland!

It is a time, then, for new beginnings with our next issue. Along with the new fiscal year, we usher in a new era for Budget Footnotes. Doris Mahaffey, another of LBO's capable Senior Economists, will be penning the Revenues section, with Allan Lundell, Economist, 'Tracking the Economy' in Ohio. Look for their bylines in future issues. Welcome aboard, Doris and Allan, in this new capacity!

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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 1a
Combined GRF and BSF Fund Balances as a % of GRF Spending (State $ Only)

	FY 1998	FY 1999
Indiana	17.7%	19.8%
Ohio	13.6%	12.5%
Michigan	12.7%	11.2%
U.S. Average (for states reporting)	9.0%	9.4%
Kentucky	8.5%	4.7%
Illinois	6.7%	7.0%
Pennsylvania	3.6%	6.1%
Wisconsin	3.5%	still in session
West Virginia	2.7%	2.6%

neighboring states and fellow Great Lakes states, except for Indiana. A comparison with these other states is in Table 1a.

As one can see in Table 1b, below, Ohio's FY 1999 year-end GRF balance was not quite as large as last year. The year-end balance shrank from $1,084.4 million to a still-healthy $976.8 million. In FY 1998, GRF non-federal revenues were $852.6 million over estimate, and GRF spending, adjusted for the shortfall in federal grants, was $178.5 million. This $1,031.1 million deviation from the forecast explained most of the big GRF fund balance that year. In FY 1999, non-federal GRF revenues were $327.9

Table 1b
Comparison of GRF Surplus, FY 1998 and FY 1999

Differences from Estimate	FY 1998	FY 1999 Revised Forecast	FY 1999 Original Forecast
GRF Non-Federal Revenue	$852.6	$327.9	$1,103.1
GRF Spending and Transfers Out	($651.3)	($314.2)	($303.7)
Federal Revenue	($472.7)	($46.6)	($432.8)
Net Spending	($178.5)	($267.6)	$129.1
Net Surplus or Deficit	$1,031.1	$595.4	$974.0
Ending GRF Balance (Unobligated)	$1,084.4	$976.8	$976.8

million above the revised estimate, and GRF spending, adjusted for the shortfall in federal grants, was $267.5 million. This amounts to $595.4 million, far short of the $976.8 million ending fund balance. However, a better comparison here is between the final revenue and spending figures, and the original forecasts upon which the FY 1998-1999 budget was based. Non-federal revenues finished $1,103.1 million above the original FY 1999 estimate. Because the federal revenue shortfall was so huge, spending and transfers, adjusted for the federal shortfall, were actually $129.1 million over the original forecast. The total deviation from the forecast was $974.0 million, close to the ending balance of $976.8 million. These calculations are summarized in Table 1b, above.[1]

The $976.8 million ending GRF balance provided for a transfer of $325.7 million to the public school building fund, $90.0 million in transfers to SchoolNet Plus and Distance Learning, a $46.4 million transfer to the BSF, a $221.5 million carryover balance for FY 1999, and a $293.2 million tax cut. The uses of the FY 1999 ending balance, with a comparison to FY 1998, are summarized in Table 1c.

Table 1c
Use of Ending GRF Fund Balance, FY 1998-1999

	FY 1998	FY 1999
Unobligated Ending GRF Balance	$1,084.4	$976.8
Transfers to Other Funds:		
School Buildings	($170.0)	($325.7)
Solvency Assistance	($30.0)	$0.0
Education Technology	$0.0	($90.0)
Budget Stabilization Fund	($44.2)	($46.4)
Total Transfers	($244.2)	($462.1)
Carryover to Next Year	($138.8)	($221.5)
Income Tax Cut (Transfer to ITRF)	$701.4	$293.2
Tax Rate Cut Percentage	9.34%	3.63%

Even with respect to the revised estimates, FY 1999 revenues were strong. Eight of the 12 GRF tax sources exceeded the revised OBM forecast. Tax revenue was $301.2 million above the estimate, or 2.1 percent. Year-over-year growth in tax revenue was 2.6 percent.[2] The total overage in non-federal revenue was $327.9 million, and year-over-year growth was 5.3 percent. The biggest revenue overages were in the personal income tax ($266.2 million), the sales and use tax ($55.3 million), the estate tax ($36.5 million), and investment earnings ($33.4 million). The biggest shortfalls were in the corporate franchise tax ($28.2 million), and the public utility excise tax ($37.4 million).

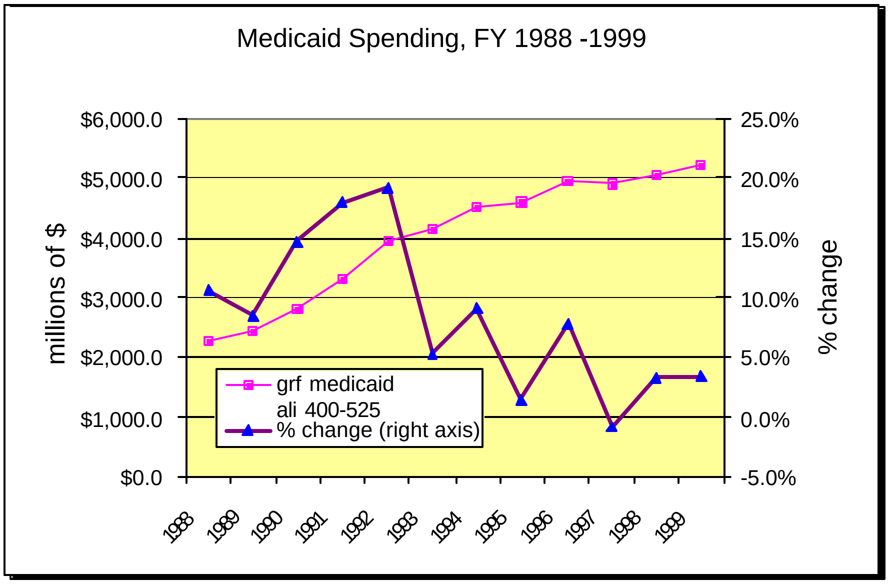
TABLE 1
General Revenue Fund
Simplified Cash Statement
($ in millions)

	Month of June	Fiscal Year 1999 to Date	Last Year	Difference
Beginning Cash Balance	$842.0	$1,649.0		
Revenue + Transfers	$2,004.0	$19,065.3		
Available Resources	$2,846.1	$20,714.3		
Disbursements + Transfers	$1,333.5	$19,201.8		
Ending Cash Balances	**$1,512.5**	**$1,512.5**	**$1,649.0**	**($136.5)**
Encumbrances and Accts. Payable		$535.7	$564.6	($28.9)
Unobligated Balance		**$976.8**	**$1,084.4**	**($107.6)**
BSF Balance		$906.9	$862.7	$44.2
Combined GRF and BSF Balance		**$1,883.7**	**$1,947.1**	**($63.4)**

When one looks at the original estimates, the star performers were clearly the income tax and the sales and use tax. The income tax finished $207.0 million above the estimate, but that is without adjusting for the impact of the 1998 tax cut. If the $627.8 million transfer from the ITRF to the GRF (89.5 percent of the total $701.4 million tax cut) is included, then the total income tax overage is $834.8 million.[3] That and the $138.6 million in the sales and use tax explain $973.4 million, or more than 88 percent, of the $1,103.1 million overage in non-federal revenue with respect to the original estimate.

The news on the other side of the ledger was also good, although not quite as striking. Spending excluding transfers was $461.1 million below the revised estimate. Year-over-year spending growth was 5.4 percent. Total outlays, including transfers, were $314.2 million below estimate. Adjusting for the shortfall in federal revenue, total outlays were $267.5 million below the revised estimate.[4]

Medicaid spending ended the year $107.5 million below the revised estimate ($231.8 million below the original estimate), although it flirted with a much larger variance until late in the year. Through March, Medicaid spending was $190 million below estimate and up only 0.6 percent over FY 1998. Spending for the last quarter of the fiscal year ate up $82.5 million of that variance, and was up 13.1 percent from last year. This was partly the



result of using $34.5 million to fund SETS penalties, and the spending of $69.5 million at the end of June that was originally planned to be encumbered but not disbursed. Even after these events, Medicaid spending for the year as a whole increased by only 3.4 percent.

By category, Medicaid spending had very large positive and negative variances, which partly cancelled each other out. HMO spending was $152.8 million below estimate, and nursing home spending was $86.7 million below estimate. All other categories were over estimate, including hospitals, prescription drugs, and physician services. HMO spending was not only below estimate, but also declined significantly from last year.

Viewed from another angle, Medicaid underspending was the result of reduced participation outweighing increasing costs per recipient. The total number of Ohioans eligible for Medicaid declined by 3.8 percent from FY 1998 to FY 1999. This was driven by the decline in the OWF-related eligible population, which has paralleled the decrease in the TANF rolls.

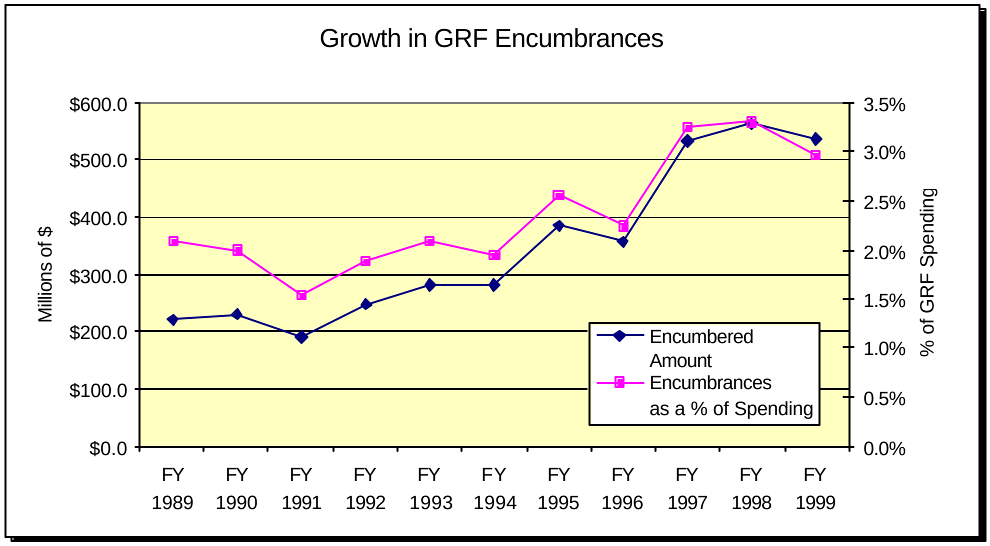
On the cost per patient side (aside from fixed fee schedule payments) Medicaid is having to pay more. Overall medical care inflation has begun accelerating again after having declined for several years. Prescription drugs in particular are seeing rapid price increases. Also, the fact that OWF-related eligibles are declining means that the higher-cost patients (ABD and other categories) make up a larger share of the total eligible population. This change in the case mix increases the cost per recipient.

Most of the other categories with significant underspending were also in the human services area. The exception is the general government area ($108.8 million), but that is largely a function of accounting adjustments, which will be discussed in the disbursements section of this report. The single biggest variance was in TANF, which ended up $153.7 million, or 16.3 percent, below the estimate. TANF spending was actually $214.9 million below the original estimate. Spending actually increased by 0.5 percent from last year, despite the fact that the number of recipients fell by over 103,000, or 26.0 percent. However, once one accounts for the $75 million in federal grant money that was not appropriated, and the $55 million lapse that was assumed at the beginning of the year, and miscellaneous other factors, total TANF underspending was about $275 million. This is the amount that was added to the ever-growing TANF reserve.

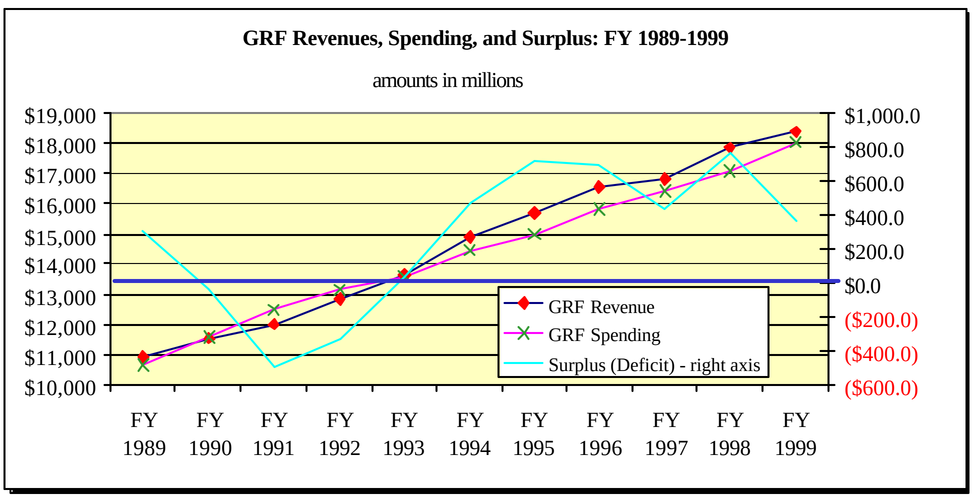
Outside of welfare and human services, there was substantial underspending in primary and secondary education ($37.4 million), but this was much less than in FY 1998. One reason for the lower variance was the change in the funding structure. H.B. 650 largely eliminated unit funding for special education and vocational education. Unit funding had been a consistent source of underspending in FY 1998 and prior years.

In FY 1999, encumbrances actually fell slightly from their record FY 1998 level. The state had been on a path of encumbering more and more year-end unspent money, allowing agencies to carry over unspent dollars to the next year for specified purposes, rather than allowing appropriations to lapse and thus adding them to the ending fund balance (and thus to a transfer of an increase in the tax cut). In FY 1999, there was at least a small reversal in that trend, with encumbrances falling from 3.3 percent of GRF spending (excluding transfers) to 3.0 percent.

However, if the $69.5 million in planned Medicaid encumbrances had been added to that total, the figure would have been 3.4 percent, yet another increase.



Why exactly the agencies feel the need to encumber more and more money at year's end is something of a puzzle. In some cases, such as Medicaid, the encumbrance is simply a timing issue: ODHS generally encumbers the final week's Medicaid payment and actually writes the check in the next fiscal year (although they didn't do that this year). In other cases, it is not clear why there has been a steady increase in the amount of appropriations that agencies cannot spend during the fiscal year, although they find that they need the money at year's end.



Finally, LBO noted last year that the states had deviated from their usual cyclical pattern of budget surpluses and deficits. The old pattern went something like this: states fall short in recessions, and so they cut spending, raise revenues, and uses the rainy day fund (if any). When the economy recovers, state forecasters are still very cautious, and the state begins to run budget surpluses. Eventually forecasts start to catch up with the new economic reality, and the executive and legislative branch become more aggressive in either increasing spending or reducing revenue in response to the surplus. Eventually the economy slows again, often catching forecasters at least somewhat unprepared, and the state once again falls into a deficit. So, a graph of budget deficits and surpluses tends to follow a sine-wave pattern.

However, in FY 1998, the continued growth in the income tax pushed Ohio and other states away from this pattern. Although Ohio's GRF surplus had been gradually shrinking through FY 1997, it resumed growing again in FY 1998. The chart above shows that, on a current operating basis, under our particular definition, the GRF surplus did shrink somewhat in FY 1999.[5] Once all transfers other than liquor profits are backed out, GRF revenues exceeded spending by $368.3 million, less than half of the $770.1 million amount for FY 1998. Given this fact, it is somewhat surprising that the ending GRF fund balance end up being almost as large at the end of FY 1999 as at the end of FY 1998. The GRF had a high enough carryover balance that a large operating surplus was not required for a large ending balance. ❑

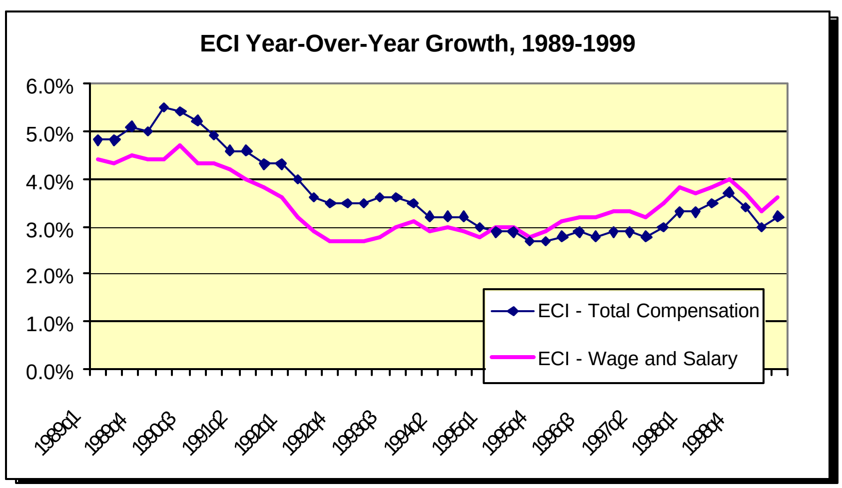
TRACKING THE ECONOMY

— Frederick Church

The current economic news is being dominated by fears of inflation. There is almost ceaseless speculation about what the Federal Reserve will do to the target federal funds rate and the discount rate at its next meeting (August 24h). Long-term interest rates are already rising: the national average 30-year fixed-rate mortgage ticked up to 8.08 percent in early August.[6] This is the first time mortgage rates have exceeded 8 percent since June of 1997. The stock markets continue to fall in reaction. For example, the Dow Jones Industrial Average (DJIA) closing value fell by 563.9 points, or 5.0 percent, in the roughly two-week span from July 16th through August 2nd. Technology stocks have been hit particularly hard by interest rate fears. Over the same period that the DJIA lost 5 percent, the NASDAQ composite index lost 8.4 percent of its value.

In the short run, one can point to particular news releases and events as a source of the renewed concern about inflation. First, Chairman Greenspan's comments in his July 23rd testimony to the House Banking Committee were interpreted as a sign that the Federal Reserve was once again seeing inflation as an imminent threat.[7] Second, the July U.S. employment report was very strong. The unemployment rate held steady at 4.3 percent, hourly wages rose faster than at any time since January, and the economy added a higher-than-expected 310,000 nonfarm jobs. Third, data showing wage increases and a productivity slowdown suggested that inflationary pressure through the labor market was re-emerging.

For some investors, the gain in nonfarm employment was the most troubling aspect of the report. Most economists had predicted gains in the range of 200,000 to 230,000 new jobs, well below the actual figure. The report revived fears that the economy is on the brink of overheating. After months of decline, manufacturing added 31,000 jobs in July, only the second increase in factory employment since March 1998. Most of the increase was concentrated in durable goods, where, according to analysts, employers took on new workers to boost their inventories. The other growth sector was retailing. Retail employment grew by 91,000 jobs. So far this year, retail job-growth has averaged about 51,000 a month, about twice the monthly average for the same period in 1998. The July gain was almost double the CY 1999 average, or almost four times as much as the CY 1998 average.



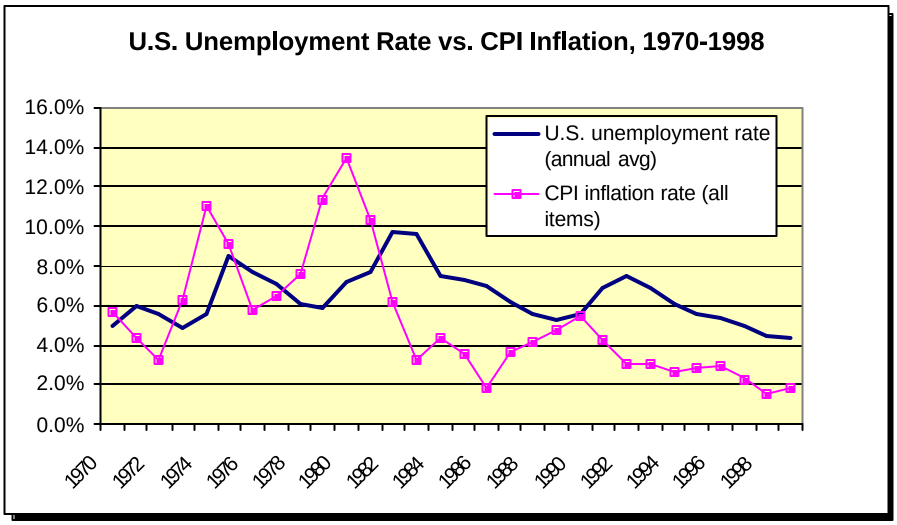
For other investors, the biggest warning sign was from the wage data. Average hourly wages in July rose to $13.29 from $13.23 in June, a six-cent increase. That compares with a five-cent gain in June and a four-cent increase in May. Over the last three months, hourly earnings have risen at an annual rate of 4.6 percent, well above the 3.8 percent July-to-July increase. In addition, the employment cost index (ECI) showed employment costs increasing by 1.1 percent in the second quarter, compared with 0.4 percent in the first quarter. The ECI is widely considered to be the most comprehensive and perhaps the best measure of wage and benefit costs to employers. However, a closer examination of the ECI makes it unclear if the second-quarter figure is more a bellwether of change or a fluke. In the first quarter, the ECI increase was a surprisingly low 0.4 percent. When the first and second quarter figures are examined together they do not necessarily suggest increased inflationary pressures. If one looks at the ECI's year-over-year increase through the second quarter, it comes out to 3.2 percent, which is only very slightly higher than the 3.0 percent year-over-year increase through the first quarter.

The year-over-year increase through June 1998 was 3.5 percent, and it was not a harbinger of an acceleration in inflation through FY 1999.

Along with the increase in the ECI and in hourly wages, productivity growth slowed in the second quarter of CY 1999. Nonfarm business productivity, which measures workers' output for each hour worked, increased at a 1.3 percent annual rate in the second quarter, slower than the first quarter's 3.6 percent pace. The productivity numbers are watched as an indicator of inflation, because increases in productivity mean that wages and benefits can increase without putting upward pressure on output prices.

As a result of the increase in wages and the slowdown in productivity growth, unit labor costs (the amount of money employers pay in wages and benefits for each unit of output) increased by 3.8 percent in the second quarter after rising only 0.8 percent in the first quarter. This was the fastest rate of increase in a year-and-a-half. Even so, the year-over-year increase in unit labor costs was only 1.4 percent.

The financial markets are clearly placing a lot of emphasis on the second-quarter results: a strong labor market, increasing wages and labor costs, slowing productivity growth. They fear that the Federal Reserve will see these as signs of a possible spurt in inflation and act to pre-emptively increase short-term interest rates. Long-term interest rates are already rising due to inflation expectations, and the equity markets are declining in response.



The question is: are financial markets over-reacting? Are the second quarter data releases the mark of a new trend, or a blip? Are the more modest year-over-year growth figures a more reliable indicator?

It may be that the financial markets' reaction to the latest economic data is the manifestation of a more deep-seated feeling, namely that the times cannot continue to be this good without an increase in inflation and a tightening by the Federal Reserve. In a sense, the markets are waiting for economic data to confirm a prior theory. Many economists have been surprised that GPD growth could be so high for so long, and that the unemployment rate could be so low for so long, without an increase in inflation.

We have discussed NAIRU theory in this space before and will not undertake an exhaustive review of it here. Suffice it to say that earlier in this expansion, many economists did not believe that the U.S. unemployment rate could drop below 6 percent for any length of time without an increase in inflation. These economists have been confounded by the fact that the unemployment rate has now been below 6 percent for 59 consecutive months. That's not a typo — five years of unemployment below 6 percent. When it became clear that the unemployment rate was going to stay below 6 percent and inflation was not about to spin out of control, NAIRU theorists set the new target at 5 percent. The unemployment rate has now been at or below 5 percent for 28 consecutive months — more than two years.

Some analysts believe that the financial markets' revived fears of inflation are overblown. DRI's June 1999 summary of the U.S. economy led with an article titled "Inflation: The Phantom Menace." The author, David Wyss, stated that for the longer term DRI expects:

(i) the core inflation rate to decrease;

(ii) the rate of increase in the ECI to slow;
(iii) productivity growth to remain strong.

The WEFA Group also sees CPI inflation of only 2.2 percent to 2.4 percent over the next few years. This low inflation would be good news for the U.S. economy. However, it does not mean that, if this forecast comes true, the stock market will necessarily rebound and resume growing soon. DRI also believes that the stock market is overvalued, and that big investor reactions to minor economic news may be based on the realization that current prices are very fragile.

It is worth remembering that as we wrapped up FY 1998, we were also writing about short-term turmoil roiling the financial markets. Last year, it was the economic/currency crisis in Asia and disappointing corporate earnings that had investors unsettled. This year it's mortgage rates, wage inflation, fears of overheating, and concern about the actions of the Federal Reserve. The turmoil at the end of FY 1998 made many people forget or dismiss the extraordinary performance of the U.S. economy in FY 1998. Professional forecasters reduced their estimates of income and GDP growth, and worried about recession. The stock market dove, beginning on July 17th. In spite of these things, the U.S. economy had another exceptional 12 month run through FY 1999. Short-term pessimism has been easy to sell, but it has not yet borne long-term fruit. ❑

Status of the General Revenue Fund

REVENUES

— Frederick Church

To recap information presented in the Fiscal Overview section, non-federal GRF revenues were $327.9 million above the revised estimate in FY 1999, and $1,103.1 million above the original estimate. Whether one uses the original or revised estimates, the biggest overages were in the income tax (if one includes the ITRF transfer) and the sales and use tax. The income tax was $266.2 million above the revised estimate, and $834.8 million above the original estimate ($207.0 million in income tax collections and $627.8 million in ITRF transfers). By LBO's calculation, baseline income tax collections (factoring out law changes, adding back losses due to the tax cut) grew by "only" 7.6 percent in FY 1999, as opposed to 14.4 percent in FY 1998. How could collections plus ITRF transfers be so much higher than the original forecast with an "ordinary" growth rate (this was approximately the average annual growth in collections in the pre-ITRF years of FY 1993-1996)? Well, since the original forecast was made before FY 1998, the huge overage in FY 1998 provided a much higher starting point for FY 1999 collections. Growth of 7.6 percent (still higher than the forecasted baseline growth) starting from a much higher level was enough to produce a huge overage in FY 1999.

