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Budget Footnotes

A NEWSLETTER OF THE OHIO LEGISLATIVE SERVICE COMMISSION — JULY 2004

FISCAL OVERVIEW

— *Allan Lundell*

FY 2004 started with economists predicting (for the third straight year) a stronger national economy in the second half of the year. This year, the recovery that always seemed to be "six months away" finally appeared. For much of the fiscal year there were improvements in most economic indicators, with the major exception of employment. Employment was considered to be the last remaining piece of the recovery puzzle because employment gains were necessary for the recovery to become self-sustaining. Total employment increased for the first time in seven months in September and enjoyed modest increases until March. The March employment increase of 353,000 was followed by increases of 324,000 in April and 235,000 in May before slowing to an increase of "only" 112,000 in June.

The pace of U.S. economic activity appears to have decelerated in June. Employment growth was lower than in the three preceding months, consumer spending slowed, and industrial production fell. Although economic activity has slowed, it is not slow. The economy is still growing, but the pace of growth is at a lower, more sustainable rate that could be better characterized as expansion rather than recovery. Throughout the fiscal year, the Ohio economy lagged the national recovery. The lag is thought to be in large part due to Ohio's greater than average reliance on manufacturing.

For June, total General Revenue Fund (GRF) revenue of $2,622 million was $177 million above the revised estimate. Tax revenues were $191 million above estimate. Revenues from the personal income tax were $155 million above estimate, but revenues from the sales and use tax were $60 million below estimate. Total

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

	Month of June	Fiscal Year 2004	Last Year	Difference
Beginning Cash Balance	-$169.3	$396.5		
Revenue + Transfers	$2,622.3	$24,030.8		
Available Resources	$2,453.0	$24,427.3		
Disbursements + Transfers	$1,919.8	$23,894.2		
Ending Cash Balances	$533.1	$533.1	$396.5	$136.6
Encumbrances and Accts. Payable		$375.6	$344.2	$31.4
Unobligated Balance		**$157.5**	**$52.3**	**$105.2**
BSF Balance		$180.7	$180.7	$0.0
Combined GRF and BSF Balance		**$338.2**	**$233.0**	**$105.2**

GRF revenue for June was boosted by a $235 million transfer from the Tobacco Master Settlement Agreement Fund made on June 30, the last day of FY 2004. Total GRF disbursements (including transfers out) of $1,920 million were $58 million above estimate. Spending for primary and secondary education was above estimate by $64 million and property tax relief was $56 million greater than estimate. Disbursements in the Health Care/Medicaid category were $40 million less than estimate.

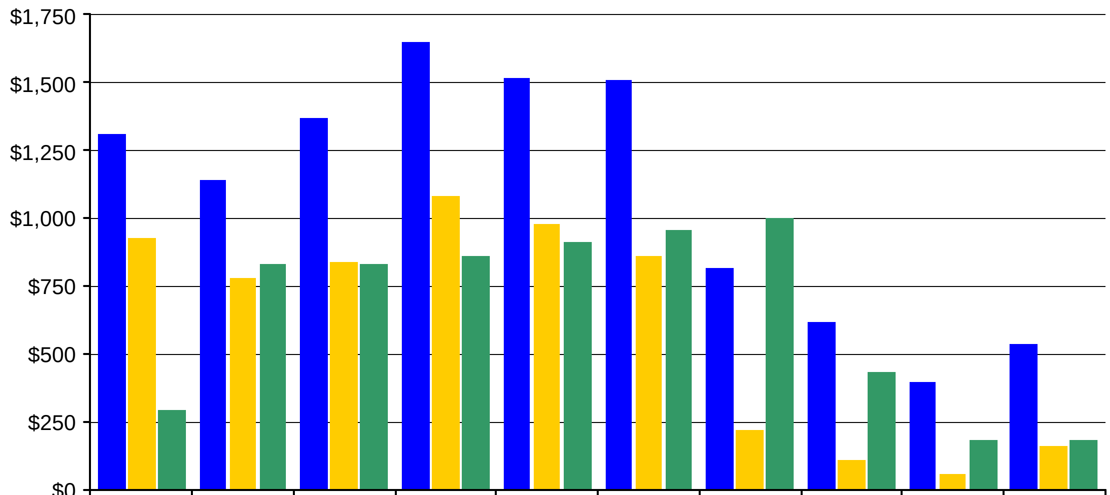
For the fiscal year, total GRF revenue of $24,031 million was $174 million above the revised estimate. Total tax revenue of $17,737 million was $159 million above the revised estimate. Total GRF revenue was up $1,581 million (7.0%) compared to FY 2003. The revenue growth was due to the increase in the state sales tax rate and an increase in federal grants. If revenue from the sales tax and federal grants is subtracted from total GRF revenue, the resulting state-source revenue from sources other than the sales tax was down $95 million (0.9%) compared to FY 2003.

