

Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE BUDGET OFFICE

DECEMBER, 1999

FISCAL OVERVIEW

— Doris Mahaffey

At the end of November, the state appears to be in pretty good financial circumstances with revenues \$180.9 million above estimate and disbursements \$230.9 million below estimate. However, reasons for caution remain. First, the revenue overage is mainly due to taxes. Most state taxes are performing either as expected or better than expected. The one tax that we still don't have much information on is the corporate franchise tax – the first payment of which is not due until the end of January. It's not clear how that will perform. The corporate franchise tax is notoriously variable, and the weakness observed in quarterly estimated payments in the personal income tax the last two quarters might be reason for pause.

Another source of revenue overage is in the other transfers category. These transfers are linked to human services spending. They essentially "reimburse" the GRF for prior-year overages in certain social services (Title XX) programs. At the same time, the transfers are offset by increased appropriations in some of the human services "other welfare" lines. Consequently, we may see eventually overages on the disbursements side to match this overage on the revenue side.

On the disbursement side, spending is starting to catch up with estimates. At the end of October nearly all spending categories had either large negative variances or small positive variances (less than \$1.2 million overages). The only exceptions were the Environment and Natural Resources category and Other Transfers Out. By the end of November, increased spending had eroded many of these negative variances. Among the categories with notable year-to-date overages are Justice and Corrections, Higher Education, and Medicaid.

The largest negative variances at this time are in the areas of Primary and Secondary Education (\$110.8 million) and Property Tax Relief (\$77 million), both of which are expected to be eliminated by the end of the fiscal year (or, in the case of primary and secondary education, any continued underage is expected to be encumbered).

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Budget Footnotes examines the fiscal position of the state GRF on a monthly basis. Each issue also contains summaries of Controlling Board actions that have policy implications, and articles on fiscal issues of current interest.

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

	Month of November	Fiscal Year 2000 to Date	Last Year	Difference
Beginning Cash Balance	(\$185.7)	\$1,512.5		
Revenue + Transfers	\$1,395.2	\$7,245.3		
Available Resources	\$1,209.5	\$8,757.8		
Disbursements + Transfers	\$1,813.1	\$9,361.4		
Ending Cash Balances	(\$603.6)	(\$603.6)	(\$440.2)	(\$163.4)
Encumbrances and Accts. Payable		\$799.0	\$1,011.8	(\$212.8)
Unobligated Balance		(\$1,402.5)	(\$1,452.0)	\$49.5
BSF Balance		\$953.3	\$906.9	
Combined GRF and BSF Balance		(\$449.2)	(\$545.1)	\$95.9

TRACKING THE ECONOMY

— Allan Lundell

The U.S. economy continued its strong performance in November. Personal income continued to grow, as did consumer spending. The housing market remained strong and labor markets tightened. Although inflation remained low, fear that this strong economic performance will lead to increased inflation led the Federal Reserve to raise its target federal funds rate to 5.50 percent and the discount rate to 5.00 percent. Another increase is possible for January.

Consumers

Personal income grew by 0.4 percent in November. Wages and salaries were up 0.3 percent, dividends were up 0.5 percent, interest was up 0.7 percent, and transfer payments were up 0.1 percent. Disposable income was up 0.4 percent. On a year-over-year basis, personal income is up 5.7 percent, wages and salaries are up 6.3 percent, dividends are up 6.0 percent, interest is up 5.8 percent, transfer payments are up 3.9 percent, and disposable income is up 5.6 percent.

Consumption spending increased by 0.5 percent in November. Spending on durable goods (led by strong vehicle sales) was up 1.3 percent, spending on non-durable goods was up 0.4 percent, and spending on services was up 0.3 percent. On a year-over-year basis, consumption spending is up 7.6 percent, spending on durable goods is up 8.2 percent, spending on non-durable goods is up 8.5 percent, and spending on services is up 7.0 percent. Spending on durable goods accounts for 13 percent of consumption spending; spending on non-durable goods, 29 percent; and spending on services 58 percent.

Housing starts fell by 2.3 percent in November, down to a seasonally adjusted annualized rate of 1.6 million. Starts for single family housing were down by 3.6 percent. Single family starts are now 6 percent below the pace

set in 1998. Multi-family starts are 14 percent higher than in 1998. Sales of existing single-family homes were up 6.0 percent in November, to a seasonally adjusted annualized rate of 5.1 million. The mortgage rate increases have slowed the housing market. Even though the market has slowed, the level of activity is still high.

After four months of decreases, the Conference Board's index of consumer confidence increased by 5.0 percent in November. The assessment of the current situation increased by 1.7 percent and the index of expectations increased by 8.8 percent. Consumers appear to be ready to continue spending, but plans to buy motor vehicles, houses, and appliances were down. Purchases of these items are sensitive to interest rates, so the actions of the Federal Reserve may be having their desired effects. However, increases in income will allow for continued spending on items whose purchases are not interest rate sensitive.

Prices

The Consumer Price Index (CPI) increased by 0.1 percent in November. The core CPI (excluding food and energy) increased by 0.2 percent. The index for energy prices was unchanged, the index for food and beverages was up 0.1 percent, the index for housing was up 0.3 percent, and the index for medical care was up 0.4 percent. The index for apparel was down 0.5 percent. On a year-over-year basis, the CPI is up by 2.6 percent and the core CPI is up by 2.2 percent, the index for energy prices is up 10.6 percent, the index for food and beverages is up 2.0 percent, the index for housing is up 2.2 percent, the index for medical care is up 3.5 percent, and the index for apparel is down 1.0 percent. The index for tobacco and smoking products is up 31.5 percent when compared to November 1998. As tobacco purchases decline in response to higher prices (LBO estimates a 12.6 percent decrease), this should result in a downward volume adjustment to payments made to states under the tobacco settlement.

The Producer Price Index (PPI) for finished goods increased by 0.2 percent in November. Prices of energy goods (led by gasoline, heating oil, and natural gas) increased by 1.4 percent in November. If the prices of food and energy products are excluded, the resulting core PPI did not change in November. This followed a 0.3 percent increase in October caused by increases in the prices of automobiles and prescription drugs. In November, the price index for intermediate goods increased by 0.3 percent (for the third straight month) and the crude goods index increased by 4 percent. On a year-over-year basis, the PPI for finished goods is up by 3.1 percent, the core PPI is up 1.8 percent, the index for intermediate goods is up 3 percent, and the index for crude goods is up 16 percent.

Inflationary pressure continues to build at the early and intermediate stages of production. These pressures have not yet made it to finished products or to consumers, primarily because of downward pricing pressures from imported goods. The fear or expectation of the release of the inflationary buildup from the crude and intermediate levels helped lead the Federal Reserve to increase the federal funds rate at its November 16 Federal Open Market Committee meeting.

Sales

After two months of slow growth, retail sales increased by 0.9 percent in November. Sales of durable goods were up 1.5 percent. Interest sensitive sales increased even though the Federal Reserve had increased interest rates. Automobile sales, helped by dealer incentives, were up 2.4 percent. Retail sales of building materials were up 0.9 percent and furniture sales were up 0.5 percent. Sales of non-durable goods were up 0.4 percent. Apparel sales were up 0.8 percent. Sales at eating and drinking places were up 0.5 percent. Warm weather at the start of November helped to keep sales down. However, sales during the Thanksgiving weekend were very strong.

On a year-over-year basis, total retail sales are up 9.2 percent. Sales of durable goods are up 10.1 percent. Auto sales are up 12.4 percent, furniture sales are up 8.4 percent, and sales of building materials are up 6.5 percent. Sales of non-durable goods are up 8.6 percent on a year-over-year basis. Apparel sales are up 6.4

percent. Sales at eating and drinking places are up 7.6 percent. These increases are quite large for this point in the economic cycle.

The continued strength in retail sales indicates that consumers are not ready to stop spending. The November increases may be part of a year end holiday spending spree, or they may be an indication of revived consumer spending.

Production

Industrial production grew by 0.3 percent in November. The temporary increase due to reconstruction brought on by hurricane Floyd came to an end. Unseasonably warm weather reduced the demand for electricity, resulting in lower than normal output from utility providers. Production of consumer goods increased by 0.1 percent, auto production increased by 1.2 percent, production of equipment increased by 1.3 percent, and production of materials increased by 0.6 percent. Capacity utilization increased slightly to 81 percent. This is below the average for the 1990's, indicating little pressure on prices at the factory level.

Factory orders increased by 1.2 percent in November and are up by 8.7 percent in a year-over-year comparison. Orders for non-durable goods increased by 1.6 percent. Orders for durable goods increased by 0.9 percent. This increase followed decreases of 1.5 percent in September and 0.9 percent in October. Orders for electronic and electrical goods increased after being down in October due to disruptions in the semiconductor supply chain caused by the earthquake in Taiwan.

Employment

The national unemployment rate remained at the 4.1 percent level it had fallen to in October. Net job creation was 234,000. The largest gains were in construction, which had 55,000 job increase. This was due to both the unseasonably warm weather in November and the clean-up after Hurricane Floyd. Average hourly earnings increased by 0.1 percent and are up by 3.6 percent in a year-over-year comparison. The labor market is tight, yet reported wage increases are small. This may be due to workers receiving non-wage compensation such as signing bonuses, production bonuses, or stock options.

Ohio's seasonally adjusted unemployment rate declined to 4.0 percent. Total employment decreased by 1,000 to 5,573,000. Those not employed but seeking work decreased by 12,000 to 231,000. Employment in goods producing industries increased by 5,000. Manufacturing employment increased by 4,000 and construction employment increased by 1,000. Employment in retail trade increased by 1,000 while government employment fell by 2,000 due to decreases in both state and local education. Average hourly earnings for workers in goods-producing industries decreased by 0.2 percent to \$16.98 in November, but are up by 2.4 percent when compared with November 1998. Average hourly earnings for workers in the construction industry decreased by 1.8 percent to \$19.68 in November, but are up by 3.9 percent compared to November 1998. Average hourly earnings for workers in retail trade increased by 1.0 percent to \$9.19 in November and are up by 6.4 percent when compared to November 1998. □

Status of the General Revenue Fund

REVENUES

— Doris Mahaffey

The revenue picture for October and November of 1999 continued in pretty much the same vein as in prior months this year – with strong performance in the personal income tax and the sales tax adding to the year-to-date overages. The non-auto sales tax was actually underestimated in October – reflecting the slowdown in retail sales largely in September. But that shortfall was offset by a small overage in the auto sales tax. And it rebounded in November when both the non-auto and auto sales tax were over estimate by \$13.9 million and \$5.4 million, respectively.

The personal income tax was also substantially over estimate in both months – again, largely due to withholding. However, in October, quarterly estimated payments were also over estimate, offsetting some of the shortfall noted in September. The higher quarterly estimated payments may also reflect the growing confidence in the economy that was picked up by the increase in consumer confidence noted by the Conference Board for November.