Table 2
General Revenue Fund Income
Actual vs. Estimate
Month of June, 1999
($ in thousands)

REVENUE SOURCE	Actual	Estimate*	Variance
TAX INCOME			
Auto Sales	$74,596	$71,499	$3,097
Non-Auto Sales & Use	440,157	411,783	28,374
Total Sales	$514,752	$483,282	$31,470
Personal Income	$589,905	$628,591	($38,686)
Corporate Franchise	229,168	183,530	45,638
Public Utility	210,831	216,000	(5,169)
Total Major Taxes	**$1,544,656**	**$1,511,403**	**$33,253**
Foreign Insurance	$1,805	$780	$1,025
Domestic Insurance	186	3,288	(3,102)
Business & Property	129	1,750	(1,621)
Cigarette	26,579	25,245	1,334
Soft Drink	0	0	0
Alcoholic Beverage	5,120	4,836	284
Liquor Gallonage	2,274	2,310	(36)
Estate	4,961	4,725	236
Racing	0	0	0
Total Other Taxes	$41,055	$42,934	($1,879)
Total Taxes	**$1,585,711**	**$1,554,337**	**$31,374**
NON-TAX INCOME			
Earnings on Investments	$39,555	$28,750	$10,805
Licenses and Fees	2,012	2,400	(388)
Other Income	41,021	40,590	431
Non-Tax Receipts	$82,588	$71,740	$10,848
TRANSFERS			
Liquor Transfers	$9,000	$9,000	0
Budget Stabilization	0	0	0
Other Transfers In	0	7,523	(7,523)
Total Transfers In	$9,000	$16,523	($7,523)
TOTAL INCOME less Federal Grants	**$1,677,299**	**$1,642,600**	**$34,699**
Federal Grants	$326,708	$271,050	$55,658
TOTAL GRF INCOME	**$2,004,007**	**$1,913,650**	**$90,357**

* July, 1998 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

The sales and use tax was $55.3 million above the revised forecast and $138.6 million above the original forecast. Year-over-year growth in the sales tax was 5.3 percent, and that growth was remarkably evenly split between auto sales and non-auto sales. This was a slowdown from the 6.0 percent growth in FY 1998. The other big overages were in the estate tax and in investment earnings. The estate tax finished the year $36.5 million above the revised estimate and $41.7 million above the original estimate. Investment earnings finished $33.4 million above the revised estimate and $64.6 million above the original estimate.

Table 3
General Revenue Fund Income
Actual vs. Estimate
Fiscal Year-to-Date 1999
($ in thousands)

REVENUE SOURCE					
TAX INCOME	Actual	Estimate*	Variance	FY 1998	Percent Change
Auto Sales	$760,406	$735,000	$25,406	$722,836	5.20%
Non-Auto Sales & Use	4,784,943	4,755,004	29,939	4,542,687	5.33%
Total Sales	$5,545,349	$5,490,004	$55,345	$5,265,523	5.31%
Personal Income	$6,416,830	$6,150,600	$266,230	$6,212,546	3.29%
Corporate Franchise	1,084,063	1,112,300	(28,237)	1,196,601	-9.40%
Public Utility	637,565	675,000	(37,435)	672,996	-5.26%
Total Major Taxes	$13,683,807	$13,427,904	$255,903	$13,347,667	2.52%
Foreign Insurance	$271,609	$260,000	$11,609	$280,941	-3.32%
Domestic Insurance	77,547	75,000	2,547	63,218	22.67%
Business & Property	6,229	7,000	(771)	6,450	-3.42%
Cigarette	290,563	297,000	(6,437)	296,627	-2.04%
Soft Drink	0	0	0	0	#N/A
Alcoholic Beverage	53,786	52,000	1,786	52,410	2.63%
Liquor Gallonage	27,650	27,500	150	27,325	1.19%
Estate	141,456	105,000	36,456	114,784	23.24%
Racing	0	0	0	0	#N/A
Total Other Taxes	$868,840	$823,501	$45,339	$841,755	3.22%
Total Taxes	**$14,552,648**	**$14,251,405**	**$301,243**	**$14,189,422**	**2.56%**
NON -TAX INCOME					
Earnings on Investments	$148,356	$115,000	$33,356	$129,000	15.00%
Licenses and Fees	36,117	40,000	(3,883)	36,318	-0.55%
Other Income	129,734	132,000	(2,266)	123,562	4.99%
Non-Tax Receipts	$314,206	$287,000	$27,206	$288,880	8.77%
TRANSFERS					
Liquor Transfers	$90,000	$87,000	$3,000	$88,000	2.27%
Budget Stabilization	0	0	0	$0	#N/A
Other Transfers In	680,078	683,671	(3,593)	280,764	142.22%
Total Transfers In	$770,078	$770,671	($593)	$368,764	108.83%
TOTAL INCOME less Federal Grants	**$15,636,931**	**$15,309,076**	**$327,855**	**$14,847,066**	**5.32%**
Federal Grants	$3,428,373	$3,475,002	($46,629)	3,290,761	4.18%
TOTAL GRF INCOME	**$19,065,304**	**$18,784,078**	**$281,226**	**$18,137,827**	**5.11%**

* July, 1998 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

The major shortfalls were in the corporate franchise tax and the public utility excise tax. The franchise tax fell $28.2 million below the revised estimate (which was unchanged from the original estimate). The public utility excise tax fell $37.4 million below the revised estimate, $15.6 million below the original estimate.

A late-year surge brought federal revenues to a finish only $46.6 million short of the estimate. Not too long before the year's end, it had looked like federal revenues might be $100 million short, but increased Medicaid and TANF spending in the last quarter led to a greater draw of federal money. Overall, federal grants did somewhat better than one would expect given the level of underspending in Medicaid, TANF, and other human services programs. In FY

1998, exactly the opposite was the case: the federal revenue shortfall was bigger than one would expect given the underspending in Medicaid, TANF, and other human services. It looks like, on balance, federal revenues for the two years combined fit the spending data much better than for either year separately. Whether this is partly the result of the mismatch between state and federal fiscal years is unclear.

Personal Income Tax

The personal income tax exceeded all the estimates except the last one. When OBM and LBO made their final forecasts for the Conference Committee on HB 283, we both assumed that GRF income tax revenues for FY 1999 would finish at about $6,450 million (LBO said $6,453.0 million). Income tax revenues actually ended up at $6,416.8 million. The overages of the last few years finally pushed us to the point where we were too optimistic.

With respect to the July 1998 revised estimates, the GRF income tax overage was $266.2 million. LBO's data on the income tax is not as complete as what we usually have by this time, but the available data shows that the overage for all funds, including the local government funds (LGFs) was $303.2 million. Every component of the tax contributed to the overage, with annual returns and refunds making the largest contributions. The variances between actual and estimated collections, and year-over-year growth by component are summarized in the table below.

FY 1999 Income Tax Collections, by Component

amounts in milions of dollars

Component	Actual	Estimate	Variance	Yr-Over-Yr Growth
Employer withhholding	$6,102.6	$6,049.6	$53.0	7.9%
Quarterly estimated payments	$1,448.1	$1,379.6	$68.5	5.5%
Annual Tax Payments	$612.1	$516.6	$95.5	-7.9%
Refunds	($1,030.5)	($1,110.0)	$79.5	30.5%
Total Major Components	$7,132.3	$6,835.8	$296.5	
Total All Components	$7,175.6	$6,872.3	$303.2	3.3%
Total GRF Amount	$6,416.8	$6,150.6	$266.2	3.3%

The 3.3 percent year-over-year growth in the income tax in FY 1999 came in spite of an increase in the ITRF rate cut from 3.99 percent in taxable year 1997 to 9.34 percent in taxable year 1998. The annual increase in the rate cut was thus 5.35 percent. As we stated earlier, LBO's calculation is that baseline tax collections increased by 7.6 percent from FY 1998 to FY 1999. The calculation of this baseline is shown in the following table.

Derivation of Baseline Income Tax Growth Percentages, FY 1993-1999

	1993	1994	1995	1996	1997	1998	1999
Income Tax Collections (GRF Baseline only)	$4,226.6	$4,535.7	$4,880.7	$5,262.8	$5,382.3	$6,212.5	$6,416.8
LLGSF, LGF, LGRAF Collections	$491.5	$549.1	$573.0	$617.8	$631.9	$729.3	$752.8
Total FY Collections	$4,718.1	$5,084.8	$5,453.7	$5,880.6	$6,014.2	$6,941.8	$7,169.6
Addback:							
Loss Due to ITRF Rate Cuts - 1st year impact					$352.8	$238.9	$596.2
Loss Due to ITRF Rate Cuts - 2nd year impact						$62.3	$42.2
Personal Exemption Increases					$40.0	$89.0	$111.0
Subtract:							
Personal Income Tax Share of Pass-Through Entity Withholding						$11.4	$39.0
Total Baseline	$4,718.1	$5,084.8	$5,453.7	$5,880.6	$6,407.0	$7,320.6	$7,880.0
% growth		7.8%	7.3%	7.8%	9.0%	14.3%	7.6%

Last year, LBO, OBM, and the Tax Department were still speculating about how much of the FY 1998 income tax overage was transitory, or "one-time." Looking back after FY 1999, we see that quarterly estimated payments grew by 5.5 percent, despite the incremental 5.5 percent tax rate reduction.

Ohio Tax Revenue Growth vs. Retail Sales Growth, FY 1995 - 1999

	FY 95	FY 96	FY 97	FY 98	FY 99
Non-Auto Sales Tax					
U.S. Retail Sales Growth (Nominal)	6.1%	4.2%	5.3%	4.3%	6.1%
Ohio Tax Revenue Growth	6.4%	5.6%	5.5%	5.8%	5.3%
Auto Sales Tax					
U.S. Retail Sales Growth (Nominal)	9.7%	8.2%	4.9%	5.4%	7.4%
Unit Sales, Light Vehicles	2.0%	1.0%	-0.6%	3.0%	2.8%
Ohio Tax Revenue Growth	4.7%	1.7%	0.7%	7.3%	5.2%

Non-auto retail sales are lagged by a month to reflect Ohio's payment schedule.

This indicates that non-wage income was still growing strongly in taxable year 1998. Although we have hard data only through taxable year 1997, there is a wealth of anecdotal evidence that capital gains realizations grew strongly again in taxable year 1998, along with the stock market. While revenues did not grow as strongly in FY 1999 as they did in FY 1998, there was certainly no "giving back" of the large gains in FY 1998.

Stock prices have increased since the beginning of taxable year 1999, although lately the major indices have dropped. We may see slower growth in capital gains realizations this year, which could lead to somewhat slower growth in the income tax in FY 2000 (both OBM and LBO built that expectation into their forecasts for the current budget). Overall business profitability is also important for the income tax, since an increasing share of receipts comes from the net income of unincorporated businesses.

What is the risk to the income tax forecast? A major stock market correction would seem to be the largest risk. The stock market has appreciated so much that even after a correction, there is probably a large stock of unrealized gains that could be taken, resulting in some additional income tax revenues. This is true unless the price correction is truly substantial, on the order of 15 percent to 20 percent.

Sales and Use Tax

The performance of the sales and use tax was steady in FY 1999, although growth was only 5.3 percent, rather than the 6.0 percent in FY 1998. The auto and non-auto components of the tax showed very similar performance. The auto tax was $25.4 million over the estimate, up 5.2 percent from last year (down from 7.3 percent in FY 1998). The non-auto tax overage was $29.9 million, with 5.3 percent growth (down from 5.8 percent in FY 1998).

Low unemployment, low inflation, low mortgage rates, and low interest rates generally made consumers willing to continue spending in FY 1999. Ironically, low inflation continues to curb sales tax revenue growth somewhat. Real purchases continue to show healthy growth, but retail inflation is so low that nominal dollar gains are not very impressive.

As the accompanying table shows, Ohio sales tax revenue growth slightly lagged national retail sales growth in FY 1999, after growing faster than retail sales in FY 1998. For the two years combined, retail sales growth and tax revenue growth are very similar. In general, non-auto sales tax growth has closely paralleled non-auto retail sales growth for the past 5 years. Interestingly, in slow years, growth in the auto sales tax has more closely followed unit sales of light vehicles, rather than the reported dollar retail sales figure.

Most of the indicators point toward continued steady growth in the sales and use tax in FY 2000 - 2001, but perhaps slower than in FY 1999. The employment and income indicators look positive for consumers. On the other hand, the recent increase in interest rates will hurt durable goods sales somewhat. The increase in mortgage rates has slowed refinancings to a crawl, which will also take away one of the sales tax growth engines. Finally, slower growth in stock prices, or an outright market correction, will curb consumption, particularly of big-ticket items. Both OBM and LBO have forecast non-auto sales tax growth of 4 percent annually for the upcoming biennium. This is slightly slower than the personal income growth rate predicted by the Governor's Economic Advisory Council (GEAC).

Corporate Franchise Tax

Ohio's franchise tax revenues from current year liability — the $1,079.2 million that it took in over January through June — fell by 9.2 percent from FY 1998. Collections were $28.2 million below the esti-

Ohio CFT Payments, FY 1987-1999 (millions of $)

	Ohio Franchise Tax, Current Payments	% change	Ohio Franchise Tax, Total Payments	% change	U.S. corp. profits, pre-tax		
FY 87	$769.0		$788.7		$222.6		
FY 88	$805.2	4.7%	$844.6	7.1%	$293.6	31.9%	
FY 89	$870.4	8.1%	$948.1	12.3%	$354.3	20.7%	
FY 90	$817.7	-6.1%	$812.6	-14.3%	$348.1	-1.7%	
FY 91	$751.7	-8.1%	$769.0	-5.4%	$371.7	6.8%	
FY 92	$747.8	-0.5%	$761.6	-1.0%	$374.2	0.7%	
FY 93	$799.5	6.9%	$801.4	5.2%	$406.4	8.6%	
FY 94	$875.4	9.5%	$897.3	12.0%	$465.4	14.5%	
FY 95	$1,026.2	17.2%	$1,043.8	16.3%	$535.1	15.0%	
FY 96	$1,103.2	7.5%	$1,114.0	6.7%	$635.6	18.8%	
FY 97	$1,127.0	2.2%	$1,150.8	3.3%	$680.2	7.0%	
FY 98	$1,189.0	5.5%	$1,196.6	4.0%	$734.4	8.0%	
FY 99	$1,177.2	-1.0%	$1,182.1	-1.2%	$717.8	-2.3%	baseline
FY 99			($98.0)				law changes
FY 99			$1,084.1				Net GRF receipts

mate, which was based on the assumption of a 7.0 percent decline. This was the result of a number of tax law changes made in HB 215, the operating budget act for the FY 1998-1999 biennium. LBO had projected that those changes would result in a net loss of $98.0 million in FY 1999.[8] As yet, we cannot tell if that $98.0 million number was approximately right or not. However, we have made calculations on the assumption that the estimate was correct.

Under this assumption, Ohio's baseline current-basis collections fell by 1.0 percent in FY 1999, while U.S. before-tax profits fell by 2.3 percent. The revenue decline was thus about 44 percent of the U.S. profit decline. This is a lower revenue elasticity than we have seen recently. Revenue growth since the recession has averaged about 60 percent of U.S. profit growth. However, the historical data shows that in years of declining profits, this relationship varies. The 44 percent figure is close to the long-run average over the FY 1990 - 1998 period.[9]

As we have stated before, there are secular factors changing the corporate franchise tax, as well as the recent law changes. The income of unincorporated businesses (including capital gains income) is both contributing to pushing up the personal income tax in Ohio and in other states, and also reducing corporate tax revenue. The owners of all types of businesses other than regular "C" corporations — proprietorships, partnerships, S-corporations, LLCs, etc. — pay the personal income tax rather than the franchise tax. If a large number of businesses are choosing to organize as flow through businesses like LLCs, rather than as C corporations, that would give an extra kick to the income tax while slowing down growth in the franchise tax.

Public Utility Excise Tax

The public utility excise tax finished the year $37.4 million below estimate, a drop of 5.3 percent, or $35.4 million, from FY 1998 collections. The drop in the certified tax liability for the tax between tax year 1997 and tax year 1998 was only $12.0 million (from $690.0 million to $678.0 million). Almost all of the decline was in natural gas ($9.1 million) and electric light ($2.8 million).

The drop in fiscal year collections exceeded the drop in tax year liability because of the now familiar "double-whammy" effect that is due to the way the tax is paid. When liability dropped from tax year 1997 to 1998, it meant that the estimated payments against tax year 1998 taxes (based on 1997 liability) were too high. Thus, when the state reconciled tax year 1998 payments and liabilities, in November and December of 1998, the state ended up owing substantial refunds to utilities. So, lower estimated payments plus refunds against last year's payments added up to a significant drop in overall collections. For this reason, fiscal year public utility excise tax collections have tended to follow a kind of sine-wave pattern.

Readers may remember that in FY 1998, pretty much the opposite scenario occurred. The state received a favorable double-impact from higher estimated payments and additional tax due instead of refunds. Natural gas was the culprit there also, as liability increased significantly from tax year 1996 to tax year 1997. As natural gas liability fell back in tax year 1998, overall public utility excise tax in FY 1999 fell back to slightly below their FY 1997 level.

Both OBM and LBO forecast significantly lower public utility tax revenues in future years. Among other things, S.B.3, the comprehensive electricity restructuring bill, replaces the public utility excise tax with a kilowatt-hour tax that will not raise as much revenue as the current tax would have. This is expected to cause a loss of $10.9 million to the GRF in FY 2001 (no impact in FY 2000), and more in future years. Also, the existing coal tax credit is increased by H.B. 384, which will reduce the excise tax paid by electric utilities until the kilowatt-hour tax begins, at which time it will act to reduce the corporate franchise tax. In FY 2001, this will cause a GRF loss of $12.5 million. ❑

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[1] The annual budget surplus (or deficit) will never be exactly equal to the ending fund balance, due to the impact of carryover balances from the prior year, the change in encumbrance amounts, and other factors.

[2] This disproves the idea current in some quarters that tax revenue “cannot possibly” grow by a number less than 3 percent. It just did. It is true that this figure is distorted by the transfers from the GRF to the Income Tax Reduction Fund (ITRF) and from the ITRF back to the GRF. This is why LBO feels that the growth in non-federal revenue is the best indicator of revenue performance, given the complications of the ITRF transfer mechanism.

[3] There is some confusion about the use of income tax collections and ITRF transfers as a summary statistic. In this case, calculating the revenue overage, it is legitimate to add them together. On the other hand, it is not really legitimate to add them together in different years, calculate the percentage changes, and assume that represents the baseline growth rate. This is a subtle point that depends upon the timing of the impact of the tax rate cut.

[4] As in FY 1998, interpreting the spending number is somewhat more difficult than interpreting the revenue number, because the spending shortfall was accompanied by a very large amount of encumbrances (commitments to spend appropriations in the next fiscal year).

[5] This is not the only definition of operating surplus available. LBO will explore the measurement of the GRF surplus at greater length in a later issue.

[6] This data is from HSH Associates, a Butler, N.J., financial publisher that collects data from mortgage lenders around the country. In April, average mortgage rates were still below 7 percent.

[7] Among other things, the chairman said that the Federal Reserve would act “promptly and forcefully ... if new data suggest it is likely that the pace of cost and price increases will be picking up.”

[8] The corporate tax reform package is often quoted as leading to a much smaller loss of $26.0 million, but that was actually a net number that included offsetting revenue increases through the personal income tax.

[9] Longtime readers of this report are probably familiar with the litany of reasons why Ohio franchise tax revenues do not correlate all that well with U.S. corporate profits: differing taxable years, the dual net worth-net income tax base, the separate treatment of financial institutions, net operating loss carryovers, etc. We presume that this has changed somewhat with the cap on the net worth tax, but it will take awhile for the new relationship to become clear.

DISBURSEMENTS

— *Jeffrey E. Golon**

It was a simple case of being seduced by the numbers. After the state's FY 1999 underage hit $574.0 million in February, it seemed from our vantage point that challenging FY 1998's $700.1 million year-end underage was well within reach. No problem. Good as Gold. Not! Following directly on February's heels were two healthy monthly overages, and, by the time the smoke had cleared at the close of FY 1999, $112.9 million had been whittled out of the year-to-date underage, knocking it back to end the year at $461.1 million under estimate.

Two forces had essentially propelled us to that February peak in underspending. The first, and foremost, was the salutary effect of declining human services caseloads, which effectively checked Temporary Assistance to Needy Families (TANF) and Medicaid program spending. Second, and not nearly as potent a force, were timing-based disbursement delays led by the Department of Education's school district subsidy programs. In the last four months of the fiscal year, this second force jumped ship and joined the other side so to speak, as many of these timing matters began to resolve themselves and state money started to flow out the door, just a little latter than had been assumed would be the case. And, as we all are keenly sensitive to in matters of state spending, what timing giveth, timing taketh away.

Table 4
General Revenue Fund Disbursements
Actual vs. Estimate
Month of June, 1999
($ in thousands)

USE OF FUNDS			
PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	$290,396	$296,993	($6,597)
Higher Education	150,193	148,685	1,508
Total Education	$440,589	$445,678	($5,089)
Health Care/Medicaid	$490,731	$435,429	$55,302
Temporary Assistance to Needy Families	48,469	45,249	3,220
General/Disability Assistance	4,554	4,234	320
Other Welfare	26,243	22,558	3,685
Human Services (2)	45,838	56,719	(10,881)
Total Welfare & Human Services	$615,835	$564,188	$51,646
Justice & Corrections	$112,912	$99,764	$13,148
Environment & Natural Resources	2,950	3,804	(854)
Transportation	815	7,912	(7,097)
Development	7,728	10,799	(3,072)
Other Government (3)	22,626	92,378	(69,752)
Capital	7,154	296	6,858
Total Government Operations	$154,185	$214,953	($60,768)
Property Tax Relief (4)	$122,593	$104,884	$17,709
Debt Service	0	0	0
Total Program Payments	**$1,333,201**	**$1,329,703**	**$3,498**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	0	0	0
Other Transfers Out	297	26,200	(25,903)
Total Transfers Out	$297	$26,200	($25,903)
TOTAL GRF USES	**$1,333,498**	**$1,355,903**	**($22,405)**

(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, 1998 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

June. Excluding transfers, the month boiled down to a pitched battle between three GRF pieces that featured one program component with a massive $74.1 million underage pitted against two other program components that had a rather sizeable combined overage totaling $73.0 million. The net result was essentially a stalemate. The rest of the GRF's program components exchanged a mix of considerably smaller underages and overages, but in the end the outcome was not altered all that dramatically, as evidenced by the tiny $3.5 million total monthly overage that was posted for June.

The lead underage in this disbursement battle totaled $74.1 million and was chipped in from the Controlling Board's budget, which is buried within the catch-all Other Government component of the Government Operations program category. While extremely large, this monthly underage did not appear to be significant. It simply reflected the results of a device — built into the original disbursement estimates assembled last August by the Office of Budget and Management (OBM) — intended to account for the portion of the Controlling Board's total FY 1999 GRF appropriation that is expected to be transferred to other state agency budgets. As the reader may be aware, Controlling Board appropriations are not disbursed per se, but are transferred to, and then disbursed from, other state agency budgets.

Of the two major monthly overages, the largest totaled $55.3 million and was thrown in by Medicaid. This overage was merely timing-based as a big portion of Medicaid funding that was to be encumbered for disbursement in July was unexpectedly disbursed in June. Thus, it hit in FY 1999 and not in FY 2000 as planned. The second major monthly overage totaled $17.7 million and emanated from the Property Tax Relief program. This June overage was also timing-based, which is typical of the monthly disbursement variances posted by this program.

Table 4 provides a more detailed picture of June's disbursements by program category.

Year-to-Date. Excluding transfers, the state closed FY 1999 with a $461.1 million year-to-date underage, $311.3 million, or 67.5 percent, of which was located in the Welfare and Human Services program category. The key player was the Department of Human Services, whose budget is the sole occupant of four of the Welfare and Human Services program category's five components. The sum of the year-to-date underages in these four components alone — HealthCare/Medicaid ($107.5 million) + Temporary Assistance to Needy Families (TANF) ($153.7 million) + General/Disability Assistance ($10.2 million) + Other Welfare ($36.2 million) — totaled $307.6 million. In effect, two-thirds (66.7 percent) of the state's year-to-date negative disbursement variance was traceable exclusively to the Department of Human Services. While some of these departmental underages were clearly timing-based, particularly in the case of the Other Welfare component, a significant portion represented true savings that were being generated as a result of declining caseloads in certain service areas of the Medicaid, TANF, and General/Disability Assistance programs. We would also respectfully hazard the observation that a noticeable chunk of federal TANF money was going unspent because the department and county governments are still trying to reengineer organizational mindsets and service delivery systems away from cash assistance to a broader system of workforce development.

A secondary contributor to this spending picture was the state's Government Operations program category with a negative disbursement variance of $111.7 million, which amounted to one-quarter (24.2 percent) of the total year-to-date underage. Two program components drove over 90.0 percent of this part of the state's underage. First, the Controlling Board pitched in $74.1 million, which we previously noted as showing in the month of June and dismissed as no more than an accounting adjustment. Second, the Department of Administrative Services, buried within the state's grouping of nonregulatory agencies, threw in another $29.1 million. Lower than anticipated rent and building operating expenses for certain state-owned buildings and slower than expected spending on computing and communications services to other state agencies were the chief culprits.

The Department of Education also deserves some mention here, particularly in light of the fact that its contribution to the year-to-date underage was somewhat masked by other disbursement variances within the Education program category that includes all primary, secondary, and higher education agencies. The department posted a $69.3 million year-to-date underage that was based upon a messy mix of three forces: (1) planned FY 1999 disbursements that were delayed and pushed into FY 2000; (2) prior years' encumbrances that were not disbursed as expected and cancelled; and (3) unexpected balances in a handful of line items with very large FY 1999 appropriations.

A more detailed picture comparing fiscal year-to-date variances by program category is provided for the reader in Table 5.

Federal Money. Of the year-to-date underspending in the TANF and Medicaid programs combined ($261.2 million), 79.6 percent, or $208.0 million, was in the federal share of these two human

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
Fiscal Year-to-Date 1999
($ in thousands)

USE OF FUNDS PROGRAM	Actual	Estimate*	Variance	FY 1998	Percent Change
Primary & Secondary Education (1)	$4,794,835	$4,832,205	($37,370)	$4,356,945	10.05%
Higher Education	2,301,054	2,288,175	12,879	2,209,215	4.16%
Total Education	$7,095,889	$7,120,380	($24,491)	6,566,160	8.07%
Health Care/Medicaid	$5,229,514	$5,336,993	($107,479)	$5,056,299	3.43%
Temporary Assistance to Needy Families	787,849	941,583	(153,733)	783,799	0.52%
General/Disability Assistance	57,836	68,082	(10,247)	56,869	1.70%
Other Welfare	401,552	437,740	(36,188)	379,576	5.79%
Human Services (2)	1,086,584	1,090,231	(3,647)	1,072,687	1.30%
Total Welfare & Human Services	$7,563,334	$7,874,629	($311,295)	$7,349,230	2.91%
Justice & Corrections	$1,592,197	$1,602,709	($10,512)	$1,495,299	6.48%
Environment & Natural Resources	120,836	117,305	3,530	122,417	-1.29%
Transportation	35,319	38,267	(2,948)	36,079	-2.11%
Development	117,946	115,724	2,223	112,983	4.39%
Other Government (3)	356,065	464,907	(108,842)	335,160	6.24%
Capital	9,818	5,000	4,818	4,255	130.76%
Total Government Operations	$2,232,182	$2,343,912	($111,730)	$2,106,192	5.98%
Property Tax Relief (4)	$1,000,948	$1,014,400	($13,452)	$958,844	4.39%
Debt Service	124,510	124,670	(161)	106,593	16.81%
Total Program Payments	**$18,016,863**	**$18,477,992**	**($461,129)**	**$17,087,020**	**5.44%**
TRANSFERS					
Capital Reserve	$0	$0	$0	$0	—
Budget Stabilization	44,184	44,184	0	34,400	28.44%
Other Transfers Out	1,140,709	993,760	146,949	735,176	55.16%
Total Transfers Out	$1,184,894	$1,037,944	$146,950	$769,576	53.97%
TOTAL GRF USES	**$19,201,757**	**$19,515,936**	**($314,179)**	**$17,856,596**	**7.53%**

(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, 1998 estimates of the Office of Budget and Management.

services programs that are jointly funded by the state and federal government. Furthermore, a substantial portion of this underspending in the federal share — $145.4 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 $253.1 million. At year's-end, the reader is once again reminded that any unspent federal TANF funding 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.