FY 2004 GRF disbursements of $23,894 million were $138 million below estimate. Disbursements for primary and secondary education were $61 million above estimate and disbursements for welfare and human services were $104 million below estimate. Disbursements for Healthcare/Medicaid were $4 million below estimate. FY 2004 total disbursements were up 5.4% compared to FY 2003.

As shown in Table 1, the GRF began June with a negative cash balance of -$169 million. Revenue, including transfers in, for June was $2,622 million. Disbursements, including transfers out, were $1,920 million. The monthly surplus of $702 million brought the ending cash balance to $533 million. The ending cash balance is larger than anticipated. If revenues and disbursements had met their revised estimates, the ending cash balance would have been $221 million, $312 million lower than the actual level.

The ending cash balance of $533 million is $137 million higher than a year ago.[1] Encumbrances of $376 million combine with the cash balance to yield an unobligated balance of $158 million, which is $105 million higher than a year ago. Looking at the ending cash balance and the unobligated balance indicates that the state's financial situation in terms of current-year

Chart 1: Fiscal Year-End Balances
(in millions)



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Cash	$1,312.2	$1,138.5	$1,367.7	$1,649.0	$1,512.5	$1,506.2	$817.1	$619.2	$396.5	$533.1
Unobligated	$928.0	$781.3	$834.9	$1,084.4	$976.8	$855.8	$219.4	$108.3	$52.3	$157.5
BSF	$293.1	$828.3	$828.3	$862.7	$906.9	$953.3	$1,002.5	$427.9	$180.7	$180.7

performance improved compared to a year ago. The $181 million balance in the Budget Stabilization Fund (BSF) is the same as a year ago, so the combined GRF and BSF balance of $338 million is $105 million higher than it was a year ago. If one looks at the combined GRF and BSF balance, the state's financial situation in terms of ability to withstand an economic shock also improved from a year ago but remains far from robust. Chart 1 presents the year-end GRF cash, GRF unobligated, and BSF balances for the past ten fiscal years. The improvement in the state's financial situation from FY 2003 to FY 2004 is evident, but also evident is how weak the current financial situation looks in comparison to the years before the 2001 recession.

[1] An incorrect cell reference in the spreadsheet used by LSC to create Table 1 resulted in the reporting of the wrong amounts in the "Last Year" column in the previous editions of *Budget Footnotes* for FY 2004.

TRACKING THE ECONOMY

¾ Phil Cummins

The economic expansion paused in June. The slowdown may be temporary, related to transitory influences such as weather, and follows rapid increases earlier. Employment growth in June was slower than in the previous three months. Purchasing managers surveyed indicated that the expansion is continuing, though increases in several measures of activity were less widespread in June than in May. Industrial production fell last month after sizable gains earlier in the second quarter. Retail sales slowed in June. Inflation eased last month. The producer price index for finished goods declined. The consumer price index rose more slowly than in May, and consumer prices excluding food and energy increased at the lowest rate since December. As had been widely anticipated, the central bank at the end of June raised its target short-term interest rate.

The rise in gross domestic product (GDP) in this year's first quarter was revised downward from a 4.4% annual rate to 3.9%, close to the 4.1% rate of advance in last year's fourth quarter. GDP growth is shown in Chart 1. In the second quarter of 2004, consumer spending growth slowed. Business equipment production rose further. Construction spending strengthened. When the United States Bureau of Economic Analysis, the source of official GDP estimates, releases figures for the second quarter on July 30, it will also revise figures for earlier quarters and years back to 2001. The GDP history is revised annually to incorporate information received too late for inclusion in monthly estimates of each previous quarter.

Employment Slowdown

Total nonfarm payroll employment nationwide rose only 112,000 in June, after larger increases totaling more than 900,000 in the previous three months. Unemployment in June remained at 5.6% of the labor force, its level in five of the last six months. Nonfarm payrolls have risen 1.5 million since the low point in August 2003, recovering more than half of the decline of 2.7 million jobs following the peak in 2001, as shown in Chart 2. But the slower increase in June, along with declines in hours worked and in the number of industries with rising employment, is an indication that economic expansion was not as robust as earlier this year.

