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Budget Footnotes

A Newsletter of the Ohio Legislative Service Commission

July 2003

Fiscal Overview

— Allan Lundell

FY 2003 started with hope of a quickening in the pace of the economic recovery, and through the first quarter that hope appeared to be met. Through September, monthly revenues from state sources exceeded estimates. Then the economy slipped into an economic "soft spot" from which it has yet to emerge. State-source revenues have been below the original estimates during seven of the nine months of the soft spot. House Bill 40 was enacted in response to the declining budget situation, and revenue estimates were revised starting in March. March was the only month in which state-source revenues exceeded the revised estimates. Fiscal year 2003 ended and FY 2004 started with economists predicting (for the third straight year) a stronger economy in the second half of the year.

Total GRF revenues, boosted by $193 million in federal aid to Ohio under the Jobs and Growth Tax Relief Reconciliation Act of 2003, exceeded both original and revised estimates in June. Comparisons with the revised estimates are more relevant in evaluating the status of the budget for the fiscal year. Total GRF revenues were $38.4 million (1.4%) above the revised estimate in June. Tax revenues were $110.4 million above estimate. Revenues from the personal income tax were $40.2 million above estimate and revenues from the corporate franchise tax were $54.0 million above estimate. However, the positive monthly variance for the corporate franchise tax was mostly the result of the Saturday filing date for May and not a cause for rejoicing. June disbursements were $238.4 million below the revised estimate, with most categories of spending under estimate.

For the fiscal year, total GRF revenues were $210.7 million less than the revised estimate. Revenue from state sources was $324.1 million below estimate, and tax revenues were $47.7 million below estimate. GRF disbursements were $251.9 million less than the revised estimate.

Dear Readers:

Budget Footnotes **will be on vacation for the month of August. The next issue will be published in September.**

The writers and editors

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Budget Footnotes examines the fiscal position of the state General Revenue Fund on a periodic basis.

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Primary and Secondary Education was $19.0 million below estimate and Higher Education was $2.4 million above estimate. Health Care/Medicaid was $142.0 below the revised estimate.

For June, GRF revenues were $2,759.0 million, and total expenditures were $1,502.9 million. The monthly surplus increased the ending cash balance to $396.5 million. The FY 2003 ending cash balance was $222.7 million less than the ending balance for FY 2002. Fiscal year 2003 encumbrances were $344.2 million, $166.7 million less than a year ago. The unobligated balance (cash balance minus encumbrances) of $52.3 million is $56.0 million less than a year ago. The Budget Stabilization Fund (BSF) balance of $180.7 million is $242.7 million less than a year ago, and the combined GRF and BSF balance of $233.0 million is $303.2 million less than a year ago.

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

	Month of June	Fiscal Year 2003 to Date	Last Year	Difference
Beginning Cash Balance	-$859.6	$619.2		
Revenue + Transfers	$2,759.0	$22,449.6		
Available Resources	$1,899.4	$23,068.8		
Disbursements + Transfers	$1,502.9	$22,672.2		
Ending Cash Balances	$396.5	$396.5	$619.2	-$222.7
Encumbrances and Accts. Payable		$344.2	$510.9	-$166.7
Unobligated Balance		**$52.3**	**$108.3**	**-$56.0**
BSF Balance		$180.7	$427.9	-$247.2
Combined GRF and BSF Balance		**$233.0**	**$536.2**	**-$303.2**

TRACKING THE ECONOMY

¾ Phil Cummins

Recent Economic Developments

Business activity in the U.S. expanded in June. Industrial production, retail sales, and housing starts rose. Purchasing managers reported increased business activity and orders. Labor markets remained weak, however. Inflation is generally low, though some energy and materials prices are well above a year ago. Short-term interest rates were reduced in late June, and the central bank may take further actions if the economy is weaker than expected. Federal tax cuts and monetary ease are supporting further expansion of the economy.

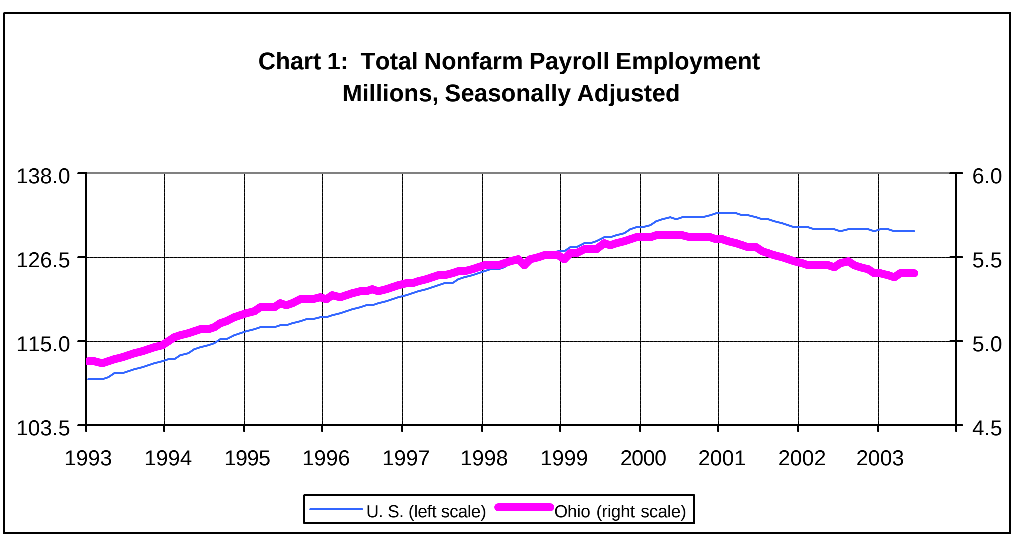
Nationwide payroll employment declined again in June, and unemployment rose to the highest rate since 1994. Total nonfarm payrolls fell 30,000 last month; they have dropped nearly 400,000 since January and 2.6 million since a cyclical peak early in 2001. The national unemployment rate rose to 6.4% in June from 6.1% in May. Rates have trended upward since the cyclical low point of 3.9% in 2000. Much of the decline in employment and rise in unemployment occurred in 2001. Productivity gains have allowed output of the economy to grow since late 2001 even as employment has shrunk and unemployment has risen.

Ohio unemployment rose in June, and nonfarm payroll employment fell. The percentage decline in Ohio payrolls since the cyclical peak has been twice as severe as nationwide. Ohio payroll employment has declined over 230,000 from a cyclical peak in 2000. Payroll employment in the latest month was 4% lower than the cyclical peak in the state, compared with a 2% decline nationwide. Statewide unemployment rose to 6.3% in June, matching that of April, the highest since 1993.

The trends in national and state payroll employment described above are illustrated in Chart 1.

In a monthly survey of purchasing managers at the nation's manufacturers, more respondents reported increases in production and orders in June than indicated declines. Increased production and orders in May and June follow declines in both measures in the previous two months. Order backlogs were unchanged in June, after a small increase in May. Inventories and employment at manufacturers continued to shrink.

A similar report on purchasing managers at nonmanufacturing organizations was more favorable. Business activity at nonmanufacturers, the counterpart to the manufacturing survey's measure of production, was up in June at the strongest rate since September 2000. Orders rose in June, with no industries reporting declines. Backlogs and employment were higher, but inventories declined.



Industrial production rose 0.1% in May and June. Manufacturing output increased 0.1% in May and 0.4% in June, after declining in most months since last August. Production of consumer durable and nondurable goods, business equipment, and defense and space equipment rose last month. Total manufacturing output in June was 1% above the recession low in December 2001 but 7% below the expansion peak in June 2000.

Retail sales rose 0.5% from May to June and were 4.2% above a year earlier. This rise followed weakness in April and May. Year-to-date sales were 4.6% ahead of last year. Consumer spending has been supported by housing sales and refinancings as well as growing incomes. Unit car and light truck sales rose 2% in June but were 4% lower in the first half of 2003 than a year earlier and have been trending downward since 2000.

The producer price index for finished goods rose 0.5% last month, after two months of declines, to 2.9% higher than a year earlier. Recent month-to-month fluctuations in this inflation measure have been due mainly to energy prices, which rebounded in June after falling for two months. Prices for natural gas as well as gasoline and other liquid fuels rose last month. Excluding energy, finished goods prices were unchanged from May to June and 0.7% higher than a year earlier. At earlier stages of production, intermediate goods prices rose 0.5% in June to 4.5% higher than a year earlier, and crude goods prices increased 4.5% last month to 29% above a year earlier. Much but not all of the rise in these price indexes was due to energy. Intermediate materials prices excluding energy were 2.4% higher in June than a year earlier, and crude materials less energy were 11% higher.

The consumer price index rose 0.2% in June to 2.1% above a year earlier. Energy prices rose in June to 9.3% higher than a year ago. Excluding energy, consumer prices were 1.5% above June 2002. In addition to energy, the cost of medical care rose rapidly during the past year, while apparel prices fell during this period.

Housing starts rose 4.0% in June. The housing market continued to be supported by the lowest long-term interest rates in more than 40 years. Year-to-date housing starts are 2% above a year earlier. For all of last year, 1.7 million housing units were started, the strongest market since 1986.

The Federal Reserve Bank on June 25 lowered its target for a key monetary policy measure, the federal funds rate, to 1% from 1.25%. A reduction in this interest rate had been widely expected, in response to lackluster economic statistics and the Fed's statement on May 6 of concern about the possibility, however remote, of a period of generally declining prices, or deflation. Long-term interest rates dropped sharply following this announcement, to lows in mid-June, but have since reversed this decline. In mid-July testimony, Fed Chairman Greenspan indicated a willingness to take further substantial actions if needed to support satisfactory performance of the economy.

A Longer-Term Perspective: The Economy in FY 2003

In July 2002, at the beginning of FY 2003, the economy appeared to be recovering, albeit at a modest pace, from the recession of 2001. Industrial output, business sales, and personal income generally trended upward in the first half of 2002. The pace of this expansion was insufficient to generate growth in employment, however. The nation's gross domestic product had been rising in the first two quarters of 2002 and the last quarter of 2001, after falling in the first three quarters of 2001, according to revised figures issued in late July 2002.

The business expansion of the 1990s and early in the current decade was judged by the Business Cycle Dating Committee of the National Bureau of Economic Research to have peaked in March 2001. This NBER group is widely regarded as the arbiter of business cycle timing. Because of the divergent trends in economic indicators, the NBER at mid-2002 had not identified a cyclical trough ending the recession that began in 2001. It now regards the recession as having ended in November 2001.

The war on terrorism, announced following the September 11, 2001, attacks on New York and Washington by al-Qaida operatives, continued to weigh on business and consumer attitudes at the start of FY 2003. Violent incidents outside the U.S. in 2002 provided evidence that terrorist networks continued to operate. The extent of the impact on

U.S. business activity is difficult to quantify, but clearly spending was at times suppressed.

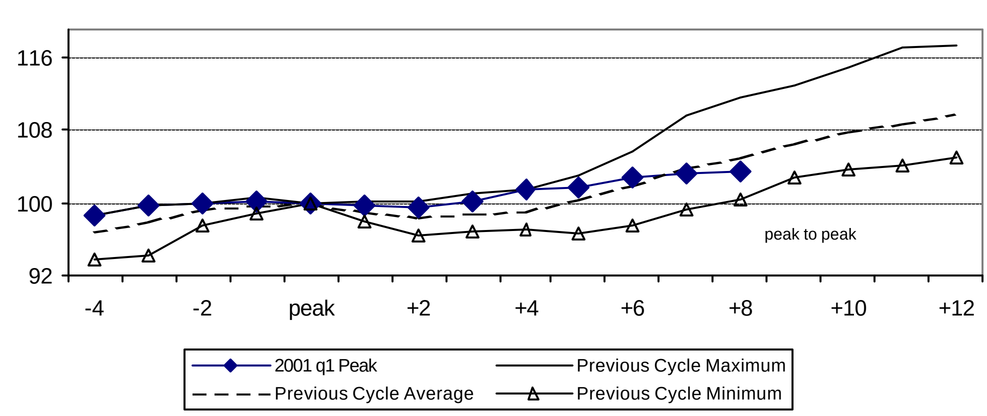
Other factors also restrained confidence and business activity in FY 2003. Several corporate scandals, following the Enron meltdown in late 2001 and the related collapse of the once highly regarded Arthur Andersen accounting firm, led to tougher scrutiny of corporate accounting and undoubtedly contributed to investor suspicion and distrust. Conflicts of interest among stock analysts, allegations of insider trading, and manipulation of markets added to such concerns. The stock market's sharp and protracted slide from its 2000 peak slashed household net worth. This decline was only partly offset by rising real estate values. Also as a result of the sustained fall in stock values, defined-benefit pension plan underfunding rose to record levels, necessitating large cash infusions to these plans by major corporations. Bankruptcies of large, well-known companies were costly to shareholders and creditors.

Corporations announced layoffs affecting thousands of workers. An overhang of excess capacity following a decade of expansion, and the Y2K investment boom in information processing equipment and software, arguably also discouraged investment spending in 2002 and into 2003. Many state and local governments cut spending and increased taxes and fees as their revenues fell short of expectations and costs of providing services continued to rise, particularly for Medicaid and education. The high value of the dollar in 2001 and early 2002, and weak foreign demand, held back U.S. exports.

The modest upturn in economic activity in the first half of 2002 slowed in the second half. Industrial production turned down, after recovering for eight months from a December 2001 low. Employment and spending were restrained. In November, the Federal Reserve Bank cut its benchmark federal funds rate 50 basis points to 1.25%, the first reduction in nearly a year. Long-term interest rates were reduced about a percentage point in the second half of 2002.

Business activity in early 2003 was dampened by rising tensions ahead of the U.S. invasion of Iraq in March, and to some extent by the transitory impact of severe weather in parts of the country, including Ohio. By late April, major hostilities had ended in Iraq, but the country remained a dangerous place that continued to claim American lives. As noted above, output and orders improved late in the fiscal year; however, labor markets stayed soft. A weaker dollar relative to other industrialized country currencies, particularly the euro, may be helping the competitiveness of U.S. goods and services in some world markets, but inflation-adjusted U.S. exports of goods and services in this year's first quarter remained 9.0% below their peak in 2000 and have shown no indication of an upturn. State and local government cutbacks to meet constitutional balanced budget mandates are offsetting part of the fiscal stimulus provided by federal tax reductions and stepped-up defense as well as nondefense spending programs, which have pushed the federal deficit up sharply.

Chart 2: U.S. Gross Domestic Product
Inflation-Adjusted, Post-World War II Business Cycle Peaks = 100



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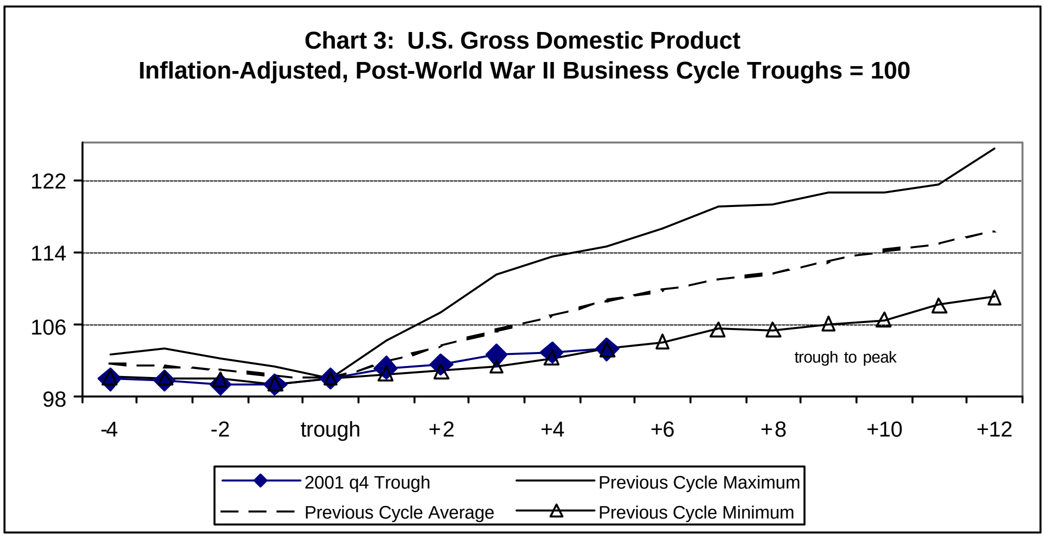
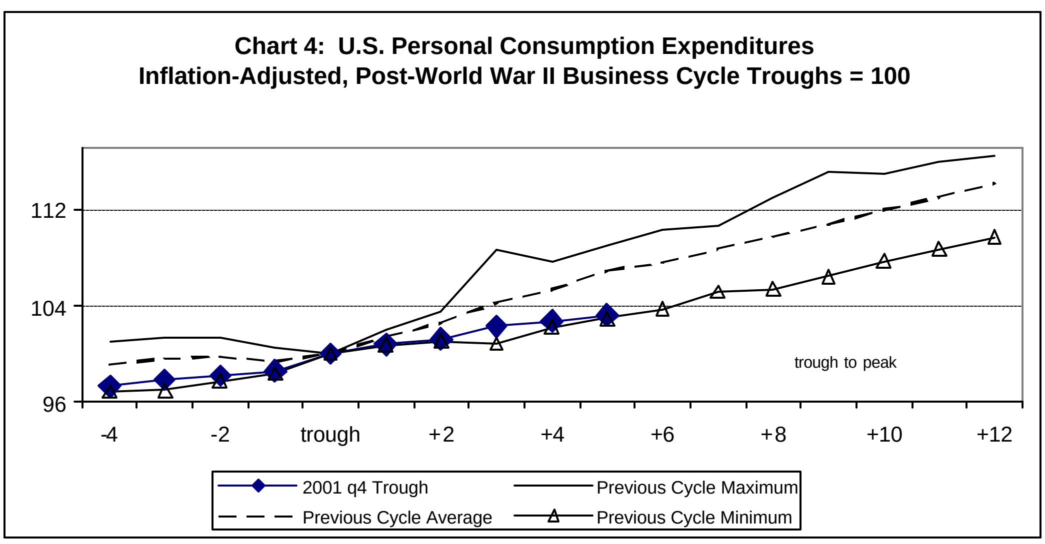
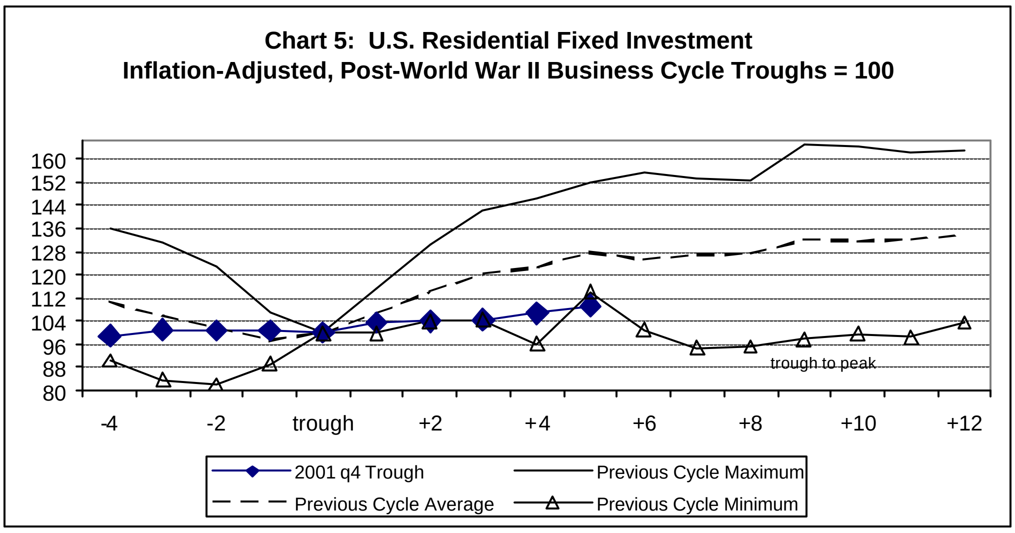


Comparison with Previous Business Cycles

The 2001 recession and the subsequent weak recovery now underway have been unusual. Every cycle is unique to some extent, but the current one is in certain ways outside the range of previous post-World War II experience. Charts 2-7 compare the current economic downturn and recovery with previous postwar business cycles. In each chart, GDP or a component is set equal to 100 in the quarter when the business cycle peak (Chart 2) or trough (Charts 3-7) occurred, for each of the nine post-World War II cycles prior to the current one. The current cycle is also normalized in this way, for the first quarter 2001 NBER peak and the fourth quarter 2001 trough. The current cycle is then compared with the high, low, and average of the previous nine business cycles. The charts are based on data in inflation-adjusted dollars.

