Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE SERVICE COMMISSION JULY, 2002

FISCAL OVERVIEW

— Doris Mahaffey

FY 2002 ended with a shudder and a sigh. On June 28, 2002, the last business day of the fiscal year, the General Revenue Fund (GRF) ending balance was $619.2 million. As shown in Table 1, $510.9 million of this was encumbered, leaving an unobligated balance of $108.3 million. The Budget Stabilization Fund (BSF) had a balance of $427.9 million – a reduction of $574.6 million from its balance at the end of FY 2001.

Needless to say, FY 2002 was a difficult year. It started with the economy in recession, although that was neither official nor really suspected at the time. In fact, the economy seemed to be heading toward another soft landing until the terrible events of September 11, 2001, slammed on the brakes.

The recession, in turn, put the brakes on state tax collections, but the recession was not the sole cause of state revenue shortfalls. The tumbling stock market contributed greatly. By the end of CY 2001, the stock market had fallen to just about the same level it had reached at the end of CY 1998. Stock market gains had helped generate large budget surpluses in FYs 1997 through 2000. However, just when everyone was getting used to the "April surprise" in the form of substantial capital-gains-led overages in personal income tax collections, April income tax collections produced a surprise of a less savory sort. The evaporation of stock market-led capital gains contributed to the year's $900 million shortfall in personal income tax revenues.

Although the largest revenue shortfall was in personal income tax revenue collections, the personal income tax was not alone. Sales and use tax and corporate franchise tax revenues were also significantly under estimate for the year. Total tax revenues were $1.4 billion under the estimates made in May 2001, when the final version of Am. Sub. H.B. 94, the general appropriations bill for the biennium, was taking shape. Since then, revenues have been reestimated numerous times – most notably in October 2001 by the Office of Budget and Management (OBM) and in May 2002 by the Legislative Service Commission (LSC). Each estimate yielded an ever-larger deficit vis-à-vis the May 2001 revenue estimates.

The first official act to repair the budget was Executive Order 2001-22T, which called for substantial reductions in agency spending. Total

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Note: Budget Footnotes will not be published in August.

Budget Footnotes is issued periodically by the fiscal staff of the Legislative Service Commission (LSC), a non-partisan agency serving the Ohio General Assembly.

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)

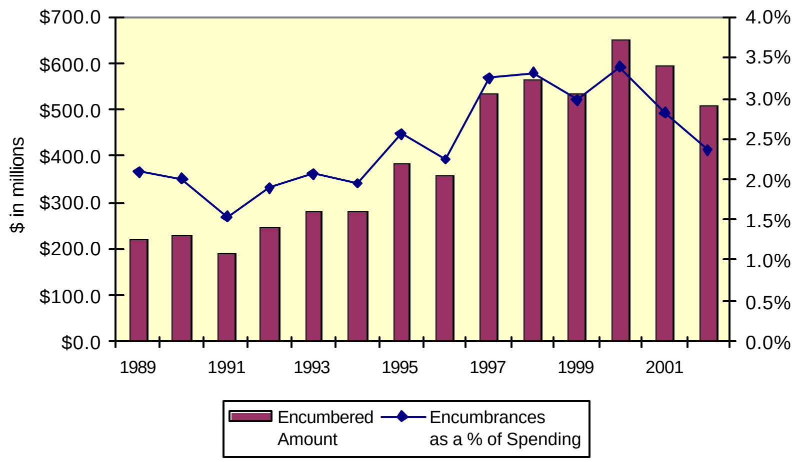
	Month of June	Fiscal Year 2002 to Date	Last Year	Difference
Beginning Cash Balance	($542.6)	$817.1		
Revenue + Transfers	$2,615.1	$21,462.6		
Available Resources	$2,072.6	$22,279.6		
Disbursements + Transfers	$1,453.4	$21,660.4		
Ending Cash Balances	$619.2	$619.2	$817.1	($197.8)
Encumbrances and Accts. Payable		$510.9	$597.7	($86.7)
Unobligated Balance		**$108.3**	**$219.4**	**($111.1)**
BSF Balance		$427.9	$1,002.5	($574.6)
Combined GRF and BSF Balance		**$536.2**	**$1,221.9**	**($685.7)**

agency spending was reduced by approximately $220 million. Two budget corrective bills followed. The first, Am. Sub. H.B. 405, passed in December 2001. It helped patch the OBM projected $709 million hole in the budget[1] by authorizing revenue transfers from the BSF and the Tobacco Trust Fund and by making changes to the sales and use tax, the cigarette tax, and the local government fund freeze. (See the Revenues article, below, for a discussion of these provisions.) Am. Sub. S.B. 261 was passed in May 2002 to patch the additional $755 million hole in the budget, based on LSC's May 2002 projections.[2] S.B. 261 authorized the transfer of additional revenues from the BSF and the Tobacco Trust Fund, as well as other funds, to the GRF to enable the state to end FY 2002 in the black. (S.B. 261 also made numerous revenue-generating tax law changes, but these were to affect FY 2003 revenues.)

Thus, with the aid of generous transfers from the BSF and the Tobacco Trust Fund, FY 2002 GRF revenues were a mere $468.9 million under estimate for the year. Disbursements were under estimate, as well, due largely to spending reductions made by executive order. The spending reductions were achieved, in part, by program cuts. For example, the Orient Correctional Institution was closed. Funding for the Department of Aging's PASSPORT program was curtailed. Some subsidies to local governments were cut. For example, the Department of Youth Services eliminated its subsidy for county detention centers, and the Public Defender Commission reduced the reimbursement rate to counties for indigent defense expenditures. Some timing delays also helped the year-end cash balance. June spending underages in the Medicaid and the Property Tax Relief categories are largely due to timing matters.

Combined revenues and transfers-in were $21.46 billion for the year. This amount fell $200 million short of the year's combined program payments and transfers-out of $21.66 million, thus reducing the year-end fund balance from $817.1 million on June 29, 2001, to the above-mentioned $619.2 million on June 28, 2002. The unobligated fund balance declined from $219.4 million to $108.3 million – a reduction of only $111.1 million. This smaller reduction was due to the decrease in encumbrances. The state ended the year with GRF encumbrances and accounts payable of only $510.9 million. The reduction or elimination of encumbrances – especially prior-year encumbrances – was another strategy used to reduce FY 2002 spending. As Exhibit 1 illustrates, total year-end encumbrances and encumbrances as a portion of prior year spending are lower than any fiscal year since 1996.

Exhibit 1 - Growth in GRF Encumbrances, FY 1989 - FY 2002



At the end of FY 2001, $597.7 million was encumbered. Exhibit 2 shows the disposition of certain of these funds – the portion that were encumbered in prior years - at the end of FY 2002 by year encumbered. At the end of FY 2002, just $76.2 million of these funds remained encumbered.

Exhibit 2 – Disposition of Prior-Year Encumbrances in FY 2002

	Disbursements	Canceled encumbrances	Remaining encumbrances
1996	77,813.50	174,313.84	0.00
1997	1,193,799.69	1,070,639.07	1,463,839.80
1998	2,163,084.13	3,798,781.82	1,262,162.14
1999	4,907,313.22	3,253,865.56	1,794,264.67
2000	30,501,135.20	6,872,186.04	19,746,263.72
2001	396,562,257.81	70,583,269.99	51,930,574.18
Total	435,405,403.55	85,753,056.32	76,197,104.51

Additional encumbrances of $434.7 million from FY 2002 appropriations were added to the remaining $76.2 million. Seven agencies accounted for 89.6 percent of these encumbrances. Eleven line items in these agencies accounted for 74 percent of these encumbrances. These are listed in Exhibit 3. The largest FY 2002 encumbrance was the $85 million encumbered in the Department of Job and Family Services (JFS) line item 600-525, Medicaid. A distant second was the $37 million in the Department of Taxation's line item 110-901, Property Tax Allocation – Taxation, which reimburses local governments for revenue lost due to state-mandated property tax rollbacks. That was followed closely by the $35.6 million that remained encumbered in JFS's line item 600-416, Computer projects. Many of these encumbrances are discussed in the Disbursements article below.

Exhibit 3 – Encumbrances Against FY 2002 Appropriations, June 28, 2002

$ In millions

Agency	Total	Major line items		Amount
Job and Family Services	$142.56	600-525	Medicaid	$85.1
		600-416	Computer projects	$35.6
Education	$81.15	200-501	Base cost funding	$15.7
		200-513	Student intervention services	$26.2
Development	$50.20	195-422	Technology Action	$12.1
		195-434	Industrial Training Grants	$9. 4
Rehabilitation and Corrections	$38.72	501-321	Institutional Operations	$22. 3
		505 -321	Institution Medical Services	$12.0
Taxation	$37.89	110-901	Property Tax Allocation - Taxation	$37.0
Mental Retardation and Developmental Disabilities	$19.50	322-413	Residential and Support Services	$19.5
Transportation	$19.37	775-451	Public Transportation - State	$14.2

[1] This refers to the projected revenue shortfall for FY 2002. OBM's October 2001 revenue estimates also projected a shortfall of $763 million in the budget for FY 2003.

[2] LSC's estimates also projected a $1.2 billion revenue shortfall for FY 2003.

TRACKING THE ECONOMY

¾ Allan Lundell and Ross Miller

June Summary

The modest recovery continued in June. The Conference Board's index of coincident economic indicators increased by 0.3 percent in June. The four variables used in constructing the index are the same variables used by the National Bureau of Economic Research (NBER) to date recessions and recoveries. Industrial production increased by 0.79 percent, real manufacturing and trade sales increased by 0.27 percent, real personal income less transfer payments increased by 0.25 percent, and nonagricultural employment increased by 0.03 percent. The index of leading economic indicators, under the influence of stock prices and consumer expectations, did not change.

Households continued to spend. Retail sales increased 1.1 percent in June and were up 3.0 percent compared to June 2001. Sales of motor vehicle and parts dealers increased 3.4 percent during the month and are up 2.0 percent compared to a year ago. Retail sales excluding motor vehicle and parts dealers increased by 0.3 percent in June and are up 3.5 percent compared to last year. The housing market remains healthy, in large part due to low mortgage rates. June housing starts of 1.7 million (this is a seasonally adjusted annualized rate, or SAAR) were down 3.6 percent compared to May, but are up 2.4 percent compared to June 2001. Existing single-family sales were 5.07 million SAAR in June. Although June sales were down 11.7 percent compared to May and 4.3 percent compared to June 2001, sales for the second quarter of 2002 are up 3.7 percent compared to the second quarter of 2001. Sales of new one-family homes were 1.01 million SAAR in June. New sales are up 0.5 percent compared to May and 12.2 percent compared to June 2001.

The unadjusted Consumer Price Index for Urban Consumers (CPI-U) increased by 0.1 percent in June. The index is up 1.1 percent compared to June 2001. The index for food was unchanged in June and is up 1.6 percent compared to a year ago. The index for energy rose by 1.6 percent in June, but is down 11.1 percent compared to a year earlier. The core index (excluding food and energy) fell by 0.1 percent in June and is up 2.3 percent compared to June 2001. The index for medical care rose by 0.2 percent in June and is up 4.5 percent compared to a year earlier. Inflation is not a short-term threat to the economy.

The unemployment rate in Ohio was 5.6 percent in June after seasonal adjustment, the lowest rate since February. According to the Bureau of Labor Statistics (BLS), this compares to a national rate that month of 5.9 percent. The Ohio Department of Job and Family Services (JFS) reports that June unemployment rates in Ohio ranged from a low of 3.3 percent in Holmes County to a high of 13.9 percent in Morgan County.

Looking Back - FY 2002 in Review

As FY 2002 began, the economy was already in a recession but we did not yet know it (or at least it had not been officially declared). In November 2001, the NBER Business Cycle Dating Committee announced that economic activity had peaked in March 2001. The peak marked the end of the longest sustained expansion in U.S. economic activity and the start of the current recession (which may be over but not yet declared to be so). The Business Cycle Dating Committee bases its decisions on the four variables that determine the Conference Board's index of coincident economic indicators: industrial production, real manufacturing and trade sales, real personal income less transfer payments, and nonagricultural employment. The performance of these variables and of the index based on them is presented in Exhibits 1-5. The data series were transformed to have a value of 100 in March 2001.

The economy was in recession before the start of the fiscal year. After data revisions, it now appears that GDP shrank during the first three quarters of 2001. The economy experienced the "two quarters of negative GDP growth" commonly used in defining a recession before the September 11 tragedy. Exhibit 6 presents the values of both nominal and real (inflation-adjusted) GDP starting in the first quarter of 2000. Exhibit 7 presents growth rates in real GDP. Growth in real GDP measures changes in the quantity of production. "QA" indicates growth calculated on a quarterly annualized basis. "YoY" indicates growth calculated on a year-over-year basis - that is, it gives percentage changes from one year earlier. Growth slowed during the second half of 2000 and was negative for the first three quarters of 2001.

Personal income and spending have held up well throughout the past year, but their growth has slowed. Exhibits 8 and 9 present the growth rates (both quarterly annualized and percentage changes from one year earlier) in personal income and personal consumption expenditures. Both income and spending have experienced slower growth, and both experienced short-term falls after September 2001. Consumer spending dropped dramatically in September 2001, but recovered spectacularly in October. Most of this recovery in spending was due to incentives and discounts offered to encourage spending (especially on motor vehicles). Consumers have continued to spend throughout the recession and this spending has helped lessen the depth of the recession. Since consumers did not reduce spending during the recession, however, there is little pent-up demand to fuel the recovery.

The slowdown in business investment was one of the causes of the recession. This slowdown included changes in nonresidential fixed investment (NRFI) and changes in inventories. The slowdown in these components of business investment is shown in Exhibit 10. The April, May, and June Reports on Business of the Institute for Supply Management indicate that inventories are expanding. Nondefense orders of capital goods are an indicator of future values of the GDP category producers' durable equipment, which is the largest component of business investment. Although these orders are down from their prerecession levels, orders increased in April and May, providing some hope for an increase in business investment. Then they fell by 8.5 percent in June, dampening that hope and indicating that any rebound in investment is likely to be modest. Recent values of these orders are presented in Exhibit 11.

The Ohio unemployment rate was 4.3 percent in July of 2001; it rose steadily to a peak of 5.9 percent in May before falling to its current level of 5.6 percent. By comparison, the national rate was a bit higher than the Ohio rate for most of the year. The national rate was 4.6 percent in July, rose to 5.8 percent in December, fell slightly, and then rose to a peak of 6.0 percent in April before arriving at its current level. Exhibit 12 shows both the Ohio and national unemployment rates during FY 2002.

As the unemployment rate rose during the year, payroll employment fell. BLS data indicate that Ohio's economy had about 48,000 fewer jobs in May than it had had the previous June, a fall of approximately 0.9 percent. About 25,000 of the jobs lost, slightly over half of the total, were in manufacturing. In comparison, the U.S. economy lost slightly over 1.4 million jobs from June 2001 to June 2002, a fall of about 1.1 percent. There is evidence that the employment picture is improving, however. May was the fourth month in a row that employment increased in Ohio (there were less than 3,000 fewer employed Ohioans in May than there had been in August). Similarly, the number of initial claims for unemployment compensation during the first quarter of 2002 was 0.8 percent below the number in the first quarter of 2001, according to JFS.

Looking Ahead - Forecasts for FY 2003

The recession appears to be over. Most of the economic news is good. Consumer spending has held up. Production has begun to increase. Business investment may even be increasing. One nagging bit of bad news is the employment situation. Businesses appear to be taking advantage of increased productivity to increase production without increasing employment. While this is good news for those who have jobs and are working some overtime, the economic recovery will not "take off" until employment recovers. The lack of pent-up demand is keeping consumers from jump-starting the recovery. A healthy jump in consumer demand would necessitate an increase in production, which would lead to increased improvement. An upward cycle would begin.

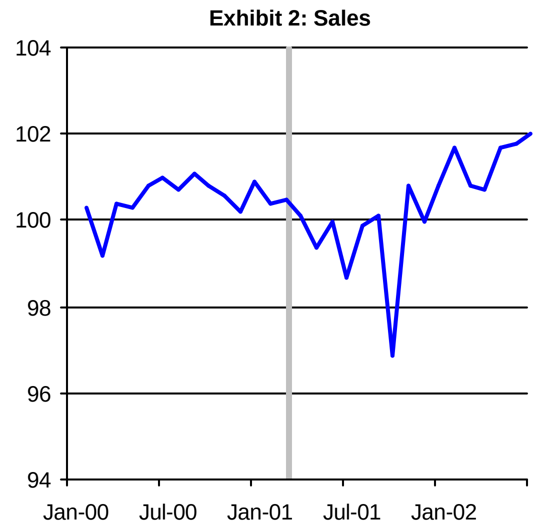
Casting a dark shadow over the recovery is the seemingly continuous stream of bad news from the financial sector. Corporate corruption, although not new, has nevertheless come to the surface in large enough amounts that it may be affecting consumer confidence in addition to influencing stock markets. Low consumer confidence may cause spending to decrease. Weakened consumer demand could stall the recovery. In addition to bad news from the financial sector, bad news from labor markets may also influence consumers to cut back on spending as a precaution. Other things that may influence the recovery include the return of federal budget deficits, the continuing trade deficit, and a weakening dollar.

Forecasting in the current economic environment is difficult. Forecasts depend on assumptions, and different assumptions lead to different conclusions. The table below summarizes some near-term forecasts for the U.S. economy. The 5.0 percent rate of growth for the first quarter of 2002 is the revised rate reported by the Bureau of Economic Analysis (BEA). This was driven largely by the change in inventories. "Core" GDP, defined as consumption plus investment less inventories, grew by just 2.15 percent during the first quarter. The rates for the remaining quarters in the table are forecasts. The BEA's advance estimate of real GDP growth for the second quarter is 1.1 percent.

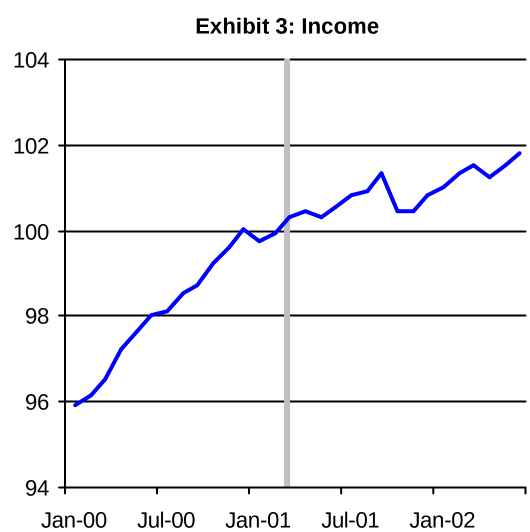
Forecasts of Real GDP Growth (quarterly annualized growth rates)

Forecast	Forecast Date	2002-1	2002-2	2002-3	2002-4	2003-1	2003-2
DRI-WEFA	Jul-02	5.0	1.2	3.0	4.6	3.8	3.5
Bank One	07/10/2002	5.0	2.3	4.2	4.1	3.4	3.0
Economy.Com	07/16/2002	5.0	2.5	2.6	2.8	3.8	na
Bank of America	07/10/2002	5.0	2.3	3.2	4.4	3.8	3.8
Wachovia Securities	07/11/2002	5.0	2.5	3.7	3.4	3.5	4.3
PNC Financial Services Group	July/August 2002	5.0	2.0	3.0	3.0	3.5	3.5
Philadelphia FRB Survey of Professional Forecasters	05/21/2002	5.0	2.5	3.2	3.4	3.5	3.6

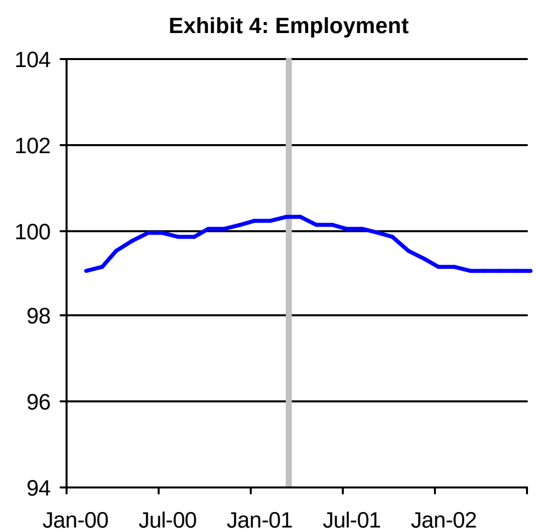
Source: National Bureau of Economic Research



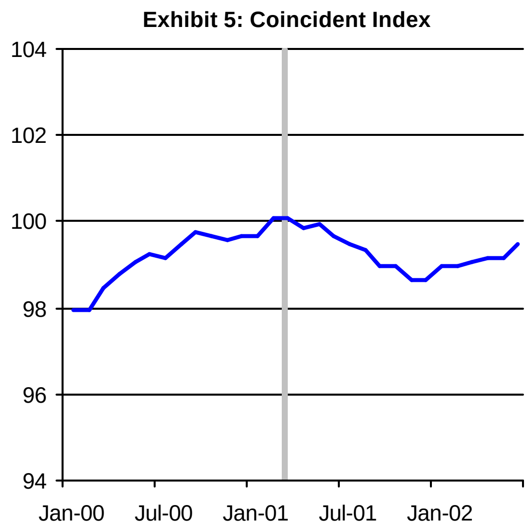
Source: National Bureau of Economic Research



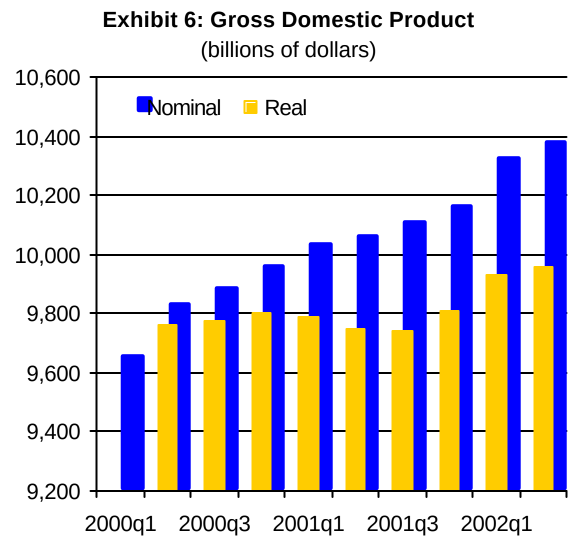
Source: National Bureau of Economic Research



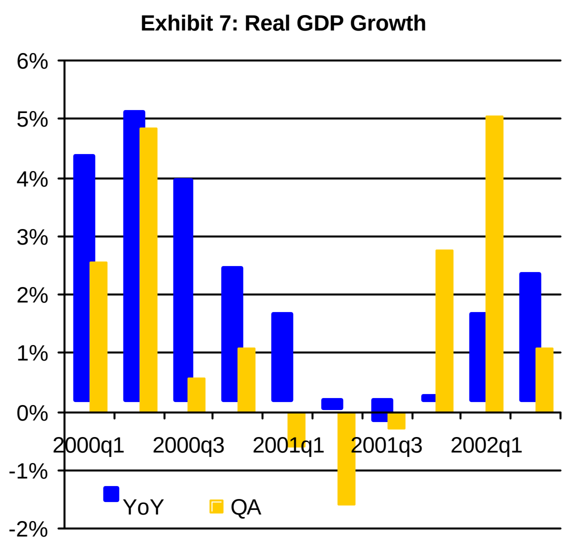
Source: National Bureau of Economic Research



Source: The Conference Board

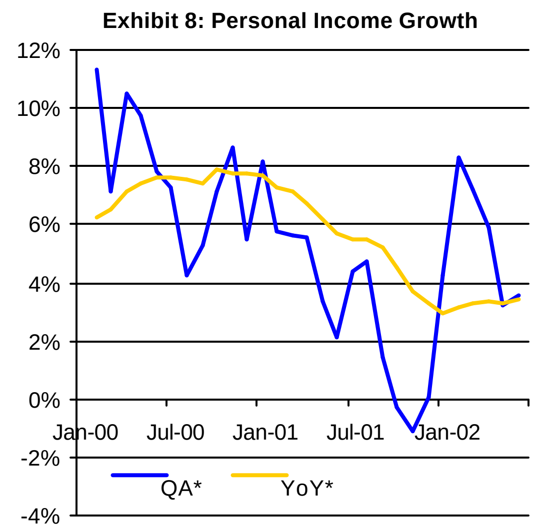


Source: U.S. Bureau of Economic Analysis



*See text for definition.