Appropriations Summary. At this point, we'd like to take a detour from our typical discussion of the variance between actual and estimated disbursements

Table 6
GRF Appropriation Summary*

Budget Fiscal Year	Original Appropriation	Transfers	Disbursements	Outstanding Encumbrances	Appropriation Balance
1990	$ 793,386	$ -	$ -		$ 793,386
1991	$ 472,579	$ -	$ 228,198	$ 37,767	$ 206,614
1992	$ 44,650	$ -	$ -	$ -	$ 44,650
1993	$ 366,179	$ -	$ 29,750	$ 59,008	$ 277,421
1994	$ 779,969	$ -	$ 386,705	$ 240,436	$ 152,828
1995	$ 3,335,121	$ -	$ 768,108	$ 655,861	$ 1,911,152
1996	$ 36,660,725	$ -	$ 4,726,213	$ 13,252,003	$ 18,682,509
1997	$ 92,373,312	$ -	$ 16,094,132	$ 29,346,763	$ 46,932,417
1998	$ 902,969,738	$ (44,972,818)	$ 334,798,444	$ 44,711,517	$ 478,486,960
1999	$ 18,587,596,290	$ 44,848,312	$ 17,659,831,581	$ 447,446,405	$ 525,166,616
Total	**$ 19,625,391,948**	**$ (124,506)**	**$ 18,016,863,131**	**$ 535,749,760**	**$ 1,072,654,552**

*Data drawn from RAPPR17S, a Central Accounting Sytem report as of June 30, 1999.

for a snapshot review of GRF appropriation activity. To do that, the reader is directed to Table 6 which contains a selective summary of the $19.63 billion in GRF appropriations that was registering in the state's accounting system as of June 30, 1999 (second data column labeled "Original Appropriation"). All of this GRF appropriation authority, theoretically at least, was available for disbursement in FY 1999.

While not surprising to seasoned watchers of state spending, exclusive of the $18.59 billion in FY 1999 appropriations, this GRF appropriations total includes $1.04 billion stretching as far back as FY 1990. The pre-FY 1998 appropriations essentially represent GRF funding that state agencies had encumbered with the intent to disburse those amounts sometime in FY 1999. The nature of the FY 1998 appropriations ($902.9 million), on the other hand, is not as straightforward. It includes not only encumbered funding but unspent FY 1998 appropriation authority as well, which is the portion of a state agency's FY 1998 appropriations that had neither been disbursed in FY 1998 nor encumbered at year's-end for disbursement in FY 1999. Although there is some guesswork involved, our best estimate is that, of the total FY 1998 appropriation, $427.7 million was encumbered and $475.2 million was unspent appropriation authority. This distinction relative to FY 1998 appropriations is important because, unlike encumbered funding, state agencies lost control of this $475.2 million in unspent 1998 appropriation authority to the Office of Budget and Management (OBM). This meant that the only way that a state agency had of accessing any of its unspent FY 1998 appropriation authority was through the acquiescence of OBM. And any such agreement typically manifests itself in the form of a request for Controlling Board approval to transfer those unused FY 1998 appropriations into FY 1999.

The third column of data in Table 6 — "Transfers" — summarizes the transfer of FY 1998 appropriations into FY 1999, as well as the moving of FY 1999 GRF appropriations among various line items. The bulk of this transfer activity occurs pursuant to Controlling Board approval of state agency requests to move GRF funding around. There were three notable transfers that moved unspent FY 1998 appropriations into FY 1999: (1) $17.9 million in unspent Department of Education appropriations to bolster subsidy funding distributed to school districts; (2) $12.8 million in unspent Ohio Instructional Grants funding to augment the Part-time Student Instructional Grant program in the Board of Regents' budget; and (3) $2.6 million in unspent Department of Health appropriations principally used to triage a cash flow problem in its disease prevention program.

The third and fourth columns of data in Table 6 — "Disbursements" and "Outstanding Encumbrances" — summarize the amount of GRF appropriations that either have been spent (disbursed) or items for which state agencies have committed appropriated funding (encumbrances) for disbursement in FY 2000.

The fifth and last column — "Appropriation Balance — summarizes the GRF appropriations that have not been transferred, disbursed, or encumbered. These are amounts that have lapsed and reverted back to the GRF's FY 1999 ending cash balance. The largest amounts of lapsed FY 1998 and FY 1999 appropriation authority were traceable to two human services programs: TANF and Medicaid. Of the lapsed FY 1998 appropriation authority, $333.6 million, or 69.7 percent, came from the TANF and Medicaid programs, with the former providing $204.4 million and the latter throwing in $129.2 million. Of the lapsed FY 1999 appropriation authority, $365.7 million, or 69.6 percent, emanated from these same two human services programs, but their relative roles were reversed. In this instance, Medicaid produced $184.0 million and TANF chipped in a slightly lower amount of $181.7 million. The basic, though certainly not the sole, force behind the lapsing of this TANF and Medicaid appropriation authority was largely the same — declining caseloads.

The lapsing of TANF's appropriation authority, however, must be seen in a different light than does the lapsing of Medicaid appropriations. The two years of lapsed TANF appropriation authority totaling $386.1 million represents a portion of the federal funding that is owed and available to the state over the lifetime of the TANF program. The two years of lapsed Medicaid appropriation authority totaling $313.2 million, however, is another matter. Of that $313.2 million, $182.2 million, or 58.2 percent, was in the federal share of this state-federal program and represents federal reimbursement that the state built into its FY 1998 and FY 1999 budgets, but did not earn. This was a loss of anticipated revenue since the state had not spent the money necessary to earn financial reimbursement from the federal government.

Disbursements in Detail. The remainder of this article contains a selective review of the disbursement activity of many, but by no means all, state agencies that utilized GRF funding during FY 1999.

Primary & Secondary Education

Arts & Sports Facilities. The Ohio Arts & Sports Facilities Commission, whose mission is to evaluate the need for arts and sports facilities and to administer their planning, design, construction, and operation, finished FY 1999 with a very noticeable $6.1 million, or 40.5 percent, overage. Its source was quickly uncovered: the commission's $24-plus million debt service appropriation (line item 371-401, Lease Rental Payments). Relative to debt service spending in FY 1999, the estimate led us to expect $14.2 million in disbursements, $9.8 million in encumbrances, and $797,591 in lapsed appropriation authority. The reality was quite different: $20.4 million in disbursements, no funds were encumbered, and $4.3 million in appropriation authority lapsed. Upon investigation, we learned that the higher-than-anticipated debt service spending was caused by the combination of a late capital bill and a quicker-paced project schedule. It appeared that the commission was accelerating the pace of its current projects so as to be further along when its new slate of capital projects became active.

Blind School. The most notable aspect to the FY 1999 disbursement story for the Ohio State School for the Blind, a residential school located in Franklin County that serves school age Ohio residents with visual disabilities, was tied to an action taken by the Controlling Board in the waning stages of the fiscal year. Due to a hiring freeze imposed by the Governor, the school was forced to delay filling five staff positions, which in turn meant that they were virtually guaranteed to lapse in excess of $200,000 from their personal services line item (226-100). Rather than lose all of that GRF funding, the school sought and received Controlling Board approval to transfer a portion of that excess personal services appropriation ($64,738) to its maintenance line item (226-200) for the purpose of undertaking certain critical health and safety repairs. Specifically, these additional maintenance funds were to be used to renovate or repair boiler systems, roofs, and lighting at the school.

Education. The Department of Education closed FY1999 with a $69.3 million underage, which was 1.5 percent below an estimated spending level of $4.7 billion. Of this underage, $47.4 million, or 68.4 percent, was traceable, in order of magnitude and discussed in more detail below, as follows: (1) $17.7 million in line item 200-520, Disadvantaged Pupil Impact Aid (DPIA); (2) $10.2 million in line item 200-502, Pupil Transportation; (3) $9.3 million in line item 200-545, Vocational Education Enhancements; (4) $7.7 million in line item 200-507, Vocational Education; and (5) $2.5 million in line item 200-534, Desegregation Costs.

What happened to produce these line item underages?

DPIA. Starting with FY 1999, the DPIA program (line item 200-520) was restructured to include funding for all-day and everyday kindergarten, K-3 class size reduction, and safety and remediation measures. DPIA program funding was enhanced as well with a healthy 37.5 percent increase that bumped FY 1999 to $386.6 million, up from $281.2 million in FY 1998. Under the restructured DPIA program, every school district with at least the statewide average concentration of poverty became eligible for all-day and everyday kindergarten funding. The $96.6 million built into the FY 1999 DPIA appropriation for all-day and everyday kindergarten was made by assuming that all 105 eligible school districts would provide all-day and everyday kindergarten at the 100 percent level, in other words, to all of their kindergarten students. An eligible school district, however, receives funding based on its actual all-day and everyday kindergarten percentage. Approximately $80.6 million was disbursed to 91 eligible school districts providing all-day and everyday kindergarten. The other 14 eligible districts did not receive any of this funding, as they chose, for whatever reason, not to provide all-day and everyday kindergarten. This was the principal factor behind the $17.7 million underage posted in the DPIA program.

<u>Pupil Transportation</u>. The $10.2 million underage in the pupil transportation program (line item 200-502) had three principal components: (1) $6.8 million in surplus funding from the FY 1999 appropriation; (2) $2.3 million in unplanned FY 1999 encumbrances; and (3) $1.1 million in cancelled prior years' encumbrances. With respect to the surplus funding, which was only 2.9 percent of the line item's $231.6 million FY 1999 appropriation, it reflected the fact that FY 1997 data was projected forward to build the line item's FY 1999 appropriation, while actual payments were based on FY 1998 and FY 1999 data. As of this writing, we were still uncertain as to what had changed in the data such that less of the FY 1999 funding was disbursed than one might have expected.

<u>Vocational Enhancements</u>. In FY 1999, the vocational education enhancements program (line item 200-545) included $152.6 million for joint vocational school districts, $24.2 million funding for additional costs of vocational education in comprehensive high schools, and $24.4 million for various vocational education related set-asides. The slower than expected disbursement of two of the set-asides ($4.9 million for the replacement or upgrading of essential instructional equipment and $3.3 million in lead vocational education school grants) was the main force behind the $9.3 million underage in this line item.

<u>Vocational Education</u>. Beginning in FY 1999, funding for vocational education was moved into line items 200-501, Base Cost Funding, and 200-545, Vocational Education Enhancements. Thus, what was left of line item 200-507, Vocational Education, for disbursement in FY 1999 consisted of $27.1 million in funding encumbered from prior years' appropriations. Of this encumbered amount, only $2.0 million was disbursed in FY 1999, $4.8 million was transferred into the FY 1999 appropriation for line item 200-501, Base Cost Funding, $20.1 million lapsed and became part of the GRF's ending cash balance, and slightly in excess of $100,000 was still encumbered and presumably available for disbursement sometime in FY 2000.

<u>Desegregation Costs</u>. The $2.5 million underage in the desegregation program (line item 200-534) was due almost entirely to the fact that the $50.4 million FY 1999 appropriation exceeded the demand for this funding, which pays for the state's share (approximately 50 percent) of the cost of court-ordered desegregation cases and associated legal fees. The bulk of the appropriation — $47.2 million — was distributed as earmarked to the Cleveland City Schools ($38.2 million), the Dayton City Schools ($4.0 million) and the Cincinnati Magnet School Program ($5.0 million). Virtually all of the remaining appropriation was simply not needed for any other desegregation-related costs in FY 1999. Looking out into the near-term future, only one school district was specifically designated to receive desegregation funding — Dayton City Schools — which is scheduled to receive at least $9.0 million in each of fiscal years 2000 and 2001.

FY 1999 Encumbrances. At its late June meeting, the Controlling Board approved the department's requests to make various appropriation changes, including the transfer of $45.6 million in operating funds from various line items, largely to effect necessary year-end revisions to the state's estimated $4.7 billion FY 1999 foundation payment plan. Of the transferred operating funds, $43.6 million was moved to supplement what is by far the largest component of that plan: line item 200-501, Base Cost Funding. This bolstering of the FY 1999 Base Costing Funding included $27.8 million in FY 1999 appropriation surpluses moved as follows: (1) $0.5 million from line item 200-500, School Finance Equity; (2) $6.8 million from line item 200-502, Pupil Transportation; (3) $17.5 million from line item 200-520, DPIA; (4) $1.3 million from line item 200-521, Gifted Pupil Program;

and (5) $1.7 million from line item 200-545, Vocational Education Enhancements. The remaining $15.8 million moved to support FY 1999 Base Cost Funding came from the unspent FY 1998 appropriation authority in various line items. These transferred operating funds, combined with line item 200-501's existing FY 1999 available balance, were then used to pay for various outstanding set-asides and for FY 1999 foundation SF-3 funding adjustments.

The foundation SF-3 funding includes the following six line items: (1) 200-500, School Finance Equity; (2) 200-501, Base Cost Funding; (3) 200-502, Pupil Transportation; (4) 200-520, DPIA; (5) 200-521, Gifted Pupil Program; and (6) 200-612, Base Cost Funding (Lottery Profits). It was not unusual to see FY 1999 surpluses in some of the foundation line items. As many people are aware, in FY 1999, a school district's SF-3 funding was subject to the following cap: the greater of a 10 percent total annual increase or a six percent annual increase in per pupil SF-3 funding. Although every component of SF-3 funding was subject to the cap, the fiscal effect that this would have in reducing spending was only worked into the FY 1999 appropriation for line item 200-501, Base Cost Funding. In other words, the full calculated formula amounts were appropriated for the other SF-3 line items.

As of June 30, 1999, the department had encumbered a total of $121.7 million from its FY 1999 GRF appropriations, with $94.4 million of that amount traceable to six line items as follows: (1) $58.6 million in line item 200-501, Base Cost Funding; (2) $12.6 million in line item 200-545, Vocational Education Enhancements; (3) $7.2 million in line item 200-503, Bus Purchase Allowance; (4) $6.1 million in line item 200-540, Special Education Enhancements; (5) $5.4 million in line item 200-514, Post-Secondary/Adult Vocational Education; and (6) $4.5 million in line item 200-520, DPIA. Most of these encumbrances will be used to pay outstanding set-asides within these line items.

The outstanding set-aside obligations within the Base Cost Funding program (line item 200-501) were covered by $41.1 million of the line item's $58.6 million in encumbrances that included: (1) $13.8 million for category three special education student supplemental reimbursements; (2) $8.5 million for post-secondary enrollment payments; (3) $6.8 million for exempt valuation adjustment payments; (4) $2.1 million to fully fund payment adjustments pursuant to sections 3317.026, 3317.027, and 3317.028 of the Revised Code; (5) $2.0 million for reappraisal guarantee payments; and (6) $2.0 million for youth service tuition. With respect to post-secondary payments within the Base Cost Funding program, it should be noted that there was no specific set-aside. These payments are to be deducted from a school district's state aid. However, the deduction generally happens one year after-the-fact. In other words, the state made post-secondary enrollment payments to colleges and universities in FY 1999. Then these payments will be deducted from school districts' state aid in FY 2000.

The remaining $17.5 million in encumbrances from the $58.6 million total encumbered within line item 200-501, Base Cost Funding, was committed for FY 1999 SF-3 payment adjustments due to data corrections. As a result of school funding reform enacted by the 122nd General Assembly, beginning in FY 1999, state foundation SF-3 funding for all students is directed to their resident district. Prior to FY 1999, state support was disbursed directly to the entity that actually educated a particular student, regardless of whether that was the child's home school district or not. Many school children, especially those receiving special and/or vocational education services, are educated by a school district other than their resident district or by an educational service center. For FY 1999, school districts were guaranteed to receive at least their comparable FY 1998 SF-3 funding amounts. To make a fair comparison, FY 1998 state unit funding for contractual special and vocational students needs to be attributed back to such a student's resident district. The comparable FY 1998 SF-3 funding amount affects FY 1999 funding calculations for a school district that is on the guarantee or subject to the cap. The department used estimated FY 1998 SF-3 funding to do calculations throughout the year while the actual data were collected. The actual data, which became available at the end of FY 1999, indicated that the amount of funding the state needed to disburse would be approximately $24.0 million higher than estimated. A higher FY 1998 funding amount will increase FY 1999 funding for a district that is on the guarantee or subject to the cap. As of this writing, the department was making those FY 1999 SF-3 funding adjustments.

Of the $12.6 million encumbrance in the vocational education enhancements program (line item 200-545), $9.8 million will be used to pay outstanding set-asides, including $4.9 million for vocational education lead school grants in comprehensive high schools and $3.3 million for vocational education equipment replacement supplement payments. The remaining $2.8 million was reserved for 58 unallocated units for joint vocational school districts (JVSDs). A total of 3,000 units were authorized for JVSDs in FY 1999. At the end of June 1999, 2,942 units were allocated and the average unit reimbursement was approximately $44,000. Units need to be formed and approved by the department. It was therefore not unusual to see additional unit allocations after the end of a fiscal year, although one may question whether all 58 unallocated units will actually be distributed.

Timing played a key role in the $7.2 million encumbrance in the bus purchase allowance program (line item 200-503). The program provides funding to assist school districts and educational service centers (ESCs) with bus purchases or bus service contracts. None of this funding ($37.3 million in FY 1999) can be distributed without approval of the Controlling Board. Up to 25 percent of the appropriation for this line item was reserved for approved buses purchased and identified as “non-public or handicapped,” which are fully reimbursed by the state. The Controlling Board released $9.3 million (25.0 percent of the total FY 1999 appropriation) for non-public and handicapped bus purchases in FY 1999. These funds, however, will not be disbursed until buses are actually delivered to school districts or ESCs. School districts and ESCs generally start the purchase process after the Controlling Board’s approval. Therefore, it was not unusual to see that a chunk of this line item’s appropriation was still encumbered at the end of a fiscal year.

The $6.1 million encumbrance within the special education enhancements program (line item 200-540) included outstanding set asides of $3.0 million for home instruction payments for special education students and $1.7 million for special education aide funding.

The $5.4 million encumbrance in the post-secondary/adult vocational education program (line item 200-514) was mainly for the year-end payment adjustment. Part of funding is not to be disbursed until participants completed training programs. Such data are often not available until the end of a fiscal year. The program provided $20.7 million in FY 1999 funding in support mostly of full-time and part-time adult vocational education programs.

The $4.5 million encumbrance in the DPIA program (line item 200-520) included a $1.5 million outstanding set-aside for the Effective School Program as well as $1.3 million unspent from the $8.7 million set aside in FY 1999 for the pilot school choice program. This latter set-aside was paid out of the DPIA formula allocation for the Cleveland City Schools and the unspent portion will be returned to the district.

Prior Years’ Encumbrances. The department entered FY 1999 with a total $197.8 million in encumbered funds from prior fiscal years, some of which stretched all the way back to FY 1995. Of that amount in prior years’ encumbrances, $114.7 million, or 58.0 percent, was disbursed, $51.3 million was cancelled and effectively transferred back to the GRF cash balance, $21.4 million was still encumbered and available for disbursement in FY 2000, and $10.4 million was transferred by action of the Controlling Board to supplement the FY 1999 appropriation authority of various departmental line items, in particular 200-501, Base Cost Funding.

The $21.4 million in remaining prior years’ encumbrances included $11.6 million in the Base Cost Funding line item from fiscal years 1996 and 1997. Conversations with the department have led us to believe that there are no outstanding obligations in this line item from those two fiscal years. Thus, we’d assume at this time that the $11.6 million in outstanding encumbrances is unlikely to get out the door, but instead will be cancelled and returned to the state’s available FY 2000 GRF cash balance.

Library Board. The State Library Board, whose mission it is to develop, maintain, provide, and disseminate information and library materials and services including the connection of the 250 public library systems in the state through the Ohio Public Library Information Network (OPLIN), finished FY 1999 with a negative disbursement variance of $656,094, 4.1 percent below the estimate. Disbursements totaling $16.1 million were expected, while the total actually disbursed hit $15.4 million. A closer look at the details of the board’s FY 1999 disbursement activity revealed that, despite the underage, very little of its total FY 1999 appropriation was left behind to lapse into the state’s ending GRF cash balance. Of the board’s $15.8 million total FY 1999 appropriation,

$14.6 million (92.1 percent) was disbursed, $1.1 million (7.1 percent) was encumbered, and a tiny $141,221 (0.9 percent) lapsed.

If one were to review its monthly disbursements over the fiscal year, you would find what are for the board some relatively large monthly overages and underages. These variances, however, were not all that significant as they were principally driven by delays in the release of subsidy payments, specifically those headed for regional libraries for the blind and physically handicapped in Cincinnati and Cleveland (line items 350-501 and 350-503, respectively). The processing of the paperwork for these subsidies moved more slowly than was expected, thus the actual date of disbursement was typically off by a month or so.

The last item of note amongst the board's eight GRF line items was 350-504, Ohio Humanities Council, which contained a $97,000 FY 1999 appropriation to fund joint humanities projects between local libraries and the Ohio Humanities Council. The estimates led us to believe that the line item's appropriation would be distributed in four quarterly payments, however, only one of the four expected quarterly payments had been made by the end of the fiscal year. Again, the paperwork necessary to release this subsidy funding moved more slowly than anticipated, thus delaying and moving its expected release date to the first month in FY 2000. To ensure that funding would still be available for distribution at that time, the remainder of the line item's FY 1999 appropriation ($72,750) was encumbered.

School Facilities Commission. The interesting and interrelated features of the School Facilities Commission's FY 1999 spending activities were twofold: first, a monster $28.3 million ending year overage (a positive 93.5 percent variance); and two, the disbursement of its entire $58.5 million FY 1999 appropriation. The expectation at the start of the fiscal year was that the commission, which provides funding, oversight, and technical assistance to local school districts in the construction and renovation of school facilities, would close FY 1999 with an encumbrance of close to $27.0 million. That did not happen, as, contrary to the expected, those funds were disbursed in May.

What happened? The commission's lone GRF line item (230-428, Lease Rental Payments) covers debt service costs incurred by the issuance of bonds to fund school building improvements. The plan called for this roughly $27.0 million to be encumbered for a bond sale that was to occur after the close of FY 1999. Apparently, market conditions were such that a decision was made to issue a considerably larger bond in May than planned, with the notion being that this action would reduce the state's future debt service costs.

SchoolNet. The Office of Information, Learning, and Technology Services (SchoolNet) — 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 and recently renamed the Ohio SchoolNet Commission — finished the fiscal year relatively close to expectations with a $1.1 million underage, which was 4.1 percent below the estimate. This negative disbursement variance was entirely attributable to line item 228-404, Operating Expenses, used almost exclusively to support SchoolNet's administrative costs. The estimate led us to expect that the line item's entire FY 1999 appropriation of $17.6 million would be disbursed, but that did not happen, as $910,504 was encumbered for disbursement in FY 2000. In addition, a much smaller amount in the line item — $160,006 — was allowed to lapse, less than one percent of its FY 1999 appropriation. From the larger perspective of SchoolNet's entire FY 1999 appropriation of $25.3 million, the amount that was allowed to lapse represented a miniscule 0.6 percent of the total.

Higher Education

Regents. The Board of Regents may have closed with a year-to-date positive disbursement variance of $12.9 million, but in the context of a $2.3 billion budget, this was only an overage of 0.6 percent relative to the estimate. There were five principal contributors to this overage, much of which was made possible by actions of the Controlling Board. First, and by far the largest, was line item 235-549, Part-time Student Instructional Grants, which funds a program of need-based financial assistance to undergraduate students attending Ohio colleges and universities for part-time study. The overage in this line item was $12.7 million, the source of which was a November 1998 transfer of $12-plus million in unused FY 1998 appropriation authority housed in the board's $90-plus million Ohio Instructional Grant program (line item 235-503). The transfer, taken in order to meet a higher-than-forecasted demand for part-time student grants, was made by the Office of Budget and Management pursuant to temporary law authorizing such a transfer to augment the Part-time Student Instructional Grant program. The effect of this transfer, which more than doubled the program's original FY 1999 appropriation of $11.9 million, was not built into the August 1998 disbursement estimates.

The second largest overage contributor was the board's $363.0 million debt service line item (235-401) with $6.4 million. As near as we could ascertain, this overage was attributable to a miscalculation in the estimate for the May 1999 debt service payment.

Third in the list of underage contributors was line item 235-508, AFIT, with $3.9 million. This represented the amount that had been transferred last December in Controlling Board funds earmarked to assist the Air Force Technology Institute (AFIT), a cooperative effort involving the Air Force, local businesses in the Dayton area community, the Board of Regents, and four Ohio universities in collaborative research on aerospace technologies. The transfer of this earmarked funding was delayed until the Board of Regents presented a spending plan for AFIT and was not built into the August 1998 disbursement estimates.

The fourth underage was line item 235-531, Student Choice Grants, which funds a financial assistance program that provides a uniform tuition grant to Ohio residents attending an Ohio independent college or university as full-time students enrolled in bachelor's degree programs. The line item was over the estimate by $2.1 million, the source of which was principally an unanticipated Controlling Board transfer that occurred in April 1999 and moved in $1.5 million of unneeded FY 1999 appropriations from the Ohio Instructional Grant program (line item 235-503). The board had projected that the actual number of Student Choice grant recipients would exceed its original estimate by roughly 700 and that additional funding was needed to head off a certain shortfall that would adversely affect spring quarter awards.