Chart 2 shows gross domestic product around NBER business cycle peaks. The 2001 recession was mild overall, with GDP declining 0.6% from the high point in the fourth quarter of 2000 to the low point in the third quarter of 2001, and actually rising by 0.2% from the NBER peak to the trough quarter. In previous post-World War II recessions, GDP typically declined 2.0% or more. But the current upturn has also been weak, compared with previous cycles. Consequently inflation-adjusted GDP is falling





increasingly short of the pace of economic expansion typical in past cycles.

Chart 3 shows gross domestic product around NBER business cycle troughs. The current expansion is one of the weakest on record, about matching the pace of the expansion in the early 1990s, sometimes referred to as a jobless recovery.

Consumer spending has continued to grow during the current expansion, as shown in Chart 4. But as is also clear from the chart, the rate of growth of consumer outlays has been below average compared with past cycles. Because consumer outlays on durable goods held up relatively well during the recession, pent-up demand for light vehicles, appliances, and furniture did not build up as in some past cycles.

Residential building and home buying have been at high levels, supported by the lowest long-term interest rates in over 40 years. Unlike some past cycles, however, housing market activity was not cut sharply ahead of and during the recession. Instead, as shown in Chart 5, residential investment has expanded gradually for the past two and one half years, and has not added much to growth as in some previous business cycle recoveries.

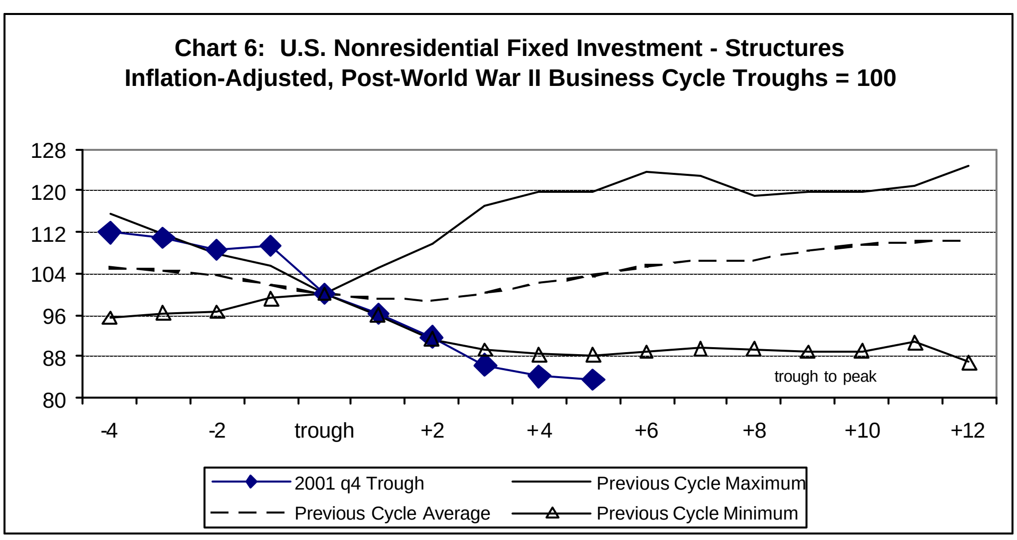
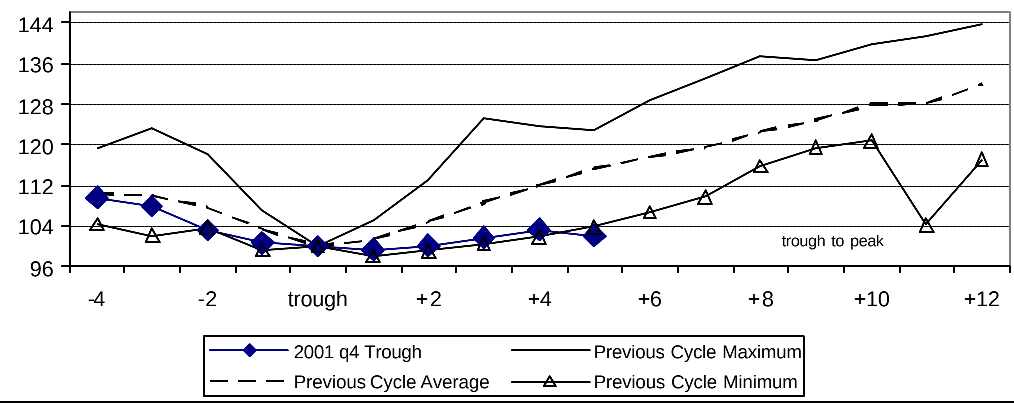


Chart 7: U.S. Nonresidential Fixed Investment - Equipment and Software
Inflation-Adjusted, Post-World War II Business Cycle Troughs = 100

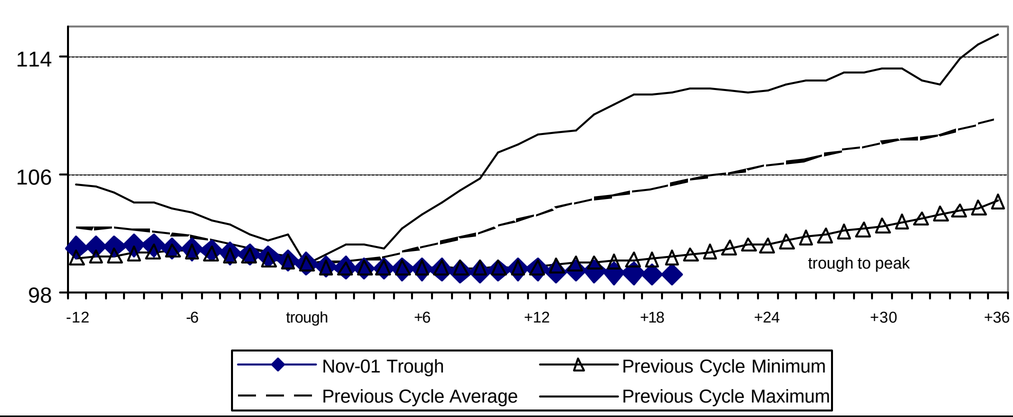


Weakness in this cycle is particularly pronounced in business investment. Chart 6 shows private nonresidential fixed investment in structures continuing to decline through the first quarter of 2003. The decline in the current cycle has been much sharper than the drop in this GDP component from the trough quarter in the weakest previous business expansion. Business construction tends to lag other sectors of the economy, but has been exceptionally weak in the current cycle.

Business investment in equipment, in contrast with structures, has started to grow, though it was down in the latest quarter. More favorable depreciation rules in the federal tax bill enacted this year may stimulate further increases. But as Chart 7 shows, this sector's upturn has been weak, only about matching the slowest upturn among previous post-World War II cycles.

Nonfarm payroll employment, as noted above, has been particularly weak in the current business cycle. Chart 8 compares monthly employment since the November 2001 trough with employment around previous post-World War II business cycle troughs. Total employment has been weaker in the current recovery than in the recovery from the 1990-1991 recession, by far the weakest previous upturn in terms of total employment. If payroll employment had instead grown in the current recovery in line with the average rise in jobs during previous business cycle expansions, the number of people employed would be 6% or 8 million higher than at present.

Chart 8: Total Nonfarm Payroll Employment
Post-World War II Business Cycle Troughs = 100



Status of the General Revenue Fund

REVENUE

— Allan Lundell, Jean Botomogno, Ross Miller, and Ruhaiza Ridzwan

Although June revenues exceeded both original and revised estimates, revenue for the fiscal year finished below both estimates. Compared to the original estimates for FY 2003 made in July 2002, total GRF revenue was $206.4 million (8.1%) above estimate in June. Total GRF revenue less federal grants (revenue from Ohio sources) was $5.4 million (0.3%) above estimate. Tax revenues were $33.8 million (2.3%) above estimate and revenues from the major taxes (personal income, sales and use, corporate franchise, public utility, and kilowatt hour) were $34.8 million (2.4%) above estimate.

For the fiscal year, total GRF revenue was $126.9 million (0.6%) below original estimate. Total GRF revenue less federal grants was $452.3 million (2.5%) below estimate. Tax revenues were $393.5 million (2.4%) below estimate and revenues from the major taxes were $403.0 million (2.6%) below estimate. The monthly and cumulative variances (differences from estimates) are presented in Exhibit 1. During the first quarter of FY 2003, revenues exceeded estimate, giving some hope that a budget crisis could be avoided. Those hopes sank as the economy slipped into what Fed chairman Alan Greenspan called a “soft spot.” The revenue picture worsened as the fiscal year progressed. The apparent improvement in comparison to the original estimates is due to the H.B. 40 sales tax acceleration and the federal aid to states which increased state revenues by over $450 million.

Compared to revised estimates that take into account changes made in H.B. 40 and more recent economic forecasts, total GRF revenue for June was $38.4 million (1.4%) above estimate. Total GRF revenue less federal grants was $112.9 million (4.9%) below estimate. Tax revenues were $110.4 million (7.8%) above estimate and revenues from the major taxes were $107.9 million (7.9%) above estimate.

For the fiscal year, total GRF revenue was $210.7 million (0.9%) below the revised estimate. Total GRF revenue less federal grants was $324.1 million (1.8%) below estimate. Tax revenues were $47.7 million (0.3%) below estimate and revenues from the major taxes were $38.2 million (0.3%) below estimate. Exhibit 2 contains four charts that compare revenues to revised estimates.

Compared to FY 2002, total GRF revenues were up by 4.6%, total revenue less federal grants was up by 2.2%, tax revenues were up 5.5%, and revenues from the major taxes were up by 3.3%. Fiscal year 2003 GRF revenues increased just under $1 billion for the year compared to FY 2002. The dollar change amounts (in millions) and the percentage change for significant categories of revenue are detailed in Exhibit 3.

The substantial dollar increases for the non-auto sales, personal income, and cigarette taxes are almost entirely due to tax changes. One-time revenue declined in FY 2003 from the high level in FY 2002, causing most of the fall in the Other Revenue category. Included in the federal grants increase is $193.1 million from the new $20 billion federal aid package to states. Without this grant, federal grants from Medicaid spending would have increased by $418 million and the state would have needed all the balance in the Budget Stabilization Fund to balance the GRF budget. Instead, a balance of $180.7 million has been left in the rainy day fund.

Ohio is estimated to receive $770 million in one-time federal aid over FY 2003 and FY 2004 from the new federal aid package. Some aid may fall into FY 2005. A second flexible payment of $193 million will be received in October 2003. The balance of the funding will come from an increase of 2.95% in the federal participation rate for the Medicaid program. Earnings will depend on actual Ohio Medicaid spending from April 2003 through the end of FY 2004.

Personal Income Tax

June GRF personal income tax revenues of $755.0 million were $3.2 million (0.4%) above original

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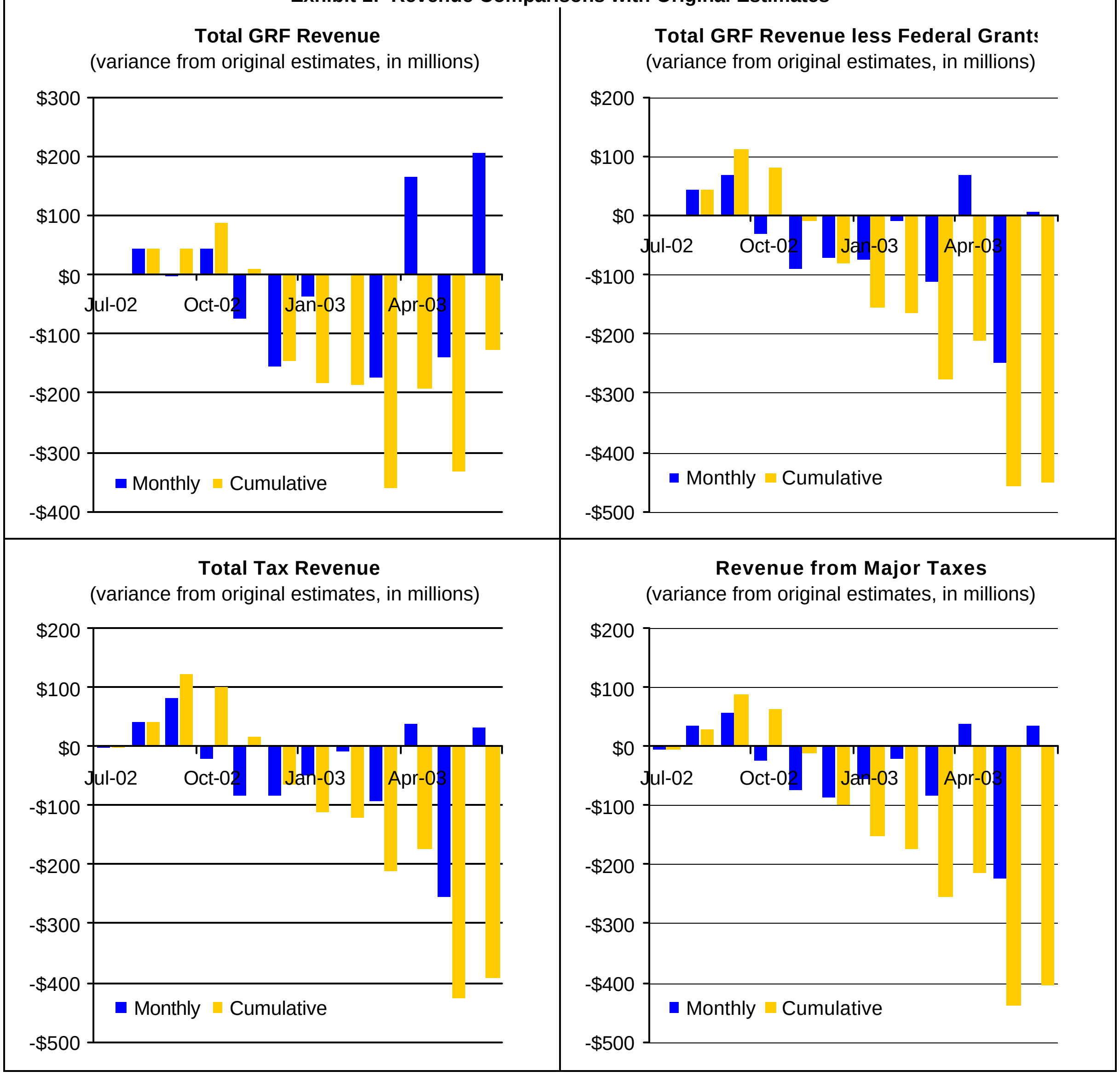
Exhibit 1: Revenue Comparisons with Original Estimates



estimate. Tax withholding was $16.5 million (2.8%) below estimate. Quarterly estimated payments were $33.9 million (12.7%) below estimate. Refunds were $6.1 million (6.3%) below estimate. Payments to the local government funds supported by the income tax were $49.7 million (135.7%) less than estimated. Instead of subtracting out $36.6 million from net collections to go to the local government funds, $13.1 million was added back into the income tax.

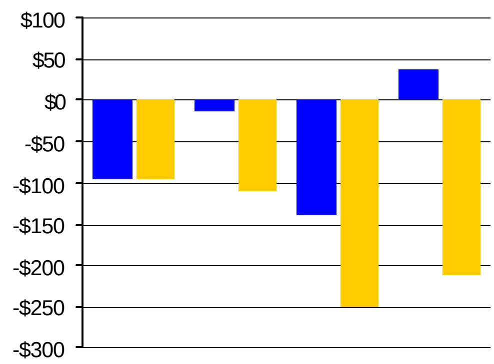
For the fiscal year, personal income tax revenues were $442.3 million (5.6%) below the original estimate. Withholding was $207.3 million (2.9%) below estimate, quarterly estimated payments were $58.1 million (4.4%) below estimate, and refunds were $86.6 million (8.9%) greater than estimated.

Compared to the revised estimates, June personal income tax revenues were $40.2 million (5.6%) above estimate. Withholding was $0.3 million (0.05%) above estimate and quarterly estimated payments were $21.4 million (8.4%) below estimate. Refunds were $6.1 million (6.3%) below estimate. Payments to the local government funds supported by the income tax were $49.7 million (135.7%) less than estimated.

Combined March through June ("post-estimate revision") GRF personal income tax revenues were $80.3 million (2.9%) below the revised estimate. Withholding was $12.8 million (0.6%) below estimate. Revenues from annual returns were $48.0 million (9.6%) below estimate. Quarterly estimated payments were $34.5 million (7.2%) below estimate.

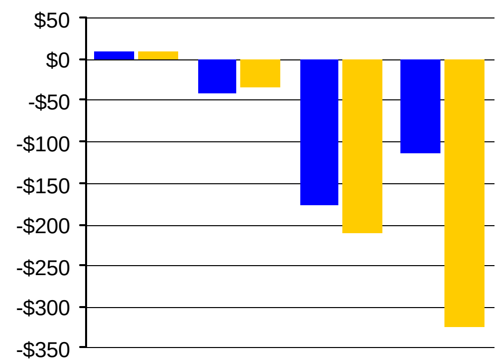
Exhibit 2: Revenue Comparisons with Revised Estimates

Total GRF Revenue
(variance from revised estimates, in millions)



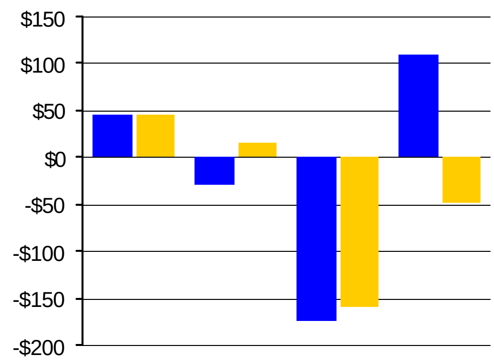
	Mar-03	Apr-03	May-03	Jun-03
Monthly	-$94.8	-$14.3	-$140.0	$38.4
Cumulative	-$94.8	-$109.2	-$249.1	-$210.7

Total GRF Revenue less Federal Grants
(variance from revised estimates, in millions)



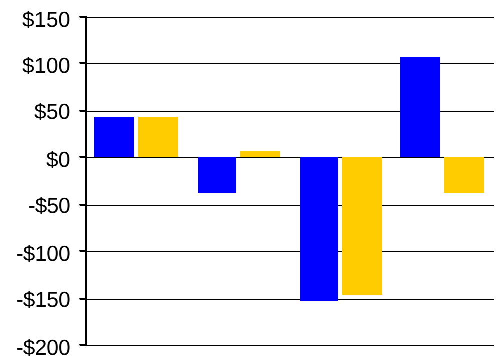
	Mar-03	Apr-03	May-03	Jun-03
Monthly	$8.0	-$42.5	-$176.7	-$112.9
Cumulative	$8.0	-$34.5	-$211.2	-$324.1

Total Tax Revenue
(variance from revised estimates, in millions)



	Mar-03	Apr-03	May-03	Jun-03
Monthly	$44.7	-$28.7	-$174.2	$110.4
Cumulative	$44.7	$16.1	-$158.1	-$47.7

Revenue from Major Taxes
(variance from revised estimates, in millions)



	Mar-03	Apr-03	May-03	Jun-03
Monthly	$43.7	-$36.8	-$152.9	$107.9
Cumulative	$43.7	$6.9	-$146.1	-$38.2

Refunds were $56.0 million (10.0%) above estimate. Payments to the local government funds supported by the income tax were $47.3 million (17.4%) less than estimated.