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

REVENUE SOURCE	Actual	Estimate*	Variance
TAX INCOME			
Auto Sales	\$60,499	\$55,100	\$5,399
Non-Auto Sales & Use	419,376	405,490	13,886
Total Sales	\$479,875	\$460,590	\$19,285
Personal Income	\$502,081	\$488,852	\$13,229
Corporate Franchise	11,260	5,372	5,888
Public Utility	(9,824)	(3,150)	(6,674)
Total Major Taxes	\$983,393	\$951,664	\$31,729
Foreign Insurance	\$1,132	\$0	\$1,132
Domestic Insurance	43	0	43
Business & Property	27	105	(78)
Cigarette	24,442	22,480	1,962
Soft Drink	0	0	0
Alcoholic Beverage	4,538	4,240	298
Liquor Gallonage	2,338	2,240	98
Estate	25,845	16,800	9,045
Racing	0	0	0
Total Other Taxes	\$58,366	\$45,866	\$12,500
Total Taxes	\$1,041,759	\$997,529	\$44,230
NON-TAX INCOME			
Earnings on Investments	\$0	\$0	\$0
Licenses and Fees	3,170	5,390	(2,220)
Other Income	4,398	6,840	(2,442)
Non-Tax Receipts	\$7,567	\$12,230	(\$4,663)
TRANSFERS			
Liquor Transfers	\$8,000	\$8,000	\$0
Budget Stabilization	0	0	0
Other Transfers In	5,000	0	5,000
Total Transfers In	\$13,000	\$8,000	\$5,000
TOTAL INCOME less Federal Grants	\$1,062,326	\$1,017,759	\$44,567
Federal Grants	\$332,841	\$308,395	\$24,446
TOTAL GRF INCOME	\$1,395,168	\$1,326,154	\$69,014

* July, 1999 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

Table 3
General Revenue Fund Income
Actual vs. Estimate
Fiscal Year-to-Date 2000
(\$ in thousands)

REVENUE SOURCE

TAX INCOME	Actual	Estimate*	Variance	FY 1999	Change
Auto Sales	\$348,961	\$326,491	\$22,470	\$320,675	8.82%
Non-Auto Sales & Use	2,102,878	2,019,902	82,976	1,936,266	8.60%
Total Sales	\$2,451,839	\$2,346,393	\$105,446	\$2,256,940	8.64%
Personal Income	\$2,546,666	\$2,475,754	\$70,912	\$2,438,110	4.45%
Corporate Franchise	52,595	53,042	(447)	72,662	-27.62%
Public Utility	206,230	204,750	1,480	202,468	1.86%
Total Major Taxes	\$5,257,329	\$5,079,939	\$177,390	\$4,970,180	5.78%
Foreign Insurance	\$128,228	\$126,854	\$1,374	\$148,329	-13.55%
Domestic Insurance	126	59	67	\$39	222.56%
Business & Property	395	538	(143)	\$123	222.26%
Cigarette	110,607	109,083	1,524	\$113,372	-2.44%
Alcoholic Beverage	22,973	22,912	61	\$22,987	-0.06%
Liquor Gallonage	11,541	11,222	319	\$11,401	1.23%
Estate	74,562	56,700	17,862	\$57,245	30.25%
Total Other Taxes	\$348,432	\$327,369	\$21,063	\$353,497	-1.43%
Total Taxes	\$5,605,761	\$5,407,307	\$198,454	\$5,323,677	5.30%
<u>NON-TAX INCOME</u>					
Earnings on Investments	\$20,479	\$35,550	(\$15,071)	\$45,037	-54.53%
Licenses and Fees	12,071	17,065	(4,994)	\$15,504	-22.14%
Other Income	43,264	40,556	2,708	\$40,070	7.97%
Non-Tax Receipts	\$75,815	\$93,171	(\$17,356)	\$100,610	-24.64%
<u>TRANSFERS</u>					
Liquor Transfers	\$35,000	\$34,000	\$1,000	\$34,000	2.94%
Budget Stabilization	0	0	0	\$0	—
Other Transfers In	28,915	0	28,915	16,313	77.25%
Total Transfers In	\$63,915	\$34,000	\$29,915	\$50,313	27.04%
TOTAL INCOME less Federal Grants	\$5,745,491	\$5,534,478	\$211,013	\$5,474,600	4.95%
Federal Grants	\$1,499,785	\$1,529,875	(\$30,090)	\$1,457,838	2.88%
TOTAL GRF INCOME	\$7,245,276	\$7,064,353	\$180,923	\$6,932,438	4.51%

* July, 1999 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

The first major payment of the public utility excise tax for tax year 2000 was made in October. It was over estimate by \$7.9 million. However, in November tax year 1999 liabilities were certified. They were under estimate and resulted in refunds in November, that were over estimate by \$6.7. Consequently, at the end of November year-to-date public utility excise tax revenues were virtually on target (over estimate by \$1.5 million).

October also saw the first big payment of the foreign insurance tax. Although slightly under estimate in October, some lagging payments recorded in November resulted in that revenue source being slightly over target (by \$1.4 million) at the end of November. However, year-to-date revenues are substantially below revenues at this time last year due to the continued phasing in of changes to the insurance tax made by H.B. 215 (the main appropriations act of the 122nd General Assembly).

Year-to-date Revenues

At the end of November tax revenues were over estimate by \$198.5 million. The personal income tax and the sales tax accounted for the bulk of the overage, but the estate tax made a sizeable contribution, as well. The other taxes are virtually on target, displaying year-to-date variances of no more than \$1.5 million either way.

In the non-tax revenue sources, transfers added to the overage, but other sources were largely under

estimate, so that overall, revenues were only \$180.9 million over estimate. Notably, federal grants were under estimate by \$52.5 million in October – reflecting lower disbursements in Medicaid and TANF. In November, federal grants began to catch up with an overage of \$24.4 million. (On the disbursement side, Medicaid was correspondingly over estimate and TANF was only \$1.5 million under.) At the end of November, Federal reimbursements remained \$30.1 million under estimate. □

DISBURSEMENTS

— Jeffrey E. Golon*

With absolutely no fanfare whatsoever, let's dive right into a review of the state's disbursement activity for the month of November and year-to-date.

November

For November, excluding transfers, the state's disbursements landed with a barely audible \$9.3 million underage. The month was perhaps best characterized as a pitched battle between two opposing alliances: an \$82.3 million underage that paired the Property Tax Relief and Education program categories versus a \$73.0 million overage that teamed the Government Operations and Welfare & Human Services program categories.

Our discussion of these program categories, arranged in order of the magnitude of their contribution to November's disbursement variance, commences below. The reader's attention is also directed to Table 4, which provides a more detailed picture of November's disbursements by program category.

Property Tax Relief

The dominant element in November's spending picture was a monster timing-based \$61.5 million underage tossed in from the Property Tax Relief program category, signaling that the departments of Education and Taxation disbursed significantly less property tax relief funding than was originally forecast. Specifically, the Department of Education's disbursements to school districts fell short

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

USE OF FUNDS

PROGRAM	Actual	Estimate*	Variance
Primary & Secondary Education (1)	\$426,194	\$468,993	(\$42,800)
Higher Education	302,830	280,829	22,001
Total Education	\$729,024	\$749,822	(\$20,798)
Health Care (Medicaid)	\$520,621	\$508,568	\$12,053
Temporary Assistance to Needy Families (TANF)	92,871	94,834	(1,963)
General/Disability Assistance	5,428	5,288	141
Other Welfare	40,766	37,231	3,535
Human Services (2)	116,248	109,001	7,247
Total Welfare & Human Services	\$775,935	\$754,921	\$21,014
Justice & Corrections	\$152,430	\$113,051	\$39,379
Environment & Natural Resources	19,910	17,171	2,739
Transportation	7,454	6,357	1,097
Development	10,758	6,117	4,640
Other Government (3)	25,620	21,116	4,504
Capital	633	1,000	(367)
Total Government Operations	\$216,804	\$164,812	\$51,991
Property Tax Relief (4)	\$90,805	\$152,346	(\$61,541)
Debt Service	0	0	0
Total Program Payments	\$1,812,568	\$1,821,902	(\$9,335)
TRANSFERS			
Local Govt Distribution	\$0	\$0	\$0
Budget Stabilization	0	0	0
Other Transfers Out	500	0	500
Total Transfers Out	\$500	\$0	\$500
TOTAL GRF USES	\$1,813,068	\$1,821,902	(\$8,835)

(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, 1999 estimates of the Office of Budget and Management.

Detail may not add to total due to rounding.

of their estimate by \$37.6 million and the Department of Taxation's disbursements to all other taxing districts landed under their estimate by \$23.9 million. A closer examination of this monthly disbursement variance, in terms of the type of property tax relief distributed, revealed that spending was under the estimate by \$44.6 million in real property tax credits/

exemptions and by \$16.9 million in tangible tax credits. The fact that the former (real property) was considerably larger than the latter (tangible) was not surprising given the amount appropriated annually for real property tax credits/exemptions greatly exceeds the amount appropriated annually for tangible tax credits.

Over the course of FY 2000, the state's Property Tax Relief program will disburse approximately \$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. As a result, large negative or positive monthly disbursement variances in the property tax relief program are not uncommon timing-based phenomena that come and go from one month to the next.

Government Operations

The Government Operations program category posted a hefty \$52.0 million overage in November, the practical effect of which was to substantially dilute the impact that the even heftier \$61.5 million underage registered by the Property Tax Relief program category would otherwise have had on the state's total monthly disbursement variance. Given the pivotal role that the Education and the Welfare & Human Services program categories typically play in the state's monthly spending, this pronounced role played by the Government Operations program category in November's disbursement variance was both a bit unexpected and somewhat out of character.

The program category's monthly overage itself was in turn largely driven by a \$39.4 million positive disbursement variance registered in its Justice & Corrections component, the primary sources being the departments of Rehabilitation & Correction (DRC) and Youth Services (DYS), with spending that landed over their November disbursement estimates by \$26.8 million and \$4.8 million, respectively. Virtually all of DRC's monthly disbursement variance was traceable to what appeared to be timing-based overages in the department's operating expenses, including a big chunk of quarterly funding used to purchase food for prison inmates that may have been moved earlier than was assumed would be the case. The primary

culprits behind DYS's monthly disbursement variance were line items 470-401, RECLAIM Ohio, and 470-510, Youth Services, which produced timing-based overages of \$2.2 million and \$2.1 million, respectively. In the case of the former line item, DYS posted one of its two-week pay periods a month earlier than expected, while in the case of the latter line item, previously delayed subsidy payments that support various juvenile court programs were finally released.

A host of other state agencies made smaller contributions to the monthly overage in the Government Operations program category, including, in order of magnitude, the Department of Development (\$4.1 million), the operating expense portion of the Department of Taxation's GRF budget exclusive of its property tax relief and utility bill credits funding (\$2.9 million), the Public Defender Commission (\$2.6 million), the Office of the Attorney General (\$2.2 million), the Ohio Environmental Protection Agency (\$1.8 million), The Judiciary/Supreme Court (\$1.6 million), the Department of Transportation (\$1.1 million), and the Department of Natural Resources (\$0.9 million).

Welfare & Human Services

Overage. The Welfare & Human Services program category itself was clearly not a primary player in November's disbursement story. Its role was really more secondary in nature, as it tossed in a \$21.0 million monthly overage that essentially neutralized a monthly underage of roughly the same magnitude generated by the Education program category (\$20.8 million).

There were three key contributors to the monthly overage posted in the Welfare & Human Services program category. The leading contributor was the Department of Mental Retardation & Development Disabilities (DMR) with a \$16.5 million monthly overage, the existence of which was largely obscured in Table 4 by underspending that cut the November overage in the program category's Human Services component down to \$7.2 million. DMR's monthly overage was fed by higher than expected spending on: 1) state subsidies to county boards for early childhood, adult, and case management services (\$8.9 million), 2) developmental center operating expenses (\$3.6 million), and 3) residential service provider payments (\$3.3 million). These overages were clearly timing-based, including adjustments to monthly underages that were recorded prior to November.

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
Fiscal Year-to-Date 2000
(\$ in thousands)

USE OF FUNDS					
PROGRAM	Actual	Estimate*	Variance	FY 1999	Percent Change
Primary & Secondary Education (1)	\$2,240,291	\$2,351,059	(\$110,768)	\$2,041,513	9.74%
Higher Education	1,116,204	1,111,173	5,031	1,051,348	6.17%
Total Education	\$3,356,495	\$3,462,231	(\$105,737)	3,092,861	8.52%
Health Care (Medicaid)	\$2,309,999	\$2,306,601	\$3,398	\$2,189,160	5.52%
Temporary Assistance to Needy Families (TANF)	333,599	383,596	(49,997)	\$343,874	-2.99%
General/Disability Assistance	25,895	24,597	1,298	\$26,005	-0.42%
Other Welfare	243,335	252,838	(9,502)	\$187,138	30.03%
Human Services (2)	586,467	643,458	(56,992)	546,574	7.30%
Total Welfare & Human Services	\$3,499,295	\$3,611,091	(\$111,796)	\$3,292,750	6.27%
Justice & Corrections	\$810,274	\$790,282	\$19,992	\$710,553	14.03%
Environment & Natural Resources	78,931	62,841	16,089	\$70,556	11.87%
Transportation	20,030	17,793	2,237	\$9,746	105.53%
Development	69,148	69,097	51	\$53,737	28.68%
Other Government (3)	201,654	220,733	(19,078)	\$186,681	8.02%
Capital	8,440	7,581	860	1,926	338.24%
Total Government Operations	\$1,188,479	\$1,168,328	\$20,151	\$1,033,199	15.03%
Property Tax Relief (4)	\$411,206	\$488,315	(\$77,109)	\$493,560	-16.69%
Debt Service	95,676	95,332	345	\$91,503	4.56%
Total Program Payments	\$8,551,151	\$8,825,297	(\$274,146)	\$8,003,872	6.84%
TRANSFERS					
Capital Reserve	\$0	\$0	\$0	\$0	N/A
Budget Stabilization	46,400	46,400	0	\$44,184	5.02%
Other Transfers Out	763,841	720,569	43,271	973,479	-21.53%
Total Transfers Out	\$810,241	\$766,969	\$43,271	\$1,017,663	-20.38%
TOTAL GRF USES	\$9,361,392	\$9,592,267	(\$230,875)	\$9,021,535	3.77%
(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, 1999 estimates of the Office of Budget and Management.					
<i>Detail may not add to total due to rounding.</i>					

The second contributor to the program category's monthly overage was the Health Care (Medicaid) component with a positive disbursement variance of \$12.1 million, due primarily to overspending of \$11.7 million and \$9.2 million in the "All Other" and "Medicare Buy-In" service categories, respectively. Disbursements for the "Medicare Buy-in" totaled \$20.0 million, roughly double the monthly estimate, and reflected inclusion of the December payment that was

made a monthly earlier than planned. The "Nursing Homes" service category exerted a braking effect on Medicaid's November overage by posting an \$11.6 million underage. (For a detailed breakdown of Medicaid's November disbursement variance by service category, see Table 6, Medicaid Spending.)

