Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE SERVICE COMMISSION MARCH 2002

FISCAL OVERVIEW

— *Doris Mahaffey*

By all accounts the recession has ended. If there even was a recession.

The U.S. index of leading indicators held steady in February after increasing by 0.8 percent in January and by 1.3 percent in December. All of the coincident indicators were up – most notably industrial production – while the index of lagging indicators (including such variables as the duration of unemployment) continued to fall.[1]

Some economists are even beginning to question whether or not the U.S. economy actually was in recession; they suggest that "recessionette" might be a more appropriate term.[2] If it was a recession, it was the shortest and shallowest on record. That does not mean that its impact on all sectors of the economy was equally transitory. "It is indisputable ... that the manufacturing sector suffered a severe and prolonged slump that ended only in January, and that 1.5 million jobs disappeared, with factory layoffs accounting for virtually all of them."[3] High-tech manufacturing was a big part of the decline. Moreover, through its impact on employment and profits, the "recessionette" has managed to do significant damage to the state of Ohio's budget in FY 2002. And FY 2003 tax revenue is also likely to suffer repercussions from it.

Regardless of the brightening prospects for the U.S. economy, Ohio's budget position continues to look gloomy. February revenues were $100 million under the original July 2001 estimates – largely due to weak personal income tax revenue, which was $92 million under estimate for the month. Compared to the December 2001 revised estimates, revenues were $75 million under estimate; the personal income tax was $92 million under the revised estimate, as well.

The original estimates are based on the Office of Budget and Management's (OBM's) May 2001 revenue projections upon which the appropriations in H.B. 94 were based. The December 2001 revised estimates take into consideration OBM's revised October 2001 revenue projections and the revenue enhancements of H.B. 405. Year-to-date FY 2002 revenues are $640 million under estimate compared to the original estimates, and $182 million under compared to the revised estimates. Year-to-date personal income tax revenue is $196 million under the revised estimate. The year-to-date variances derived from the revised estimates have accumulated just since December 2001. To the extent that they take into consideration both the revised revenue projections of

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Budget Footnotes examines the fiscal position of the state GRF on a periodic basis.

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

	Month of February	Fiscal Year 2002 to Date	Last Year	Difference
Beginning Cash Balance	($1,198.7)	$817.1		
Revenue + Transfers	$1,357.8	$12,832.2		
Available Resources	$159.1	$13,649.3		
Disbursements + Transfers	$1,565.2	$15,055.4		
Ending Cash Balances	($1,406.1)	($1,406.1)	($302.8)	($1,103.3)
Encumbrances and Accts. Payable		$549.0	$600.6	($51.6)
Unobligated Balance		**($1,955.1]**	**($903.5)**	**($1,051.6)**
BSF Balance		$1,002.5	$1,002.5	$0.0
Combined GRF and BSF Balance		**($952.6)**	**$99.0**	**($1,051.6)**

October 2001 and the revenue provisions of H.B. 405, any shortfall they disclose indicates a very real hole in the state's budget.

Disbursements are unlikely to provide any relief. Although spending is under estimate, much of the underspending is either timing-related or specifically due to the executive budget cuts of October 2001 or the spending provisions of H.B. 405, which were undertaken to help offset some of the revenue shortfall arising in light of OBM's October 2001 revised forecast.

Disbursements for the month were $33 million under estimate. Education was the program area with the largest amount of underspending, most of which was timing-related. Year-to-date disbursements through February were $392 million under estimate ($395 million under, excluding transfers). Sixty percent of the year-to-date underspending ($240.5 million) was in the education program category.

The program areas with the largest amounts of overspending for the month were Health Care/Medicaid and Temporary Assistance for Needy Families (TANF). The overspending in TANF was somewhat timing-related, as state funds were substituted for federal funds to make advances to county departments of job and family services. (In prior years, federal TANF moneys were deposited into the General Revenue Fund (GRF), so the substitution of state funds for federal funds in any particular month would not have had an obvious impact on the GRF accounts. H.B. 94 established a separate non-GRF line to receive federal reimbursements for TANF.) As it is, year-to-date GRF spending for TANF remains $21.6 million under estimate.

The overspending in Medicaid is another story. It is a continuation of the growing Medicaid caseloads and cost pressures in the health care industry that have been plaguing Ohio and other states since last year. Year-to-date Medicaid expenditures are only $24 million over estimate, but some of the Medicaid expenditure categories have a long lag between services rendered, claims submitted, and payments made; so the overage is expected to continue to grow. However, provisions exist in the budget to take care of potential Medicaid overspending. Specifically, H.B. 94 allows for the transfer of up to $150 million over the biennium from the Budget Stabilization Fund (BSF) to the GRF to cover the state share of Medicaid expenses beyond current appropriations. The additional appropriations would then draw down additional federal revenues.

Thus, it is the continued erosion in state revenues – specifically the income tax – rather than significant overspending that will hamper the state's efforts to end the fiscal year in the black. At $1,358 million, February revenues fell short of disbursements by over $200 million – thus increasing the state's negative cash balance to -$1.4 billion, as shown in Table 1, and putting the state over a billion dollars deeper in the red than what it was last year at this time. This is a precarious position for the state's budget to be in at the end of February, especially considering that last year the state's cash balance did not climb into positive territory until May, and the unobligated balance did not follow suit until early June.

[1] "U.S. Leading Economic Indicators and Related Composite Indexes for February 2002," The Conference Board, March 21, 2002. Five of the leading indicators for February were positive, four were negative, and one was unchanged. The largest positive contributor to the leading index was real money supply, followed by average weekly initial claims for unemployment insurance (inverted). The coincident indicators include industrial production, personal income less transfer payments, manufacturing and trade sales, and employees on nonagricultural payrolls. All were up in February. The negative contributors to the lagging index were commercial and industrial loans outstanding and average duration of unemployment.

[2] Nariman Behravesh made this point in the March 19, 2002, DRI-WEFA teleconference, "How Likely is a Double-Dip Recession?"

[3] Nariman Behravesh, Andrew Hodge, and Cynthia Latta, "U.S. Executive Summary: Was It or Wasn't It?" DRI-WEFA, March 2002.

TRACKING THE ECONOMY

— Ross Miller

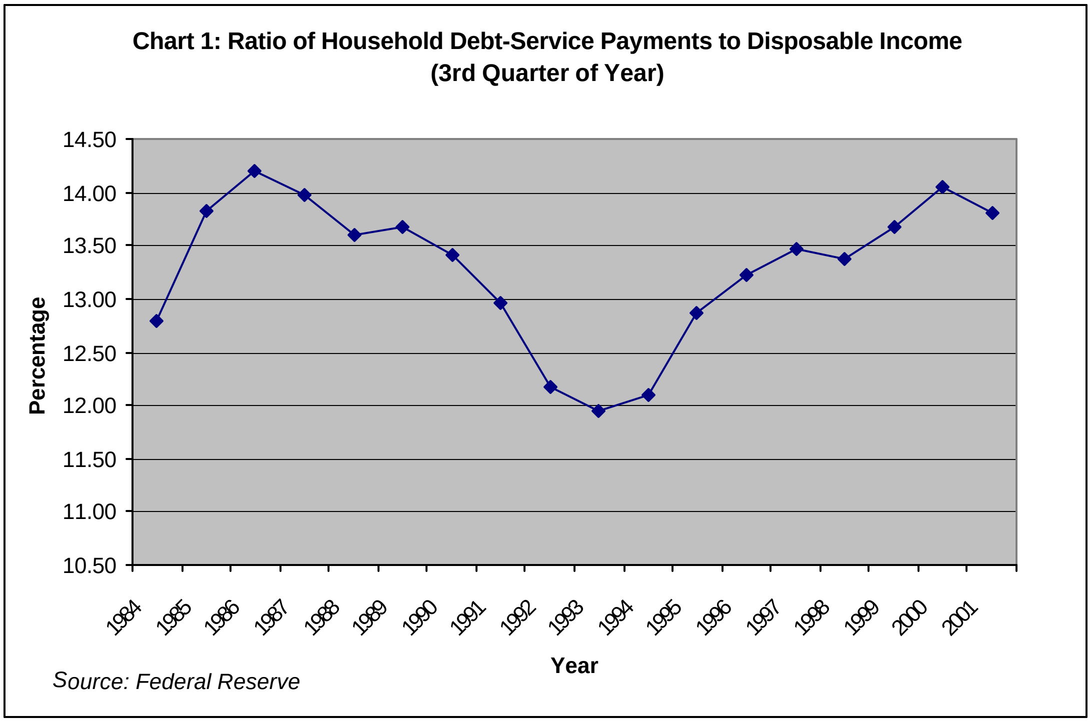
After a couple of months of mixed signals from economic data, late February and March saw a more consistently positive signal emerging. This positive signal led economists at the economic forecasting firm DRI-WEFA to proclaim that "the recession of 2001 is over."[1] The Federal Open Market Committee released a more restrained evaluation, although still a positive one, after its March 19 meeting, stating that "the information that has become available since the last meeting of the committee indicates that the economy, bolstered by a marked swing in inventory investment, is expanding at a significant pace." As a result of its reading of the economic tea leaves, the committee shifted its view of the risks to the economy in coming months. For over a year its view has been that recession is a greater risk than inflation, which has motivated its aggressive reductions in the federal funds rate. Its new view is that "the risks are balanced," which raises the possibility that the committee may begin increasing the federal funds rate sometime late this spring or early this summer. The committee's next scheduled meeting will be May 7.

Perhaps the main reason for DRI-WEFA's bold prediction is the announcement by the U.S. Bureau of Economic Analysis that U.S. real gross domestic product (GDP) rose by 1.4 percent in the fourth quarter of 2001 (2001 Q4). This "preliminary estimate" of real GDP growth was revised significantly upward from January's "advance estimate" of 0.2 percent growth. As discussed in last month's "Tracking the Economy" article, the advance estimate of real GDP growth can be revised significantly, but this upward revision caught many analysts by surprise, because of both its magnitude and its direction—DRI-WEFA had forecast that the revision would be downward. The revision was largely due to an increase in estimated consumer spending on nondurable goods (accounting for 0.3 percentage points of the revision) and a decrease in estimated imports of goods (accounting for 0.5 percentage points of the revision). The final estimate is scheduled to be released on March 28.

The good news extends to the labor market. The U.S. Bureau of Labor Statistics (BLS) announced that the unemployment rate in February was 5.5 percent, after seasonal adjustment, down from the 5.6 percent rate for January. And unlike the rate BLS reported for January, the reduced unemployment rate was accompanied by an actual increase in employment, by a seasonally adjusted 66,000 jobs nationally. There were 371,000 initial claims for unemployment insurance in the week ending March 16, down from 383,000 the previous week. The broadly positive story about the labor market falters a little on the topic of earnings. The BLS reports that real (i.e., inflation-adjusted) average weekly earnings fell by 0.1 percent from January to February; on the other hand, they did rise by 2.2 percent from February 2001 to February 2002. For workers who have not yet experienced the positive developments in the employment picture, on March 9 President Bush signed a stimulus package passed by Congress that extends unemployment compensation benefits for 13 weeks beyond the usual limit of 26 weeks.

The construction industry continues its remarkable record of recent stability. The U.S. Department of Commerce reports that housing starts in February, stated as a seasonally adjusted annualized rate, were 1.77 million units. This figure was 2.8 percent higher than the revised January figure, and 9.0 percent above the February 2001 figure. Among the likely reasons for this robust performance are the relatively mild winter and continuing low mortgage rates. The Cleveland Federal Reserve's contribution to the March Beige Book states that both commercial and residential builders throughout the Cleveland district, which includes all of Ohio, eastern Kentucky, and western Pennsylvania, characterize business conditions as "favorable."

Consumers drive the economy, and news sources report that the University of Michigan Survey of Consumer Sentiment showed a sharp increase from February to March. Although this is a hopeful sign, suggestive that consumer spending may continue to contribute to economic growth, economists have a tendency to be skeptical



of survey data. The U.S. Department of Commerce estimates that retail and food service sales rose by 0.3 percent from January to February, after adjusting for seasonal and holiday-related factors, and by 2.9 percent from February 2001 to February 2002. Although this report is reasonably positive, the 0.3 percent increase in retail sales was significantly lower than analysts expected – Bloomberg News reports that analysts had expected growth of a full 1 percent that month. Preliminary reports for early March produced by Instinet Research are even more cautionary – they indicate that retail sales at discount, chain, and department stores in the first two weeks of March were below the figure for February.

Inflation continues to be quite moderate. The BLS reports that the Consumer Price Index for all Urban Consumers (CPI-U) increased by just 1.1 percent over the year ending in February. Excluding food and energy, the CPI-U rose by 2.6 percent over that period.

Has there been any bad economic news? There has been some, of course. The ratio of household debt-service payments to disposable income reached 14.2 percent in 2001 Q2; only one quarter since 1980 (specifically 1986 Q4) has seen a higher ratio according to the Federal Reserve (see Chart 1 above). Even this bad news is tempered, however, by the fact that the ratio dropped a bit in 2001 Q3. DRI-WEFA economists see no looming danger to the economy in current household debt levels, but there are economists who disagree with that assessment. Also the trade deficit remains very high. Although this may seem an esoteric thing to be concerned about, it does mean that the debt owed by U.S. businesses, households, and governments to foreigners is increasing. That in turn means that interest payments and profit payments to foreigners will increase in the future (faster than their payments to us will). Finally, the Index of Leading Economic Indicators showed no increase in February, although it was 2.4 percent higher than it had been six months before (in August).

Has Manufacturing Hit Bottom?