Compared to FY 2002, GRF personal income tax revenues were up 1.6%. If the new tax on trusts is not counted, GRF revenues were up just 0.7%. The tax on trusts yielded $63.4 million in revenue, $21.6 million (25.4%) less than estimated. Withholding was up 2.7% and quarterly estimated payments were down 19.0%. Refunds were up 8.3% and payments to the local government funds supported by the income tax were down 2.4%.

Sales Tax

The Non-Auto Sales and Use Tax

The non-auto sales and use tax provided $460.9 million in June 2003. These receipts lagged original estimated revenue by $10.2 million or 2.2%. June 2003 tax receipts were higher than June 2002 revenues by $29.6 million or 6.9%, showing some improvement over a year ago. However, this improvement may have been due in part to the acceleration of sales tax payments, not a corresponding growth in the non-auto sales taxable base. Overall, the non-auto sales and use tax was

Exhibit 3: FY 2003 Revenue Changes

Revenue Source	$ Increase (in millions)	% Change
Auto Sales	$39	4.2%
Non-Auto Sales and Use	$321	6.3%
Personal Income	$80	1.6%
Corporate Franchise	$35	4.9%
Public Utility	-$41	-15.9%
Cigarette	$319	113.3%
Total Taxes	**$844**	**5.5%**
Earnings on Investments	-$65	-82.0%
Other Revenue	-$414	-41.1%
Total Revenue less Federal Grants	$346	2.2%
Federal Grants	$611	14.0%
TOTAL GRF REVENUE	**$987**	**4.6%**

disappointing in fiscal year 2003. At the end of the fiscal year, the non-auto sales and use tax had generated $5,431.7 million, $46.8 million or 0.9% more than the original estimates for the year. Receipts from this revenue source were $321.3 million or 6.2% above FY 2002 non-auto sales and use tax revenue. However, all of this increase can be accounted for by tax changes. The non-auto sales tax has stagnated in the last three fiscal years. Non-auto sales tax revenue growth in FY 2002 was slightly negative (-0.3%) and increased 6.3% in FY 2003 mostly from the impact of H.B. 40.[1] Prior to H.B. 40, at the end of March 2003 (in FY 2003), year-over-year growth had been 1.5%, reflecting a weak growth in revenue.

Exhibit 4 shows the variance of non-auto sales tax revenue in FY 2003. The chart provides the cumulative variance of non-auto sales tax revenues from original estimates and also from FY 2002 revenues. The shortfall (when compared to original

Exhibit 4: Cumulative Variance of Non-Auto Sales Tax Revenue in FY 20
(from original FY 2003 estimates and FY 2002 revenues, $ in millions)

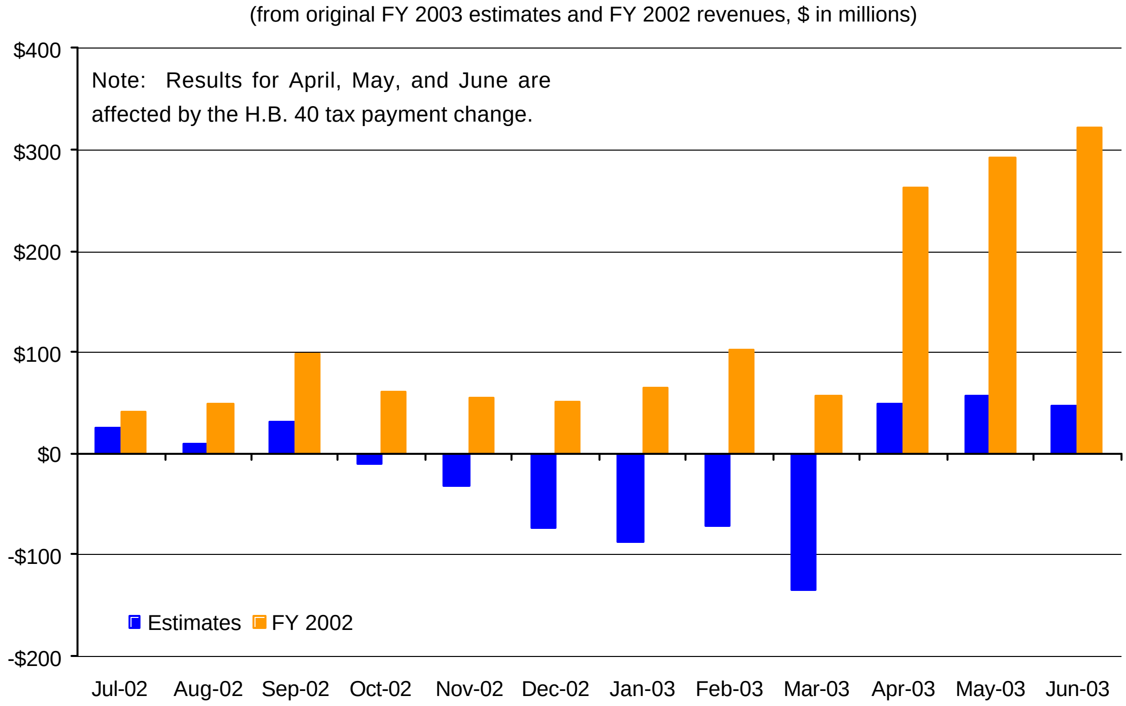
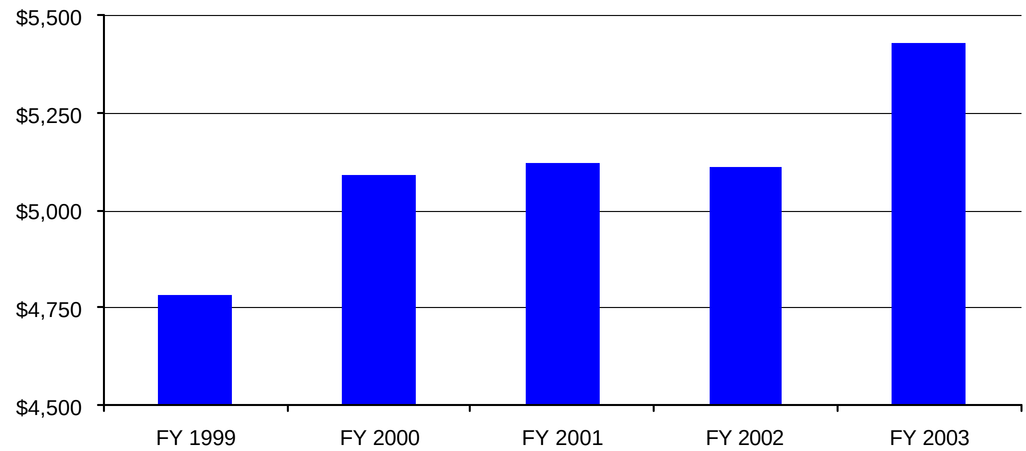


Exhibit 5: Non-Auto Sales and Use Tax Receipt
($ in millions)



estimates) grew every month from October 2002 to March 2003, when revenues were $135.4 million or 3.4% below estimates. Compared to prior year receipts, the cumulative surplus varied but remained under $102.0 million through March 2003. Then those two trends changed. Receipts increased starting in April 2003 with the first installment of accelerated sales and use tax payments, cumulative variance from estimates became positive, and the year-over-year growth extended.

A closer analysis of non-auto sales and use tax receipts in the last few years indicates that the performance of the non-auto sales and use tax improved slightly in FY 2003. Non-auto sales and use tax receipts grew in FY 2003, after declining in FY 2002. Without the added revenues from the Ohio tax amnesty[2] and the change in the tax treatment of leases from H.B. 405,[3] non-auto sales and use tax receipts in FY 2002 would have declined about 2.1%

Exhibit 6: Cumulative Variance of Auto Sales Tax Revenues in FY 2(
(from original FY 2003 estimates and FY 2002 revenues, $ in millions)

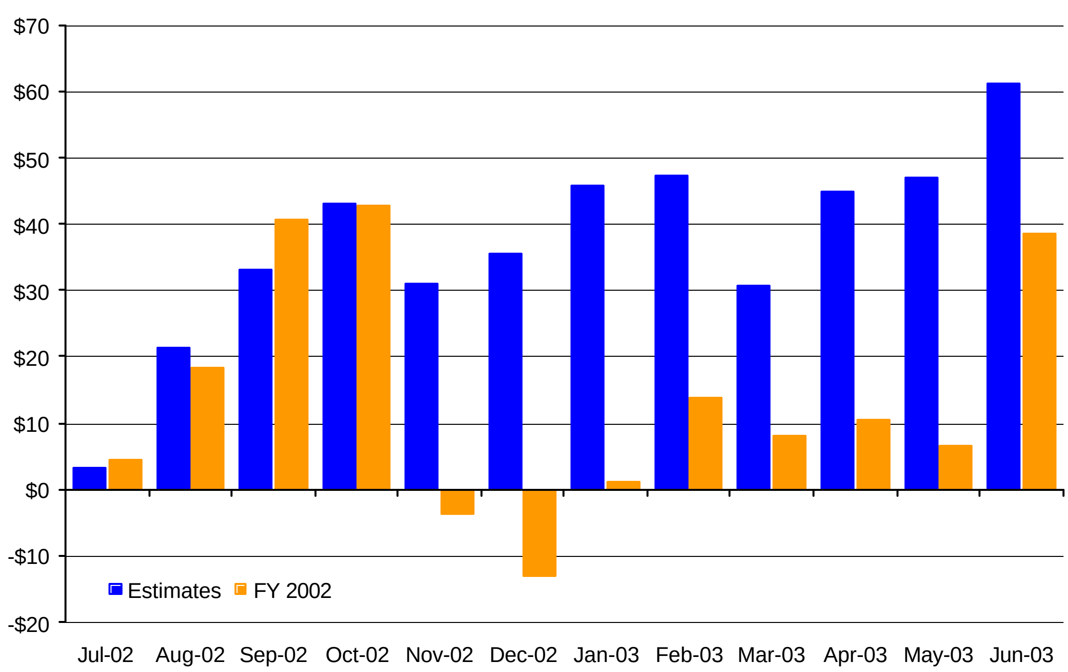
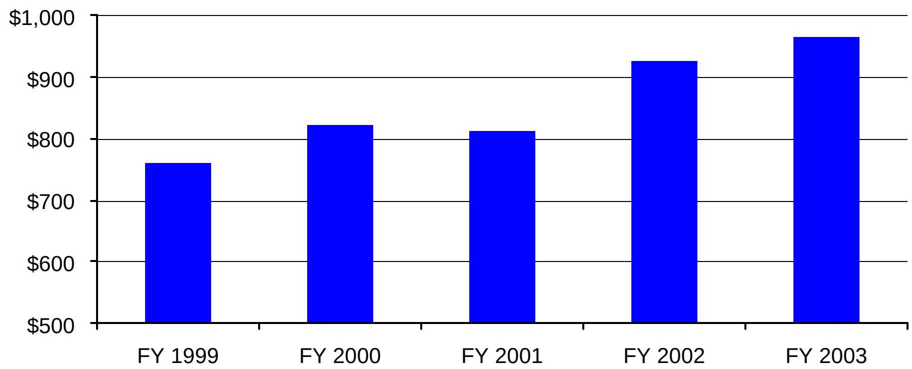


Exhibit 7: Auto Sales Tax Receipts, FY 1999-FY 200
($ in millions)



from FY 2001 revenues. After subtracting the additional revenues from the acceleration of sales and use tax payments in the last quarter of the fiscal year and non-auto sales tax revenues from changes in the taxation of auto leasing, non-auto sales and use tax revenues growth was flat.

The Auto Sales Tax

Auto sales tax receipts were $100.1 million in June 2003, $14.1 million or 16.3% above original estimates. June receipts were $31.9 million or 46.9% above June 2002 receipts. For the third time this fiscal year, monthly auto sales tax revenues reached $100.0 million. The other two months were August 2002 and April 2003. In June 2003, auto sales tax revenues may also have increased in part due to an impending sales tax rate increase on July 1, 2003. This may have prompted buyers to advance some purchases into June. However, sales from the last ten days of June are likely to be reflected in July revenue collections due to the normal auto sales tax collection process. Nationally, June auto sales were about 4.0% higher than sales in the same period the prior year, to an annualized rate of 16.4 million units.

For the fiscal year, the performance of auto sales tax revenues was again incredible. Auto sales tax revenues in FY 2003 were $966.2 million, $61.2 million or 6.8% above estimates. These receipts were $38.7 million or 4.2% above FY 2002 revenues. Prior to FY 2002, auto sales tax revenues had been $811.5 million (FY 2001), $821.7 million (FY 2000), and $760.4 million (FY 1999). Besides good sales (including sales of used vehicles), a decrease in the popularity of auto leasing also increased auto sales tax receipts during the last several years.

Exhibit 6 illustrates the cumulative variances of auto sales tax revenues in FY 2003 from original estimates and from FY 2002 results. The cumulative variance from estimates was positive all through the fiscal year. Except for the months of November and December, the cumulative variance from FY 2002 revenue was positive for the rest of the year.

Auto sales tax revenues generally reflect overall economic conditions, growth in vehicle unit sales, change in the vehicle stock, price changes, level of manufacturer's incentives, and changes in the auto sales tax base. Although overall economic conditions have not been favorable lately due to slow economic growth, the other factors have contributed to enhance auto sales tax revenues.

Recently, more light trucks than cars have been sold. For example, in June 2002, light trucks were 50.5% of unit sales. This year in the same month, 53.3% of unit sales were light trucks, according to Ward's AutoInfobank data. Continued manufacturers' incentives have strengthened unit sales, and average transaction prices have increased (up 3.0% versus a year ago, with more than a third of vehicles sold above $30,000). The purchasing behavior of auto buyers has affected both the non-auto and the auto sales and use tax. The growth in the leasing market has declined.[4] Tighter credit standards and higher costs of leasing have affected the willingness of finance companies to provide cheap leases, and offers of free financing for purchases have combined to reduce the leasing share of vehicle purchases. From a high of 36.7% of vehicles sold in CY 1998, the leasing share of vehicle sales declined to approximately 26.0% in CY 2001[5] and likely declined even further in CY 2002.

Table 2
General Revenue Fund Income
Actual vs. Estimate
Month of May 2003
($ in thousands)

REVENUE SOURCE	Actual	Estimate*	Variance
TAX REVENUE			
Auto Sales	$100,148	$85,975	$14,173
Non-Auto Sales & Use	$460,938	$471,188	($10,250)
Total Sales	$561,085	$557,163	$3,922
Personal Income	$754,960	$751,800	$3,160
Corporate Franchise	$122,938	$58,460	$64,478
Public Utility	$7,031	$41,000	($33,969)
Kilowatt Hour Excise Tax	$22,283	$25,125	($2,842)
Total Major Taxes	**$1,468,298**	**$1,433,548**	**$34,750**
Foreign Insurance	($8,783)	$0	($8,783)
Domestic Insurance	$879	$3,875	($2,996)
Business & Property	$1,748	$4,552	($2,804)
Cigarette	$51,723	$48,297	$3,426
Alcoholic Beverage	$4,990	$5,510	($520)
Liquor Gallonage	$2,661	$2,610	$51
Estate	$12,452	$1,820	$10,632
Total Other Taxes	$65,669	$66,664	($995)
Total Taxes	**$1,533,966**	**$1,500,212**	**$33,754**
NON-TAX REVENUE			
Earnings on Investments	$466	$15,300	($14,834)
Licenses and Fees	$1,349	$1,320	$29
Other Revenue	$393,779	$504,001	($110,222)
Non-Tax Receipts	$395,594	$520,621	($125,027)
TRANSFERS			
Liquor Transfers	$9,000	$9,000	$0
Budget Stabilization	$115,423	$0	$115,423
Other Transfers In	$128,471	$147,200	($18,729)
Total Transfers In	$252,894	$156,200	$96,694
TOTAL REVENUE less Federal Grants	**$2,182,455**	**$2,177,033**	**$5,422**
Federal Grants	$576,583	$375,579	$201,004
TOTAL GRF REVENUE	**$2,759,038**	**$2,552,612**	**$206,426**

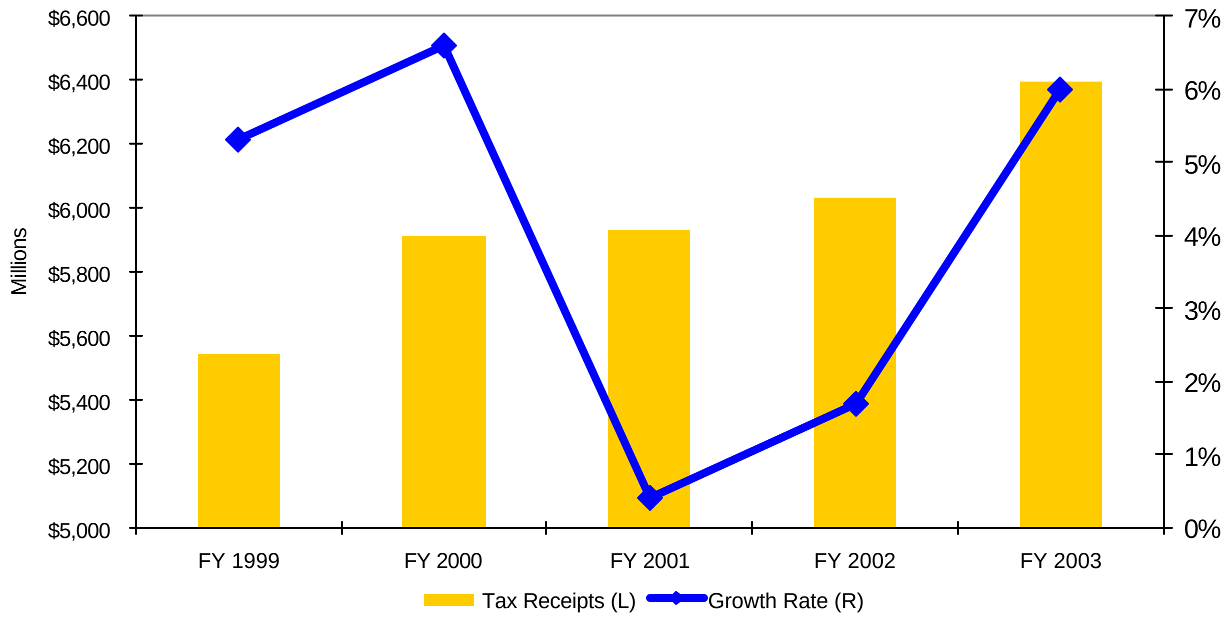
* July, 2002 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

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 from 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.

Overall, total sales and use tax receipts in FY 2003 were $6,397.9 million, $107.8 million or 1.7% above original estimates. Benefiting from additional revenue

Exhibit 8: Sales and Use Tax Receipts and Growth Rat
(combined auto and non-auto)



from H.B. 40 and the strong performance of the auto sales tax, total sales and use tax receipts were up $359.9 million or about 6.0% above FY 2002 receipts. Exhibit 8 illustrates sales and use tax receipts and growth rates between FY 1999 and FY 2003.

Legislative Changes Affecting the Sales and Use Tax in FY 2003

Am. Sub. H.B. 40 changed the timing of sales and use tax payments for certain vendors and increased the vendor discount for a brief period of time. Remittance of sales and use tax payments varies according to the type of taxpayers,[6] the timing, and the method by which sales tax payments are made. Payments of tax collected are required to be made by electronic funds transfer in cases where the taxpayer's annual tax liability exceeds a particular threshold. The Tax Commissioner notifies taxpayers required to use this payment method. Am. Sub. H.B. 40 required direct pay permit holders, vendors, and sellers that remit sales and use taxes by electronic funds transfer to make tax payments more often. Under previous law, a permit holder was required to remit sales tax payments on or before the 23rd day of each month for taxes due the previous month. The act required such a permit holder to pay each month one-fourth of the tax liability for the same month in the preceding calendar year on the 11th, 18th, and 25th days of each month; on the 23rd day of each month, the permit holder must report the taxes due for the previous month less any amounts already paid during the month under the new provision. This provision was expected to increase revenues in FY 2003 by up to $288.0 million, with no effect in future years. However, the actual tally was likely less than this estimate.