Ohio nonfarm payroll employment fell 14,300 from May to June, to 17,800 below a year earlier. The cyclical low point for employment in Ohio

Chart 1: Gross Domestic Product

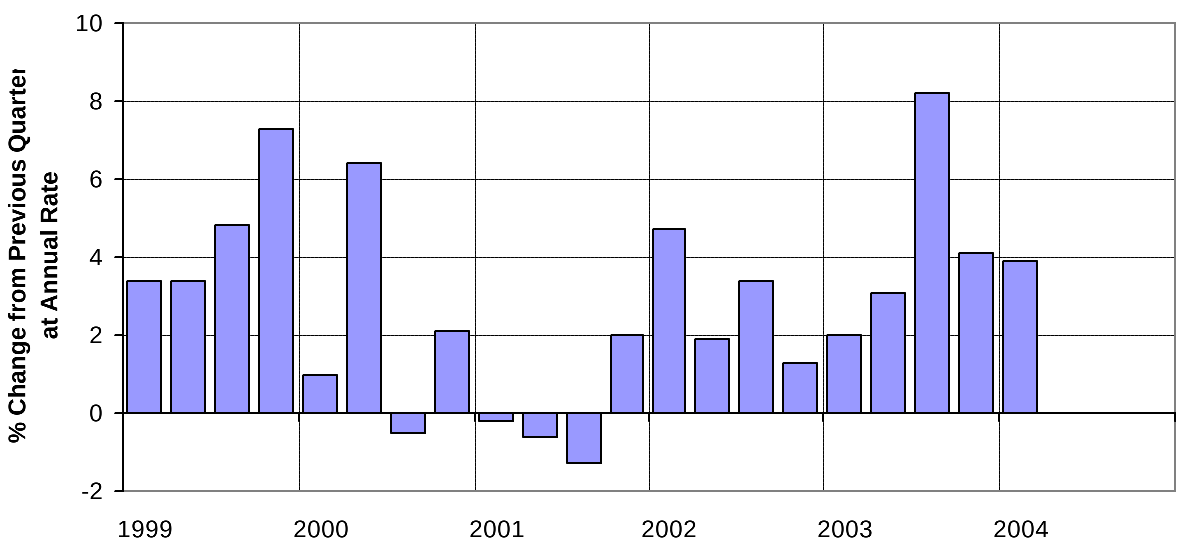
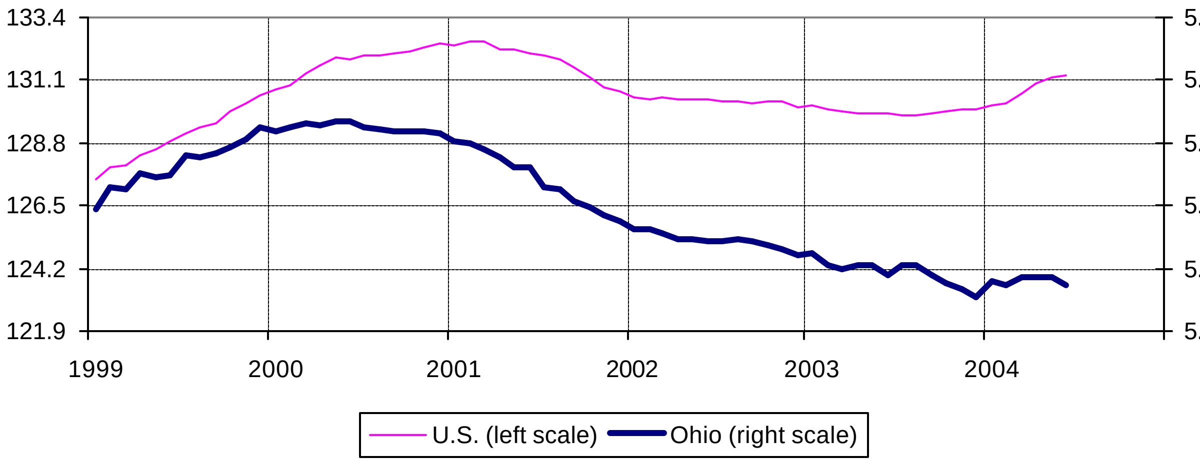


Chart 2: Nonfarm Payroll Employment
Millions, Seasonally Adjusted



was in December 2003, but the net increase since then was only 17,600 persons. Total nonfarm payroll employment in Ohio is shown in Chart 2. Declines in employment in June were widespread among both goods-producing industries and services-producing industries. Statewide unemployment rose in June to 5.8% of the labor force, from 5.6% in May.

Factory employment nationwide, shown in Chart 3, has risen in most months since January, but the increase has been quite small, totaling 64,000 out of more than 14 million workers. The all-time peak for U.S. manufacturing employment was nearly 20 million workers in 1979. Ohio factory employment in June declined 3,400, to 21,100 below a year earlier. At 824,700, manufacturing employment in Ohio was at a new low for this cycle and appears to be at its lowest level since 1940.[1] The peak for manufacturing employment in Ohio was 1.5 million employees in 1969.