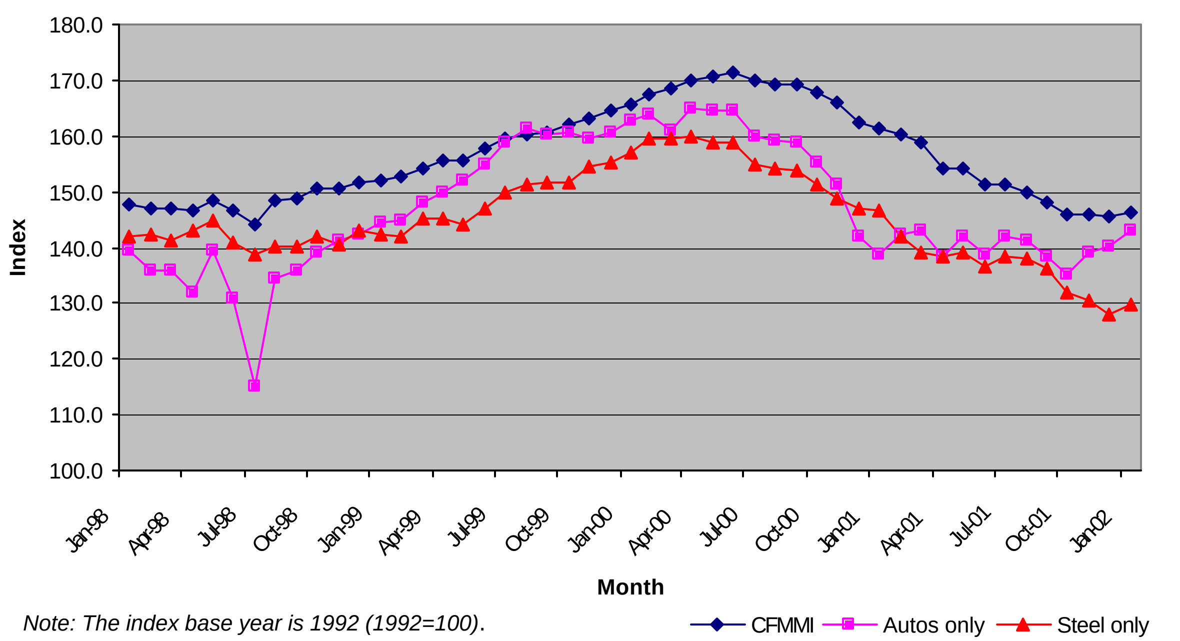
Even manufacturing, the sector of the economy hardest-hit by the recession, is showing some signs that recovery may be coming. The Federal Reserve (Fed) reports that industrial production increased by 0.4 percent in February, following a (revised) 0.2 percent increase in January. These are the first consecutive monthly increases since August and September 2000, the Fed points out. The Cleveland Fed reports in the March Beige

Book that there were slight increases in new orders and in production at manufacturers throughout the Cleveland district. Some auto plants in the district are working overtime to meet the demand for their models, and several steel companies have been able to increase prices.

The last two "Tracking the Economy" articles have included charts showing the Chicago Fed's Midwest Manufacturing Index (CFMMI). This index, released monthly, estimates changes in manufacturing output in the Chicago Fed district. While Ohio is not in the Chicago district, that district includes regions with economies similar to Ohio's: Michigan, northern Indiana, northern Illinois, southern Wisconsin, and Iowa. Because Ohio's economy is more similar to the economies of these states than it is to the national economy, the CFMMI probably provides a better picture of what is happening to Ohio's manufacturing sector than the Fed's national index. The CFMMI uses measures of electrical power consumed and hours worked to estimate changes in production activity in 16 manufacturing industries. The index reached a peak of 171.3 in June of 2000, since which it has fallen by 14.7 percent, to 146.1 (in January – see Chart 2 below). The good news is that the index appears to be bottoming out, increasing by 0.3 percent from December to January. Separate component indices are reported for each of four subsectors. Among these, the auto subsector has increased for three months in a row, while the steel subsector registered its first gain in six months from December to January.

In an attempt to provide further support to the steel industry, this month President Bush announced the imposition of temporary tariffs on imports of steel products. The tariffs were imposed for a three-year period, and steel imported from Canada, Mexico, and developing countries was exempted. The tariffs were imposed at rates ranging from 8 percent (for stainless steel wire) to 30 percent (for slab steel, flat products, tin mill products, and hot-rolled and cold finished bar). These tariffs should provide significant relief to the Ohio steel industry, which has been struggling since a surge in the amount of imported steel in 1998. However, they may harm companies such as Ford, General Motors, and Honda that purchase steel as an input in their products. The Bush administration maintains that the tariff rates were set low enough to avoid any harm to steel consumers, but that is a difficult thing to judge. This national policy exposes the Ohio economy to some risk: the BLS estimates that there were about 73,000 Ohio jobs in the primary metal industries (which would include the steel industry) in January, compared to about 130,000 in transportation equipment manufacturing, 140,000 in industrial machinery and equipment manufacturing, and 122,000 in fabricated metal products.[2]

Chart 2: Chicago Fed Midwest Manufacturing Index



Note: The index base year is 1992 (1992=100).

What Will the Recovery Look Like?

The burning debate among economic forecasters is no longer about when the recovery will begin. Nearly all forecasters foresee it starting very soon if it has not already. The burning debate is now about what the recovery will look like. Some, typified by Stephen Roach at Morgan Stanley Dean Witter, expect a "double-dip" in this recession, meaning that real GDP decreases again before reaching a stable growth path. Others expect steady growth to begin, but at rates that are more modest than those seen in the late 1990s. Some very optimistic, but reputable, forecasters foresee annualized rates of real GDP growth above 5 percent this quarter (2002 Q1). We may not be out of the woods yet (or maybe we are), but the weight of forecasters' opinions seems to be that the sun is breaking through the deep forest gloom.

Update of Ohio Economic Data

The unemployment rate in Ohio rose to 5.3 percent in February, after seasonal adjustment, from a revised 5.1 percent in January. The increased rate was accompanied by a decrease in employment, from 5,547,500 in January to 5,544,300 in February. Despite the worsening labor market picture, there are ten counties in the state with unemployment rates below 4.5 percent. Unfortunately, six counties have unemployment rates above 10.0 percent: Morgan (15.8 percent), Vinton (15.5 percent), Adams (13.7 percent), Pike (11.3 percent), Meigs (10.9 percent), and Monroe (10.4 percent).

Exhibit 1: U.S. Industrial Capacity

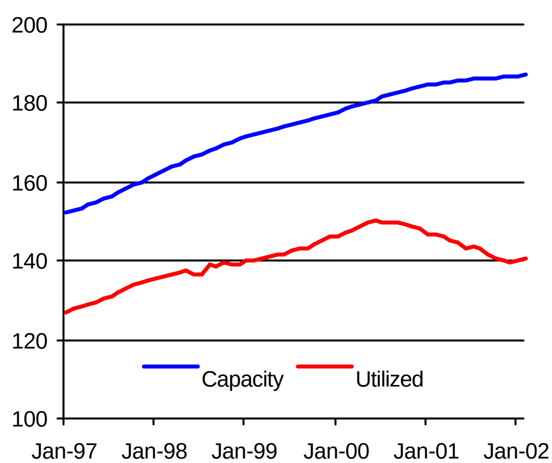


Exhibit 2: Consumer Price Indices
(percentage changes from one year earlier)

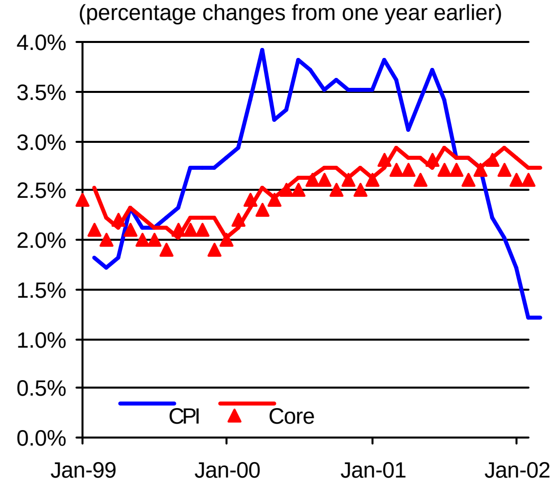


Exhibit 3: Housing Starts

(Midwest, thousands of units)

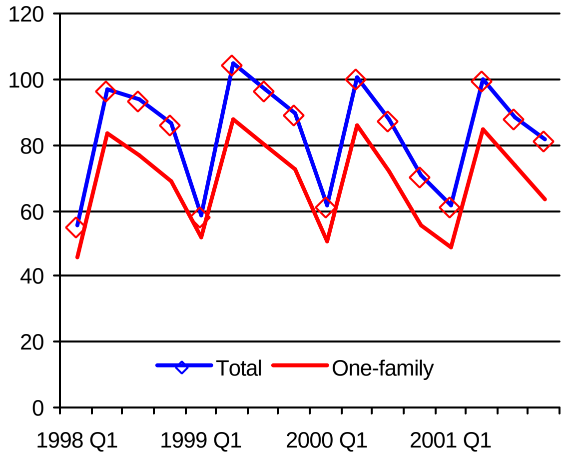
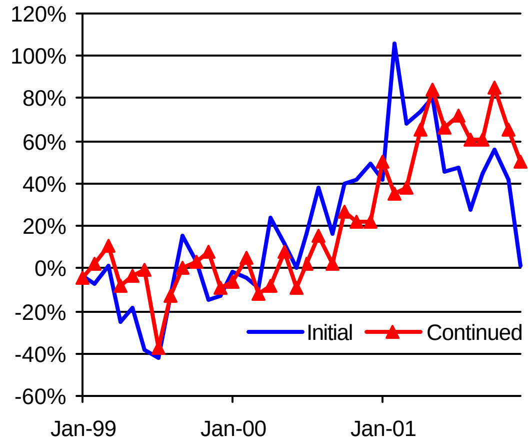


Exhibit 4: Ohio Unemployment Claims

(percentage changes from one year earlier)



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[1] In the March issue of the firm's *U.S. Executive Summary*.

[2] An additional risk arises from the possibility of retaliation by U.S. trading partners. Several have filed formal complaints with the World Trade Organization (WTO) against the U.S. tariffs, maintaining that they violate WTO rules, and the European Union is threatening to impose some form of protection of its own steel industry. The Bush administration maintains that the U.S. tariffs are consistent with WTO rules.

Status of the General Revenue Fund

REVENUES

— *Doris Mahaffey**

Revenues continue to lag. February revenues were (once again) under estimate in comparison to either the July 2001 estimates or the revised December 2001 estimates. Table 2 provides a detailed comparison of actual February revenues and the July 2001 revenue estimates by major revenue category.

The Office of Budget and Management (OBM) derived the revenue estimates used in Table 2 from the FY 2002 revenue projections used in the final version of H.B. 94. The state's budget has been revised since then – chiefly with the passage of H.B. 405 in December 2001 – and OBM has subsequently developed new revenue estimates incorporating the assumptions and revenue provisions of H.B. 405. These assumptions include the October 2001 revised revenue projections. The revenue changes in H.B. 405 that affect FY 2002 revenues for the most part involved a gain of $82.5 million from tax changes and up to $376 million in transfers into the General Revenue Fund (GRF). The tax changes involved the sales and use tax on auto leases and the vendor discount on tobacco sales. The transfers entailed a transfer of $120 million from the Tobacco Trust Fund in FY 2002 and transfers of up to $256 million from the Budget Stabilization Fund (BSF) over the biennium. In spite of these revisions, *Budget Footnotes* will continue to make comparisons vis a vis the original (July 2001) estimates and to use these estimates in Tables 2 and 3, making references to the revised (December 2001) estimates as appropriate.

Regardless of which set of estimates is used for comparison, the personal income tax made a dismal showing in February – continuing its poor performance from January. It was $92 million under estimate compared to either estimate. Withholding and refunds were the source of the variance. Refunds were significantly over estimate for the month and withholding was significantly under estimate.

As Table 2 shows, compared to the July 2001 estimates, both the auto and the non-auto portions of the sales tax, along with the kilowatt-hour tax and the foreign insurance tax, also contributed to the underage. The corporate franchise tax was, for once, over estimate. The public utility excise tax and federal reimbursements were both pretty much on target. Compared to the December 2001 estimates, the sales and use tax (both components), the corporate franchise tax, and the public utility excise tax were all slightly over estimate, while the kilowatt-hour tax and the foreign insurance tax were slightly under estimate.

The transfers-in category was also over estimate, but that was largely a result of one of the provisions of H.B. 405. Of the $256 million transfer from the BSF authorized by H.B. 405, $8 million was not to plug the existing revenue shortfall, but for emergency purposes, namely, to fund homeland-security-type measures. The $8 million transfer was made February 19 and was the source of much of the month's positive variance in the "transfers in" category in Table 2.

Year-to-date revenues at the end of February were $640 million under estimate (compared to the original estimates). Tax revenues were $673 million under, with the personal income tax, the sales and use tax, and the corporate franchise tax all showing significant shortfalls. (See Table 3.) The personal income tax was $444 million under, and the sales and use tax was $132 million under (with the non-auto portion $216 million under and the auto portion $84 million over). The corporate franchise tax was $135 million under and the public utility excise tax was $62.5 million over.