The fifth, and last notable contributor to the board's year-to-date overage, was line item 235-514, Central State Supplement, which supplies a supplemental subsidy to Central State University in addition to the funding received from the board's massive instructional subsidy (line item 235-501). This supplemental subsidy landed $1.8 million over the estimate. The source of this overage was an unanticipated Controlling Board transfer that occurred in May 1999 and moved in $1.8 million of unneeded FY 1999 appropriations from the Ohio Instructional Grant program (line item 235-503). The purpose of the transferred funding was to assist the university with the payment of arbitration orders and one-time salary adjustments for faculty and staff.

The cumulative effect of this $26.9 million in line item overages was in turn diluted by a mix of line item underages. The three notable underages included: (1) $5.0 million in cancelled prior years' encumbrances; (2) $4.3 million in the Ohio Instructional Grant program; and (3) $3.1 million from the board's mission-based performance-related "Challenge" line items. The underage in the Ohio Instructional Grant program (line item 235-503) was to be expected, as the number of needy Ohio students drawing this financial assistance was less than originally assumed. This reality was what made $3.3 million of the line item's FY 1999 appropriation authority unnecessary and thus available for transfer to augment Central State University's subsidy funding and the Student Choice Grant program. And although the "Challenge" line items posted an underage, the funding was not lost, as it was simply encumbered for disbursement in early FY 2000. It seemed that the final FY 1999 allocations were determined too late to have been disbursed prior to the close of the fiscal year.

Health Care/Medicaid

Spending from the $5-plus billion Health Care/Medicaid program continued its salutary contribution to the state's fiscal picture, by replicating its FY 1998 performance and hauling in another round of annual underspending, this one totaling $107.5 million in FY 1999. Over the 12-month period, occasionally large monthly overages were basically overwhelmed by a more steady parade of large monthly underages.

With regard to the original FY 1999 appropriation of $5.46 billion (contained in Am. Sub. H.B. 215 of the 122nd General Assembly), some significant changes were made. First, Am. Sub. H.B. 650 of the 122nd General Assembly, which established a new system for funding education, reduced the program's FY 1999 appropriation by $30.1 million. Second, actions taken by the Controlling Board cut another $70.0 million from the appropriation, $30.1 million of which came out of the state portion of the program and $39.9 million of which was trimmed from the federal share of the program. The specific actions taken by the Controlling Board transferred $33.1 million of that $70.0 million in Medicaid appropriations as follows: (1) $14.6 million to cover federal penalties related to the state's failure to have its Child Support Enforcement Systems (SETS) certified; (2) $7.5 million for county administration of the Disability Assistance, Medicaid, and Food Stamp programs; (3) $6.0 million to fund the Department of Human Services' third party liability recovery contract; (4) $4.0 million into the Department of Health's Ohio Early Start line item to fund Welcome Home, a program administered by the Department of Health that supports home visits by registered nurses to first-time and teen parents as part of the state's Family and Children First Initiative; and (5) $1.0 million to provide cash assistance to certain households affected by disasters. The other portion of the $70.0 million — $36.9 million — reflected a reduction in the amount of federal Medicaid reimbursement money that the state expected to earn in FY 1999.

The net effect of these changes was to knock $100.1 million out of the FY 1999 Medicaid appropriation, thus reducing it to $5.36 billion. Of this adjusted FY 1999 Medicaid appropriation, $5.18 billion was disbursed, $2.4 million was encumbered for disbursement in FY 2000, and $183.9 million reverted (lapsed) to the GRF's ending cash balance.

For FY 1999, the Medicaid program also carried $53.9 million in FY 1998 encumbrances. The department disbursed all of the FY 1998 encumbrances with the exception of $4.2 million, which included $3.6 million that was still encumbered at year's-end and around $600,000 that was cancelled and returned to the GRF's ending cash balance.

What this general review of FY 1999 Medicaid disbursements is intended to point out is that the analytical picture is muddied somewhat by: (1) the commingling of current fiscal year appropriations with the disbursement of outstanding encumbrances from prior fiscal years; and (2) the aforementioned Controlling Board transfers that moved portions of the program's state share of appropriation authority to other welfare and human service programs and reduced the program's federal share. For our more detailed end-of-year treatment of the Medicaid program, see the article in this issue entitled "Medicaid Spending: A FY 1999 Retrospective" authored by our colleague Ogbe Aideyman.

TANF

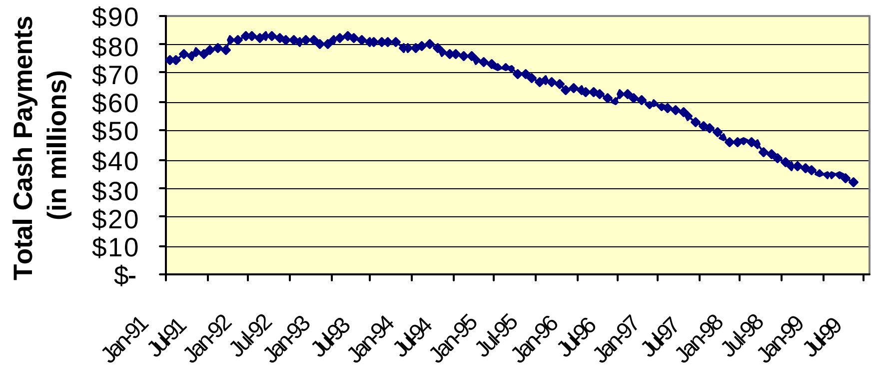
Like last year, spending from the Temporary Assistance to Needy Families (TANF) program in FY 1999 was considerably below estimate, landing under by $153.7 million, or 16.3 percent. This disbursement variance was almost entirely a function of $145.4 million in unspent federal money ($137.7 million from the current year's appropriation plus $7.7 million in prior year encumbrances). However, upon further examination, one can see that this disbursement variance really understates the size of the state's pot of federal TANF dollars that were unspent but available in FY 1999. Unlike last year, the FY 1999 estimate assumed that $55.0 million of the $653.0 million FY 1999 appropriation in line item 400-411, TANF Federal Block Grant, would lapse and thus was not even included in the total amount estimated for disbursement. In addition, $75.0 million of available funds from the TANF Federal Block Grant were unappropriated and intentionally left "on account" at the federal level as a reserve for caseload contingencies. Thus, out of the state's total $728.0 million federal block grant funding available in FY 1999 ($653.0 million FY 1999 appropriation plus $75.0 million unappropriated), the true amount of unspent but available federal TANF funds totaled a much larger $275.4 million for FY 1999. From these federal funds, $33.2 million has been encumbered for use in FY 2000.

Adding to the TANF underage was about $700,000 in unspent state TANF dollars. These funds contribute to Ohio's required maintenance of effort (MOE) and have been encumbered and should be spent prior to the end of the federal fiscal year on September 30. Also, some $6.6 million in prior years' encumbrances from the now defunct Aid to Dependent Children (ADC) program had been encumbered for county reconciliation purposes, but went unspent in FY 1999, and lapsed.

The driving force behind this considerable underage in the TANF program is a steadily declining caseload. At the start of FY 1999, the total number of Ohio Works First (OWF) recipients stood at 341,839. At the end of the fiscal year, the number of OWF recipients had declined to 244,278 — a 28.5

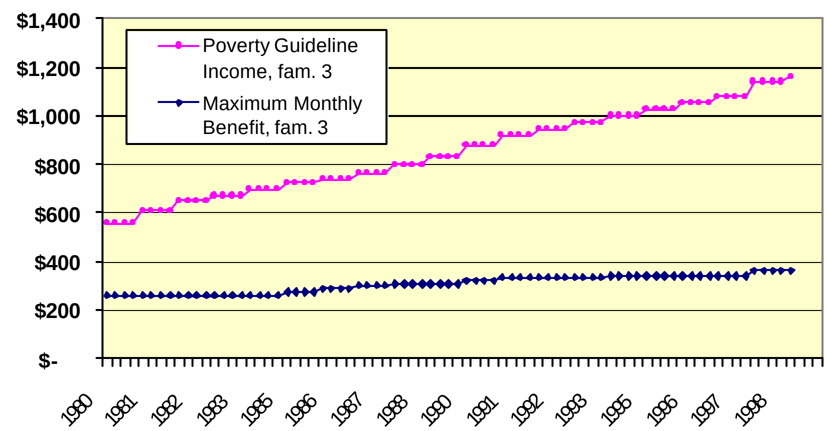
percent drop in one year (this decline was 3 tenths of a percent smaller than the previous year). The OWF/ADC caseload has been declining steadily since March 1992 when the number of recipients peaked at 748,717 — three times its current size. This decline in caseload is reflected in a smaller monthly total cash payment to OWF recipients, as we've depicted in Figure 1.

FIGURE 1
Monthly ADC/OWF Cash Payments
January 1991--June 1999



A number of reasons have been cited as explaining this downward trend in the welfare caseload. Included among commonly cited reasons are: (1) the economic expansion that has created many jobs; (2) the federal Earned Income Tax Credit which provides an incentive for work; and (3) welfare program changes such as increased income disregards, time limits for benefits, stricter work requirements, sanctions, and the declining real value of welfare cash benefits. While there is certainly a range of opinion on the issue of which factors are most significant in producing the lower welfare caseload, there is a broad consensus among experts that the improved economy and the federal Earned Income Tax Credit have produced the largest share of the impact. These factors impact the caseload primarily by helping to reduce the number of families whose situation would lead them to apply for assistance in the first place. Some of the other factors which influence the rate at which recipients exit from assistance, while perhaps not as statistically significant in a causal model, certainly play a key role in the overall picture of the new structure of incentives and disincentives in the welfare system.

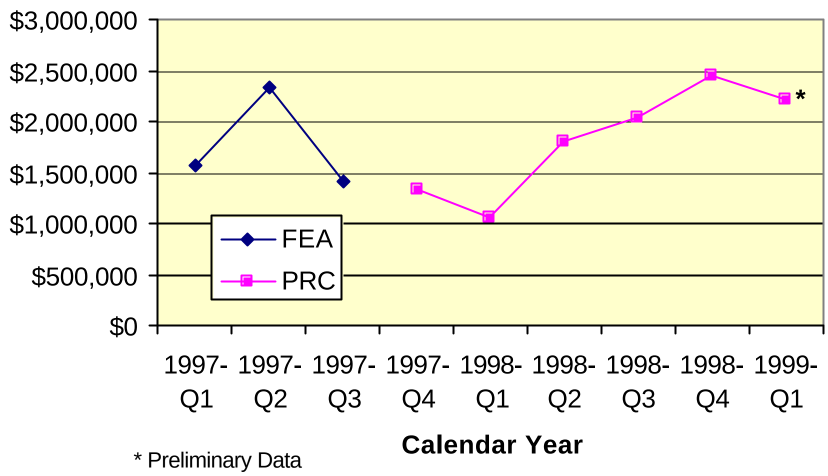
FIGURE 2
Poverty Guideline Monthly Income and OWF Maximum Benefit, Family of Three, Quarterly, 1980-1999



For example, of all the OWF cases closed in FY 1999 (some cases are reopened and closed again), over 28,000, or about 21.0 percent, were closed due to a sanction being applied. The rate of sanctioning increased considerably after OWF began to be implemented in October 1997, and is now a significant factor in explaining the caseload decline. In addition to stricter work requirements and a system of sanctions, the real value of the OWF benefit has declined steadily, thus increasing the incentive provided by wages and the increasing numbers of jobs. In Figure 2, we've compared the maximum monthly OWF/ADC cash benefit available to a family of three with the monthly income equal to the poverty guideline for a family of three.

Clearly, the increasing gap between the maximum OWF benefit and the guideline for what constitutes poverty has become harder to fill with other supports like food stamps, and thus makes work more attractive.

FIGURE 3
FEA and PRC Expenditures,1997-1999



It is also clear that the combination of all of the factors mentioned have produced a dramatic shift in the nature of the welfare system. Increasingly, welfare is being seen as a temporary alternative to work, and Ohio's welfare system is being transformed into a system of workforce development that supports the transitioning off welfare, or prevents the necessity of turning to welfare. Depicted in Figure 3 is data on expenditures in the Prevention, Retention, and Contingency (PRC) program for the first six quarters of its operation, with a comparison to the last three quarters of the old Family Emergency Assistance program that was replaced by the PRC program.

We see that, after a slow start, the PRC program has now begun to regularly exceed spending levels of the older program — meaning that the PRC program, which has a greater range of allowable means of providing short-term support for families in need, including supports that help individuals retain employment, is now beginning to have a significant presence in the mix of Ohio's TANF program.

E&T. One of the other key initiatives in the TANF budget that began implementation in FY 1999 was the TANF Employment and Training program. This program originated in April 1998 when the executive branch withdrew its application for a Welfare-to-Work (WtW) matching grant from the federal Department of Labor. WtW grant moneys are available to provide more intensive job preparation services for "hard to serve" welfare clients. In place of a program based on a WtW grant, the executive designed a program that would largely serve the same population and would be funded out of federal TANF reserve funds. In FY 1999, $44.0 million was designated for distribution to the counties to begin this program. Showing evidence of a slow start up, as of July 21, 1999, counties had reported expenditures of only $2.4 million in TANF E&T funds for FY 1999.

General/Disability Assistance

The FY 1998 disbursement story in the Disability Assistance (DA) program (a state- and county-funded effort that provides cash and/or medical assistance to persons presently ineligible for public assistance programs that are supported in whole or in part by federal funds) was a slow decline in the number of cash recipients and a stable caseload of medical recipients. The average cash payments declined from $1.47 million per month in FY 1998 to $1.19 million per month in FY 1999, while the average medical payments increased from $3.11 million per month in FY 1998 to $3.51 million in FY 1999. Despite the stability in the number of medical recipients, total DA medical expenses increased from $37.3 million in FY 1998 to $42.2 million in FY 1999. The prescription component of DA medical costs exceeds 60 percent and inflation in this component is a driving force in the increase.

Overall, DA's 1999 disbursements registered negative variances in 10 out of 12 months, but still managed to slightly outspend FY 1998. For the year, DA disbursements were $4.2 million below the original estimate, representing a 6.8 percent negative disbursement variance.

Another factor contributing to the negative disbursement for the whole GA/DA program was the slowness in distributing slightly over $6.0 million that the department had encumbered for the purpose of making awards to the plaintiffs in the civil matter known as the Taber class action law suit. In a process that required filing an application, by the end of May, the total number of applications for plaintiff awards had reached 213. Of these applications, 15 had been approved, 174 had been denied, and 24 were still pending. Only $3,935 has so far been paid out in awards. It appears likely that the bulk of the $6-plus million will go unclaimed, and thus is likely to lapse back into the state's unappropriated and unobligated GRF cash balance sometime during FY 2000. The interested reader will find more detail on the cause of action and court rulings on the Taber case in our January, 1998 and the July/August, 1998 issues.

Other Human Services

Aging. Disbursements for the Department of Aging were $1.7 million over the estimate for the month of June, a fact that could be attributed directly to PASSPORT expenditures. The PASSPORT program is funded using general revenue funds, federal reimbursement for a portion of state Medicaid expenditures, nursing home franchise fees, and designated revenues from off-track betting, with the majority of the program's revenue being drawn from the GRF and federal Medicaid reimbursement. PASSPORT's estimated disbursements assumed that the program's June spending would be a mix of $3.9 million in GRF and $7.2 million in federal Medicaid reimbursement. Actual disbursements were $6.4 million and $4.3 million, respectively. For nearly every month throughout FY 1999, GRF PASSPORT disbursements ran several hundred thousand dollars below the estimate due to lower than expected administrative costs. Rather than allowing these "excess" administrative moneys to lapse, the department disbursed the excess in June to area agencies on aging (AAAs) to pay for PASSPORT services. On the other hand, the unused federal funds did not lapse, but remained on hand as available cash to the department. Thus, reducing the June disbursement of federal PASSPORT funds had no adverse effect on the program, as these funds will simply be carried forward and spent in the new fiscal year, utilizing FY 2000 appropriation authority.

For the year, Aging disbursements were $1.9 million under the estimate, the consequences of which were revealed in two ways: (1) larger than anticipated year-end encumbrances; and (2) lapsed FY 1999 appropriation authority. The department encumbered $10.1 million for the year, as compared to the original estimate of $8.0 million (a variance of $2.1 million). Furthermore, the department lapsed $532,765 in FY 1999 appropriation authority, the majority of which came from line items 490-408, STARS, and 490-418, Area Agency on Aging Region 9.

The STARS line item funds a program known as Seniors Teaching and Reaching Students in which seniors provide tutoring and mentoring in schools. The line item's lapse totaled $234,560, 12.1 percent of its FY 1999 appropriation. According to the department, the lapsed FY 1999 funding was because they had fewer volunteers than they had hoped, and a financial audit and an effectiveness evaluation of the program ended up costing much less than had originally been planned.

The Area Agency on Aging Region 9 line item lapsed $236,547, 18.3 percent of its FY 1999 appropriation. Most of the lapsed amount in the line item was budgeted for AAA 9 operations, but simply ended up not being needed. The most interesting facet of this line item, however, is the story behind its creation. Early in FY 1999, the department became aware of serious fiscal issues at AAA 9, which serves a nine-county area that includes Belmont, Carroll, Coshocton, Guernsey, Harrison, Holmes, Jefferson, Muskingum, and Tuscarawas counties. In October 1998, the Controlling Board approved a contract with AAA 10B (Akron) to provide fiscal management services at the troubled AAA 9. The Controlling Board also approved a transfer of $191,806 in unused FY 1998 funds from GRF line item 490-412, Residential State Supplement (RSS), to the newly created GRF line item 490-418, Area Agency on Aging Region 9, to pay for the contracted services through the end of FY 1999. In December 1998, the Controlling Board approved the transfer of an additional $1,101,770 in unneeded FY 1998 and FY 1999 RSS appropriations to the new line item. The transferred RSS funds were used to ensure that services in Region 9 would continue without interruption and to pay the Auditor of State (approximately $32,000) for a special audit of the AAA. The fiscal management services contract with AAA 10B was subsequently renewed for $77,036 by the Controlling Board to cover the period of July 1, 1999 through December 31, 1999.

The RSS program provides clients with a supplemental income that allows them to reside in a group home setting and receive a protective level of care. The funds were unneeded because all available RSS slots were not filled. In FY 1999, there were approximately 2,750 RSS recipients, more than half of which are under age 60. Furthermore, more than half of the recipients suffer from some type of chronic mental illness. During FY 1999, Aging was engaged in a discussion with the departments of Health and Mental Health regarding the future of the RSS program. LBO believes that it was unclear at that time whether or not the program would remain with the Department of Aging, therefore, the department was not aggressive in filling all the available slots. However, it is now clear that the program will remain with Aging. The recently enacted budget covering fiscal years 2000 and 2001 included several RSS program reform measures, the implementation of which is to be evaluated during FY 2001 by the departments of Aging, Health, Mental Health, and a group of key relevant constituencies.

Alcohol & Drug Addiction. The Department of Alcohol and Drug Addiction Services ended the fiscal year with an overage of nearly $900,000. The entire overage can be attributed to disbursements from line item 038-404, Prevention Services, which is used to fund community substance abuse prevention, teen pregnancy prevention, and higher education substance abuse prevention programs. The original disbursement estimate for this line item mistakenly assumed that the department would encumber the entire appropriation for disbursement in FY 2000. In fact, contrary to that expectation, the appropriation was fully disbursed in FY 1999.

Employment Services. After a yearlong parade of uneven monthly overages and underages, what was most amazing about the Bureau of Employment Services was that, at the end of FY 1999, it landed virtually on top of the disbursement estimate. At year's-end, the bureau posted a miniscule negative disbursement variance of $86,008, 0.3 percent below the estimate. A further look at the bureau's numbers indicated that, of its $28.7 million FY 1999 operating budget, $27.8 million (96.8 percent) had been disbursed, around $900,000 (3.1 percent) was encumbered, and about $21,000 (0.1 percent) was left to lapse back into the GRF's ending cash balance.

The driving force behind the bureau's GRF disbursements was, as expected, line item 795-407, OBES Operations, which accounted for close to 80.0 percent of its total FY 1999 GRF appropriation. By the end of June, the bureau had disbursed over 99.0 percent of the line item's FY 1999 appropriation of $22.5 million, with the remainder of the appropriation having been encumbered for disbursement in FY 2000.

A few of the bureau's "lesser" line items (i.e., those comprising a much smaller share of its total GRF budget) exhibited a persistent pattern of underspending throughout the fiscal year and were primarily responsible for the bulk of its year-end encumbrances. This pattern of underspending was not in itself remarkable in light of two factors: historical experiences suggesting that these were not unusual disbursement wrinkles as well as the bureau's use of an accounting system known as ICESA FARS (the Interstate Conference of Employment Security Agencies Finance and Reporting System).

As we noted in past issues, ICESA FARS is one of three systems that has the ability to allocate indirect costs in accordance with the federal Department of Labor's approved cost allocation plan. Since the bureau receives approximately 80.0 percent of its funding from the federal government, adherence to these accounting imperatives is critical.

Indirect costs are assigned directly to federal grants in ICESA FARS and in the state's central accounting system (CAS) to the bureau's federal Fund 331, Federal Operating. Since ICESA FARS must be reconciled on a quarterly basis with CAS via the use of intrastate transfer vouchers (ISTVs) "lags" between actual date of disbursement and posting often occur. Because of this, monthly variances between actual and estimated disbursements may be misinterpreted as either issues of timing, bad estimates, or difficulties encountered with certain budget initiatives. In fact, the FY 1999 year-end encumbrances totaling approximately $900,000 can be directly attributed to the quarterly reconciliation that must be done between ICESA FARS and CAS.

There were also three notable Controlling Board actions taken over the last year that have affected the bureau's FY 1999 GRF disbursement activity. First, disbursements from line item 795-418, TANF Employment & Training, created by action of the Controlling Board in June 1998 to assist with the costs of the bureau's TANF-driven administrative expenses, were sluggish relative to the estimate all fiscal year long and never turned around. The line item ended with a 53.5 percent underage and managed to disburse only 46.0 percent of its $400,000 FY 1999 appropriation. Although the remainder of the line item — $215,905 — was encumbered and not allowed to lapse back into the GRF's ending cash balance, we were still left with some uncertainty as to what the bureau had intended with this admittedly small amount of money. An appropriation to support the administrative functions of the TANF Employment and Training Program was made using federal funds in the amount of $700,000 in each year of the biennium (line item 795-620). The availability of these funds is dependent upon an interagency agreement for a transfer from the Department of Human Services.

Second, the bureau took a few proactive steps throughout the fiscal year to redirect GRF funds to program areas that required supplemental appropriations. In March 1999, for example, the Controlling Board approved a transfer of $70,000 from line item 795-412, Prevailing Wage/Minimum Wage and Minors, that was split between two line items: 795-413, OSHA Match, and 795-417, Public Employee Risk Reduction Program. The transferred funds represented excess appropriations that built up due to an unfilled director position and disability leave taken by an assistant director. At that time, both of the line items to which these excess funds were moved showed signs of exhausting their GRF appropriations before the end of the fiscal year. Of the transferred funds, $20,000 was moved to bolster the state's OSHA match money, thus leveraging $100,000 in additional federal enforcement funding, while the remainder — $50,000 — was used to cover a projected deficit in the Public Employee Risk Reduction program.

Third, and last, in December, the Controlling Board transferred, pursuant to a bureau request, the unencumbered FY 1999 balance from line item 795-416, Veterans' Programs, into the Ohio Veterans' Home's GRF operating budget. The original FY 1999 appropriation in the bureau's line item was $67,900, of which $30,781 was actually transferred over to the Veterans' Home. The purpose of the bureau's line item was to fund activities associated with the Ohio Veterans' Hall of Fame, which honors outstanding veterans for successful endeavors following military service. The Controlling Board transfer was initiated in order to comply with an executive order previously signed by the Governor that shifted responsibility for the Hall of Fame from the bureau to the Veterans' Home.

Health. The Department of Health closed FY 1999 with an underage that was $8.7 million, or 10.3 percent, below the estimate for total GRF disbursements. Around 85 percent, or $7.4 million, of that underspending was concentrated in the department's FY 1999 budget appropriations, while the remaining 15 percent, or $1.3 million, was attributable to funding encumbered from prior fiscal years' appropriations for disbursement in FY 1999.

From among the department's 25-plus GRF line items, we identified, in order of magnitude, the following five as prime culprits in this underspending: (1) 440-501, Local Health Districts ($3.9 million); (2) 440-444, AIDS Prevention/AZT ($2.3 million); (3) 440-418, Immunizations ($1.4 million); (4) 440-413, Ohio Health Care Data System ($1.1 million); and (5) 440-416, Child and Family Health Services ($1.0 million). Also of note was the fact that, of the total amount appropriated to these five line items in FY 1999 — $29.9 million — close to one-third, or $9.7 million, had not been disbursed by the close of June. On a brighter note though, the department sent a clear signal that it fully expected to eventually spend a considerable portion of this unspent $9.7 million, as it encumbered $8.5 million of that amount for disbursement in FY 2000.

Of these aforementioned five line items, two merit some additional remarks. First, as has been discussed in prior issues, disbursements from line item 440-501, which contains subsidy funding for the 144 local health districts in Ohio, tend to lag behind the estimate, and, in fact, often are not disbursed until the following fiscal year. For example, FY 1998 local health district subsidy funding was not disbursed until August and November of FY 1999. Since the amount of a subsidy that a given health district receives is determined by a formula in the Revised Code, the department literally cannot distribute any of this subsidy funding until it receives certain core bits of information from all of the 144 local health districts. In the case of the $3.9 million appropriated for FY 1999 subsidy funding, none of it was disbursed and the entire amount was encumbered for disbursement sometime in late summer or early fall.

Second, line item 440-413, which funds the Ohio Health Care Data System, a statewide, uniform electronic claims system that collects information on all recipients of publicly funded health care, lapsed slightly over 30 percent ($570,362) of its adjusted FY

1999 appropriation of $1.9 million. During FY 1999, the department merged the activities of the health care policy (line item 440-458, Health Care Policy and Regulation) and data system units. As a result of this merger, payroll costs were reduced in both units, producing not only line item 440-413's funding lapse, but a lapse of $380,699 in line item 440-458 as well. Line item 440-413 was also a significant player in the department's $1.3 million of underspending in prior years' encumbrances. Just over $1 million of this line item's FY 1998 appropriation was encumbered for disbursement in FY 1999, but only $306,654 was actually disbursed. Virtually all of this encumbered funding reflected a planned contract payment to The Gallop Organization for its work on the Ohio Family Health Survey, a project whose aim was to determine the number of uninsured and underinsured persons in Ohio and provide required baseline and descriptive health care information. As it turned out, the majority of Gallop's work was actually performed in FY 1999 and thus was paid for using FY 1999 appropriations rather than FY 1998 encumbrances as had been expected.