Chart 4 updates a chart that appeared in this report last March. The chart shows the share of the civilian population age 16 and older, sometimes referred to as the working age population, that is either employed or actively looking for work but

Chart 3: Manufacturing Employment
Millions, Seasonally Adjusted

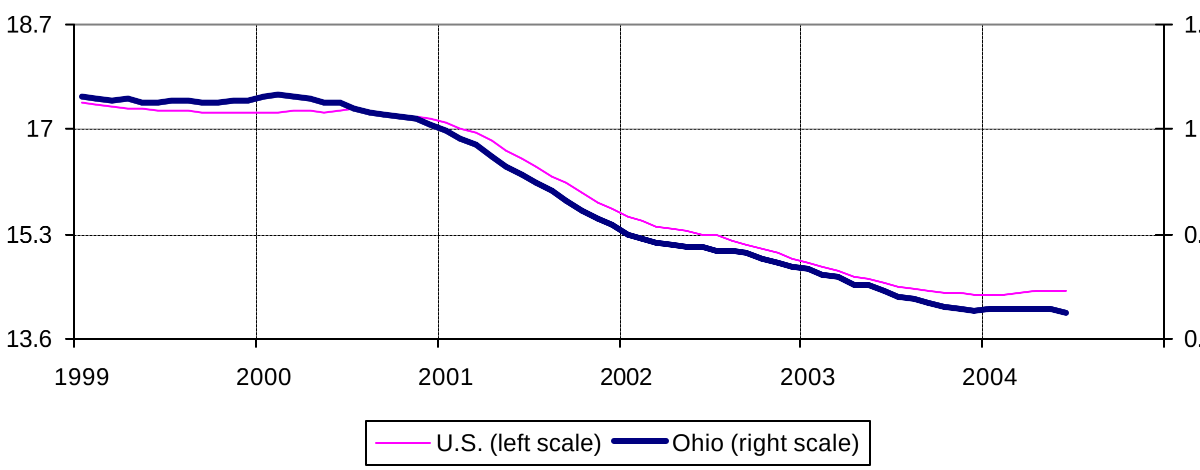
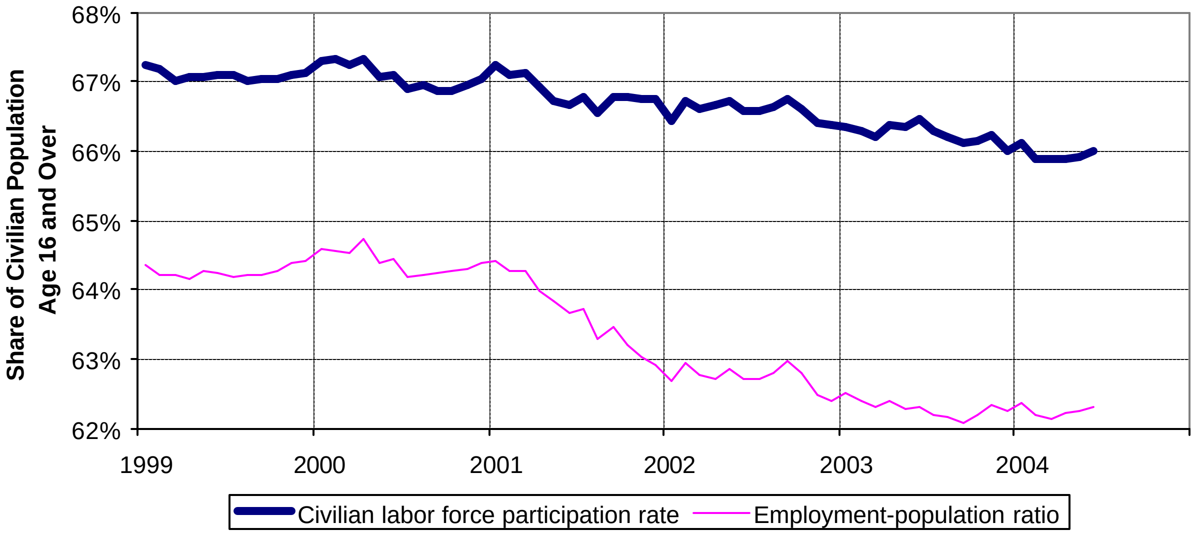


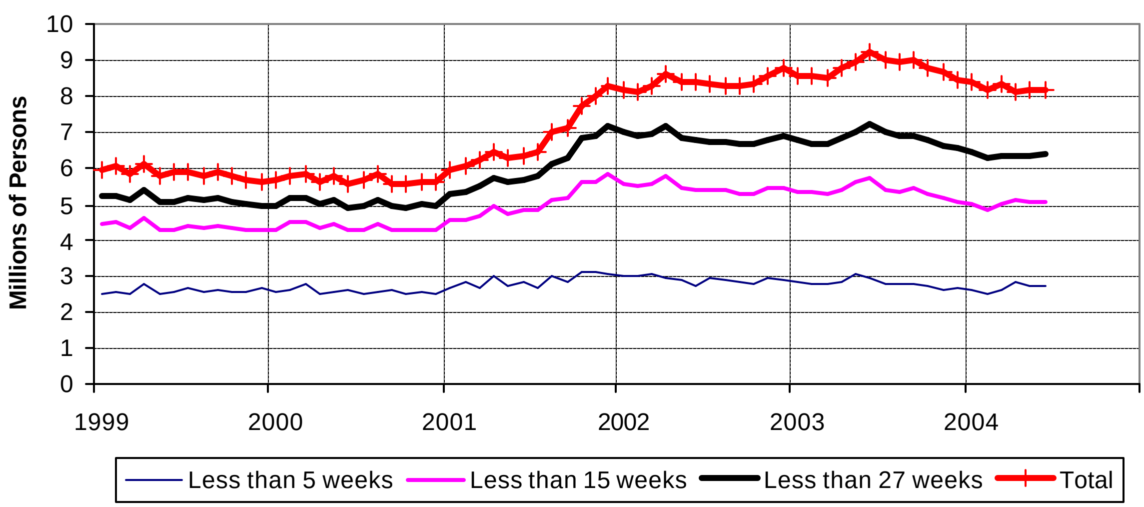
Chart 4: Labor Force Participation and Employment