Once again, these comparisons are all made to the original estimates. The picture formed by the revised estimates is similarly disappointing. Year-to-date tax revenues through February were $196 million under estimate; total revenues were $180 million under estimate. In particular, the personal income tax was $196 million under estimate and the corporate franchise tax was $55 million under. While the shortfall does appear smaller by this calculation, it takes into consideration all of the

Table 2
General Revenue Fund Income
Actual vs. Estimate
Month of February 2002
($ in thousands)

REVENUE SOURCE	Actual	Estimate*	Variance
TAX INCOME			
Auto Sales	$47,676	$51,563	($3,887)
Non-Auto Sales & Use	$318,529	$338,613	($20,084)
Total Sales	$366,205	$390,176	($23,971)
Personal Income	$344,980	$436,095	($91,115)
Corporate Franchise	$121,156	$110,770	$10,386
Public Utility	$30,429	$29,700	$729
Kilowatt Hour Excise	$21,003	$28,100	($7,097)
Total Major Taxes	**$883,772**	**$994,841**	**($111,069)**
Foreign Insurance	$54,453	$56,350	($1,897)
Domestic Insurance	$3	$575	($572)
Business & Property	$388	$83	$305
Cigarette	$19,835	$19,600	$235
Alcoholic Beverage	$4,449	$4,200	$249
Liquor Gallonage	$2,173	$2,175	($2)
Estate	$68	$0	$68
Total Other Taxes	$81,369	$82,983	($1,614)
Total Taxes	**$965,141**	**$1,077,824**	**($112,683)**
NON-TAX INCOME			
Earnings on Investments	$0	$0	$0
Licenses and Fees	$1,761	$4,200	($2,439)
Other Income	$13,865	$7,478	$6,387
Non-Tax Receipts	$15,626	$11,678	$3,948
TRANSFERS			
Liquor Transfers	$10,000	$9,000	$1,000
Budget Stabilization	$8,000	$0	$8,000
Other Transfers In	$0	$0	$0
Total Transfers In	$18,000	$9,000	$9,000
TOTAL INCOME less Federal Grants	**$998,767**	**$1,098,502**	**($99,735)**
Federal Grants	$359,031	$359,063	($32)
TOTAL GRF INCOME	**$1,357,797**	**$1,457,565**	**($99,768)**

* July 2001 estimates of the Office of Budget and Management.

Totals may not add up due to rounding.

anticipated revenues from the "fix" of H.B. 405; thus, it represents a very real hole in the budget that is unlikely to be plugged by sufficient unanticipated surpluses in other GRF revenue sources.

Personal income tax

In February the personal income tax essentially continued its trend from January. February personal income tax revenues were $92 million under estimate in comparison to either the original or the revised revenue estimates. The shortfall was largely due to withholding ($43.5 million under estimate compared to the original estimates) and refunds ($56 million over estimate compared to either set of estimates).

Compared to February 2001 receipts, withholding was down 1 percent; estimated payments were down 12 percent and refunds were down 11 percent; annual returns were up 12 percent. Total revenues were up 4.4 percent, while revenues to the GRF were up 4.8 percent. This slight difference in the proportion going to the GRF was largely due to a provision in H.B. 405 that called for the recalculation of the local government fund freeze to take into consideration lower-than-projected revenues from all the major tax sources in FY 2002. The recalculation netted the GRF an additional $11.7 million in February. Of this $11.7 million, $5.5 million came from the local government fund, $0.8 million came from the local government revenue assistance fund, and $5.4 million came from the library and local government support fund. Thus, $11.7 million of February personal income tax revenue that would otherwise have been deposited into one of these funds was instead deposited in the GRF. Due to the dismal performance of the personal income tax in FY 2002, it is likely that there will be another such correction in June of this year.

February withholding reflects conditions in the labor market – chiefly employment, hours worked, average wages, and bonuses. Many of these conditions were essentially unchanged from January. According to the Bureau of Labor Statistics Establishment Survey for February, the average hours worked per week in the U.S. were unchanged from January, while average hourly earnings and average weekly earnings rose slightly. While total employment in the U.S. increased in February, it is not clear how employment in Ohio fared. According to Establishment Survey data, manufacturing lost 50,000 jobs in February. This is down from the average monthly job loss in manufacturing of 111,000 for the prior 12 months, so it suggests that the decline is easing, but it is still a decline.[1]

The Federal Reserve Bank's March 6 *Beige Book* for Cleveland, which summarizes reports gathered the third week of February and reflects business conditions for the first six weeks of 2002, gave the employment situation in Ohio a mixed review. Labor markets in the Fourth District (which includes Ohio and parts of Kentucky and western Pennsylvania) continued to struggle, and demand for temporary employment, which many economists consider a leading indicator for a region's employment situation, was soft. Hiring freezes remained in effect across most industries, but the widespread layoffs – especially in the steel and aerospace industries – seem to have subsided. Otherwise, manufacturing seems to have improved somewhat in the first six weeks of the year, helped largely by the auto industry. A few auto plants even scheduled overtime to meet demand.

Upon examination, the overage in refunds probably results from a combination of factors. First, many people lost jobs over the course of 2001. To the extent that they did not quickly find new jobs or the jobs they found paid less than their former jobs, their withholding from the previous jobs would have been excessive, and they would be due larger refunds. Second, people in reduced circumstances would probably have been motivated to obtain their refunds more quickly and would have filed more quickly. This second reason would make the excess refunds more of a timing issue and would not affect the amount of refunds overall. This would be good for the state budget. However, the first reason (related to job losses) would suggest that the amount of refunds has been underestimated, which would not be particularly good news for the state budget.

Both refunds and estimated refunds for the month were down from a year ago. This should come as no surprise, as last year Ohio taxpayers benefited from a temporary income tax cut, financed by transfers from the Income Tax Reduction Fund. Due to revenue problems, no such tax cut was forthcoming this year. Hence, the effective tax rate on income is higher this year, and households that were otherwise not affected by the recession will be seeing fewer and smaller refunds.

The prognosis for Ohio personal income tax revenues does not look particularly good – either for the rest of the fiscal year or for the biennium. Withholding typically constitutes over 80 percent of gross personal income tax revenues, and it is largely dependent on employment. Employment is generally regarded as a "lagging" indicator. In other words, it improves only after other parts of the economy have begun to improve. At the start of an economic recovery, businesses initially attempt to meet rising demand with longer hours and overtime. Only when the economy clearly appears to be improving do they hire additional help. (Often, temporary employees will be the first new hires.) The March 2002 forecast of the economic forecasting firm DRI-WEFA expects the U.S. employment situation to improve only gradually:

Table 3
General Revenue Fund Income
Actual vs. Estimate
FY 2002 To Date Through February 2002
($ in thousands)

REVENUE SOURCE					
TAX INCOME	**Actual**	**Estimate***	**Variance**	**FY 2001**	**Percent Change**
Auto Sales	$603,781	$519,752	$84,029	$510,018	18.38%
Non-Auto Sales & Use	$3,424,609	$3,640,762	($216,153)	$3,469,224	-1.29%
Total Sales	$4,028,390	$4,160,514	($132,124)	$3,979,242	1.24%
Personal Income	$4,531,200	$4,975,616	($444,416)	$4,640,127	-2.35%
Corporate Franchise	$214,968	$349,933	($134,965)	$286,527	-24.97%
Public Utility	$161,050	$98,500	$62,550	$236,252	-31.83%
Kilowatt Hour Excise	$211,160	$227,720	($16,560)	$0	—
Total Major Taxes	**$9,146,768**	**$9,812,283**	**($665,515)**	**$9,142,148**	**0.05%**
Foreign Insurance	$169,381	$183,540	($14,159)	$184,695	-8.29%
Domestic Insurance	$3,015	$2,875	$140	$1,849	63.11%
Business & Property	$1,417	$1,163	$254	$1,129	25.47%
Cigarette	$174,628	$170,800	$3,828	$173,474	0.67%
Alcoholic Beverage	$36,414	$36,260	$154	$35,625	2.22%
Liquor Gallonage	$19,924	$19,721	$203	$19,842	0.42%
Estate	$63,405	$61,250	$2,155	$78,939	-19.68%
Total Other Taxes	$468,184	$475,609	($7,425)	$495,552	-5.52%
Total Taxes	**$9,614,951**	**$10,287,892**	**($672,941)**	**$9,637,701**	**-0.24%**
NON-TAX INCOME					
Earnings on Investments	$56,583	$81,000	($24,417)	$91,194	-37.95%
Licenses and Fees	$18,861	$23,363	($4,502)	$21,569	-12.56%
Other Income	$118,874	$78,316	$40,558	$105,570	12.60%
Non-Tax Receipts	$194,317	$182,679	$11,638	$218,333	-11.00%
TRANSFERS					
Liquor Transfers	$72,000	$66,000	$6,000	$68,000	5.88%
Budget Stabilization	$8,000	$0	$8,000	$0	—
Other Transfers In	$11,626	$6,237	$5,389	$627,022	-98.15%
Total Transfers In	$91,626	$72,237	$19,389	$695,022	-86.82%
TOTAL INCOME less Federal Grants	**$9,900,894**	**$10,542,808**	**($641,914)**	**$10,551,056**	**-6.16%**
Federal Grants	$2,931,308	$2,929,634	$1,674	$2,795,468	4.86%
TOTAL GRF INCOME	**$12,832,202**	**$13,472,442**	**($640,240)**	**$13,346,524**	**-3.85%**

* July 2000 estimates of the Office of Budget and Management.

Totals may not add up due to rounding.

We expect overall employment to stop falling by the second quarter and then recover slowly, regaining its previous peak only in spring 2003. Unemployment will also lag, not peaking until next summer.[2]

Generally, employment in the Midwest, including Ohio, is expected to lag that in the rest of the country; so, in the short run, employment is not likely to increase sufficiently to meet withholding estimates any time soon. The hole in the budget noted above is only likely to grow through the balance of the fiscal year.

One of the reasons that many economists expect employment in the Midwest to recover so slowly has to do with substantial investments made in the region in the late 1990s and the productivity improvements that came with them. According to one economist:

> Even once production picks up, the increase will not be accompanied by a strong rebound in manufacturing hiring. As sales rise, businesses that aggressively cut at the first sign of faltering orders will hold off on new hiring until the recovery is certain. Additionally, the increased returns from using new technologies in the workplace permanently reduce the need for manufacturers to expand payrolls significantly to meet production demands. This also means that many of the job cuts that have occurred in recent years are permanent.
>
> New facilities generally require far fewer workers than those they replace. For example, General Motors just opened a new state-of-the-art assembly plant in Lansing, MI that employs roughly one-half the number of workers of older plants. To illustrate the point, in the two years following the last recession, manufacturing payrolls in the Midwest increased by 400,000 jobs. In contrast, the expected increase for the next two years is only 150,000 jobs.[3]

Sales Tax

The Non-auto Sales and Use Tax. Receipts from the non-auto sales and use tax were $318.5 million in February 2002, lagging estimates by $20.1 million or 5.9 percent. Revenues from this source have been below estimates every month this fiscal year, except for October 2001.[4] February sales tax revenues largely reflect January retail sales, which are normally much lower than December sales. This is reflected in reduced sales tax revenue in February. Preliminary estimates from the U.S. Department of Commerce indicate that, excluding auto sales, nationwide retail sales in January declined 0.1 percent relative to December 2001 sales. The drop in sales tax revenues was much higher. February sales and use tax receipts declined 43.8 percent from January revenues. For a better indication of the growth or decline of taxable retail sales, sales tax revenues are compared to revenues in the same month the previous year. February 2002 receipts were $37.8 million, or 9.1 percent, lower than February 2001 sales and use tax revenues. Clearly, taxable retail sales in Ohio are still suffering from the overall economic doldrums. Better sales tax receipts may be ahead. Excluding autos, February retail sales, according to advanced estimates, grew 0.2 percent over January sales.

Year-to-date sales tax revenues through February 2002 were $3,424.6 million, which was below estimate by $216.2 million or 5.9 percent. February 2002 revenues were also $44.6 million or 1.3 percent below February 2001 sales and use tax receipts. It has been a certainty for a few months that the non-auto sales and use tax will not reach estimates this fiscal year. (The revised revenue projections for FY 2002 from October 2001 are nearly $300 million below the original projections.) The question now is whether the non-auto sales and use tax could at least match the levels recorded last year.

The Auto Sales Tax. Auto sales tax receipts in February were $47.7 million, or $3.9 million below estimates. These tax receipts were also 20 percent below January receipts. This decline occurred despite the fact that nationwide, February auto and auto part sales grew 0.4 percent from January.[5] Receipts were $8.2 million or 14.7 percent below sales tax revenue for February 2001. For only the second time this fiscal year, revenues from this tax source were below estimate.

Nationwide auto sales so far in CY 2002 are 3.8 percent below last year's pace. Although this may provide some evidence of a softening of car sales, the current pace of 16.6 million units recorded for the first two months of this calendar year is still surprisingly robust and in line with historical sales. The record level of car sales in the last quarter of 2001 was generally explained by a "pull ahead" of future sales. However, upon closer analysis, October auto sales included up to two weeks of delayed purchases due to the terrorists attacks. Also, the extent to which additional sales were drawn into that quarter from future sales may have been small because of stringent conditions placed on customers wanting to qualify for the "zero percent" financing. Another explanation for the lack of a precipitous decline in sales this year may be the direct relationship between floor traffic and purchases.

New vehicle shoppers may take up to six months from the time they first enter the showroom to look at vehicles until they actually make an acquisition. Increased floor traffic during October and November may have translated into additional sales in January and February. Customers who were lured into showrooms by the "zero percent" incentives, but did not qualify,[6] are now purchasing new cars. Interest rates are still low and auto incentives are ongoing. Even though auto sales might still slump, resumption of economic growth and continuation of auto incentives will probably reduce any serious decline in auto sales the rest of this fiscal year. Year-to-date auto sales tax revenues are $84.0 million or 16.2 percent above current year estimates. Compared to the same month last year, FY 2002 auto sales tax revenues are $93.8 million ahead of FY 2001 receipts.