Notable Overages. In the midst of this underspending, the department did register overages in two line items, both of which were traceable to actions of the Controlling Board. Line item 440-451, Prevention, which funds operational expenses of the department's disease prevention program and subsidizes local health agencies, ended the fiscal year with a positive disbursement variance of $1.7 million. Why? Largely because on July 27, 1998 the Controlling Board transferred a total of $2.2 million in various unspent FY 1998 GRF appropriations to line item 440-451's FY 1999 appropriation, in an effort to address a $1.4 million cash flow problem associated with the department's federal Preventive Block Grant.

Line item 440-459, Ohio Early Start, which provides state funding to participating counties for direct services to children aged birth to three years who are at high risk for developmental delay, abuse, or neglect because of their environmental, family, or health circumstances, ended the fiscal year with a positive disbursement variance of $2.5 million. Why? Because, also on July 27, 1998, the Controlling Board transferred $4.0 million from the Department of Human Services' Medicaid program to line item 440-459 to provide funding for Welcome Home, a program administered by the Department of Health that supports home visits by registered nurses to first-time and teen parents as part of the state's Family and Children First Initiative.

Mental Health. At year's-end, the Department of Mental Health's disbursements were $10.3 million over the estimate. Of this variance, $6.8 million was traceable to employee pay raises. In FY 1999, the department employed approximately 3,300 personnel, 3,000 of which worked at state psychiatric hospitals. Last fall, the Controlling Board approved the transfer of $60.4 million in GRF funding that had been explicitly appropriated to assist state agencies with absorbing the cost of employee compensation increases. Of the funding transferred to Mental Health, $672,924 was moved into the department's personal services line item (333-100) and a much larger $6.1 million was dropped into its hospital operations line item (334-408). The transfer of this employee pay raise money resulted in an end-of-year overage because the August 1998 estimates that we base our disbursement discussions on did not include fund transfers that had not yet happened.

The Department of Mental Health also posted a $9.5 million underage for the month of June. We did not, however, attach any significance to the June underage itself as it was directly attributable to an error made in the calculation of the monthly estimates for various line items.

Rehabilitation Services. The Rehabilitation Services Commission closed the year with an underage of $3.3 million, or 14.4 percent below the estimate. Repeated monthly underages in its line item 401-506, Case Services for People with Disabilities, equalled just over $3.5 million and essentially propelled this negative state of fiscal affairs. According to the commission, the variance was the result of having to allocate its state match funding so as to be in alignment with the manner in which it draws federal vocational rehabilitation funding. Not surprisingly then, FY 1999 disbursements from line item 401-506 mirrored previous years. As in the past, the commission encumbered a load of this funding for disbursement in the early stages of the next fiscal year. Of the line item's $11.1 million FY 1999 appropriation, $4.9 million, or 44.1 percent, was encumbered for disbursement in FY 2000.

The size of the commission's year-end underage was reduced slightly from what it would otherwise have been as a result of somewhat greater-than-expected spending on personal services. This was due to the $315,291 in GRF funding that the Controlling Board approved for transfer last fall into the commission's budget to cover employee pay raises that were not built into its FY 1999 disbursement estimates.

Veterans' Home. The Ohio Veterans' Home, one of the nation's largest state-operated homes for veterans, ended FY 1999 with an overage of $1.2 million, which was 7.3 percent over the estimate. One factor explains this overage — the transfer of operating fund appropriations totaling $1.3 million. There were actually two such transfers; the most significant of which occurred last August. At that time, the Controlling Board approved the transfer of $900,000 from its Emergency Purposes/Contingencies line item to the home's budget. The purpose of the transfer was to provide the home with the funding necessary to hire 53 additional fulltime staff and bring its staffing levels up to recommended levels. This move became necessary because in May 1998, the Ohio Department of Health (DOH) auditors had cited and fined the home for insufficient staffing in its Secrest-Giffin nursing home. With staff augmented as a result of this August 1998 funding transfer, the home subsequently passed a June 1999 DOH audit without citation. The home phased in the hiring of these 53 new staff (mostly nurse aides) over the course of the fiscal year so as to stretch this money as far as possible.

The second transfer occurred last fall when the Controlling Board approved the movement of $60.4 million in GRF funding that had been explicitly appropriated to assist state agencies with absorbing the costs of employee compensation increases. Of that transferred employee compensation funding, $407,000 was moved into the home's personal services line item.

Because the hiring of these 53 new staff was phased-in over the course of the fiscal year, as well as other financial maneuvers, the home was actually able to constrain its year-end overage from being even higher.

Justice & Corrections

Adjutant General. Based upon the fact that the Adjutant General — charged with assisting state and local law enforcement agencies during periods of disaster, disturbance, or other emergency situations — closed with a small year-to-date positive disbursement variance of $351,834, or 2.4 percent above the estimate, one could have stopped and assumed that not much was going. In the details below this quiet looking surface we found two line items with dramatically different disbursement variances: 745-409, Central Administration, and 745-406, Tuition Grant Program. The Central Administration line item, which supports the Adjutant General's annual operating expenses, posted an overage of $1.4 million. The source of this overage was essentially $1.8 million in Controlling Board-approved operating fund transfers that occurred at various times during the fiscal year. Of that amount, $1.4 million was related to the rendering of disaster assistance when the Ohio National Guard was activated by the Governor twice during FY 1999: once in July 1998 to assist communities in recovering from tornado and storm damage and flooding in 26 counties stretching from Toledo to Marietta, and once in April 1999 in response to high wind and tornado damage in Clinton, Hamilton, and Warren counties.

Working then to somewhat offset this rather large overage in the Central Administration line item was a $900,000-plus underage in the $4.0 million Tuition Grant Program line item, which provides tuition assistance for full- or part-time undergraduate work to individuals who enlist in the Ohio National Guard for six years. Any concern that this apparent failure to spend around one-quarter of this program's FY 1999 appropriation might generate in certain circles should have been eased by the discovery that the balance of the line items had been encumbered. Upon conversing with the Adjutant General, we learned that schools were slow in submitting requests for payment and as a result the agency had not yet paid on its commitments for the spring and summer 1999 academic terms. (Under the recently enacted biennial budget covering fiscal years 2000 and 2001, this program's funding was moved into the Board of Regents under line item 235-599, National Guard Tuition Grant Program. The funding itself, however, will continue to be disbursed at the direction of the Adjutant General.)

Attorney General. As they had managed to string together an uninterrupted line of seven monthly overages from last December through this June, it was not startling to discover that the Office of the Attorney General closed FY 1999 with a year-to-date positive disbursement variance of $3.4 million, 7.0 percent above the estimate. The source of this ending-year overage — traceable to their GRF budget driving, $47.6 million operating expense line item (055-321, Operating Expenses) — was twofold. First, last fall, the Controlling Board approved the transfer of GRF funding that had been explicitly appropriated to assist state agencies with absorbing the costs of employee compensation increases; $3.1 million of which was moved into the Attorney General's personal services line item and would not have been built into its FY 1999 disbursement estimates. Second, and considerably more critical from a policy perspective, the Office of the Attorney General transferred the payroll costs associated with around 20 positions into its GRF budget from Fund 419, Claims Section, the latter of which was experiencing a cash flow problem that we previously discussed in our February, 1999 issue. We were unable, however, to discern how much each of these two factors contributed independent of one another to the yearly overage.

Claims Section. This fund receives the Attorney General's cut of the action for collecting claims due to various state agencies, and their "take" is in turn used to fund the Attorney General's revenue recovery actions as well as to support officewide operating expenses. Recently, its two largest clients — the Department of Taxation and the Bureau of Workers' Compensation — successfully upgraded their own in-house capabilities to collect these claims, which decreased the number of claims handled, and the revenue generated, by the Attorney General's collection operation. As a result, the total dollar amount of claims collected annually by the Attorney General was anticipated to fall from around $150 million to about $140 million, which would then produce an annual revenue loss to the Attorney General's Claims Section Fund of close to $1.0 million. From the Attorney General's perspective, this was not a positive change of affairs since the fund's healthy cash flow has traditionally offered an attractive and easy target for supplementing its GRF budget. Adding to this revenue woe was the concern that expenditures would still rise in the future, even in the face of certain claims dropping, as the nature of those claims still turned over the Attorney General's collection operation were expected to become more complex and labor intensive. The recently enacted biennial budget that covers fiscal years 2000 and 2001 contained a permanent law change intended to ameliorate the Attorney General's revenue loss by specifying that up to 11.0 percent of all amounts collected by the Attorney General on claims due to the state be paid into the Claims Section Fund. Preexisting law set the amount of the Attorney General's take of this action at 9.0 percent, 2.0 percent less than will be the case for fiscal years 2000 and 2001.

Criminal Justice Services. The estimate for the Office of Criminal Justice's total FY 1999 disbursements was $4.3 million, while its actual total FY disbursements registered considerably less at $3.0 million. This translated into a $1.3 million year-ending underage, 31.1 percent below the estimate. Most of this variance was attributable to the office's line item 196-401, Criminal Justice Information System Plan, the purpose of which was intended to improve the capturing of data related to the disposition of criminal cases, information that is subsequently transmitted to the state, specifically the Attorney General's Bureau of Criminal Identification and Investigation (BCII). Of the line item's $1.1 million FY 1999 appropriation, only $170,849, or 16.0 percent, was disbursed; however, of the remainder, $894, 773, or 83.6 percent, was encumbered. Of that encumbered amount, $435,000 is slated to assist Montgomery County with various criminal justice information system enhancements, which include upgrading hardware and software to achieve Y2K compliance and facilitating fingerprint image transfers to BCII. A microscopic $4,378, or 0.4 percent, of the line item's FY 1999 appropriation was permitted to lapse back into the GRF's ending cash balance.

Judicial Conference. While the Ohio Judicial Conference's disbursements landed far below the estimate, it did end 1999 with a little bit of a bang. First, the landing. The conference ended the fiscal year with a negative disbursement variance of $7.0 million, 68.5 percent under the estimate. This lack of disbursement activity, however, was not unexpected news to anyone who is a regular reader of this publication. In prior conversations with the conference about its court security program — which provides grants to local courts for the implementation of security improvements — it was quite clear that award process was moving slower than expected. Not surprisingly, the conference managed to disburse only 17.0 percent of the $9.7 million appropriated for this purpose in FY 1999 (line item 018-502, Court Security Subsidy). This sluggish pace accounted for why the conference's FY 1999 disbursement activities fell significantly behind those of the other twelve state agencies that make up the Justice and Corrections program category.

Then, the bang. While the focus has been on the conference's inability to relieve itself of this court security subsidy funding, it did end the fiscal year on a bright spot that should not be overlooked. Of the $2.6 million that was disbursed from this line item in FY 1999, including almost $1.0 million in FY 1998 encumbrances, 80.8 percent occurred in the final two months of the fiscal year. In anticipation of being able to promptly distribute a huge portion of grant funding within the first few months of FY 2000, the conference encumbered $8.0 million of its unspent FY 1999 appropriation authority. The conference does anticipate though that approximately $1.0 million of this encumbered funding may not be needed and would then be allowed to lapse back into the state's unappropriated and unobligated GRF cash balance.

Public Safety. Although in the scheme of things, the Department of Public Safety is a very small player in the state's GRF budget — with a mere $7.9 million of the department's $400-plus million FY 1999 operating budget being covered by the GRF — as it is heavily financed by moneys earmarked from the state's gasoline tax revenue — it did close with a somewhat eye-popping year-ending overage of 39.9 percent, or $2.0 million.

How exactly did the department accomplish that, since realistically speaking, a state agency can't engage in deficit spending? The answer in two words was Controlling Board. On three separate occasions over the course of FY 1999, the Controlling Board approved requests to transfer operating fund appropriations that in total increased the department's FY 1999 GRF budget by $2.0 million. Of this amount, $1.3 million was to provide disaster assistance funding to counties that were damaged by storms and flooding in early summer of 1998, around $576,000 was to fund earmarks for the American Red Cross and the Miami Valley Urban Search and Rescue Task Force that were not fully disbursed in FY 1998 as called for in the biennial budget bill, and close to $200,000 went to assist the department with absorbing the payroll costs associated with employee pay raises.

The other facet of the department's FY 1999 GRF budget that caught our attention was line item 764-404, Transportation Enforcement Operations, which supports operating expenses of its motor carrier inspection unit. Of the line item's $2.1 million FY 1999 appropriation, only two-thirds, or $1.3 million, had been disbursed. A closer examination revealed that a much larger amount than expected had been encumbered for disbursement in FY 2000 ($777,260, or 37.5 percent of the FY 1999 appropriation). Upon conversing with the department, we learned that, early on in FY 1999, they took a deliberately cautious approach to spending this line item's appropriation. The result was that a nice pile of this FY 1999 money was built up, and subsequently encumbered, for the purpose of making some necessary equipment purchases for the motor carrier inspection unit, including laptops and printers, in-car cameras, hand held radios, vehicle light bars, and three patrol vehicles.

Rehabilitation & Correction. As we see it, here is the basic description of the Department of Rehabilitation and Correction's FY 1999 disbursement story. Its year-to-date underage peaked halfway through FY 1999 at $70.3 million. And then following that December high, we witnessed its slow erosion in the face of a fairly relentless six-month assault of overages that included $8.0 million in June. As a result, by the time FY 1999 closed, the department's year-to-date underage had been driven all the way down to $5.4 million, 0.5 percent below the estimate. This drop in the departmental underage was, however, a little less steep than this ending number suggests. Buried within that bottom line underage were overages totaling $8.3 million produced by the department's debt service and community-based correctional facility programs. Were it nor for those programmatic overages, the department's end-of-year underage would have been closer to $14.0 million.

Describing the department's disbursements though was the relatively easy part. What is much more problematic is trying to analyze, or attach some larger meaning, to its spending variances. Why? Because the process of estimating the department's disbursements, especially monthly spending, is, in our opinion, as much art as it is science. Why? Because this department has learned to adapt to, as well as manipulate, its contingency-laden environment, and the leadership of the executive branch, in recognition of that reality, has typically given the department fairly wide latitude in altering its plan for spending $1-plus billion in GRF annually.

And, as it unfolded, FY 1999 was no different. The department's initial FY 1999 GRF appropriation totaled $1.19 billion, which included $190.4 million in additional funding to essentially begin the activation, and in some cases fully open, seven new correctional facilities, to expand existing operations by hiring more security, unit management, mental health, and parole staff, and to pump close to $20.0 million in community corrections subsidies into the street. Late in FY 1998, the General Assembly cut more than $20.0 million from the department's FY 1999 GRF budget as part of a larger appropriation reduction strategy tied to creating a new system for funding education. Then in the fall of FY 1999, the Controlling Board funneled $31.3 million into the department's GRF budget to assist with employee pay raises, which, for the department is no small feat when one considers that over 14,000 of its employees are paid from the GRF.

Other factors, three in particular, jumped into the mix to reduce spending and generate the further likelihood that variances would develop between planned and actual disbursements. First, the activation or opening of some of the new correctional facilities was delayed, in some cases until FY 2000 or beyond. Second, a hiring freeze imposed by Governor Taft delayed the hiring of newly authorized staff. Third, the department instituted a host of changes related to staff overtime, meal management, inmate transportation, and so forth that cut the day-to-day cost of running prisons from what it would otherwise have been.

Further muddying the disbursement picture was the department's decision, as it approached the end of FY 1999, to spend, with the approval of the Office of Budget and Management, a chunk of its GRF funding to push forward the purchase of equipment enhancements and upgrades and the making of institutional repairs. While there was no doubting the critical or necessary nature of these purchases and repairs, it is important to understand in the context of disbursements that this was GRF funding that was not going to be spent as planned and would have otherwise lapsed.

This discussion points out that these changes in the department's funding levels and spending plans were not self-evident or easily extractable from an examination of its FY 1999 disbursement variances. One had to look beyond simple disbursement variances to the portions of the department's FY 1999 appropriation authority that were either encumbered for disbursement in FY 2000 or left to lapse back into the state's ending cash balance. And when one did that, you found that the department had: (1) encumbered $42.9 million, roughly three times larger than the amount that we would have expected; and (2) lapsed $19.0 million, almost 40.0 percent more than the number we had anticipated.

Youth Services. The most notable feature in the Department of Youth Services' FY 1999 disbursement picture was the lapsing of $5.2 million, or 35.0 percent, of its $14.9 million debt service appropriation (line item 470-412, Lease Rental Payments). Although this lapsed amount clearly represented a rather healthy portion of the line item's appropriation, it was not a surprising or particularly alarming outcome for two reasons. First, OBM had originally estimated a lapse in the department's FY 1999 debt service appropriation of roughly this magnitude — $4.2 million. Second, OBM's historically conservative approach to debt service appropriations, combined with a rather long-running favorable bond market, have created conditions under which the state has gained access to the big pots of cheap money that are necessary to finance various capital improvements.

This line item picks up the state's debt service tab that must be paid to the Ohio Building Authority (OBA) for its obligations incurred as a result of issuing bonds that cover the department's capital appropriations. The appropriation authority and actual spending levels are set and controlled by OBM, and not by the department. The moneys made available as a result of these bonds finance the design, construction, renovation, and rehabilitation phases of various departmental capital projects, as well as construction and renovation costs associated with local criminal justice projects, including community rehabilitation centers and juvenile detention centers.

Environment & Natural Resources

Natural Resources. The first thing one noticed about the Department of Natural Resources at fiscal year's-end was that its total disbursements registered over the estimate by $2.7 million, or 2.9 percent. One needed only to recall a Controlling Board transfer action taken last fall to easily place this overage in its proper context. At that time, the Controlling Board approved the transfer of $2.7 million in operating fund appropriations into the department's budget to cover pay raises that were not built into its FY 1999 disbursement estimates.

The second thing we noticed was that, of the department's $100.8 million FY 1999 GRF operating budget, $96.4 million (95.7 percent) had been disbursed, $916,079 (0.9 percent) had been encumbered, and $3.4 million (3.4 percent) lapsed. From amongst these disbursement details, we looked more closely at the three line items that covered $2.9 million, or almost 85.0 percent, of the funding that lapsed: (1) 725-404, Fountain Square Rental Payments, (2) 725-413, OPFC Rental Payments, and (3) 729-321, Computer Information Services. The first two line items cover debt service payments, and the lapsing of these funds (a total of $2.3 million) was not new, nor surprising. A healthy economy in tandem with debt service appropriations beefed-up to reassure bond markets have combined to the state's favor in recent years to conserve debt service spending and produce funding lapses.

More surprising was the $657,148 lapse in line item 729-321's funding, which supports the annual operating expenses of the Office of Computers & Communications, a group charged with various technological responsibilities, including radio, voice, and data networks, server management, data processing, and geographical information systems. From the department's perspective, although this lapse represented 55.3 percent of the line item's $1.2 million FY 1999 appropriation, it was fiscally more responsible to lapse excess funding than to simply spend it on unnecessary purchases.

For a seasoned reader, this combination at year's-end of a disbursement overage with a mix of fund encumbrances and lapses should not be the least perplexing. A state agency can simultaneously post an overage and still leave funds unspent, as its disbursement estimate generally assumes that not all line item appropriations will be spent. Thus, assumptions are made about funding amounts that may be encumbered or lapsed, and these are typically the funds that are unexpectedly tapped during the fiscal year and create the inaccurate impression that a state agency somehow overspent or exceeded its appropriation authority.

Transportation

ODOT. The Department of Transportation's GRF operating budget, which is relatively small at not even $50 million in the scheme of a total operating budget in the neighborhood of $2.0 billion that is fueled by the state's gasoline tax and other non-GRF revenue streams, ended June with a negative disbursement variance of $7.1 million and closed FY 1999 with a negative year-to-date disbursement variance of $2.9 million. Both outcomes were largely traceable back to the department's dominant GRF line item — 775-451, Public Transportation – State. This line item carried an adjusted FY 1999 appropriation of $27.1 million plus $16.3 million in prior years' encumbrances (a total of $43.4 million in appropriation authority) used to provide capital and operating assistance to 50-plus transit systems around the state operating fleets that consist of busses, vans, light transit vehicles, automobiles, and rail cars. Although only $21.1 million of that line item's total appropriation authority was actually disbursed in FY 1999, a very scanty $9,915 was all that was left to lapse as another $22.3 million was encumbered for disbursement in FY 2000. This underspending reflected delays in transit systems taking delivery of capital items, specifically busses. Apparently, the nation's largest bus manufacturer went out of business, bankruptcy proceedings ensued, and items had to be rebid, all of which has delayed the delivery of busses up to two years in some instances. And until a transit system takes delivery of such a capital item, the department was not releasing funds.

It was also hard to miss a facet of the department's aviation program, in particular line item 777-471, Airport Improvements – State, which funds airport improvements grants. This line item's FY 1999 appropriation totaled $7.2 million, $3.9 million of which was transferred from the Controlling Board's budget. It appeared at the close of FY 1999 that the department's intention was to let close to $2.0 million, or 27.6 percent, of that appropriation lapse and revert to GRF's ending cash balance. While under existing state law that was exactly what would have occurred, it was in fact not what happened. Instead, temporary language was placed in the recently enacted main appropriations act covering fiscal years 2000 and 2001 (Section 127 of Am. Sub. H.B. 283 of the 122nd General Assembly) that "notwithstood" existing state law and allowed $1.9 million of the unexpended balance in the line item's FY 1999 appropriation to be reappropriated to the line item's FY 2000 appropriation.

Development

Agriculture. In the aggregate, there was nothing in the Department of Agriculture's FY 1999 disbursements that jumped out at us. Although the department did close the fiscal year with a negative disbursement variance of $742,894, 3.8 percent below the estimate, it didn't let much of its GRF funding go unutilized. Of its $20.8 million FY 1999 GRF operating budget, $19.4 million (93.3 percent) was disbursed, $1.1 million (5.3 percent) was encumbered, and $287,698 (1.4 percent) lapsed. That said, the really notable FY 1999 disbursement events occurred in three of the department's line items with relatively small appropriations: (1) 700-404, Ohio Proud; (2) 700-409, Farmland Preservation; and (3) 700-503, Swine and Cattle Breeder Awards.

Disbursements from line item 700-404, which supports the Ohio Proud program, a logo identification program aimed at increasing the awareness and consumption of Ohio grown, raised, and processed agricultural products, slowly picked up steam over the fiscal year and then ended with a flurry as close to 50.0 percent of the $263,495 FY 1999 appropriation was unexpectedly spent in the fourth quarter. By the time that the smoke had cleared, the department had lapsed less than $1 of the line item's FY 1999 appropriation. Responsibility for the line item's sluggish disbursements was attributable to the fact that some program staff who were to be paid from this line item were in fact covered by another line item (700-411, International Trade & Market Development) for well over half of the fiscal year.

The department's Farmland Preservation program, which works with Ohio counties to encourage the preservation of Ohio's prime farmland, lapsed almost 30.0 percent of its $194,196 FY 1999 appropriation in line item 700-503. Two forces were at play here. First, the office operated much of the year without an executive director, so staffing costs were less than expected. Second, the office had planned on assuming duties associated with a new program related to the acquisition of agricultural land and agricultural easements. The legislative vehicle containing that programmatic authority (Am. Sub. S.B. 223 of the 122nd General Assembly), however, took longer to enact than was assumed and was not effective until April 1999.

Lastly, the smallest of the department's 20 GRF line items — 700-503 — lapsed $20,130, or 16.6 percent, of its $121,250 FY 1999 appropriation. Demand for this subsidy funding, which defrays the rental and prize costs incurred by a nonprofit livestock association staging an exhibition at the Ohio Expositions Center, was less than expected. Demand for this financial assistance, however, should increase as the result of a permanent law change contained in the recently enacted biennial budget covering fiscal years 2000 and 2001. Preexisting law limited financial assistance to exhibitions that involved certain "species," defined as diary cattle, beef cattle, swine, and sheep. This definition has been expanded to include rabbits and poultry.

Other Government

Administrative Services. Despite posting monthly overages in the last quarter of the fiscal year, the Department of Administrative Services hardly put a dent in the year-to-date underspending that had accumulated through the preceding three-quarters of monthly underages. Thus, at the close of FY 1999, the department had a year-to-date negative disbursement variance of $29.1 million, 18.6 percent below the estimate. And the storyline looked strikingly similar to the one that the department's disbursements wrote in FY 1998. A huge portion of this annual underage was a function of: (1) lower than expected payments for rent and operating costs on certain state-owned buildings; and (2) slower than expected disbursements on computing and communications services to other state agencies. Four building rent and operating payment line items (100-433, 100-447, 100-448, and 100-449) produced underspending that totaled $16.0 million, while four computing and communications line items (100-416, 100-417, 100-419, and 100-430) created underspending that totaled $11.8 million.

We singled out two of the computing and communications line items for some additional attention: 100-430, Year 2000 Assistance, and 100-417, MARCS. The Year 2000 Assistance line item, intended to provide the department with the necessary resources to lead, support, and facilitate achievement of Year 2000 compliance throughout state government so that computer systems can recognize century dates, finished the fiscal year with a $5.4 million underage. It carried a FY 1999 appropriation totaling $10.8 million plus prior year encumbrances of around $650,000. At fiscal year's-end, only $6.0 million, about half, of that total had been disbursed. Of the remainder ($5.4 million), $3.9 million, or roughly one-third, was encumbered and $1.5 million, or around 13.0 percent, lapsed and reverted to the GRF's ending cash balance. We don't believe that this slow spending signaled that the department, and thus the state, was having problems with its Year 2000 compliance effort generally as much as it indicated that state agency computer projects were not all moving at the same speed. Also of note is that, in the recently enacted biennial budget for fiscal years 2000 and 2001, this line item received no appropriations. The legislature did, however, put a funding contingency in place as it appropriated $5.9 million over the biennium in the Controlling Board's budget to assist the department with its unreimbursed Year 2000 costs.

The MARCS line item closed the fiscal year with an underage of $2.9 million, which really understated the amount of funding that was left to lapse and revert to the GRF's ending cash balance. This line item carried an adjusted FY 1999 appropriation of $6.3 million plus prior year encumbrances of close to $290,000 to be used to pay operating and administrative costs incurred by the department in the development and implementation of the multi-agency radio communications systems known as MARCS. At fiscal year's-end, only $1.5 million, about one-fifth, of that total had been disbursed. Of the remainder ($5.1 million), about $575,000, less than 10.0 percent, was encumbered. More notable was that $4.5 million, or almost 70.0 percent, lapsed and reverted to the GRF's ending cash balance. This inability to spend available MARCS appropriations should have been a sudden revelation to no one, as the project has been plagued by delays, including those created by concerns raised relative to escalating cost estimates. MARCS was originally planned to be self-supporting by FY 1999, but in all likelihood will continue to require GRF seed moneys for background infrastructure improvements and additions through at least FY 2001. At that point, it is hoped that MARCS will be operational and can be supported by its users, with the four biggest consumers of the system expected to be the departments of Public Safety, Transportation, Natural Resources, and Rehabilitation & Correction.