The third contributor to the program category's monthly overage was the Other Welfare component

with \$3.5 million, which includes all of the Department of Human Services activities exclusive of Medicaid, TANF, and General/Disability Assistance. The key pieces of this overage consisted of higher than estimated spending for non-TANF county administrative advances (\$5.0 million) plus a \$2.5 million disbursement for food banks. The budget bill contained temporary law addressing the matter of distributing these food bank funds through the GRF, but their disbursement was not included in the estimates for the department's FY 2000 spending. Numerous smaller underages in various other departmental line items combined to then cut Other Welfare's monthly overage roughly in half from what it would otherwise have been.

Underages. There were also four readily identifiable areas of the Welfare & Human Services program category with relatively small underages that worked to reduce the program category's monthly overage to \$21.0 million. The first such area involved the spending of the Department of Alcohol & Drug Addiction Services, which landed under its monthly disbursement estimate by \$5.6 million. Basically, second quarter subsidy allocations in line item 038-401, Alcohol and Drug Addiction Services, used for the purpose of providing alcohol and drug addiction prevention, intervention, treatment, counseling, and residential and community support services, were not disbursed to certain local boards as planned. Reportedly, several boards did not submit their required quarterly expenditure information to the department in November, so their funds were withheld.

The second underage area occurred in the Department of Mental Health's budget, which reported spending that fell short of the estimate by \$2.2 million. The source of this monthly underage was simply the timing of subsidy payments to local boards that are used to cover their operating expenses and provide mental health services to severely mentally disabled persons in the community.

The third underage area was found in the Temporary Assistance to Needy Families (TANF) program with November spending that was, given recent experiences, surprisingly under estimate by only \$2.0 million. For example, just one month before (October), TANF underspending was \$17.0 million, or 23.1 percent below the estimate. Unlike previous months, none of the negative disbursement variance in October or November was attributable to caseload decline. In fact, the number of recipients increased by

7,200 in October, and by another 2,000 in November. Cash benefits increased by over \$700,000 in October, and held steady in November. Much of the increase in recipients seemed to stem from changes in TANF's program rules that were required by the budget bill.

The fourth underage area barely hit \$1.6 million and was located in the Department of Health's budget. Driving Health's monthly underage was a delay in distributing \$2.0 million of subsidy funding for the state's 140-plus local health districts that did not occur as planned. Simple timing was afoot here. This pool of money represented the remaining portion of the \$4.0 million in FY 1999 subsidy funding for local health districts that was encumbered by the department for disbursement in FY 2000. One-half of this encumbered funding was previously released in September, two months later than was assumed.

Education

The Education program category closed November with a \$20.8 million negative disbursement variance that reflected the results of a battle between a \$45.1 million underage posted by the Department of Education and a \$22.0 million overage registered by the Board of Regents.

The monthly underage reported by the Department of Education was a function of delays in disbursing: 1) administrative cost reimbursement subsidies for chartered nonpublic schools (\$48.1 million), 2) subsidies for data acquisition sites that provide computer services on a regional basis (\$11.7 million), and 3) grants for alternative education programs (\$4.6 million). A large dent was made in this collective underage by a \$28.6 million overage recorded in the department's bus purchase allowance program, reflecting the fact that this subsidy funding, which was to be distributed to school districts and educational service centers in August, was finally released by the Controlling Board in November.

The monthly overage posted by the Board of Regents consisted principally of \$26.1 million in higher education subsidies that were released earlier than was assumed in the estimates for FY 2000 spending. This disbursement variance included \$19.9 million in "success challenge" funding designed to promote degree completion by "at-risk" students enrolled at the main campus of state-assisted universities along with \$6.2 million in "jobs challenge" funding directed

at state-assisted two-year college campuses in support of noncredit job-related training. A few line items combined relatively small underages to knock around \$4.0 million out the Board's month-ending overage, the most notable of which was \$3.0 million in student financial assistance that was not disbursed from the Ohio Instructional Grants program as planned. Presumably, as we have noted on prior occasions, some higher education institutions had not submitted the enrollment/eligibility data that would trigger the release of their student financial aid funding.

Year-to-Date

For the year-to-date, excluding transfers, the state posted a \$274.1 million negative disbursement variance, which actually represented a \$15.2 million drop in the size of the year-to-date underspending from when we last reported on the state's spending in our November 1999 issue. The major elements in that decline were what appeared to be principally timing-based overages lobbed into the disbursement picture from: 1) the property tax relief program in October, and 2) the Department of Rehabilitation & Correction, the Board of Regents, the Department of Mental Retardation & Developmental Disabilities, and the Medicaid program in November.

Our discussion of these program categories, arranged in order of the magnitude of their contribution to the state's year-to-date disbursement variance, commences below. The reader's attention is also directed to Table 5, which provides a more detailed picture of year-to-date disbursements by program category.

Welfare & Human Services

The Welfare & Human Services program category unsurprisingly led the year-to-date underage with a negative disbursement variance that totaled \$111.8 million, with the Education program category not far behind at \$105.7 million. There were two major contributors to the underage in the Welfare & Human Services program category: 1) Temporary Assistance to Needy Families/TANF (\$50.0 million), and 2) the Department of Mental Health (\$30.8 million).

TANF's \$50.0 million year-to-date negative disbursement variance, all of which registered in line item 400-411, TANF Federal Block Grant, was attributable to lower than anticipated advances to counties for administrative expenses, less spending on

"non-assistance" services than was estimated, and slower than expected billing for computer projects.

When we looked at the federal and state contributions to the TANF picture, we saw that there was also a key timing issue at work. TANF's year-to-date negative disbursement variance resulted from the mixing of \$81.9 million in underspending from line item 400-411, TANF Federal Block Grant, \$30.7 million of overspending from line item 400-410, TANF State, and \$1.2 million of overspending from line item 400-413, Day Care Match/MOE. Regular readers should recall that the rather large positive disbursement variance in line item 400-410 was wholly an issue of timing since the Department of Human Services decided to start spending toward Ohio's MOE (maintenance of effort) requirement for federal FY 2000 with an early contribution in September.

Running right behind the TANF underage was the Department of Mental Health (DMH) with a year-to-date negative disbursement variance of \$30.8 million, virtually all of which was traceable to the quarterly distribution of DMH's three largest GRF subsidy line items: 1) 334-408, Community and Hospital Mental Health Services, 2) 335-502, Community Mental Health Services, and 3) 335-508, Services for Severely Mentally Disabled. In anticipation of local boards experiencing a cash flow crisis induced by recent changes in the Medicaid reimbursement process, DMH planned to permit them to request a draw on their state subsidies up to one quarter ahead of time (previously discussed in our November 1999 issue). DMH's disbursement estimates were constructed to reflect the expectation that, as a result, local boards would opt to take their state subsidies earlier than historical experiences would suggest. That has not turned out to be the case, as many local boards have not opted to draw on their state subsidies any earlier than they would have in the past.

More distant contributors to the year-to-date underage in the Welfare & Human Service program category were the departments of Human Services (\$9.5 million), Mental Retardation & Developmental Disabilities (\$8.8 million), and Health (\$7.6 million).

The \$9.5 million year-to-date underage reported by the Department of Human Services, which is the sole occupant of the Other Welfare component in the Welfare & Human Services program category and excludes the department's Medicaid, TANF, and General/Disability Assistance programs, had many

ingredients, all of which tied back to contractual spending and subsidy distributions that were running either below or above estimates. Areas of the department's budget that were posting underages included computer projects (\$6.5 million), electronic benefits transfer (\$4.1 million), adoption services (\$2.9 million), child and family services (\$2.7 million), and child support administration (\$1.8 million). Their combined impact was in turn diluted by overages related to non-TANF county administrative advances (\$7.1 million) and food banks (\$2.5 million). These underages and overages were driven by a confluence of forces that included, in no particular order, timing, faulty estimates, program population changes, and administrative obstacles.

When November closed, the Department of Mental Retardation & Developmental Disabilities was left holding a negative year-to-date disbursement variance of \$8.8 million, 4.1 percent below the estimate. The two primary factors behind this underspending were line items 322-413, Residential and Support Services, and 323-321, Residential Facilities Operations, which tossed in underages totaling \$11.0 million and \$9.0 million, respectively. These year-to-date variances reflected, in the case of line item 322-413, the fact that service providers were not billing the department as promptly as had been anticipated, and, in the case of line item 323-321, the fact that the

department had chosen to cover the operating costs of its 12 developmental centers with a heavier mix of federal funds and less GRF money to this point in the fiscal year. It should be noted that trimming these underages was line item 322-501, County Board Subsidies, which had exceeded estimated spending on state subsidies to county boards for early childhood, adult, and case management services by \$8.5 million. This overage was no more than a matter of timing.

Virtually all of the Department of Health's negative \$7.6 million year-to-date disbursement variance was attributable to line items 440-505, Medically Handicapped Children, and 440-501, Local Health Districts, which recorded underages totaling \$4.0 million and \$2.0 million, respectively. Both line items were victims of timing. As noted in our November 1999 issue, the department decided to pay for services provided to certain children with medical handicaps by tapping more heavily into its non-GRF money first and then hitting its GRF appropriations later in the fiscal year. And, in the matter of the department's subsidies to local health districts, we have noted in many prior issues of this publication that there tends to be a gap between when their distribution is expected to occur and when the funding is actually released.

Table 6
Medicaid (400-525) Spending in FY 2000

Service Category	November '99				Year-to Date Spending		
	Actual	Estimate	Variance	Percent Variance	Actual thru' Nov.	Estimate thru' Nov.	Variance
Nursing Homes	\$176,840,482	\$188,431,050	(\$11,590,568)	-6.2%	\$865,026,873	\$890,186,035	(\$25,159,162)
ICF/MR	\$29,780,936	\$30,593,881	(\$812,945)	-2.7%	\$146,037,771	\$147,973,511	(\$1,935,740)
Hospitals	\$119,133,404	\$116,197,215	\$2,936,189	2.5%	\$511,511,087	\$503,380,903	\$8,130,184
Inpatient Hospitals	\$89,141,214	\$90,135,537	(\$994,323)	-1.1%	\$380,607,995	\$386,132,611	(\$5,524,616)
Outpatient Hospitals	\$29,992,190	\$26,061,678	\$3,930,512	15.1%	\$130,903,092	\$117,248,292	\$13,654,800
Physicians	\$26,743,291	\$27,801,887	(\$1,058,596)	-3.8%	\$117,129,480	\$120,794,899	(\$3,665,419)
Prescription Drugs	\$65,067,972	\$63,371,784	\$1,696,188	2.7%	\$265,241,381	\$263,121,878	\$2,119,503
Payments	\$82,494,587	\$79,480,496	\$3,014,091	3.8%	\$345,504,256	\$338,178,157	\$7,326,099
Rebates	\$17,426,615	\$16,108,712	\$1,317,903	8.2%	\$80,262,875	\$75,056,279	\$5,206,596
HMO	\$30,438,027	\$30,511,426	(\$73,399)	-0.2%	\$151,141,553	\$151,735,387	(\$593,834)
Medicare Buy-In	\$20,023,569	\$10,789,450	\$9,234,119	85.6%	\$61,222,062	\$53,939,175	\$7,282,887
All Other***	\$52,593,115	\$40,871,219	\$11,721,896	28.7%	\$192,688,703	\$175,473,079	\$17,215,624
TOTAL	\$520,620,796	\$508,567,912	\$12,052,884	2.4%	\$2,309,998,912	\$2,306,604,867	\$3,394,045
CAS	\$520,620,796		\$12,052,884	2.4%	\$2,309,998,911		\$3,394,044
Est. Federal Share	\$303,697,894	\$296,666,989	\$7,030,905		\$1,347,510,145	\$1,345,530,270	\$1,979,875
Est. State Share	\$216,922,902	\$211,900,923	\$5,021,979	2.4%	\$962,488,766	\$961,074,597	\$1,414,169

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

** Includes spending from prior year encumbrances in the All Other category.

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

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

Considerably smaller contributions to the year-to-date underage came from the departments of Alcohol & Drug Addiction Services (\$3.3 million) and Aging (\$2.6 million). The source of these underages was no more than the timing of subsidy payments.