The auto sales tax is mitigating dismal results from the non-auto sales and use tax. With four months remaining, the sales and use tax is $132.2 million or 3.2 percent under estimates this fiscal year. Due to the strong performance of the auto sales tax, year-to-date sales and use tax receipts are $49.1 million or 1.2 percent ahead of last year's receipts.

Corporate Franchise Tax

Earlier this month, Congress passed the "Job Creation and Worker Assistance Act of 2002," which contains several tax and unemployment benefits provisions. Among the tax provisions, the temporary depreciation "bonus" and changes in the federal net operating loss deduction will significantly impact corporate franchise tax receipts starting in FY 2003. These federal changes will decrease state corporate and personal income tax revenues by at least $100 million starting in FY 2003.

Corporate taxpayers will get a first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified property. To qualify, the property must (1) be acquired after September 10, 2001, and before September 11, 2004, and (2) satisfy the general rules under the Modified Accelerated Cost Recovery System (MACRS). Most tangible assets (except real property) purchased by businesses will be eligible for the depreciation "bonus." The federal legislation also extended the net operating loss (NOL) carry-back period. Current law allows taxpayers to carry back net operating losses two years. The new federal law increases the carry-back period to five years for losses that arise in taxable years ending in 2001 and 2002. This change might induce some corporations to file amended returns to reduce already established tax liabilities and get corporate refunds starting in FY 2003.

An accelerated depreciation schedule from the "bonus depreciation" and the lengthening of the NOL deductions increase corporate expenses and decrease federal taxable income, while improving companies' cash flow. Federal taxable income is the starting point of the Ohio corporate tax returns. An Ohio corporate taxpayer would use federal depreciation schedules, other deductions, and NOL rules to calculate its federal taxable income. Then, various adjustments (additions and deductions) specific to Ohio are made to the reported federal taxable income. This results in the Ohio taxable income to which franchise income tax rates are applied to calculate the tax on net income.

February 2002 corporate tax receipts were $121.2 million, $10.4 million above estimates. Revenues were also higher than February 2001 corporate receipts by $20.9 million, or 20.8 percent. In FY 2002 to date through February, franchise tax receipts were about $215.0 million, $135.0 million or 38.6 percent below estimates for the year to that point. At the end of January 2002, year-to-date receipts were 60.8 percent below estimates. Thus, the gap between actual revenues and estimates has narrowed. A year ago, franchise tax revenues were $286.5 million. Thus, corporate revenues so far this year at $215.0 million are still significantly below last year's receipts. The franchise tax payment in March will be critical to reducing the underage in tax revenues if the franchise tax is to limit the current year's deficit.

**Jean Botomogno also contributed to this Revenue article.*

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[1] See "The Employment Situation: February 2002" from the Bureau of Labor Statistics, United States Department of Labor.

[2] Nariman Behravesh, Andrew Hodge, and Cynthia Latta, "Was It or Wasn't It?" DRI-WEFA, March 2002.

[3] Sophia Koropeckyi, "No Midwest Miracle This Time," Economy.com, February 27, 2002.

[4] This overage was probably due to delayed remittance and processing of sales tax returns in September.

[5] U.S. Department of Commerce, U.S. Retail and Food Service Advance Estimates for February 2002.

[6] Most customers that benefited from the incentives had to have an excellent credit. The shorter loan term for the "zero percent program," usually 36 months, was also a limiting factor for a large number of car shoppers.

DISBURSEMENTS

*— Steve Mansfield**

February's General Revenue Fund disbursements (excluding transfers) were $33.4 million below the estimate, bringing total year-to-date disbursement activity to $395.3 million below the estimate. When we unpack this aggregate number to look at the trajectory of the year-to-date disbursement variances of four of the state's major GRF program categories, as depicted in Figure 1, we see that three of the four program categories are in negative territory, while one category (Tax Relief) posted a small positive disbursement variance in February to move its year-to-date disbursement variance just barely into positive territory. For the month of February, one other program category (Welfare and Human Services) posted a relatively sizable positive disbursement variance of $47.0 million, while the remaining two program categories (Education and Government Operations) posted negative disbursement variances of $74.1 million and $2.7 million, respectively. Of the total year-to-date negative disbursement variance of $395.3 million, $240.5 million, or 60.8 percent, is from the Education program category.

As is our usual practice, we will examine the February and year-to-date disbursement activity by looking at these four major GRF program categories in the order of the magnitude of their contributions to the year-to-date negative disbursement variance: (1) Education, (2) Welfare and Human Services, (3) Government Operations, and (4) Tax Relief. Within each program category, we then examine the state agency budgets and programs that have contributed most notably to either positive or negative disbursement variances. The reader's attention is also directed to Tables 4 and 5, which provide a more detailed picture of the February and year-to-date disbursement variances, respectively, by program category.

Education (-$240.5 million)

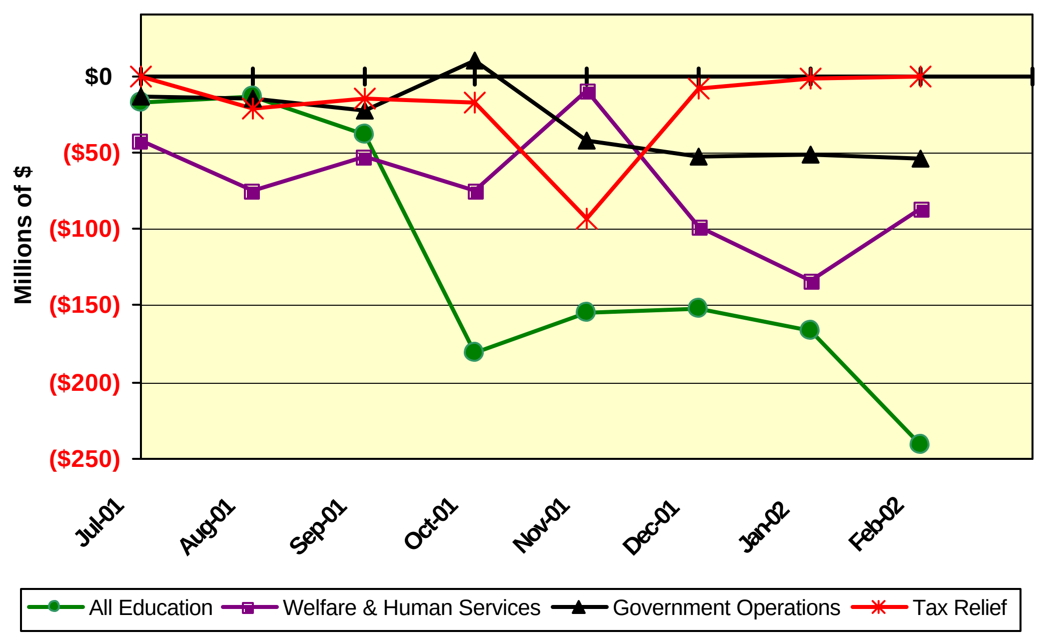
Disbursements in the Education program category were under the February estimate by $74.1 million. This was the result of a $44.7 million negative disbursement variance in Primary and Secondary Education and a $29.5 million negative disbursement variance in Higher Education. For the year to date, Education program category spending through February stood at $240.5 million under the estimate.

Department of Education. February's negative disbursement variance of $44.9 million pushed the department's year-to-date disbursement variance to $188.3 million below the estimate. Timing, rather than budget reductions, was the main reason for February's underspending. The principal source of the negative disbursement variance was line item 200-511, Auxiliary Services, which posted a disbursement variance that was $61.1 million below the estimate. Line item 200-511 is used to provide assistance to chartered nonpublic elementary and secondary schools for nonreligious activities, including the purchase of secular textbooks, health services, programs for the handicapped, and transportation to services offered off-site. Funds from this line item are distributed on a per-pupil basis. The appropriation for line item 200-511 for FY 2002 is $123.2 million and the estimate anticipated that most of the appropriation would be distributed in September and February. The payment scheduled for February was not actually made until early March, and thus February's negative disbursement variance in this line item will most likely be offset with a timing-based positive variance in March's disbursement report.

When we look at the department's disbursement activity for the year to date, the disbursement variance in line item 200-511 (discussed above) is the largest contributor to the year-to-date negative disbursement variance of $188.3 million. Other notable contributors to the year-to-date negative disbursement variance include the following line items: (1) 200-501, Base Cost Funding ($35.9 million), (2) 200-513, Student Intervention Services ($25.1 million), (3) 200-406, Head Start ($13.9 million), and (4) 200-520, Disadvantaged Pupil Impact Aid (DPIA) ($12.2 million). The situation regarding the disbursement activity in these line items has not changed much from last month's report.

Regents. In February, the Board of Regents posted a $29.5 million negative variance that was

Figure 1.
Year-to-Date GRF Disbursement Variances
by Program Category, FY 2002



largely the result of underages in two line items: 235-501, State Share of Instruction ($16.6 million), and 235-503, Ohio Instructional Grants ($9.5 million). Line item 235-501, State Share of Instruction, supports all of Ohio's publicly assisted institutions of higher education in their efforts to reduce the tuitions and fees charged to students. An underage in line item 235-501 was expected since its FY 2002 appropriation authority was reduced by $99.5 million under Executive Order 2001-22T.

The underage in line item 235-503, Ohio Instructional Grants, was largely due to the bulk of a planned disbursement for February actually posting in January. Line item 235-503 provides for financial grants for higher education to students who are Ohio residents and whose family incomes do not exceed a specified level.

Year-to-date disbursement activity by the Board of Regents stands at $51.1 million below the estimate. The bulk of the year-to-date underage ($33.2 million, or 65 percent) is driven by January and February underspending posted in line item 235-501 (discussed above). The most notable item contributing to the nearly $18 million remaining in the year-to-date negative disbursement variance is line item 235-590, Twelfth Grade Proficiency Stipend. This line item carries $19.2 million in FY 2001 encumbrances that were transferred from the Department of Education. It is used to provide a $500 scholarship to students who pass all five parts of the twelfth grade proficiency test and attend a college or university in Ohio. Am. Sub. S.B. 1 of the 124th General Assembly eliminates the twelfth grade proficiency test and the $500 scholarship for all students graduating after the 2000-2001 school year. Students who passed all five parts of the twelfth grade proficiency test in the spring of 2001 are the last group of students who will be eligible for this scholarship. The scholarship will not be disbursed until an eligible student actually enrolls in a college or university in Ohio. Disbursement activity in this line item is slower than expected.

Welfare/Human Services (-$86.5 million)

As we see in Table 4, disbursements in the Welfare and Human Services program category were above the February estimate by $47.0 million. Table 5 shows that, for the year to date through February, disbursements in the program category stood at $86.5 million below the estimate. The following paragraphs in this section discuss the particular contributors to the year-to-date result in order of their magnitude, going first to negative disbursement

Table 4
General Revenue Fund Disbursements
Actual vs. Estimate
Month of February 2002
($ in thousands)

USE OF FUNDS			
PROGRAM	**Actual**	**Estimate***	**Variance**
Primary & Secondary Education (1)	$491,284	$535,943	($44,658)
Higher Education	$169,099	$198,566	($29,467)
Total Education	$660,383	$734,508	($74,125)
Health Care/Medicaid	$615,456	$596,351	$19,105
Temporary Assistance to Needy Families (TANF)	$46,235	$0	$46,235
General/Disability Assistance	$7,559	$6,705	$854
Other Welfare (2)	$23,240	$30,473	($7,233)
Human Services (3)	$52,996	$64,958	($11,962)
Total Welfare & Human Services	$745,486	$698,487	$46,999
Justice & Corrections	$115,398	$124,109	($8,711)
Environment & Natural Resources	$6,544	$5,895	$649
Transportation	$3,594	$2,372	$1,223
Development	$14,003	$7,675	$6,328
Other Government (4)	$16,573	$18,789	($2,216)
Capital	$33	$0	$33
Total Government Operations	$156,145	$158,839	($2,695)
Property Tax Relief (5)	$1,732	$0	$1,732
Debt Service	$1,451	$6,785	($5,334)
Total Program Payments	**$1,565,197**	**$1,598,619**	**($33,422)**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	$0	$0	$0
Other Transfers Out	$0	$0	$0
Total Transfers Out	$0	$0	$0
TOTAL GRF USES	**$1,565,197**	**$1,598,619**	**($33,422)**

(1) Includes Primary, Secondary, and Other Education.
(2) Includes the Department of Job and Family Services, exclusive of Medicaid, TANF, and General/Disability Assistance.
(3) Includes Mental Health, Mental Retardation and Developmental Disabilities, and Other Human Services.
(4) Includes Regulatory and Nonregulatory agencies, Pension Subsidies, and Reissued Warrants.
(5) Includes property tax rollbacks, homestead exemption, and tangible property tax exemption.

* August 2001 estimates of the Office of Budget and Management.

Totals may not add up due to rounding.

variances and then to positive disbursement variances.

Job and Family Services. Year-to-date disbursement activity in the Department of Job and Family Services' operating expenses and subsidy programs – exclusive of Medicaid, TANF, and Disability Assistance, which are tracked under separate components of the Welfare and Human Services program category – fell an additional $7.2 million short of the estimate in February. For the year to date, the underage stood at $65.3 million.