Prior to Am. Sub. H.B. 40, a 0.75% discount on sales and use tax collected was granted to vendors who remitted tax payments on or before the date the tax return was required to be filed. The act increased the vendor discount to 1.1% for the period after May 1, 2003 and before July 1, 2003. This provision decreased GRF revenues by about $4.0 million in FY 2003. This temporary increase in the vendor discount expired on July 1, 2003. However, Am. Sub. H.B. 95 (the appropriations act for the current biennium) modified the vendor discount, increasing it to 0.9%.

Corporate Franchise Tax

Corporate franchise tax receipts in June 2003 were $122.9 million, $64.5 million or 110.4% above original estimates. The surplus in June was due in part to the falling of the filing date on the last weekend of May 2003. Some of the tax returns were therefore processed and recorded in June. June receipts reduced the cumulative revenue shortfall registered under this tax source at the end of May 2003. For the entire year, the corporate franchise tax generated $747.2 million, lagging original estimates by $27.1 million or 3.5%. However, corporate franchise tax revenues grew 4.9%, as receipts were $34.9 million above FY 2002 tax receipts. Throughout the year, cumulative receipts from this tax source were generally below FY 2003 estimates and generally above FY 2002 revenues. Exhibit 9 illustrates the cumulative variances in corporate franchise tax revenue during FY 2003.

Franchise tax revenues in a given fiscal year generally reflect corporate profits in the prior calendar year. The franchise tax for tax year 2003 (generally fiscal year 2003) is based upon the taxpayer's activity during its taxable year ending in 2002. Revenue under the corporate franchise tax improved in FY 2003, growing 4.9%, after declining 22.2% in FY 2002. The turnaround in franchise tax revenues somewhat mirrors improving corporate profits. Nationwide measures of corporate profits indicate that profits are growing (measures of Ohio corporate profits are unavailable).[7] Corporate profits before tax in calendar year 2001,[8] as measured by the Bureau of Economic Analysis, decreased 14.3% (and Ohio corporate franchise tax revenue declined 22.2% in FY 2002). Nationally, before-tax corporate profits in CY 2002 declined 0.7%. However, profits from current production (which do not reflect depreciation accounting for federal income tax purposes) increased 7.6% in CY 2002 (compared to a decrease of 7.2% in CY 2001). Similarly, Ohio corporate franchise tax receipts increased 4.9%.

Corporate profits improved for most industries. Nationally, except for the transportation and utilities sectors in CY 2002, profits[9] grew 11.0% in manufacturing, 5.6% in wholesale, 2.7% in retail, and 19.5% in the financial industry. Profits declined 39.7% in the transportation and utilities sectors. In CY 2001, profits declined for most sectors except retail and financial services. Profits decreased 47.8% in manufacturing, 24.3% in the transportation and utilities sectors, and 27.9% in wholesale. Corporate profits in the retail and the financial sectors grew 7.8% and 4.8% in CY 2001, respectively.

Prior to FY 2003, franchise tax revenues had declined in each of the previous 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. Franchise tax revenue grew to $747.2 million in FY 2003. As the amount of revenue from this source and GRF tax receipts increased, the

Exhibit 9: Cumulative Corporate Franchise Tax Variance in FY 2003
(from original FY 2003 estimates and FY 2002 revenues, in millions of dollars)

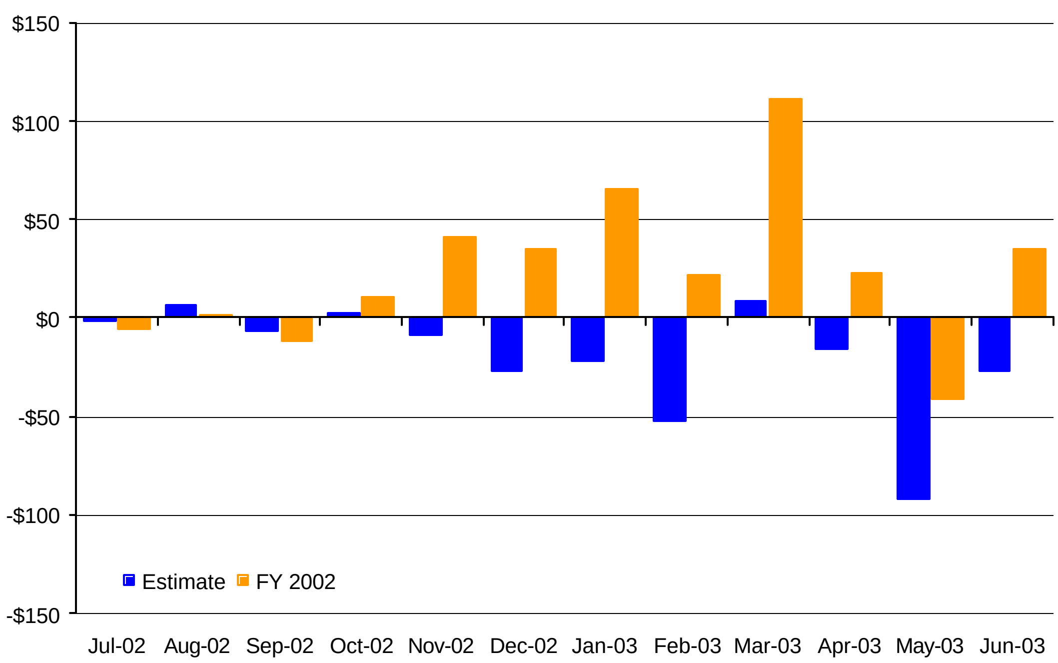


Table 3
General Revenue Fund Income
Actual vs. Estimate
FY 2003 to Date as of June 2003
($ in thousands)

REVENUE SOURCE					Percent
TAX REVENUE	**Actual**	**Estimate***	**Variance**	**FY 2002**	**Change**
Auto Sales	$966,213	$905,000	$61,213	$927,549	4.17%
Non-Auto Sales & Use	$5,431,732	$5,385,001	$46,731	$5,110,411	6.29%
Total Sales	$6,397,945	$6,290,001	$107,944	$6,037,960	5.96%
Personal Income	$7,420,665	$7,863,000	($442,335)	$7,304,148	1.60%
Corporate Franchise	$747,196	$774,301	($27,105)	$712,302	4.90%
Public Utility	$218,678	$265,000	($46,322)	$260,130	-15.94%
Kilowatt Hour Excise Tax	$339,853	$335,001	$4,852	$323,348	5.10%
Total Major Taxes	**$15,124,337**	**$15,527,303**	**($402,966)**	**$14,637,888**	**3.32%**
Foreign Insurance	$216,351	$225,000	($8,649)	$214,319	0.95%
Domestic Insurance	$160,126	$155,000	$5,126	$132,421	20.92%
Business & Property	$30,000	$56,902	($26,902)	$7,075	324.04%
Cigarette	$599,941	$568,200	$31,741	$281,290	113.28%
Alcoholic Beverage	$56,574	$58,000	($1,426)	$55,730	1.51%
Liquor Gallonage	$29,737	$30,000	($263)	$29,322	1.42%
Estate	$100,811	$91,000	$9,811	$116,259	-13.29%
Total Other Taxes	$1,193,540	$1,184,102	$9,438	$836,415	42.70%
Total Taxes	**$16,317,876**	**$16,711,405**	**($393,529)**	**$15,474,303**	**5.45%**
NON-TAX REVENUE					
Earnings on Investments	$14,246	$85,000	($70,754)	$79,009	-81.97%
Licenses and Fees	$33,667	$33,000	$667	$31,099	8.26%
Other Revenue	$593,811	$746,500	($152,689)	$1,008,197	-41.10%
Non-Tax Receipts	$641,724	$864,500	($222,776)	$1,118,305	-42.62%
TRANSFERS					
Liquor Transfers	$115,000	$105,000	$10,000	$112,000	2.68%
Budget Stabilization	$115,423	$0	$115,423	$48,352	138.71%
Other Transfers In	$287,115	$248,500	$38,615	$348,206	-17.54%
Total Transfers In	$517,538	$353,500	$164,038	$508,558	1.77%
TOTAL REVENUE less Federal Grants	**$17,477,138**	**$17,929,405**	**($452,267)**	**$17,101,167**	**2.20%**
Federal Grants	$4,972,430	$4,647,100	$325,330	$4,361,387	14.01%
TOTAL GRF REVENUE	**$22,449,568**	**$22,576,505**	**($126,937)**	**$21,462,553**	**4.60%**

* July, 2002 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

relative contribution of the corporate franchise tax to total GRF tax revenue has shrunk. From 8.2% of total GRF tax revenue in FY 1998, the corporate franchise tax contributed 4.6% of GRF tax revenue in FY 2002 and about the same amount in FY 2003.

Public Utility Excise Tax and Kilowatt Hour Tax

The GRF received $218.7 million from the public utility excise tax (PUET) in FY 2003, a decrease of $41.5 million or 15.9%, compared with FY 2002

Table 3a
General Revenue Fund Income
Actual vs. Revised Estimate
Fiscal Year 2003
($ in thousands)

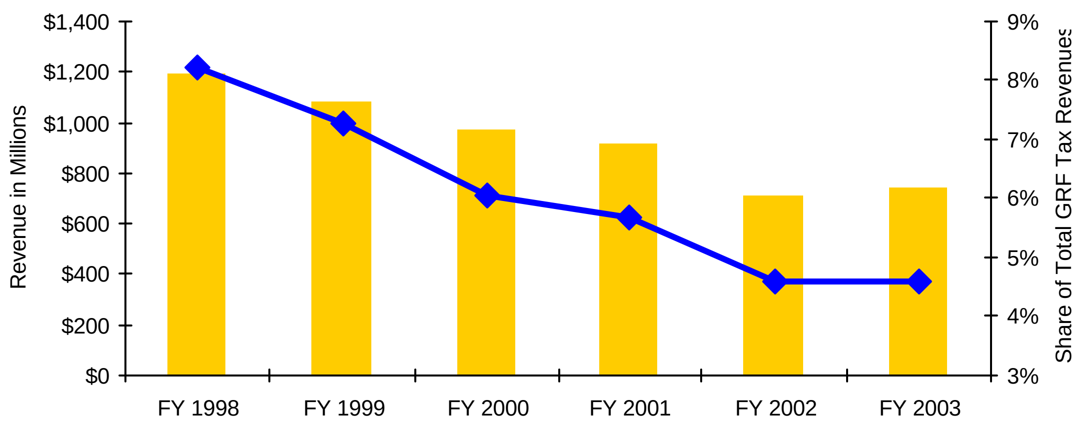
REVENUE SOURCE				
TAX REVENUE	**Actual**	**Estimate***	**Variance**	**Percent**
Auto Sales	$966,213	$905,000	$61,213	6.8%
Non-Auto Sales & Use	$5,431,732	$5,456,500	($24,768)	-0.5%
Total Sales	$6,397,945	$6,361,500	$36,445	0.6%
Personal Income	$7,420,665	$7,501,000	($80,335)	-1.1%
Corporate Franchise	$747,196	$725,000	$22,196	3.1%
Public Utility	$218,678	$240,000	($21,322)	-8.9%
Kilowatt Hour Excise Tax	$339,853	$335,000	$4,853	1.4%
Total Major Taxes	**$15,124,337**	**$15,162,500**	**($38,163)**	**-0.3%**
Foreign Insurance	$216,351	$225,000	($8,649)	-3.8%
Domestic Insurance	$160,126	$155,000	$5,126	3.3%
Business & Property	$30,000	$56,900	($26,900)	-47.3%
Cigarette	$599,941	$583,200	$16,741	2.9%
Alcoholic Beverage	$56,574	$58,000	($1,426)	-2.5%
Liquor Gallonage	$29,737	$30,000	($263)	-0.9%
Estate	$100,811	$95,000	$5,811	6.1%
Total Other Taxes	$1,193,540	$1,203,100	($9,560)	-0.8%
Total Taxes	**$16,317,877**	**$16,365,600**	**($47,723)**	**-0.3%**
NON-TAX REVENUE				
Earnings on Investments	$14,246	$50,000	($35,754)	-71.5%
Licenses and Fees	$33,667	$33,000	$667	2.0%
Other Revenue	$593,811	$791,500	($197,689)	-25.0%
Non-Tax Receipts	$641,724	$874,500	($232,776)	-26.6%
TRANSFERS				
Liquor Transfers	$115,000	$105,000	$10,000	9.5%
Budget Stabilization	$115,423	$149,600	($34,177)	-22.8%
Other Transfers In	$287,115	$306,500	($19,385)	-6.3%
Total Transfers In	$517,538	$561,100	($43,562)	-7.8%
TOTAL REVENUE less Federal Grant	**$17,477,139**	**$17,801,200**	**($324,061)**	**-1.8%**
Federal Grants	$4,972,430	$4,859,049	$113,380	2.3%
TOTAL GRF REVENUE	**$22,449,568**	**$22,660,249**	**($210,681)**	**-0.9%**

* March, 2003 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

revenue. The kilowatt hour (KWH) tax raised $339.9 million for the GRF in FY 2003, an increase of 5.1% compared to FY 2002. Part of the reduction in revenue from the PUET is attributable to electric restructuring as provided by Am. Sub. S.B. 3 of the 123rd General Assembly. The last payment made by electric companies under the PUET was received in December of 2001, and payments from electric companies contributed $47.5 million to FY 2002 revenues under the tax. S.B. 3 established the KWH tax to replace the revenue lost under the PUET as a result of exempting electric companies, so Exhibit 11

Exhibit 10: Franchise Tax Revenue and Share of Total GRF Tax Receipts

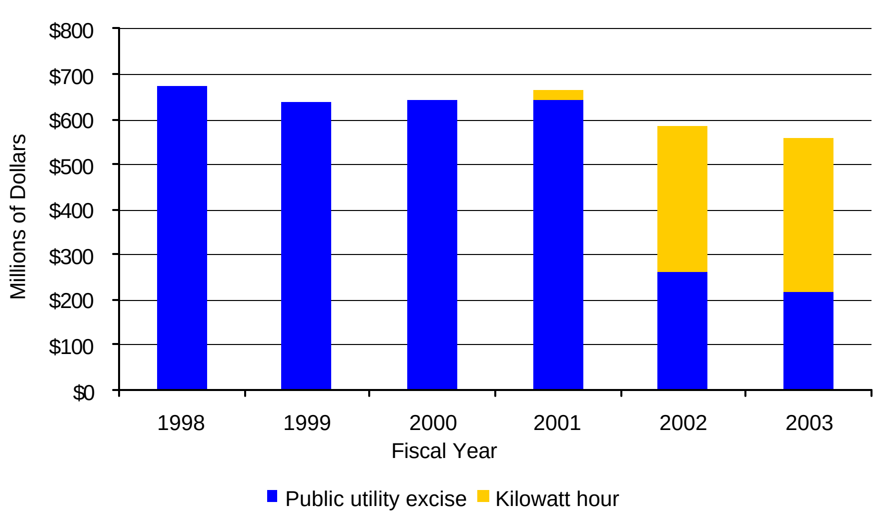


shows the combined revenue from the two taxes. The total collected under the two taxes has declined by $104.8 million since FY 2001, but S.B. 3 also subjected electric utilities to the corporate franchise tax for the first time, increasing receipts under that tax.

Revenues under the PUET were approximately $21.3 million, or 8.9%, below OBM's revised estimate. The amount paid by natural gas companies under the tax fell by $15.5 million in FY 2003, but this was more than made up by an increase of $19.8 million paid by telephone companies. The most likely reason for the variance was the local government fund freeze contained in Am. Sub. H.B. 94 of the 124th General Assembly. The act froze the local government funds' shares at their levels in FY 2001, when electric companies were still subject to the tax.[10] The local government funds' shares would have been much larger when electric companies were paying the tax than they would be today; the variance may be due to overlooking this fact in producing the estimate.

Revenue reports from the Central Accounting System (CAS) seemed to indicate that electric power companies paid a negative $36.7 million under the tax in FY 2003. Officials with the Department of Taxation report that this money was in fact transferred to the Local Government Fund and to the Local Government Revenue Assistance Fund; this was how the local government fund freeze was accounted for in CAS. The January 2003 edition of *Budget Footnotes* incorrectly reported that the negative balance shown represented refunds to electric

Exhibit 11: Utility Taxes



companies that were due to overpayments that did not take into account the Ohio coal usage tax credit. Further discussions with Department of Taxation officials clarified the nature of the negative entries.

Cigarette and Other Tobacco Products Tax

Cigarette and other tobacco products tax receipts in June were $51.7 million, $3.4 million or 7.0% above original estimates. These revenues were $29.3 million or 130.6% higher than June 2002 receipts.

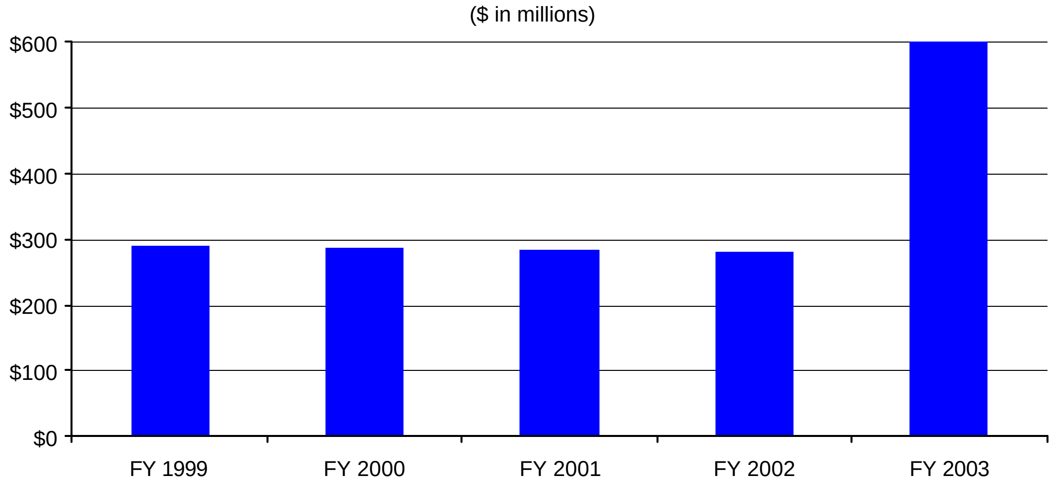
For the fiscal year, cigarette and other tobacco products tax receipts were $599.9 million, $31.7 million or 5.6% above July 2002 estimates. The floor tax on inventory resulted in a one-time FY 2003 pickup of GRF revenues of $35.3 million (included in the total for the fiscal year). Cigarette and other tobacco products tax receipts were $318.6 million or 113.3% above FY 2002 receipts. Cigarette and other tobacco product tax revenues surged from a cigarette tax rate increase included in Am. Sub. SB 261 of the 124th General Assembly. On July 1, 2002, S.B. 261 increased the rate to 55 cents per pack of 20 cigarettes, up from 24 cents, but did not change the tax rate on other tobacco products.

Generally, cigarette consumption declines on average 1.5 to 2.0% each year. The rate increase was expected to decrease consumption substantially and increase tax avoidance strategies by Ohio consumers in FY 2003. However, it appears that several factors may have limited a more drastic decline in consumption of taxed cigarettes, at least in the first year following the tax increase. Cigarette stamping in Ohio may have limited the amount of smuggling or bootlegging that occurs when prices are raised. Several neighboring states raised taxes at about the same time. Also, most consumers purchase their cigarettes by the pack or the carton. To save money from tax avoidance, smokers would have to buy a large amount of cigarettes. If purchasing via the Internet, consumers still have to pay shipping and handling charges, which increase the cost of avoiding Ohio tax. However, it is possible that the downward adjustment in consumption from the tax increase will continue in FY 2004.