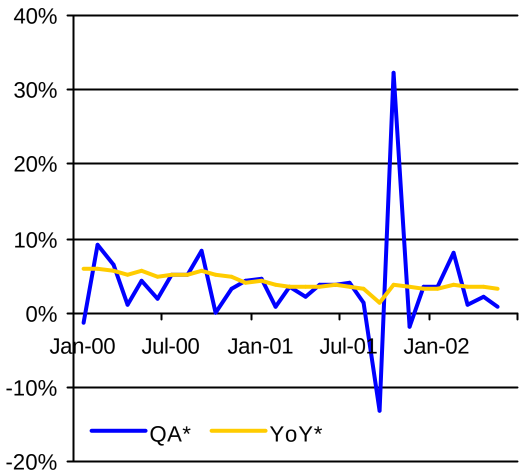
Source: U.S. Bureau of Economic Analysis



*See text for definition.

Source: U.S. Bureau of Economic Analysis

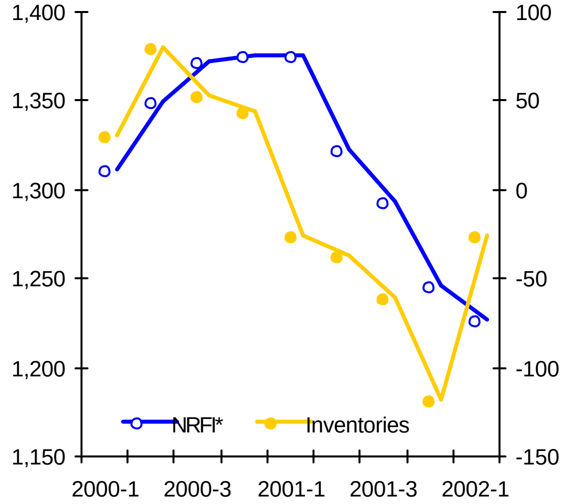
Exhibit 9: Personal Consumption Expenditure Growth



*See text for definition.

Source: U.S. Bureau of Economic Analysis

Exhibit 10: Real Business Investment

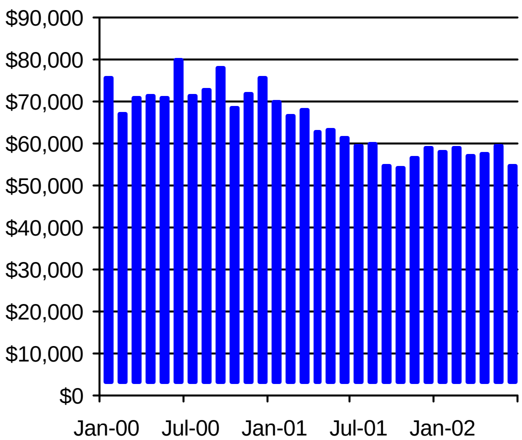


*See text for definition.

Source: U.S. Bureau of Economic Analysis

Exhibit 11: New Orders for Nondefense Capital Goods

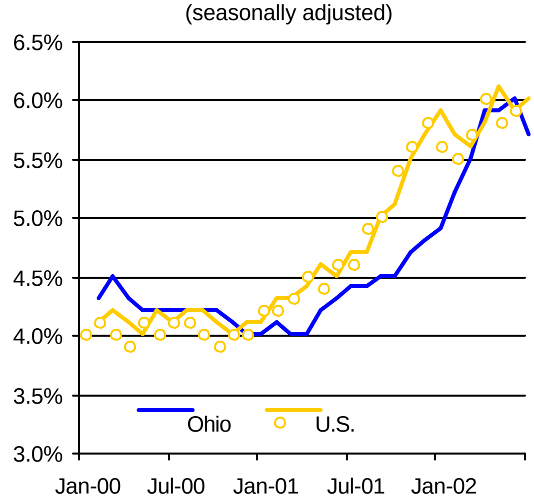
(millions of dollars, seasonally adjusted)



Source: U.S. Census Bureau

Exhibit 12: Unemployment Rates

(seasonally adjusted)



Source: U.S. Bureau of Labor Statistics

Status of the General Revenue Fund

REVENUES

— *Doris Mahaffey**

Total General Revenue Fund (GRF) revenues in FY 2002 amounted to $21,462,533 – an increase of 0.83 percent over FY 2001 revenues. $534.2 million of this was transferred into the GRF from the Budget Stabilization Fund (BSF) on June 28, the last day of the fiscal year. Without this transfer, total revenue would have registered a decline of 1.7 percent from FY 2001 revenue.

Total receipts to the GRF in June 2002 came to $2,615.1 million.[1] Twenty percent of this was the $534.2 million BSF transfer made on June 28, which provided just enough cash to offset the year's disbursements and encumbrances and leave an unobligated balance of $108 million in the GRF. The transfer was made in the form of an intrastate transfer voucher (ISTV) and thus is included in Table 2, below, in the "other income" category, rather than the transfer category.

Table 2 shows the revenues by category for the month of June. Most revenue sources – except for the "transfers in" and "other income" categories – were under estimate for the month. Total tax revenues were under estimate by $107.1 million. Even revenues from the auto sales tax and the public utility excise tax were under estimate for the month. The personal income tax had one of its smallest shortfalls this fiscal year – GRF receipts were only 1 percent under estimate. This number is deceptive, however, since the GRF received an extra $63 million from personal income tax revenue in June due to the adjustment to the local government fund freeze made by Am. Sub. H.B. 405 of the 124th General Assembly. Without the adjustment, revenue from the personal income tax would have been $70 million or 10.1 percent under estimate for the month.

The most notable entry in Table 2 is the $778 million overage in the "other income" category. As noted above, $534 million of this was essentially a transfer from the BSF. This overage, along with the $78 million overage in the "transfers in" category, was instrumental in generating the $698 million overage for the month.

June's $698 million overage, in turn, was instrumental in reducing the shortfall at the end of the fiscal year to a mere $469 million under estimate. See Table 3, which compares actual FY 2002 revenue by revenue category with the original revenue estimates for FY 2002 used by Am. Sub. H.B. 94. By this comparison, total FY 2002 GRF tax revenues were $1.4 billion under estimate. They were $59.8 million under LSC's revised estimates of May 2002.

Table 3 also compares actual FY 2002 revenue with actual FY 2001 revenue. It provides convincing evidence of the difficulty of the fiscal year just ended, as revenues in most major revenue categories actually declined from their FY 2001 levels. Tax revenues are the most significant indicator. While total revenues were slightly up for the year, total FY 2002 tax revenues were nearly 1 percent less than FY 2001 tax revenues. Earnings on investment were also significantly down in FY 2002. Federal grants were down as well, but this is due to the fact that starting in FY 2002 federal reimbursements for the Temporary Assistance to Needy Families (TANF) program are no longer deposited into the GRF.

The personal income tax accounted for the lion's share of the $1.4 billion tax revenue shortfall, as personal income tax revenues were $911 million under estimate. Non-auto sales tax and corporate franchise tax revenues were an additional $307 and $295 million under estimate, respectively. The only taxes whose revenues were not under estimate were the auto sales tax, the public utility excise tax, the domestic insurance tax, the cigarette tax, and the liquor gallonage tax. Of these, the auto sales tax is the only one whose revenues had a sizeable overage in FY 2002 ($102 million).

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

REVENUE SOURCE			
TAX INCOME	**Actual**	**Estimate***	**Variance**
Auto Sales	$68,109	$78,375	($10,266)
Non-Auto Sales & Use	$431,369	$471,349	($39,980)
Total Sales	$499,478	$549,724	($50,246)
Personal Income	$692,477	$699,149	($6,672)
Corporate Franchise	$46,584	$73,008	($26,424)
Public Utility	$28,068	$39,300	($11,232)
Kilowatt Hour Excise	$24,086	$25,680	($1,594)
Total Major Taxes	**$1,290,692**	**$1,386,861**	**($96,169)**
Foreign Insurance	$872	$460	$412
Domestic Insurance	$1,951	$2,185	($234)
Business & Property	$1,838	$332	$1,506
Cigarette	$22,421	$25,200	($2,779)
Alcoholic Beverage	$5,170	$5,320	($150)
Liquor Gallonage	$2,597	$2,465	$132
Estate	$1,438	$11,250	($9,812)
Total Other Taxes	$36,286	$47,212	($10,926)
Total Taxes	**$1,326,978**	**$1,434,073**	**($107,095)**
NON-TAX INCOME			
Earnings on Investments	$7,278	$33,750	($26,472)
Licenses and Fees	$1,348	$1,400	($52)
Other Income	$817,276	$39,300	$777,976
Non-Tax Receipts	$825,901	$74,450	$751,451
TRANSFERS			
Liquor Transfers	$10,000	$10,000	$0
Budget Stabilization	$0	$0	$0
Other Transfers In	$149,838	$71,800	$78,038
Total Transfers In	$159,838	$81,800	$78,038
TOTAL INCOME less Federal Grants	**$2,312,718**	**$1,590,323**	**$722,395**
Federal Grants	$302,416	$326,534	($24,118)
TOTAL GRF INCOME	**$2,615,134**	**$1,916,857**	**$698,277**

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

Totals may not add up due to rounding.

A portion ($941 million) of the tax revenue shortfall was offset by overages in the nontax revenue sources, bringing the total revenue shortfall to $468.9 million. The largest overage was in the “other income” category, which was $853.2 million over estimate. Again, 62 percent of the overage was due to the $534.2 million BSF ISTV made the last day of the fiscal year.

With the exception of the “other income” category, the revenue story for June pretty much follows the themes developed early in FY 2002. Personal income tax revenues were significantly under estimate, as were revenues from the non-auto sales and use tax and the corporate franchise tax. The balance of this article discusses the performance of the major revenue categories throughout FY 2002.

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

REVENUE SOURCE					Percent
TAX INCOME	**Actual**	**Estimate***	**Variance**	**FY 2001**	**Change**
Auto Sales	$927,549	$825,002	$102,547	$811,468	14.30%
Non-Auto Sales & Use	$5,110,411	$5,417,801	($307,390)	$5,124,113	-0.27%
Total Sales	$6,037,960	$6,242,803	($204,843)	$5,935,581	1.72%
Personal Income	$7,304,148	$8,215,100	($910,952)	$7,263,434	0.56%
Corporate Franchise	$712,302	$1,007,001	($294,699)	$915,259	-22.17%
Public Utility	$260,130	$247,000	$13,130	$640,547	-59.39%
Kilowatt Hour Excise	$323,348	$329,000	($5,652)	$22,806	1318%
Total Major Taxes	**$14,637,888**	**$16,040,904**	**($1,403,016)**	**$14,754,821**	**-0.79%**
Foreign Insurance	$214,319	$230,000	($15,681)	$220,563	-2.83%
Domestic Insurance	$132,421	$115,000	$17,421	$109,292	21.16%
Business & Property	$7,075	$8,301	($1,226)	$9,498	-25.51%
Cigarette	$281,290	$280,000	$1,290	$282,481	-0.42%
Alcoholic Beverage	$55,730	$56,000	($270)	$55,032	1.27%
Liquor Gallonage	$29,322	$29,002	$320	$28,999	1.11%
Estate	$116,259	$125,000	($8,741)	$166,005	-29.97%
Total Other Taxes	$836,415	$843,303	($6,888)	$871,870	-4.07%
Total Taxes	**$15,474,303**	**$16,884,207**	**($1,409,904)**	**$15,626,692**	**-0.98%**
NON-TAX INCOME					
Earnings on Investments	$79,009	$135,000	($55,991)	$153,339	-48.47%
Licenses and Fees	$31,099	$35,001	($3,902)	$32,910	-5.50%
Other Income	$1,008,197	$153,001	$855,196	$181,737	454.76%
Non-Tax Receipts	$1,118,305	$323,002	$795,303	$367,986	203.90%
TRANSFERS					
Liquor Transfers	$112,000	$98,000	$14,000	$102,000	9.80%
Budget Stabilization	$48,352	$0	$48,352	$0	#N/A
Other Transfers In	$348,206	$320,100	$28,106	$661,927	-47.40%
Total Transfers In	$508,558	$418,100	$90,458	$763,927	-33.43%
TOTAL INCOME less Federal Grants	**$17,101,167**	**$17,625,309**	**($524,142)**	**$16,758,604**	**2.04%**
Federal Grants	$4,361,387	$4,306,100	$55,287	$4,527,831	-3.68%
TOTAL GRF INCOME	**$21,462,553**	**$21,931,409**	**($468,856)**	**$21,286,435**	**0.83%**
* July 2001 estimates of the Office of Budget and Managemer	$21,586,995			$21,462,553	0.83%

Totals may not add up due to rounding.

Personal Income Tax

The personal income tax produced the largest share of revenue to the GRF in FY 2002 (34 percent), as well as the largest revenue shortfall.

June personal income tax revenues were below estimate for the 11th of the 12 months in FY 2002 (December posted a small overage). Revenues to the GRF were $692.5 million, $6.7 million (1.0 percent) below estimate. The monthly shortfall was the smallest of the fiscal year, due largely to the recalculation of the local government fund freeze. Total personal income tax revenues followed the same disappointing pattern as in previous months. Combined withholding was under estimate by $15.3 million (2.8 percent) and quarterly estimated payments were under estimate by $30.1 million (11.0 percent). Revenues from annual returns exceeded the estimate by $800 thousand (5.9 percent). Refunds were over estimate by $34.2 million (53.4 percent).

FY 2002 personal income tax revenues were $911.0 million (11.1 percent) below estimate. Withholding was $289.8 million (4.1 percent) below estimate, reflecting the declining employment and work hours. Quarterly estimated payments were $168.9 million (9.8 percent) below estimate. The erosion of capital gains and the poor profit performance of proprietorships and other pass-through entities are largely to blame. Revenues from annual returns were $284.9 million (29.6 percent) below estimate, and refunds were $258.9 million (36.1 percent) above estimate, reflecting the poor performance of the economy, in general, and the same problems listed above for quarterly estimated payments. Distributions to the three local government funds supported by the state income tax (the Local Government Fund, the Local Government Revenue Assistance Fund, and the Library and Local Government Support Fund) were $67.5 million (7.3 percent) less than estimated. This shortfall increased GRF revenues by $67.5 million.

H.B. 94 enacted a temporary "freeze" to local government fund distributions. Accordingly, revenues to the three local government funds – the LGF, the LGRAF, and the LLGSF – from each of the major taxes in FY 2002 were to remain the same as they were in FY 2001. This was expected to increase GRF revenue by what otherwise would have been the growth in distributions to the local government funds. This, of course, assumed that revenue from the major taxes would grow in FY 2002. As Table 3 shows, this did not happen: revenue from the major taxes fell by 0.8 percent in FY 2002.

Halfway through FY 2002, H.B. 405 was enacted. It included a provision that modified the local government fund freeze. Essentially, the local government funds were to get the lower of the freeze amount or the statutory amount in FYs 2002 and 2003. To implement the freeze, the Department of Taxation was to make a calculation twice a year (in February and June) comparing the total revenues deposited in the local government funds in the preceding months to the amount that would have been deposited in the respective funds in accordance with the statutory formula. To the extent that the total revenue deposited in the LGF, the LGRAF, and the LLGSF exceeded the amount that that fund would have received in accordance with the statutory formula, the excess was to be deducted from the deposits to that fund from the personal income tax receipts in the subsequent month. (The personal income tax was chosen to receive the "transfers" because it is the only tax source that provides revenue to all three of the local government funds.) Thus, GRF personal income tax revenues in February and June were increased by a total of $75.3 million – $11.7 million in February and $63.6 million in June – due to the recalculation of the local government fund freeze. Not all of this revenue, however, was due to the poor performance of the personal income tax. Declines in the other major tax sources from a year earlier also contributed.

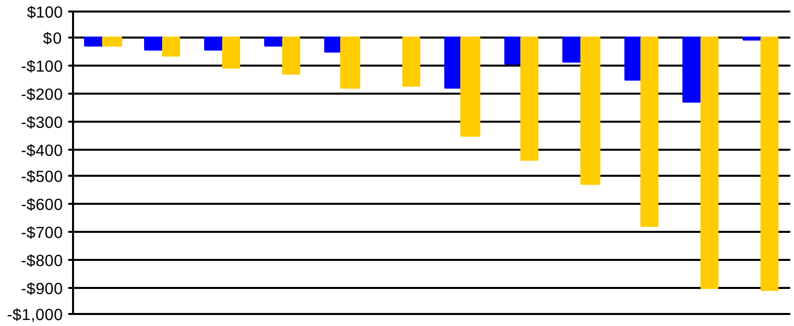
The final result of these recalculations of local government fund revenues was that the local government fund freeze actually had no effect in FY 2002. Revenues to both the state and the local government funds were equal to what they would have been in the absence of the freeze. However, judging from LSC's May 2002 revenue projections for FY 2003, along with the tax changes made by Am. Sub. S.B. 261 of the 124th General Assembly, the freeze is expected to divert revenue from the local government funds to the GRF in FY 2003. The freeze would again have no impact if revenues to the major taxes in FY 2003 continued to fall short of FY 2001 revenues. This last contingency seems unlikely, but it might be wise to keep your fingers crossed for luck.

With the exception of a brief pause in December, the cumulative personal income tax revenue shortfall grew larger each month of FY 2002. The growth in the shortfall is presented in Exhibit 1, below. Near-term prospects for improvement are few. Although the economy appears to be in recovery, employment and income are lagging production. Bearish stock markets will keep capital gains (and tax revenues from them) down.

As Table 3 shows, personal income tax revenues did grow slightly in FY 2002 compared to FY 2001. The growth was due to monthly withholding, which was up 1.4 percent over FY 2001 withholding, and to refunds, which were down 11.5 percent.

Again, these numbers are deceptive. In addition to the freeze recalculation, which produced $7 million more in personal income tax GRF revenues than would have been received under the statutory formula, the comparison between FY 2001 and FY 2002 personal income tax revenues is complicated by the impact of the income tax reduction fund (ITRF)

Exhibit 1: FY 2002 Income Tax Variances
(from original estimates, $ in millions)



	Jul-01	Aug-01	Sep-01	Oct-01	Nov-01	Dec-01	Jan-02	Feb-02	Mar-02	Apr-02	May-02	Jun-02
Monthly	-$24.1	-$38.6	-$39.6	-$23.4	-$48.2	$3.1	-$182.5	-$91.1	-$80.7	-$150.5	-$228.6	-$6.7
Cumulative	-$24.1	-$62.7	-$102.3	-$125.8	-$173.9	-$170.8	-$353.3	-$444.4	-$525.1	-$675.7	-$904.3	-$911.0

mechanism on FY 2001 personal income tax revenues. In FY 2001 there was a substantial income tax cut, funded by a transfer from the ITRF. There was no such tax cut this year. Thus, a more accurate comparison of FY 2002 personal income tax revenues to FY 2001 revenues would add last year's transfer from the ITRF to the GRF income tax receipts. This produces an adjusted GRF personal income tax revenue figure for FY 2001 of $7,709.7 million. FY 2002's personal income tax revenue of $7,304.1 million represents a decline of 6.5 percent from this adjusted figure.