We can't close this discussion of the Welfare & Human Services program category without some mention of the remarkable fact that Health Care (Medicaid) was playing virtually no role in the year-to-date disbursement picture, having posted a miniscule \$3.4 million overage. This bottom line variance actually concealed widely different spending patterns that were occurring within Medicaid's service categories. For example, three of Medicaid's service categories posted notable overages: 1) "All Other" (\$17.2 million), 2) "Outpatient Hospitals" (\$13.7 million), and 3) "Medicare Buy-In" (\$7.3 million). The impact of these service category overages was then diluted by a large \$25.2 million underage registered in the "Nursing Homes" service category. Although the "Medicare Buy-In" overage was a timing-based event that transpired in November, we were still searching for clues behind the variances in many of the other service categories and hope to offer some meaningful observations in our next issue. (For a detailed breakdown of Medicaid's year-to-date disbursement variances by service category, the reader is directed to Table 6, Medicaid Spending, on the previous page.)

Education

Year-to-date, the Education program category posted a \$105.7 million negative disbursement variance, almost entirely attributable to underspending in the Department of Education's budget that totaled \$107.0 million. The Ohio SchoolNet Commission chipped another \$3.8 million into the underage, with less funding than planned having been awarded in the form of technical and instructional professional development grants. Offsetting a small portion of these underages was the Board of Regents with a year-to-date overage slightly in excess of \$5.0 million.

The huge year-to-date underage thrown in by the Department of Education was principally a function of delays in disbursing: 1) administrative cost reimbursement subsidies for chartered nonpublic schools (\$48.1 million), 2) subsidies for data acquisition sites that provide computer services on a regional basis (\$11.0 million), 3) certain portions of disadvantaged

pupil impact aid (\$10.0 million), 4) classroom and community reading grants awarded under the recently enacted OhioReads program (\$9.1 million), and 4) portions of the state's special education enhancement funding (\$8.1 million).

The Board of Regents closed November with a positive year-to-date disbursement variance of \$5.1 million. Not obvious from the surface of this relatively small variance was its origin: the collision of two opposing and much larger overage and underage forces. The primary piece in the overage forces was the release of \$26.1 million in "success" and "jobs" subsidy funding to higher education institutions that had transpired earlier than planned, as we noted in our above discussion of disbursement variances for the month of November. The primary piece in the underage forces was \$21.1 million located in various student financial aid programs that had not been distributed as planned, which included Ohio Instructional grants (\$12.3 million), Student Choice grants (\$5.6 million), National Guard Tuition grants (\$1.8 million), and Part-Time Student Instructional grants (\$1.4 million). Timing was the principal fuel behind both of these overage and underage forces.

Property Tax Relief

Year-to-date, the Property Tax Relief program category, which distributes compensation to local governments for certain lost tax revenue, stood with a hard-to-ignore underage totaling \$77.1 million, pieces of which were located in the departments of Education (\$41.6 million) and Taxation (\$35.5 million). A closer examination of this year-to-date disbursement variance, in terms of the type of property tax relief distributed, revealed that spending was under the estimate by \$54.6 million in real property tax credits/exemptions and by \$22.5 million in tangible tax credits. This outcome was not alarming, as it was consistent with prior cycles of sizeable underages and overages in the state's property tax relief activity that self-correct over time.

Government Operations

The Government Operations program category ended November with a year-to-date \$20.2 million positive disbursement variance, composed principally of overages posted in two of its program components: 1) Justice & Corrections (\$20.0 million), and 2) Environment & Natural Resources (\$16.1 million). The state agencies fueling those overages included: the

Department of Rehabilitation & Correction (\$8.8 million), the Ohio Environmental Protection Agency (\$8.2 million), the Department of Natural Resources (\$7.9 million), and The Judiciary/Supreme Court (\$5.1 million). Assorted state agencies in the Justice & Corrections component, notably the Department of Youth Services, the Judicial Conference of Ohio, the Adjutant General, and the Office of the Attorney General, collectively provided another \$8.3 million to the program category's year-to-date overage.

Virtually all of the Department of Rehabilitation & Correction's year-to-date disbursement variance was traceable to various overages in the department's operating expense line items. The primary source of these departmental overages appeared to be timing, but some amount of uncertainty remained in our minds as to whether that was in fact truly the case.

The existence of year-to-date overages in the Department of Natural Resources (DNR) and the Ohio Environmental Protection Agency (Ohio EPA) were not a surprise, particularly in light of the observations made in our November 1999 issue. The disbursement estimates for these two state agencies failed to fully capture spending plans. In the case of DNR's disbursements estimates, they did not correctly reflect operational expenditures planned for the Division of Parks and Recreation, including the payment of central support service charges. And, in the case of Ohio EPA's disbursement estimates, they did not reflect the state agency's intent to hit their GRF funding first, exhaust that revenue stream, and then move on to spend their federal money.

A counterpunching underage of approximately half the magnitude of these overages was thrown in the mix from the Other Government component of the Government Operations program category (\$19.1 million). Leading this component's underage was the Department of Administrative Services with a year-to-date negative disbursement variance of \$15.5 million, 15.8 percent under the estimate. An extremely large proportion of this underage was a function of two factors: 1) slower than expected disbursements on computing and communications services to other

state agencies, and 2) lower than expected payments for rent and operating costs on certain state-owned buildings, including the State of Ohio Computer Center. More specifically, four computing and communications line items collectively tossed in a \$6.8 million underage that, in order of magnitude, included: 1) MARCS/Multi-Agency Radio Communication System (line item 100-417), 2) Year 2000 Assistance (line item 100-430), 3) Strategic Technology Development Programs (line item 100-416), and 4) Ohio SONET/State of Ohio Synchronous Optical Network (line item 100-419). An additional \$6.9 million in underspending was thrown in by four state building rent and operating cost line items. The fact that these two factors were playing a significant role in the department's year-to-date underage was not surprising. In the previous biennium, they were the key contributors to the building of relatively large end-of-year departmental underages in fiscal years 1998 and 1999.

Federal Money

It is important to remind the reader that many Department of Human Services activities, in particular Medicaid and TANF, are jointly funded by state and federal money that is appropriated as part of the GRF budget. Thus, some portion of the monthly or year-to-date disbursement variance that we might be analyzing at any point in time is likely to include federal money.

In terms of the disbursement of this federal money year-to-date, we readily identified \$81.9 million that was attributable to underspending in the federal share of TANF, plus a \$2.0 million year-to-date overage in the federal share of the state's Medicaid program. Once the federal money associated with TANF's underage was backed out, and an adjustment for the Medicaid overage was made, the year-to-date underspending in non-federal state GRF money was reduced from \$274.1 million to \$194.2 million. At year's-end, the reader is also reminded that any unspent federal TANF funding really represents money the state will have earned to spend at some point in the future, if the state has met its required maintenance of effort (MOE). □

**LBO colleagues who contributed to the development of this disbursement story included, in alphabetical order, Ogbe Aideyman, Laura Bickle, Brian Friedman, Sybil Haney, Eric Karolak, Steve Mansfield, Jeff Petry, Nelson Fox, Chuck Phillips, David G. Price, Jeffrey M. Rosa, and Wendy Zhan.*

School Facility Capital Spending

Since LBO routinely receives inquiries from members of the General Assembly as well as the public at large concerning the amount of moneys that have been appropriated and spent on school construction, it was decided to begin providing quarterly spending updates as a part of **Budget Footnotes**. These updates are comprised not only of what the state spent during the most recent quarter and for the year to date, but also the factors driving spending and the degree to which the School Facilities Commission (SFC) is progressing in disbursing appropriated moneys.

—Jeff Newman

Spending Patterns of Prior Fiscal Years

In order to put current spending levels in the proper context, it is helpful to first examine the recent history of school facilities spending. While the General Assembly has appropriated approximately \$1.6 billion since the creation of SFC in 1997, a major criticism remains that actual spending or disbursement levels have not kept up with the brisk pace of appropriations. While such criticism is understandable, the delay in disbursing appropriated moneys primarily lies in the fact that it took time to develop and implement program guidelines and to then get districts to the ballot. Further delaying spending has been the fact that once a district gets to the ballot and is approved, the size of most projects, as well as the necessity to sequence work in relation to the school year, means it will therefore take a number of years to spend these moneys once they are encumbered.

From the creation of SFC through the end of FY 1999, it had disbursed a total of \$329.6 million, with the majority of that amount (\$208.9 million or 63.4 percent) spent in FY 1999. While these spending figures are relatively small compared to the amount of moneys appropriated in recent years, they were on target with annual SFC goals. Of the \$329.6 million spent through the end of 1999, \$186.4 million (56.6 percent) was disbursed from Fund 32 (School Building Program Assistance Fund), while \$140.8 million (42.7 percent) came from Fund 21 (Public School Building Fund). Fund 32 is supported through the sale of bonds, while Fund 21 is supported through cash appropriations and interest income revenue. Although \$893.6 million in bonds have been authorized by the General Assembly since 1994 to support the state share of funding school construction, only of \$333.6 million (37.3 percent) of that amount had been issued through the end of fiscal year 1999.

Fiscal Year 2000 – First Quarter Spending

Through the first quarter of FY 2000, \$29.8 million (9.9 percent) of an annual goal of \$300 million had been disbursed, with \$18.4 million (61.9 percent) of that amount expended from Fund 32 and \$10.8 million (36.4 percent) from Fund 21. These two funds are used to support the Classroom Facilities Assistance Program (CFAP), as well as the Big Eight, Emergency Repair, Disability Access, and Exceptional Needs Programs. With the \$18.4 million expended from Fund 32 during the first quarter, the total amount of spending supported through bond sales increased to \$286.6 million. That being said, in order to meet continuing cash flow needs of the fund, the Treasurer of State issued an additional \$142 million in elementary and secondary education bonds in December 1999. These bonds are the first general obligation bonds issued under expanded authority recently granted through the approval of Issue One.

While the \$29.8 million disbursed through the first quarter of FY 2000 suggests that spending is behind schedule in terms of meeting the annual goal of \$300 million, SFC still anticipates reaching that goal. As for the slow start, SFC views it as a matter of timing the approved allocations and the erratic disbursement patterns of certain programs. Specifically, while it appears that the rate of spending in FY 2000 lags considerably behind the \$64.2 million disbursed in the first quarter of FY 1999, SFC attributes a large portion of this difference to the fact that during the same period in FY 1999 \$35 million was disbursed through the Big 8 and Emergency Repair Programs that have historically experienced uneven disbursement patterns. SFC believes that as the year progresses, the issues of timing will be resolved and that as construction schedules continue and additional projects come on line it should succeed in meeting its goal for the year. □

TANF Spending Update

LBO has decided to provide a quarterly update on the spending of state and federal TANF funds. This update will present not only the spending totals but also a break-out of spending by category and a running tally of the TANF federal reserve. Tracking these expenditures by the reporting categories should reveal the way expenditures shift in response to declining caseloads and an increased emphasis on welfare prevention and job retention strategies.

TANF EXPENDITURES BY COMPONENT, FFY 1997, 1998, 1999

— Steve Mansfield

The expenditure of federal TANF funds are reported to the federal government on a quarterly basis by category against the TANF federal grant award that was made in a specific federal fiscal year. Thus in a particular quarter, expenditures from federal funds may be filed simultaneously against the awards that were made in different years. In contrast to federal dollars, expenditures from state TANF funds are reported against the state's maintenance of effort (MOE) requirement, so that what is spent in a particular federal fiscal year counts against that year's MOE requirement.

Table 1 shows what has been spent by federal reporting categories from the federal TANF block grant awards that have been made beginning with the first TANF award in FFY 1997. *Table 2* shows what has been spent in each category to reach Ohio's MOE requirement. The right hand column in both tables shows each component's share of total spend-

ing to date from the TANF block grant (*Table 1*) or the state's MOE (*Table 2*). All TANF spending to date (both state and federal) totals \$2,482,539,761. The accumulated reserve of unspent TANF federal dollars totals \$733,871,851.