not employed, and so considered to be in the labor force. The gap between the lines for the share of the working age population that is employed and the share that is in the labor force represents the unemployed. When employment is scarce and the share of the population that is employed declines, some of those persons who are no longer employed choose not to look for jobs. Similarly, some persons previously not in the labor force, who might in a stronger labor market have sought and found work, choose to remain out of the labor force and not to seek jobs. Recently, with the economy expanding, the share of the population that is employed has risen but remains well short of prerecession levels, as shown in Chart 4. Hypothetically, if the labor force participation rate in June 2004 was as high as in June 2003, more than a million additional people would have been active in the labor market. Unless higher employment absorbed some portion of these assumed additional labor market participants, the unemployment rate currently would match the high for this cycle of 6.3% in June 2003. That the actual unemployment rate in June 2004 was instead 5.6% can be attributed to lower labor force participation than a year ago.

With stronger economic recovery in the past year, the number of long-term unemployed nationwide has declined. Persons unemployed 27

Chart 5: Duration of Unemployment
Seasonally Adjusted



weeks or more in June, at fewer than 1.8 million, were at the lowest level since early 2003. Long-term unemployment tripled between 2000 and 2003, as shown in Chart 5, and remains high.

Factory Production Slowed in June

Industrial production fell 0.3% from May to June. The drop was mainly due to a 2.3% decline in utility output as temperatures returned to more seasonable levels after being above normal in May. Manufacturing output fell 0.1% last month. Production of motor vehicles and parts fell 2.5%, and output in several other industry groups registered smaller declines, largely offset by increases elsewhere. Despite the June slowdown, rapid increases earlier imply that factory output in the second quarter was up from the first quarter at a robust 7.1% annual rate.

Manufacturers' new orders slowed in April and May, but the latest drop in this volatile series followed sharp increases earlier. Year-to-date factory orders were 10% higher than a year earlier. Trends in manufacturers' new orders are shown in Chart 6. Order backlogs have grown 8% since reaching a cyclical low at the beginning of 2003. These uptrends in factory orders and backlogs can be expected to support growing production in the months ahead.

Purchasing managers at manufacturers nationwide again reported expanding business activity in June, with more of them noting increases than declines in production, orders, backlogs, and employment, accompanied by widespread price increases. Factory inventories increased, in the Institute for Supply Management report, for the first time in over four years. But the difference, for all of these measures except inventories, between the number of respondents reporting increases and the number reporting decreases was smaller than in May. Purchasing managers in the nonmanufacturing sector said business activity, orders, backlogs, and employment were rising in June. Indications of rising business activity were less widespread in June than in May, but unlike the manufacturing report, increases in the other measures were more widespread than the month before. Prices paid increased for many products, and several types of goods were in short supply.

Consumer Spending Slowdown

Retail sales nationwide fell 1.1% from May to June. The drop mainly resulted from slower unit sales of cars and light trucks, but retail sales excluding motor vehicles were down 0.2%. April and May sales were revised downward. In part, the June slowdown in retail sales, measured in dollars, probably reflects lower prices last month, notably for gasoline. Sales at gasoline stations fell 0.9%. But sales were soft in some other sectors, such as at general merchandisers.