Ohio's disappointing FY 2002 income tax collection was not an isolated incident. Most states that levy a personal income tax saw FY 2002 revenues decline sharply from FY 2001 revenues. A survey of states found that for the first four months of CY 2002, state personal income tax withholding revenues were down an average of 3 percent; final payments (i.e., annual returns) were down 26.3 percent, estimated payments were down 27 percent, and refunds were up 14.4 percent.[2] The sharp decline in final payments was viewed by several states as an "April nightmare" in contrast to the "April surprise" that many states had experienced in the budget surplus years of 1998 through 2001.

In comparison, Ohio appears to have fared better than average, which on the face of it is surprising since by some measures Ohio was hit harder by the recession than most other states. For the same January-through-April period, Ohio personal income tax refunds were down. Moreover, FY 2002 estimated payments were down a mere 7 percent, and annual returns were down only 11.7 percent.

The explanation again is the ITRF mechanism, which, at least in FY 2002, has dampened the impact of the recession on state income tax revenue growth. As FY 2001 ended without any appreciable revenue surplus, no funds were transferred to the ITRF to fund a tax reduction. Thus, Ohio personal income was taxed at the statutory rate for the first time since 1996.

Sales Tax

The Non-auto Sales and Use Tax. The non-auto sales and use tax provided $431.4 million in June 2002. As in most of FY 2002, revenue from this source was below estimate. June non-auto sales and use tax revenue lagged estimated revenue by $40 million or 8.5 percent. This was no surprise because May retail sales were weak. According to the U.S. Department of Commerce, May retail sales (excluding autos) declined 0.4 percent from April retail sales, but were 3.2 percent better than May retail sales a year ago. June non-auto sales and use tax revenues largely reflect May retail sales. June 2002 tax receipts were higher than June 2001 receipts by $6.5 million or 1.5 percent, thus showing some improvement over a year ago.[3]

Non-auto sales and use tax revenue was disappointing throughout FY 2002, befitting the year-long lingering economic malaise. At the end of the fiscal year, the non-auto sales and use tax had generated $5,110.4 million, $307.4 million or 5.7 percent less than the original estimates. Receipts were $6.5 million or 0.3 percent below FY 2001 non-auto sales and use tax revenues. After growing at an average annual rate of 5.8 percent from FY 1998 to FY 2000, revenue from the non-auto sales tax has stagnated in the last two fiscal years. Non-auto sales tax revenue growth in FY 2001 was slightly positive at 0.6 percent, and in FY 2002 it turned slightly negative, at -0.3 percent. Results for the year would have been lower still if not for the tax changes in H.B. 405, discussed below.

Exhibit 2 shows the shortfall of non-auto sales tax revenue in FY 2002. The chart shows the cumulative variance of non-auto sales tax revenues for each month in FY 2002 from original FY 2002 estimates, and also from FY 2001 monthly revenues. The shortfall grew almost every month (except in October 2001, when the amounts reflected timing issues arising from the events of September 11, 2001). Compared to FY 2001 monthly revenues, the cumulative shortfall in FY 2002 varied, but remained under $50 million all year.

A closer analysis indicates, however, that the performance of the non-auto sales and use tax was worse than the slight decline shown from FY 2001. The Ohio Tax Amnesty program included in H.B. 94 and the leasing provisions of H.B. 405 boosted non-auto sales and use tax revenues by about $95.5 million in FY 2002; most of this occurred in the second half of the fiscal year. Without these additional revenues, the shortfall would have been worse. H.B. 94 granted an amnesty for certain delinquent state taxes whereby outstanding tax delinquencies would be paid without payment of associated penalties and without payment of one-half of the accrued interest. Taxpayers had to apply for the amnesty between October 15, 2001, and January 15, 2002. The Ohio Tax Amnesty provided a boost of $16.3 million to non-auto sales and use tax revenues.[4]

H.B. 405 significantly changed the way the Ohio sales and use tax is applied to the lease of motor vehicles, watercraft, outboard motors, and aircraft.[5] Effective February 1, 2002, the sales tax on leases is computed and paid at the beginning of the lease rather than on monthly payments. Prior to H.B. 405, the tax was collected each month, based on the monthly lease payments. Under H.B. 405, the entire tax is collected at the time the lease is consummated, and it is applied to the total amount that will be paid throughout the term of the lease. Car, motorboat, and aircraft leases are mostly included in the non-auto sales tax base, rather than the auto sales tax base. For leases by an Ohio leasing company where the leasing company (or the car dealer) is collecting and remitting the tax, the tax is reported and paid under the company's vendor license. An out-of-state leasing company collects and pays the tax on a seller's use tax account. Exhibit 3 illustrates the changes in the taxes and payments for a hypothetical lease before and after the changes made by H.B. 405.

Exhibit 2: Cumulative Shortfall of Non-Auto Sales Tax Revenues in FY 2002
(variances from original FY 2002 estimates and FY 2001 revenues, $ in millions)

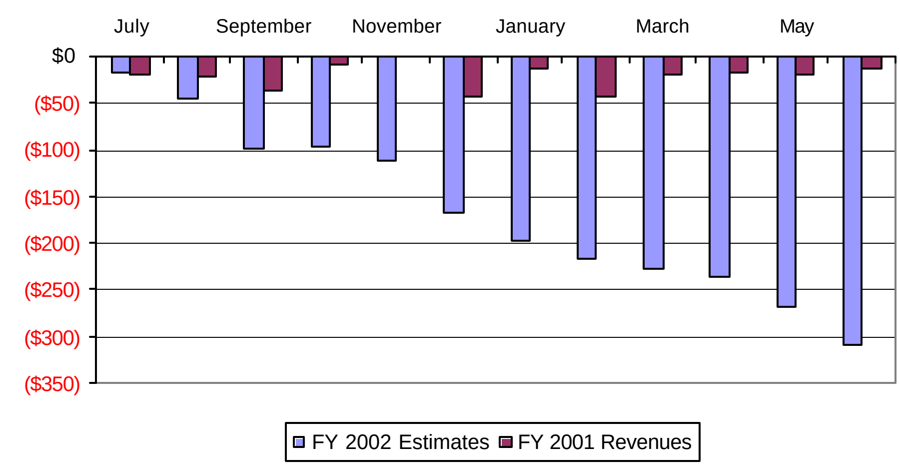


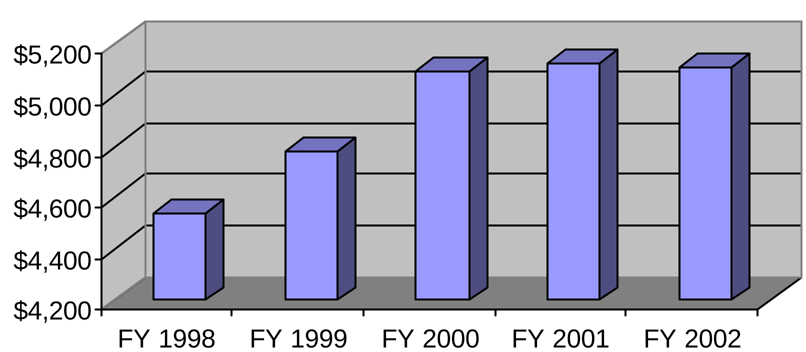
Exhibit 3: Effect of H.B. 405 on a hypothetical auto lease and on sales tax revenues

	Before H.B. 405	After H.B. 405
Sales tax rate	5.0%	5.0%
Interest rate	6.50%	6.50%
Lease terms (in months)	60	60
Cost of the vehicle	$22,000.00	$22,700.00
Residual Value after 5 years	$8,000.00	$8,000.00
Sales tax on the lease at 5.0%	N/A	$700.00
Principal and interest at 6.5%, prior to H.B. 405	$232.36	N/A
Sales tax per month at 5.0%	$11.62	N/A
Principal, interest, and tax at 6.5% after H.B. 405	N/A	$246.00
Total monthly payment by lessee	*$243.98*	*$246.00*
Total taxes (paid to state over time)	*$697.09*	*$700.00*

For the lessee, the sales tax is rolled into the cost of the vehicle and is financed for the duration of the lease. In the hypothetical vehicle lease presented in the table, the monthly lease payment would increase $2.02 for the lessee, and total sales tax payments to the state would be higher by $2.91 due to law changes in H.B. 405. Changes to the auto monthly lease payment and the net effect on state revenues would vary depending on the vehicle price, interest rates, and the length of the lease. Most leases that were in effect before February 2002 are continuing their established monthly payment schedule (unless terms of the lease are modified), and provide monthly receipts to the sales tax. Revenues from those "grandfathered" leases will dwindle in the future as leases expire and payments come to an end. This may result in decreased sales tax revenues from leases in the future.

Together, the changes to the treatment of leases and to the Ohio Tax Amnesty program provided about $95.5 million in additional tax revenues to the non-auto sales tax in FY 2002. Without the added revenues from these law changes, revenues from the non-auto sales and use tax in FY 2002 would have declined about 2.1 percent from FY 2001 revenues. This is a strong contrast to the tax's performance in the late 1990s when non-auto sales tax revenues grew at about 5.8 percent per year. Exhibit 4 shows non-auto sales and use tax revenues from FY 1998 to FY 2002.

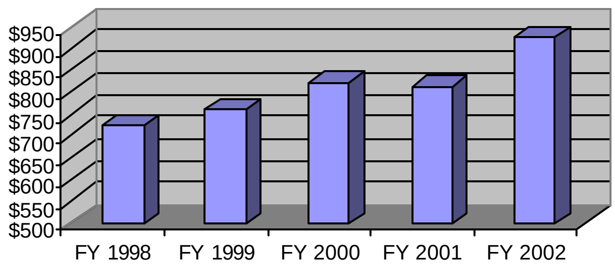
Exhibit 4: Non-Auto Sales Tax Receipts,
FY 1998-FY 2002
($ in millions)



The Auto Sales Tax. Auto sales tax receipts were $68.1 million in June, $10.3 million or 13.1 percent below estimates. June receipts were $9.4 million or 12.2 percent below June 2001 receipts. After surging to $97.8 million and $87.1 million in April and May 2002, respectively, the auto sales tax took a breather in June. Among major U.S. automakers, only General Motors was able to increase sales from May to June. GM sales increased 4.6 percent from May sales.[6] Ford sales declined 10.7 percent and Chrysler sales declined 3.6 percent. Toyota sales were just about the same, while Honda sales inched up 1.8 percent.

Fierce competition in the leasing business drove down prices in the mid to late 1990s. Low monthly payments on leases became the norm and customers snatched up the deals. The cheap leases came at a huge cost to banks, independent finance companies, and leasing subsidiaries of the auto manufacturers.[7] Ultimately, leasing companies tightened credit standards and the costs of leases, at the same time automakers were ratcheting up the incentives for car purchases. Those actions further reduced the leasing market and the leasing share of vehicle purchases.[8] From a high of 36.7 percent of vehicles sold in CY 1998, the leasing share of vehicle sales declined to approximately 26.0 percent in CY 2001, and is expected to decline further in CY 2002.

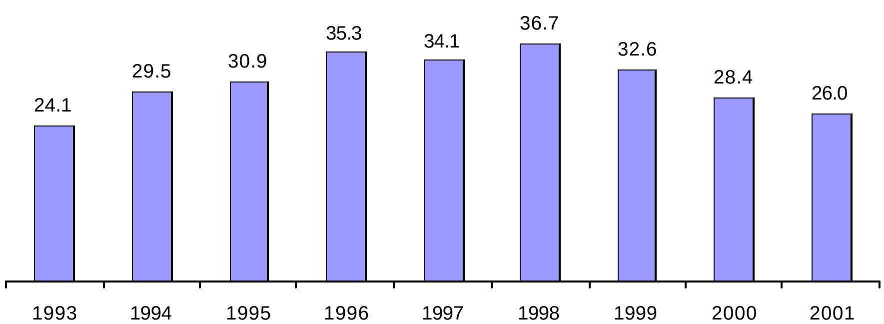
Exhibit 5: Auto Sales Tax Receipts,
FY 1998 - FY 2002
($ in millions)



For the fiscal year, however, auto sales tax revenues were just incredible. At $927.5 million, auto sales tax revenues in FY 2002 were $102.5 million or 14.3 percent above estimate. Receipts surged $116.0 million or 14.3 percent above FY 2001 auto sales tax revenues. Exhibit 5 shows the growth of auto sales tax receipts from FY 1998 to FY 2002. Except for a small decline in FY 2001, auto sales tax receipts have been growing throughout this period.

A study by CNW Marketing & Research found that a quarter of consumers that purchased cars with the "zero percent" financing in October and November intended to buy their vehicles with cash and another 32 percent wanted to lease.[9] A consumer shift from leasing to purchasing automobiles modifies simultaneously the non-auto sales tax and the auto sales and use tax bases. Whether a customer purchases a vehicle with cash or finances it directly with a loan, revenues to the auto sales tax are not affected. However, the shifting by consumers from leasing to outright purchases decreases tax revenues from leasing (most of which go to the non-auto sales and use tax) and increases revenues to the auto sales and use tax. Although the magnitude of the shift in Ohio is difficult to estimate, the shifting affects both tax bases and may amplify the volatility of both sales tax sources.

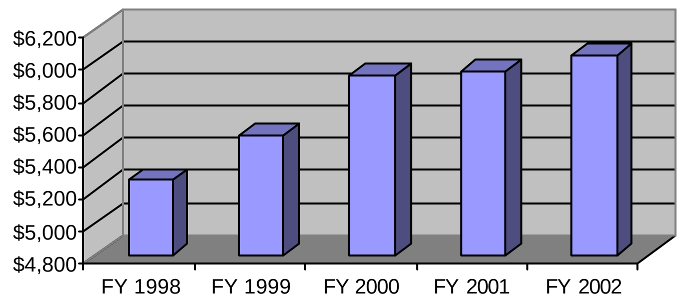
Exhibit 6: Leasing Share of Vehicle Unit Sales By Calendar Year



Source: CNW Marketing & Research, *Cross Roads in the New Economy*

Auto sales tax revenues generally reflect overall economic conditions, growth in vehicle unit sales, price changes, and changes in the auto sales tax base. Recent trends in the purchasing behavior of auto buyers have affected the sales and use tax and increased its volatility. The change in H.B. 405 dealing with the treatment of auto leases (which increases the cost of leases) not only affects non-auto sales and use tax revenues, but it may intensify an existing flight from auto leases to auto purchases.

Exhibit 7: Sales and Use Tax Receipts, FY 1998-FY 2002 ($ in millions)



Earlier this month, General Motors brought back a new version of the "zero percent" incentive, and increased rebates and other incentives on 2002 left-over model pickup trucks, sport-utility vehicles, minivans, and midsized cars, guaranteeing a new price and incentive war. Ford and Chrysler quickly followed GM's lead. After September 11 events, automakers kept sales robust by offering "zero percent" financing for qualified buyers and other incentives, like cash rebates and longer warranties. These incentives led to the highest unit retail sales[10] on record in October 2001, at 1.71 million units. With the announcements of new incentives, FY 2003 auto sales tax receipts may start on a good note, although it would be hard to fathom a performance better than that of FY 2002.

Total sales and use tax receipts were $6,037.9 million in FY 2002, accounting for 23.8 percent of FY 2002 revenues. Receipts lagged estimates by $204.8 million or 3.4 percent. Benefiting from the strong performance of the auto tax, through, total sales and use tax receipts were up $102.4 million or 1.7 percent from FY 2001 receipts, which at $5,935.6 million were themselves barely above FY 2000 sales and use tax revenues (FY 2000 sales and use tax revenues were $5,913.7 million). Without the $95 million from the tax changes, total sales and use tax receipts in FY 2002 would have been just about identical to FY 2001 receipts, in which case, growth in total sales and use tax revenues would have almost stalled for the second year in a row.

Corporate Franchise Tax

Corporate franchise tax receipts in June 2002 were $46.6 million, which was $26.4 million or 36.2 percent below estimate, concluding a dismal fiscal year for this revenue source. For the entire year, the corporate franchise tax generated $712.3 million, lagging estimates by $294.7 million or 29.3 percent. FY 2002 receipts included $7.5 million from the Ohio Tax Amnesty. Corporate franchise tax revenues fell 22.2 percent as receipts came in $203.0 million below FY 2001 corporate franchise tax receipts. Throughout the year, receipts from this tax source

Exhibit 8: Cumulative Shortfall of Corporate Franchise Tax Revenues in FY 2002
(variances from FY 2002 estimates and FY 2001 revenues, $ in millions)

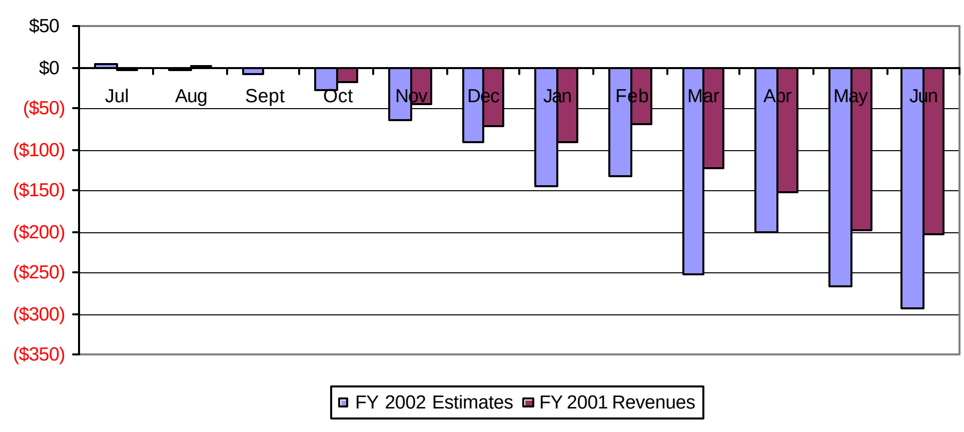


Exhibit 9: Largest declines from a year earlier in franchise tax revenues	
FY 1983	25.2%
FY 2002	22.2%
FY 2000	10.6%
FY 1999	9.4%
FY 1990	8.5%

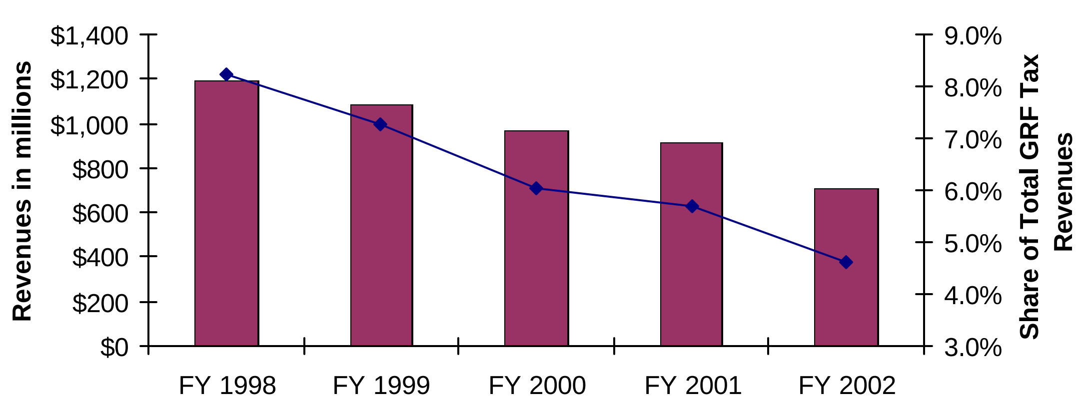
were below FY 2002 monthly estimates and FY 2001 monthly revenues. Exhibit 8 shows the cumulative shortfall of corporate franchise tax revenue during FY 2002.

A look at the history of corporate franchise tax receipts shows how poorly the corporate franchise tax fared in FY 2002. Exhibit 9 shows the largest declines from a year earlier (not adjusted for legislative tax changes) in corporate franchise tax revenue. Receipts fell 25.2 percent in FY 1983, which still is the largest one-year drop in franchise tax revenue. The 22.2 percent decline in receipts in FY 2002 is the second-biggest decline on record. The next two were also recent: a 10.6 percent decline in FY 2000 and a 9.4 percent decline in FY 1999.

Lower franchise tax revenues in a given fiscal year generally reflect poor corporate profits in the prior calendar year. Franchise tax liability for tax year 2002 (generally FY 2002) is based on the taxpayer's activity during its taxable year ending in 2001. Corporate profits before tax in calendar year 2001,[11] as measured by the Bureau of Economic Analysis (BEA), were 17.4 percent below profits recorded in 2000. CY 2001 profits were also 10.0 percent below profits in CY 1999. In the manufacturing sector, the profit decline was even more pronounced. Profits in the manufacturing industry in CY 2001 were lower by 48.8 percent than in CY 2000 and by 51.4 percent than in CY 1999.[12] These large declines would be significant due to the importance of manufacturing to the state. For CY 2000, the Department of Taxation reported that 40 percent of corporate franchise tax receipts came from manufacturing.