Very little has changed since last month's report regarding the largest contributors to the negative year-to-date disbursement variance in this segment of the department's budget. The five line items that are the largest contributors are, in order of magnitude: (1) 600-416, Computer Projects ($23.8 million), (2) 600-504, Non-TANF County Administration ($7.7 million), (3) 600-200, Maintenance ($6.6 million), (4) 600-437, Temporary Heating

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
FY 2002 To Date Through February 2002
($ in thousands)

USE OF FUNDS

PROGRAM	Actual	Estimate*	Variance	FY 2001	Percent Change
Primary & Secondary Education (1)	$4,247,926	$4,437,290	($189,364)	$3,800,940	11.76%
Higher Education	$1,685,062	$1,736,233	($51,171)	$1,739,454	-3.13%
Total Education	$5,932,988	$6,173,523	($240,535)	$5,540,394	7.09%
Health Care/Medicaid	$4,902,602	$4,878,528	$24,074	$4,358,133	12.49%
Temporary Assistance to Needy Families (TANF	$366,395	$388,009	($21,615)	$619,207	-40.83%
General/Disability Assistance	$57,942	$56,533	$1,409	$47,460	22.09%
Other Welfare (2)	$355,114	$420,410	($65,296)	$390,559	-9.08%
Human Services (3)	$813,061	$838,086	($25,025)	$807,586	0.68%
Total Welfare & Human Services	$6,495,114	$6,581,567	($86,453)	$6,222,946	4.37%
Justice & Corrections	$1,227,720	$1,271,055	($43,335)	$1,210,687	1.41%
Environment & Natural Resources	$97,540	$100,041	($2,501)	$102,288	-4.64%
Transportation	$35,471	$32,293	$3,177	$28,811	23.12%
Development	$130,402	$133,029	($2,627)	$126,692	2.93%
Other Government (4)	$278,146	$295,831	($17,685)	$269,325	3.28%
Capital	$8,982	$3,322	$5,660	$43,123	-79.17%
Total Government Operations	$1,778,260	$1,835,571	($57,312)	$1,780,926	-0.15%
Property Tax Relief (5)	$633,498	$633,396	$102	$590,979	7.19%
Debt Service	$185,535	$196,683	($11,148)	$167,085	11.04%
Total Program Payments	**$15,025,394**	**$15,420,740**	**($395,346)**	**$14,302,330**	**5.06%**
TRANSFERS					
Local Govt Distribution	$0	$0	$0	$0	——
Budget Stabilization	$13,104	$13,104	$0	$49,200	-73.37%
Other Transfers Out	$16,858	$13,078	$3,780	$804,025	-97.90%
Total Transfers Out	$29,962	$26,182	$3,780	$853,225	-96.49%
TOTAL GRF USES	**$15,055,356**	**$15,446,922**	**($391,566)**	**$15,155,555**	**-0.66%**

(1) Includes Primary, Secondary, and Other Education.
(2) Includes the Department of Job and Family Services, exclusive of Medicaid, TANF, and General/Disability Assistance.
(3) Includes Mental Health, Mental Retardation and Developmental Disabilities, and Other Human Services.
(4) Includes Regulatory and Nonregulatory agencies, Pension Subsidies, and Reissued Warrants.
(5) Includes property tax rollbacks, homestead exemption, and tangible property tax exemption.

* August 2001 estimates of the Office of Budget and Management.

Totals may not add up due to rounding.

Assistance ($6.4 million), and (5) 600-528, Adoption Services ($5.4 million). Some of these underages reflect the impact of budget reductions imposed under Executive Order 2001-22T. This is particularly the case with line item 400-416, Computer Projects, and line item 600-200, Maintenance.

The appropriation for line item 600-528, Adoption Services, provides assistance to families that are adopting children. The amount expended from this line item depends in part on the rate of growth in adoptions in the state. The rate of growth has been lower than the department had forecast. Underlying the slower rate of growth are two factors. First, a federal policy change has impeded the use of private agencies for adoption by making families that adopted a child through a private adoption agency ineligible for an adoption subsidy. This federal policy has since been reversed. Second, the department was slower than anticipated in conducting public outreach and awareness activities. These activities tend to influence the adoption rate.

Mental Retardation. The same theme of little change is also to be found in the disbursements story for the Department of Mental Retardation and Developmental Disabilities – only the numbers have changed since last month's report. The department closed February with a $21.6 million negative year-to-date disbursement variance. As has been the case for several months, the bulk of the negative disbursement variance ($14.7 million from current-year funds and $5.2 million from prior-year funds) stems from line item 322-413, Residential and Support Services, reflecting factors affecting the processing of payments to service providers.

TANF. The year-to-date negative disbursement variance in GRF spending in the Temporary Assistance to Needy Families (TANF) program was reduced to $21.6 million in February with an overage of $46.2 million for the month. The bulk of the year-to-date underage is registered in line item 600-411, TANF Federal Block Grant, with spending of prior-year funds being $18.1 million below the estimate. Of this amount, $9.5 million was canceled under Executive Order 2001-22T.

February's positive disbursement variance of $46.2 million was timing-based, as state GRF funds in line item 600-410, TANF State, were substituted for federal funds to make advances to county departments of job and family services. These state funds were available due to underspending, particularly in October and December.

During the month, an additional $48.9 million was disbursed from non-GRF federal TANF funds.

Also in February, cash assistance benefits totaled $26.7 million. The number of TANF cash assistance recipients declined by about 2,500 to stand at about 200,400. The number of recipients per assistance group also continued to decline. The average number of recipients per assistance groups now stands at an all-time low of 2.31. This low ratio of recipients to assistance groups reflects the increasing proportion of cases that are classified as "child only" cases. Typically, these are cases where the children are living with an adult relative other than a parent, who is not also a TANF recipient. These cases make up nearly 45 percent of all TANF cases.

Health Care/Medicaid. Year-to-date disbursement activity through February in the Health Care/Medicaid program (primarily line item 600-525) stood at $24.1 million, or 0.5 percent, over the estimate of $4.88 billion. In February, the program recorded a $19.1 million positive disbursement variance.

As we have stated in previous monthly reports, the role that particular service categories played in producing this result is difficult to determine because the total of the estimates for the service categories that were produced by the Department of Job and Family Services differs from the original disbursements estimate developed in August 2001 by the department and the Office of Budget and Management (OBM). The disbursement estimates for the service categories that are included in Table 6 assume the inclusion of $65 million that is to be transferred from the Budget Stabilization Fund (BSF) and an additional federal contribution of $93 million in matching funds. These additional state and federal funds totaling $158 million (or an additional 2.2 percent) were not included in OBM's original disbursement estimates for the program as a whole. Moreover, the transfer has not yet taken place and appropriation authority for those funds does not yet exist. Tables 4 and 5, therefore, reflect the original disbursement estimates that were based on the program's appropriation authority in Am. Sub. H.B. 94. The Department of Job and Family Services and OBM have chosen to produce "budgeted" service category estimates that include the BSF and federal funds since Am. Sub. H.B. 94 permits the department to access these funds and OBM expects the department to use approximately $158 million (total from federal and state funds) in this fiscal year.

In order to reconcile Tables 4, 5, and 6, Table 6 includes an adjustment for these differences by subtracting from the bottom line the portion that is attributable to the BSF and matching federal funds. We are still left, however, with a fundamental "apples and oranges" problem when trying to discuss disbursement variances from the service category estimates. We see in Table 6, for example, that the year-to-date total disbursement variance plus the Children's Health Insurance Plan (CHIP) program is $83.4 million *under* the estimate, whereas when the BSF and matching federal funds are removed from

Table 6
Health Care Spending in FY 2002
Medicaid, ALI 600-525
($ in thousands)

Service Category	February Actual	February Estimate	February Variance	February Percent Variance	Year-to-Date Spending Actual thru' February	Year-to-Date Spending Estimate thru' February	Year-to-Date Spending Variance	Year-to-Date Spending Percent Variance
Nursing Facilities	$216,272	$208,125	$8,147	3.9%	$1,611,985	$1,630,867	($18,881)	-1.2%
ICF/MR	$33,288	$34,874	($1,586)	-4.5%	$269,931	$273,185	($3,253)	-1.2%
Hospitals	$101,100	$129,605	($28,505)	-22.0%	$1,003,308	$1,110,147	($106,839)	-9.6%
Inpatient Hospitals	$71,787	$94,409	($22,622)	-24.0%	$711,829	$806,638	($94,808)	-11.8%
Outpatient Hospitals	$29,313	$35,196	($5,883)	-16.7%	$291,479	$303,509	($12,030)	-4.0%
Physicians	$43,822	$36,979	$6,843	18.5%	$307,993	$315,490	($7,497)	-2.4%
Prescription Drugs	$81,879	$77,679	$4,199	5.4%	$675,405	$679,510	($4,105)	-0.6%
Payments	$103,028	$98,828	$4,199	4.2%	$823,453	$827,554	($4,101)	-0.5%
Rebates	($21,149)	($21,149)	$0	0.0%	($148,047)	($148,044)	($4)	0.0%
ODJFS Waivers[1]	$12,940	$12,375	$565	4.6%	$107,401	$103,938	$3,463	3.3%
HMO	$50,988	$47,528	$3,460	7.3%	$376,896	$351,675	$25,222	7.2%
Medicare Buy-In	$11,595	$10,795	$800	7.4%	$87,362	$84,622	$2,739	3.2%
All Other[2]	$59,751	$47,792	$11,958	25.0%	$433,296	$405,856	$27,440	6.8%
DSH offset	$0	$0	$0		$0	$0	$0	
Total ALI 600-525	**$611,635**	**$605,753**	**$5,881**	**1.0%**	**$4,873,578**	**$4,955,289**	**($81,712)**	**-1.6%**
FMAP	58.94%	58.94%			58.94%	58.94%		
Est. Federal Share	$360,497	$357,031	$3,466		$2,872,487	$2,920,647	($48,161)	
Est. State Share	$251,137	$248,722	$2,415		$2,001,091	$2,034,642	($33,551)	
BSF Shortfall[3]	$0	($13,228)			$0	($107,521)		
Total ALI 600-525 Disb.	**$611,635**	**$592,525**	**$19,109**	**3.2%**	**$4,873,578**	**$4,847,769**	**$25,809**	**0.5%**
Est. Federal Share	$360,497	$349,234	$11,263		$2,872,487	$2,857,275	$15,212	
Est. State Share	$251,137	$243,291	$7,846		$2,001,091	$1,990,494	$10,597	
Children's Health Insurance Plan (CHIP-II), ALI 600-426[4]								
Total ALI 600-426	**$3,821**	**$3,826**	**($4)**	**-0.1%**	**$29,025**	**$30,760**	**($1,735)**	**-5.6%**
Enhanced FMAP	71.19%	71.19%			71.19%	71.19%		
Est. Federal Share	$2,720	$2,724	($3)		$20,663	$21,898	($1,235)	
Est. State Share	$1,101	$1,102	($1)		$8,362	$8,862	($500)	
Total Health Care	**$615,456**	**$609,579**	**$5,877**	**1.0%**	**$4,902,602**	**$4,986,049**	**($83,447)**	**-1.7%**
Total Hlth Care w/o BSF	**$615,456**	**$596,351**	**$19,105**	**3.2%**	**$4,902,602**	**$4,878,528**	**$24,074**	**0.5%**

1. Waivers provide home care alternatives to consumers whose medical conditions/functional abilities would otherwise require Long Term Care facility residence.
2. "All Other" includes all other health services funded by 600-525 and prior years encumbrance.
3. The budget estimate assumed $65M of the Budget Stabilization Fund (BSF) will be used to increase appropriation in line item 525 by $158M, all funds in SFY02.
4. This portion of the table only includes CHIP-II spending through Job & Family Services' 600-426 line item.
CHIP-II, effective 7/1/2000, provides health care coverage for children under age 19, with family incomes between 150-200% of FPL.
Note: Due to accounting differences, the totals do not exactly match the amounts from Tables 4 and 5.

Source: BOMC8300-R001, BOMC8350-R001&R002 Reports, Ohio Department of Job & Family Services.

consideration, the year-to-date disbursement variance is converted to $24.1 million *over* the estimate.

Some useful information, however, can still be gleaned from the disbursement variances that are based on "budgeted" service category estimates, including anticipated BSF and matching federal funds, as opposed to estimates based on appropriated amounts. Indeed, we continue to see the pattern that we have reported on in previous months: disbursements to cover costs in the Nursing Facilities, Hospitals, Physicians, and Prescription Drug service categories all recorded disbursement variances under the "budgeted" estimates.

A similar observation can be made for the year-to-year comparison data in Table 7. There we see that spending in the Physicians, Prescription Drugs, ODJFS Waivers, HMO, and All Other service categories continues to outpace spending at the same point in time during the previous year.