Chart 6: Manufacturers' New Orders
Seasonally Adjusted

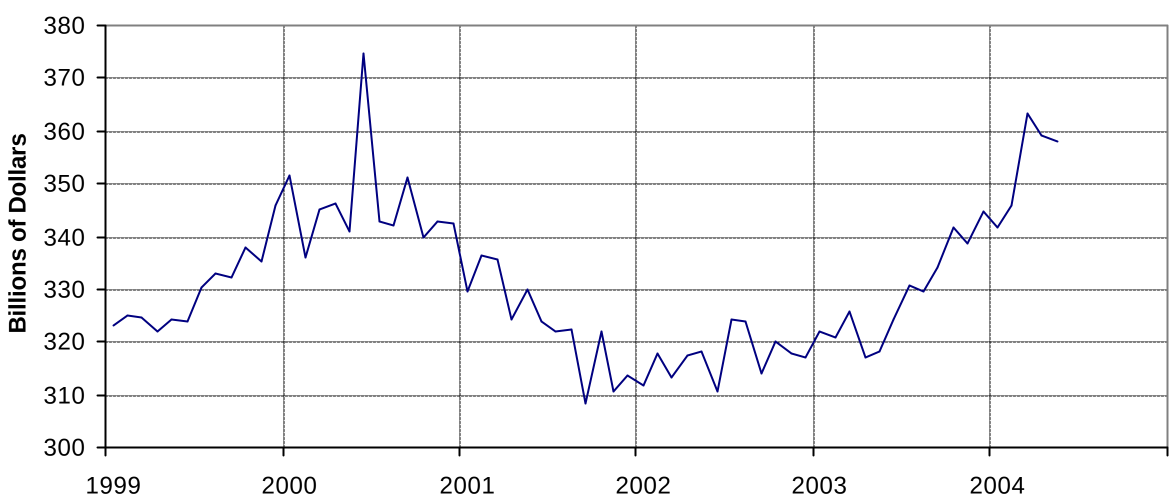
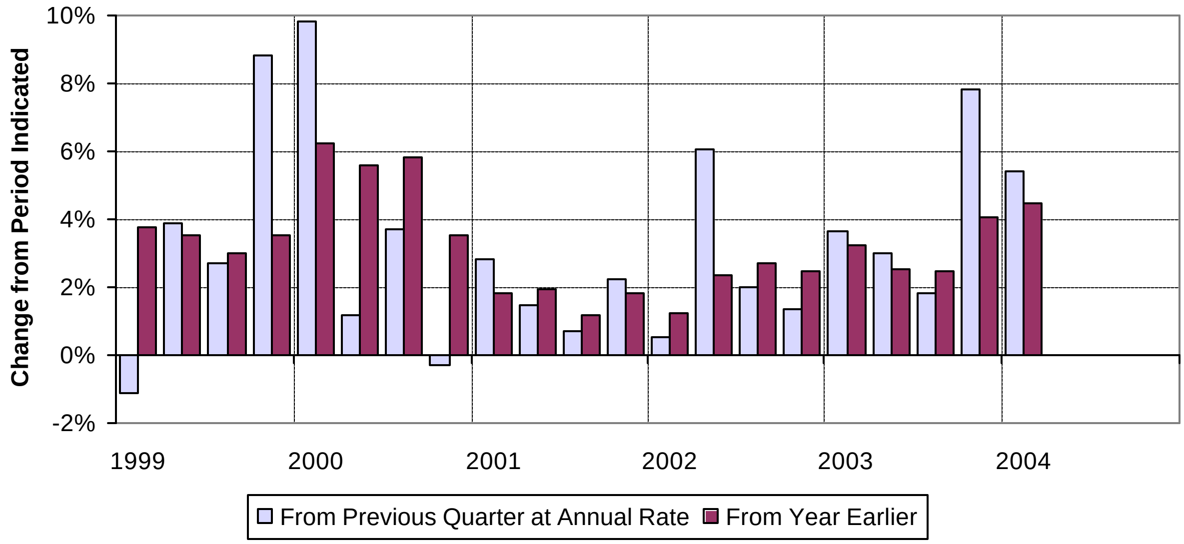


Chart 7: Ohio Personal Income



Personal income growth in Ohio picked up in the latest two quarters, through the first quarter of 2004, as shown in Chart 7. Increases shown are based on nominal dollar amounts and are not adjusted for inflation. During the latest year, Ohio personal income growth of 4.5% was less than the increase for the entire United States of 5.2%. Nevertheless, this increase in Ohio personal income was the largest one-year rise since 2000.

Construction Strengthens

Housing markets continue strong, supported by historically low fixed-rate mortgage interest rates, which have declined in recent weeks. New single-family home sales nationwide in May were the highest ever. Year-to-date sales were 24% above a year earlier. Used home sales in May, reported by the National Association of Realtors, were also the highest ever.