The decline in franchise tax receipts appears to have been made worse by net worth tax changes in H.B. 215 (the FY 1998-1999 operating budget bill). The franchise tax has two bases: the net worth base (generally determined as net book value of assets minus the net carrying value of liability) and the net income base (generally, the Ohio portion of the federal taxable income with exclusions and additions as required by statute). Differing tax rates apply to each tax base. The corporate taxpayer calculates its Ohio tax liability under the two bases and pays the higher of the two tax liabilities. H.B. 215 decreased the net worth tax rate from 5.82 mills to 4 mills and

Exhibit 10: Corporate Franchise Tax: Revenues and Share of Total GRF Tax Revenues



capped the net worth tax at $150,000 for each corporation. The timing of the full impact of those net worth tax changes on franchise tax revenues was unfortunate. In the current environment of plummeting corporate net income and profits, the cushioning effect of the net worth tax base on franchise tax receipts may have been reduced by the changes in H.B. 215. Exhibit 10 shows the decline in franchise tax revenues and the contribution of these revenues to total GRF tax revenues since FY 1998.

Franchise tax revenues have declined in each of the last five fiscal years. From $1,196.6 million in FY 1998, receipts declined to $1,084.0 million in FY 1999, $969.4 million in FY 2000, $915.3 million in FY 2001, and $712.3 million in FY 2002. Since FY 1998, corporate franchise tax revenues have fallen about 40.5 percent. As the amount of revenue has declined, the relative contribution of the corporate franchise tax to total GRF tax revenues has also shrunk. From 8.2 percent in FY 1998, the share fell to only 4.6 percent of GRF tax revenue (and 3.3 percent of total GRF revenue) in FY 2002.

The franchise tax troubles will not be confined to FY 2002. The recession's effect on this revenue source will carry on into next fiscal year's receipts. Corporate profit growth was negative in the first half of 2002. In its latest forecast (July 2002) DRI-WEFA, an economics forecasting firm, projected that the turnaround in corporate profits growth (on a year-earlier basis) will not occur until the fourth quarter of 2002. Even more optimistic economic forecasters now believe that this year's growth in corporate profits from a year earlier may not be positive. Therefore, for the entire CY 2002, profit growth will be anemic, which may lead again to lackluster corporate franchise tax revenues in FY 2003.

Legislative changes affecting the corporate franchise tax in FY 2002

Numerous bills were passed in FY 2002 that will affect future corporate franchise tax revenues. In December 2001, H.B. 405, the first "budget repair" bill of the fiscal year, was enacted. It exempted "high technology" companies from the net worth base of the franchise tax, created a job retention tax credit, and changed the tax applicable to certain dealers in intangibles from the intangibles tax to the franchise tax. S.B. 261, the second "budget repair" bill, was enacted in May. It changed the treatment of the depreciation deduction for Ohio corporations.

The net worth tax exemption for "high technology" companies. H.B. 405 created an exemption from the net worth computation of the corporate franchise tax for newly formed "high technology" companies. The primary activity of such companies is research and development, biotechnology, information technology, and application of new technologies to various endeavors. The duration of the exemption for each eligible corporation is three years, and will be available in tax year 2003 through tax year 2007. The revenue loss from this exemption in FY 2003 is estimated to be $2.9 million.

The job retention tax credit. H.B. 405 created a nonrefundable job retention tax credit for companies making capital investments exceeding $200 million over a three-year period at a specific project site. In order to qualify, eligible companies must employ at least 1,000 individuals at the project site.[13] The tax credit applies to capital investments (buildings, equipment, and machinery) made after January 1, 2002. Thus, a company may potentially claim the credit in FY 2003, if all necessary investments are made by CY 2002. The tax credit can be carried forward for three years after the year for which the credit is granted. The maximum credit is equal to 75 percent of the Ohio income tax withheld from the employees of the eligible business occupying full-time employment positions at the project site. The cost of the job retention tax credit may be as high as $4.4 million a year, but it is unlikely to cost that much in FY 2003.

Changes in the tax on dealers in intangibles. H.B. 405 amended the taxing structure of the dealers in intangibles tax[14] and tightened the eligibility requirements for certain financial institution subsidiaries to be taxed as dealers in intangibles. The tax changes are expected to increase revenues by expanding the financial institutions tax base of the corporation franchise tax. The Department of Taxation has estimated that the modifications to both the corporate franchise tax and the dealers in intangibles tax will increase GRF revenues by up to $41.0 million in FY 2003.

Changes in the treatment of depreciation by Ohio corporations. S.B. 261 modified the treatment of depreciation expenses for Ohio corporate and individual taxpayers. Under the new federal depreciation rules contained in the federal economic stimulus package that became law in March 2002, corporate taxpayers may claim a first-year depreciation deduction equal to 30 percent of the adjusted basis of a qualified property. After the first year, the remaining depreciable amount from the purchased asset would be deducted under the preexisting depreciation rules.[15]

Federal taxable income is the starting point of the Ohio corporate returns. An Ohio taxpayer uses federal depreciation schedules in calculating federal taxable income. Then, various adjustments (additions and deductions) specific to Ohio are made to the reported federal taxable income. S.B. 261 requires Ohio taxpayers who claim the "bonus" depreciation on their federal tax returns to add back five-sixths of the amount of "bonus" depreciation (deducted in the federal tax returns) to their Ohio corporate tax returns. In each of the next five consecutive years, taxpayers may then deduct one-fifth of the depreciation addback. In essence, the bill spreads out over six years any "bonus" depreciation claimed on the corresponding federal tax returns by Ohio taxpayers.

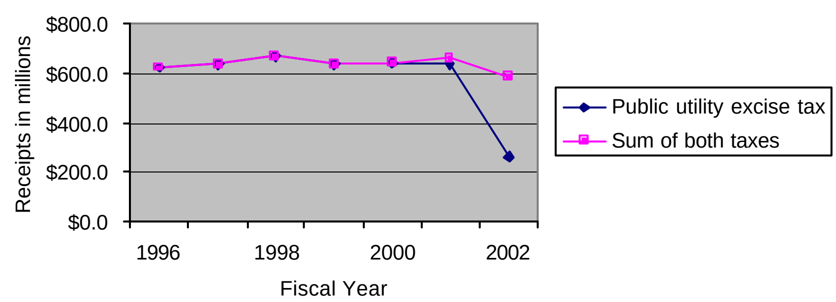
These modifications to the treatment of the depreciation deduction prevent a decrease in corporate franchise tax revenues in FY 2003 and 2004 of up to $90.0 million and $78.0 million, respectively. The same modifications are also applied to depreciation under the personal income tax to prevent additional losses under that tax.

Forty-six states have a corporate or business tax linked to the federal depreciation rules. Strategies to deal with the bonus depreciation allowances vary from conforming with the federal law, to requiring an add-back of depreciation, to completely separating state corporate law from federal rules. Ohio is one of five states that required a full or partial add-back of depreciation in corporate returns. Nebraska, Maine, Minnesota, and Oklahoma are the other four.

Public Utility Taxes

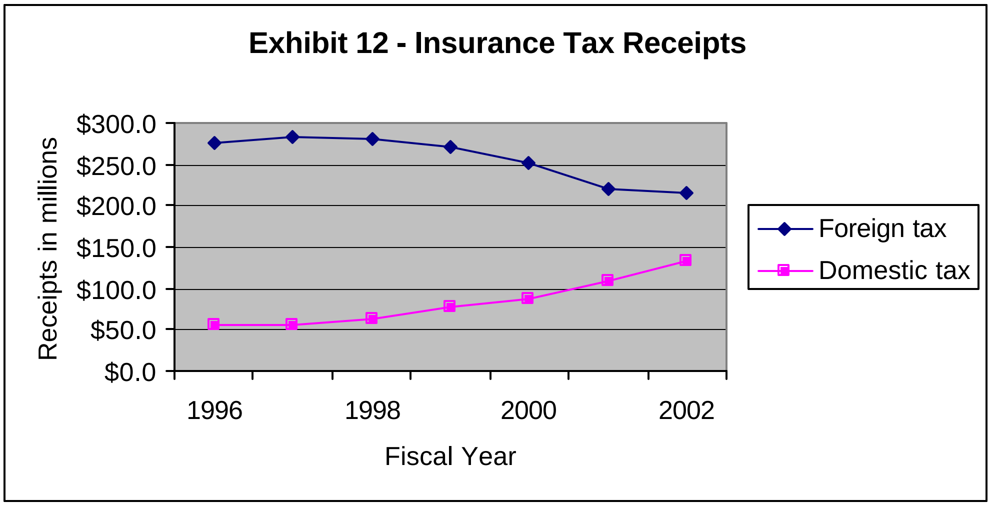
Receipts from the public utility excise tax were $260.1 million in FY 2002, over 59 percent lower than they had been in FY 2001 ($640.5 million). This very sharp drop is due largely to changes made by Am. Sub. S.B. 3 of the 123rd General Assembly to the taxes paid by electric utilities. Am. Sub. S.B. 3 exempted electric utilities from the public utility excise tax, subjecting them instead to the corporate franchise tax. In addition, the bill subjected electricity distributors to a newly created kilowatt-hour (KWH) tax, which raised $323.3 million in FY 2002. As a result of these changes, it is probably more instructive during this transition year to compare the combined receipts from the public utility excise tax and the KWH tax to the combined receipts from FY 2001. Receipts from the two taxes combined still fell, but by a more moderate 12.0 percent. Exhibit 11 shows the GRF receipts from these two taxes over the last seven years.

Exhibit 11 - Public Utility Excise and KWH Tax Receipts



A breakdown of receipts by type of utility shows that, from FY 2001 to FY 2002, taxes paid by natural gas companies rose by 2.1 percent while taxes paid by telephone companies fell by 9.8 percent. The combined taxes (public utility excise and KWH) paid by electric companies fell by 17.6 percent. Part of the decline in electric company receipts is due to the fact that S.B. 3 also subjected electric companies to the corporate franchise tax, so the franchise tax paid by the electric companies was to offset part of the lost revenue from the public utility excise tax exemption. We will probably not know until much later how much electric companies actually paid in franchise taxes. To the extent that they paid any, this year's performance of the franchise tax will be all that much worse.

The tax base for the public utility excise tax is gross receipts from intrastate business. Therefore the reduction in taxes paid by telephone companies



is likely to be due to a fall in those companies' revenues, which would presumably be due to increased competition in supplying telephone services to commercial customers. Some of the lost revenue is made up by increases in corporate franchise and sales tax revenues. Corporate franchise taxes are paid by new competitive telephone companies that are not classified as utilities for tax purposes. Similarly, the reduction in (combined) taxes paid by electric companies should be partially made up by corporate franchise tax receipts collected both from electric utilities, newly subject to the tax, and from new competitors in the electricity distribution business that were never subject to the utility tax.[16] Sales tax revenues will increase as consumers use more telecommunications services that are not subject to the excise tax, such as wireless and long-distance services.

Insurance Taxes

Domestic insurance tax revenues for FY 2002 were $132.4 million, 21.2 percent higher than the revenues for FY 2001. In contrast, foreign insurance tax revenues were $214.3 million, 2.8 percent lower than in FY 2001. Both the healthy increase in domestic tax revenues and the reduction in foreign tax revenues continue recent trends. Revenues from the domestic tax have more than doubled since FY 1998, while revenues from the foreign tax have fallen for five years running. Exhibit 12, below, shows receipts from each tax for the last six fiscal years.

Both taxes are levied on premium revenue received by insurance companies for covering Ohio risks—the domestic tax is collected from insurance companies domiciled in Ohio while the foreign tax is collected from insurance companies headquartered in other states. As discussed in last month's issue of *Budget Footnotes*, the disparity in tax revenue collections under the two taxes is not due to differences in premium growth between domestic and foreign companies. Ohio Department of Insurance data show both types of companies enjoying healthy growth in premium revenue between (calendar years) 2000 and 2001. The two lines of insurance that generate the most premium revenue are life insurance and fire and casualty insurance. These two lines account for just over 80 percent of the revenues from domestic insurance taxes and over 97 percent of the revenues from foreign insurance taxes. The growth in premium revenue from 2000 to 2001 for these two lines of insurance (combined) was 12.1 percent for domestic insurers and 31.0 percent for foreign insurers. Considering the premium data from the Department of Insurance, one would expect revenues from foreign insurance taxes to have increased more sharply than those from domestic insurance taxes, yet precisely the reverse is true. The mystery deepens!

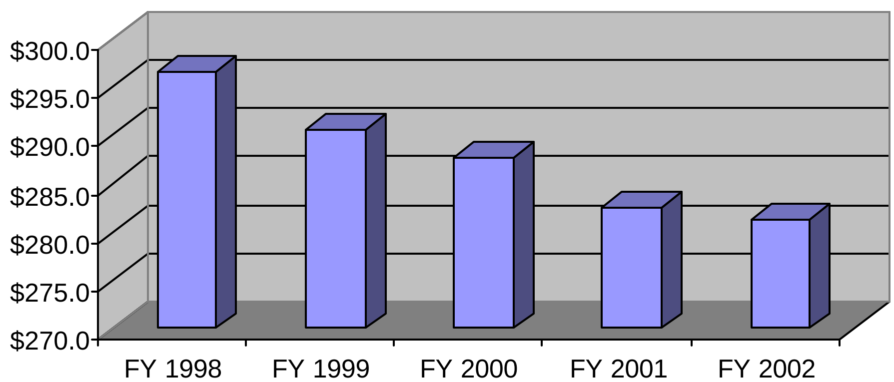
The culprit in this whodunit is, as many readers will have quickly realized, the insurance tax changes that were made in Am. Sub. H.B. 215, the general appropriations bill of the 122nd General Assembly. FY 2002 was the final transition year to a new tax structure, for both domestic and foreign insurance taxes, created in that bill. Beginning in FY 2003, both foreign and domestic insurance companies will be taxed 1.4 percent of their gross premium revenues. Since the passage of H.B. 215 the premium tax rate has been reduced in stages for both types of insurance companies, which accounts for the slight reduction in tax revenues from foreign insurance companies (despite the higher premium revenue received). The domestic insurance tax had a slightly more complicated structure historically, so there was no similarly straightforward reduction in tax revenues. Domestic insurers historically paid the *lesser of* 2.5 percent of gross premiums or 0.6 percent of their capital and surplus, meaning that many companies paid less than 2.5 percent of premiums (the rate that their foreign company competitors were paying). So even though the tax rate on premiums is being reduced, the phasing-out of the opportunity to pay a tax based on capital and surplus (if less than the tax on premiums) means that many domestic insurers are paying higher insurance taxes as a result of H.B. 215.[17] This reinforces the 12.1 percent increase in premium revenue mentioned above, leading to the very sharp 21.2 percent increase in tax revenues mentioned above.

Cigarette and Tobacco Products Tax

Cigarette and other tobacco products tax[18] receipts were $281.3 million in FY 2002, $1.3 million or 0.5 percent above estimates. Tax receipts were $1.2 million or 0.4 percent lower than FY 2001 receipts. The decrease in tax receipts from FY 2001 levels would have been steeper except for a provision in H.B. 405 that decreased the discount available to cigarette wholesalers. The provision increased FY 2002 revenues by an estimated $3.5 million.

As Exhibit 13 shows, the cigarette tax has been a declining source of state revenue. Price increases have played a role in that decline.[19] (Cigarettes are taxed on volume sold, not dollar sales.) In order to pay for the Master Settlement Agreement signed in November 1998 with the states, tobacco products manufacturers have consistently raised cigarette prices. Between FY 1999 and FY 2002, Ohio state minimum cigarette prices more than doubled. Prices have increased on generic as well as brand-name cigarettes. Consequently, cigarette and other tobacco tax receipts have declined as tobacco consumers quit or look for sources of nontaxed cigarettes.

Exhibit 13 - Cigarette and Other Tobacco Products Tax Receipts, FY 1998 to FY 2002 ($ in millions)



Revenues from taxed cigarettes are generally 91 to 93 percent of the take from the cigarette and other tobacco products tax. Tobacco products other than cigarettes provide between 7 and 9 percent of the tax receipts. Trends for the two tax bases are not always similar. In the last three years prior to FY 2001, cigarette tax receipts declined slowly each year while tax revenues from other tobacco products increased.[20] However, in FY 2001, growth in cigarette tax receipts was flat, while other tobacco products tax receipts plunged by about 24 percent. In FY 2002, tax receipts from both sources declined slightly.

Legislative changes affecting the cigarette tax

H.B. 405 and S.B. 261 both contained provisions affecting the cigarette tax. H.B. 405, which was passed in December 2001, reduced to 1.8 percent the discount available to wholesale dealers of cigarettes for affixing and canceling stamps or meter impressions. Under the previous law, the discount for tobacco tax stamps was 3.6 percent of wholesalers' tax liability. The change, which took effect in January of this year, increased estimated cigarette and other tobacco tax receipts by 3.5 million in FY 2002.

S.B. 261, which passed in May, included a cigarette tax increase starting July 1, 2002. The new tax will be 55 cents per pack of 20 cigarettes, up from 24 cents. The bill did not change the tax rate on other tobacco products. The tax increase reduced the cigarette tax differential between Ohio and Michigan, but widened the tax differential with West Virginia and Kentucky.[21]

The tax increase is expected to decrease consumption and increase tax-avoidance strategies by Ohio consumers. There are basically four ways (both legal and illegal) consumers can avoid paying Ohio taxes on cigarettes: (1) purchase cigarettes in other states (legally or illegally, depending on the quantity), (2) purchase cigarettes from Ohio retailers who buy large quantities of smuggled cigarettes (and are able to offer lower prices), (3) purchase cigarettes directly from independent smugglers and middlemen, and (4) purchase cigarettes via the Internet. Cigarette stamping limits the amount of smuggling or bootlegging that occurs when prices are raised. Also, most consumers purchase their cigarettes by the pack or the carton. Consumers who purchase via the Internet still have to pay shipping and handling charges, which increases the cost of avoiding the Ohio tax. Thus, tax avoidance by individual consumers may have a limited impact on revenues. However, the bill may increase the profitability of organized cigarette smuggling.

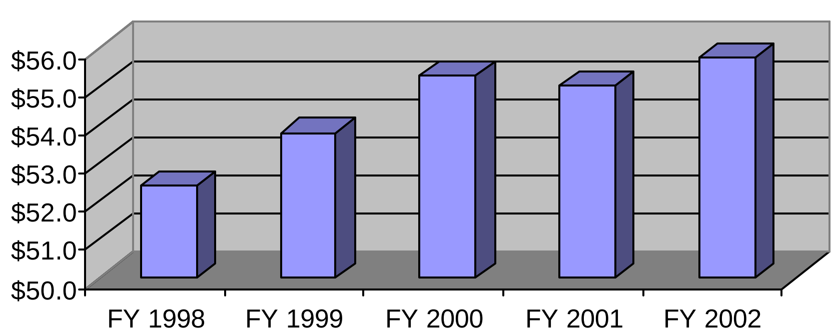
As a result of the tax increase, cigarette prices are expected to increase by an amount at least equal to the increase in tax. This price increase is expected to decrease consumption of taxed cigarettes by about 6 percent.[22] (Even before the tax increase, the consumption of cigarettes was declining. The long-term annual decline in cigarette consumption has been about 1.5 percent to 2.0 percent. This trend is expected to continue.) The tax change will boost the relative share of nontaxed cigarettes due to increased smuggling and Internet purchases. Also, some consumers will switch to other tobacco products whose taxes are left unchanged. LSC has estimated that the net impact of the tax change (after taking all of these other factors into consideration) will be an increase in tax revenues of about $246.5 million in FY 2003 from cigarette sales.

S.B. 261 also allowed the payment of the net additional tax due on cigarettes in inventory (floor tax) as of June 30, 2002, due to the tax change to be paid in three payments, due July 31, August 31, and September 20 of CY 2002. The tax on cigarettes in inventory will result in a one-time pickup of GRF revenues in FY 2003 totaling $13.2 million.

Alcoholic Beverages Tax

Alcoholic beverage tax receipts in FY 2002 were $55.7 million, lagging estimates by 0.3 million or 0.5 percent. Tax receipts from this revenue source were $0.7 million or 1.3 percent higher than FY 2001 revenues. The alcoholic beverages tax applies to sales of beer, malt beverages, wine, and mixed alcoholic beverages. The tax is based on a per-container rate depending on the type of beverage sold. Beer is taxed

Exhibit 14 - Alcoholic Beverage Tax Revenues,
FY 1998-FY 2002
($ in millions)

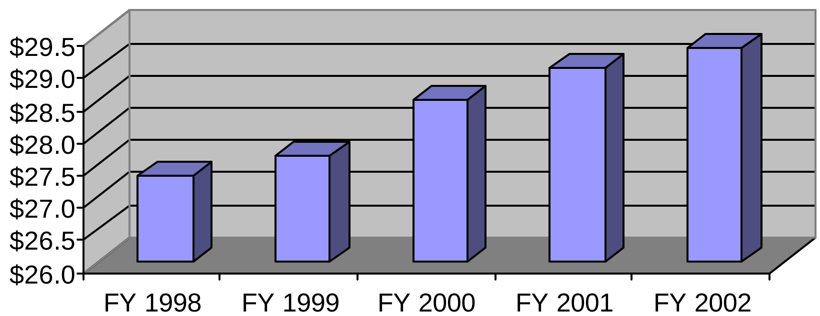


at varying rates that are equivalent to 0.14 cents per ounce. Wine of 14 percent or less alcohol by volume is taxed at 32 cents per gallon. Wine of more than 14 percent but not more than 21 percent alcohol by volume is taxed at $1.00 per gallon. Mixed beverages are taxed at $1.20 per gallon. Major exemptions to the tax are provided for sacramental wine, sales to the federal government, and sales in interstate commerce. Exhibit 14 shows GRF revenues from alcoholic beverage taxes for the last five fiscal years.[23]

million. The liquor gallonage tax is levied at the rate of $3.38 per gallon of spirituous liquor. Revenue is deposited into the General Revenue Fund. Liquor gallonage tax receipts have increased each year in the last five years as shown in Exhibit 15.