Table 7
FY 2002 to FY 2001 Comparison[1] of Year-to-Date Medicaid (600-525) Spending
($ in thousands)

Service Category	FY 2002[1] Yr.-to-Date as of Feb. '01	FY 2001[1] Yr.-to-Date as of Feb. '00	Dollar Change	Percent Increase
Nursing Facilities	$1,611,985	$1,521,891	$90,095	5.9%
ICF/MR	$269,931	$256,463	$13,469	5.3%
Hospitals	$1,003,308	$971,166	$32,143	3.3%
Inpatient Hospitals	$711,829	$706,441	$5,389	0.8%
Outpatient Hospitals	$291,479	$264,725	$26,754	10.1%
Physicians	$307,993	$263,173	$44,820	17.0%
Prescription Drugs	$675,405	$546,764	$128,641	23.5%
Payments	$823,453	$680,668	$142,785	21.0%
Rebates	($148,047)	($133,904)	($14,144)	10.6%
ODJFS Waivers[2]	$107,401	$90,514	$16,888	18.7%
HMO	$376,896	$273,367	$103,529	37.9%
Medicare Buy-In	$87,362	$78,419	$8,943	11.4%
All Other[3]	$433,296	$339,041	$94,255	27.8%
DSH offset	$0	$0	$0	
Total (600-525)	**$4,873,578**	**$4,340,796**	**$532,782**	**12.3%**
Estimated Federal Share[4]	$2,872,487	$2,546,745	$325,742	12.8%
Estimated State Share	$2,001,091	$1,794,051	$207,040	11.5%

1. Includes spending from prior year encumbrances in the "All Other" category.
2. Waivers provide home care alternatives to consumers whose medical conditions/functional abilities would otherwise require Long Term Care facility residence.
3. "All Other" includes all other health services funded by 600-525 and prior year encumbrance.
4. The FMAP rate for SFY 2001 is 58.67%. The FMAP rate for SFY 2002 is 58.94%.
Note: Due to accounting differences, the totals do not exactly match the amounts from Table 5.

The Medicaid caseload continued to grow by more than 11,000 eligibles in February. The Covered Families and Children (CFC) caseload is now at nearly 52,000 persons above the projection for February, marking the fifth month in a row that CFCs have exceeded the projection. The Aged, Blind, or Disabled (ABD) caseload has exceeded the projection for each month so far this fiscal year. ABDs are now about 6,700 persons above the caseload projection.

Mental Health. As we have reported in previous reports, the main factor that produces disbursement variances in the budget of the Department of Mental Health is the discretion that county mental health boards exercise in drawing down subsidy payments, particularly from line item 334-408, Community and Hospital Mental Health Services. The timing of payments can differ a great deal from the pattern of last fiscal year, on which this year's disbursement estimates are based. February's disbursements from line item 334-408 were $8.1 million under the estimate, thus reducing the department's positive year-to-date disbursement variance to $20.4 million.

Government Operations (-$57.3 million)

Rehabilitation & Correction. The Department of Rehabilitation and Correction recorded a $7.0 million negative disbursement variance in February, bringing its year-to-date disbursement variance to $36.2 million below the estimate. Mirroring last month, the bulk of the negative year-to-date disbursement variance ($21.6 million, or 59.7 percent) is traceable to line item 501-321, Institutional Operations. Executive Order 2001-22T reduced the FY 2002 appropriation authority in line item 501-321 by $16.8 million. Most of the department's other GRF line items are also spending under their estimates.

Administrative Services. Through February, the Department of Administrative Services (DAS) posted an $11.5 million negative year-to-date disbursement variance. A significant portion of the year-to-date underage is attributable to slower-than-anticipated reconciliation of contractor billings for several of the component line items within the department's Computer Services program series. In particular, spending from line item 100-419, Ohio SONET, which pays for the costs of leasing fiber optic lines used by all state agencies, is $2.0 million below the year-to-date estimate. Expenditures in this line item frequently lag the estimate due to billing delays.

Another $3.0 million of the department's negative year-to-date disbursement variance (as we noted last month as well) can be explained by less-than-expected debt service or "rental payments" from line item 100-447, OBA Building Rent Payments, which are made on behalf of agencies occupying buildings managed by the Ohio Building Authority.

Tax Relief ($0.1 million)

The Property Tax Relief program, which carries a FY 2002 GRF appropriation of nearly $1.2 billion, reimburses school districts and local governments for revenue that is lost due to tax relief provided by state law to property owners and businesses. Tax relief funds are disbursed to school districts and local governments by the Department of Education and the Department of Taxation, respectively. Each of these departments divides its property tax relief program into two components: real property tax credits/exemptions, and tangible tax exemptions. Through February, $633.5 million had been disbursed, which represented spending that is a negligible $102,000 above the year-to-date estimate.

**LSC colleagues who contributed to the development of this disbursement report included, in alphabetical order, Melaney Carter, Ivy Chen, Nelson Fox, Chris Murray, David Price, Joseph Rogers, Maria Seaman, and Holly Simpkins.*

DPIA ALL-DAY AND EVERYDAY KINDERGARTEN FUNDING UPDATE[1]

— *Wendy Zhan*

It has been four years since the inception of state funding for all-day and everyday kindergarten within the Disadvantaged Pupil Impact Aid (DPIA) program in FY 1999.[2] Today, the vast majority of school districts that are eligible for the all-day and everyday kindergarten funding are providing this service to their kindergarten students. Approximately 34 percent of kindergarten students statewide are eligible for the all-day and everyday kindergarten funding, and approximately 31 percent of kindergarten students actually receive the service and the state funding. The percentage of eligible districts that actually provide the service has increased from 85.7 percent in FY 1999 to 97.2 percent in FY 2002. The number of eligible districts providing the service has increased from 91 in FY 1999 to 104 in FY 2002, an increase of 14.3 percent.

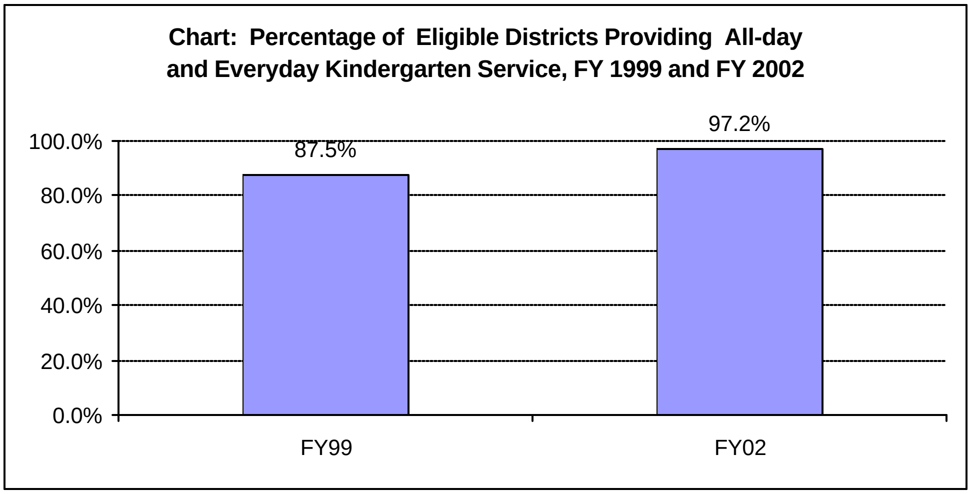
Under the DPIA program, a district with a DPIA index of at least one (which would indicate that the district has at least the statewide average poverty rate) or with a three-year average formula ADM (average daily membership) exceeding 17,500 is eligible for the all-day and everyday kindergarten funding. Meanwhile, an eligible district that actually provided the service in a preceding year is guaranteed to receive the funding regardless of change in the district's DPIA index from one year to another. The change in a district's DPIA index from slightly above one to slightly below one or vice verse has a significant impact on the district's all-day and everyday kindergarten funding. However, the "grandfather" provision protects districts that have taken part in the program from losing their eligibility for funding.

The FY 2002 DPIA appropriation item (200-520) contains approximately $109.1 million in all-day and everyday kindergarten funding for the 107 eligible districts. The appropriation was made by assuming all eligible districts will provide this service to all of their kindergartens students. However, the actual funding amount is based on each district's percentage of kindergarten students actually receiving the service. The formula to determine a district's actual funding amount for all-day kindergarten in FY 2002 is as follows:

FY 2002 Kindergarten ADM x 50% x $4,814
x Actual All-day and Everyday Kindergarten %
($4,814 – per pupil base cost formula amount in FY 2002)
(The other 50% of kindergarten ADM are included in the formula to qualify for base cost funding.)

An eligible district is required to certify its all-day and everyday kindergarten percentage to the Department of Education by August 1. According to data reported by the 107 eligible districts, 67 districts (62.6 percent) provide the service at the 100 percent level and 37 districts (34.6 percent) provide the service at the levels ranging from less than 10 percent to 99.8 percent. The remaining three districts (2.8 percent) do not provide the all-day and everyday kindergarten service in FY 2002. In fact, New Lexington City and Crooksville Exempted Village (both in Perry County) are the only two eligible districts that have not provided the all-day and everyday kindergarten service in all four years. (North Bass Local in Ottawa County is eligible, but does not have any kindergarten students.)

It appears from current available data that the all-day and everyday kindergarten appropriation may exceed the needed funding by approximately $15.1 million in FY 2002. Of this amount, however, only $9.1 million is due to the fact that some eligible districts provide this service to only a portion of their kindergarten students and three eligible districts do not provide this service at all in FY 2002. The other



$6.0 million in "surplus" money is due to the kindergarten student enrollment projection that was used for the appropriation. That projection exceeds the actual October student counts by approximately 2,496 students.

All Big Eight districts[3] are eligible for the all-day and everyday kindergarten funding. Columbus City and Canton City (Stark County) provide the service to 99.8 and 97.2 percent, respectively, of their kindergarten students. The other six Big Eight districts provide the service to all of their kindergarten students. Of $94.0 million in all-day and everyday kindergarten funding in FY 2002, $55.0 million (or 58.5 percent) goes to the Big Eight districts.

It should be noted that the DPIA appropriation item is one of several line items that are collectively used to pay state formula aid obligations for school districts and joint vocational school districts. H.B. 94 of the 124th General Assembly states that the first priority of these formula line items, with the exception of specific set-asides, is to fund state formula aid obligations under Chapter 3317. of the Revised Code. If it is necessary to reallocate funds among the formula aid appropriation items to meet the state obligations, the Department of Education is required to seek approval from the Controlling Board to transfer funds among the formula aid appropriation items.

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[1] The FY 2002 update is based on the February No. 2 payment file calculated by School Finance of the Department of Education. There may be some minor data corrections throughout the rest of the fiscal year. The year-end payments for some districts may be somewhat different.

The updates for FY 1999 and FY 2000 can be found in previous issues of *Budget Footnotes* (Vol. 22, no. 4, January 1999, and Vol. 23, no. 5, March 2000). The FY 2001 update was provided in the section called The Foundation SF-3 Formula of the Education Redbook – an analysis of the executive budget for the Department of Education for FY 2002-FY 2003, February 2001.

[2] The state provides half-day kindergarten funding for all school districts. Kindergarten students are counted at the 50 percent level in each district's formula ADM (average daily membership) count to qualify for base cost funding.

[3] These districts are Akron City, Canton City, Cincinnati City, Cleveland City, Columbus City, Dayton City, Toledo City, and Youngstown City.

Previous Next

School District Property Tax Replacement – S.B. 3 and S.B. 287 of the 123rd General Assembly

Wendy Zhan

Changes made by S.B. 3 and S.B. 287 of the 123rd General Assembly reduce the assessment rates on certain tangible personal property of electric utilities and all tangible personal property of gas utilities from 50 percent, 88 percent, or 100 percent of true value to 25 percent of true value beginning in tax year 2001. These rate changes reduce the valuation of public utility tangible property by approximately $4.4 billion statewide and result in a property tax revenue loss of approximately $198.0 million per year for the 612 school districts and the 49 joint vocational school districts. However, S.B. 3 and S.B. 287 also create two new taxes: the kilowatt-hour tax (KWH tax) on electricity and the thousand cubic foot tax (MCF tax) on natural gas. Twenty-five and four-tenths percent of KWH tax revenues and 68.7 percent of MCF tax revenues are earmarked for the School District Property Tax Replacement Fund to be used for reimbursing schools for their property tax losses. Since the assessment rate reductions first occurred in tax year 2001 and public utilities pay taxes on the same schedule as real property taxpayers, the tax changes first impacted local revenues in the February 2002 collection. This article explains the mechanism under which schools are compensated for their tax losses. The first direct reimbursement payment, of approximately $99.0 million, was made to school districts and joint vocational school districts on March 1, 2002. The money was paid out of funds from appropriation item 200-900 (Fund 053), School District Property Tax Replacement.