As a consequence of declining caseloads and a shift in the kind of program spending to more transitional services for those who have left OWF, as well as more intensive services for the "hard to serve" who remain on OWF, we are likely to see the overall proportion of spending for cash assistance decline relative to other TANF expenditures. However, the data in both *Table 1* and *Table 2* show that a large portion of state and federal funds is used to support cash assistance. It is also evident that a larger share of federal funds is employed for work activities, transitional services, and other expenditures as compared to the spending of state dollars, while state dollars are more prominently used for cash assistance. With

ITEMS	FFY 1997 Award	FFY 1998 Award	FFY 1999 Award	Expenditures To-Date	% of Total To-Date
Cash & Work Based Assistance	\$436,063,538	\$197,819,005	\$65,750,966	\$699,633,509	56.8%
Work Activities	3,034,139	16,113,133	4,260,906	23,408,178	1.9%
Child Care	0	29,416,442	0	29,416,442	2.4%
Administration	32,221,858	38,048,953	48,182,313	118,453,124	9.6%
Information Systems	0	14,562,288	31,370,732	45,933,020	3.7%
Transitional Services	0	3,858,137	0	3,858,137	0.3%
Other Expenditures	108,851,899	145,690,659	56,397,483	310,940,041	25.2%
TOTAL	\$580,171,434	\$445,508,617	\$205,962,400	\$1,231,642,451	100.0%
Federal Grant Award	\$727,968,260	\$727,968,260	\$727,968,260	\$2,183,904,780	
Transfer to Title XX	\$72,796,826	\$72,796,826	\$72,796,826	\$218,390,478	
UNSPENT FEDERAL RESERVE	\$75,000,000	\$209,662,817	\$449,209,034	\$733,871,851	

TABLE 2: OHIO MOE EXPENDITURES BY CATEGORY

ITEMS	FFY 1997	FFY 1998	FFY 1999	Expenditures To-Date	% of Total To-Date
Cash & Work Based Assistance	\$305,589,897	\$314,094,233	\$314,625,299	\$934,309,429	74.7%
Work Activities	8,912,399	624,678	408,315	9,945,392	0.8%
Child Care	45,628,354	51,850,611	49,435,554	146,914,519	11.7%
Administration	22,452,646	16,614,890	13,189,648	52,257,184	4.2%
Information Systems	0	5,068,027	3,345,493	8,413,520	0.7%
Transitional Services	0	0	0	0	0.0%
Other Expenditures	34,391,885	31,820,351	32,845,030	99,057,266	7.9%
TOTAL MOE	\$416,975,181	\$420,072,790	\$413,849,339	\$1,250,897,310	100.0%

the introduction of programs that are required to use “qualified state expenditures” (for example, the Kinship Care Services program required by Am. Sub.

H.B. 283 of the 123rd G.A.), the proportion of state dollars dedicated to cash assistance is likely to decrease. □

Issues of Interest

HISTORY OF PROPERTY TAXATION

FREDERICK CHURCH

Editor's note: Fred Church was the author of the status of Ohio's economy and revenues section until his departure for the Maryland Comptroller of the Treasury this past summer. Fred left behind a legacy of work at LBO that included the following short essay that was still in the "pipeline." We publish it now, with Fred's permission, as a companion piece to the article by Jeff Petry, "Inside Mill Switch," which follows.

The 1925 law that established the sexennial re-appraisal cycle for real property in Ohio also imposed a levy limitation. When the reappraisal law was enacted, there was concern in the legislature that the periodic reappraisals would result in "windfall" gains to local governments. As a result, the act was written so that increases in the value of existing property would not raise additional tax money from existing levies. Local governments could get additional tax money from three sources: new construction, unvoted ("inside") millage, or from voting additional levies.

Until 1976, the freeze on property tax revenue from increases in valuation was accomplished through the old "millage rollback" system. County auditors were responsible for the millage rollbacks. When the auditors reappraised real property in their counties, they would calculate the revenue that existing levies would generate from carryover property both before and after reappraisal. They would then reduce the millage rates in each taxing district, so that the new rate would yield the same revenue from existing property as before the reappraisal.

The Achilles heel of the old millage rollback system was that the new millage rates were applied to all property in the taxing district, real and tangible. Tangible property is not reappraised: it depreciates according to schedule. The millage rollbacks were therefore capable of producing a shift in the property tax burden from business to residences.

In fact, this shift in tax burden from businesses to residences was being partly forestalled by the county auditors. The law required that they assess all real property at the same percentage of true value, but in fact they were generally assessing businesses at a much higher percentage than residences and farms. The by-now famous Park Investment cases that began in the 1960s challenged the differential assessment rates.

The Park case dealt with Cuyahoga county assessment practices. Old sales ratio studies suggest that other counties were also assessing residential property below 35 percent and business property above 35 percent, but the variation in assessment was not as large in most counties as in Cuyahoga. Some sources say that business property generally was only being assessed at around 40 percent of market value.

Based on the uniform rule clause of the Ohio Constitution (Article XII, Section 2), the Ohio Supreme Court issued a series of orders that required the Board of Tax Appeals (BTA), which then oversaw the administration of the real property tax, to ensure that counties did uniform assessment. At the time, county auditors were assessing real property in such a way that *aggregate* assessed value was 35 percent of market value, but business property was being assessed at 50 percent or more, while residential and agricultural property was being assessed in the 15 to 20 percent range.

After some debate, the legislature passed a law allowing the required assessment changes to be phased in as each county went through its reappraisal cycle. As it happened, this was occurring in the mid-1970s, when home prices were increasing very rapidly. This meant that residential property would be facing an assessment increase of 15 to 20 percentage points on a greatly increased market value. Since the millage rollbacks were also applied to non-residential real property, the millage rollbacks would undercompensate homeowners for their increased value, while business property would be overcompensated. This shift in burden was exacerbated by the fact that tangible property also received the benefit of the millage rollbacks.¹

The legislature responded to this by passing H.B. 920 of the 111th General Assembly in 1976. This replaced the old millage rollbacks with the current system of tax reduction factors (TRFs) that apply only to real property.² The bill also created the Department of Tax Equalization (now a division within the Tax Department) to oversee property tax administration and calculate the TRFs. Finally, HB 920 also began a series of assessment percentage reductions that reduced the assessment on inventories from 45 percent to 35 percent, and on all other tangible property (except public utility property) from 50 percent to 35 percent. There were growth triggers and other phase-in provisions. Subsequent legislation set the tangible property assessment percentage at 35 percent in 1983, with additional one percent annual reduction until the assessment percentage hit its current level of 25 percent in 1993.³

One further important change was made to the TRFs to produce the system that we have today. The uniform rule requirement was altered in 1980 by adoption of Section 2a, Article XII, which split real property into two classes, residential/agricultural and all other, so that separate reduction factors could be calculated for each class of property.

To summarize, the present system of tax reduction factors is not really doing anything different than Ohio has been doing for seven decades. The real difference from the old millage rollback system is that, all other things constant, it tends to shift the burden of taxation from real property to tangible property.

In real life, however, all other things are not held constant. Table 1, below, shows that between tax year 1975 (the last year before H.B. 920) and tax year 1997, the actual percentage of taxes paid on real property has increased from 61.8 percent of the total to 71.5 percent of the total, an increase of almost 10 percentage points. Most of the decrease has been in “general business” tangible property, rather than public utility property. Of course, the revisions to the taxation of telecommunications property beginning with tax year 1995 have blurred the line between what is general business property and what is public utility property although even the telecommunications property assessed a 25 percent is still included in public utility property. That line will get even blurrier when S.B. 3 reduces the assessment percentage on non-generation electric property to 25 percent.

If the percentage of tax from each category had stayed at its 1995 amount (e.g. if the real property tax had stayed at 61.8 percent of the total), then to raise \$8,794.3 million, real property taxes would have been \$850 million lower, and tangible property taxes would have been \$850 million higher. This is clearly a huge burden shift, and one that runs counter to the notion that the HB 920 system shifts the burden from real to tangible taxes.

What happened between 1975 and 1997? As we said above, in the real world, all other things are not held constant. For one thing, the assessment percentages on tangible property, including some public utility property, have been sharply reduced. Inventory property has been reduced from 45 percent to 25 percent assessment, and is to be phased out completely under the biennial budget act, H.B. 283. Other tangible prop-

Tax Type	1975 Property Taxes		1997 Property Taxes		Avg Annual Compound Growth Rate, 1975-1997
	Amount	%	Amount	%	
Real Property, After Relief	\$1,431.1	61.8%	\$6,289.0	71.5%	7.0%
Tangible Property	\$598.9	25.9%	\$1,519.3	17.3%	4.3%
Public Utility Tangible Property	\$283.9	12.3%	\$985.9	11.2%	5.8%
Total Property Taxes	\$2,313.9	100.0%	\$8,794.3	100.0%	6.3%

Note: This comparison excludes intangible property taxes, which did not exist in tax year 1997.

Tax Type	1997 Actual Property Taxes	1997 Hypothetical Property Taxes, No HB 920	Difference: Actual Minus Hypothetical	Percentage Difference
Real Property	\$6,289.0	\$5,561.0	\$728.0	11.6%
Personal Property	\$1,519.3	\$1,917.7	(\$398.4)	-26.2%
Public Utility	\$985.9	\$922.7	\$63.3	6.4%
Total	\$8,794.3	\$8,401.4	\$392.9	4.5%

Note 1: Hypothetical 1997 taxes assume that assessment rates and millage rates were left at 1975 levels, but that there were no reduction factors to limit growth in real property taxes.

Note 2: In 1975, there was no 2.5% property tax rollback. The homestead exemption existed, but the parameters were different than in 1997. To facilitate comparison, 1997 hypothetical taxes were estimated, assuming that the 2.5% rollback and the homestead exemption provided the same percentage reductions in real property taxes as they did in 1997.

erty has been reduced from 50 percent to 25 percent assessment. In 1975, almost all utility property was assessed at 100 percent of “true value”, rural electric companies being the exception. The average assessment rate on utility property as a whole was close to 100 percent. For tax year 1997, only 20 percent of utility property was still assessed at 100 percent, and the overall average assessment rate had fallen to 74 percent. Other things in the business world have also changed. Industrial employment has fallen and service employment increased. Services use far less business property. The housing world has also changed with new homes much larger than in 1975. Also there are substantially more households and thus more housing units.

It is a little-recognized fact that this reduction in the assessment percentage on tangible property was started in H.B. 920 itself. Annual assessment percentage reductions were set in motion to reduce assessment percentages on tangible property to 35 percent. So, the original legislation recognized the potential for a burden shift and sought to balance that change with a roughly offsetting reduction in assessment percentages.

An interesting “thought experiment” can be done calculating what 1997 property taxes would have been if assessment percentages had been left at their 1975 levels, and millage rates had stayed at their 1975 levels also. The results of this calculation are shown in Table 2, above.

This thought experiment produces some interesting results. First, a system of taxation that had left assessment percentages and millage rates alone, but allowed all valuation increases to be fully felt by taxpayers (which is not the same as simulating the old millage rollback system) produces less money overall than the current system. Of course, one cannot determine if taxpayer behavior would have been the

same under such a system, so one cannot say whether valuation growth would have been the same. Nevertheless, this can be used as a rough indicator that the H.B. 920 system of rolling back real property taxes is not doing very much, if anything, to hold back aggregate revenue growth.

Just as in the case where we asked what real property taxes would have been in a constant-percentage case, we see that the current real property tax burden is higher than in the hypothetical case. The increase in real property tax burden here is \$728 million rather than \$850 million, but that is still a substantial amount. Public utility taxes also see a burden increase, despite assessment percentage reductions, because millage rates grew so much from 1975 to 1997. General business tangible property taxes are \$398 million less than they would have been in a constant assessment, constant millage world. In summary, the existing system of property taxation has caused taxes to be higher than if millage rates and assessment percentages had been frozen, and valuations (the tax base) had been allowed to grow unchecked. In summary, the net result is an increase in total property taxes paid, with real property taxes increasing by more than the whole amount so that the burden on tangible property could be reduced.

Another way of looking at the changes in property taxation between 1975 and 1997 is to examine overall effective tax rates. That is, what percentage of market value, or depreciated value, or “true value” is actually being paid in taxes, after tax relief is subtracted? Table 3 shows that effective tax rates on real property rose between 1975 and 1997, despite the H.B. 920 tax reduction factors. Effective tax rates on tangible property fell, as the decreases in assessment percentages more than offset the increases in millage rates that resulted from tangible property no longer sharing in millage reductions. The overall effective tax rate on all property increased slightly be-

Property Tax Type	Tax Year 1975			Tax Year 1997		
	Market Value, Depreciated Value, or True Value	Taxes Paid	Effective Tax Rate	Market Value, Depreciated Value, or True Value	Taxes Paid	Effective Tax Rate
Real Property Taxes, After Tax Relief	\$101,114.6	\$1,431.1	1.42%	\$392,985.3	\$6,289.0	1.60%
Tangible Property Taxes	\$26,196.6	\$598.9	2.29%	\$83,920.8	\$1,519.3	1.81%
Public Utility Tangible Property Taxes	\$6,238.0	\$283.9	4.55%	\$19,541.8	\$985.9	5.05%
Total	\$133,549.2	\$2,313.9	1.73%	\$496,447.9	\$8,794.2	1.77%
Property Tax Type				Property Taxes at Constant Effective Tax Rates	Actual Taxes Paid	Difference
Real Property Taxes, After Tax Relief				\$5,562.0	\$6,289.0	\$727.0
Tangible Property Taxes				\$1,918.6	\$1,519.3	(\$399.3)
Public Utility Tangible Property Taxes				\$889.4	\$985.9	\$96.5
Total				\$8,370.0	\$8,794.2	\$424.2

tween 1975 and 1997, rising from 1.73 percent to 1.77 percent.