The General Assembly recently passed Sub. H.B. 330, which modifies the population quota restrictions for agency stores that sell spirituous liquor. H.B. 330, which also makes other changes to liquor laws, will result in a minimal increase in GRF revenues.[24]

Exhibit 15 - Liquor Gallonage Tax Revenues,
FY 1998-FY 2002
($ in millions)



Beer and malt beverages generate 84 or 85 percent of alcoholic beverage tax revenues, accounting for the bulk of tax receipts. Revenues from this source have stagnated in the last few years, growing approximately 0.5 percent annually between FY 1998 and FY 2001. The next largest source of revenue is the tax on wines, at 9 percent of total receipts. Tax receipts from wines have grown at an average annual rate of 4.0 percent. Mixed beverages contribute about 6 percent of total tax receipts. Receipts from that source have grown 7 percent per year. Tax receipts from vermouth, sparkling wines, and cider are declining each year.

During FY 2002, the General Assembly passed Sub. H.B. 371, which revises the definition of beer and makes other changes to the Liquor Control Law. Any potential gain in alcoholic beverage tax revenues from this legislation is expected to be minimal.

Liquor Gallonage Tax

Liquor gallonage tax receipts were $29.3 million in FY 2002, $0.3 million or 1.1 percent higher than estimates. Revenues from this tax source were higher than FY 2001 receipts by the same amount: $0.3

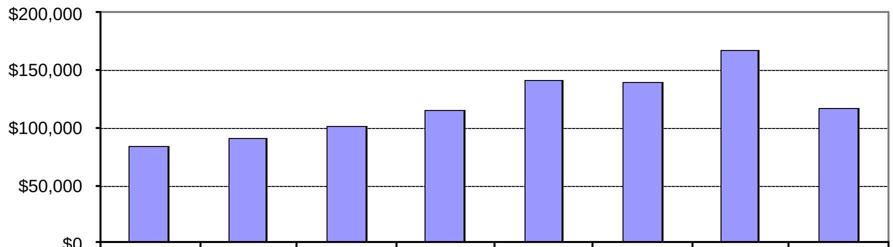
Estate Tax

In FY 2002, the state GRF received $116.3 million in estate tax revenue – 7 percent below the FY 2002 estimate and 30 percent lower than the estate tax revenue it received in FY 2001.

The estate tax is one of the more volatile state revenue sources, as the estate of a very wealthy individual can account for 10 percent or more of the total state estate tax revenues. The drop in the stock market, lower interest rates, changes in estate tax valuations, and recent legislation all contributed to lower estate tax revenue collections in FY 2002 than in previous fiscal years.

S.B. 108 of 123rd General Assembly (effective September 29, 2000) reduced Ohio's estate taxes by 36 percent for estates valued under $675,000, which is the current federal exemption figure. It also changed the disposition of estate tax revenues. The GRF receives 30 percent of the estate tax revenues from the estates of persons whose deaths occurred after January 2001 and before January 2002. The portion falls to 20 percent for estates of those dying after January 1, 2002. The bill also increased the size

Exhibit 16: State Estate Tax Collections,
FY 1995 - 2002
$ in thousands



	1995	1996	1997	1998	1999	2000	2001	2002
Total	$83,360	$89,947	$101,966	$114,785	$141,456	$139,953	$166,005	$116,260

of estates exempted from paying any death taxes from $200,000 net taxable value to $338,000 net taxable value. That provision affects about 12 percent of estates.

Future Ohio estate tax revenue will also be affected by the repeal of the federal estate tax by HR 1836, The Economic Growth and Tax Relief Reconciliation Act of 2001. Federal estate taxes are assessed on the net worth of an individual at death. No tax is levied on the first $675,000 of the estate, but beyond that threshold, taxes are assessed at a rate ranging from 37 percent to 55 percent. The federal bill decreased the unified estate and gift tax rates and increased the exemption from the estate tax each year until the tax is completely repealed in 2010. Ohio estate tax revenues were not affected by these changes in FY 2002, but will be in future fiscal years.

Nontax Revenue

FY 2002 Investment Earnings

Due to declining balances and lower market interest rates, state GRF investment earnings fell significantly in FY 2002. FY 2002 earnings on investment deposited to the GRF were slightly over $79 million, below the FY 2002 estimates by 42 percent or $56 million, and down by over 48 percent from FY 2001 earnings of over $153 million. Exhibit 17, below, shows the state's investment earnings deposited into the GRF from FY 1995 to FY 2002.

Fees and Licenses

The GRF benefits from a number of licenses and fees that are either completely or partially deposited into it. In FY 2002, over $31 million in license- and fee-generated revenue was distributed to the GRF, providing just over 0.14 percent of GRF revenue.

Exhibit 17 - State Investment Earnings,
FY 1995 to FY 2002
$ in thousands

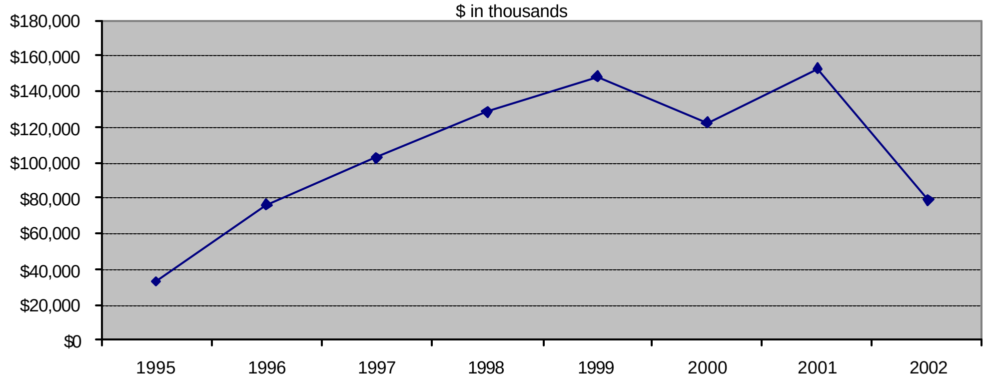
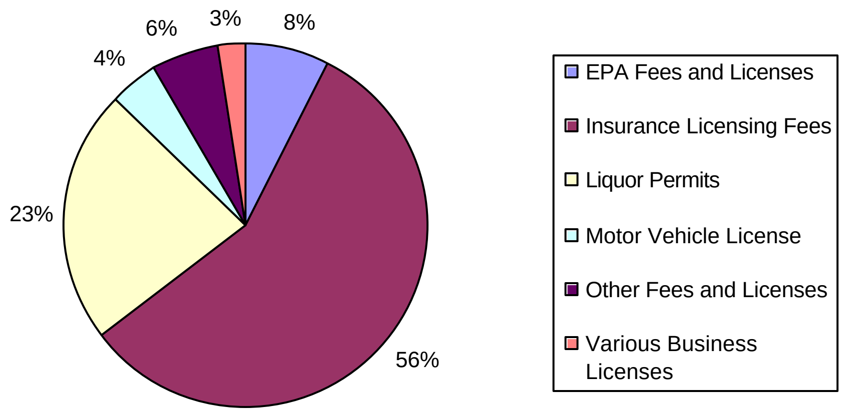


Exhibit 18 - FY 2002 GRF Revenues from Fees and Licenses

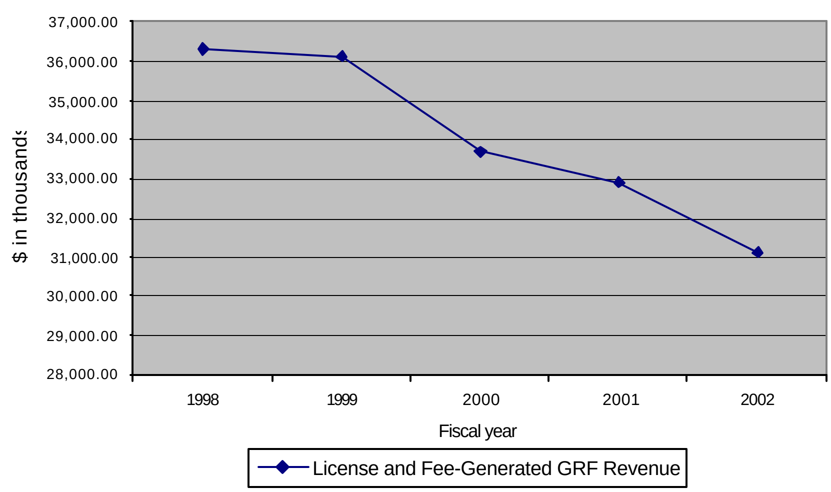


As Exhibit 18 shows, insurance licensing fees are responsible for over half of all fee-generated revenue deposited into the GRF. In fact, in FY 2002, the Ohio Department of Insurance deposited $17.7 million into the GRF. Of this amount, approximately $5.2 million was generated by a tax on domestic life insurance companies. Fees on agent appointments and renewals generated approximately $6.5 million. Various other filing fees and fees on risk retention groups made up the remaining $6.0 million deposited by the department.

Liquor permits are also responsible for a large amount of fee-generated revenue going to the GRF. In FY 2002, liquor permits generated about $7.0 million for the GRF. However, as with the insurance license fees, this constitutes only a portion of the total generated by liquor permits. The total amount of revenue collected for liquor permits in FY 2002 was $25 million. The remaining revenue was distributed to the Ohio Department of Alcohol and Drug Addiction Services and local taxing districts.

As Exhibit 19 shows, GRF revenue from licenses, fees, and permits has declined over the past five years. Several factors have contributed to this decline, one of the largest of which is the trend away from depositing fees into the GRF. Many fees that once were completely or partially deposited into the GRF are now going into various state special revenue (SSR) funds or other non-GRF funds. In fact, while in FY 1996, 49 individual business licenses and fees were being deposited into the GRF, in FY 2002 only 36 different business licenses and fees were being so deposited.

Exhibit 19 - License- and Fee-Generated GRF Revenues



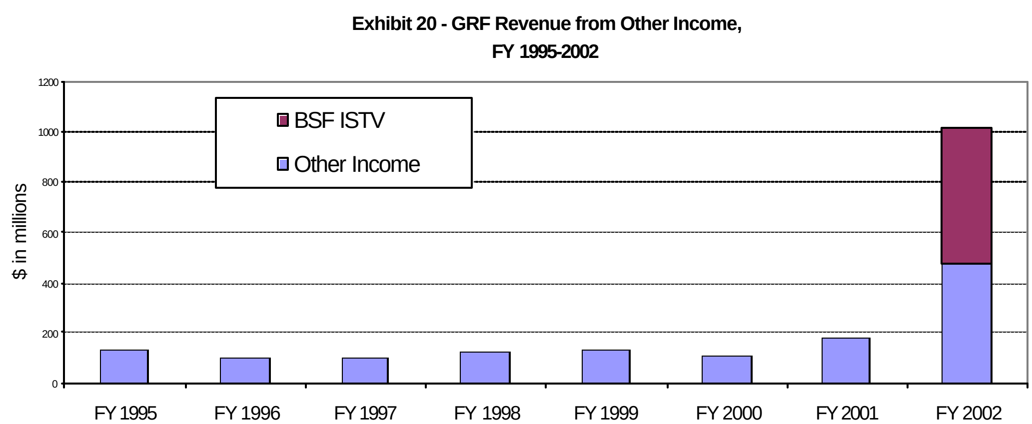
One example of this is the Secretary of State's filling fees. Until FY 2002, the Secretary of State's filling fees were deposited in part in the GRF and in part in the SSR Fund 599, Business Services Operating Expenses. In FY 2000 the split was about 50/50, and produced approximately $4.5 million for the GRF. H.B. 94 changed the disposition of these fees, depositing them completely into SSR Fund 599. Similar changes affecting other fees have been made through previous legislation.

Total license- and fee-generated GRF revenue has also been strongly affected by legislation enacting fee changes. For example, H.B. 612 of the 123rd General Assembly, the first of two "taxpayer services" bills, eliminated and reduced various vendor fees, resulting in an estimated annual loss to the GRF of $2.7 million.

GRF in June). The revenue was posted to the "rentals and miscellaneous revenue" service category. The transfers were authorized by H.B. 94 and S.B. 261. H.B. 94 authorized the transfer to the GRF of up to $30 million in unclaimed funds over the FY 2002-2003 biennium. S.B. 261 increased the authorized amount to $80.8 million.

Transfers In

The "transfers in" category furnished 2.4 percent of total GRF revenue in FY 2002. This was a smaller portion than in FYs 1999 and 2001 when substantial transfers were received from the income tax reduction fund (ITRF). Although transfers were over estimate for the fiscal year (compared to the original July 2001 estimates), they were less than anticipated, since major transfers from the BSF and the Tobacco



Other Income

The "other income" category provided 4.7 percent of GRF revenue in FY 2002 – a substantial increase from FY 2001, when it provided only 0.9 percent. The increase was mainly due to interagency transfers of cash from other funds via intrastate transfer vouchers or ISTVs. In FY 2001 ISTVs accounted for only $86.5 million of total GRF revenues. In FY 2002 they accounted for $927.9 million. Most of the transfers ($781.4 million) were made in June and included transfers from the BSF and the Tobacco Master Settlement Fund. The $534 million BSF ISTV mentioned above accounted for 58 percent of total transfers.

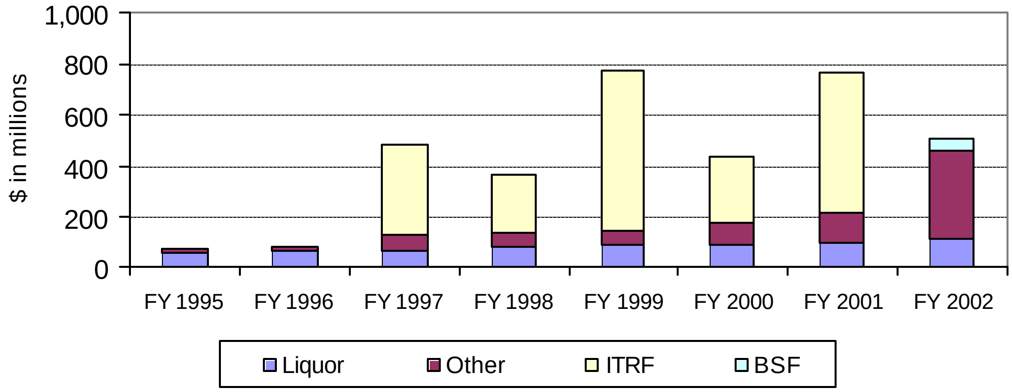
The GRF also received $55 million in unclaimed funds in FY 2002 ($25 million was transferred to the

Master Settlement Fund were made via ISTV and were not included in this category.

The other transfer category does include the transfer of $105.7 million on June 25, 2002, from the Tobacco Master Settlement Fund to the GRF.

Total transfers of $40.3 million were made to the GRF from the BSF in FY 2002. This included an $8 million transfer in February and a $32.3 million transfer in May. The February transfer, which was authorized by H.B. 405, was to fund an $8 million increase in appropriations for emergency purposes in response to the events of September 11, 2001. (S.B. 261 later reduced the appropriation to $2 million, since federal money was forthcoming to pay for increased security measures.) The May transfer, which was authorized by H.B. 94, was to fund an increase in Medicaid

Exhibit 21 - GRF Transfers In,
FY 1995 - 2002



expenses in excess of H.B. 94 appropriations. The transfer paid the state share of the expenditures and drew down additional federal money to pay the federal share. This accounts, in part, for the FY 2002 "overage" in federal reimbursements.

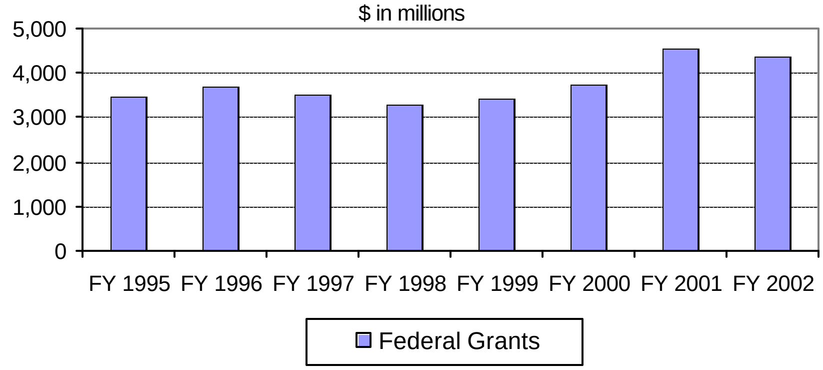
Federal Grants

In FY 2002 federal reimbursements provided 20.3 percent of total GRF income. This is a decrease from FY 2001, when they provided 21.2 percent. Federal reimbursements to the GRF are composed of federal grants from the Department of Health and Human Services, which are deposited in the GRF to pay the federal share of Medicaid and certain other programs for low-income individuals. Since Medicaid costs have grown dramatically in FY 2002, the decline in federal reimbursements illustrated by Exhibit 22 may appear anomalous.

The decline, however, has nothing to do with Medicaid. Rather it is due to the fact that federal reimbursements for the Temporary Assistance for Needy Families (TANF) program are no longer (as of FY 2002) deposited into the GRF. H.B. 94 created a Federal Special Revenue Fund to receive TANF grant moneys.

In FY 2001 TANF grant moneys accounted for $640 million. Excluding that amount from the calculation (as well as the small amount of TANF moneys deposited into the GRF in FY 2002), federal reimbursements are seen to have grown by 12 percent from FY 2001 to FY 2002. Medical Assistance Title XIX Subsidy (Medicaid) receipts alone grew by 14 percent.

Exhibit 22 - GRF Federal Reimbursements,
FY 1995 - 2002
$ in millions



[1] That was the second-highest month for GRF revenues ever. (The highest was January 2001, when the GRF received a transfer of $546.3 million from the income tax reduction fund.)

[2] The survey was conducted by the Nelson A. Rockefeller Institute of Government at the State University of New York at Albany, in conjunction with the National Conference of State Legislatures, the Federation of Tax Administrators, and the National Association of State Budget Officers.

[3] One might have expected that June 2002 sales tax revenues should have exceeded June 2001 sales tax revenues by 3.2 percent rather than the 1.5 percent. However, the relationship between sales tax revenues and retail sales is not so simple. The non-auto sales tax base does not include all the items counted as retail sales by the Department of Com merce. For example, it does not include sales of gasoline or sales of food for consumption off premises. At the same time it does include some things – such as certain business services – that are not included in the definition of retail sales**.**

[4] Total receipts from the Ohio Tax Amnesty program were $48.5 million.

[5] The change in law also applied to leases of tangible personal property used for business purposes.

[6] http://www.autochannel.com/content/news/2002/07/02.

[7] Industrywide losses totaled $11 billion in 2000. Banks and independent finance companies lost $9 billion, while auto manufacturers and finance companies lost $2 billion. Overall industry losses were $10 billion in 2001. Similar losses are expected this year (CNW, quoted in www.bankrate/yho/news/auto). For full-term leased vehicles re turned to lessors, the average loss per vehicle increased from $1,920 in CY 1999 to $2,342 in CY 2000 to $2,451 in CY 2001 (Consumers Bankers Association - *Automobile Finance Study, 2002*).

[8] To entice buyers concerned with affordable monthly payments, the industry has lengthened the terms of leases. This lengthening is also acting to make leasing less attractive, because a primary reason to lease is to get a new vehicle every few years. In 2001, 36 percent of all new lease originations were for terms greater than 48 months, compared to 29 percent in 2000.

[9] http://www.nvo.com/cnwbyweb/ltr8coverstory.

[10] Prior to October 2001, average October auto and light trucks sales in the previous three years were about 1.34 million units.

[11] Corporate profits with inventory valuation and capital consumption adjustment. This is also known as profits from current production. Several measures of corporate profits are available from Bureau of Economic Analysis (BEA), a unit of the United States Department of Commerce.

[12] Corporate profits before tax with an inventory valuation adjustment. BEA believes it is the best available measure of industry because estimates of the capital consumption adjustment by industry do not exist. This measure of profits is different than the previous one.

[13] A project site is defined as an "integrated complex, as specified by the Tax Credit Authority, within a 5-mile radius where a taxpayer in this state is primarily operating as a manufacturer as defined in section 5739.011 of the Revised Code.

[14] The "dealers in intangibles tax" is imposed on businesses (excluding financial institutions and insurance companies) that engage in lending money and in buying and selling or discounting mortgages, stocks, and bonds.

[15] To qualify, the property must (1) be acquired after September 10, 2001, and before September 11, 2004, and (2) sat isfy the general rules under the Modified Accelerated Cost Recovery System (MACRS). Eligible property includes property with a recovery period of 20 years or less, water utility property, some computer software, and qualified leasehold improvements. Current first-year depreciation for five-year property, seven-year property, ten-year property, or 15-year property is 20 percent, 14.29 percent, 10 percent, or 5 percent, respectively.

[16] Confidentiality considerations prevent the Ohio Department of Taxation from releasing data that would verify these presumptions.

[17] The higher Ohio taxes paid by domestic insurance companies are offset to some extent by many other states reducing their foreign insurance taxes (levied on Ohio companies). This reduction occurs due to the complicated "retaliatory" tax structure that many states have.

[18] This tax is levied on cigarettes, cigars, chewing tobacco, snuff, smoking tobacco, and other tobacco products. In FY 2002, cigarettes were taxed at a rate of 24 cents per package of 20 cigarettes. Other tobacco products were taxed at 17 percent of their wholesale price.

[19] Other factors such as restrictions on where people can smoke and general awareness of health issues associated with smoking are also contributing to the decline in tobacco consumption.