Determination of the Tax Value Loss

The Department of Taxation is required to determine the tax value loss for each taxing district due to the assessment rate reductions. This is a one-time determination. The tax value loss for a taxing district is defined as the difference between its actual valuation and what its valuation would have been if S.B. 3 and S.B. 287 had been in effect in a certain year. Tax year 1998 data were used for the electric utilities determinations and tax year 1999 data were used for the gas utilities determinations. According to the Department of Taxation's calculations, S.B. 3 and S.B. 287 reduce the valuation of public utility tangible property by approximately $4.4 billion statewide, representing approximately 32.4 percent of the public utility tangible valuation or 2.3 percent of total assessed valuation statewide in tax year 1999. Per pupil tax value loss ranges from more than $10,000 in a few districts to less than $300 in other districts, with a statewide average of $2,582 per pupil. The statewide median tax value loss is $1,320 per pupil. The tax value loss as a percentage of total assessed valuation ranges from more than 10 percent in a few districts to less than 1 percent in many other districts. While the statewide average loss is 2.3 percent, the statewide median loss is 1.3 percent. Chart 1 shows the distribution of the tax value loss as a percentage of districts' total assessed valuations. For 533 districts (or 87.1 percent), the tax value losses are less than

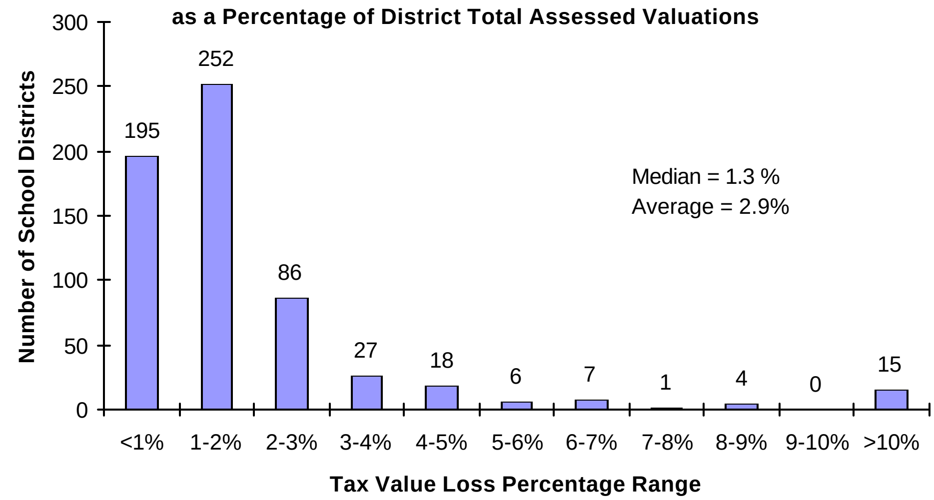


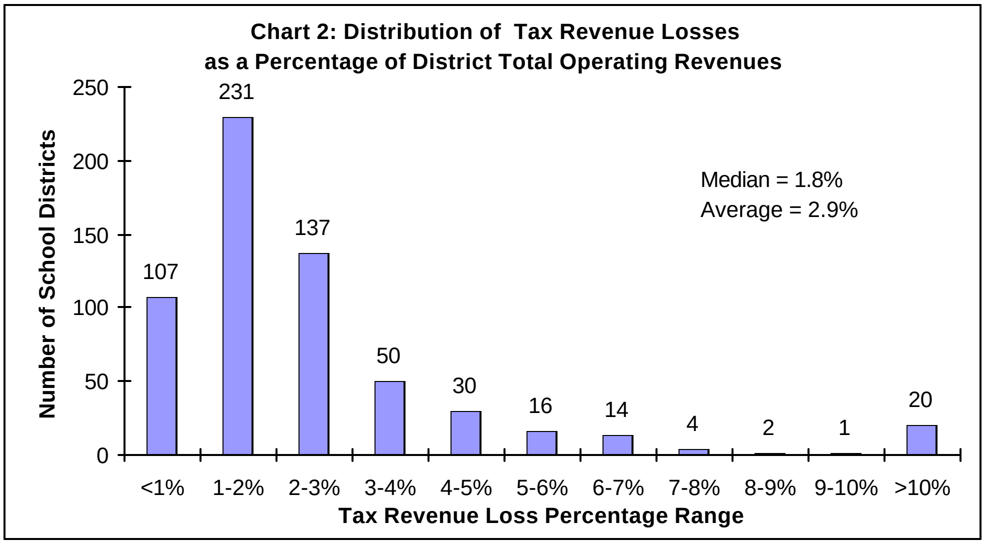
Chart 1: Distribution of Tax Value Losses as a Percentage of District Total Assessed Valuations

3 percent of their total assessed valuations and for 578 districts (or 94.4 percent) the losses are less than 5 percent. Meanwhile, the losses are more than 10 percent in 15 districts and are approximately 40 percent in three of those 15.

Determination of the Tax Revenue Loss

The Department of Taxation is also required to determine the tax revenue loss for each taxing unit; this loss is used as the basis for direct reimbursements. Again, this is a one-time determination, which uses the greater of the effective tax rates in tax years 1998 and 1999 (except for levies passed after June 30, 1999) for electric property and the greater of the effective tax rates in tax years 1999 and 2000 for gas property. To calculate the tax loss, levies are grouped into two categories: fixed-rate levies in which the gross tax rate is constant, such as current operating expense or permanent improvement levies, and fixed-sum levies in which the gross tax rate is adjusted annually to raise a specific amount of money every year, such as emergency or bond levies. While the fixed-rate-levy tax loss is fully eligible for reimbursements, the fixed-sum-levy loss has to meet a 0.25 mill threshold in order to be eligible. Under current law if a taxing unit's total assessed value decreases, the fixed-sum-levy rates will be adjusted upward to ensure the specified amount of money is raised. If the tax value loss due to S.B. 3 and S.B. 287 results in fixed-sum-levy rate adjustments of less than 0.25 mills, the tax rates will be allowed to increase and no state reimbursements will be made. If the rate adjustments are more than 0.25 mills, the state will reimburse the district for the full amount above 0.25 mills. While all school districts are eligible for fixed-rate-levy tax loss reimbursements, only 44 districts (or 7.2 percent) meet the 0.25 mill threshold and will be reimbursed for fixed-sum-levy tax losses.

According to the Department of Taxation's determinations, the fixed-rate-levy tax loss amounts to approximately $186.2 million for the 612 school districts and $8.0 million for the 49 joint vocational school districts. The 44 school districts eligible for fixed-sum-levy tax loss reimbursements will also receive approximately $3.8 million in these reimbursements. The total loss in these three categories is $198.0 ($186.0 + $8.2 + $3.8) million. Per pupil fixed-rate-levy tax losses range from more than $1,000 in a few districts to less than $10 in some other districts, with a statewide average of $108 per pupil. The statewide median loss is $57.0 per pupil. The fixed-rate-levy tax loss as a percentage of school district total operating revenues (including both property taxes and school district income taxes) ranged in FY 2001 from more than 10 percent in a few districts to less than 1 percent in many other districts. Chart 2 shows the distribution of total fixed-rate tax losses as a percentage of district total operating revenues. Once again, it can be seen that the tax revenue losses due to S.B. 3 and S.B. 287 for the majority of school districts (475 districts or 77.6 percent) are less than 3 percent of their total operating revenues. The statewide average loss is 2.9 percent, and the statewide median loss is 1.8 percent; 57 school districts experience losses of more than 5 percent. The losses for 20 of these 57 districts are more than 10 percent, with the highest percentage being approximately 47.0 percent.



Duration of the Tax Revenue Loss Reimbursements

Direct reimbursements are to be made to the 612 school districts for five years (2002-2006). After five years, a district will be reimbursed only if the change in its state education aid from FY 2002 to a given fiscal year is less than the inflation-adjusted fixed-rate-levy tax loss. This comparison will be made for ten additional years (2007-2016). Only a small number of school districts, those with significant tax revenue losses, are likely to be eligible for direct reimbursements after 2006. For the 49 joint vocational school districts, tax losses are to be reimbursed for 15 years (2002-2016). Bond levies are to be reimbursed for the life of the levy. Emergency levies are generally to be reimbursed for five years with potential additional reimbursements for ten years if levies are renewed.

It should be noted that any money in the School District Property Tax Replacement Fund that is not needed for direct reimbursements in a given year will be distributed to school districts (including joint vocational school districts) on a per pupil basis for capital improvements. In other words, after 2006 the bulk of the money deposited into the School District Property Tax Replacement Fund will be distributed to school districts on a per pupil basis. This will provide an additional source of state capital funding for schools.

Disbursements of the Tax Revenue Loss Reimbursement Money

The Department of Education is responsible for distributing the reimbursement money to school districts and joint vocational school districts. Payments are to be made twice a year, once in late February and once in late August. As mentioned earlier, the first payment of approximately $99.0 million was disbursed on March 1, 2002. Each school district received in the first payment 50 percent of its total tax loss as determined by the Department of Taxation. Beginning in July 2002, a state education aid offset will be calculated every year for each school district. The state education aid offset is the amount of additional state aid a district receives due to a lower valuation resulting from S.B 3 and S.B. 287. The difference between a district's total tax revenue loss and the state education aid offset will be directly disbursed to school districts in two (August and February) equal payments every year. The remaining sections of this article discuss the interaction between state education aid and direct reimbursements.

State Education Aid Offset

To understand the concept of the state education aid offset, one has to first understand the Ohio school funding model and how state aid is distributed to school districts. The Ohio school funding model includes two main cost components: a uniform per pupil base cost and various adjustments to the base cost to account for unique cost pressures facing individual school districts (such as labor market costs, special education, career-technical education, student poverty, and pupil transportation). The model includes both state and local funding. Once the total cost is determined for an individual district, various formulas are used to split the total cost between the state and the district.

Why Calculate the State Education Aid Offset?

The heart of the Ohio school funding model is the base cost, and the bulk of state education subsidies are distributed to school districts through the base cost funding formula. The base cost funding formula guarantees a minimum amount of per pupil funding (adjusted by a countywide cost of doing business factor) for every student in every district. The per pupil base cost funding is $4,814 in FY 2002 and $4,949 in FY 2003. Total base cost for a district in FY 2003 is determined by multiplying $4,949 by the number of students and by the cost of doing business factor as follows:

Total Base Cost = $4,949 x Cost of Doing Business Factor x Number of Students

Example 1

If District A has 1,000 students and a cost of doing business factor of one, the district's total base cost in FY 2003 will be $4,949,000 ($4,949 x 1 x 1,000).

The base cost funding guarantee reflects a partnership between the state and local school districts. The local share is a fixed amount of revenues generated by a uniform 23 effective mills against total property valuation. To prevent significant fluctuations in state aid from one year to another, the base cost funding formula phases in (or recognizes) over a three-year period a district's reappraisal/update growth in real property. The local share is determined as follows:

District's Local Share = 23 Mills (0.023) x Total Recognized Valuation

Example 1, continued

Assuming District A's total recognized valuation is $107,586,957 in FY 2003, the district's local share will be $2,474,500 ($107,586,957 x 0.023).

The state share of the base cost funding is defined as the difference between the total base cost and the district's local share.

State Base Cost Funding = Total Base Cost - District's Local Share

Example 1, continued

Under the formula, the state base cost funding for District A will be $2,474,500 ($4,949,000 - $2,474,500). In other words, for the average-wealth District A, the state pays 50 percent ($2,475,500/$4,949,000) of the total base cost funding and the district pays the other 50 percent.

Now let's assume District A's total property value decreases by 10 percent to $96,828,261 in FY 2003. Since the number of students remains the same, the total base cost for District A therefore remains the same at $4,949,000. However, with a lower valuation, the same 23 mills will generate a smaller amount of revenues. The district's local share therefore decreases from $2,474,000 to $2,227,050 ($96,828,261 x 0.023). The state base cost funding for District A accordingly increases from $2,474,000 to $2,721,950 ($4,949,000 - $2,227,050). The state now provides 55 percent ($2,721,950/$4,949,000) of District A's total base cost funding and the district pays the remaining 45 percent.

As can be seen from District A's example, when a district's property value decreases, the base cost funding formula automatically requires the state to provide more state aid to the district. In other words, the base cost funding formula generally provides more state aid to a district to make up its tax loss from the first 23 mills. This is why a state education aid offset needs to be calculated every year. Without this calculation, the state would be forced to compensate school districts twice for their tax revenue losses for the first 23 mills – once via state education aid and once in direct reimbursements from the School Property Tax Replacement Fund.

The lower assessment rates resulting from S.B. 3 and S.B. 287 first affect tax data in tax year 2001. Tax year 2001 data are used for calculating state education aid in FY 2003 (July 1, 2002 – June 30, 2003). Since tax year 2001 data do not affect state education aid calculations in FY 2002, the first February 2002 payment therefore did not have the state education aid offset effect.[1] All school districts received 50 percent of their total annual tax losses. Beginning in FY 2003, however, the lower valuations due to S.B. 3 and S.B. 287 will increase state aid for many school districts. Each district's state education aid offset therefore needs to be calculated every year beginning in FY 2003. The Department of Education is required to calculate each district's state education aid offset by July 31 every year. The difference between a district's total annual tax loss and its state education aid offset will be disbursed directly to the district in two equal payments.

Calculating the State Education Aid Offset

While the base cost funding formula generally makes up the first 23 mills of tax loss for a school district, the tax rates on public utility property for the vast majority of school districts are higher than 23 mills. The statewide average tax rate on public utility property was approximately 43 mills in tax year 2000. In other words, state aid is unlikely to make up the full amounts of tax revenue losses for most school districts.

It should be noted that the base cost funding is only one – albeit the biggest – component of the school funding formulas. A decrease in a district's property value will also affect the amount of state aid the district will receive through various other components of the formulas. A district's state share percentage of the base cost funding is used to determine state funding amounts from many of those components.[2] The state education aid offset for a district includes the effect of a lower property valuation on all components of the school funding formulas.

To calculate a district's state education aid offset in FY 2003, for example, the Department of Education will first calculate the district's state education aid based on tax year 2001 data. Then the Department of Education will add back the district's certified tax value loss and recalculate the district's state education aid. Since the total state and local education funding remains the same for the district, a higher valuation generally decreases the district's state aid amount. The difference between the original (generally higher) state aid amount and the recalculated (generally lower) state aid amount is deemed the state education aid offset.

Example 2

> District B's certified total tax value loss is \$167,616,871 and its certified total tax revenue loss is \$5,339,498. District B's total property value in tax year 2001 was \$407,976,766. On the basis of this valuation, District B will receive \$20,771,023 in formula-calculated state education aid in FY 2003.
>
> To determine District B's state education aid offset, the Department of Education will calculate the amount of state aid District B would receive if the district's total property value were \$575,593,637 (\$407,976,766 + \$167,616,871). Assuming the calculated amount is \$16,771,023, then the state education aid offset would be \$4,000,000 (\$20,771,023 - \$16,771,023). In other words, of \$20,771,023 in District B's state education aid in FY 2003, \$4,000,000 would be due to a lower valuation resulting from S.B. 3 and S.B. 287.
>
> The difference between District B's certified tax revenue loss (\$5,339,498) and the state education aid offset (\$4,000,000) would be \$1,339,498, which would be disbursed directly to the district from the School District Property Tax Replacement Fund. District B would receive \$669,749 (\$1,339,498/2) in the August 2002 payment and another \$669,749 in the February 2003 payment.