Senate Bill 261 also reduced the relative contribution of receipts from other tobacco products to this tax source. Taxed cigarette revenues were generally 91.0% to 93.0% of the cigarette and other tobacco products tax receipts. Tobacco products other than cigarettes provided between 7.0% and 9.0% of the tax receipts. Other tobacco products tax receipts were $25.7 million in FY 2003, or 4.3% of total receipts from this tax source. The growth in other tobacco tax receipts was 5.1% in FY 2003, which was somewhat comparable to their growth in prior years. From FY 2000 to FY 2002, receipts from other tobacco products grew 4.7%, 5.1%, and 4.8% respectively.

Exhibit 12 shows cigarette and other tobacco products tax receipts in the last five years.

Exhibit 12: Cigarette and Other Tobacco Products Tax Receipts
($ in millions)



Insurance Taxes (Domestic and Foreign)

The domestic insurance tax, which is paid by insurance companies headquartered in Ohio, raised $160.1 million for the GRF in FY 2003, while the foreign insurance tax (which is paid by insurance companies headquartered in other states) raised $216.4 million. Revenues from the domestic tax grew by over 20.0% in FY 2003, while revenues from the foreign tax grew by less than 1.0%. The contrast between these growth rates is accounted for by the fact that FY 2003 was the first year of a new tax structure that was created by Am. Sub. H.B. 215 of the 122nd General Assembly and phased in over five years. The tax rates under both taxes are now identical, at 1.0% of premiums for health insuring corporations and 1.4% of premiums for other insurers. The growth rates for revenues under the two taxes are likely to be similar in the future.

The variance for the foreign insurance tax was -3.8% of revenues, as compared with the OBM revised estimate, while the variance for the domestic tax was 3.3% of revenues over estimate. These variances are not very large in percentage terms in spite of the difficulties created for forecasters by the phase-in of the new tax structure for both taxes. In the case of the domestic insurance tax, the FY 2002 revenue was based in part on the old tax formula, which allowed companies to pay the lesser of 2.5% of gross premiums or 0.6% of their capital and surplus. The FY 2003 revenue is based solely on the (new) tax rate applied to premiums. The shift from a tax with two bases to a tax with a single base has made revenue growth more difficult to forecast.[15]

Although the change in the foreign insurance tax involved a relatively straightforward reduction in the tax rate, forecasting revenues has been complicated by the fact that many states (including Ohio) impose a so-called "retaliatory" tax on foreign insurers. A state that imposes a retaliatory tax taxes a foreign insurer at the higher of its chosen tax rate or the rate that the home state of that insurer imposes on foreign insurers (where "foreign" is determined from the point of view of the second state).[16] As Ohio has decreased its foreign insurance tax rate in recent years, receipts from Ohio's retaliatory tax have risen dramatically. While the decreases in the tax rate have led to reduced revenue under the tax, the revenue loss has been partially offset in most recent years, and was more than offset in FY 2003, by an increase in collections under the retaliatory tax. The effects of the tax decreases have therefore been complicated by an interaction between Ohio's (falling) tax rate and the tax rates imposed by other states through the retaliatory portion of the tax.

Alcoholic Beverages Tax

Alcoholic beverages tax receipts in FY 2003 were $56.6 million, lagging estimates by $1.4 million or 2.5%. Tax receipts from this revenue source were $0.9 million or 1.5% better than FY 2002 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 at varying rates that are equivalent to 0.14 cents per ounce. Wine less than 14.0% alcohol by volume is taxed at 33 cents per gallon. Wine between 14.0% and 21.0% alcohol

Exhibit 13: Insurance Taxes

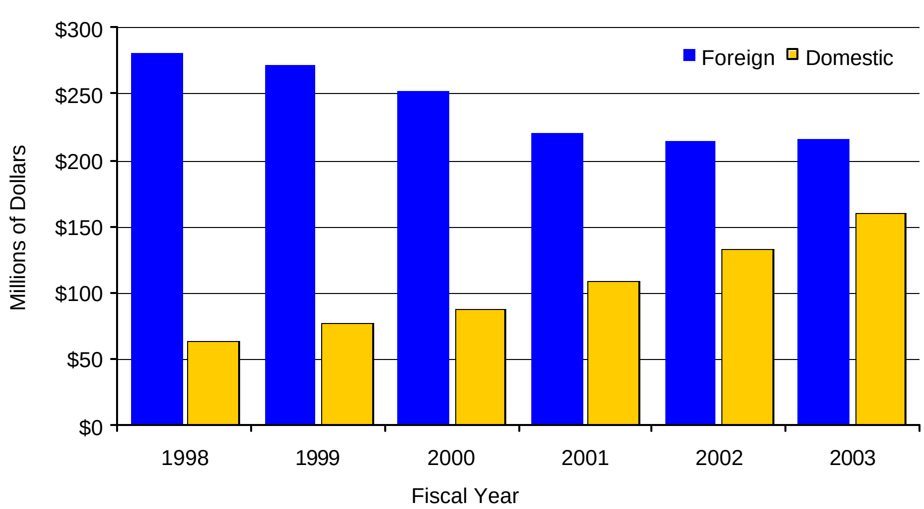
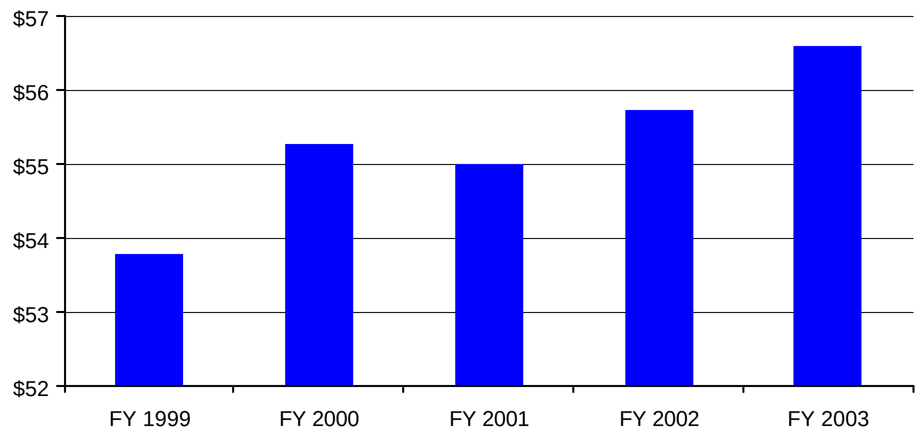


Exhibit 14: Alcoholic Beverage Tax Revenue
($ in millions)



by volume is taxed at $1.00 per gallon. Mixed beverages are taxed at $1.20 per gallon.[17] Major exemptions from the tax are sacramental wine, sales to the federal government, and sales in interstate commerce. Revenue is deposited in the General Revenue Fund.[18]

Exhibit 14 presents alcoholic beverage tax receipts for the last five fiscal years. Overall, this tax source has grown slowly, on average 1.5% annually between FY 1999 and FY 2003. Beer and malt beverages generate 84.0% or 85.0% of tax receipts. The next largest source of revenue is the tax on wines, at about 9.0% of total tax receipts. Mixed beverages contribute about 6.0% of total tax revenues. Contributions to tax receipts from vermouth, sparkling wines, and cider are small and appear to be declining each year.

Liquor Gallonage Tax

Liquor gallonage tax receipts were $29.7 million in FY 2003, $0.3 million or 1.1% better than estimates. Revenues from this tax source were higher than FY 2002 receipts by the same amount, $0.3 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.

Exhibit 15: Liquor Gallonage Tax Revenue
($ in millions)

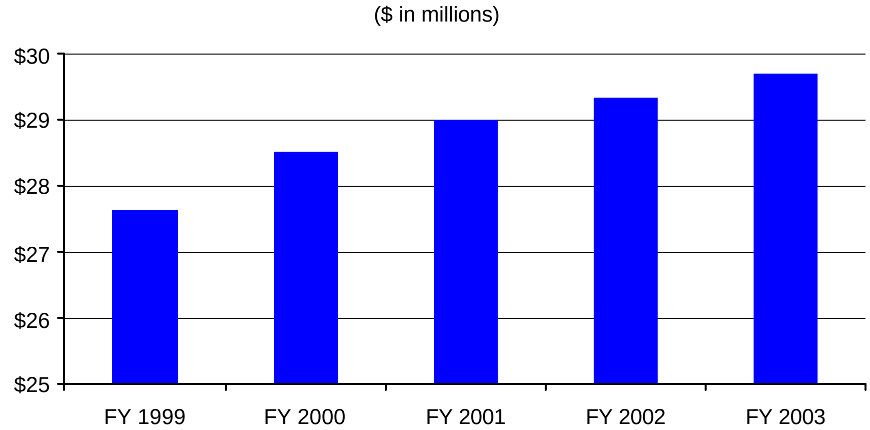
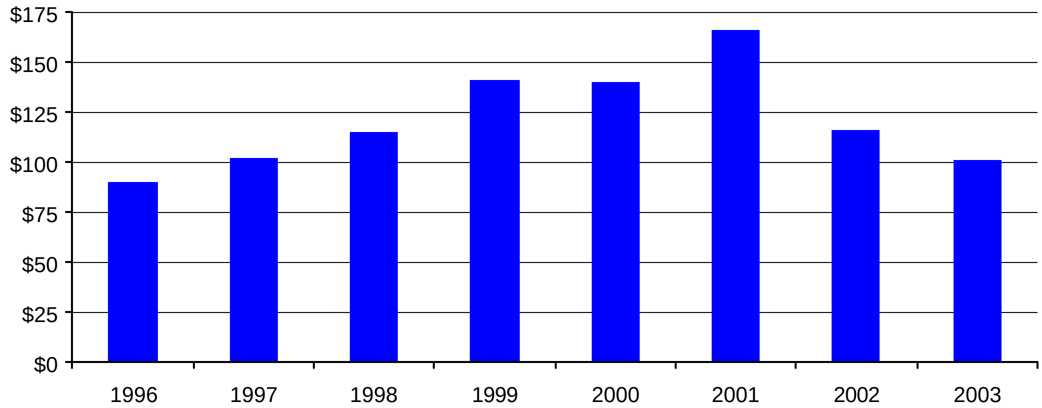


Exhibit 16: Estate Tax Revenue
($ in millions)



Estate Tax

In FY 2003, Ohio received $100.8 million in estate tax revenue, 6.0% over the estimate. FY 2003 revenue was $15.5 million (13.0%) lower than FY 2002 revenue of $116.3 million.

The estate tax is one of the more volatile state revenue sources. The poor performance of the stock market, lower interest rates, and the full effects of the changes in estate tax valuations and credits in S.B. 108 of the 123rd General Assembly were several factors that affected estate tax revenue collections in FY 2003 compared to the previous fiscal years.

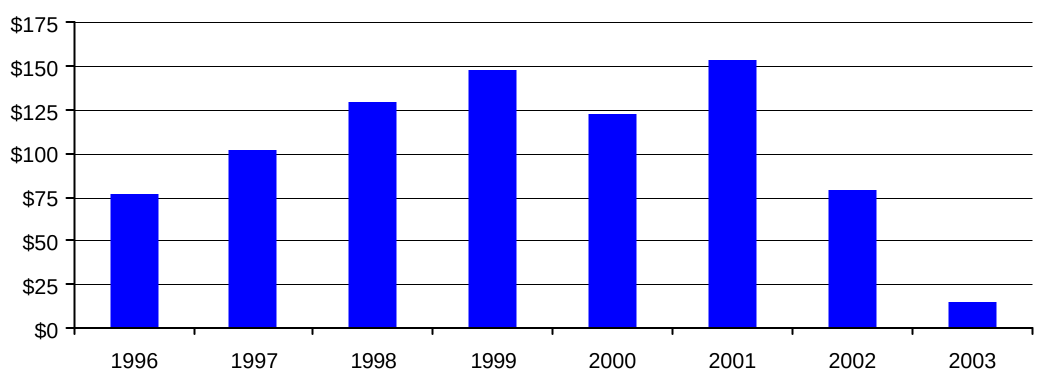
Earnings on Investment

Ohio's investment portfolio produced less revenue in FY 2003 compared to FY 2002. At the end of FY 2003, earnings on investment were slightly over $14.0 million, $35.8 million or 72.0% below the FY 2003 estimates. FY 2003 earnings on investment were down by over $65.0 million or 82.0% from FY 2002 earnings on investment of over $79.0 million.

The main reasons for the low earnings on investment were the small amount of money available for investments and low returns on investment. Overall, FY 2003 state revenues were shrinking; therefore the amount of funds available for investments were low. In reviewing the general performance of the financial markets from the second half of 2002 through the first half of 2003, conditions were bearish, with low annual stock returns, yields on fixed income investments, and interest rates.

Exhibit 17 shows the state's investment earnings from FY 1996 to FY 2003.

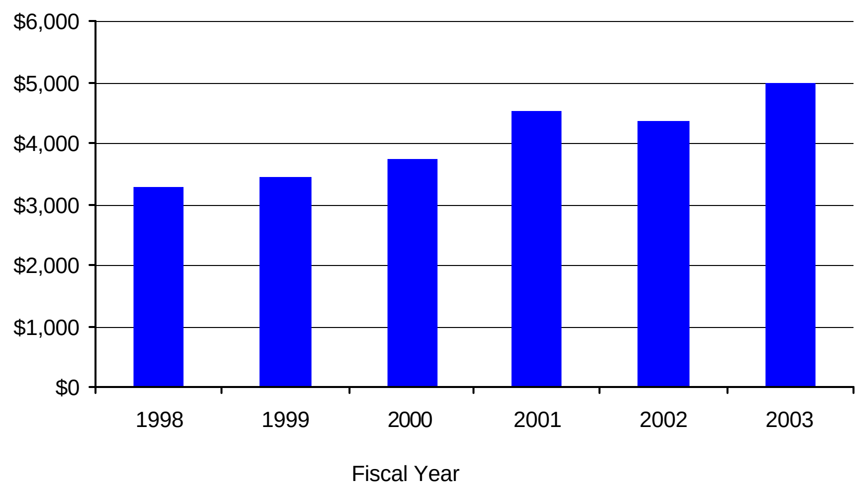
Exhibit 17: Earnings on Investmer
($ in millions)



Federal Grants

Federal grants provided $4.97 billion for the GRF in FY 2003, an increase of about $610 million, or 14.0%, compared to FY 2002. Revenue recorded in this category consists mostly of federal reimbursements for Medicaid and other human services programs administered by the Department of Job and Family Services. The substantial growth in this category is based largely on growth in Medicaid expenditures, which grew by 12.3% during the fiscal year. Also contributing to growth in this category was the passage of the Jobs and Growth Tax Relief Reconciliation Act of 2003, which provided a $193 million block grant that was received in June.

Exhibit 18: Federal Grants
($ in millions)



[1] H.B. 40 accelerated sales tax receipts by taxpayers that pay by electronic fund transfers, starting in April 2003. For the last quarter of FY 2003, H.B. 40 increased non-auto sales tax revenue by up to $288.0 million.

[2] Am. Sub. H.B. 94 granted an amnesty for certain delinquent state taxes whereby outstanding tax delinquencies could 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 for non-auto sales and use tax revenues in FY 2002.

[3] Am. Sub. H.B. 405 changed the way Ohio sales and use tax is applied to the lease of motor vehicles, watercraft, outboard motors, and aircraft. Effective February 1, 2002, the sales tax on leases has been 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. With H.B. 405, the entire tax is collected at the time the lease is consummated and applied to the total amount that would 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. H.B. 405 was expected to provide up to $180.0 million in FY 2003, about $100.0 million more than in FY 2002. However, this estimate was made when leasing rates were higher than they have been lately. Thus, amounts collected from the change in the tax treatment of leases were likely less than this estimate. Therefore, additional revenue over FY 2002 was probably much less than previously estimated.

[4] To entice buyers concerned with affordable monthly payments, lease terms have been lengthening. The lengthening of lease terms is also contributing to make leasing less attractive, because a primary reason to lease is to get a new vehicle every few years. In 2001, 36.0% of all new lease originations were for terms greater than 48 months compared to 29.0% in 2000.

[5] CNW Marketing & Research, *Cross Roads in the New Economy*.

[6] R.C. sections 5739.17, 5739.031, 5739.12, 5739.17, and 5741.12 describe the various taxpayers and schedules.

[7] The relationship between Ohio corporate franchise tax receipts and measures of national corporate profits is not straightforward. Also, the Ohio franchise tax has a net worth tax base and a net income tax base, and corporations pay the higher of the two tax calculations.

[8] 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 the Bureau of Economic Analysis (BEA), a unit of the United States Department of Commerce.

[9] 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 from the previous one.

[10] At the time, electric companies accounted for approximately 60% of total tax revenues.

[11] The cigarette and other tobacco products 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 17.0% of their wholesale price.

[12] The floor tax is the additional tax (31 cents per pack) on cigarettes in inventory that had an “old” stamp of 24 cents per pack.

[13] Price increases and other factors, such as restrictions on where people can smoke and general awareness of health issues associated with smoking, contribute to the decline in tobacco consumption.

[14] Consumption of taxed cigarettes was estimated to decline up to 15.0% or 20.0% from the rate increase. Although consumption data is not available yet, the decrease in consumption of taxed cigarettes in FY 2002 was probably less than 15.0%. There are basically four ways consumers can avoid paying Ohio taxes on cigarettes. Consumers may: (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, or (4) purchase cigarettes via the Internet.

[15] Many domestic insurers paid the old tax based on their capital and surplus because that meant paying less tax than they would have paid based on their premiums. As that opportunity has been phased out, revenues have grown significantly under the tax, increasing by more than 20.0% in four of the last five fiscal years. 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, meaning that for many Ohio insurance companies their overall tax burden has fallen even as they paid more taxes to Ohio. This reduction has not been implemented intentionally by other states; it is a result of applying the “retaliatory” tax that many states, including Ohio, impose while the tax rate that Ohio imposes on foreign insurance companies is falling.

[16] This is not as complicated as it may seem from this description. To illustrate, suppose that New York imposes a tax of 2.0% on foreign insurers, including companies headquartered in Ohio, and suppose that New York imposes a retaliatory tax. Then New York would impose a tax rate of 2.0% on Ohio companies, since 2.0% is higher than Ohio’s rate of 1.4%. Similarly, Ohio would impose a rate of 2.0% on New York-based insurers (also because New York’s 2.0% rate is higher than Ohio’s 1.4% rate). On the other hand, if New York reduced its tax rate to 1%, it would then start to impose a tax of 1.4% on Ohio companies, since its new chosen rate (1.0%) would be less than Ohio’s foreign insurance tax rate (1.4%), and Ohio would begin to tax New York companies at a rate of 1.4%.

[17] The corresponding tax rates would be: 10.0 cents for a six-pack of 12 oz. containers for beer, 5.4 cents for a standard 750 ml bottle of wine with less than 14.0% alcohol, 17.0 cents for a standard 750 ml bottle of wine with more than 14.0% alcohol, and 20.4 cents for a standard 750 ml bottle of mixed beverages.

[18] Revenue is deposited in the General Revenue Fund with two exceptions. One percent of the tax is deposited in the Beverage Tax Administration Fund and 5.0 cents per gallon of wine is deposited into the Ohio Grape Industries Fund.

DISBURSEMENTS

— *Steve Mansfield**

For the year, General Revenue Fund (GRF) expenditures totaled $22.7 billion, an increase of slightly more than $1.0 billion (or 4.7%) from FY 2002 GRF spending.