[20] A plausible explanation is that huge cigarette price increases led some smokers to buy other tobacco products instead of cigarettes. Cigarette prices grew 9.8 percent, 30.9 percent, 11.2 percent, and 7.8 percent in 1998, 1999, 2000, and 2001, respectively. Other tobacco products prices grew 3.4 percent, 7.6 percent, 7.1 percent, and 3.4 percent during the same years. More recently, some smokers may have switched back to more affordable generic cigarettes that cost less than brand-name cigarettes, looked for cheaper cigarettes in neighboring states, and purchased through mail-order catalog or Internet salesat lower cost.

[21] Michigan's tax rate is 75 cents per pack. Pennsylvania's rate will increase to 69 cents per pack July 15, 2002. Due to a recent increase, Indiana's rate is 55.5 cents per pack. Lower per-pack tax rates are 17 cents in West Virginia and 3 cents in Kentucky.

[22] The average weighted price used in making these calculations includes both generic and premium cigarettes. The price elasticity of demand for cigarettes is assumed to be at -0.6, which means that a 10 percent price increase results in a 6 percent decrease in consumption. Accepted ranges of price elasticity of demand for cigarettes are between -0.4 and -0.6.

[23] Revenue from these taxes is deposited in the General Revenue Fund with two exceptions. One percent of the tax revenue is deposited in the Beverage Tax Administration Fund and five cents per gallon of wine is deposited into the Ohio Grape Industries Special Account.

[24] This bill may increase liquor permit fees, portions of which are distributed to the GRF.

**Jean Botomogno, Allan Lundell, Ross Miller, Ruhaiza Ridzwan, and Nicole Ringer contributed to this Revenues article.*

DISBURSEMENTS

*— Steve Mansfield**

The executive and legislative branches' efforts in the just-completed fiscal year to adjust and readjust to declining revenues sometimes seemed like throwing darts at a fast-moving target. As we discuss below, those adjustments were of course reflected in altered spending patterns that differed from what was originally anticipated and thus were captured in our analysis of disbursements.

For the year, General Revenue Fund (GRF) expenditures totaled $21.7 billion, a reduction of more than $300 million, or 1.5 percent, from FY 2001 GRF spending. A key factor contributing to the overall reduction in spending since a year earlier was the recategorization of federal block grant funds for the Temporary Assistance to Needy Families (TANF) program from a component of the GRF to a component of the Federal Special Revenue Fund. When federal TANF funds are removed from FY 2001 spending so that there is an "apples-to-apples" comparison with FY 2002, we see that FY 2002 GRF spending was $241.4 million, or 1.1 percent, higher than FY 2001 GRF spending. Taking into account the change in how TANF funds are categorized in the budget, this relatively small increase in GRF expenditures failed to keep pace with the 1.3 percent annual rate of inflation experienced in the Midwest during the fiscal year.

Following the passage of Am. Sub. H.B. 94 at the end of the previous fiscal year, which itself saw several downward adjustments in revenue projections and spending, FY 2002 saw two budget corrective bills and an executive order that reduced appropriation authority. In October 2001, the Office of Budget and Management (OBM) issued the first of several revisions of revenue estimates for FY 2002 and FY 2003. At the same time, the Governor issued Executive Order 2001-22T, calling for substantial reductions in spending. The ordered reductions to agency budgets totaled approximately $220 million. In December 2001, OBM again revised its revenue estimates for FY 2002 and FY 2003, and, at the same time, the legislature passed H.B. 405, which provided some revenue enhancements and some additional appropriation reductions. In March 2002, OBM projected new revenue shortfalls for FY 2002 and FY 2003. And, in May 2002, the Legislative Service Commission provided a projection of even further revenue shortfalls. On May 29, the House passed Am. Sub. S.B. 261, the second budget corrective bill of the fiscal year. The bill used the May LSC estimates. On May 30, the Senate concurred in the House's changes. The Governor signed the bill on June 5, and it became effective immediately. While some FY 2002 savings were realized through Am. Sub. S.B. 261, by design, most of its fiscal impact will be realized in FY 2003 and future years.

In December 2001, in response to the budget reductions imposed by Executive Order 2001-22T, OBM revised all of its original FY 2002 disbursement estimates. Because the budget reductions affected agencies differently, sometimes reflecting or responding to changed spending patterns that were developed in anticipation of reductions, the changes in disbursement estimates for state agencies or programs (excluding the Capital, Debt Service, and Reissued Warrants reporting categories) led to *39* state agencies and programs having their monthly disbursement estimates *decreased* from the original estimates, to *27* agencies and programs having their monthly disbursement estimates *stay the same* as the original estimates, and to *18* agencies and programs having their monthly disbursement estimates *increased* from the original estimates. To avoid the fundamental problem of how to analyze and report expenditures in comparison to the revised estimates, we opted not to follow suit, and, as has been this publication's practice for many years, continued to use the original disbursement estimates for the fiscal year as our base of comparison to actual disbursements. As a result, with regard to discussing year-end disbursements, this publication and OBM's Monthly Financial Report were written from different perspectives, and for the readers of both, finding common points of reference will no doubt be somewhat problematic.

Over the course of the fiscal year, reductions in FY 2002 appropriations ordered by the Governor totaled $252.5 million. In addition, a balance of $295.9 million of appropriation authority was categorized as either "unallotted and unassigned" or as "available balance." These latter funds are FY 2002 GRF appropriations that have not been disbursed, transferred, or encumbered. These are amounts that have

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

USE OF FUNDS			
PROGRAM	**Actual**	**Estimate***	**Variance**
Primary & Secondary Education (1)	$471,830	$435,227	$36,603
Higher Education	$159,453	$168,756	($9,303)
Total Education	$631,283	$603,983	$27,300
Health Care/Medicaid	$447,721	$542,839	($95,118)
Temporary Assistance to Needy Families (TANF)	$439	$0	$439
General/Disability Assistance	$5,318	$5,954	($636)
Other Welfare (2)	$17,271	$28,486	($11,215)
Human Services (3)	$39,416	$66,249	($26,833)
Total Welfare & Human Services	$510,165	$643,528	($133,363)
Justice & Corrections	$115,427	$123,468	($8,040)
Environment & Natural Resources	$2,162	$2,670	($507)
Transportation	$340	$9,079	($8,739)
Development	$4,336	$8,603	($4,267)
Other Government (4)	$15,099	$23,286	($8,187)
Capital	$4	$0	$4
Total Government Operations	$137,368	$167,105	($29,737)
Property Tax Relief (5)	$157,962	$226,384	($68,422)
Debt Service	$16,572	$21,159	($4,586)
Total Program Payments	**$1,453,350**	**$1,662,159**	**($208,809)**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	$0	$0	$0
Other Transfers Out	$4	$0	$4
Total Transfers Out	$4	$0	$4
TOTAL GRF USES	**$1,453,354**	**$1,662,159**	**($208,805)**

(1) Includes Primary, Secondary, and Other Education.
(2) Includes the Department of Job and Family Services, exclusive of Medicaid, TANF, and General/Disability Assis
(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, the homestead exemption, and the tangible property tax exemption.

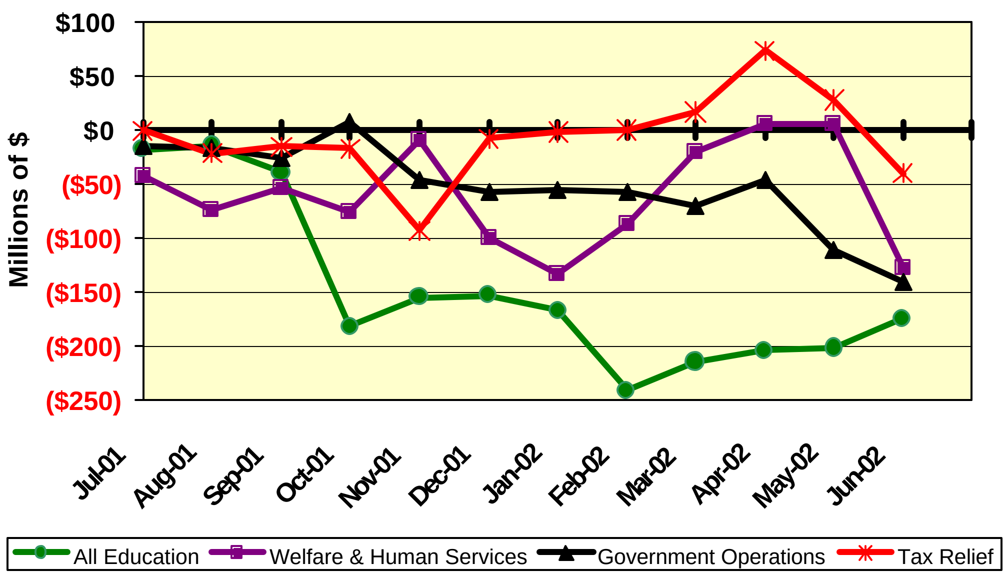
* August 2001 estimates of the Office of Budget and Management.

Totals may not add up due to rounding.

lapsed and reverted back to the GRF's FY 2002 ending cash balance. The largest amounts of lapsed FY 2002 appropriation authority are traceable to the budgets of five departments. In order of magnitude, these are the Department of Education ($81.4 million), the Department of Job and Family Services ($43.2 million), the Department of Rehabilitation and Correction ($34.3 million), the Department of Taxation ($31.1 million), and the Department of Administrative Services ($23.1 million). At the end of the fiscal year, $432.2 million from FY 2002 appropriations remained encumbered.

The state's GRF disbursements finished the fiscal year $494.0 million below the estimate, excluding transfers. June's General Revenue Fund disbursements were $208.8 million under 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 program categories registered relatively large negative disbursement variances in June, while the other program category (Education) registered a positive disbursement variance. June's strong net negative disbursement variance was led by the Welfare and Human Services program, which posted an underage of $133.4 million. The bulk of June's negative disbursement variance in Welfare and Human Services was posted by the Health Care/Medicaid program in the Department of Job and Family Services and was traceable to delayed payments to providers. At the end of the fiscal year, the Education program category remained the largest source of the total year-to-date negative disbursement variance at $173.8 million below the estimate.

Figure 1.
GRF Disbursement Variance
by Program Category, FY 2002



As is our usual practice, we will examine monthly and year-long disbursement activity by looking at these four major GRF program categories in the order of the magnitude of their contributions to the year-end negative disbursement variance: (1) Education, (2) Government Operations, (3) Welfare and Human Services, 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 June and year-end disbursement variances, respectively, by program category. The year-to-year comparisons in Table 5 show that increases from FY 2001 expenditure levels were experienced in Primary and Secondary Education (9.6 percent), Health Care/Medicaid (10.3 percent), and Property Tax Relief (2.9 percent). Increases in expenditures were also experienced in the following smaller program areas: Disability Assistance (22.1 percent), Transportation (14.6 percent), and Debt Service (11.8 percent). The remaining categories were about even with or less than, FY 2001 levels.

Education (-$173.8 million)

Disbursements in the Education program category were over the June estimate by $27.3 million. This was the result of a $36.6 million positive disbursement variance in Primary and Secondary Education and a partially offsetting $9.3 million negative disbursement variance in Higher Education. For the year as a whole, Education program category spending was $173.8 million under the estimate.

Department of Education. June's positive disbursement variance of $34.9 million reduced the department's year-end negative disbursement variance to $47.3 million below the estimate. The month's

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
FY 2002 through June 2002
($ in thousands)

USE OF FUNDS

PROGRAM	Actual	Estimate*	Variance	FY 2001	Percent Change
Primary & Secondary Education (1)	$6,086,314	$6,136,891	($50,577)	$5,554,127	9.58%
Higher Education	$2,406,915	$2,530,149	($123,234)	$2,518,790	-4.44%
Total Education	$8,493,229	$8,667,041	($173,812)	$8,072,917	5.21%
Health Care/Medicaid	$7,173,717	$7,158,521	$15,196	$6,505,689	10.27%
Temporary Assistance to Needy Families (TANF	$367,306	$388,009	($20,704)	$928,871	-60.46%
General/Disability Assistance	$87,222	$84,662	$2,560	$71,442	22.09%
Other Welfare (2)	$474,646	$561,718	($87,071)	$527,069	-9.95%
Human Services (3)	$1,105,556	$1,142,981	($37,425)	$1,114,126	-0.77%
Total Welfare & Human Services	$9,208,447	$9,335,891	($127,444)	$9,147,196	0.67%
Justice & Corrections	$1,811,991	$1,906,353	($94,361)	$1,814,004	-0.11%
Environment & Natural Resources	$119,032	$126,322	($7,289)	$129,593	-8.15%
Transportation	$45,607	$50,169	($4,562)	$39,799	14.59%
Development	$172,622	$181,120	($8,498)	$180,591	-4.41%
Other Government (4)	$380,264	$412,470	($32,206)	$379,413	0.22%
Capital	$9,164	$3,322	$5,842	$50,759	-81.95%
Total Government Operations	$2,538,681	$2,679,755	($141,074)	$2,594,159	-2.14%
Property Tax Relief (5)	$1,151,502	$1,191,533	($40,031)	$1,119,191	2.89%
Debt Service	$235,584	$247,241	($11,657)	$210,700	11.81%
Total Program Payments	**$21,627,442**	**$22,121,460**	**($494,018)**	**$21,144,164**	**2.29%**
TRANSFERS					
Local Govt Distribution	$0	$0	$0	$0	--
Budget Stabilization	$13,104	$13,104	$0	$49,200	-73.37%
Other Transfers Out	$19,862	$13,078	$6,785	$805,025	-97.53%
Total Transfers Out	$32,966	$26,182	$6,785	$854,225	-96.14%
TOTAL GRF USES	**$21,660,409**	**$22,147,642**	**($487,233)**	**$21,998,389**	**-1.54%**

(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, the homestead exemption, and the tangible property tax exemption.

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

Totals may not add up due to rounding.

overage stemmed primarily from the timing-related disbursement of funds from line item 200-501, Base Cost Funding ($24.1 million over estimate), and line item 200-406, Head Start ($7.8 million over estimate).

The notable contributors to the department's $47.3 million year-end negative disbursement variance include the following line items: (1) 200-513, Student Intervention Services ($19.6 million), (2) 200-520, Disadvantaged Pupil Impact Aid (DPIA) ($11.6 million), and (3) 200-406, Head Start ($7.8 million). In the case of line item 200-513, Student Intervention Services, the disbursement of these funds was delayed to FY 2003. The underage in the other two line items was traceable to estimates that proved to be too high.

Regents. In June, the Board of Regents posted a $9.3 million negative disbursement variance that was

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

Service Category	June Actual	June Estimate	June Variance	June Percent Variance	YTD Actual thru' June	YTD Estimate thru' June	YTD Variance	YTD Percent Variance
Nursing Facilities	$97,140	$144,476	($47,336)	-32.8%	$2,280,472	$2,368,236	($87,764)	-3.7%
ICF/MR	$33,579	$34,052	($473)	-1.4%	$399,005	$405,556	($6,551)	-1.6%
Hospitals	$120,135	$131,030	($10,895)	-8.3%	$1,554,239	$1,665,600	($111,361)	-6.7%
Inpatient Hospitals	$84,497	$95,483	($10,986)	-11.5%	$1,099,141	$1,211,366	($112,226)	-9.3%
Outpatient Hospitals	$35,638	$35,547	$91	0.3%	$455,098	$454,233	$864	0.2%
Physicians	$28,410	$37,785	($9,375)	-24.8%	$470,003	$475,269	($5,266)	-1.1%
Prescription Drugs	$31,657	$81,137	($49,480)	-61.0%	$985,682	$1,026,174	($40,492)	-3.9%
Payments	$76,491	$102,287	($25,796)	-25.2%	$1,242,010	$1,258,814	($16,804)	-1.3%
Rebates	($44,833)	($21,149)	($23,684)	112.0%	($256,328)	($232,640)	($23,688)	10.2%
ODJFS Waivers[1]	$14,950	$13,069	$1,881	14.4%	$162,477	$158,787	$3,690	2.3%
HMO	$56,701	$49,650	$7,050	14.2%	$597,183	$547,087	$50,096	9.2%
Medicare Buy-In	$11,521	$10,773	$749	6.9%	$133,386	$127,747	$5,640	4.4%
All Other[2]	$50,153	$48,901	$1,252	2.6%	$660,720	$612,349	$48,371	7.9%
DSH offset	$0	$0	$0		($116,557)	($117,333)	$776	
Total ALI 600-525	**$444,246**	**$550,872**	**($106,626)**	**-19.4%**	**$7,126,610**	**$7,269,471**	**($142,861)**	**-2.0%**
FMAP[3]	58.94%	58.94%			58.94%	58.94%		
Est. Federal Share	$261,839	$324,684	($62,845)		$4,200,424	$4,284,626	($84,202)	
Est. State Share	$182,407	$226,188	($43,781)		$2,926,186	$2,984,845	($58,659)	
BSF Shortfall[4]	$0	($12,030)			$0	($158,057)		
Total ALI 600-525 Disb.	**$444,246**	**$538,842**	**($94,596)**	**-17.6%**	**$7,126,610**	**$7,111,414**	**$15,196**	**0.2%**
Est. Federal Share	$261,839	$317,594	($55,755)		$4,200,424	$4,191,468	$8,956	
Est. State Share	$182,407	$221,249	($38,841)		$2,926,186	$2,919,947	$6,239	
Children's Health Insurance Plan (CHIP-II), ALI 600-426[5]								
Total ALI 600-426	**$3,475**	**$3,997**	**($522)**	**-13.0%**	**$47,106**	**$47,106**	**($0)**	**0.0%**
Enhanced FMAP	71.19%	71.19%			71.19%	71.19%		
Est. Federal Share	$2,474	$2,845	($371)		$33,535	$33,535	($0)	
Est. State Share	$1,001	$1,151	($150)		$13,571	$13,571	($0)	
Total Health Care	**$447,721**	**$554,869**	**($107,148)**	**-19.3%**	**$7,173,716**	**$7,316,578**	**($142,861)**	**-2.0%**
Total Hlth Care w/o BSF	**$447,721**	**$542,839**	**($95,118)**	**-17.5%**	**$7,173,716**	**$7,158,521**	**$15,196**	**0.2%**

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 line item 600-525 and prior-year encumbrances.
3. Federal Medical Assistance Percentage.
4. The budget estimate assumed $65 million of the Budget Stabilization Fund (BSF) will be used to increase the appropriation in line item 525 by $158 million, all funds in state fiscal year 2002.
5. 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.

the result of a $16.6 million underage in line item 235-501, State Share of Instruction, which was only partially offset by smaller positive variances. Line item 235-501 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 offsetting positive variance for June was composed of a number of positive variances spread through the Regents' budget with only one standout: line item 235-590, Twelfth-grade Proficiency Stipend.

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

Service Category	FY 2002[1] Through June '02	FY 2001[1] Through June '01	Dollar Change	Percent Increase
Nursing Facilities	$2,280,472	$2,265,717	$14,755	0.7%
ICF/MR	$399,005	$383,306	$15,699	4.1%
Hospitals	$1,554,239	$1,483,736	$70,502	4.8%
Inpatient Hospitals	$1,099,141	$1,071,311	$27,830	2.6%
Outpatient Hospitals	$455,098	$412,426	$42,672	10.3%
Physicians	$470,003	$420,245	$49,758	11.8%
Prescription Drugs	$985,682	$861,187	$124,495	14.5%
Payments	$1,242,010	$1,053,849	$188,160	17.9%
Rebates	($256,328)	($192,662)	($63,665)	33.0%
ODJFS Waivers[2]	$162,477	$141,367	$21,110	14.9%
HMO	$597,183	$424,530	$172,653	40.7%
Medicare Buy-In	$133,386	$120,370	$13,016	10.8%
All Other[3]	$660,720	$535,731	$124,990	23.3%
DSH offset	($116,557)	($156,887)	$40,330	
Total (600-525)	**$7,126,610**	**$6,479,303**	**$647,308**	**10.0%**
Estimated Federal Share[4]	$4,200,424	$3,801,407	$399,017	10.5%
Estimated State Share	$2,926,186	$2,677,896	$248,290	9.3%

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 encumbrances.
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.

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 eliminated 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 Spring 2001 are the last group of students who will be eligible for this scholarship. After delays in the processing of payouts of this stipend, June's disbursement of $14.6 million ($14.1 million over the estimate) made up for months of spending under the estimate.

Disbursement activity in the budget of the Board of Regents completed FY 2002 at $123.2 million below the estimate. The bulk of the FY 2002 underage ($99.5 million, or 80.8 percent) was driven by the underspending posted in line item 235-501 (discussed above).

Government Operations (-$141.1 million)

While the Department of Rehabilitation and Correction and the Department of Administrative Services were the most significant contributors to the disbursement variance in the Government Operations category, there are also some noteworthy items from other components of the category. The following paragraphs briefly set out such points in order of the magnitude of their contributions to the year-end underage.

Rehabilitation and Correction. The Department of Rehabilitation and Correction posted a $6.6 million negative disbursement variance in June, and finished the year with a disbursement variance of $75.1 million below the estimate. The bulk of the negative year-end disbursement variance was 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. In addition, line item 501-321 lapsed $11.2 million in FY 2002 appropriation authority, and encumbered $22.3 million for disbursement in FY 2003. Contributing to the savings in this line was closure of the Orient Correctional Institution. Savings for FY 2002 from the closure were $3.4 million, with annual savings in FY 2003 and future years expected to be about $28.5 million. Staff reductions in other correctional institutions also contributed to the department's savings.

Also contributing to the year-end negative disbursement variance was line item 501-406, Lease Rental Payments. For the year as a whole, disbursements from this debt service line item were $11.1 million below the estimate. This FY 2002 appropriation authority was lapsed.