Auditor. The Auditor of State ended the fiscal year in dramatic and unexpected fashion by encumbering $5.3 million in two line items: (1) 070-321, Operating Expenses, which covers personnel, maintenance, and equipment costs; and (2) 070-406, Uniform Accounting Network, which pays for the development and operation of a financial accounting computer system for townships, villages, and libraries. These funds were encumbered to purchase a mainframe lease and hardware, computer software, and to pay for Year 2000 computer equipment upgrades. In prior issues of this publication, we had observed that the Auditor appeared to be continuing a several year trend of ending each fiscal year with a significant amount of underspending. This strategy was to constrain operational expenses and force the lapsing of a large chunk of the Auditor's appropriations back into the state's unappropriated and unobligated GRF cash balance. Our assumption about this strategy was wrong. Although the Auditor ended the fiscal year with a $5-plus million underage, less than $200,000 of its total FY 1999 appropriation of $34.3 million was allowed to lapse.

Budget & Management. Halfway through FY 1999 in our January, 1999 issue, we focused on the $4.9 million in encumbered funding that the Office of Budget and Management (OBM) had on-hand for assisting in the stabilization of the financially-troubled Central State University and also noted that OBM was expecting that the entire amount would be spent by fiscal year's-end. Six months later at the close of the fiscal year, our eyes were still drawn to the line item that housed this encumbered funding — 042-407, Central State Deficit Reduction. When June ended, $2.3 million of the $4.9 million had been disbursed while $2.6 million was still encumbered. Of the amount still encumbered for disbursement sometime in FY 2000, we learned that about $500,000 will be going to pay a salary arbitration settlement for back pay to employees and around $600,000 is anticipated to be spent on furniture for a new residence hall; the purpose for which the remaining $1.5 million would be disbursed was not certain as of this writing.

This line item was first created with an appropriation of $10.3 million in FY 1997 by Am. Sub. S.B. 6 of the 122nd General Assembly for the explicit purpose of helping get the university out of significant financial distress. And, in fact, the $4.9 million carried into FY 1999 represents the residual amount from that FY 1997 appropriation that had not yet been disbursed. Originally, this fiscal assistance was intended to help with *non-recurring university expenses*, but over time the legislature has expanded its range of permissible uses to include *reoccurring operating expenses*.

Alas, we would be remiss if no mention was made of a Controlling Board action taken at the request of OBM in the waning moments of the fiscal year. On June 21, 1999, the Controlling Board approved a transfer of $3.0 million from its Emergency Purposes & Contingencies line item (911-401) to a new OBM line item (042-900, OBM Y2K Contingency) as part of OBM's contingency plan, should unanticipated problems develop with the state's Central Accounting System (CAS) transition into the Year 2000. The $3.0 million itself was used by OBM to establish an account that would allow the state to write checks in the event that CAS was unable to process payments on July 1, 1999 or January 1, 2000. To date, and as OBM expected, no such problems have occurred and none of this money has been spent. OBM will replenish any of the $3.0 million that is actually spent and return the entire amount to the state's GRF sometime after January 1, 2000 has passed.

Pension Subsidies. Although all five retirement systems (PERS, SERS, STRS, Police & Fire, and Highway Patrol) are now supported by a combination of employer and employee contributions, each system has been receiving state GRF subsidies for some time that support certain retirement benefit enhancements. The total FY 1999 appropriation covering these "subsidies" (16 line items) was $28.0 million, of which $1.7 million, or 6.1 percent, was left in the available balance at fiscal year's-end and lapsed. This lapse was the result of both timing and a decreasing number of persons eligible for payments (due to the death of the retirees and their survivors). The majority of this unspent FY 1999 appropriation authority amount was attributable to three line items: (1) 090-530, PERS Ad Hoc Cost of Living ($630,007), (2) 090-531, STRS Ad Hoc Cost of Living ($492,433), and (3) 090-520, PERS Pension Benefits ($316,061). This disbursement picture was almost identical to the one that we painted at the end of FY 1998 when $1.6 million, or 6.0 percent, of the pension subsidy funding was still sitting in the available appropriations.

Timing's contribution to the lapsing of these pension subsidy appropriations works something like this. On the first day of August, the board of trustees of each retirement system certifies to the Treasurer of State, who is custodian of the subsidies, the amount required to be paid in the **preceding fiscal year** to eligible persons. Since appropriations are made for two years, there is no sure way of knowing the exact amount due. Although the amounts appropriated for these subsidies have been declining for some time now, there will continue to be lapses in each fiscal year. Since PERS has the greatest number of participants, it only follows that the largest lapsed amounts should occur in their line items. Barring any further benefits enhancements granted by the General Assembly or a loss of financial footing by any of the five systems, there will eventually come a time when state subsidies to the systems will cease entirely.

The lone exception to this expected cessation of these pension subsidies lies in two line items: (1) 090-544, Police and Fire State Contribution, and (2) 090-575, Police and Fire Death Benefits. These two subsidies will continue to be made annually absent a change in policy, which does not seem imminent given the General Assembly just increased appropriations in the Police and Fire Death Benefits line item by $480,00 in each of fiscal years 2000 and 2001 in order to expand the eligibility of certain groups of survivors for benefits.

Taxation. At fiscal year's-end, disbursements from the Department of Taxation's government operations component, which contains 20.0 percent of its GRF budget and essentially funds the department's operating expenses (personal services, maintenance, and equipment), posted a year-to-date overage of $8.0 million, 9.6 percent above the estimate. Approximately $6.2 million of that overspending was directly attributable to an error made in the calculation of the monthly estimates, which meant that the "true" overage was a much lower $1.8 million. Almost eighty percent — $1.4 million — was traceable to Taxation's personal services spending (line item 110-100), the source of which was employee pay raise money. Last fall, the Controlling Board approved the transfer of $60.4 million in GRF funding that had been explicitly appropriated to assist state agencies with absorbing the costs of employee compensation increases; $3.1 million of which was moved into Taxation's personal services line item. The transfer of this employee pay raise money guaranteed that the department would post personal services overages throughout the fiscal year because the Taxation estimates upon which we base our disbursement discussions did not include fund transfers that had not yet happened. The other notable piece of the department's year-to-date overage was simply attributable to timing-based equipment expenditures involving their ongoing Integrated Tax Administration System (ITAS) project, the centerpiece of which is the replacement of an outdated computer system. Close to $800,000 in equipment funding was disbursed earlier than planned; it was expected that this amount would encumbered for disbursement in FY 2000. If you happened to catch the review of April disbursements in our May, 1999 issue, this outcome and the factors behind it were no surprise.

Capital

Capital. Lying at the bottom of the Government Operations program category is a $40-plus million component that rarely passes anyone's lips — Capital. It finished FY 1999 with a June overage of $6.9 million and a year-to-date overage of $4.8 million.

This component captures capital projects that are funded with money directly out of the GRF, with the departments of Transportation, Administrative Services, and Natural Resources being the primary beneficiaries. As many are aware, little of the state's money in the GRF is used in this way anymore as one of the state's more preferred approaches to capital improvements is to generate cash through the issuance of bonds with other state funds, including the GRF, being used to make the necessary debt service payments.

The June and year-to-date overages were almost entirely attributable to the Department of Administrative Services, which serves as the home for capital appropriations that are earmarked for numerous rural and urban community assistance projects around the state. Given the unexpectedly long delay in enacting the 122nd General Assembly's capital bill (Am. Sub. H.B. 850), this outcome was neither surprising nor alarming.

Property Tax Relief

Over the course of FY 1999, the property tax relief program disbursed slightly in excess of $1 billion back to school districts, counties, municipalities, townships, and other special taxing districts as compensation for credits or exemptions provided to taxpayers under existing state law. The timing of the state's distribution of this funding depends heavily on how quickly the settlement process goes at the local level and when county auditors apply to the state for relief payments.

Not unexpectedly, timing threw its patented wrinkle into June's property tax relief payments. During the month, payments distributed by the Department of Education to local school districts were processed faster than expected due to the month of May's slower than expected settlement process ($12.7 million underage), which in turn created a $19.6 million June overage in line-item 200-901, Property Tax Allocation-Education. Conversely, the Department of Taxation's disbursement of its Property Tax Allocation appropriation (line-item 110-901) back to local governments proceeded much faster than in earlier months (March and April), which in turn resulted in a much slower than expected settlement process in May ($27.4 million underage) and June ($1.9 million underage). The net of the two monthly disbursement variances for June was a timing-based $17.7 million overage.

For the year, however, the property tax relief program landed in the opposite direction with a $13.5 million underage, which was 1.3 percent below the estimate. As a result, of the $1-plus billion appropriation for property tax relief payments in FY 1999, $15.5 million, or 1.5 percent, was not disbursed, of which $9.8 million was encumbered for disbursement in FY 2000 and the remainder — $5.7 million — was left to lapse back into the state's ending cash balance. ❑

**LBO colleagues who hunkered down with the raw materials integral to the development of this fiscal year's-end disbursement story included, in alphabetical order, Susan Ackerman Murray, Ogbe Aideyman, Laura Bickle, Nelson Fox, Elisabeth Gorenstein, Sybil Haney, Sharon Hanrahan, Alexander Heckman, Eric Karolak, Steve Mansfield, Cliff Marsh, Jeff Newman, Jeff Petry, Chuck Phillips, David G. Price, Jeffrey M. Rosa, Corey Schaal, Katherine B. Schill, Erica Thomas, and Wendy Zhan.*

Lottery Profits Quarterly Report

Lottery Ticket Sales and Profits Transfers Fourth Quarter, FY 1999

— Allan Lundell

Total sales for the fourth quarter of FY 1999 were $517.2 million, up 1.6 percent from third quarter sales but 0.6 percent less than sales for the fourth quarter of FY 1998. Total sales for FY 1999 were $2,144 million, 2.3 percent lower than total sales for FY 1998 ($2,195.4 million). For the fourth quarter of FY 1999, operating transfers to the Lottery Profits Education Fund (LPEF) totaled $162.6 million, up 1.3 percent from the third quarter but 4.0 percent less than profits transfers for the fourth quarter of FY 1998. Total profits transfers for FY 1999 were $671.3 million, 3.4 percent lower than transfers for FY 1998 ($695.2 million). Table 1 presents information about sales and transfers for FY 1999.

Projected transfers for FY 1999 were $688.9 million. Actual transfers were $17.6 million (2.6 percent) less than projected. The shortfall would have been worse except for the record sales experienced in December 1998. Five Ohio Lottery records were set in December, including the highest total monthly sales - $257.8 million and the largest monthly transfer to education - $70.4 million. For the other eleven months of FY 1999, profits transfers were $28.3 million (4.5 percent) less than projected.

Detailed sales information for FY 1999 is presented in Table 2. Total sales for the fourth quarter were up 1.6 percent compared to third quarter sales. Combined on-line sales were up by 5.7 percent and sales of instant tickets were down by 1.9 percent. Compared to sales for the fourth quarter of FY 1998, total sales were 0.6 percent lower. On-line sales were 2.5 percent lower, and sales of instant tickets were 1.3 percent higher.

Total sales for FY 1999 were down 2.3 percent compared to total sales for FY 1998. Combined on-line sales were down by 4.5 percent and sales of instant tickets were down by 0.3 percent. The only game to experience an increase in sales was Pick 4 which increased by 0.9 percent. Pick 3 sales were down by 5.2 percent, Buckeye Five sales were down by 4.9 percent, Super Lotto sales were down by 5.3 percent, and Kicker sales were down by 5.4 percent.

Table 1, FY 1999 Lottery Ticket Sales and Transfers to LPEF (in millions of dollars)

Month	Transfers	Projected Transfers	Variance	Percent Variance	Sales	Transfers as a Percent of Sales
Jul-98	$ 53.6	$ 57.4	$ -3.8	-6.5%	$ 165.8	32.3%
Aug-98	55.3	57.0	-1.7	-3.0%	171.7	32.2%
Sep-98	55.1	56.3	-1.2	-2.2%	169.9	32.4%
Q1	**164.0**	**170.7**	**-6.7**	**-3.9%**	**507.4**	**32.3%**
Oct-98	56.7	56.4	0.3	0.5%	177.3	32.0%
Nov-98	57.0	57.7	-0.7	-1.2%	175.7	32.5%
Dec-98	70.4	59.7	10.7	17.9%	257.5	27.3%
Q2	**184.2**	**173.8**	**10.3**	**5.9%**	**610.5**	**30.2%**
Jan-99	51.2	57.6	-6.4	-11.1%	167.2	30.6%
Feb-99	53.3	56.0	-2.7	-4.8%	164.3	32.4%
Mar-99	55.9	59.5	-3.5	-5.9%	177.4	31.5%
Q3	**160.5**	**173.1**	**-12.6**	**-7.3%**	**508.9**	**31.5%**
Apr-99	53.4	57.6	-4.2	-7.4%	171.6	31.1%
May-99	55.2	56.6	-1.4	-2.5%	174.3	31.7%
Jun-99	54.0	57.0	-3.0	-5.2%	171.3	31.5%
Q4	**162.6**	**171.2**	**-8.6**	**-5.0%**	**517.2**	**31.4%**
Total	**$ 671.3**	**$ 688.9**	**$ -17.6**	**-2.6%**	**$ 2,144.0**	**31.3%**

Table 2, FY 1999 Lottery Ticket Sales by Game

(in millions of dollars)

Month	Pick Three3	Pick Four	Buckeye Five	Super Lotto	Kicker	On-Line Subtotal	Instants	Total Sales
Jul-98	$ 33.5	$ 10.4	$ 6.3	$ 27.2	$ 4.5	$ 81.9	$ 83.9	$ 165.8
Aug-98	32.1	10.0	6.0	28.7	4.7	81.5	90.2	171.7
Sep-98	31.7	10.0	5.9	30.0	4.8	82.5	87.5	169.9
Q1	**97.3**	**30.5**	**18.2**	**85.9**	**14.0**	**245.9**	**261.5**	**507.4**
Oct-98	32.8	10.6	6.2	29.3	4.7	83.6	93.8	177.3
Nov-98	31.1	9.9	5.8	22.9	3.9	73.6	102.1	175.7
Dec-98	34.6	10.8	5.8	70.4	8.9	130.6	126.9	257.5
Q2	**98.4**	**31.4**	**17.7**	**122.6**	**17.5**	**287.7**	**322.8**	**610.5**
Jan-99	31.9	9.9	5.4	28.4	4.6	80.2	87.0	167.2
Feb-99	31.6	9.8	5.4	21.8	3.8	72.3	92.0	164.3
Mar-99	35.8	11.0	6.1	24.7	4.2	82.0	95.4	177.4
Q3	**99.3**	**30.7**	**16.9**	**75.0**	**12.6**	**234.5**	**274.4**	**508.9**
Apr-99	35.3	10.8	6.1	21.1	3.6	77.0	94.6	171.6
May-99	34.6	10.9	5.5	28.0	4.6	83.7	90.6	174.3
Jun-99	34.4	10.8	5.4	31.7	4.9	87.3	84.0	171.3
Q4	**104.3**	**32.5**	**17.0**	**80.9**	**13.2**	**248.0**	**269.2**	**517.2**
Total	**$ 399.4**	**$ 125.1**	**$ 69.9**	**$ 364.4**	**$ 57.2**	**$ 1,016.0**	**$ 1,127.9**	**$ 2,144.0**

Lottery Sales and Transfers in the 1990's

Table 3 presents sales information for fiscal years 1990 through 1999. FY 1999 total sales of $2,144.0 million were 32.9 percent greater than FY 1990 sales of $1,613.8 million. For the decade, total sales grew at an annualized rate of 3.2 percent. However, looking at total sales for the first and last years of the decade ignores changes that occurred during the decade. In FY 1990, Super Lotto was the most popular game and on-line games accounted for 69 percent of sales. In FY 1999, Instant Tickets were the most popular games, accounting for almost 53 percent of total sales.

Although sales grew for the decade, they did not grow throughout the decade. Total lottery sales peaked at $2,353.2 million in FY 1996. For FY 1990-1996, sales grew by 45.8 percent (4.3 percent annualized growth). Since peaking in FY 1996, sales have fallen by 8.9 percent (3.1 percent annualized decline). The only game that grew throughout the decade was Pick 4. Table 4 presents growth rates for the decade as a whole and the periods of growth and decline.

Table 3, Lottery Sales, FY 1990 – FY 1999

(in millions of current dollars)

Fiscal Year	Pick Three	Pick Four	Buckeye Five	Super Lotto	Kicker	On-Line Subtotal	Instant Tickets	Total Sales
1990	$ 424.0	$ 77.6	$ 0.0	$ 528.0	$ 84.1	$ 1,113.6	$ 500.2	$ 1,613.8
1991	411.7	79.2	0.0	452.9	71.6	1,015.3	551.6	1,566.9
1992	408.7	84.9	24.3	500.0	69.5	1,087.4	528.5	1,615.9
1993	428.3	91.0	122.4	493.5	65.6	1,200.8	716.4	1,917.2
1994	421.0	92.0	118.2	370.6	54.3	1,056.1	797.8	1,853.9
1995	446.2	102.1	100.4	437.8	63.3	1,149.7	960.3	2,110.0
1996	450.7	108.2	87.3	455.8	66.7	1,168.6	1,184.5	2,353.2
1997	435.6	116.5	78.8	410.6	63.4	1,105.0	1,198.9	2,303.9
1998	421.1	124.0	73.5	384.9	60.5	1,064.0	1,131.4	2,195.4
1999	399.4	125.1	69.9	364.4	57.2	1,016.0	1,127.9	2,144.0

Table 4, Percentage Changes in Lottery Ticket Sales

Time Period		Pick Three	Pick Four	Buckeye Five	Super Lotto	Kicker	On-Line Subtotal	Instant Tickets	Total Sales
1990-99	growth	-5.8%	61.2%	-42.9%	-31.0%	-32.0%	-8.8%	125.5%	32.9%
	annualized	*-0.7%*	*5.4%*	*-8.9%*	*-4.0%*	*-4.2%*	*-1.0%*	*9.5%*	*3.2%*
1990-96	growth	6.3%	39.4%	-28.7%	-13.7%	-20.7%	4.9%	136.8%	45.8%
	annualized	*1.0%*	*5.7%*	*-10.7%*	*-2.4%*	*-3.8%*	*0.8%*	*15.5%*	*6.5%*
1996-99	growth	-11.4%	15.6%	-19.9%	-20.1%	-14.2%	-13.1%	-4.8%	-8.9%
	annualized	*-3.9%*	*5.0%*	*-7.1%*	*-7.2%*	*-5.0%*	*-4.6%*	*-1.6%*	*-3.1%*

Table 5, Ohio Lottery Sales and Personal Income
(dollar amounts in millions)

Fiscal Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Lottery Sales	$ 1,614	$ 1,567	$ 1,616	$ 1,917	$ 1,854	$ 2,110	$ 2,353	$ 2,304	$ 2,195	$ 2,144
Personal Income	191,229	199,824	208,723	218,662	229,580	242,252	252,039	264,120	276,242	287,896
Percent	0.84%	0.78%	0.77%	0.88%	0.81%	0.87%	0.93%	0.87%	0.79%	0.74%

Another way to look at sales is as a percentage of income. Table 5 presents lottery tickets sales, Ohio personal income, and sales as a percentage of income. Lottery sales are less than one-percent of income. This percentage peaked in 1996 and has declined since.

Lottery sales grew during the 1990's. The expansion in Ohio lottery sales that peaked in FY 1996 was part of the expansion of gaming throughout the United States. However, the general expansion of gaming is now a major reason for the decline in Ohio lottery sales during the last three years of the decade. Increased competition has decreased Ohio lottery sales. Ohioans who wish to spend a portion of their income on gaming now have many options: multi-state lotteries such as Powerball and The Big Game; riverboats in Indiana and Kentucky; casinos in Michigan and Canada; and enhanced racetracks in West Virginia.

Changes in transfers to the LPEF mirrored changes in lottery sales. Chart 1 depicts and Table 6 contains information on lottery sales and transfers. Lottery sales grew from $1,614 million in FY 1990 to a peak of $2,353 million in FY 1996 and fell to $2,144 million in FY 1999. Transfers to education grew from $616 million in FY 1990 to a peak of $714 million in FY 1996 and fell to $671 million in FY 1999. For FY 1990 to FY 1996, sales grew by 45.8 percent (6.5 percent annualized growth). Since peaking in FY 1996, sales have fallen by 8.9 percent (3.1 percent annualized decline). From FY 1990 to FY 1996, transfers grew by 15.7 percent (2.5 percent annualized growth). Since peaking in FY 1996, transfers have fallen by 5.9 percent (2.0 percent annualized decline).

Although sales grew by almost 33 percent between FY 1990 and FY 1999, in real terms (adjusted for inflation) sales grew by just 2.5 percent, from

Chart 1, Lottery Sales and Transfers

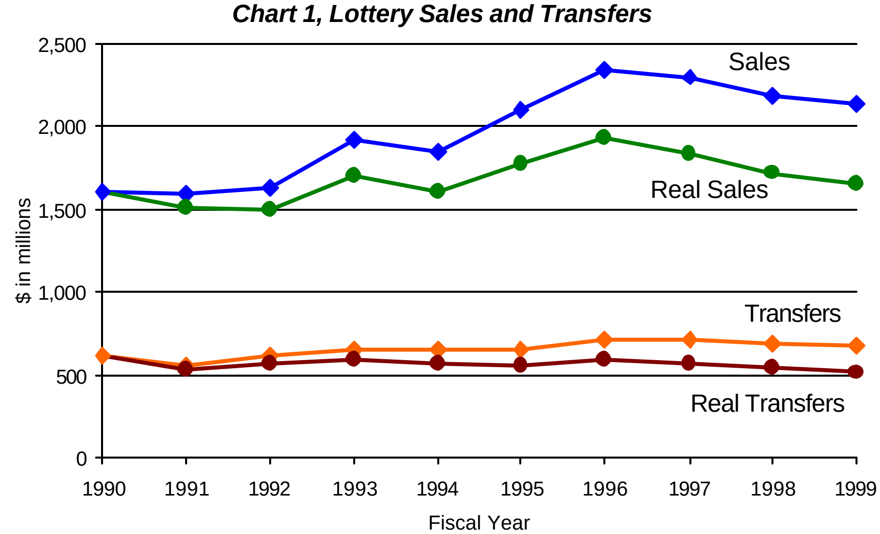


Table 6, Ohio Lottery Sales and Transfers
(dollar amounts in millions)

Fiscal Year	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Lottery Sales	$ 1,614	$ 1,567	$ 1,616	$ 1,917	$ 1,854	$ 2,110	$ 2,353	$ 2,304	$ 2,195	$ 2,144
Operating Transfers	616	561	618	658	652	656	714	711	695	671
Transfers as a Percent of Sales	38.2%	35.8%	38.3%	34.3%	35.2%	31.1%	30.3%	30.8%	31.7%	31.1%
Real Sales	$ 1,614	$ 1,503	$ 1,493	$ 1,708	$ 1,610	$ 1,784	$ 1,938	$ 1,838	$ 1,724	$ 1,654
Real Transfers	616	530	568	587	566	555	588	567	546	518

$1,614 million to $1,654 million in 1990 dollars. Transfers, which grew by almost 9 percent between FY 1990 and FY 1999, fell by 16 percent in real terms from $616 million in FY 1990 to $516 million in 1990 dollars. During the expansion (FY 1990-96), real sales grew by 20.1 percent or 3.1 percent annualized. During the contraction (FY 1996-99), real sales fell by 14.6 percent or 5.1 percent annualized. During the expansion, inflation adjusted transfers fell by 4.7 percent or 0.8 percent annualized. During the contraction, real transfers fell by 11.8 percent or 4.1 percent annualized.

Future Lottery Sales and Transfers

Lottery sales are difficult to predict. Incomes continue to grow and this will act to increase expenditures on gaming. However, although incomes continue to grow and attitudes towards gaming remain generally favorable, the increased competition in the gaming market has decreased lottery ticket sales. Ticket sales have declined since 1996 and this decline is expected to continue. LBO estimates that lottery sales will be $2,059.7 million in FY 2000 and $1,967.9 million in FY 2001. The Lottery Commission (OLC) forecasts sales to be $2,139.3 million in FY 2000 and $2,152.7 million in FY 2001. LBO's forecast is based on recent trends in sales and assumes no change in the current mix of games offered by the Ohio Lottery. The Lottery's forecast incorporates proposed changes in games, prizes, and advertising that are expected to boost sales. The Lottery's forecast of sales without the changes in games, prizes, and advertising are $2,049.0 million in FY 2000 and $1,977.6 million in FY 2001. If the Lottery's proposed changes are not considered, the forecasts of LBO and the Lottery are essentially the same.

Lottery profits transfers are required by law to be at least 30 percent of sales. As sales grew throughout the 1990's, so did transfers to the LPEF. Transfers grew from $616 million in fiscal year 1990 to over $713 million in fiscal year 1996. As ticket sales have declined since 1996, profits transfers have declined, and the decline in profits is also expected to continue.

Table 7 presents forecasts of sales and profits for fiscal years 2000 and 2001. In forecasting profits based on their forecast of sales, the Lottery assumed that profits were 30.9 percent of sales. LBO used the same percentage in estimating profits based on its forecast of sales.

LBO's forecasts of sales and profits are based on trend and assume no change in the current mix of games offered by the Ohio Lottery. If the game mix or game structures are changed, sales and profits may be positively impacted. The Ohio Lottery is making revisions to its games to reduce and possibly reverse the decline in sales and profits. Changes already implemented are the red ball promotion for Pick 3 and midday drawings for the Pick 3 and Pick 4 games. Other changes considered include: the addition of an instant winner element to purchases of Super Lotto tickets; modifying the structure of Super Lotto; increasing advertising expenditures; and increasing expenditures out of the Unclaimed Prize Fund.

Table 7, Forecasts of Lottery sales and Profits
(in millions of dollars)

	Sales		***Profits***	
Forecast	FY 2000	FY 2001	FY 2000	FY 2001
OLC with changes	$ 2,139.3	$ 2,152.7	$ 661.0	$ 665.2
OLC with no changes	2,049.0	1,977.6	633.1	611.1
LBO	2,059.7	1,967.9	636.4	608.1

The Lottery estimates that the game revisions and increased advertising will increase sales by $90.3 million in FY 2000 and $175.1 million in FY 2001. However, revisions do not guarantee an increase in sales and profits. The FY 2000-2001 Education Budget makes appropriations based on the assumption that the game revisions and increased advertising are successful. If these changes are not successful, then transfers will be $82 million less than the amounts appropriated. Although this is a small percentage of the total amount appropriated for education across the biennium, such a shortfall would certainly create some inconvenience. ❑

Lottery Profits Education Fund Disbursements Fiscal Year 1999 Disbursements Totaled $728.2 Million

— *Wendy Zhan*

Lottery Profits Education Fund (LPEF) disbursements in fiscal year 1999 totaled $728.2 million, $48.2 million more than fiscal year 1998 disbursements of $685.7 million. The bulk of disbursements ($666.1 million or 91.5 percent) occurred in item Base Cost Funding (200-612). Lottery Profits Education Reserved Fund (LPERF) disbursements was $2.3 million in FY 1999. The table below shows the LPEF and LPERF appropriation and disbursement summary as of June 30, 1999.