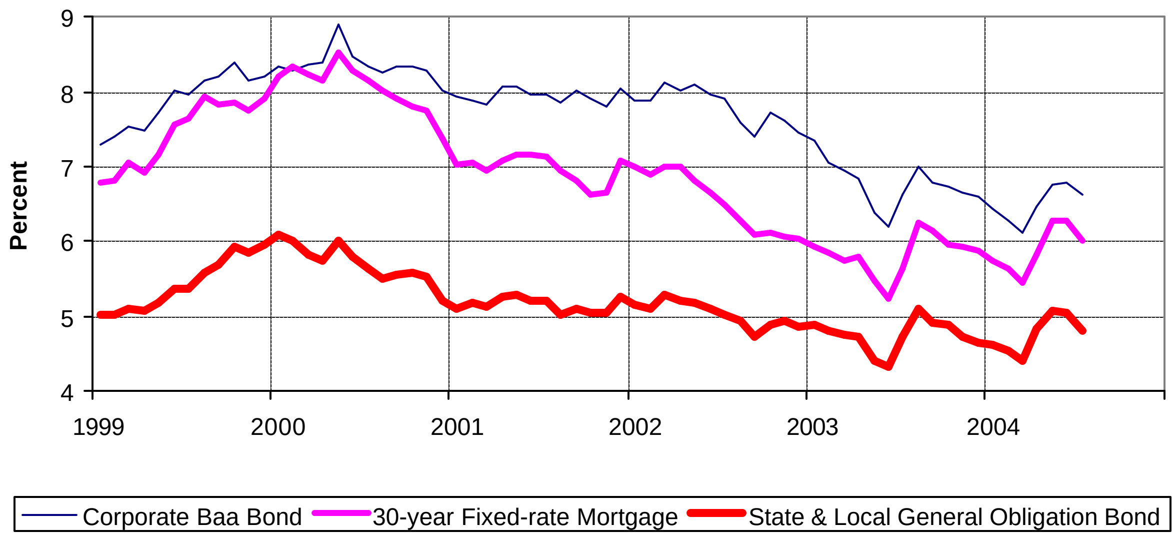
Total construction spending rose 0.3% in May 2004 to about 10% above the pace of activity a year earlier. The expansion in residential construction activity has continued, and growth appears to be picking up in other segments of private nonresidential as well as public construction. The development of commercial space, health care facilities, hotels and motels, office buildings, and educational institutions was stronger in the first two months of the second quarter than in the first quarter, seasonally adjusted. In the public sector, an increase in the construction of streets and highways accounts for about half of the rise in building activity from the first quarter to April and May.

Inflation Moderated for Finished Goods and Services in June

The producer price index for finished goods fell 0.3% from May to June. This decline followed increases averaging more than 0.5% in the first five months of 2004. Producer finished goods prices in the first six months of 2004 rose at a 5% annual rate, up from a 4% increase in 2003. June's drop in the finished goods index resulted from lower prices for energy products, notably for gasoline, which fell 5.2% in price last month at the producer price level, and for food. Excluding food and energy, finished goods prices rose 0.2% last month, about in line with average increases earlier in the year. At earlier stages of production, intermediate goods prices rose 0.5% in June, after more rapid increases earlier in the year, and were up at an 11% annual rate in the first six months of 2004, after increasing 3.9% in 2003. Crude materials prices rose 1.6% in June, and were higher at a 28% annual rate in 2004's first six months, an acceleration from a 20% increase in 2003.

The consumer price index rose 0.3% from May to June and was 3.3% above a year earlier. Consumer prices in the first half of 2004 rose at a 4.9% annual rate, up from a 1.9% increase for all

Chart 8: Selected Interest Rates



of 2003. The increase in consumer prices in June was below the rate earlier in the first half. June's rise in consumer prices resulted in part from a 2.6% increase in energy prices, reflecting increases in prices for natural gas, electricity, fuel oil, and gasoline (in contrast with the decline in gasoline prices at the producer price level, as well as in observed prices at Columbus-area pumps). Food prices rose 0.2% in June, and consumer prices for all items other than energy and food rose only 0.1%, the smallest increase since last December.

Monetary Policy Tightens as Expected, Longer-Term Interest Rates Ease

As had been widely expected, the Federal Open Market Committee, meeting in late June, raised its target for federal funds from 1% to 1.25%. This increase was the central bank's first firming in more than four years. Further increases in short-term interest rates appear likely later this year, probably in quarter-point increments unless finished goods and services inflation ratchets upward.

Longer-term interest rates have eased in recent weeks but are still well above lows reached in June 2003, when the central bank was focused on the risk of deflation. Shown in Chart 8 are interest rates representing borrowing costs to corporations and to homebuyers, plotted through July 9, and to state and local governments, plotted through July 8.[2]

Economic Developments during Fiscal Year 2004

At the beginning of FY 2004, the national economy had been expanding for more than 1-1/2 years, following the 2001 recession. Employment, however, had continued to decline, and unemployment had risen to its cyclical high. Ohio's economy appears to have turned down earlier than that of the U.S. as a whole and lagged in the recovery. Consumer price inflation was near the lowest rates since the 1960s, though some energy and materials prices had increased.

Government policy in mid-2003 was stimulative. The nation's central bank, concerned about the risk of deflation, a general or widespread decline in price levels, reduced its target short-term interest rate in June 2003 to 1%, the lowest in more than 40 years. Longer-term interest rates were at their lowest levels in about four decades. Federal tax cuts and spending increases, for military purposes related to fighting in Iraq and the war against terrorism as well as for nonmilitary programs, were boosting the economy. State and local government budgets, however, generally remained tightly constrained by revenue shortfalls.