Administrative Services. For FY 2002 as a whole, the Department of Administrative Services posted a $12.5 million negative disbursement variance. Approximately $9.3 million of the department's negative year-end disbursement variance 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. The $9.3 million of FY 2002 appropriation authority remaining in line item 100-447 at the end of the fiscal year was lapsed.

Youth Services. Reductions ordered by the Governor in the FY 2002 budget of the Department of Youth Services totaled $9.7 million. The bulk of the reduction came from line item 470-401, RECLAIM OHIO ($3.1 million), and from line item 470-502, Detention Subsidies ($5.8 million). In the case of line item 470-502, the department eliminated virtually its entire FY 2002 appropriation of $6.2 million for county detention center subsidies. The appropriations were to provide, in the case of line item 470-401, institutional placement and juvenile court community program services, and in the case of line item 470-502, funding to help county detention centers meet their maintenance and operational expenses.

Public Defender Commission. While the commission was among the smaller contributors to the year-end negative disbursement variance, there is an interesting aspect to its $3.6 million negative disbursement variance for FY 2002. The commission's supporting reimbursements to counties for indigent defense expenditures were subject to the cuts the Governor mandated. Prior to the cuts, the commission reimbursed counties for up to 50 percent of the indigent defense expenditures related to the operation of local public defender offices or the use of appointed counsel. As a result of the cuts, the reimbursement rate for FY 2002 was approximately 39 percent. The executive order reduced the appropriation authority in line item 019-501, County Reimbursement, Non-Capital Cases, by $2.6 million in FY 2002.

Welfare and Human Services ($-141.1 million)

As we see in Table 4, disbursements in the Welfare and Human Services program category were sharply below the June estimate by $133.4 million. Table 5 shows that, for the year as a whole, disbursements in the program category stood at $127.4 million below the estimate. The following paragraphs discuss the notable contributors to the year-end result in order of their magnitude, going first to negative disbursement variances and then to positive disbursement variances.

Job and Family Services. Disbursement activity in the category "Other Welfare," which includes all of 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 $11.2 million short of the estimate in June. This marks the 11th straight month of underages in this category. For the year as a whole, the underage stood at $87.1 million.

The largest contributors to the negative year-end disbursement variance in this segment of the department's budget were, in order of magnitude, (1) 600-416, Computer Projects ($30.9 million), (2) 600-528, Adoption Services ($10.6 million), (3) 600-200, Maintenance ($10.3 million), and (4) 600-437, Temporary Heating Assistance ($6.8 million).

Some of these underages reflect the impact of budget reductions imposed under Executive Order 2001-22T. This is particularly the case with line items 600-416, Computer Projects, and 600-620, Maintenance. FY 2002 appropriation authority in line item 600-416 was reduced in Executive Order 200-22T by $13.0 million, and another $15.1 million lapsed. FY 2002 appropriation authority in line item 600-200 was reduced by $3.6 million and another $10.2 million lapsed.

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. As we have been reporting for several months now, the rate of growth in FY 2002 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. In late May, the Controlling Board approved the transfer of $1.2 million from line item 600-528 to two line items supporting other administrative activity.

TANF. The Temporary Assistance to Needy Families (TANF) program posted a year-end negative disbursement variance in GRF spending of $20.7 million. The bulk of the year-end underage was registered in line item 600-411, TANF Federal Block Grant, where spending of prior-year funds was $18.1 million below the estimate. Of this amount, $9.5 million was canceled under Executive Order 2001-22T. Beginning with FY 2002, the TANF Block Grant was no longer a component of the GRF. During FY 2002, $619.2 million was disbursed from federal TANF funds.

TANF cash assistance benefits paid during the fiscal year totaled $316.9 million. The average number of TANF cash assistance groups per month decreased from FY 2001 to FY 2002 by about 3,600 to stand at about 86,000, a decrease of 4.1 percent. The average number of TANF recipients per month decreased from FY 2001 to FY 2002 by about 17,400 to stand at about 198,500, a decrease of 8.0 percent. The larger percentage decrease for recipients than for assistance groups reflects the continuing shrinking of the average size of assistance groups and further reveals 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 now make up over 45 percent of all TANF cases. The number of "child only" cases has increased from approximately 25,000 in 1991 to approximately 38,000 at the present time.

Mental Retardation. The Department of Mental Retardation and Developmental Disabilities closed FY 2002 with a $14.1 million negative disbursement variance. As was the case throughout the year, the bulk of the negative disbursement variance ($16.4 million) stems from line item 322-413, Residential and Support Services, reflecting, in part, timing factors that affect the processing of payments to service providers, and from an $8.0 million appropriation reduction ordered by the Governor. Line item 322-413 also lapsed $5.8 million in FY 2002 appropriation authority.

Aging. The Department of Aging completed FY 2002 with a negative disbursement variance of $10.0 million. This result was traceable to the reduction of appropriation authority by $6.1 million pursuant to executive order, and to the lapsing of another $4.8 million in FY 2002 appropriation authority. The bulk of the underage was experienced in line item 490-403, PASSPORT. The PASSPORT program is a Medicaid waiver program that provides in-home alternatives to nursing home care for low-income seniors. The reduction in this program was absorbed by putting those who sought to enter the program on a waiting list.

Health. For FY 2002, the Department of Health posted a $6.2 million underage. This negative disbursement variance was tied mainly to budget reduction activities (e.g., the hiring freeze and an equipment purchase freeze) that resulted from a $6.7 million appropriation reduction ordered by the Governor.

Mental Health. For FY 2002 as a whole, the Department of Mental Health registered a negative disbursement variance of $5.1 million. Consistently over estimate throughout the fiscal year, line item 334-408, Community and Hospital Mental Health Services, ended the year just slightly over estimate (by about $200,000). This was more than made up for by year-end underages spread over several of the department's other line items.

Health Care/Medicaid. For the year as a whole, disbursement activity in the Health Care/Medicaid program (primarily line item 600-525) was $15.2 million, or 0.2 percent, over the estimate of $7.16 billion. In June, the program recorded a $95.1 million negative disbursement variance primarily by delaying $82.2 million in payments to providers. If these postponed payments were included in the FY 2002 total and that total were compared with FY 2001 expenditures, the increase from FY 2001 to FY 2002 would have been 11.3 percent, rather than the 10.0 percent reported in Table 7.

The total number of Medicaid eligibles in June was 1,488,973, over 162,000 more than at the beginning of the state fiscal year, and over 100,000 more than forecast. The number of Covered Families and Children (CFC) recipients has increased by nearly 147,000 during the state fiscal year to stand at about 1,098,000. The number of Aged, Blind, and Disabled (ABD) recipients increased by over 15,000 during the state fiscal year to nearly 392,000. Although greatly outnumbered by the CFC population, the ABD population accounts for over 70 percent of all Medicaid expenditures.

The costs over the estimate were supported by funds from the Budget Stabilization Fund (BSF). Additional costs in the Health Care/Medicaid program were anticipated in Am. Sub. H.B. 94 of the 124th General Assembly, which provided that with Controlling Board approval, funds from the BSF, along with matching federal Medicaid funds, could be appropriated to fund an expected overage. In its May 20 meeting, the Controlling Board approved a request from the Department of Job and Family Services to transfer $40.4 million from the BSF.

As we stated in our monthly reports throughout the fiscal year, the role that particular service categories play in producing each month's disbursement variance is difficult to determine because the total estimate reached by adding all the service categories together 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 inclusions of $65 million from the BSF and an additional federal contributions of $93 million in matching funds. These additional state and federal funds totaling $158 million were not included in OBM's original disbursement estimates for the program as a whole. The department and OBM chose to produce "budgeted" service category estimates that included the $158 million from the BSF and matching federal funds, which exceeds the actual amount of additonal funding that was required. In contrast, Tables 4 and 5 reflect the orginal disbursements estimates, which were based on the program's appropriation authority in Am. Sub. H.B. 94, and compare the original estimates with actual spending.

Some useful information, however, can still be gleaned in Tables 6 and 7 with regard to the changing composition of Medicaid services and costs. The Nursing Home, Intermediate Care Facilities for the Mentally Retarded (ICF/MR), and Hospitals service categories consistently posted monthly negative disbursement variances against the "budgeted" estimates and ran behind the overall growth rate as compared to spending from the preceding year, suggesting lower utilization rates.

In contrast, we see in Tables 6 and 7 that for FY 2002, payments to HMOs were over estimate by $50.1 million, and registered a 40.7 percent increase over FY 2001. While a portion of the difference in HMO payments can be explained by a 4.6 percent rate increase that took effect in July 2001, and another portion by a weakening economy that has pushed up enrollments, the bulk of the difference results from an increase in the number of participants who, under the "preferred option" program, are being automatically enrolled in HMOs, as opposed to being enrolled on a fee-for-service basis. The "preferred option" program exists in counties where there is voluntary enrollment in managed care plans. This program automatically enrolls recipients in managed care if they fail to select the traditional fee-for-service option.

We also see that rebates for prescription drugs were above estimate for June ($23.7 million), and for the year as a whole ($23.7 million). (Since these rebates are payments to the state they are recorded as negative dollars in the expenditure tables.) Prescription drug rebates were 33.0 percent higher in FY 2002 than in FY 2001.

Tax Relief ($-40.0 million)

The Property Tax Relief program, which carried 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 rollbacks/exemptions, and tangible tax exemptions.

Disbursement activity in the Property Tax Relief program was $68.4 million below the estimate for the month of June, and completed the fiscal year $40.0 million below the estimate. For the year as a whole, property tax relief by the Department of Education was under estimate by $8.5 million. This underage was due mostly to estimates that proved to be too high. The Department of Taxation's tax relief program finished the fiscal year $31.5 million below the estimate – a variance similarly due in part to overestimation, but also due in part to timing, as some payments to counties scheduled for June were delayed until after the start of FY 2003.

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

Lottery Profits Quarterly Report

LOTTERY TICKET SALES AND PROFITS TRANSFERS FOURTH QUARTER, FY 2002

— Jean Botomogno

Ticket Sales

During the fourth quarter of FY 2002, the Ohio Lottery made some changes to an established game and started a new On-line game. The Ohio Lottery entered the Mega Millions multistate game in May 2002, and in April increased from four to six the number of days on which drawings are held each week for Buckeye 5. Buckeye 5 reversed a decline in ticket sales and grew 10.5 percent from FY 2001 levels. Mega Millions contributed $16.5 million to On-line ticket sales and total sales. The game operated in Ohio for about half of the quarter. Table 1 summarizes Lottery ticket sales by game in the fourth quarter of FY 2002. It shows that total ticket sales in the quarter were $522.1 million and Instant ticket sales were $246.3 million or 47.2 percent of quarterly sales. On-line ticket sales were $275.9 million, 12.0 percent higher than Instant ticket sales. April had the highest monthly ticket sales during the fourth quarter, due to strong Super Lotto ticket sales. This game started the fourth quarter with a five-week "roll,"[1] helping boost overall ticket sales and profits. Ticket sales declined 17.0 percent in May to $167.5 million, and another 8.8 percent in June to $152.8 million. Both Instant and On-line ticket sales decreased

Table 1: Fourth-Quarter Lottery Ticket Sales by Game (millions of current dollars)									
	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	Instant Tickets	On-line Tickets	Total Sales
Apr	$34.5	$12.9	$6.6	$6.6	$55.5	NA	$85.7	$116.1	$201.8
May	$34.1	$13.1	$3.1	$7.9	$18.6	$6.3	$84.3	$83.2	$167.5
Jun	$32.3	$12.1	$2.5	$5.8	$13.8	$10.1	$76.3	$76.6	$152.8
Total	$101.0	$38.1	$12.1	$20.2	$87.9	$16.5	$246.3	$275.9	$522.1

Totals may not add up due to rounding. Mega millions operated part of May.

Super Lotto sales were 16.8 percent of ticket sales in the fourth quarter. Pick 3 sales were 19.3 percent. Pick 4, Buckeye 5, and Kicker contributed 7.3 percent, 3.9 percent, and 2.3 percent, respectively.

Compared to the same quarter a year ago, total ticket sales increased $49.1 million, or 10.4 percent. On-line ticket sales were up $37.5 million (including $16.6 million from Mega Millions), or 15.7 percent. Instant ticket sales improved $11.6 million, up 4.9 percent. Super Lotto sales were up $15.3 million or 21.0 percent. Buckeye 5 sales increased $6.5 million or 47.6 percent. Pick 3 receipts declined $2.0 million or 1.9 percent. Pick 4 revenues were up $0.3 million or 0.8 percent.

Table 2 shows quarterly ticket sales in FY 2002. Quarterly ticket sales improved each quarter during the fiscal year, from $479.4 million in the first quarter to $522.1 million in the fourth quarter. Second-quarter ticket sales were $488.4 million, and third-quarter ticket sales were $492.7 million. For the fiscal year, Pick 3 provided 20.6 percent of total ticket sales, Super Lotto provided 15.0 percent, and Pick 4 contributed 7.8 percent. Buckeye 5 and Kicker sales were 3.1 percent and 2.3 percent of total ticket sales, respectively. Instant ticket sales were 50.3 percent and On-line ticket sales were 49.7 percent of total ticket sales.

Table 2: Quarterly Lottery Ticket Sales by Game
(millions of current dollars)

	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	Instant Tickets	On-line Tickets	Total Sales
Q1	$99.6	$37.2	$12.4	$13.9	$84.2	N/A	$232.1	$247.2	$479.4
Q2	$102.3	$39.5	$9.8	$14.2	$59.9	N/A	$262.6	$225.7	$488.4
Q3	$106.4	$39.9	$10.7	$14.0	$66.0	N/A	$255.7	$236.9	$492.7
Q4	$101.0	$38.1	$12.1	$20.2	$87.9	$16.5	$246.3	$275.9	$522.1
Total	$409.2	$154.6	$45.0	$62.4	$298.1	$16.5	$996.8	$985.8	$1,982.5

Totals may not add up due to rounding.

Table 3 illustrates the trend in quarterly ticket sales in FY 2002. It reveals the not-so-surprising growth in Buckeye 5 ticket sales in the fourth quarter, up 44.5 percent from the previous quarter. Super Lotto ticket sales dropped 28.9 percent in the second quarter, but ended in the fourth quarter with a strong growth of 33.3 percent. The first and the fourth quarters had huge Super Lotto jackpots. Similarly, On-line ticket sales grew 16.4 percent, helping total ticket sales to grow 6.0 percent in the fourth quarter. Excluding Mega Millions ticket sales, growth in On-line ticket sales would have been 9.5 percent, and growth in total ticket sales would have been 2.6 percent. Pick 3 and Pick 4 had disappointing sales in the fourth quarter, declining 5.1 percent and 4.5 percent, respectively. On-line and Instant games had contrasting quarterly results during the year. When Instant ticket sales grew, On-line ticket sales were feeble. When Super Lotto and On-line ticket sales weakened in the second quarter, Instant ticket sales were strong. On-line ticket sales grew in the first, third, and fourth quarters, while Instant ticket sales declined. Instant ticket sales are traditionally highest in the second quarter, due to the numerous Instant games offered during the holiday season.

Transfers to the Lottery Profits Education Fund (LPEF)

Table 4 summarizes quarterly transfers to the LPEF in FY 2002. Increasing ticket sales led to increasing quarterly transfers during the fiscal year. Fourth-quarter transfers were $161.7 million, up 6.7 percent from $151.5 million in the third quarter and up 8.9 percent from $148.5 million in the second quarter. Transfers in the fourth quarter were $13.1 million higher than projected transfers, more than erasing the cumulative shortfall of $11.7 million at the end of the third quarter. Quarterly transfers as a percentage of sales were all above 30 percent in FY 2002. For the fiscal year, transfers from operations were 30.8 percent of ticket sales.

Year in Review

After a decline of 10.7 percent in FY 2001, lottery ticket sales rose in FY 2002. Table 5 compares ticket sales per game, and shows dollar and percentage variances for each game between FY 2001 and

Table 3: Percentage Change in Ticket Sales from Previous Quarter in FY 2002

	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	Instant Tickets	On-line Tickets	Total
Q1	-3.3%	-1.6%	9.4%	1.6%	15.9%	NA	-1.1%	3.7%	1.3%
Q2	2.8%	6.2%	-20.4%	1.9%	-28.9%	NA	13.1%	-8.7%	1.9%
Q3	3.9%	1.0%	9.0%	-1.2%	10.2%	NA	-2.6%	5.0%	0.9%
Q4	-5.1%	-4.5%	13.3%	44.5%	33.3%	NA	-3.7%	16.4%	6.0%

Table 4: Ticket Sales and Transfers to the LPEF (millions of current dollars)						
	Ticket Sales	Actual Transfers	Projected Transfers	Dollars Variance	Percentage Variance	Transfers as Percentage of Sales
Q1	$479.4	$148.4	$151.0	-$2.7	-1.8%	31.0%
Q2	$488.4	$148.5	$158.5	-$10.0	-6.3%	30.4%
Q3	$492.7	$151.5	$150.6	$1.0	0.6%	30.8%
Q4	$522.1	$161.7	$148.6	$13.1	8.8%	31.0%
Total	$1,982.5	$610.1	$608.7	$1.4	0.2%	30.8%

Totals may not add up due to rounding.

FY 2002. Total ticket sales in FY 2002 were $1,982.5 million, $62.5 million or 3.3 percent higher than FY 2001 ticket sales. Even without the $16.5 million additional sales from Mega Millions in FY 2002, ticket sales growth would have been positive (2.4 percent growth over a year ago) due to strong Super Lotto revenues. Compared to sales a year ago, Super Lotto ticket sales surged $35.6 million or 13.5 percent in FY 2002. Instant ticket sales increased $8.4 million, up 0.9 percent from $988.3 million in FY 2001. On-line ticket sales gained $54.2 million, up 5.8 percent from FY 2001 sales of $931.6 million. Buckeye 5 ticket sales were $62.4 million, $5.9 million or 10.5 percent higher than sales a year ago. Kicker ticket sales improved $2.1 million or 4.9 percent. Pick 3 was the only game with declining sales from a year ago. Its sales decreased $9.8 million to $409.2 million, down from $419.0 million in FY 2001.

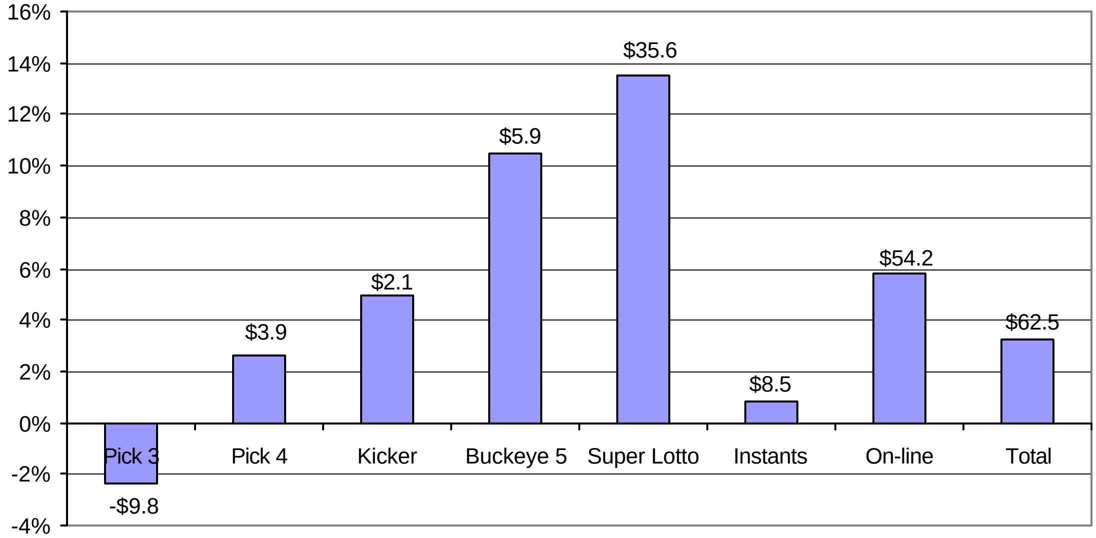
Table 5: Ticket Sales by Game, FY 2001 and FY 2002 (millions of current dollars)									
	Pick 3	Pick 4	Kicker	Buckeye 5	Mega Millions	Super Lotto	Instant Tickets	On-line Tickets	Total
FY 2001	$419.0	$150.7	$42.9	$56.4	NA	$262.5	$988.3	$931.6	$1,920.0
FY 2002	$409.2	$154.6	$45.0	$62.4	$16.5	$298.1	$996.8	$985.8	$1,982.5
$ Variance	-$9.8	$3.9	$2.1	$5.9	$16.5	$35.6	$8.5	$54.2	$62.5
% Variance	-2.3%	2.6%	4.9%	10.5%	NA	13.5%	0.9%	5.8%	3.3%

Totals may not add up due to rounding.

The proportion of Instant ticket to total ticket sales decreased to 50.3 percent in FY 2002, down from 51.5 percent in FY 2001. Instant ticket games have lower profit margins (or higher payout ratio) than On-line games. The payout ratio for Instant tickets was 63.2 percent in the last two years. On-line ticket payout ratios were 52.4 percent in FY 2001 and 51.4 percent in FY 2002. Put another way, for every $100 in Instant tickets sold, $63.20 is distributed back to the players. For an identical sale of On-line tickets, $51.4 is paid out to the players. A decrease in the share of Instant ticket sales relative to total ticket sales generally improves the profitability of Lottery operations. The graph below shows the contribution of each game to the increase in total ticket sales in FY 2002, and the percentage change in sales from FY 2001 for each game.