Rental Payments, of the School Facilities Commission. Total GRF appropriation for the program was $58.5 million in FY 1999. These moneys were used to pay bond service charges on $333.6 million in bonds issued since FY 1996 for the classroom facilities assistance program.

Base cost funding and the lease rental payments have historically been the two major education programs partially supported by the lottery moneys. However, the lottery moneys were also used to fund

Table 1: LPEF (017) and LPERF (018) Appropriation/Disbursement Summary - As of June 30, 1999

Agency	Fund	Line Item	Line Item Name	FY 1999 Appropriations	FY 1999 Disbursements	Appropriation Balance
EDU	017	200-612	Base Cost Funding	$ 666,093,028	$ 666,093,028	$ 0
EDU	017	200-682	Lease Rental Payment Reimbursement	$ 32,780,000	$ 32,780,000	$ 0
EDU	017		Transfer to Textbooks/Instructional Materials Fund (5F8)	$ 15,000,000	$ 15,000,000	$ 0
EDU	017	200-694	Bus Purchase One Time Supplement	$ 9,208,579	$ 7,438,958	$ 0*
NET	017	228-690	SchoolNet Electrical Infrastructure	$ 27,000,000	$ 6,929,621	$ 20,070,379
			Total LPEF	**$ 750,081,607**	**$ 728,241,607**	**$ 21,840,000**
SFC	018	230-649	Disability Access Project	$ 4,925,420	$ 2,292,594	$ 2,632,826

**A total of $1,769,662 was encumbered.*

The $666.1 million lottery profits appropriation in FY 1999 blended with the General Revenue Fund (GRF) base cost funding (line item 200-501) appropriation ($3,028.7 million) to, among other things, provide equalized subsidies to school districts to guarantee $3,851 in per pupil funding with the cost of doing business factor adjustment at the combination of state and local revenues at 23 mills and to subsidize each district's additional special education cost based on the district's state share percentage of the base cost funding. With the combination of GRF and LPEF moneys, base cost funding ($3,694.8 million), the biggest education subsidy item, represents about 69.7 percent of Department of Education's FY 1999 GRF and LPEF budget. The lease rental appropriation ($32.8 million) was transferred to GRF to support the GRF appropriation for item 230-428, Lease

several other programs in FY 1999, including $15 million for textbook/instructional materials subsidies, $9.2 million for one-time school bus purchase supplement payments, $27 million for SchoolNet electrical infrastructure grants, and $4.9 million for disability access project grants. The $1.7 million unspent funds in item Bus Purchase One Time Supplement was encumbered and should be spent in FY 2000. Am. Sub. H.B. 282 of the 123rd General Assembly transferred available balances in items SchoolNet Electrical Infrastructure ($20.1 million) and Disability Access Project ($2.6 million) into FY 2000. It should be noted that the original appropriations for items Bus Purchase One Time Supplement ($10 million), SchoolNet Electrical Infrastructure ($30 million), and Disability Access Project ($5.1 million) were made in FY 1998.

No Excess Lottery Profits in Fiscal Year 1999

While FY 1999 lottery disbursements were $48.2 million higher than FY 1998 disbursements, there were no excess lottery profits in FY 1999. This happened for the first time since FY 1996. The difference between the actual transfer to the Lottery Education Profits Fund and the estimated transfer in a given year represents excess lottery profits. The excess profits from fiscal years 1996 to 1998 were $23.2 million, $56.0 million, and $59.1 million, respectively. In fact, the FY 1999 actual transfer was $17.6 million (or 2.6 percent) below the estimate. The original estimated transfer was $688.9 million and the actual transfer only amounted to $671.3 million. Throughout the year, October and December were the only two months in which actual transfers were higher than estimates.

Although the FY 1999 actual transfer was below the estimate, the cash balance in the LPEF was sufficient to meet FY 1999 appropriations for the base cost funding, lease rental payments, and textbook/instructional materials programs. Therefore, a reallocation of funds pursuant to section 50.23 of Am. Sub. H.B. 650 of the 122nd General Assembly was not necessary.

The shortfall was partially offset by interest earnings in the fund. Interest earnings were credited to the fund, but were not included in the original transfer estimate. Due to the nature of capital projects, relative low disbursements in item SchoolNet Electrical Infrastructure (228-690) also helped alleviate the lottery profits shortfall problem. It can be seen from Table 1 that only $6.9 million out of $27 million appropriation was disbursed in FY 1999. The $27 million spending authority was transferred from FY 1998 appropriation and was not included in the profits estimate of $688.9 million for FY 1999. ❑

Issues of Interest

IT'S TEA (TEA-21) TIME FOR OHIO IN THE TWENTY-FIRST CENTURY

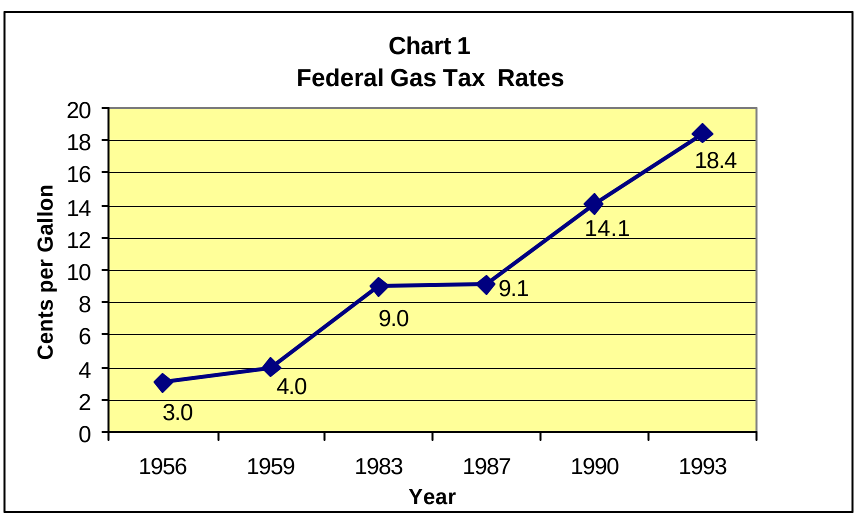
CLIFFORD R. MARSH

The **Transportation Efficiency Act of the Twenty-First Century**, or **TEA-21** has been highly anticipated by the fifty states. Passed in 1998, TEA-21 is the continuation of the policy directives established by its predecessor, the Intermodal Surface Transportation Efficiency Act, ISTEA. TEA-21, however, represents a 40% total (all states) increase in funding from ISTEA; and over its five-year effective period, TEA –21 will distribute $220 billion to the 50 states.

Ohio will see an increase in Federal aid to $900 million in FY 2000, and $915 million in FY 2001- a total increase over the last biennium of 14%. Federal funding in the previous biennium was $714.6 million in FY 1998 and $878.1 million in FY 1999.

Federal Gas Tax Rates

An increase in the number of drivers on America's roads, partly due to relatively low gas prices, has led to a substantial balance accumulated in the Highway Trust Fund, the recipient of federal gas tax moneys from the states. ***Chart 1*** illustrates how gas tax rates have grown since the inception of the Highway Trust Fund in 1956 to the current rate of 18.4 cents per gallon.[1]



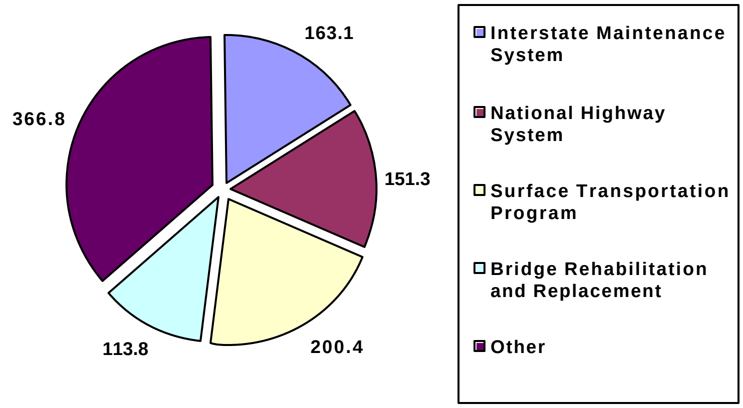
TEA-21 Program Highlights

There are a number of programs that TEA-21 uses to channel funds to the states. The states receive their allocations based upon formulas unique to each program and the amount of their contribution into the Highway Trust Fund. Some of the programs of TEA-21include:

- **Interstate Maintenance (IM)**- the ongoing improvement and maintenance of the 46,000 mile system of highways created by the Eisenhower administration;
- **National Highway System (NHS)**- a 163,000-mile network of rural and urban roads (including the IM);
- **Surface Transportation Program (STP)**- discretionary funding used for a variety of environmental, multi-modal, and infrastructure projects;
- **Bridge Rehabilitation and Replacement**- the servicing of bridges located on any public road;
- **Congestion Mitigation and Air Quality Improvement (CMAQ)**- funding used to reduce the effects of pollution and traffic congestion by meeting National ambient air quality standards;

- **Appalachian Development Highway System**- highway development and rehabilitation in the 13 states of the Appalachian region;
- **High Priority Projects**- Congressionally identified projects totaling 1,850, to be funded over the life of the Act;
- **Metropolitan Planning**- to support the planning efforts of metropolitan planning organizations (MPO's) and other state planning entities;
- **Minimum Guarantee**- a set-aside of funds which ensure that states receive 90.5% of their contribution to the Highway Trust Fund; to be distributed as **STP** funds.[2]

Chart 2
TEA-21 FY 2000 Ohio Apportionments (in millions)



Distribution of Funds

Ohio has 16 Metropolitan Planning Organizations (MPO's) and five large cities that receive moneys from TEA-21at the discretion of ODOT. ODOT has historically given over and above the required amounts mandated by a population-based suballocation formula to the MPO's. The MPO's are required to produce a listing of projects in accordance with the Federal-aid Highway Act of 1962 and the Urban Mass Transportation Act of 1964. This 3-C (continuing, cooperative, and comprehensive) Transportation Plan process is a four-year activity involving ODOT as well as interested parties from local government and multi-modal (transit and bikeway) transportation.[3] This process, in conjunction with ODOT's State Transportation Improvement Program (STIP) provides a comprehensive prioritization of Ohio's transportation needs and available resources.

All projects that are eligible to receive federal funding must be listed through documentation in the Transportation Plan. The plans submitted by the MPO's are then received by ODOT and in turn, submitted to the Federal Transit Administration (FTA) and the Federal Highway Administration (FHWA). ***Chart 2*** shows some of the federal moneys available to either fully fund or to match state or local contributions for projects identified by the MPO's Transportation Plans.[4] The amounts displayed in Chart 2 represent the apportionments and not the actual ceiling of allowable spending, which is $900 million in FY 2000. The total amount of estimated apportionments for FY 2000 is $995.4 million.

While the lion's share of TEA-21 may deal with transportation infrastructure development, it is not exclusively used for these purposes. In fact, other programs funded by TEA-21 fall into categories such as:

- transit programs involving job access and transportation accessibility;
- highway technology research and development;
- disaster relief and mitigation;
- bikeways and alternative transportation methods;
- traffic safety and driver education;
- adherence to motor-carrier safety regulations; and
- environmental impact studies.[5] ❑

[1] National Taxpayers Union Foundation. "Taking Taxpayers for a Ride: Why TEA-21's Toll Scheme is Bad Economics" Issue Brief 109. Jeff Dircksen, November 10, 1998 http://www.ntu.org/issues/state/aktolls2.htm (6/21/99).
[2] Provisions Governing the Allocation of Federal Funds for Highway Purposes http://www.fhwa.dot.gov/ohim/hwytaxes/f106.pdf (6/24/99)
[3] MORPC SFY 2000-2003 Final Draft TIP, April 9, 1999 http://www.morpc.org (6/24/99).
[4] Estimated FY 2000 Apportionments Pursuant to TEA-21 as Amended by the TEA-21 Restoration Act Before Redistribution of Minimum Guarantee Funds http://www.tea21.org/docsa/feb99/2000before.htm (6/24/99).
[5] TEA-21 Fact Sheets http://www.fhwa.dot.gov/tea21/factsheets/index.htm (7/20/99).

MEDICAID IN OHIO

AN OVERVIEW OF SIGNIFICANT CHANGES IN FY 1999

OGBE AIDEYMAN

Health Care/Medicaid

Included in the Disbursements section of this issue of ***Budget Footnotes*** is a general depiction of fiscal year1999 Medicaid expenditures. Some of the information is repeated here, but as the Medicaid program comprises nearly 27.3 percent of the annual General Revenue Fund portion of Ohio's budget(both state GRF and federal fund spending for Medicaid are counted as GRF spending), we offer the following detailed picture of the underages and overages that combined to equal annual fiscal year underspending of $107.5 million.

Over the biennium, significant changes were made to the FY 1999 appropriation of $5.46 billion (contained in Am. Sub. H.B. 215 of the 122nd General Assembly). First, Am. Sub. H.B. 650 of the 122nd General Assembly, which established a new system for funding education, reduced the program's FY 1999 appropriation by $30.1 million. Second, actions taken by the Controlling Board cut another $70.0 million from the appropriation, $30.1 million of which came out of the state portion of the program and $39.9 million of which was trimmed from the federal share of the program. Actions taken by the Controlling Board were as follows: (1) $14.6 million to cover federal penalties related to the state's failure to have its Child Supports Enforcement Systems (SETS) certified; (2) $7.5 million for county administration of the Disability Assistance, Medicaid, and Food Stamp programs; (3) $6.0 million to fund the Department of Human Services' third party liability recovery contract; (4) $4.0 million into the Department of Health's Ohio Early Start line item to fund Welcome Home, a program administered by the Department of Health that supports home visits by registered nurses to first-time and teen parents as part of the state's Family and Children First Initiative; and (5) $1.0 million to provide cash assistance to certain households affected by disasters. The remainder of the $70.0 million — $36.9 million — reflected a reduction in the amount of federal Medicaid reimbursement money that the state expected to earn in FY 1999.

The net effect of these changes was to knock $100.1 million out of the FY 1999 Medicaid appropriation, thus reducing it to $5.36 billion. Of this adjusted FY 1999 Medicaid appropriation, $5.18 billion was disbursed, $2.4 million was encumbered for disbursement in FY 2000, and $183.9 million reverted (lapsed) to the GRF's ending cash balance.

For FY 1999, the Medicaid program also carried forward $53.9 million in FY 1998 encumbrances. The department disbursed all of the FY 1998 encumbrances with the exception of $4.2 million, which included $3.6 million that was still encumbered at year's end and around $600,000 million that was cancelled and returned to the GRF's ending cash balance.

What this general review of FY 1999 Medicaid disbursements is intended to point out is that the analytical picture is muddied somewhat by: (1) the commingling of current fiscal year appropriations with the disbursement of outstanding encumbrances from prior fiscal years; and (2) the aforementioned Controlling Board transfers that moved portions of the program's state share of appropriation authority to other welfare and human service programs and reduced the program's federal share.

Medicaid Spending Breakdown

Table 1, Medicaid Spending, shows a breakdown of FY 1999 Medicaid disbursement variances by major service category. Presented in column 5 of the data in this table is actual spending in FY 1999, while column 6 of the data contains the corresponding FY 1999 estimated annual spending level. Columns 7 and 8 of the data present the spending variance amounts and percentages, respectively, indicating the size of the departure from the FY 1999 estimates. Table 2, FY 1999 to FY 1998 Comparison, contains FY 1998 spending by major service category in column 2 of the data. The growth in spending amounts and the percentage change from FY 1998 to FY 1999 are shown in columns 3 and 4 of the data, respectively.

As the reader no doubt is already aware, and can plainly see from Table 1, the bottom line from the perspective of state spending is good news — Medicaid underspent the FY 1999 spending estimate by $107.5 million, or 2.0 percent. That said, budget watchers may notice that this underage is below the LBO estimate used by the conference committee during its deliberations on biennial budget matters in mid-June 1999. That difference is a result of two factors that we were unaware of in June. First, in late June 1999, the Controlling Board reduced the FY 1999 Medicaid appropriation by $34.5 million, $14.6 million of which was transferred from the program's state share to cover the aforementioned federal SETS penalty.

Second, and more importantly, $69.5 million in FY 1999 encumbrances that were to be held until FY 2000 were unexpectedly disbursed, an outcome which the LBO estimate did not assume. We had assumed that the Department of Human Services would continue to use a method that many of us have become somewhat accustomed to, although not the preferred accounting method, which involves encumbering the final fiscal year weekly payment from the Medicaid 400-525 line item and then disbursing it early in the next fiscal year. This last weekly payment was, however, made in FY 1999, and contributed significantly to the overage for the month of June.

Also evident in Table 1 is that there was a mix of service categories that generated overages, while another mix of service categories worked in opposition and promoted underages. For example, the HMO and Nursing Homes service categories contributed to the positive news (underspending), while other service categories (Hospitals, Prescription Drugs and All Other) tossed in the negative news (overspending).

However, the primary factor responsible for the year's underspending is not self-evident from these service categories, but is more readily discernible

Table 1
Medicaid (400-525) Spending in FY 1999

	June '99				Year-to Date Spending			
Service Category	**Actual**	**Estimate**	**Variance**	**Percent Variance**	**Actual** thru' June**	**Estimate** thru' June**	**Variance**	**Percent Variance**
Nursing Homes	$161,786,019	$174,205,613	($12,419,594)	-7.1%	$1,967,983,642	$2,054,694,780	($86,711,138)	-4.2%
ICF/MR	$28,995,783	$28,406,601	$589,182	2.1%	$343,556,772	$338,188,877	$5,367,895	1.6%
Hospitals	$112,249,069	$75,664,071	$36,584,998	48.4%	$1,185,617,634	$1,134,830,537	$50,787,097	4.5%
Inpatient Hospitals	$84,958,002	$59,330,434	$25,627,568	43.2%	$901,702,939	$882,239,029	$19,463,910	2.2%
Outpatient Hospital	$27,291,067	$16,333,637	$10,957,430	67.1%	$283,914,695	$252,591,508	$31,323,187	12.4%
Physicians	$27,771,720	$20,835,162	$6,936,558	33.3%	$289,566,368	$278,974,858	$10,591,510	3.8%
Prescription Drugs	$75,680,540	$52,071,287	$23,609,253	45.3%	$597,537,375	$580,628,649	$16,908,726	2.9%
Payments	$76,327,096	$53,370,737	$22,956,359	43.0%	$735,509,303	$718,310,081	$17,199,222	2.4%
Rebates	$646,556	$1,299,450	($652,894)	-50.2%	$137,971,928	$125,340,222	$12,631,706	10.1%
HMO[1]	$30,311,639	$45,326,029	($15,014,390)	-33.1%	$299,541,273	$452,309,127	($152,767,854)	-33.8%
Medicare Buy-In	$9,454,558	$10,034,526	($579,968)	-5.8%	$121,762,936	$115,853,896	$5,909,040	5.1%
All Other***	$44,948,345	$28,885,545	$16,062,800	55.6%	$423,948,138	$381,523,154	$42,424,984	11.1%
TOTAL	$491,197,673	$435,428,834	$55,768,839	12.8%	$5,229,514,138	$5,337,003,878	($107,489,740)	-2.0%
CAS	$490,730,900		$55,302,066	12.7%	$5,229,514,138		($107,489,740)	-2.0%
Est. Federal Share	$286,024,405	$253,550,210	$32,474,195		$3,045,146,083	$3,107,737,360	($62,591,277)	
Est. State Share	$205,173,268	$181,878,624	$23,294,644	12.8%	$2,184,368,056	$2,229,266,521	($44,898,466)	-2.0%

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

** Includes spending from FY 1998 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.

1. $57.4 million in HMO payments were made from IMD/DSH funds in FY 1999 therefore, total program payments for HMO coverage of eligibles in FY 1999 is $356.94 million.

when one looks at the recipient categories captured in Chart 1, Medicaid Eligibility - Monthly Averages. In that chart, most noticeable is the steady decline of the average number of monthly recipients associated with the Ohio Works First/ Aid to Families with Dependent Children (OWF-Related) caseload. While this would be welcome news on any day, these declining caseloads can be said to have negative effects as well, by having shot down the ability of the department to move more eligible recipients into a managed care setting.

Table 2
Medicaid Spending
FY 1999 to FY 1998 Comparison*

Service Category	FY 1999[1]	FY 1998[2]	Variance	Percent Variance
Nursing Homes	$1,967,983,642	$1,911,125,710	$56,857,932	3.0%
ICF/MR	$343,556,772	$330,712,935	$12,843,837	3.9%
Hospitals	$1,185,617,634	$1,120,618,070	$64,999,564	5.8%
Inpatient Hospitals	$901,702,939	$869,360,484	$32,342,455	3.7%
Outpatient Hospital	$283,914,695	$251,257,586	$32,657,109	13.0%
Physicians	$289,566,368	$275,282,862	$14,283,506	5.2%
Prescription Drugs	$597,537,375	$511,362,195	$86,175,180	16.9%
Payments	$735,509,303	$620,399,077	$115,110,226	18.6%
Rebates	$137,971,928	$109,036,882	$28,935,046	26.5%
HMO[3]	$299,541,273	$432,641,853	($133,100,580)	-30.8%
Medicare Buy-In	$121,762,936	$122,366,057	($603,121)	-0.5%
All Other***	$423,948,138	$352,189,649	$71,758,489	20.4%
TOTAL	$5,229,514,138	$5,056,299,331	$173,214,807	3.4%
Est. Federal Share	$3,045,146,083	$2,954,142,884	$91,003,199	3.1%
Est. State Share	$2,184,368,056	$2,102,156,447	$82,211,609	3.9%

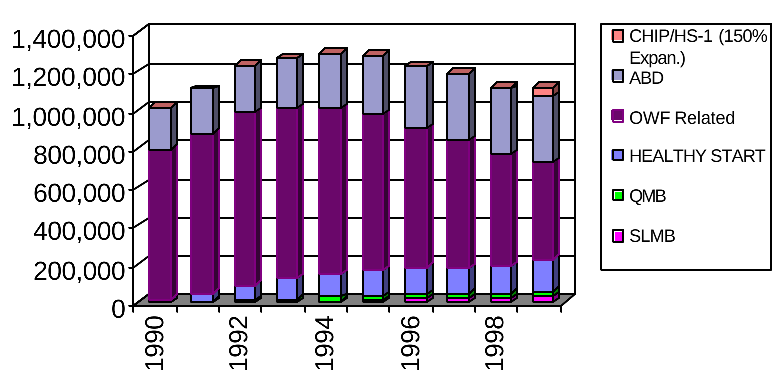
* This table only includes Medicaid spending through Human Services' 400-525 line item.
1. Includes FY 1998 encumbrances of $54 million.
2. Includes FY 1997 encumbrances of $78.6 million.
3. $57.4 million in HMO payments were made from IMD/DSH funds in FY 1999 therefore, total program payments for HMO coverage of eligibles in FY 1999 is $356.94 million.

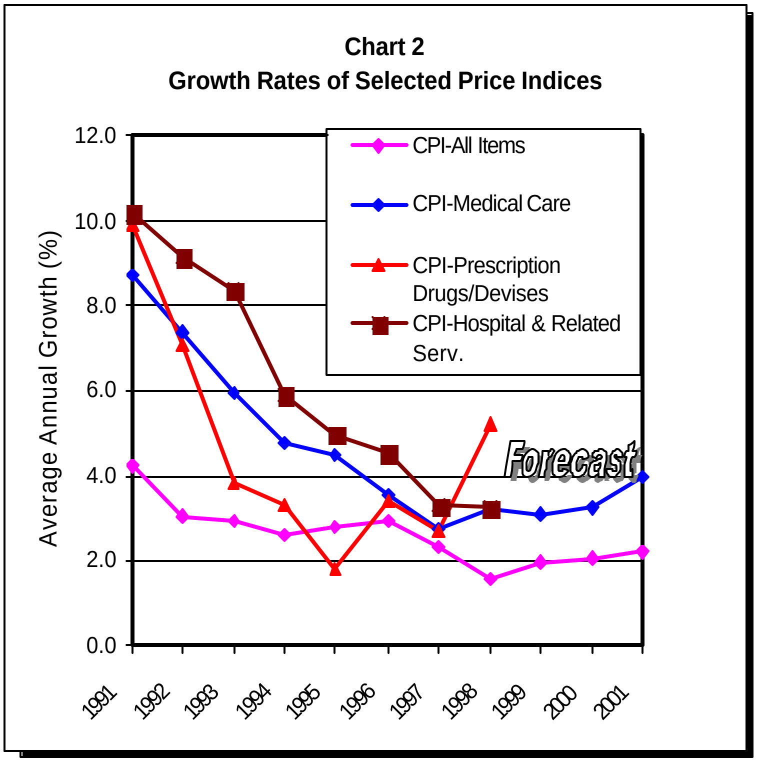
Original fiscal year 1998 and 1999 budget estimates were predicated on the notion that 60.0 percent of all OWF/Health Start Medicaid eligibles would be enrolled in HMOs by the end of FY 1997. From that base, the department planned to increase this "HMO penetration rate" to 78.0 percent by the end of FY 1999. Considerable progress was made in this direction, as we reported in prior issues, with HMO penetration rates reaching 54.4 percent in December 1997, before starting to slide to 41.0 percent in November 1998 and eventually averaging about 39 percent for all of FY 1999.

The effect of this lower than anticipated HMO penetration rate is that anticipated gains in Medicaid fee-for-service spending on the TANF/Healthy Start population were not realized as is evident when spending on hospital services is analyzed.

While the decline in the OWF-related population continued to contribute to the slowing down of Medicaid spending growth, cost factors continue to have the opposite effect. Medicaid spending on health care services that are market driven significantly outweigh program payments to providers that are tied to fee schedules. Consequently Medicaid, like any other third party payer, is very susceptible to market forces. The consumer price index for medical care, which had receded to more modest levels of increase for the better part of six years, (falling from an 8.7 percent rate of increase in 1991 to 2.8 percent in 1997), reversed and rose at an annual average rate of 3.2 percent in 1998. From December 1997 to November 1998, medical care inflation had a net acceleration from 2.8 percent to 3.5 percent. In the same period, the consumer price index had a net deceleration from 1.7 percent to 1.5 percent. Buried in the midst of medical care inflation is the cost index for prescription

Chart 1
Medicaid Eligibility - Monthly Averages





drugs and devices, which increased from 2.5 percent to 5.2 percent in the same time frame.