A problem with this analysis is that the market value figures for real property were calculated using assessed values and working back to market values, assuming the statutory assessment percentage of 35 percent. However, sales ratio studies by the Department of Taxation show that actual assessment rates on real property are generally less than 35 percent. Sales ratio studies by the department for calendar year (CY) 1996 show that average assessment rates on real property, based on properties actually sold, were only 29.975 percent. If this were the average assessment percentage on all property then market value would be higher than that shown in Table 3, and the average effective tax rate would be lower (approximately 1.37 percent instead of 1.60 percent). However, sales ratio analysis for 1975 found that average assessment rates on real property were 28.25 percent. So, if those assessment percentages were used to derive market value in 1975, the effective tax rate on real property that year would have been 1.14 percent rather than 1.42 percent. So the conclusion is not changed. The numbers in Table 3 show the effective tax rate on real property rising from 1.42 percent to 1.60 percent; using the sales ratio studies results in the rate rising from 1.14 percent to 1.37 percent. What it does mean is that the dollar figures shown for the burden shift must be regarded as estimates.

The bottom half of Table 3 shows that, using the estimates of effective tax rates, real property taxes were \$727 million higher in tax year 1997 than they would have been if overall effective tax rates had remained constant. In contrast, general business tangible taxes were \$399 million lower than they would have been with constant tax rates. Finally, public utility property taxes were \$96 million higher than they would have been with constant effective rates, and total property taxes were \$424 million higher than they would have been.

Not all of the increase in the burden borne by real property taxpayers is from increases in effective tax rates. Over the 1975 to 1997 period, the underlying real property tax base (estimated market value) increased by 289 percent, while the value of tangible property increased 220 percent, and the value of utility tangible property increased by 213 percent. The increase in the tax burden on real property was thus driven by two factors: faster growth in the underlying tax base, and higher effective tax rates. So, part of the increase in the burden on real property was due to economic reasons, while part was due to Ohio's property tax system (and the choices of local voters).

All this is not done in an attempt to show that tangible property taxes should not have been cut. On the contrary, much research, including the work of the Committee to Study the Ohio Economy and Tax

Structure (CSOETS) has concluded that Ohio's tangible property taxes are still a hindrance to the state's competitive position, even after the assessment reductions that have been made and are still happening. The proper question is, if tangible property taxes needed to be reduced for economic reasons, should real property taxes have shouldered so much of the burden of replacing them? Or, should that have been accomplished through spending controls, increases in other taxes, or a combination of both?

The recommendations of the CSOETS emphasized shifting Ohio's tax system from one that taxed investment, whether in tangible property or in other things, to one that taxed consumption. While on the surface the taxation of real property looks like taxation of investment, in fact there is a sizable consumption component. In tax year 1997, residential and agricultural property value (assessed) was 75.3 per-

cent of all real property value. Residential property was 93.7 percent of the residential and agricultural total, or 70.6 percent of all real property. Some residential property is held for investment purposes, but the bulk of it is used to provide housing services to the people who live in it. That is, most of it is in fact used for consumption purposes. The shift in the burden of property taxation from tangible property to real property over the 1975 to 1997 period does in fact, for the most part, meet the test of shifting the burden from investment to consumption.

This still leaves open the question of whether it would have been better to shift the burden to a more broad-based consumption tax, such as the sales tax, rather than one that fell on the consumption of a particular good, namely housing. That question will doubtless be the subject of further debate by the General Assembly.

¹ In fact, the history of property tax growth limitations is more tangled than this compressed retelling shows. For example, temporary law in budget bills actually allowed for some revenue growth from existing voted school district levies (no others) on carryover property from 1967 through 1970. Only some districts were able to take advantage of this revenue growth.

² For further explanation of the tax reduction factor mechanism, please see the article titled "The Ominous Tax Reduction Factor" in LBO's November, 1999 issue of Budget Footnotes at <http://www.lbo.state.oh.us/footnotes/>.

³ Am. Sub. H.B. 283 of the 123rd General Assembly eliminates the personal property tax on inventory over a 25 year period by reducing the assessment percentage by 1 percent per year beginning in Fiscal Year 2002. For further information, please see the LBO Final Analysis on Tax Law Changes at <http://www.lbo.state.oh.us/ohbudget/opanalysis/finalanalysis/>.

INSIDE MILL SWITCH: LESS LEVIES TO VOTERS OR UNKNOWN TAX INCREASE?

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JEFF PETRY
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A method, commonly referred to as the “inside mill switch,” has recently become popular with a small group of Ohio school districts. It allows the district to gain a little additional revenue without voter approval. The issue has come to light in last year in Columbiana County where almost all of the school districts have switched a majority or portion of their inside mills from operating to capital purposes. The maneuver is a technical reclassification of property tax mills, one that is not clearly understood by district residents. This article seeks to explain property taxes in general; then focuses on how the inside mill switch is done and its possible fiscal ramifications.

Constitutional Background

Taxation of real and tangible property consists of two tax levy types: (1) Inside tax levies and (2) outside tax levies. The terms inside and outside are commonly used to refer to the guidelines set forth in the Ohio Constitution that no property shall be taxed in excess of one percent of true value, which is defined in terms of an assessment rate (a certain percent of market value), without voter approval (Article XII, Section 2).¹ Inside tax levies are those levies up to one percent that may be levied without voter approval in a tax district and outside levies are the levies that require tax district voter approval due to bringing the tax rate over the one percent limitation. Property tax

nomenclature refers to tax levies in terms of millage rates and not percentages, where one mill is equal to one-tenth of one-percent or 0.1 percent. Therefore, the state constitution allows for up to ten mills (one percent) to be levied by a tax district without voter approval.

Comprehension of inside and outside tax levies is important to understanding a property owner’s tax bill. Three types of property taxes may be levied at the local level by a tax jurisdiction. The tangible personal property tax is applied to machinery, equipment, and inventories used by businesses in Ohio at an assessment rate of 25 percent.² The real property tax (Class I and Class 2 properties) is applied to land and its improvements at an assessment rate of 35 percent. While real property tax levies are annually adjusted to limit the effects of property value inflation (commonly referred to as the H.B. 920 reductions), the tangible property tax does not have such a mechanism.³ The third type of property tax is levied on public utility tangible property.⁴

School District Property Tax Levies

School districts may levy a variety of both voted and unvoted taxes on all three types of property (see Real Property Tax Levy Types box).

Real Property Tax Levy Types

- *Operating Levy* – Used for a school district’s general operating expenses and may be used for any expense.
- *Permanent Improvement Levy* – Generates an annual income for new buildings, repairs, parking lots, etc.
- *Emergency Levy* – Generates a specific amount of annual income for emergency expenses and only lasts 1-5 years (no legal definition of emergency expense)
- *Debt Service Levy* – Generates a specific amount of annual income to retire debt.

*Ensuring a Minimum Local Effort***Property Tax Levies Subject to H.B. 920 Reduction Factors**

Voted Operating Levies (Outside Millage)
Voted Permanent Improvement Levies (Outside Millage)

Property Tax Levies Not Subject to H.B. 920 Reduction Factors

Unvoted Operating Levies (Inside Millage)
Unvoted Permanent Improvement Levies (Inside Millage)
Unvoted Debt Service Levies (Inside Millage)
Voted Debt Service Levies (Outside Millage)
Voted Emergency Levies (Outside Millage)

While levies are adjusted when property values change, school districts are required to levy the equivalent of 20 mills dedicated to current operating expenses in order to qualify for state aid. This is done to insure at least a minimum local effort by every school district.⁶ Therefore, school district revenues are protected from H.B. 920 reduction factors

if the impact of these reductions would cause the millage dedicated to the payment of current operating expenses to fall below 20 mills. This is referred to as the H.B. 920 20-mill floor. It is important to note that the H.B. 920 20-mill floor applies only to current operating expenses levies, which means that any millage levied for purposes other than the payment of current operating expenses are not included in the mix when determining if the district is at the H.B. 920 20-mill floor. Therefore, bond levies, permanent improvement levies, and emergency levies are all “off” the floor.

The “Switch”

Under current law, any school board may pass a resolution at a public hearing to reclassify all or a portion of their allocated inside mills from operating expenses inside mills to non-operating expenses inside mills. The maneuver is commonly referred to as the millage switch.⁷ This action removes those inside mills from the H.B. 920 20-Mill Floor calculation, moving the district marginally or significantly closer to the 20-mill floor. A recent factor aiding movement toward the H.B. 920 20-mill floor is the new requirement that school districts set aside four percent of revenues for improvements and repairs as required by H.B. 412 of the 122nd General Assembly. Either the general fund or a permanent improvement levy, or both, can be used for this purpose. However, this constraint will make it more likely that a permanent improvement levy, which does not count

Unvoted Tax Levies – Inside Mills

School districts received an average of 4 to 6 inside mills (unvoted taxes levied under the Ohio Constitution) based on the share the school district received in the five years leading up to 1935. Inside mills are not subject to H.B. 920 reductions and may count towards the H.B. 920 20-mill floor (see H.B. 920 20-Mill Floor text box). Inside millage may be used for operating levies, permanent improvement levies, and debt service (see Real Property Tax Levy Types text box). Until recently, school districts used the inside mills almost exclusively for current operating expenses while other units of government used them for the full range of possible purposes.

Voted Tax Levies – Outside Mills

With voter approval, school districts may levy property taxes outside of the 10-mill limitation for current operating expenses, permanent improvements, repayment of long-term debt in the form of bond issues, and to cover “emergency” expenses (see Real Property Tax Levy Types text box).⁵ Voter approved levies are of two types based on whether or not they are subject to H.B. 920 reduction factors. Levies subject to H.B. 920 reduction factors are voted operating levies and voted permanent improvement levies. The second type of levy is for a fixed amount, so it doesn’t grow at all and therefore is not subject to H.B. 920 reduction factors. Debt service and emergency levies comprise this type.

H.B. 920 20-Mill Floor Guarantee

H.B. 920 guarantees that each school district receives at least 20 mills (2 percent) worth of tax revenue for a school district’s *current operating expenses*.

Current Operating Expenses are defined as the inside mills **designated** as operating expenses plus voted operating levies, or:

Current Operating Expenses = Designated Inside Operating Mills + Voted Outside Operating Levies

Property Taxes Increase for the Following Reasons:

- Inside Millage applied to higher assessed values.
- Property improvements (new construction)
- New voted Tax Levies
- 20 Mill Floor
 - *Voting Evolution* – Effective Tax rate of voted levies decreases over time.
 - *Strategic Action* – Rearranging millage rates to quicken voting evolution.

towards the 20-mill floor, is put to the district's voters in lieu of a general operating levy, or a millage switch is used. Either way moves more districts towards the floor in the long run.

One benefit of reclassifying inside mills and reaching the 20-mill floor is that a school district does not have to continually bombard district residents with levies on the ballots for voter approval. Reclassification of inside mills provides additional revenue for the district and allows school district staff to pursue their duties instead of campaigning for ballot levies. The district simply announces and passes the resolution at a public hearing (e.g., school board meeting) to reclassify the inside mills to receive additional revenue.

For property tax payers, the downside to the reclassification is that it leads to additional revenues — i.e., districts residents are paying more in their property tax bills. Given the complexity of property taxation, the average homeowner may not fully understand the impact of the reclassification resolution until their property tax bill arrives. This may result in the property owner calling their school boards, county auditors, and legislative representatives upset with the tax increase.