Table 6 shows ticket sales, actual and projected transfers from operations, and transfers as a percentage of ticket sales from FY 2000 through FY 2002. Transfers from operations in FY 2002 were $610.1 million, $1.9 million or 0.3 percent less than in FY 2001. Comparing FY 2002 and FY 2000, transfers from operations declined $50.9 million or 7.7 percent in FY 2002. Transfers from operations have declined 14.5 percent from a high of $713.5 million in FY 1996 to $610.1 million in FY 2002.[2] Transfers from operations are supplemented each year by amounts from the Unclaimed Prize Fund or the Deferred Prize Trust Fund. In each of the last three fiscal years, $25 million from the Unclaimed Prize Fund was added to

Dollar (in millions) and Percentage Changes in Ticket Sales, FY 2001 to FY 2002



profits from operations and transferred to the LPEF. Thus, total transfers to the LPEF were $680.0 million in FY 2000, $637.1 million in FY 2001, and $635.1 million in FY 2002.

Table 6: Ticket Sales and Transfers to LPEF, FY 2000 to FY 2002 (millions of current dollars)						
	Ticket Sales	Actual Transfers	Projected Transfers	Dollars Variance	Percentage Variance	Transfers as Percentage of Sales
FY 2000	$2,150.4	$661.0	$661.0	$0.0	0.0%	30.7%
FY 2001	$1,920.0	$612.0	$665.2	-$53.2	-8.0%	31.9%
FY 2002	$1,982.5	$610.1	$608.7	$1.4	0.2%	30.8%

Legislative changes affecting the Ohio Lottery in FY 2002

Am. Sub. H.B. 94, the current biennial budget, removed a provision of law requiring that at least 30 percent of ticket sales be transferred to the Lottery Profit Education Fund (LPEF). Thus, the Ohio Lottery operated with greater flexibility in the design and the mix of games for FY 2002. Instant ticket sales could benefit from these changes because the Ohio Lottery could offer Instant games with a higher payout ratio than in previous years. The percentage payout for Instant games was 63.2 percent in FY 2001, lower than non-Ohio Lottery products that may reach 75 to 90 percent payout. Increasing the payout ratio may in turn help the Ohio Lottery compete against other organizations' scratch-offs, pull-tabs, bingo, and "charitable" instant games. The greater flexibility afforded the Ohio Lottery did not change by much the payout ratio for Instant tickets in FY 2002. At 63.3 percent, the payout ratio in FY 2002 remained similar to the payout ratio in FY 2001. A higher payout ratio means less profit from operations would be derived from Instant ticket sales, unless sales grow significantly. The Ohio Lottery has to strike a balance between the objective of increasing the payout from Instant games to better compete with nonlottery Instant games and the need to maintain the levels of profit from Instant games.

Am. Sub. H.B. 94 also changed the manner in which the Ohio Lottery transfers profits to the LPEF. A target amount for such transfers will be determined for each biennium during the legislative budget process. The biennial budget for FYs 2002-2003 required the Ohio Lottery Commission to transfer to the LPEF at least $633.7 million in FY 2002, and $621.7 million in FY 2003.[3] Am. Sub. H.B. 405 gave legislative approval for the Ohio Lottery's entry into a multijurisdictional game. The bill also increased the required transfer amount for FY 2003 to $662.7 million, up $41 million from $621.7 million, conditional upon entry into a multistate game.

The Ohio Lottery joined the Big Game (which became Mega Millions) on May 15, 2002. The other participating states are Georgia, Illinois, Michigan, Maryland, Massachusetts, New Jersey, New York, and Virginia. Washington State will join Mega Millions in September 2002. The entry of additional states (New York and Ohio) into Mega Millions prompted the game to modify its prize matrix, which almost doubled the odds against winning the top prize to 135 million:1 from about 76 million:1. The Mega Millions game requires a ticket purchaser to match five balls out of a group of 52, and to draw a single "Gold Mega Ball" from a separate batch of 52 balls. The jackpot starts at $10 million. The entry of Ohio in Mega Millions will impact Lottery sales in several ways. Super Lotto ticket sales are expected to decline by 10 to 15 percent because its top prize will become less exciting to players, until the jackpot starts growing.[4] This loss in Super Lotto sales will be more than compensated by ticket sales for Mega Millions. Other games could also be affected positively or negatively by the new game. Total ticket sales will likely increase with the addition of a new game within the state. Also, large jackpots from Mega Millions will help recapture some of the gaming dollars currently leaking into Powerball states (Kentucky, Indiana, West Virginia, and Pennsylvania) through cross-border sales. Also depending on the jackpot level in Mega Millions, the Ohio Lottery will benefit from sales to out-of-state players. Mega Millions contributed $16.5 million to sales in FY 2002 and is expected to increase sales by at least $120 million in FY 2003. For this increase to be a net sales increase for the lottery, Mega Millions sales will need to be higher than $120 million. Also, Mega Millions will have a positive net effect on profits because the payout ratio from Mega Millions (about 50 percent) is lower than that of Super Lotto (59.7 percent).

1 A roll is a period of continuous drawings without a winner for the top prize. Super Lotto reached jackpots of $75 million in April 13, 2002, and $34 million in June 8, 2002.

2 In 1996 dollars, transfers from operations have declined approximately 25 percent to $535.0 million.

3Transfers are from net income from operations and supplemented by the Unclaimed Prized Fund. In each of the last three fiscal years, transfers from the Unclaimed Prized Fund have been $25.0 million.

4 Some of the players who currently purchase Super Lotto tickets will buy instead the multistate game because of the larger jackpot in Mega Millions. Also, some players who were occasionally lured by high Super Lotto prizes will be lost due to the introduction of Mega Millions. Other players may play both games when the prize is high. The Ohio Lottery will also probably make some changes to the Super Lotto prize matrix following the entry into the multistate game. It is too early to tell the extent to which Mega Millions has affected other On-line games. Interestingly, ticket sales in June 2002 (the first full month of Mega Millions) for Super Lotto and Kicker were the games' lowest monthly sales in the last 24 months.

Previous Next

LOTTERY PROFITS EDUCATION FUND DISBURSEMENTS FOURTH QUARTER, FY 2002

— Sara Doddy

Lottery Profits Education Fund (LPEF) disbursements in FY 2002 totaled $642.6 million. Nearly all of this amount ($604.0 million) came from appropriation item 200-612, Base Cost Funding. The Lottery Profits Education Reserve Fund (LPERF) had no disbursements in FY 2002. Disbursements for the year were just a few hundred thousand dollars short of the appropriation amount.

Base Cost Funding

The $604.0 million of lottery profits spending was combined with GRF appropriation item 200-501, Base Cost Funding ($4,235.5 million), to fund the state foundation aid program. This program provided the state's share of per pupil funding that guarantees $4,814 per pupil in state and local funding for FY 2002. The program also provided the state's share of additional special and career-technical education costs, known as weight cost funding. With the combination of GRF and LPEF moneys, base cost funding ($4,839.5 million) represented 57.9 percent of the Department of Education's disbursements for FY 2002.

SchoolNet Plus Supplement

Moneys for this line item were transferred from prior amounts allocated to appropriation item 228-690, SchoolNet Electrical Infrastructure. These funds are to be used to supplement moneys from the tobacco settlement. The funds will be used to implement the SchoolNet Plus program up to the sixth grade.

SchoolNet Electrical Infrastructure

To help school districts implement SchoolNet and SchoolNet Plus initiatives, the 122nd General Assembly originally appropriated $27.0 million in LPEF moneys in FY 1998 for electrical service upgrades. The SchoolNet Commission distributes the funding through a competitive grant application process. School districts with a valuation per pupil less than $200,000 are eligible for the funding. The maximum grant amount for a single district is $1.0 million. Approximately $17.6 million was disbursed by the end of FY 2001. The remaining balance of $9.4 million was transferred into FY 2002 under Am. Sub. H.B. 94 of the 124th General Assembly. Of that balance, $8.0 million was transferred to appropriation item 228-603, SchoolNet Plus Supplement, in FY 2002. Nearly $1 million was disbursed from this appropriation item in FY 2002.

Table 1: FY 2002 LPEF (017) and LPERF (018) Appropriation/Disbursement Summary
As of June 28, 2002

Agency	Fund	Line Item	Line Item Name	FY 2002 Appropriation	FY 2002 Disbursement	Appropriation Encumbrance	Appropriation Balance
EDU	017	200-612	Base Cost Funding	$ 604,000,000	$ 604,000,000	$ 0	$ 0
EDU	017	200-682	Lease Rental	$ 29,722,100	$ 29,722,100	$ 0	$ 0
NET	017	228-603	SchoolNet Plus Supplement	$ 8,000,000	$ 7,988,224	$ 11,776	$ 0
NET	017	228-690	SchoolNet Electrical Infrastructure	$ 1,343,621	$ 888,260	$ 0	$ 445,360
			Total LPEF	**$ 643,065,721**	**$ 642,620,361**	**$ 0**	**$ 445,360**
SFC	018	230-649	Disability Access Project	$ 1,300	$ 0	$ 0	$ 1,300

Issues of Interest

WHAT IS THE THIRD FRONTIER INITIATIVE?

— *Allison Thomas**

"Two hundred years ago, the settlers transformed Ohio wilderness into civilization. Generations later, the pioneers of flight and light conquered another frontier to make Ohio a powerhouse of the industrial revolution.... We are the pioneers of Ohio's third frontier – a frontier of exploration and discovery where knowledge is king."

Governor Bob Taft
State of the State Address
February 5, 2002

The **Third Frontier Initiative** is Ohio's economic development plan to invest $1.6 billion over a ten-year period in its research and development technologies, its workforce, and its future. The initiative is composed of four parts:

- Funding of $500 million over a ten-year period to the existing Technology Action Fund and the Biomedical Research and Technology Transfer Trust Fund;
- The Wright Brothers Capital Fund of $50 million per year for ten years to provide competitive grants for capital assets;
- A proposed $500 million bond issue for applied research and technology commercialization; and
- A $100 million fixed-asset loan proposal for targeted industry sectors in Ohio.

These four components provide a framework for the state's economic development plan for research and development technologies. The initiative is intended to coordinate these components with existing programs to better align the state's economic development programs, to maximize their impact, and to leverage other funding sources.

According to the *Ohio Plan Study Committee's Final Report*, which adopted the Third Frontier Initiative as part of its plan, Ohio stands tenth nationally in overall university research and development (with its university research base outpacing national growth rates from FYs 1995 to 1999) and ninth nationally in internal industry research and development.[1] Created in Am. Sub. H.B. 94 of the 124th General Assembly, the Ohio Plan Study Committee was designed to promote collaborative efforts among state government, higher education, and business and industry to identify research and growth opportunities in science and technology within the state.

Continued Funding of Existing Programs

Technology Action Fund

The first part of the initiative is the continued funding of current programs. The Technology Action Fund, administered by the Department of Development, provides competitive grants for entrepreneurial activities, including research and development, across the state. Funded by GRF appropriation item 195-422, Technology Action, the program seeks to encourage the creation of quality job opportunities in technology-driven sectors. After two executive reductions, the Technology Action Fund received $12,962,600 of appropriation authority in FY 2002 and used it to distribute grants for venture capital and preseed funds, liquid crystal development, genomics, and drug research.

Biomedical Research and Technology Transfer Trust Fund

The Biomedical Research and Technology Transfer Trust Fund receives its funding from payments made to the State under the master settlement agreement with the major American tobacco companies. It will provide grants for biomedical research and technology transfer projects to improve the health of Ohioans and provide economic development opportunities within the state. The trust fund's allotment from the settlement was $30.0 million in FY 2002 and $25.5 million in FY 2003. Due to a delay in the decision process, no grants have been awarded for FY 2002 funds; however, grant proposals include genome, cancer, tobacco-related illness, and respiratory disorder research.

Within the Third Frontier Initiative, the Technology Action Fund and the Biomedical Research and Technology Transfer Trust Fund will receive funding of up to $500 million over a ten-year period.

Wright Brothers Capital Fund

Am. Sub. S.B. 261 of the 124th General Assembly provided the first new appropriation of funds for the initiative – $50 million of bond obligations to the credit of the Higher Education Improvement Fund (Fund 034) for the Wright Brothers Capital Fund program. This translates into $50 million of spending authority for the Board of Regents to use for the acquisition, renovation, or construction of facilities and the purchase of equipment for research programs, technology development, product development, and commercialization programs over FYs 2003 and 2004. The bonds will be issued under the authority granted in Article VIII, Section 2n of the Ohio Constitution. In order to comply with the Higher Education Improvement Fund's constitutional requirements, this program must fund projects involving capital improvements and capital facilities at state-supported and state-assisted institutions of higher education. Appropriation item CAP-068, Third Frontier Project, provides the authority for such activities.

While Am. Sub. S.B. 261 did not specify a name for the grant recipients, the Department of Development intends to designate them as Wright Centers of Innovation. The funds will be used for grants, which will be awarded on a competitive basis and will be administered by the Department of Development, for capital assets, specifically buildings and equipment for conducting research and commercializing new technologies at Wright Centers of Innovation. According to the *Ohio Plan Study Committee Final Report*, the purpose of the Wright Centers of Innovation is to:

> Increase the success of business and industry already in the state and strengthen the ability to attract and grow new industries and jobs in Ohio. This will be accomplished by concentrating investments on Ohio's current and emerging research strengths in those major categories of technology with the highest commercialization and development potential.[2]

The Wright Centers are intended to draw together Ohio business and industry, higher education and non-profit research institutions, and the state to pursue research and development opportunities.

The Department of Development will formulate guidelines for this program in collaboration with the Board of Regents, the Governor's Science and Technology Advisor, and any other parties at the department's discretion. At this time, no formal decisions have been made regarding the structure of the program. The department believes that when the grants are provided, a mechanism similar to the Board of Regents' joint use agreements will be used. A joint use agreement is currently used between the Board of Regents and nonprofit community organizations that receive capital funding through the state's capital budget. After a Board of Regents staff review, the joint use agreement is presented to the Board. After approval, the appropriate university prepares a Controlling Board request for the appropriated funds; once approved by the Controlling Board, funds are released to the community project with the university acting as the fiscal manager. The agreement language and process for the Third Frontier projects may differ based on the structure of the Wright Centers of Innovation.

Appropriations for debt service were not included in Am. Sub. S.B. 261. According to Legislative Service Commission estimates, the addition of $50 million in capital appropriations for higher education improvements would require added debt service of $400,000 for FY 2004 and $1,200,000 for FY 2005. Debt service amounts would continue to increase for several years until a maximum annual level of $4,100,000 was reached in FY 2008. These estimates assume an interest rate of 5.25 percent. All debt would be repaid in 25 years.

Bond Issue

The next initiative of the Third Frontier includes a $500 million authorization for debt to support research and technology commercialization, which breaks down into $50 million each year for ten years. These activities would be noncapital in nature and would complement the Wright Brothers Capital Fund's activities which are for capital activities. This issue is not likely to be placed on the ballot until May 2003.

Innovation Ohio Fund

The final component of the Third Frontier Initiative is the Innovation Ohio Fund. This is a $100 million proposal for fixed-asset loans in targeted industry sectors across Ohio. The purpose of the initiative is to build upon Ohio's strengths, allowing for high growth in these sectors and for high-wage companies to remain competitive in the industry. The funds will be generated from economic development bonds that will be backed by liquor profits. Liquor profits currently support economic development bonds that fund the Department of Development's Facilities Establishment Fund, which includes programs such as the 166 Direct Loan Program; in FY 2002, approximately $16 million was used toward debt service for these issues.

* David Price and Ruhaiza Ridzwan also contributed to this article.

[1] Ohio Plan Study Committee, *Ohio Plan Study Committee Final Report*, March 15, 2002, p.2.

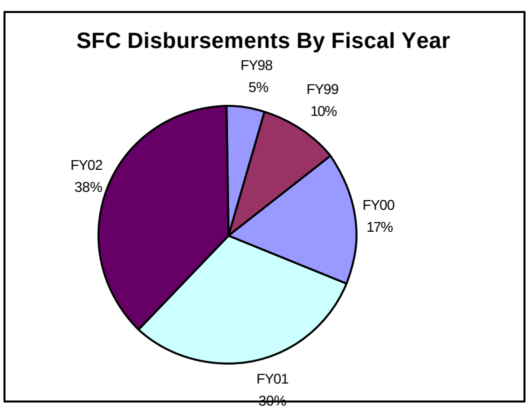
[2] *Ohio Plan Study Committee Final Report*, p.3.

School Facilities Update

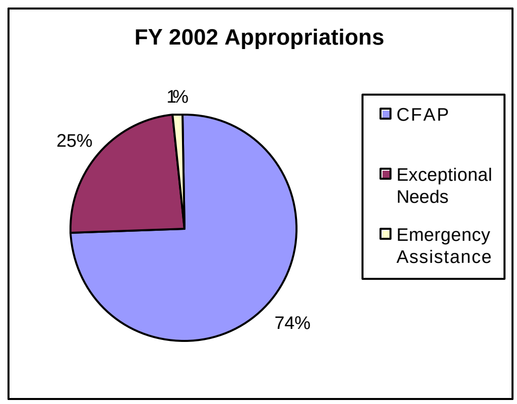
—Meegan M. Michalek

From the creation of the School Facilities Commission (SFC) in 1997 through the end of FY 2002, the General Assembly has appropriated approximately $2.7 billion for school facilities programs; $1.07 billion has been authorized in bond sales for school facilities through FY 2002 with the remaining balance coming from cash appropriations. Of the total amount, $2.043 billion the total amount has been appropriated to the Classroom Facilities Assistance Program (CFAP) and $358 million for the Exceptional Needs Program. In addition, $120 million was appropriated for the Big Eight Program (a repair program for the major urban school districts), and $130 million was appropriated for the Emergency Repair Program.

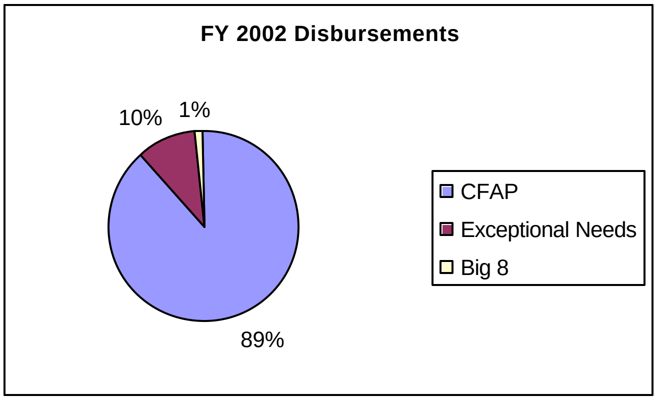
From FY 1997 through the end of FY 2002, the SFC has disbursed a total of $2.12 billion. Of the $2.12 billion spent, 82 percent (or $1.76 billion) has been disbursed as part of the CFAP. Every district in the state is eligible for CFAP funding, although the eligibility order is based on the Department of Education's Equity List. The SFC has issued $735 million of debt, about 70 percent of the authorized amount. Disbursement lags are due to the fact that the SFC encumbers the money at the beginning of a project, and bonds are sold shortly before a school district actually needs the cash. The remaining portion of disbursements has come from current revenues.



In FY 2002, the General Assembly appropriated $533 million for school facilities projects. Three programs received funding in FY 2002. The CFAP received the bulk of the funding with $394 million (or 74 percent of total appropriations). Since 1997, the CFAP has received 76 percent of all total appropriations. The Exceptional Needs Program received 25 percent, or $131 million, in funding from the General Assembly in FY 2002. Historically, this program has received about 13 percent of all appropriations. The Emergency Assistance Program received $7.5 million. This program started in FY 2001 when it also received $7.5 million in funding from the General Assmbly.



In FY 2002, the SFC spent $814 million on school improvement projects throughout the state. This is an increase of $169 million over the $644 million spent in FY 2001. The CFAP disbursed approximately $720 million, or 88 percent of the total disbursements. The program has emerged as the dominant school facilities funding program, while the Emergency Repair Program has gradually wound down. The Big Eight Program spent approximately $11.3 million in FY 2002, about 1 percent of the total disbursements for the year. In contrast, the Emergency Repair Program has only $450,715, or about 0.06 percent of total disbursements, down approximately 89 percent from last year. Part of the reason for the dramatic decline in spending for Emergency Repairs has been that the SFC has finished most of the repair work and is moving forward with new school projects. The Exceptional Needs Program targets the health and safety needs of districts of below



average wealth. In FY 2002, $81.4 million (or 10 percent of total disbursements) was disbursed to districts as part of this program.

The Canton and Youngstown City School Districts are currently in the midst of their CFAP projects. The rest of the Big Eight school districts (Columbus, Cleveland, Cincinnati, Toledo, Dayton, and Akron) become eligible for CFAP money in FY 2003, assuming local shares are available. Master plans for all six districts were firmed up by the close of FY 2002. The Accelerated Urban Initiative allows these districts to receive state assistance sooner than they may have otherwise. The "Big Six" districts will receive approximately $3 billion in state aid, with the largest projects being in Columbus, Cleveland, and Cincinnati. Cleveland will be receiving the largest amount of state funds, with more than $1 billion needed to overhaul 121 schools in the Cleveland School District. Columbus, Cleveland, and Cincinnati City School Districts have the largest student populations of all of the Big Six districts. However, Akron, Cleveland, and Toledo are eligible for the largest amounts of state aid because of their high state shares for their projects. Dayton is also among the urban districts with a high state share percentage (61 percent).

DISTRICT	**STATE SHARE**	**ESTIMATED STATE AID (in millions)**
Cincinnati	23%	$211
Columbus	30%	$395
Akron	61%	$409
Dayton	61%	$297
Cleveland	68%	$1,024
Toledo	77%	$614
TOTAL	**--**	**$2,950**