Some adjustments to this depiction are, however, warranted. As noted below in Table 5, Medicaid expenditures were 11.6% higher in FY 2003 than in FY 2002. If the $94.2 million FY 2003 expenditure for the medical portion of the Disability Assistance program is excluded (because in FY 2002 it was not included in the Health Care/Medicaid program), and the $84.6 million of payments scheduled for June 2002 but postponed to July 2002 is shifted back to FY 2002, the rate of growth in the Health Care/Medicaid program was 7.9%. A similar adjustment is warranted in the case of Property Tax Relief, which posted an 11.5% increase. That program saw $37.0 million in tax relief payments postponed from June 2002 to July 2002 in order for the FY 2002 budget to balance. Shifting that amount back to FY 2002 shows a 4.9% rate of growth for the Property Tax Relief program. Extending these adjustments to the year-over-year comparison of total GRF expenditures results in a 3.5% rather than 4.7% rate of growth.

reasonable since even though the appropriation is made from the GRF, federal funds constitute most of its funding. If, however, the state's share of Medicaid expenditures is included and only the federal portion is excluded, the rate of growth for the GRF is 3.2%. From June 2002 to June 2003 the consumer price index for the Midwest region increased by 1.8%, while the increase for the nation as a whole was 2.1%. The rate of inflation for medical care reported by the U.S. Department of Labor for the period June 2002 to June 2003 was 4.1%. We thus see that in the portion of the GRF that does not include Medicaid, GRF growth in FY 2003 was fairly close to the overall rate of inflation.

Many of the individual expenditure categories showed low or negative growth for the year. The percentage changes are given in the final column of Table 5. Percentage and dollar changes for the larger categories are given below:

In dollar terms, more than the total increase of $1,012.0 million for FY 2003 is accounted for by Primary and Secondary Education ($187.0 million), Health Care/Medicaid ($835.0 million), and Property Tax Relief ($132.0 million). However, since Medicaid consists of approximately 58.8% federal funding, the Medicaid and total can be reduced by $491.0 million, making the net state spending increase $521.0 million and the state share of Medicaid increase $344.0 million, or two-thirds of the total.

Program Expenditure Category	$ Change (in millions)	FY 2003 Percentage Change
Primary and Secondary Education	$187	3.08%
Higher Education	$-54	-2.25%
Health Care/Medicaid*	$835	11.64%
Temporary Assistance for Needy Families	$-15	-3.97%
Other Welfare	$-9	-2.42%
Human Services	$10	0.91%
Justice and Corrections	$16	0.89%
Other Government	$-5	-1.40%
Property Tax Relief*	$132	11.49%
Debt Service	$23	9.74%

*See the second paragraph of this article for an explanation of why these percentages are overstated.

If we go further in making adjustments and exclude the costs of the Health Care/Medicaid program in their entirety but include the adjustment made above for the Property Tax Relief program, the year-over-year rate of growth in GRF expenditures is 2.3%. The exclusion of the Health Care/Medicaid program from calculating the GRF growth rate seems

Because of lower than anticipated revenues, several budget adjustments were made in FY 2003. These took the form of three rounds of executive-ordered budget cuts and a corrective budget act (Am. Sub. H.B. 40, the third corrective budget act of the biennium). In all, the executive ordered reductions in FY 2003 totaled $638.5 million. The first of these reductions (announced on July 1, 2002 and totaling $375.0 million) was included in the disbursement estimates prepared by the Office of Budget and Management (OBM) in August. These estimates have been tracked in *Budget Footnotes* over the last year. The two subsequent rounds of budget reductions ($121.0 million announced January 22, 2003, and $142.5 million announced March 5, 2003), totaling $263.5 million, are reflected in our analysis as variances from the original estimate, along with other factors that affected the line items. In FY 2003, total GRF program payments (excluding transfers) were $163.6 million under the estimate. The effect of the second and third rounds of budget reductions is, however, partially offset by a positive disbursement variance in the Health Care/Medicaid program, which required tapping the Budget Stabilization Fund.

June's GRF disbursements (excluding transfers) accounted for $152.0 million of the $163.6 million negative year-to-date disbursement variance. When we disaggregate these numbers to look at the disbursement variances of four of the state's major GRF program categories, as depicted in Figure 1, we see that three program categories registered negative disbursement variances for the year, while the other program category (Welfare and Human Services) registered a positive disbursement variance. All four program categories posted negative disbursement variances in June (see Figure 1 and Table 4).

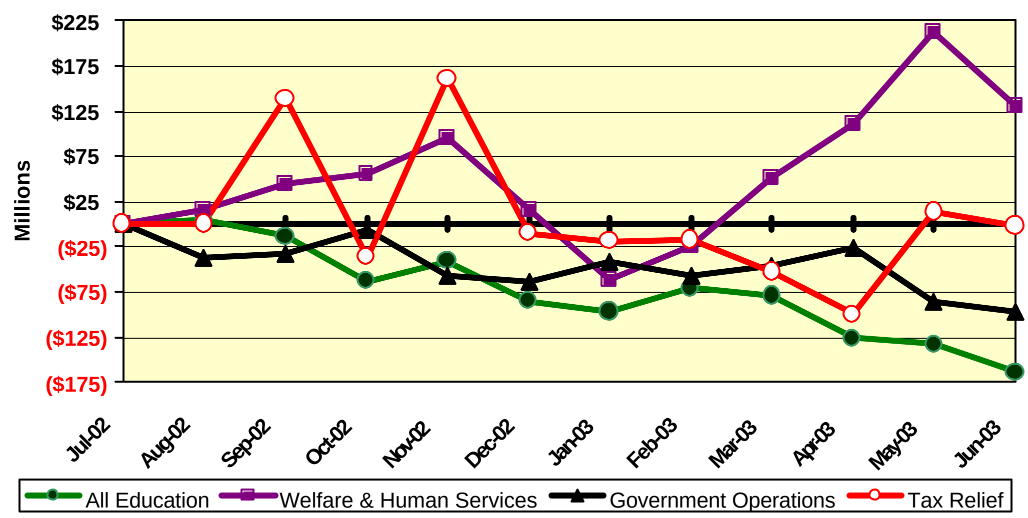
In the sections that follow, we examine in more detail the disbursement activity in each of the four major GRF program categories in the order of magnitude of its contribution to the year-to-date negative disbursement variance. Summary information about GRF disbursement activity is presented in Tables 4 and 5, and a detailed comparison of year-over-year disbursement activity in the Health Care/Medicaid program is presented in Table 6.

Education (-$164.5 million)

Disbursements in the Education category finished the year $164.5 million below the estimate. The Department of Education accounted for $114.2 million of the category's negative disbursement variance, the Board of Regents for $42.1 million, and the Ohio Arts Council for $3.1 million. This section discusses disbursements in these agencies and a few of the other small agencies in the category.

Department of Education. Executive-ordered reductions for the Department of Education in FY 2003 totaled $120.7 million. The January and

Figure 1
GRF Disbursement Variances
by Program Category, FY 2003



March rounds of reductions were not included in the disbursement estimates. Hence these reductions have the effect of showing up as negative disbursement variances from the original estimates. Among the largest cuts within the Department's budget were: line item 200-501, Base Cost Funding ($63.7 million); line item 200-502, Pupil Transportation ($9.4 million); line item 600-540, Special Education Enhancements ($6.1 million); line item 200-410, Professional Development ($5.3 million); line item 200-525, Parity Aid ($5.3 million); and line item 200-520, Disadvantaged Pupil Impact Aid ($5.2 million).

The Department of Education finished FY 2003 with a negative disbursement variance of $114.2 million. Line item 200-520, Disadvantaged Pupil Impact Aid, posted for the year a negative disbursement variance of $27.7 million. This appropriation item is used to provide funds to school districts that incur higher educational costs due to a higher concentration of economically disadvantaged students. There are three major components, all-day kindergarten, K-3 class size reduction, and safety and remediation. With an original appropriation of $360.1 million, this line item was cut $5.2 million in March. In addition, the Department received Controlling Board approval to transfer $8.0 million from this item to line item 200-546, Charge-Off Supplement, and to transfer $22.6 million from line item 200-520, Disadvantaged Pupil Impact Aid, to line item 200-501, Base Cost Funding. The cut and transfers account for all of the negative disbursement variance in this line item.

With an appropriation of $53.3 million, line item 200-513, Student Intervention Services, finished FY 2003 $23.2 million under the estimate. This item is used to reimburse school districts for part of their expenditures on state-mandated intervention services. These services include summer and regular school year interventions for third-graders reading below grade level, as well as fourth, sixth, and ninth-graders who fail three or more of the five proficiency tests for their grade levels. Since this item has received transfers from Temporary Assistance for Needy Families (TANF) funds in the Department of Job and Family Services, students receiving intervention reimbursements must be TANF-eligible. Utilization of these funds, and also utilization of TANF funds for Head Start, were lower than anticipated. The department encumbered an additional $6.0 million in this line item and allowed $17.2 million to lapse.

As noted above, the appropriation for line item 200-501, Base Cost Funding, was reduced by $63.7 million. Disbursements from this item, however, were under estimate by only $13.4 million. This result was possible because of a transfer of $37.5 million from other line items (the largest source of which was the $22.6 million transfer from line item 200-520, Disadvantaged Pupil Impact Aid, mentioned above), and with a June increase approved by the Controlling Board of $13.7 million in a set-aside for the program.

Other notable negative disbursement variances for FY 2003 include: line item 200-502, Pupil Transportation ($9.8 million); line item 200-540, Special Education Enhancements ($9.0 million); line item 200-525, Parity Aid ($8.7 million); and line item 200-410, Professional Development ($8.4 million). Significant offsetting positive disbursement variances for FY 2003 were registered in line item 200-546, Charge-Off Supplement ($6.3 million), and line item 200-437, Student Assessment ($4.9 million). Appropriation item 200-546 is used to subsidize districts that do not raise enough local operating revenue to cover the local formula share assumed by the state funding formula. Appropriation item 200-437 is used to pay for developing, scoring, and reporting the results of the state proficiency and achievement tests, as well as for developing the state's diagnostic assessments. Proficiency test costs were higher than expected, and funds for them were transferred from other items.

Regents. The Board of Regents' financial results in FY 2003 were significantly affected by the three budget reductions. Including cuts to prior year funds, during FY 2003 a total of $182.9 million was taken out of the appropriation. The Board was allowed a degree of discretion in allocating the reductions among its appropriation items. The major appropriation item affected by the budget reductions was line item 235-501, State Share of Instruction, which was reduced by $139.3 million (or 8.4%). The cuts to this line item accounted for 80.0% of the total reduction. Other major items incurring reductions were line item 235-415, Jobs Challenge ($0.9 million); line item 235-418, Access Challenge ($3.9 million); line item 235-454, Research Challenge ($1.7 million); line item 235-503, Ohio Instructional Grants ($1.5 million); line item 235-511, Cooperative Extension Service ($2.3 million); line item 235-514, Central State Supplement ($1.0 million); line item 235-531, Student

Table 4
General Revenue Fund Disbursements
Actual vs. Estimate
Month of June 2003
($ in thousands)

USE OF FUNDS			
PROGRAM	**Actual**	**Estimate***	**Variance**
Primary & Secondary Education (1)	$470,857	$486,366	($15,509)
Higher Education	$138,920	$154,970	($16,051)
Total Education	$609,777	$641,336	($31,560)
Health Care/Medicaid	$538,884	$624,388	($85,504)
Temporary Assistance to Needy Families (TANF)	$682	$0	$682
General/Disability Assistance	$461	$505	($44)
Other Welfare (2)	$22,641	$20,168	$2,473
Human Services (3)	$31,305	$29,862	$1,443
Total Welfare & Human Services	$593,973	$674,923	($80,949)
Justice & Corrections	$120,497	$122,259	($1,762)
Environment & Natural Resources	$2,219	$3,410	($1,191)
Transportation	$937	$757	$180
Development	$7,762	$14,756	($6,994)
Other Government	$19,786	$21,054	($1,268)
Capital	$0	$0	$0
Total Government Operations	$151,201	$162,236	($11,035)
Property Tax Relief (4)	$139,614	$154,776	($15,163)
Debt Service	$8,001	$21,255	($13,254)
Total Program Payments	**$1,502,566**	**$1,654,527**	**($151,961)**
TRANSFERS			
Local Govt Distribution	$0	$0	$0
Budget Stabilization	$0	$0	$0
Other Transfers Out	$330	$0	$330
Total Transfers Out	$330	$0	$330
TOTAL GRF USES	**$1,502,896**	**$1,654,527**	**($151,631)**

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

* August 2002 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

Choice Grants ($1.3 million); and line item 235-535, Ohio Agricultural Research and Development Center ($3.2 million).

The second and third rounds of FY 2003 reductions in the Board's appropriations totaled $52.4 million. The agency's negative disbursement variance for FY 2003 totaled $42.1 million. The State Share of Instruction, Access Challenge, and Success Challenge items mentioned above registered the largest negative disbursement variances of $39.2 million, $1.5 million, and $1.2 million, respectively.

Three line items in the Board of Regents' budget posted significant positive variances for the fiscal

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
FY 2003 to Date as of June 2003
($ in thousands)

USE OF FUNDS *PROGRAM*	Actual	Estimate*	Variance	FY 2002	Percent Change
Primary & Secondary Education (1)	$6,273,738	$6,396,130	($122,391)	$6,086,314	3.08%
Higher Education	$2,352,692	$2,394,816	($42,124)	$2,406,915	-2.25%
Total Education	$8,626,430	$8,790,946	($164,515)	$8,493,229	1.57%
Health Care/Medicaid	$8,008,531	$7,787,401	$221,130	$7,173,717	11.64%
Temporary Assistance to Needy Families (TANF)	$352,741	$352,749	($8)	$367,306	-3.97%
General/Disability Assistance	$24,488	$23,425	$1,063	$87,222	-71.93%
Other Welfare (2)	$463,159	$523,904	($60,745)	$474,646	-2.42%
Human Services (3)	$1,115,660	$1,145,529	($29,869)	$1,105,556	0.91%
Total Welfare & Human Services	$9,964,579	$9,833,008	$131,571	$9,208,447	8.21%
Justice & Corrections	$1,828,110	$1,881,041	($52,930)	$1,811,991	0.89%
Environment & Natural Resources	$114,683	$117,377	($2,695)	$119,032	-3.65%
Transportation	$32,265	$39,561	($7,296)	$45,607	-29.25%
Development	$169,984	$190,653	($20,669)	$172,622	-1.53%
Other Government	$374,922	$387,750	($12,828)	$380,264	-1.40%
Capital	$0	$1,535	($1,535)	$9,164	-100.00%
Total Government Operations	$2,519,964	$2,617,917	($97,953)	$2,538,681	-0.74%
Property Tax Relief (4)	$1,283,826	$1,285,917	($2,091)	$1,151,502	11.49%
Debt Service	$258,529	$289,179	($30,650)	$235,584	9.74%
Total Program Payments	**$22,653,329**	**$22,816,968**	**($163,639)**	**$21,627,442**	**4.74%**
TRANSFERS					
Local Govt Distribution	$0	$0	$0	$0	---
Budget Stabilization	$0	$0	$0	$13,104	-100.00%
Other Transfers Out	$18,917	$15,836	$3,082	$19,862	-4.76%
Total Transfers Out	$18,917	$15,836	$3,082	$32,966	-42.62%
TOTAL GRF USES	**$22,672,246**	**$22,832,803**	**($160,557)**	**$21,660,409**	**4.67%**

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

* August 2002 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

year. Line item 235-404, College Readiness Initiatives, received an increase of $1.6 million to fund additional programs under the Ohio College Access Network and thus posted a corresponding positive disbursement variance. Line item 235-503, Ohio Instructional Grants, and line item 235-599, National Guard Scholarship Program, both had disbursements estimated below the appropriation level. Both programs experienced higher demand than had been anticipated. Line item 235-503 exhausted its appropriation in May and line item 235-599 came within $1.0 million of exhausting its appropriation.

Ohio Arts Council. The $3.1 million negative disbursement variance for the Ohio Arts Council in FY 2003 stemmed largely from line item 370-502,

Previous Next

Program Subsidies. This appropriation item provides grants on a competitive basis to various arts institutions, organizations, and individual artists. The award and payment process for these funds typically produces a significant encumbrance for the line item. In addition, $0.3 million of the $2.5 million executive-ordered reduction in line item 370-502 was not included in the estimates.

SchoolNet Commission. There was an FY 2003 negative disbursement variance of $1.7 million for the SchoolNet Commission. A little over $0.4 million of the variance is traceable to second and third-round budget cuts, with the remainder attributable to agency spending restraint. The largest negative disbursement variances for the year were posted in line item 228-406, Technical and Instructional Professional Development ($0.8 million), and in line item 228-404, Operating Expenses ($0.7 million).

Historical Society. The Ohio Historical Society finished FY 2003 with a positive disbursement variance of $1.2 million. This, however, is somewhat misleading. The result is wholly traceable to a $1.5 million positive disbursement variance in line item 360-503, Ohio Bicentennial Commission. The Bicentennial Commission is distinct from the Historical Society, with the latter acting as the fiscal agent for the former. The overage was supported with a transfer from the Controlling Board that had been held for use by the Bicentennial Commission.

Educational Telecommunications Network Commission. The Educational Telecommunications Network Commission posted a $0.7 million negative disbursement variance for FY 2003. About half of this negative variance is traceable to line item 374-403, Ohio SONET. This line item funds the operating expenses and leasing of fiber optic capacity for the state. The system connects the Commission with each of Ohio's public television and radio stations, radio reading services, and educational technology agencies.

Government Operations (-$98.0 million)

Disbursements for the Government Operations category for FY 2003 were $98.0 million under the estimate. The Department of Rehabilitation and Correction accounted for $37.0 million of the negative variance, the Department of Development contributed a $20.1 million negative disbursement variance, and the Department of Administrative Services added a $9.6 million negative variance. There were several other significant contributors too. The details about a number of agencies in the category will be discussed in the following paragraphs in order of their magnitude.

Rehabilitation & Correction. In order to deal with revenue shortfalls, the executive ordered reductions in the budget of the Department of Rehabilitation and Correction that totaled $70.9 million, with $31.3 million of this reduction being made in the second and third rounds and thus not contained in the estimates. Of the total $70.9 million reduction, $53.8 million, or about 76.0%, was made to line item 501-321, Institutional Operations. The remaining reductions were spread generally across the Department's other GRF line items. The Department implemented several measures to reduce expenditures, including the following:

- The closure of the Orient Correctional Institution at the end of FY 2002 resulted in the layoff of 114 persons and a savings of about $30.0 million in FY 2003. The Department also closed inmate housing units in eight of the remaining prisons, which produced a savings of about $6.0 million.
- There were also numerous other reductions in expenditures for institutional operations that involved the consolidation of various services. These included consolidation of both Adult Parole Authority (APA) field services and certain geographical offices. These changes, along with layoffs in the APA system, produced a total reduction in APA expenditures around $11.0 million.
- An early retirement incentive program, offering a two-year buyout for eligible employees, was instituted. The savings in FY 2003 resulting from this program was $13.8 million.
- The reduction of staffing in the institutions resulted in expenditure reductions in FY 2003 of about $12.9 million.
- A moratorium on all nonemergency equipment purchases was instituted.

For FY 2003, disbursements were $37.0 million below estimate. The $31.3 million in second and third-round budget reductions account for the bulk of the disbursement variance. The appropriation item with the largest negative variance was line item 501-321, Institutional Operations, which was $27.5 million under the estimate. This line item supports the operation of the state's 32 adult prisons.

Development. The Department of Development finished FY 2003 with a negative disbursement variance of $20.1 million. Second and third-round budget reductions account for $1.3 million of this variance. Overall, the Department experienced a total of $18.0 million in reduced appropriations. The bulk of the negative disbursement variance can be traced to several development grant programs and to the timing of the awards and their processing. Considering both current and prior year funds, the largest of these include: line item 195-401, Thomas Edison Program ($1.2 million); line item 195-407, Travel and Tourism ($2.0 million); line item 195-412, Business Development Grants ($5.1 million); line item 195-416, Governor's Office of Appalachia ($3.3 million); and line item 195-434, Investment in Training Grants ($1.9 million).

Public Works Commission. For FY 2003, the Public Works Commission posted a negative disbursement variance of $13.5 million. This disbursement variance is largely due to the timing of infrastructure and conservation project requests compared to available funding. The two GRF appropriation items in the Commission's budget are used to pay debt service and financing costs. These costs proved lower than estimated due to lower than expected interest rates. The Commission will apparently lapse $22.9 million from the FY 2003 appropriation for these two line items.