The Producer Price Index (PPI, the PPI surveys discounted and negotiated prices paid by third parties in urban and rural areas) for prescription drugs accelerated from 2.5 percent in August 1997 to 21.4 percent in July 1998, apparently due to a jump in the price of psychotherapeutic drugs, ending the year with an average increase of 14.97 percent in 1998. Without psychotherapeutic drugs, the PPI for prescription drugs would have risen by about 6.4 percent in 1998. We present the PPI here to highlight the upside risk for Medicaid prescription drug costs and the fact that it presents a reasonable picture of third party payers like Medicaid, and is a better indicator of Medicaid prescription drug costs than the CPI for prescription drugs which includes the effect of price changes for medical devices and equipment. Furthermore, Medicaid's prescription drug costs tend to be higher than that for the general population due to the special population needs of certain Medicaid eligibles. This phenomenon is not unique to Ohio. For example, the average wholesale price for prescription drugs has been on a steady mountain climb, dragging Medicaid drug expenditures along with it to the tune of a 14.5 percent increase in FY 1998 from FY 1997 levels, and grew by 16.9 percent in FY 1999. A policy initiative implemented in October, 1997 changed the reimbursement formula from an average wholesale price (AWP) basis to a wholesale acquisition cost (WAC) basis. However, the rapidly rising market prices for prescription drugs quickly eroded the anticipated savings of 4.2 percent, resulting in an estimated savings of 2.0 percent on brand name drugs. Had the policy change not been put in place, Medicaid spending for prescription drugs would have been even higher.

Turning back to the data in Table 2, a comparison of Medicaid spending in FY 1999 with FY 1998 revealed a relatively slow growth pattern at the bottom line, similar to that which was observed from FY 1997 to FY 1998. Medicaid spending grew by $173.2 million, or 3.4 percent, from FY 1998 to FY 1999 (see the "**TOTAL**" line in the last two columns of data in Table 2).

Nursing Homes. Over the course of FY 1999, Medicaid's Nursing Homes service category, with the exception of September 1998 and February 1999, exhibited negative disbursement variances, leading us to conclude a few months ago that the original disbursement estimate for the Nursing Homes service category assumed a higher growth rate than was merited. When FY 1999 finally came to a close, the Nursing Home service category had finished $86.7 million, or 4.2 percent, below the estimate, on total spending of $1.97 billion (see Table 1). Expenditures on this service category grew by 3.0 percent from FY 1998 levels. Table 3, Medicaid Spending on Nursing Homes, then provides some clues as to the possible sources of this slow growth rate, including the change in the per diem cost and number of recipients from FY 1998 to FY 1999. In summary, the average

Table 3
Spending on Nursing Facilities Services

	FY 1996	FY 1997	FY 1998	FY 1999	FY 98 - 99 % Change
Claim per Diem	$97.78	$101.07	$108.13	$112.83	4.35%
Recipients	59,910	56,286	58,318	58,825	0.87%
Payments	$1,691,580,504	$1,753,500,078	$1,911,124,629	$1,967,983,942	2.98%

per diem in FY 1999 increased by 4.35 percent from FY 1998 levels of $108.13 to $112.83, while the nursing home population remained fairly stable, growing by a 0.87 percent blip. Clearly, while in-home care may be contributing to reducing the need for new nursing home placements, the patients acuity level is on the increase as the people entering such facilities tend to need more care.

HMOs. Medicaid spending on HMO services in FY 1999 totaled $356.9 million, declining by about $133. million, or 26.9 percent, from FY 1998 levels (not discernable from Table 2, due to funding mix). Of the $356.9 million, $299.5 million was paid from Medicaid's lone GRF line item 400-525. The balance of $57.4 million was covered by using a mix of state and federal money earned from the state's IMD/DSH (Institutions for Mental Disease Disproportionate Share) program. Despite funding adjustments made at the beginning of FY 1999 to properly reflect the HMO enrollment rate experience in FY 1998, HMO spending in FY 1999 still landed well below anticipated levels by $152.7 million, or 33.8 percent.

The purchase of HMO coverage for OWF/ADC and Healthy Start (HS) eligibles has been a major policy initiative of the state's Medicaid program. When planning Medicaid spending, one key assumption involves the use of managed care to finance the health care needs of OWF-related/Healthy Start eligibles. Although Ohio has contracted with HMOs since the late 1970s to provide care for certain Medicaid eligibles, the use of capitated rates was not given major emphasis in Ohio's program until the state received an 1115 demonstration waiver in January 1995. As one initiative of the federally approved OhioCare proposal, the state was given the freedom to require mandatory HMO enrollment by OWF-related/ Healthy Start Medicaid eligibles. Ohio Medicaid's experience with mandatory enrollment on a large scale began in 1996, with the implementation of the waiver. Currently, ten counties (Butler, Cuyahoga, Franklin, Hamilton, Lorain, Lucas, Montgomery, Stark, Summit and Wood) have mandatory HMO enrollment, up from seven counties at the beginning of the FY 1998-99 biennium, while six others (Clark, Greene, Mahoning, Miami, Pickaway and Trumbull) have a voluntary enrollment option.

As part of that initiative, the department estimated the number of HS and OWF/ADC eligibles and then assumed in FY 1998 that 60 percent of those eligibles would be enrolled for HMO services as opposed to the traditional fee-for-service system, and that the number would increase to 78 percent by the end of the FY 1998-99 biennium. This plan to move more folks into managed care settings thus impacts on the number of people who we forecast will remain in the fee-for-service system. However, the unexpected rapid decline of the cash assistance recipients in the OWF-related eligibility category severely hampered the department's ability to get anywhere close to the number of anticipated HMOs enrollees. In FY 1999 Medicaid managed care enrollment dropped to a monthly average of 259,000 persons from an average of 331,000 in FY 1998, a 21.7 percent drop (see Table 4).

Table 4

Medicaid HMO Enrollment

Monthly Averages

(Subset of Total Eligibility)

FISCAL YEAR	TOTAL OWF/HS	ENROLLED IN HMO	ENROLLMENT RATE
1990	795,775	111,515	14.01%
1991	875,835	125,829	14.37%
1992	976,427	133,513	13.67%
1993	989,948	148,009	14.95%
1994	981,732	169,133	17.23%
1995	938,701	190,528	20.30%
1996	861,479	254,153	29.50%
1997	796,122	331,239	41.61%
1998	718,739	331,048	46.06%
1999*	668,679	259,884	38.87%

* Average monthly eligibles through March 1999

Faced with this reality, its impact on Medicaid MCPs, the Medicaid program objective of being a value purchaser, and commitment to using managed care plans as a point of accountability for access, quality, a desire to achieve cost predictability, and perhaps savings, the administration implemented a 4.9 percent adjustment increase to the average Medicaid HMO rate at the recommendation of the program's actuary. The actuary's study in other states suggested that due to welfare reform, the reduction in Medicaid enrollment, especially among adults, has resulted in an increase in the cost of remaining enrollees. These enrollees on average may be less healthy and use more services. In addition, the rate adjustment was necessary to accurately reflect the average cost of the fee-for-service experience upon which the rates are based.

Furthermore, uncertainties of the outcome of current events in the managed care industry somewhat cast a shadow on this policy initiative. The managed care market place is in a state of flux, as some large managed care providers (MCPs) are seeking to exit the business, while others are attempting to consolidate or acquire competitors. Some industry observers foresee that MCPs are ending a cycle of intense competition that produced flat premium rates in recent years, evidenced by the number and size of different premium increases negotiated by MCPs between 1998 and 1999. Some see pressure building from a number of sources: consumer disaffection; stronger contract negotiations by network providers like hospitals and physicians; the return of overall health care cost inflation; and changes in the public sector such as changes in Medicare reimbursements. All this pressure is likely to increase capitation rates.

Ohio's Medicaid experience with managed care has provided an opportunity to test alternatives to the traditional fee-for-service delivery system. System wide improvements to the fee-for-services delivery system that have also accrued to the Medicaid program from this managed care relationship cannot be overlooked.

Prescription Drugs. Spending on Prescription Drugs totaled $597.5 million in FY 1999, outrunning the estimate by $16.9 million, or 2.9 percent. Expenditures on this service category grew by 16.9 percent from FY 1998 levels. This large rise in spending was driven primarily by increases in: (1) market prices resulting from the introduction of a large number of new drugs; (2) mass market consumer advertising (in particular television); and (3) to a lesser extent, utilization rates by the Aged, Blind, and Disabled (ABD) Medicaid population (increasing by 6.35 percent from FY 1998 levels). Utilization for the OWF-related population remained steady, increasing by 0.63 percent while utilization by the HS population decreased by 26.0 percent. The ABD population accounted for about 89.3 percent of Medicaid prescription drug expenditure in FY 1999. Also affecting prices is the development of new drugs that treat disease more effectively but are also disease specific, i.e. do not have a wide therapeutic use.

A new study released by the National Institute for Health Care Management reports that national spending on prescription medications soared by 84% between 1993 and 1998. The study found that retail price increases accounted for 64% of the total increase. It also found that the "10 most heavily advertised drugs," including Claritin, Propecia and Zocor, "accounted for 22% of the total increase in drug spending from 1993-1998." Please note that Ohio's Medicaid program does not pay retail prices but reimburses providers by the reimbursement formula discussed earlier, the wholesale acquisition cost (WAC) basis plus a dispensing fee.

Table 5 presents a comparison of Ohio Medicaid prescription drug expenditures with total National expenditures. Over the past 7 years, Ohio Medicaid prescription drug expenditures have grown significantly both in terms of total spending and as a share of all Health Care/Medicaid expenditures, as have

Table 5
Ohio Medicaid Program and National Expenditures on Prescription Drugs

	Ohio Medicaid Program				National Expenditures[2]		
Year[1]	Prescription Drug Expenditures (in millions)	Annual Growth in prescription drug expenditures	Annual Growth in Ohio Medicaid expenditures	Prescription drug spending as a percent of total Medicaid expenditures	Prescription Drug Expenditures (in millions)	Annual Growth in prescription drug expenditures	Annual Growth in all health care expenditures
1999*	$597.5	16.9%	3.4%	11.3%	$100,629	12.9%	6.1%
1998*	$511.4	14.6%	3.3%	10.1%	$89,963	13.5%	5.3%
1997	$446.4	8.4%	-0.9%	9.1%	$78,888	14.0%	4.8%
1996	$411.9	13.5%	7.8%	8.3%	$69,111	13.0%	5.0%
1995	$362.8	10.9%	1.4%	7.9%	$61,060	11.0%	5.2%
1994	$327.0	16.7%	9.0%	7.2%	$55,189	9.0%	5.0%
1993	$280.3	3.3%	5.3%	6.8%	$50,632	9.0%	7.0%
1992	$291.5	14.4%	19.3%	7.4%	$46,598	11.0%	9.0%
Average annual growth, 1992-99		12.3%	6.1%			11.7%	5.9%

* National expenditures for 1998 & 1999 are estimates.
1. Represents State Fiscal Year, and Calendar year for national expenditures.
2. Source: Health Care Financing Administration (HCFA), Office of the Actuary.

Table 6
Ohio Medicaid Eligibles
(Average Monthly Eligibles)

FISCAL YEAR	ABD	% chg.	QMB	% chg.	SLMB[1]	% chg.	HEALTHY START (non-exp.)	% chg.	OWF Related[2]	% chg.	TOTAL without CHIP Expansion	% chg.	CHIP/HS-1[3] 150% Expansion	% chg.	TOTAL with CHIP Expansion	% chg.
1990	214,247		1,646		0		15,837		779,937		1,011,667		0		1,011,667	
1991	228,955	6.87%	3,674	123.26%	0		47,007	196.81%	828,828	6.27%	1,108,464	9.57%	0		1,108,464	9.57%
1992	246,369	7.61%	9,602	161.38%	0		82,166	74.80%	894,261	7.89%	1,232,398	11.18%	0		1,232,398	11.18%
1993	263,676	7.02%	16,067	67.32%	420		109,162	32.86%	880,786	-1.51%	1,270,110	3.06%	0		1,270,110	3.06%
1994	286,655	8.71%	20,191	25.67%	6,395	1422.59%	123,663	13.28%	858,069	-2.58%	1,294,972	1.96%	0		1,294,972	1.96%
1995	309,576	8.00%	22,773	12.79%	12,955	102.58%	129,826	4.98%	808,875	-5.73%	1,284,005	-0.85%	0		1,284,005	-0.85%
1996	321,978	4.01%	22,736	-0.16%	22,069	70.35%	139,529	7.47%	721,950	-10.75%	1,228,262	-4.34%	0		1,228,262	-4.34%
1997	323,023	0.32%	23,791	4.64%	23,233	5.28%	133,719	-4.16%	662,403	-8.25%	1,166,169	-5.06%	0		1,166,169	-5.06%
1998	315,884	-2.21%	23,683	-0.45%	25,925	11.59%	137,912	3.14%	580,827	-12.32%	1,084,231	-7.03%	11,873		1,096,104	-6.01%
1999*	314,684	-0.38%	23,612	-0.30%	35,998	38.85%	167,099	21.16%	501,580	-13.64%	1,042,973	-3.81%	51,972	337.73%	1,094,945	-0.11%

1. SLMB population growing due to a federal expansion for Medicare eligibles effective January 1, 1998.
   All costs related to this new group, Additional Low-income Medicare Beneficiaries, are 100% federally reimbursable
2. OWF related, includes OWF Cash Assistance, Transition & Low-income Medicaid Eligibles.
3. CHIP/HS-1, Phase I are a combined group of kids eligible for the states' 150% of FPL expansion implemented January 1, 1998.

* Average monthly eligibles through March 1999.

national expenditures, but at a faster clip. Ohio Medicaid prescription drug spending grew, on average, from FY 1992 to FY 1999 by 12.3 percent compared with a 6.1 percent growth rate for total Health Care/ Medicaid expenditures. Over the same period, prescription drug spending as a share of total Ohio Medicaid expenditures has grown from 7.4 percent in FY 1992 to 11.3 percent in FY 1999.

Hospitals. Payments for hospital services, which have posted a mix of positive and negative monthly disbursement variances throughout FY 1999, ended the month of June with an overage of $36.6 million on total spending of $112.2 million. A good deal of this overage amount is tied to the payment of previously planned encumbrances. For FY 1999, payments to hospitals totaling $1.18 billion were over the estimate by $50.8 million, or 4.5 percent. This fiscal year hospital spending outpaced the spending in FY 1998 by $64.9 million, or 5.8 percent. Besides the payment of these planned encumbrances, the decline of OWF-related caseloads has also had an impact, with (i) folks not moving to managed care settings as planned, and (ii) increasing acuity as the "more healthy" individuals exit the system leaving individuals who on average may be less healthy and use more services.

All Other. Payments for All Other services include dental services, ODHS waiver services and a host of "smaller" services, and also acts as a catch all category for various expenditures not "tagged" to the appropriate service categories on the monthly reports. This makes any meaningful analysis of spending versus estimates difficult. All Other spending ended the month of June with an overage of $16.1 million on total spending of $44.9 million. For the fiscal year, All Other payments totaled $423.9 million and were over the estimate by $42.4 million, or 11.1 percent. FY 1999 All Other spending grew by $71.8 million or 20.4 percent from FY 1998 levels. While All Other service spending is difficult to analyze, LBO believes that a significant portion of the growth in spending is due to the expansion of ODHS waiver slots in July 1998 and a higher than anticipated take-up of these new waiver slots. We are uncertain of how this expansion was planned for in the original disbursement estimates.

The ODHS waiver program has focused on offering home and community-based services (HCBS) alternatives to consumers in need of long-term care services. Effective July 1, 1998, the administration implemented the new Ohio Home Care Program, which consolidated the former Disability and Medically Fragile waivers into a single waiver and added 2,000 more slots, for a total of 7,088 slots. In addition, the initiative integrated the home health services available to all Medicaid consumers and intensive home care services available only to waiver consumers. In FY 1998, a combined 5,065 Disability and Medically Fragile waiver slots were used. In FY 1999, following the addition of 2,000 slots, 7,030 slots of the new Ohio Home Care Program were used. According to HUM, spending on HCBS grew by 482 percent between FY 1991 and FY 1997, while expenditures for nursing homes grew by 42 percent in the same period. The number of individuals in nursing homes in that time period grew by 5.5 percent, while HCBS alternatives have provided care for four times the number in nursing homes. This investment in HCBS alternatives will continue to benefit the state, consumers, and providers as the demand for non-institutional home care continues to grow.

Caseload. The total number of persons eligible for Medicaid declined by 3.8 percent from 1,084,231 persons in FY 1998 to 1,042,973 in FY 1999 (see Table 6, Ohio Medicaid Eligibles). Please note that the discussion here focuses on the total number of eligibles without the CHIP/HS-1 expansion, since the provision of health care for these children was funded with IMD/DSH revenues as opposed to the traditional GRF 400-525, Health Care/ Medicaid line item.

The consistent decline in the cash assistance aid group, OWF, that started in FY 1992 has been the primary driving force behind the drop in total caseload. From FY 1998 to FY 1999, the OWF-related eligibility group declined by 13.4 percent, to a monthly average of 501,580 persons. Although OWF-related Medicaid eligibility has declined in recent years, due primarily to the decline in the OWF cash assistance caseload, it remains the largest Medicaid eligibility group, representing 48.1 percent of all eligibles in FY 1999. Until recently, the other major component of the Medicaid caseload — the Aged, Blind, and Disabled (ABD) population — had been increasing as was evident by a growth rate in the first half of the 1990s averaging 7.6 percent. The numbers for FY 1997, 1998 and 1999, however, suggested a stabilizing or decrease in the ABD caseload was afoot, as an almost imperceptible percentage increase of 0.3 percent was posted in FY 1997, followed by a 2.2 percent drop in FY 1998, and then was notched down by 0.4 percent in FY 1999.

Other Medicaid eligibility categories have nonethe-less experienced some growth. Caseload growth is primarily driven by the Healthy Start and CHIP-I population, as a result of outreach efforts, and the re-enrollment of some children who have lost OWF eligibility due to increased incomes. The Specified Low-Income Medicare Beneficiaries (SLMBs) population is growing due to a federal expansion for Medicare eligibles. Qualified Medicare Beneficiaries (QMBs) and SLMBs, are the result of a federal mandate that states Medicaid programs must "buy-in" to Medicare coverage for certain individuals. QMBs have incomes below 100 percent of the FPL, and Medicaid must pay for their Medicare premiums, copayments, and deductibles. For SLMBs, Medicaid covers the Medicare Part B premiums only for those with incomes between 100 and 120 percent of FPL. Premiums for both of these eligibility groups (and for Medicare-eligible ABD eligibles for whom the state chooses to buy-in to Medicare) are reflected in the Medicare buy-in service category. The copayments and deductibles of QMBs are reflected in the appropriate service categories, which Medicare covers. Although the growth in the number of QMB and SLMB eligibles in recent years has been declining, the Balanced Budget Act of 1997 created two new eligibility groups under the name, Additional Low-Income Medicare Beneficiaries (ALMB) or Qualified Individuals (QIs). Effective January 1, 1998, the Department of Human Services is required to pay the full Medicare Part B premium for Medicare eligible individuals with incomes between 120 and 135 percent of FPL (known as the QI-1 group), and to reimburse the Home Health Care portion of the Medicare Part B premium to individuals with incomes between 135 and 175 percent of FPL (known as the QI-2 group). All costs associated with the ALMB population are 100 percent federally funded.

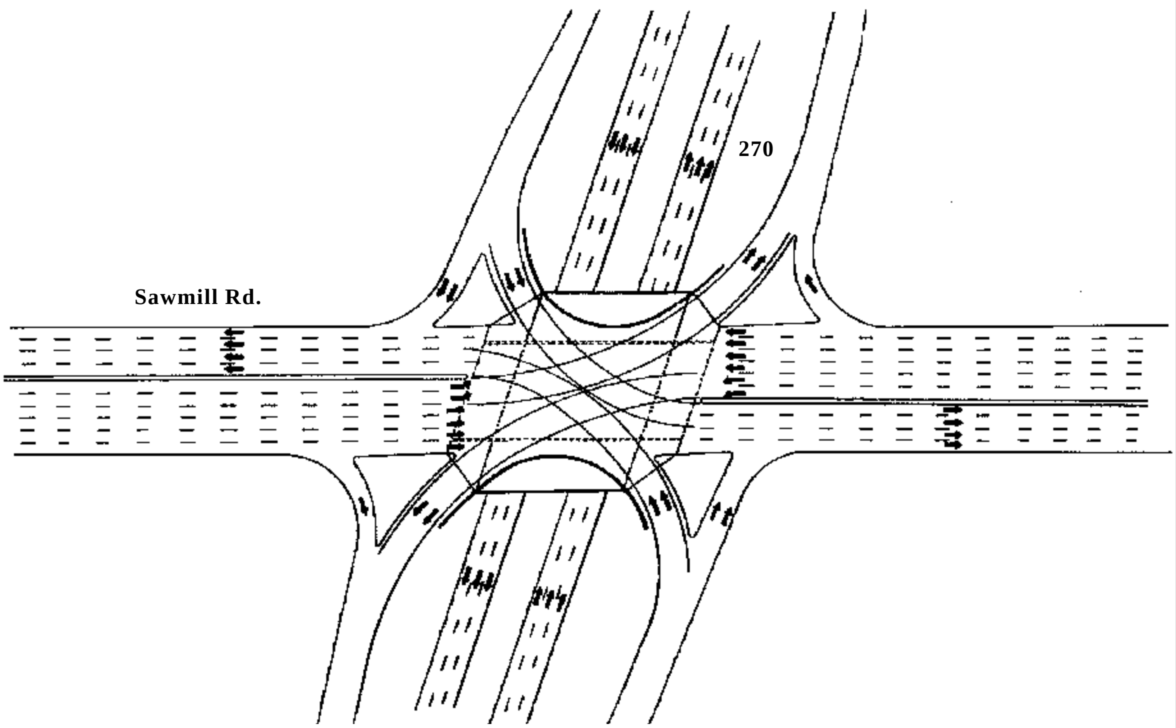
The decline in cash assistance recipients in Ohio Works First (OWF) has also caused a significant change in the Medicaid caseload composition. Aged, Blind, and Disabled (ABD) eligibles comprised around 28 percent of the more than 1.2 million Medicaid eligibles in FY 1996, yet generated over 70 percent of all care-related Medicaid costs. By FY 1998, the ABD population had moved up to comprise 31 percent of the 1.1 million Medicaid eligibles and generated about 76 percent of Medicaid spending. The cost of long-term care was the primary reason for the relative expense of the ABD population. This increase in the ABD population and related costs has been a result of a natural shift in the program and not the result of any policy changes. In addition, the ABD population heavily utilizes some of the services with the fastest growing costs such as prescription drugs. Thus, while we have experienced a slowing in expenditure growth, the change in caseload composition could trigger bigger increases in the near future.

CHIP/HS-1. IMD/DSH funds in addition to offsetting GRF payments for HMO services were also used to provide funding for the Children's Health Insurance/ Healthy Start expansion for children living in families with incomes at or below 150 percent of the federal poverty level (FPL). This program's expenditures were estimated to be $12.7 million in FY 1998 and $69.9 million FY 1999. And not unlike any new program, the take-off was rather slow in the early stages, leading to an expenditure of only $5.9 million in FY 1998, and $47.3 million in FY 1999. Enrollment in the program averaged 11,873 children monthly in FY 1998. In FY 1999, enrollment grew by 337.7 percent to an average monthly eligible children of 51,972. ❑

Ohio Facts Extra!

Pay Me Now, or Pay Me Later…
Central Ohio Residents Bite the Bullet With SPUI

— ***Clifford R. Marsh***



Urban interchange layout with the freeway depressed and the turning movements on the bridge structure. This schematic provides for eight through lanes on the cross-road and dual left turn movements in all four quadrants.

Ohio will have its first Single Point Urban Interchange (SPUI) with the completion of the Sawmill Road/I-270 interchange. In a move that alludes to the old adage of "Pay me now, or pay me later", ODOT has chosen the former, by embarking on a massive effort that will essentially provide new highway for the uppermost portion of the heavily traveled Columbus outerbelt, from SR 161 to US 33. In fact, by sacrificing now, ODOT plans on delivering more for central Ohio residents than anticipated. Original plan level estimates to extend I-270 to three lanes in each direction along this stretch amounted to $90 million. Now, for an amount estimated to be in the mid-$90 million range, I-270 will be extended to four lanes in each direction, the SPUI will be constructed, and there will be bridge replacement and rehabilitation over the Scioto River. Tackling this task as one project, rather than as a piecemeal project over a number of years has contributed to the savings.

The focal point of this construction will be the SPUI at Sawmill Road and I-270. There are over fifty SPUIs in operation in the United States. The SPUI differs from the traditional diamond configuration of the present interchange in that it:

- requires less right-of-way, because it is not as wide as the 45^{o} off-ramps of the diamond interchanges and can fit into tighter spaces;
- can be cost effective when weighing the cost of the SPUI bridge vs. purchasing right-of-way
- can be built while the diamond interchange remains open thereby reducing public inconvenience;
- is more conducive for large numbers of left turns onto roads and merging traffic patterns;
- will improve the flow of traffic by utilizing 1-three phase signal in the center of the SPUI interchange, rather than 2-four or more phase signals impeding through traffic.

This two-year effort will provide this growing region of Central Ohio with proactive transportation infrastructure development well into the next century. ❑

Virtually LBO

Newly Available in Our Virtual Office

If you stopped by our virtual office recently, you noticed the wealth of information placed on our website within the last month or so. We continue to add to our collection of online budget materials with the following now available.

- Final Compare Document. http://www.lbo.state.oh.us/ohbudget/opanalysis/comparedocs/
  This document provides a comparative analysis of the temporary law changes and fiscal effects of permanent law changes made among the versions of the budget bill as it was Introduced, As Passed by the House, As Passed by the Senate, and As Reported by Conference Committee. All temporary law changes associated with agency appropriation sections and all other temporary law changes with fiscal effects appear in this document. For permanent law, only changes that have a fiscal effect are presented. This document is organized by agency, and generally, by subject.

- Appropriation Spreadsheets. http://www.lbo.state.oh.us/ohbudget/opanalysis/spreadsheets/
  The final spreadsheets display appropriation amounts contained in the five appropriations acts from the beginning of the process to the final stage.

- Forecasts and Testimony. http://www.lbo.state.oh.us/ohbudget/opanalysis/forecasts/
  Link up here for the final estimates of economic growth, revenues, and public assistance expenditures for the next biennium, as presented to conference committee.

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