Determining which districts have reclassified inside operating mills to inside non-operating mills may be seen in at least two publicly published data sets: School District Abstracts and Property Tax Rate Abstracts.⁸ The School District Abstract Data sets shows average inside mills designated for operating

expenses have gradually decreased from 4.67 mills in 1994 to 4.61 mills in 1998. This is not big statewide decrease, but is noticeable considering the number is an average of 611 school districts. The Property Tax Rate Abstract

shows every enacted and continuing property tax levy in a given year. Analysis of levies show that approximately 37 school districts were not using a portion of inside mills for current operating expenses in 1997 (cumulative through 1997). Of these 37 school districts, 19 reclassified 1.00 inside mills or greater to non-operating inside mills, with the maximum reclassification being 5.10 inside mills. Columbiana County alone accounts for 7 of the 19 with more than one mill (data through 1997), districts and has the five highest inside mill reclassifications (5.1, 4.6, 4.1, 2.5, and 2.0).⁹

District Type that Benefits from the Switch

Reclassifying inside operating mills to inside non-operating mills can provide a revenue boost to school districts, but only a certain type of district would notice anything more than a marginal increase in revenues. Therefore, three examples have been created which represent identical homeowners who are located in a school district not close to the 20-mill floor, a school district near the 20-mill floor, and a school district at the 20-mill floor. Initially, the only difference in the districts is the amount of local tax effort shown in the operating effective mills. Each homeowner's property will then go through a property valuation reappraisal, with each example showing before appraisal and after appraisal taxes paid on the different types of levies. But, before reappraisal occurs, the local school board passes a resolution to reclassify a large part of the school district's inside operating mills to inside non-operating mills (the "switch"). A second column is presented to show

H.B. 920 20-Mill Floor

Enacted in 1976 by the 121st General Assembly (see History of Property Taxation article in this issue), the bill enacted Ohio's present system of tax reduction factors along with guaranteeing that each school district receives at least 20 mills (2 percent) worth of tax revenue for a school districts current operating expenses and not allowing tax reduction factors to push effective millage rates below this level. When reduction factors do push effective millage rates below 20 mills in a school district, the Tax Commissioner must recalculate the tax reduction factors to keep 20 effective mills. In order to qualify for the 20 mill floor a school district must have levied at least 20 mills of local funding effort (A minimum millage provision is a common national requirement for schools.). All school districts in Ohio have shown such effort and qualify for the 20-mill floor.

what property taxes would have been if the resolution had not been passed. In each example, the percentage and dollar increase in taxes is presented for both the millage switch case and the no millage switch case. The bottom-most line, shaded in gray, tells the additional revenue each identical homeowner paid due to the school board reclassifying inside millage.

For each example, the following assumptions are made:

1. The initial market value of the home is \$100,000 (approximate statewide average).
2. The taxable value of the home is therefore \$35,000 (35 percent assessment rate).
3. Each school district has 5 inside mills classified for operating expenses.
4. Each school district has 3 outside mills for permanent improvements.
5. Each school board passes a resolution reclassifying 4 inside operating mills to 4 non-operating inside mills for permanent improvements.
6. The market value of each home after reappraisal is \$125,000 (25 percent increase). This percentage increase was chosen for simplicity in the example.
7. The taxable value of each home is therefore \$43,750 (35 percent assessment rate).

School District 1 – Not Close to the H.B. 920 20-Mill Floor

School District Type 1 has a lot of voted levies (40 operating effective mills) and is nowhere near the H.B. 920 20-mill floor with 45 total operating mills (Operating inside mills + Operating effective mills). Before re-appraisal, the homeowner's total effective millage rate is 48.0 mills, generating a tax liability (property tax bill) of \$1,680.00. A breakdown of tax

liability shows that the operating inside mills generates \$175.00, operating effective mills generate \$1,400.00, and the voted permanent improvement levy generated \$105.00.

The next tax year comes with both a reappraisal that increases the home's value by 25 percent and a school board resolution is passed reclassifying four inside operating mills to inside non-operating mills dedicated to a permanent improvement project. This reduces operating inside mills from five mills to one mill. Operating effective mills are reduced by tax reduction factors that allow only \$1,400 to be generated on the voted levies. With the reappraisal, operating effective mills are reduced from 40 mills to 32 mills and, thereby, generate \$1,400 in tax revenue. The same holds true for the voted permanent improvement levy, which is reduced from 3.0 mills to 2.4 mills after reappraisal to maintain \$105.00 in tax revenue from the voted levy. The new inside mills permanent improvement levy (*italicized*) of 4.0 mills generates \$175.00 after reappraisal. The homeowner's property tax liability is \$1,723.75, which represents a \$43.75 increase over the previous years property tax liability.

Comparing the after reappraisal mill reclassification scenario to the no reclassification scenario, the homeowner's property tax liability is also \$1,723.75, an increase of \$43.75 or 2.6 percent in tax liability. Exactly the same as if the school board reclassified inside millage! This is due to the school district being well above the H.B. 920 20-mill floor. Therefore, the school district receives no additional revenue in the short-term from inside mill reclassification.

It is possible that in the long run, given voter preferences of not voting new or renewing existing lev-

School District 1 – Not Close to the H.B. 920 20-Mill Floor						
<i>Before Re-Appraisal</i>			<i>After Re-Appraisal</i>			
Appraised Value	\$100,000		\$125,000			
Taxable Value	\$35,000		\$43,750			
School District Levies	Mills	Revenue	<i>Reclassification</i>		<i>No reclassification</i>	
			Mills	Revenue	Mills	Revenue
Operating Inside	5.0	\$175.00	1.0	\$43.75	5.0	\$218.75
Operating Effective	40.0	\$1,400.00	32.0	\$1,400.00	32.0	\$1,400.00
Voted Perm. Improvement	3.0	\$105.00	2.4	\$105.00	2.4	\$105.00
<i>Inside Perm. Improvement</i>			4.0	\$175.00		
Total Operating	45.0	\$1,575.00	33.0	\$1,443.75	37.0	\$1,618.75
Total Effective/Tax Liability	48.0	\$1,680.00	39.4	\$1,723.75	39.4	\$1,723.75
		Tax Liability Increase (\$)		\$43.75		\$43.75
		Tax Liability Increase (%)		2.6%		2.6%
Increase in homeowner's tax liability due to reclassification:				\$0.00		

ies, for the school district to “fall” to the H.B. 920 20-mill floor, where such a move would provide additional revenues (as in the following examples). This can be seen in the number of total operating mills. The school district has 33 total operating mills with reclassification and 37 operating without reclassification. The switch moved the district marginally closer to the H.B. 920 20-mill floor, even though total effective mills stayed the same at 39.4 mills.

District 2 – Near the H.B. 920 20-Mill Floor

School District 2 is near the H.B. 920 20-mill floor (21 operating mills) and will likely fall to the floor after re-appraisal. Before re-appraisal, the homeowner’s total effective millage rate is 24.0 mills, generating a tax liability (property tax bill) of \$840.00. A breakdown of tax liability shows that operating inside mills generate \$175.00, operating effective mills generate \$560.00, and the voted permanent improvement levy generated \$105.00.

With Reclassification

The next tax year comes with both a reappraisal that increases the home’s value by 25 percent and a school board resolution reclassifying four inside operating mills to inside non-operating mills dedicated to a permanent improvement project. This reduces operating inside mills from five mills to one mill. The action also removes 4 inside mills from the calculation of the H.B. 920 20-mill floor, leaving the school district before reappraisal with 17 operating mills and, therefore, under the minimum millage level. Because the district had voted at least 20 mills for operating expenses, H.B. 920 will not allow operating mills to go below 20 mills. Therefore, reappraisal will force the standard tax reduction factor calculation to be

suspended and require the Tax Commissioner to maintain 20 operating mills. Here, one operating mill is an inside tax levy and the remaining operating effective mills will be increased from 16 mills to 19 mills to achieve the necessary 20 mills. Therefore, because the school district was near the floor and removed 4 inside mills from the operating expenditures classification, operating effective mills will generate more than \$560.00 in revenue. This district’s operating effective mills will generate \$831.25, a \$271.25 increase on voted operating effective levies.

Because voted permanent improvement levies are not subject to H.B. 920, \$105 will be generated from the new, lower effective rate of 2.4 mills, which is the same as in previous example. Operating inside mills will generate \$43.75 and permanent improvement inside mills generates \$175.00 with inside mill reclassification (italicized), also the same as in the previous example. Total effective mills actually increase from the before re-appraisal 24.0 mills to 26.4 mills due to the district millage rate structure being close to the H.B. 920 20-mill floor and reclassification of inside mills.

With No Reclassification

In the case of no reclassification, inside mills generate \$218.75, which is the sum of both inside mill levies with reclassification. This school district drops to the H.B. 920 20-mill floor, but will not fall below the floor. Total effective mills decrease from the before re-appraisal 24.0 mills to 22.4 mills.

Overall, the homeowner will see a \$315.00 (37.5 percent) increase in their tax liability with reclassification but would have only seen a \$140.00 (16.7 percent) increase with no reclassification. The result

School District 2 – Near the H.B. 920 20-Mill Floor							
<i>Before Re-Appraisal</i>				<i>After Re-Appraisal</i>			
Appraised Value		\$100,000		\$125,000			
Taxable Value		\$35,000		\$43,750			
School District Levies	Mills	Revenue	<i>Reclassification</i> Mills	Revenue	<i>No reclassification</i> Mills	Revenue	
Operating Inside	5.0	\$175.00	1.0	\$43.75	5.0	\$218.75	
Operating Effective	16.0	\$560.00	19.0	\$831.25	15.0	\$656.25	
Voted Perm. Improvement	3.0	\$105.00	2.4	\$105.00	2.4	\$105.00	
Inside Perm. Improvement			4.0	\$175.00			
Total Operating	21.0	\$735.00	20.0	\$875	20.0	\$875.00	
Total Effective/Tax Liability	24.0	\$840.00	26.4	\$1,155.00	22.4	\$980.00	
				Tax Liability Increase (\$)		\$315.00	
				Tax Liability Increase (%)		37.5%	
Increase in homeowner’s tax liability due to reclassification:				\$175.00			

School District 3 – At the H.B. 920 20-Mill Floor						
Before Re-Appraisal			After Re-Appraisal			
Appraised Value		\$100,000	\$125,000			
Taxable Value		\$35,000	\$43,750			
School District Levies	Mills	Revenue	<i>Reclassification</i>		<i>No reclassification</i>	
			Mills	Revenue	Mills	Revenue
Operating Inside	5.0	\$175.00	1.0	\$43.75	5.0	\$218.75
Operating Effective	15.0	\$525.00	19.0	\$831.25	15.0	\$656.25
Voted Perm. Improvement	3.0	\$105.00	2.4	\$105.00	2.4	\$105.00
<i>Inside Perm. Improvement</i>			4.0	\$175.00		
Total Operating	20.0	\$700.00	20.0	\$875	20.0	\$875.00
Total Effective/Tax Liability	23.0	\$805.00	26.4	\$1,155.00	22.4	\$980.00
		Tax Liability Increase (\$)		\$350.00		\$175.00
		Tax Liability Increase (%)		43.5%		21.7%
Increase in homeowner's tax liability due to reclassification:				\$175.00		

from the school board passing a resolution to pull inside mills from the operating floor formula is a \$175.00 increase in tax liability for the homeowner. This is an immediate revenue gain for the school district and could amount to a considerable sum contingent on the school district's property value profile.

District 3 – At the H.B. 920 20-Mill Floor

School District Type 3 is at the H.B. 920 20-mill floor (20 operating mills) and levies a total of 23.0 effective mills with the 3.0 mill permanent improvement levy. Before re-appraisal, this homeowner's total effective millage rate is 23.0, generating a tax liability (property tax bill) of \$805.00. A breakdown of tax liability shows that operating inside mills generate \$175.00, operating effective mills generate \$525.00, and the voted permanent improvement levy generated \$105.00.

With Reclassification

The next tax year comes with both a reappraisal that increases the home's value by 25 percent and a school board resolution reclassifying four inside operating mills to inside non-operating mills dedicated to a permanent improvement project. This reduces operating inside mills from five mills to one mill. The action also removes 4 inside mills from the calculation of the H.B. 920 20-mill floor, leaving the school district before reappraisal with 16 operating mills and, therefore, under the floor. Because the district had voted at least 20 mills for operating expenses, H.B. 920 will not allow operating mills to go below 20 mills. Therefore, reappraisal will force the standard tax reduction factor calculation to be suspended and require the Tax Commissioner to maintain 20 operating

mills. In this case, one operating mill is an inside tax levy and the remaining voted operating effective mills will be increased from 15 mills to 19 mills to achieve the floor. Therefore, because the school district was at the floor and removed 4 inside mills from the operating expenditures classification, operating effective mills will generate more than \$525.00 in revenue. This district's operating effective mills will generate \$831.25, a \$306.25 increase on voted levies.