Administrative Services. Disbursements for the Department of Administrative Services finished FY 2003 $9.6 million less than estimated. Budget reductions not included in the estimates account for $1.4 million of this disbursement variance. The Computer Service Division of DAS experienced about half of the total disbursement variance, with line item 100-416, Strategic Technology Development Programs, and line item 100-418, E-Government Development, together contributing $3.2 million to the negative disbursement variance.

Transportation. For FY 2003, the Department of Transportation posted a negative disbursement variance of approximately $7.2 million. About $0.6 million of this disbursement variance is traceable to budget reductions that were ordered after the estimates were developed. The largest contributor to this variance was line item 775-451, Public Transportation-State, which posted $2.2 million below estimates. This appropriation item funds the Office of Transit's operating expenses and is used to match federal funds for the Ohio Public Transportation Grant program and the Ohio Coordination program. The negative disbursement variance seems to be largely a matter of timing, as the Department encumbered $13.4 million of this appropriation.

Youth Services. The Department of Youth Services finished FY 2003 with a negative disbursement variance of $6.7 million. Of this total, $4.2 million is traceable to budget reductions that were ordered after the estimates were prepared. The bulk ($5.8 million, or 86.7%) of the negative disbursement variance was in line item 470-401, Reclaim Ohio. This line item is used to provide institutional placement and community program services to youth who have been convicted of a felony offense and to any delinquent child, unruly child, or juvenile traffic offender who is under the jurisdiction of a juvenile court.

Judiciary/Supreme Court. For FY 2003, Judiciary/Supreme Court registered a $5.9 million negative variance. Part of this disbursement variance is traceable to a voluntary $2.1 million reduction in appropriations. Line item 005-321, Operating Expenses, accounted for the lion's share of the negative disbursement variance. About half of the variance is encumbered.

Natural Resources. The Department of Natural Resources finished FY 2003 with a negative disbursement variance of $2.8 million for the year. Of this amount, $2.0 million is traceable to budget reductions that were not included in the estimates. While the negative disbursement variance is spread across several of the Department's GRF line items, the two with the largest negative variances for the year are line item 729-321, Office of Information Technology ($0.7 million), and line item 730-321, Division of Parks and Recreation ($0.5 million). Line item 729-321, Office of Information Technology, supplements operations of the Office of Computer Information Services and the Multiple Agency Radio Communication System (MARCS). The negative disbursement variance in line item 729-321 represents 42.0% of the original estimate. Line item 730-321, Division of Parks and Recreation, is used for the operations of this division, which develops, manages, promotes, and acquires land for the state's park system. The negative disbursement variance in line item 730-321 represents 1.5% of the original estimate.

Legislative Service Commission. The Legislative Service Commission posted a negative disbursement variance of $1.9 million for FY 2003. Approximately $1.0 million of this variance is traceable to voluntary budget reductions that were not included in the original estimates. About half of the disbursement variance was absorbed by line item 035-410, Legislative Information Systems, which posted a $0.9 million negative disbursement variance. Most of the remainder of the variance registered in line item 035-321, Operating Expenses, which received the bulk of the budget reduction.

Public Defender. The Public Defender Commission finished FY 2003 with a negative disbursement variance of $0.9 million. This negative variance stems from the $0.9 million in budget reductions that were not reflected in the estimates. Total reductions for the agency in FY 2003 were $7.8 million.

Line item 019-501, County Reimbursement – Non-Capital Cases, accounts for $0.8 million or 91.3% of the total negative disbursement variance for the year. This line item is used to reimburse counties for up to 50.0% of their costs of operating county public defender offices, joint county public defender offices, and appointed counsel systems.

Tax Relief (-$2.1 million)

The Property Tax Relief program, which carries an FY 2003 GRF appropriation of over $1.3 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 through the homestead exemption, the property tax rollbacks, and the $10,000 tangible tax exemption programs. Tax relief funds are disbursed to school districts and local governments by the Department of Education and the Department of Taxation, respectively. Each of these departments divides its property tax relief program into two components: real property tax credits/exemptions and tangible tax exemptions. For FY 2003, the property tax relief program of the Department of Taxation finished at $12.3 million over estimate, and the program of the Department of Education finished at $14.4 million under estimate, for a negative net disbursement variance of $2.1 million or 0.2%.

Welfare/Human Services ($131.6 million)

With a negative disbursement variance of $80.9 million in June, the Welfare/Human Services category as a whole finished the fiscal year at $131.6 million above the estimate for the year to date. Both June's negative disbursement variance and the year's positive variance are traceable primarily to the Health Care/Medicaid program, with smaller positive and negative variances in the rest of the category. The following paragraphs discuss the disbursements in the components of this category in more detail.

Health Care/Medicaid. For FY 2003, the Health Care/Medicaid program (primarily line item 600-525) posted a $221.1 million positive disbursement variance. An $85.5 million negative disbursement variance in June helped bring down the overage from a level in May that exceeded $300.0 million. This overage was covered by drawing from the Budget Stabilization Fund (BSF). In FY 2003, up to $149.6 million was available to be drawn from the BSF to cover overages in the Health Care/Medicaid program. The associated federal financial match of this $149.6 million is approximately $213.8 million. Thus, in total, $363.5 million was available. The Department of Job and Family Services received in May approval from the Controlling Board to transfer sufficient funds to line item 600-525 to meet expenditures up to these maximum amounts. In addition, the Controlling Board approved an increase of $45.0 million in line item 600-692, Health Care Services. This $45.0 million, which represents a projected increase in drug rebates and third-party revenue, is used to offset expenditures in line item 600-525. The full amount from the BSF was not needed, and after the transfer of $115.4 million, $34.2 million of the funds earmarked for Medicaid remained. This $34.2 million contributed to the $180.7 million FY 2003 ending balance in the BSF. The $115.4 million transfer drew $164.9 million in federal funds.

We see in Table 6, which compares FY 2003 and FY 2002 actual Health Care/Medicaid spending by service category, that the overall rate of increase year over year is slightly over 10.0%, once offsets and rebates are included. As noted above, if the

$94.2 million FY 2003 expenditure for the medical portion of the Disability Assistance program is excluded (because in FY 2002 it was not included in the Health Care/Medicaid program), and the $84.6 million of Medicaid payments scheduled for June 2002 but postponed to July 2002 is shifted back to FY 2002, the rate of growth in the Health Care/Medicaid program is 7.9%. Service categories posting year-over-year percentage increases that exceed the average rate by large amounts are the DA Medical, All Other, CHIP II, HMO, Prescription Drugs, Outpatient Hospitals, and Inpatient Hospitals categories. Significantly below the average rate of the year-over-year increase are expenditures in the Nursing Facilities and Intermediate Care Facilities for the Mentally Retarded (ICF/MR) categories.

The categories with large rates of increase reflect an increase in the medical inflation rate (this is especially true for prescription drugs) and a strong rate of growth for the Medicaid and Disability Assistance (DA) caseloads. The total number of Medicaid eligibles in June 2003 was 1,592,929, an increase of over 108,000 (or 7.3%) since June 2002. The number of Covered Families and Children (CFC) recipients stands at about 1,187,000, while the number of Aged, Blind, and Disabled (ABD) recipients is now a little over 406,000. Although greatly outnumbered by the CFC population, the ABD population accounts for over 70% of all Medicaid expenditures.

TANF. The state's portion of the TANF program that is expended from the GRF is composed of funds from line item 600-410, TANF State, a portion of line item 600-413, Day Care Match/MOE, and a portion of line item 600-321, Support Services. These are supplemented by General Services Fund 4A8, line item 600-658, Child Support Collection, and by county expenditures for part of the program's administrative costs.

At the end of June, year-to-date disbursement reports on line items 600-410 and 600-413 show a negative disbursement variance of approximately $8,000. Total FY 2003 disbursements from these two components of Ohio's TANF Maintenance of Effort (MOE) requirement were $372.7 million.

Table 6
FY 2003 to FY 2002 Comparison of Year-to-Date Health Care Spending
($ in thousands)

Service Category	FY 2003 Yr.-to-Date as of June '03	FY 2002 Yr.-to-Date as of June '03	Dollar Change	Percent Increase
Nursing Facilities	$2,331,438	$2,280,472	$50,966	2.23%
Payments	$2,591,745	$2,464,508	$127,237	5.16%
NF Franchise Fees Offset[1]	($260,307)	($184,036)	($76,272)	41.44%
ICF/MR	$408,925	$399,005	$9,920	2.49%
Payments	$429,244	$416,579	$12,665	3.04%
ICF/MR Franchise Fees Offset	($20,319)	($17,574)	($2,745)	15.62%
Inpatient Hospitals	$1,260,304	$1,099,141	$161,164	14.66%
Outpatient Hospitals	$537,138	$455,098	$82,041	18.03%
Physicians	$525,625	$470,003	$55,622	11.83%
Prescription Drugs	$1,522,255	$1,242,010	$280,246	22.56%
HMO	$661,634	$597,183	$64,450	10.79%
Medicare Buy-In	$147,007	$133,386	$13,621	10.21%
ODJFS Waiver[2]	$170,771	$162,477	$8,294	5.10%
All Other[3]	$775,535	$610,471	$165,064	27.04%
CHIP II[4]	$57,660	$47,106	$10,554	22.40%
DA Medical[5]	$94,243	$62,948	$31,295	49.71%
Total Health Care	**$8,492,535**	**$7,559,300**	**$933,235**	**12.35%**
DSH Offset	($136,354)	($116,557)	($19,797)	
Drug Rebates	($348,745)	($256,328)	($92,417)	
Prior Year Encumbrance	($83,539)	$1,547	($85,086)	
Total Health Care (Net of Offsets)	**$7,923,897**	**$7,187,963**	**$735,934**	**10.24%**
Est. Federal Share[6]	$4,613,307	$4,193,911	$419,396	
Est. State Share	$3,310,590	$2,994,052	$316,538	

1. Some of the money generated from nursing home franchise permit fees is used to make payments to nursing facilities to offset GRF nursing facilities spending. The NF franchise fee is $3.30 per bed per day in FY 2002 and is $4.30 per bed per day in FY 2003.
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 line item 600-525.
4. CHIP II, effective July 1, 2000, provides health care coverage for children under age 19 whose family incomes are between 150% and 200% of FPL. The state receives enhanced FMAP for CHIP II.
5. DA Medical is a state-only funded program.
6. For FY 2003 the FMAP is 58.83% and the enhanced FMAP is 71.18%. For FY 2002 the FMAP is 58.78% and the enhanced FMAP is 71.15%.

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

A total of $485.6 million was disbursed by the Department of Job and Family Services from federal TANF funds during FY 2003.

TANF cash assistance benefits paid during the fiscal year totaled $312.4 million, down slightly from $316.9 million in FY 2002. The average number of TANF cash assistance groups per month increased from FY 2002 to FY 2003 by 253 to stand at about 86,000, an increase of 0.3%. The average number of TANF recipients per month, however, decreased from FY 2002 to FY 2003 by 4,131 to stand at about 194,300, a decrease of 2.1%. How is it possible to have the number of assistance groups increase and at the same time to have the number of recipients decrease? This is the result of the increasing proportion of cases that is 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 a TANF recipient. These cases now make up 46.3% of all TANF cases. The number of "child only" cases has increased from approximately 25,000 in 1991 to approximately 39,000 at the present time.

Job and Family Services. FY 2003 disbursements for the Department's operating expenses and subsidy programs (which are captured in the "Other Welfare" subcategory in Tables 4 and 5 and which exclude Medicaid, TANF, and Disability Assistance and are tracked as separate components of the Welfare and Human Services program category) were $60.7 million under the estimate. Budget reductions totaling $13.1 million were ordered in January and March and thus are not reflected in the disbursement estimates. Total FY 2003 budget reductions for the Department were $70.1 million.

Line item 600-416, Computer Projects, with a negative variance of $21.2 million ($13.5 million of this variance involves current year funds) was the largest single item contributing to the category's negative disbursement variance for the year. The spending underestimate in line item 600-416 is traceable to projects being converted to state staff support only, equipment freezes, and changes in timelines and rollout schedules. These steps are the result of a reduction in line item 600-416 by an additional $7.8 million in the January and March rounds of budget reductions. (Another $2.8 million was transferred from this line item by the Controlling Board to line item 600-525, Health Care/Medicaid in early June.) As of June 30, line item 600-416 had $33.7 million in outstanding encumbrances.

Contributing $14.2 million to the negative disbursement variance for the year was line item 600-321, Support Services. This line item was reduced by an additional $1.4 million in the second and third-round of budget reductions. (The Controlling Board also transferred $3.6 million from line item 600-321 to line item 600-525.) The Department encumbered $11.2 million of this line item, approximately $8.0 million of which is to used for the local operations transition.

Line item 600-528, Adoption Services, was also a significant contributor to the negative disbursement variance for the year. The under spending in Adoption Services, which amounted to $7.4 million, stemmed in large part from a lower than expected rate of growth in the program.

Mental Health. The Department of Mental Health finished FY 2003 with a negative disbursement variance of $14.3 million for the year. Of this total, $7.9 million is traceable to budget reductions ordered after the estimates were prepared. Three line items account for 93.7% of the year's variance. These are: line item 334-408, Community and Hospital Mental Health Services ($5.3 million); line item 335-502, Community Mental Health Programs ($5.3 million); and line item 335-508, Services for Severely Mentally Disabled.

Health. The Department of Health posted a negative disbursement variance of $6.3 million. Of this total, $1.9 million stems from the second and third rounds of budget cuts that were not included in the estimates. The line item with the largest negative variance ($3.3 million) was 440-418, Immunizations. Encumbered from this line item was $5.6 million. Approximately $0.9 million of the negative disbursement variance is traceable to line item 440-453, Health Care Facility Protection and Safety, which pays expenses for nursing home survey, certification, and licensure activities, adult care facility licensing and regulation, and certification and enforcement of nurse aide training activities. Within these purposes more work eligible for federal funding was claimed, thus using less state funds than had been anticipated.

Mental Retardation and Developmental Disabilities. For FY 2003, the Department of Mental Retardation and Developmental Disabilities posted a negative disbursement variance of $5.8 million. This variance is wholly traceable to second and third-round budget reductions of $7.9 million that are not included in the estimates. There are two notable line items that account for the bulk of the variance. Line item 322-413, Residential and Support Services, registered a negative disbursement variance of $10.9 million; $6.0 million of this amount stemmed from these budget reductions, and the remainder was encumbered. Line item 322-413 funds residential services including, among other things, the Supported Living program and the GRF share of two home and community-based Medicaid waivers. Line item 322-501, County Boards Subsidies, is used to subsidize the basic operating expenses of the state's county boards of mental retardation. This line item posted a negative disbursement variance of $4.4 million, which is encumbered.

**LSC colleagues who contributed to the development of this disbursement report included, in alphabetical order, Sara Anderson, Melaney Carter, Ivy Chen, Phil Cummins, Sean Fouts, Erin Jones, Jonathan Lee, Chris Murray, Jeremie Newman, Laura Potts, David Price, Ruhaiza Ridzwan, Wendy Risner, Carol Robison, Joseph Rogers, Maria Seaman, Jamie Slotten, Kerry Sullivan, Zak Talarek, Allison Thomas, Clay Weidner, and Holly Wilson.*

Lottery Profits Quarterly Report

FOURTH QUARTER LOTTERY TICKET SALES AND PROFITS TRANSFERS

— Jean Botomogno

Ticket Sales

The Ohio Lottery made no substantial changes to its games in FY 2003. The year ended the way it started, with good one-month sales of Mega Millions. It was the first full year this multistate game was played in Ohio. The last major changes in the Ohio Lottery games were made during the fourth quarter of FY 2002, when the number of weekly drawings for Buckeye 5 increased from four to six days in April 2002 and Mega Millions started in May 2002. Table 1 summarizes Lottery ticket sales by game in the fourth quarter of FY 2003. It shows total ticket sales in the quarter were $521.1 million and Instant ticket sales were $266.6 million, 51.2% of quarterly sales. On-line ticket sales were $254.5 million, 4.5% lower than Instant ticket sales. Mega Millions ticket sales in June were more than double those in April or May 2003.

Table 1: Fourth-Quarter Ticket Sales by Game, in millions of dollars

	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	Instants	On-line	Total
April	$33.6	$12.9	$2.7	$6.0	$17.4	$10.1	$85.9	$82.6	$168.5
May	$35.2	$13.8	$2.2	$6.5	$12.9	$11.1	$93.5	$81.7	$175.2
June	$30.6	$12.0	$2.1	$5.4	$12.6	$27.4	$87.2	$90.1	$177.4
Total	$99.3	$38.7	$6.9	$17.9	$42.9	$48.7	$266.6	$254.5	$521.1

Totals may not add up due to rounding.

Pick 3 sales were 19.1% of sales in the fourth quarter. Super Lotto sales were 8.2% and Mega Millions 9.3% of ticket sales. Pick 4, Buckeye 5 and Kicker contributed to total sales 7.4%, 1.3%, and 3.4%, respectively.

Compared to the same quarter a year ago, total ticket sales decreased $1.0 million, or 0.2%. Instant ticket sales improved $20.4 million, up 8.2%. On-line ticket sales were down $21.4 million or 7.7%. Only Pick 4 and Mega Millions had better sales in the fourth quarter of FY 2003 than in the same period a year ago. However, Mega Millions operated for only half of the quarter last year. Super Lotto sales declined $45.0 million or 51.2%. Kicker sales declined $5.2 million or 42.9%. Buckeye 5 sales declined $6.5 million or 47.6%. Pick 3 receipts declined $1.6 million or 1.6%. Pick 4 revenues were up $0.6 million or 1.7%.

Table 2 shows quarterly ticket sales in FY 2003. Ticket sales were $486.6 million in the first quarter and then increased to $538.4 million in the second quarter on the strength of "Holiday" Instant ticket sales. Ticket sales dropped 5.6% to $508.5 million in the third quarter and increased 2.5% to $521.1 million in the fourth quarter. For the fiscal year, Pick 3 provided 19.6% of total ticket sales. Mega Millions was 8.6% of total sales. Super Lotto provided 7.8% of total ticket sales. Pick 4 contributed 7.5% of total ticket sales. Buckeye 5 and Kicker sales were 3.4% and 1.3% of total ticket sales, respectively. Instant tickets sales were 51.8% and On-line ticket sales were 48.2% of total ticket sales.

Table 2: Quarterly Lottery Ticket Sales by Games in FY 2003, in millions of dollars									
	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	Instants	On-line	Total
Q1	$98.7	$37.3	$7.0	$17.4	$40.1	$54.0	$231.3	$254.5	$486.6
Q2	$101.5	$39.1	$6.9	$16.9	$40.8	$36.3	$296.9	$241.5	$538.4
Q3	$102.3	$39.0	$6.5	$16.7	$37.0	$37.2	$269.7	$238.8	$508.5
Q4	$99.3	$38.7	$6.9	$17.9	$42.9	$48.7	$266.6	$254.5	$521.1
Total	$401.9	$154.2	$27.3	$68.9	$160.8	$176.2	$1,064.5	$989.3	$2,054.6

Totals may not add up due to rounding.

Transfers to the Lottery Profits Education Fund

Table 3 summarizes quarterly transfers to the Lottery Profits Education Fund (LPEF) in FY 2003. Fourth-quarter transfers were $151.6 million, up 1.7% from $149.1 million in the third quarter, and were down 5.3% from $160.1 million in the second quarter. Transfers in the fourth quarter were $5.1 million lower than projected transfers, increasing the cumulative shortfall to $31.3 million, up from $26.3 million at the end of the third quarter. The cumulative shortfall in the amount transferred from operations required a one-time $30.0 million disbursement from the Lottery Profits Reserve Fund to LPEF.[1] Quarterly transfers as a percentage of sales were all below 30.0% in FY 2003. For the fiscal year, transfers from operations were about 29.5% of ticket sales.