Example 2 shows how funding works for school districts receiving state aid under the formula calculations alone. However, the amounts of state aid received by some districts are not completely dependent on the formula calculations. Various guarantee provisions in the school funding formulas provide state aid above the formula-calculated amounts to school districts. Some districts are on the guarantee because their levels of property wealth are above the base cost funding formula equalization level. Other districts are on the guarantee due to their rapid growth in property value or declining enrollments or both. (In FY 2003, an estimated 21 districts will be too wealthy to receive any state base cost funding from the formula calculations alone and roughly 69 other districts are likely to be on the guarantee due to changes in their property value or enrollment or both.) For a guarantee district, a decrease in its property value may or may not change its state education aid amount. If the loss in property value is not big enough to push the district out of the guarantee, the district's state education aid amount will not change and its state education aid offset will be zero. The district will receive the full amount of its certified tax revenue loss from direct reimbursements. If a guarantee district becomes a formula district due to the decrease in property value, the district's state education aid will increase and its state education aid offset will be greater than zero. The district's tax loss will then be reimbursed partly by an increase in state aid and partly by direct reimbursements.

The state education aid offset for each of the 49 joint vocational school districts will be determined in the same fashion as for other school districts beginning in FY 2003. The local share of the base cost funding for the joint vocational school districts is a uniform 0.5 mills of property tax levies.

H.B. 94 of the 124th General Assembly appropriated \$102.0 million in FY 2002 for item 200-900 (Fund 053), School District Property Tax Replacement. This money is used to support the February 2002 payment, which does not have the state education offset effect. The FY 2003 appropriations include $115,911,593 for the School District Property Tax Replacement item and an estimated $91,488,407 in the state education aid offset within item 200-501, Base Cost Funding. The Department of Education will perform the actual state education aid offset determination in late July 2002. The Director of Budget and Management is authorized to adjust appropriations for these two line items based on the Department of Education's determination. In short, through the combination of the state education aid offset and direct reimbursements, school districts are guaranteed to receive assistance reflecting their certified annual tax losses of approximately $198.0 million per year.

[1] In FY 2002 state education aid calculations are based on tax year 2000 data.

[2] The other components of the school funding formulas that will be affected by the changes in property value include the special education weight cost funding, special education speech service supplement, career-technical weight cost funding, career-technical associated service funding, GRADS teacher grant, gifted unit funding, pupil transportation, excess cost supplement, equity aid, parity aid, and the charge-off supplement.

Local Government Property Tax Replacement – S.B. 3 and S.B. 287 of the 123rd General Assembly

Nickie Ringer

The changes S.B. 3 and S.B. 287 made to public utility tangible property taxes affect not only school districts, but also any local government with property tax levies. As explained in the "School District Property Tax Replacement" article above, the assessment rate changes reduced the valuation of public utility tangible property by approximately $4.4 billion statewide. This reduction is equal to 2.3 percent of the assessed value of all taxable property. The reduction resulted in a property tax revenue loss of more than $90 million per year for local taxing districts.[1] Like school districts, local taxing districts are reimbursed for this loss. S.B. 3 established the Local Government Property Tax Replacement Fund.[2] This fund receives 11.6 percent of kilowatt-hour tax revenue and 31.3 percent of thousand-cubic-foot (MCF) tax revenue.[3] H.B. 94 of the 124th General Assembly appropriated $43.7 million in FY 2002 and $88.8 million in FY 2003 for item 110-900 (Fund 054), Local Government Property Tax Replacement, to make the required reimbursements.

Reimbursements to Local Governments

Reimbursement to local governments for the public utility tangible property tax revenue loss is relatively clear-cut. In October 2001, the Department of Taxation calculated the "tax value loss" and the "tax revenue loss" determinations for each taxing district as described in the "School District Property Tax Replacement" article above. The annual fixed-rate-levy loss[4] amounts to approximately $89.6 million for local governments. For the first five years, CY 2002-2007, local governments are fully reimbursed for the loss. In the next five years, CY 2008-2013, they receive 80 percent of the calculated loss. The remaining revenue in the fund is to be distributed to local governments, but its distribution is based on a different formula, as described below. In the following five years, 2014-2019, payments are to be phased out by about 13.3 percent per year.[5] Beginning in 2020, no direct payments for fixed-rate levies will be made from the Local Government Property Tax Replacement Fund. Four local governments are eligible for reimbursement for fixed-sum levy losses. Fixed-sum reimbursements are to be reimbursed for the life of the levies, whether more or less than 15 years. Currently the total of fixed-sum reimbursements to local governments is just over $1 million per year.

Beginning in CY 2002, any excess money in the Local Government Property Tax Replacement Fund is to be allocated to counties for distribution to taxing districts in the county. One-half of the excess is to be distributed based on the proportion of each taxing district's calculated loss to the total loss for all districts in the county. The other half is to be distributed based on population. Each county must distribute these revenues to all taxing districts based on each district's current property tax as a proportion of all local government property taxes in the county. This distribution method will continue after direct payments are completely phased out.

The Department of Taxation is responsible for distributing the reimbursement money to local governments. Payments equal to one-half of the local government annual total tax loss (that is, the sum of the fixed-rate-levy loss and the fixed-sum-levy loss) are to be made twice a year, once in late February and once in late August. The first distribution of the Local Government Property Tax Replacement Fund took place on March 1, 2002. The Department of Taxation distributed $45.3 million to county auditors, who then distributed the moneys to each local government within the counties.[6] Because the reimbursement calculations for the Local Government Property Tax Replacement Fund are one-time calculations, the amount distributed to each local government will remain constant for the first five years.[7]

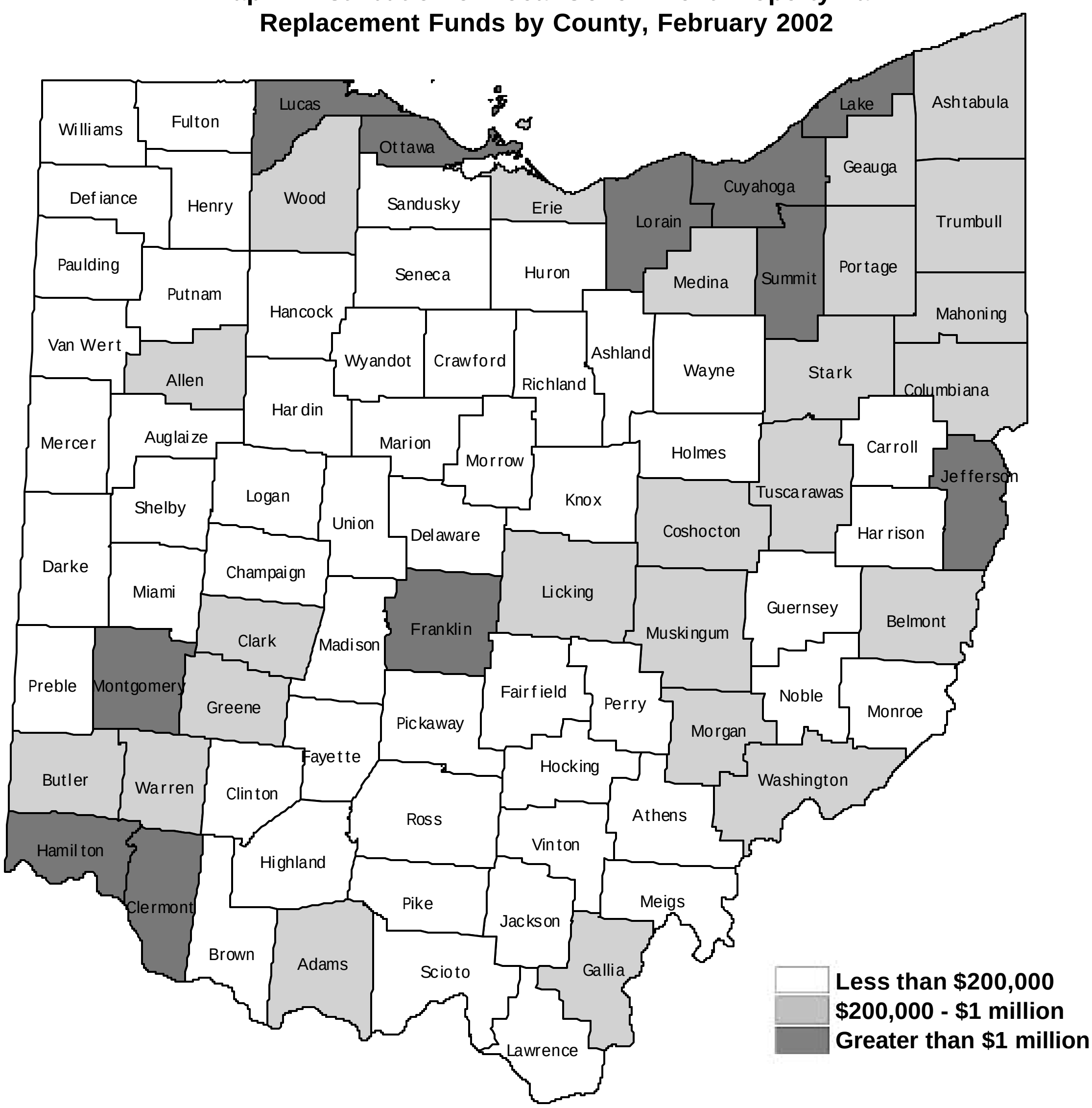
The amounts distributed to counties in February varied greatly from county to county. For example, local governments in Wyandot County received a total of $15,840; in Lake County local governments received a total of $5,355,184. Map 1, below, displays the range of total disbursements made to each county. In 53 of the 88 counties, total reimbursements to local governments were less than $200,000. In 24 counties the total amount reimbursed to local governments was $200,000 - $1 million. In 11 counties the total amount reimbursed to local governments was greater than $1 million. Map 2 displays the ranges of February disbursements per capita. These figures show a more even distribution, with a few exceptions for counties with significant power plant installations. For example, Adams County received $31.49 per capita while Wyandot County received $0.69 per capita. In fact, in 76 of the 88 counties the amount distributed per capita was less than $5.00. In eight counties the amount distributed per capita was $5.00 - $20.00. Four counties received more than $20.00 per capita.

As stated above, the Department of Taxation distributes the moneys to each county auditor, who then credits each taxing district with the appropriate amount. Statewide, counties are to receive 54 percent of the reimbursements from the Local Government Property Tax Replacement Fund, townships are to receive 19 percent, municipalities are to receive 16 percent, and special taxing districts are to receive the remaining 11 percent.

Recoupment of County Auditor and Treasurer Fees

The reduction of the assessment rates, and thus property tax revenues, created a reduction in revenue for county auditors and county treasurers, who currently are permitted to collect a small percentage

Map 1: Distribution of Local Government Property Tax Replacement Funds by County, February 2002



of property tax revenues to cover the cost of administering the taxes. The law also permits county auditors and treasurers to recoup this lost revenue. For the first five years the recoupment is the value loss times 0.9659 percent in counties with over $150 million in total property tax collections. In counties with $150 million or less in total property tax collections, the value loss is multiplied by 1.1159 percent. For the following five years the reimbursement is the difference between the 1998 fees and the fees in the current year. This year county auditors and treasurers will recoup $2,976,338. They will recover the recoupment from regular property tax collections.

Map 2: Distribution of Local Government Property Tax Replacement Funds Per Capita by County, February 2002

Less than $5.00 per capita
$5.00 - $20.00 per capita
Greater than $20.00 per capita

Sources: *The Ohio Department of Taxation, Tax Analysis.*

[1] In this article the terms “local taxing districts” and “local governments” are used to refer to counties, municipal corporations, townships, and various special taxing districts that levy property taxes. As used in this article, the terms specifically exclude school districts.

[2] S.B. 3 concerned only electric utility property. S.B. 287 created the MCF tax to replace the lost property tax revenue from the reduced assessment rates on natural gas company property. The receipts are to be deposited into the School District Property Tax Replacement Fund and the Local Government Property Tax Replacement Fund, created by S.B. 3.

[3] The kilowatt-hour tax is an excise tax levied on the distribution of electricity, the MCF tax is an excise tax levied on the distribution of natural gas.

The distribution of the kilowatt-hour tax and the MCF tax was altered in Sub. H.B. 129 of the 124th General Assembly, which will be effective on June 3, 2002. The percentages of the taxes benefiting the Local Government Property Tax Replacement Fund were slightly increased, while the percentage benefiting the School District Property Tax Replacement Fund were slightly decreased. The revised distribution formula is based on a more accurate calculation of the respective share of revenue that each local government category lost due to the assessment rate reductions. The new rates are reflected in this article.

[4] As described in the discussion of the School District Property Tax Replacement Fund, a "fixed rate levy" is a levy with a constant gross tax rate. By contrast, a "fixed sum levy" is a levy generating a constant sum; the rate is adjusted to account for increases and decreases in the taxable value (e.g., debt levies).

[5] S.B. 3 made an exception for the Lake County Park District. It will receive 100 percent of its payments for the full 15 years.

[6] This amount slightly exceeds the amount appropriated. Uncodified law in H.B. 94 appropriated additional moneys for this purpose if it is determined that such appropriations are needed.

[7] Some small corrections have been made to the reimbursement amounts since the first payment.