Because voted permanent improvement levies are not subject to H.B. 920, \$105 will be generated from the new, lower effective rate of 2.4 mills, which is the same as in previous examples. Also the same is operating inside mills generating \$43.75 and permanent improvement inside mills generating \$175.00. Total effective mills actually increase from the before re-appraisal 23.0 mills to 26.4 mills due to being at the H.B. 920 20-mill floor and reclassification of inside mills.

With No Reclassification

In the case of no reclassification, inside mills generate \$218.75, which is the sum of both inside mill levies with reclassification. Operating effective mills generate \$656.25 and the voted permanent improvement levy generates \$105.00. Total effective mills decrease from the before re-appraisal 23.0 mills to 22.4 mills.

Overall, this homeowner will see a \$350.00 (43.5 percent) in their tax liability with reclassification but would have only seen a \$175.00 (21.7 percent) increase with no reclassification (like the previous example). The result from the school board passing a resolution to pull inside mills from the operating floor

Before Reappraisal	District 1		District 2		District 3	
Total Operating Mills	45.0		21.0		20.0	
Total Effective Mills	48.0		24.0		23.0	
Total Taxes Due	\$1,680.00		\$840.00		\$805.00	
After Reappraisal	<i>Switch</i>	<i>No Switch</i>	<i>Switch</i>	<i>No Switch</i>	<i>Switch</i>	<i>No Switch</i>
Total Operating Mills	33.0	37.0	20.0	20.0	20.0	20.0
Total Effective Mills	39.4	39.4	26.4	22.4	26.4	22.4
Total Taxes Due	\$1,723.75	\$1,723.75	\$1,155.00	\$980.00	\$1,155.00	\$980.00
Tax bill Increase (\$)	\$43.75	\$43.75	\$315.00	\$140.00	\$350.00	\$175.00
Tax bill Increase (%)	2.6%	2.6%	37.5%	16.7%	43.5%	21.7%
Increase From Switch	\$0.00		\$175.00		\$175.00	

formula is a \$175.00 increase in tax liability for this homeowner.

Summary

Table 1 shows the summary statistics for the identical homeowners in the three school district examples. In school district 1, operating mills are far from the H.B. 920 20-mill floor and reclassification generates no additional revenues in the short run. Reclassification does provide smaller total operating levies, 33 mills instead of 37 mills in absence of the 4 inside mills, but total effective mills are the same with or without reclassification. The homeowner's property tax liability increases by \$43.75 or 2.6 percent. The district receives no short-term revenue benefit from reclassification of inside mills.

District 2 is near the floor and will fall to the floor after reappraisal. Without millage reclassification, the district falls to exactly 20 operating mills, but not below it. The next reappraisal will put the district below 20 operating mills, assuming no new or continuing tax levies are voted. But, with inside mill reclassification, the district is able to fall below 20 operating mills in this reappraisal process and receive additional revenues of \$175 from the homeowner. Total effective millage actually is more with reclassification, 26.4 mills compared to 22.4 mills. Assuming the district's residents votes no more tax levies, total operating mills will not be reduced further and will be maintained at 20 mills. Total effective mills will decrease over the next few years as the permanent improvement levy's effective rate is reduced to account for districtwide property value increases.

District 3 is already at the H.B. 920 20-mill floor and cannot be reduced below the floor. The after reappraisal millage rates are the same as District 2, but because the district is already at the floor, additional revenue is realized. The before reappraisal tax liability is \$805.00 and with the same reappraisal conditions, the district is able to exactly match School District 2's revenue from the identical homeowner, which had a slightly higher voted tax rate. A gain of \$175 is seen from the millage reclassification and the homeowner's total tax liability is increased by 43.5 percent (District 2 homeowner saw a smaller 37.5 percent increase). This district was able to realize an immediate revenue gain from reclassification.

In these "static" examples, only one levy generated different revenues based on reappraisal and/or reclassification: Operating Effective Mills. In each district type, the before reappraisal 5 operating inside mills generated \$175.00 and the before reappraisal 3 mills permanent improvement levy generated \$105.00. After reappraisal, with the inside millage reclassification, the one inside operating mill generated \$43.75, the voted permanent improvement levy was reduced to 2.4 mills to generate \$105.00, and the new inside 4 mills permanent improvement levy generated \$175.00. The only levy that generated a different amount of revenue was the operating effective mills, which was contingent upon the proximity to the H.B. 920 20-mill floor. School districts that are at the floor or could drop to the floor with the reclassification were able to gain substantial additional revenue and districts away from the floor cannot realize immediate revenue gains from reclassification.

A school district can lessen the impact of reclassifying inside mills by reclassifying smaller amounts of millage over a period of several years. Given resident approval of such a maneuver, residents would be able to acclimatize easier to a higher tax levy.

Columbiana County districts did not usually go as far as examples 2 and 3. They tended to take actions that prevented the effective tax rate from falling due to reappraisal rather than causing the effective tax rate to rise as in examples 2 and 3. While these examples are possible, they may not be likely. School districts will probably behave more cautiously than what is depicted in examples 2 and 3.

Just One Cog in the Property Tax Complexity Machine

This analysis looked at simple examples of identical homeowners in different school districts and how significant unvoted revenues can be realized by school districts that make this switch. But, those districts close to or already at the 20-mill floor are the only

ones able to realize this gain, in the short-term. There is little or no immediate revenue benefit for districts safely above the floor to pass such a resolution.

There are pros and cons to the reclassification maneuver. Allowing school districts to reclassify inside mills removes the need to continually mount a levy ballot campaign, which frees up school district employees to perform their assigned tasks. But, if reclassification is misconstrued to district residents or residents don't fully understand the impact, then more district revenues will result in residents protesting their new higher tax bills.

Given the complexity of property taxation in Ohio and general misunderstanding of its dynamics, the simple fact has been overlooked or intentionally misinterpreted that a portion of the tax liability increase was due to action taken by the local school board, an action that school districts residents may reverse by simply reclassifying the inside non-operating mills back to inside operating mills. □

¹ <http://www.legislature.state.oh.us/constitution.cfm?Part=12&Section=02>

² Am. Sub. H.B. 283 of the 123rd General Assembly eliminates the personal property tax on inventory over a 25 year period by reducing the assessment percentage by 1 percent per year beginning in Fiscal Year 2002. For further information, please see the LBO Final Analysis on Tax Law Changes at <http://www.lbo.state.oh.us/ohbudget/opanalysis/finalanalysis/>.

³ For further explanation of the tax reduction factor mechanism, please see the article titled "The Ominous Tax Reduction Factor" in LBO's November, 1999 issue of Budget Footnotes at <http://www.lbo.state.oh.us/footnotes/>. H.B. 920 prevents tax districts from receiving windfall revenue from voted levies due to property values increasing (see Property Tax History article in this issue for legislative intent). The Tax Commissioner annually calculates a tax reduction factor (TRF) that reduces the voted tax rate so the rate produces the same amount of income on the existing property as it did the previous year. This reduced rate is called the effective tax rate.

⁴ Due to the complexity of taxing public utility property and deregulation of electricity, the tax is not discussed in this paper. Please refer to Doris Mahaffey's paper titled "Re-Assessing Ohio's Public Utility Property Tax in an Era of Public Utility Restructuring" in LBO's Ohio Issues Report, which can be found at http://www.lbo.state.oh.us/pdf/ISSUE_02.PDF for general information on the public utility tax and the Enacted Fiscal Note of Am. Sub. S.B. 3 of the 123rd General Assembly located at <http://www.lbo.state.oh.us/fiscalnotes.cfm> for information on the deregulation of electricity.

⁵ There is no legal definition of an emergency expense.

⁶ A minimum millage provision is a common national requirement.

⁷ S.B. 201 of the 122nd General Assembly requires a public hearing when a school board is reclassifying inside operating mills to inside non-operating mills. The school district's county auditor may not accept the resolution ONLY if the school district did not follow the proper procedure set forth in the Revised Code.

⁸ Both data sets are available on the Ohio Department of Taxation's webpage, <http://www.state.oh.us/tax>.

⁹ LBO believes 1998 data will show that 10 of the 11 school districts in Columbiana County reclassified inside operating mills to inside non-operating mills.

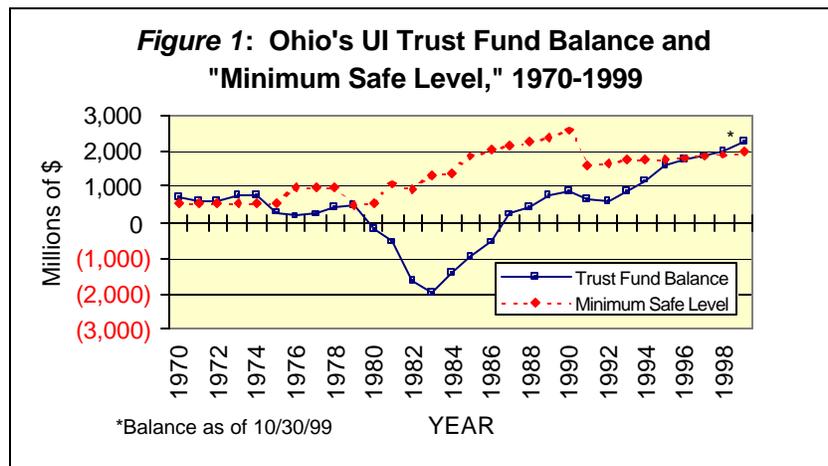
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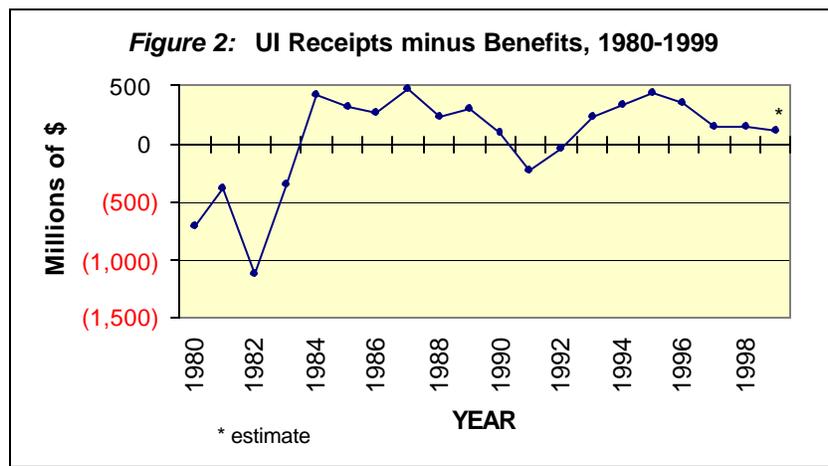
— **Steve Mansfield**

- Based on a tax on wages, the Unemployment Insurance (UI) program is designed to counter the effects of downturns in the business cycle. UI provides temporary partial compensation for wage loss to eligible workers during periods of involuntary unemployment caused by layoffs. It was designed to promote economic stability by maintaining purchasing power and preventing the dispersal of an employer's trained workforce.

- Figure 1** shows that during periods of economic expansion, when claims for benefits are low, trust fund balances are built up; while during economic recessions, as in the early 1980s and again in the early 1990s trust fund reserves are drawn down.



- The "Minimum Safe Level" is calculated annually and tax rates may be altered depending on the relationship of the balance and the safe level. The method of calculating the minimum safe level is established by statute and has changed several times since 1970. When the balance exceeds the minimum safe level a tax rate adjustment is "triggered." UI taxes have been reduced three times since 1995. Today, depending on an employer's experience of unemployment, the tax rate ranges from zero to 6.4 percent. The average employer pays a rate of 1.5 percent on the first \$9,000 of an employee's wages—the lowest average rate since 1975.



- States with insufficient reserves to meet their obligations to pay benefits may borrow funds from the federal unemployment account. Ohio was forced to borrow approximately \$2.1 billion during the early 1980s. **Figure 2** depicts the large gap between total UI receipts (tax and interest) and benefits that required this borrowing. These loans were paid off between 1983 and 1987 as the economy recovered and increased taxes restored the trust fund to solvency.
- Interest earned on the trust fund balance can be significant. The estimate of interest earnings for 1999 is approximately \$135 million. □

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Beginning with the new year, we rolled out our new website! Many of our online documents have moved to an HTML format, versus the previous PDF format. These changes have been made to ensure that our website is a more fluid environment; in addition, documents now load more quickly — giving our online visitors greater access to more material than ever before.

Having said that, you'll notice that this month's online issue of Budget Footnotes is still in PDF. We continue to migrate files to the more user-friendly HTML, and next month's issue of Budget Footnotes will be available — in a new layout — in both HTML and PDF.

Stop in at <http://www.lbo.state.oh.us/>. □