Table 3: Lottery Ticket Sales and Transfers to LPEF in FY 2003, in millions of dollars						
Quarter	Ticket Sales	Actual Transfers	Projected Transfers	Dollar Variance	Percent Variance	Transfers as a Percent of Sales
Q1	$486.6	$145.5	$150.3	-$4.8	-3.2%	29.9%
Q2	$538.4	$160.1	$163.5	-$3.4	-2.1%	29.7%
Q3	$508.5	$149.1	$167.1	-$18.0	-10.8%	29.3%
Q4	$521.1	$151.6	$156.8	-$5.1	-3.3%	29.1%
Total	$2,054.6	$606.4	$637.7	-$31.3	-4.9%	29.5%

Totals may not add up due to rounding.

Year in Review

After a decline of 10.7% in FY 2001, lottery ticket sales rose 3.2% in FY 2002 and 3.6% in FY 2003. Table 4 compares ticket sales per game, as well as dollar and percentage variances for each game, between FY 2002 and FY 2003. Total ticket sales in FY 2003 were $2,054.6 million, $71.5 million or 3.6% higher than FY 2002 ticket sales. Most of the increase in ticket sales was due to improved Instant ticket sales. Compared to sales a year ago, Instant ticket sales surged $67.0 million or 6.7%. Increased payout rates (decreased profit rates) were one factor in the sales increase.

On-line Ticket Sales

On-line ticket sales increased only $3.7 million or 0.4%. Among On-line games, only Buckeye 5 gained over the previous year, increasing $6.5 million or 10.5% from an extra two drawings per week in FY 2003. Kicker sales declined $17.8 million or 39.5%. Super Lotto sales declined $137.0 million or 46.0% as Mega Millions depressed sales for this similar game. Pick 4 sales, at $154.2 million, were just about the same as in FY 2002. Pick 3 sales declined $7.4 million or 1.8%.

Previous Next

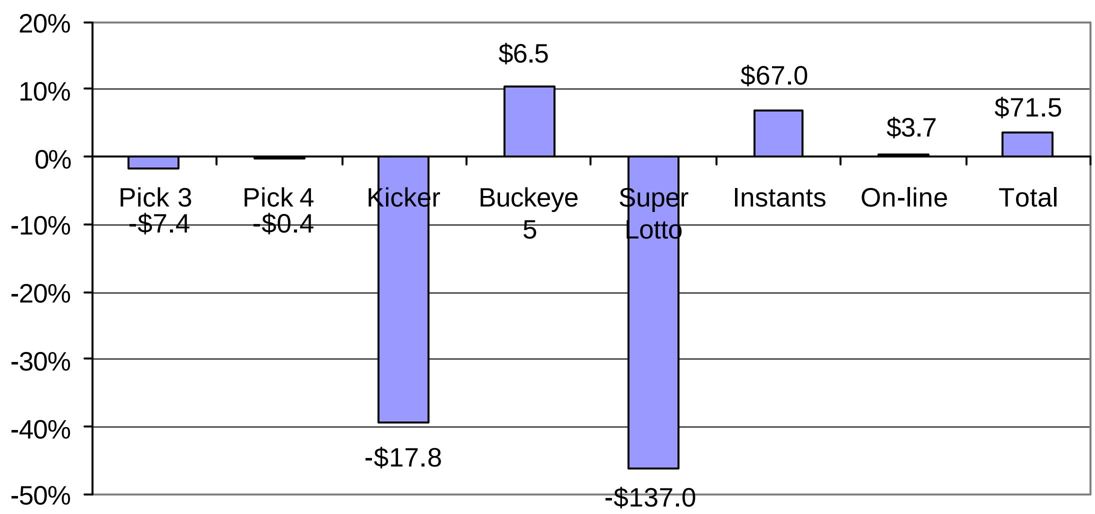
Table 4: Ticket Sales by Games in FY 2003 and FY 2002, in millions of dollars									
Year	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	Instants	On-line	Total
FY 2003	$401.9	$154.2	$27.3	$68.9	$160.8	$176.2	$1,064.5	$989.3	$2,054.6
FY 2002	$409.2	$154.6	$45.0	$62.4	$297.9	$16.5	$997.5	$985.6	$1,983.1
$ Variance	-$7.4	-$0.4	-$17.8	$6.5	-$137.0	$159.7	$67.0	$3.7	$71.5
% Variance	-1.8%	-0.3%	-39.5%	10.5%	-46.0%	968.0%	6.7%	0.4%	3.6%

Totals may not add up due to rounding.

Sale of Instant Tickets

The sale of Instant tickets as a share of total ticket sales inched up to 51.8% in FY 2003, up from 50.3% in FY 2002. Instant ticket games have lower profit margins (or higher payout ratio) than On-line games. The payout ratio for Instant tickets was about 66.4% in FY 2003 (year to date as of April 2003), higher than the 63.2% recorded in FY 2002. On-line games' average payout ratio was about 51.7% (year to date as of April 2003), compared to 51.2% in FY 2002. Put another way, for every $100 in Instant tickets sold, $66.4 is distributed back to the players. For an identical sale of On-line games, $51.7 is paid out to the players. For a particular level of total lottery ticket sales, for example, $100 in total lottery ticket sales, an increase in the share of Instant tickets sales relative to total ticket sales generally decreases the profitability of Lottery operations. The graph below describes the contribution of various games (excluding Mega Millions)[2] to the increase in total ticket sales in FY 2003 and gives the percentage change in sales from FY 2002 for each game.

Dollars (in millions) and Percentage Change in Sales of Selected Games, FY 2002 to FY 2003



Super Lotto, Kicker, and Mega Millions Ticket Sales

The Ohio Lottery joined Mega Millions on May 15, 2002. Super Lotto ticket sales were expected to decline because its top prize would become less "exciting" to players, and some players would substitute Mega Millions tickets for Super Lotto tickets. Also, Kicker sales would decrease because players cannot purchase Kicker separately from Super Lotto. These losses in Super Lotto and Kicker sales would be more than compensated by ticket sales of Mega Millions. Table 5 provides a detailed analysis of selected ticket sales in FY 2003 and

Table 5: Changes in Selected Lottery Ticket Sales from Mega Millions (millions of dollars)				
	FY 2003	FY 2002	Dollar Variance	Percent Variance
July	$39.2	$45.6	-$6.4	-14.1%
August	$34.3	$26.0	$8.3	32.0%
September	$27.6	$25.0	$2.6	10.3%
October	$31.4	$20.7	$10.7	51.8%
November	$28.1	$18.9	$9.1	48.3%
December	$24.5	$30.1	-$5.6	-18.7%
January	$27.4	$24.6	$2.7	11.1%
February	$28.3	$20.8	$7.5	36.1%
March	$25.0	$31.3	-$6.2	-20.0%
April	$30.1	$62.1	-$32.0	-51.5%
May	$26.3	$28.1	-$1.8	-6.4%
June	$42.1	$26.4	$15.7	59.3%
Total	$364.3	$359.6	$4.7	1.3%

FY 2002 and illustrates changes brought about by the multistate game. Fiscal year 2002 monthly sales are primarily sales of Kicker and Super Lotto games.[3] Fiscal year 2003 sales are aggregate sales of Kicker, Super Lotto and Mega Millions games.

Table 5 shows an increase of $4.7 million or 1.3% in ticket sales from entry into Mega Millions. Mega Millions sales were below expectations. The Ohio Lottery expected that Mega Millions would generate at least $50 million each quarter. Only in the first quarter did Mega Millions sales achieve this level with $54.0 million in sales. For the remaining three quarters in FY 2003, Mega Millions sales were below $50.0 million, although the tally was close in the fourth quarter with $48.7 million in sales. Super Lotto and Kicker sales were also expected to decline with the start of Mega Millions with about 20.0% to 25.0% in lost sales. However, the magnitude of the declines (46.0% for Super Lotto and 39.5% for Kicker) was unanticipated.[4]

In FY 2003, despite higher total ticket sales than the year before, the overall profitability of Lottery operations was hurt by a combination of less than expected Mega Millions sales, higher Instant ticket sales with a higher payout ratio (66.4% in FY 2003 and 63.4% in FY 2002), and a higher than anticipated decline in Super Lotto and Kicker sales.

Table 6 shows ticket sales, actual and projected transfers from operations, and transfers as a percentage of ticket sales from FY 2000 through FY 2003. Transfers from operations in FY 2003 were $606.4 million, $3.7 million or 0.6% less than in FY 2002. Transfers from operations have declined each of the last four years, down from $661.0 million in FY 2000. Transfers from operations have declined 14.5% from a high of $713.5 million in

Table 6: Tickets Sales and Transfers from Operations to LPEF, FY 2000 to FY 2003 (millions of dollars)						
	Ticket Sales	Actual Transfers	Projected Transfers	Dollar Variance	Percentage Variance	Transfers as Percentage of Sales
FY 2000	$2,150.4	$661.3	$661.0	$0.3	0.0%	30.7%
FY 2001	$1,920.0	$612.0	$665.2	-$53.2	-8.0%	31.9%
FY 2002	$1,983.1	$610.1	$608.7	$1.4	0.2%	30.8%
FY 2003	$2,054.6	$606.4	$637.7	-$31.3	-4.9%	29.5%

FY 1996 to $606.4 million in FY 2002. Transfers from operations are supplemented each year by amounts from the Unclaimed Lottery Prizes Fund or the Deferred Prizes Trust Fund. In FYs 2000, 2001 and 2002, $25.0 million from these nonoperating sources was added each year to profits from operations and transferred to LPEF. In FY 2003, $35.0 million from nonoperating sources was transferred to LPEF. Thus, total transfers to LPEF were $686.3 million in FY 2000, $637.1 million in FY 2001, $635.1 million in FY 2002, and $641.3 million in FY 2003.

Legislative changes affecting the Ohio Lottery in H.B. 95

Elimination of the Unclaimed Lottery Prizes Fund

Am. Sub. H.B. 95, the new biennial budget act, eliminated the Unclaimed Lottery Prizes Fund, as well as the power to conduct lotteries in order to disburse unclaimed prize awards, and required unclaimed prize awards to be returned to the State Lottery Fund. The act directs the Office of Budget and Management to transfer up to $7.5 million from the Unclaimed Lottery Prizes Fund (Fund 872) to the Lottery Profits Education Reserve Fund, and the remaining balances as of July 31, 2003 to the State Lottery Fund (Fund 044). As a result of this change, money from the Unclaimed Lottery Prizes Fund will no longer be available to supplement transfers from operations to the Lottery Profits Education Fund. Instead, any funds from nonoperating sources may be provided from the Deferred Prizes Trust Fund or the Lottery Profits Education Reserve Fund to shore up transfers when transfers from operations are insufficient to meet targets established during the budget process.[5]

Deduction of Debt Owed the State from Prizes

Am. Sub. H.B. 95 95 also requires the Ohio Lottery to deduct from lump sum or annual installment payments worth $5,000 or more any tax, workers' compensation premium, unemployment contribution or other penalties owed by the prize winner until the debt is satisfied.

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[1] Controlling Board approval on June 16, 2003. The remaining balance in the Lottery Profits Reserve Fund (Fund 018) is $8.5 million. A similar transfer occurred in FY 2001 to address a shortfall of about $53.0 million in projected transfers from operations.

[2] Mega Millions was excluded because the game started in May of FY 2002, giving comparison to prior year results little relevance.

[3] May and June sales in FY 2002 include Mega Millions sales of $6.3 million and $10.2 million, respectively.

[4] In a dollar-for-dollar substitution of sales, Mega Millions is more profitable than Super Lotto. Mega Millions' payout ratio is about 48% this fiscal year, while Super Lotto's payout ratio is much higher, about 64%. Thus, a dollar in ticket sales for Mega Millions that replaces a dollar Super Lotto sales earns the Ohio Lottery 16 cents in gross profits.

[5] Am. Sub. H.B. 94 (123rd General Assembly) removed a provision of law requiring that at least 30% of ticket sales be transferred to the Lottery Profits Education Fund (LPEF), thus allowing the State Lottery Commission greater flexibility in the design and the mix of games. Am. Sub. H.B. 94 also changed the manner in which the Commission transfers profits to LPEF. A target for such transfers is determined for each biennium during the legislative budget process.

Lottery Profits Education Fund Disbursements Fourth Quarter, FY 2003

¾ *Sara D. Anderson*

Lottery Profits Education Fund (LPEF) disbursements in FY 2003 totaled $672.7 million. Nearly this entire amount came from appropriation item 200-612, Base Cost Funding.

Base Cost Funding

The $637.0 million of lottery profits spending from 200-612, Base Cost Funding, was combined with GRF appropriation item 200-501, Base Cost Funding ($4,376.6 million), to fund the state school foundation aid program in FY 2003. This program provides the state's share of per pupil funding that guarantees $4,949.0 per pupil in state and local funding for FY 2003. The program also provides the state's share of additional special and career-technical education costs, known as weight cost funding. With the combination of GRF and LPEF money, base cost funding ($5,013.6 million) represented 56.4% of the Department of Education's disbursements in FY 2003.

The Department of Education requested that the Controlling Board transfer up to $38.4 million from the Lottery Profits Education Reserve Fund (LPERF), Fund 018, to the LPEF, Fund 017. Of that amount, $30.0 million was used to offset the shortage in lottery profits in FY 2003, leaving a balance of $8.4 million in the LPERF. Lottery profits for FY 2003 are analyzed in another article in this issue of *Budget Footnotes*.

Lease Rental Payments

Money from appropriation item 200-682, Lease Rental, is transferred to the School Facilities Commission to support GRF appropriation item 230-428, Lease Rental Payments. The funds are disbursed according to a schedule determined by the Director of Budget and Management.

SchoolNet Plus Supplement and SchoolNet Electrical Infrastructure

The projects funded by appropriation items SchoolNet Plus Supplemental and SchoolNet Electrical Infrastructure have been completed. A small obligation payable from these items was finally disbursed in FY 2003.

Table 1: FY 2003 LPEF (017) Appropriation/Disbursement Summary
As of June 30, 2003

Agency	Fund	Line Item	Line Item Name	FY 2003 Appropriation	FY 2003 Disbursement	Appropriation Encumbrance	Appropriation Balance
EDU	017	200-612	Base Cost Funding	$ 637,000,000	$ 637,000,000	$ 0	$ 0
EDU	017	200-682	Lease Rental	$ 35,722,600	$ 35,722,600	$ 0	$ 0
NET	017	228-603	SchoolNet Plus Supplement	$ 11,776	$ 10,676	$ 0	$ 1,100
NET	017	228-690	SchoolNet Electrical Infrastructure	$ 455,360	$ 0	$ 0	$ 455,360
			Total LPEF	**$ 673,189,736**	**$ 672,733,276**	**$ 0**	**$ 456,460**

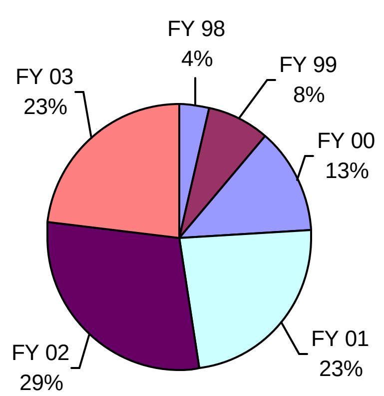
School Facilities Update

$646 MILLION SPENT ON SCHOOL FACILITIES IN FY 2003

— *Zak Talarek*

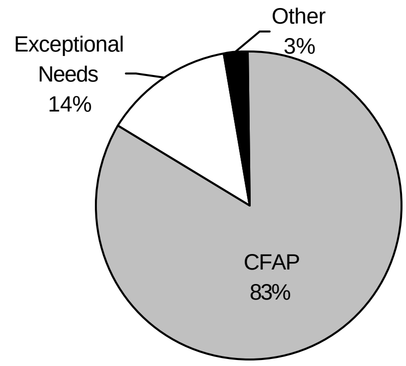
The School Facilities Commission (SFC) was created in 1997 by S.B. 102 of the 122nd General Assembly. Since its inception, the SFC has disbursed almost $2.8 billion and has received appropriations through FY 2004 of $3.6 billion. In FY 2003, SFC saw its disbursements decline by nearly 21%, from $814.0 million in FY 2002 to $646.0 million in FY 2003. According to the SFC, fewer districts have been accepted for participation in the Classroom Facilities Assistance Program in recent years. Among those districts that were accepted have been a number of urban districts. Because of the size of these districts, there is a longer lead time before building construction actually begins. In addition, unlike the situation with smaller districts, where the state contribution is disbursed before the local contribution, in the urban districts the state and local shares are disbursed at the same time during the project.

SFC Disbursements by Fiscal Year



Of the $646.0 million disbursed in FY 2003, $540.0 million was disbursed through the Classroom Facilities Assistance Program (CFAP). This was approximately $180.0 million, or 25.0%, less than the previous fiscal year. The Exceptional Needs Program disbursed $89.0 million in FY 2003, which was $8.0 million, or 9.0%, greater than the previous fiscal year. Of the remaining $17.0 million disbursed during FY 2003, approximately $12.0 million was disbursed through the "Big 8" program.

FY 2003 Disbursements



In May of 2002, the General Assembly passed S.B. 261, which transferred $345.0 million of tobacco settlement payments intended for the Education Facilities Trust Fund in FY 2002 and FY 2003 to the General Revenue Fund to help balance the state budget. To make up for the transfer, S.B. 261 authorized the issuance of bonds and appropriated $345.0 million in bond proceeds for the biennium beginning on July 1, 2002.

On the same day that S.B. 261 was passed, the General Assembly also passed S.B. 242, the tobacco settlement appropriations bill, which appropriated $148.4 million in tobacco settlement payments to the SFC for the CFAP. However, this appropriation was reduced by $122.8 million (to $25.6 million) in June of 2003 with the passage of H.B. 95, the operating budget act for FY 2004 and FY 2005. To make up for the loss of these funds, H.B. 95 made a capital appropriation to the SFC in the same amount, $122.8 million.

In December 2002, the SFC received an additional capital appropriation of $314.2 million for FY 2003

Previous

and FY 2004 in H.B. 675, the capital appropriations act of the 124th General Assembly. In addition, H.B. 675 created a new program to provide classroom facilities assistance to the 49 joint vocational school districts and allows the SFC to set aside up to 2% of its capital project appropriations each year for the program.

In FY 2003, 13 school districts were approved to participate in the CFAP, bringing the total served by this program to 113 school districts. Included in this fiscal year's group were the six remaining "Big 8" urban districts that had not yet entered the CFAP. (Canton and Youngstown had previously been approved for participation.) The table below lists both the state and local shares of the projects in the six urban school districts that were approved in FY 2003.

Two school districts were accepted to participate in the Exceptional Needs Program in FY 2003. Unlike the CFAP, where eligibility is based on an equity list developed by the Ohio Department of Education and the entire district's facility needs are addressed, the Exceptional Needs Program is designed to assist school districts with below average wealth in addressing the health and safety needs associated with a specific building. The state contribution for these two projects amounts to $45.0 million, or approximately 75.0% of the $61.0 million total cost. This brings the total number of school districts who have been served by the Exceptional Needs Program to 22.

In addition to these projects, the SFC approved 44 school districts for participation in the Expedited Local Partnership Program in FY 2003, increasing the total number of school districts served by this program to 104. Under this program, school districts are able to use local funds in order to begin their school facility projects before becoming eligible for the CFAP. Once the school district becomes eligible under the CFAP, the school district receives a credit for the local funds it spent against its required local contribution under the CFAP. The state contribution for these 44 projects is estimated to be $1.2 billion, or 59.0% of the total cost of $2.1 billion.

School District	State Share	% of Total	Local Share	% of Total
Akron	$408,983,204	59%	$284,208,000	41%
Cincinnati	$210,667,485	23%	$705,278,104	77%
Cleveland	$1,024,331,841	68%	$482,038,513	32%
Columbus	$394,826,238	29.5%	$942,932,465	70.5%
Dayton	$297,810,839	61%	$190,403,000	39%
Toledo	$614,319,229	77%	$183,498,000	23%