Growing consumer spending and residential building had accounted for much of the economy's growth from the end of the recession through June 2003. Information technology investment had been recovering from the post-Y2K downturn, but other categories of business capital spending remained prostrate. Inventories were lean and inventory building had contributed only modestly to economic recovery. The American appetite for foreign products pulled in mounting imports while slack foreign demand restrained U.S. exports.

National economic conditions improved substantially during the fiscal year just ended. Production of goods and services grew more rapidly (see Chart 1), factory orders strengthened (Chart 6), employment nationwide and in Ohio reached low points and began expanding (Chart 2), and unemployment started receding. The decline in the measured unemployment rate from last year's peak, however, appears to be due at least in part to more labor market dropouts than a year ago (Chart 4).

Terrorist incidents in Iraq, Saudi Arabia, and elsewhere contributed to upward pressure on energy prices in FY 2004. About 14 months after the U.S.-led coalition overthrew the Hussein government in Iraq, the U.S. handed over nominal sovereignty to an Iraqi interim government in June 2004, but continues a large military presence in the country. Concerns over terrorism and the U.S. war on terrorism appeared at times in 2003 to exert dampening effects on confidence and willingness to spend. Those effects on the domestic economy seem to have eased in FY 2004, but high energy prices continue to divert American purchasing power from other goods and services.

Rising commodity prices and an upturn in inflation at the consumer and finished producer goods levels in FY 2004 shifted the focus of monetary policy away from deflation. Escalating energy prices accounted for a large portion of the uptick in inflation at the finished products level. Also, higher prices for steel, nonferrous metals, electronic components, and other commodities reflected in part growth of demand from China and other expanding economies abroad. In December 2003, the administration removed tariffs on steel imports imposed in 2002. With the upturn in hiring, more costly employer-paid medical benefits, and slower productivity growth, the period when declining business unit labor costs held down inflation appears to have come to an end. As noted above, the central bank raised its federal funds target in June 2004. Longer-term interest rates fluctuated during the fiscal year and were higher at the end than at the beginning of the year (Chart 7).

Consumer spending and residential fixed investment continued to grow in FY 2004, but other sectors of the economy accounted for an increasing share of GDP growth. With the rise in stock prices in 2003 and the continued uptrend in housing prices, balance sheets of households, as a group, have substantially recovered from the adverse effects of the stock market decline in the previous three years. Capital spending in FY 2004 was supported by strong growth of profitability and by faster-than-usual tax write-offs for qualifying investments under the 2003 tax act. These provisions expire at the end of 2004 and 2005.[3] Business investment in information processing equipment and software strengthened during FY 2004, and businesses boosted other types of capital equipment outlays. The decline in nonresidential construction slowed, and this sector appears to have begun growing in the second quarter. U.S. exports expanded, reflecting economic recovery abroad, but imports also continued to rise, pushing the U.S. trade deficit with the rest of the world to a record level.

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[1] Because of a change in the way employment is classified by industry, current data are not fully comparable with numbers prior to the 1990s.

[2] Specifically, interest rates shown are Moody's seasoned corporate bond yield for Baa-rated credits, the Federal Home Loan Mortgage Corporation contract interest rate on fixed-rate first mortgage commitments, and the Bond Buyer index of state and local general obligation bonds with 20 years to maturity, all as published by the Federal Reserve. Plots are monthly averages except for July 2004.

[3] Bonus depreciation, allowing 50% of qualifying investments to be expensed, expires at the end of 2004. Expensing of the first $100,000 of qualifying investments by small businesses, up from $25,000 previously, expires at the end of 2005.

Status of the General Revenue Fund

REVENUE

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

Ohio revenues finished FY 2004 with a strong month that offered some hope heading into FY 2005. Total GRF revenue of $2,622.3 million was $179.5 million (7.3%) above original estimate and GRF revenue less federal grants (state-source revenue) was $199.8 million (10.3%) above estimate.[1] Total tax revenue was $182.6 million (11.2%) above estimate and revenue from the major taxes was $124.8 million (8.0%) above estimate.[2] Personal income tax revenue was above estimate by $154.8 million (20.7%) in June, but revenue from the sales tax was below estimate by $59.9 million (8.6%). June revenue was boosted by a $234.7 million transfer from the Tobacco Master Settlement Agreement Fund.

Total GRF revenue finished FY 2004 $75.7 million (0.3%) below original estimate. State-source revenue was $87.2 million (0.5%) below estimate, and total tax revenue was $65.7 million (0.4%) below estimate. Revenue from the major taxes, which accounted for 69% of total GRF revenue and 90% of state-source revenue for the fiscal year, was $14.9 million (0.1%) below the original estimate.

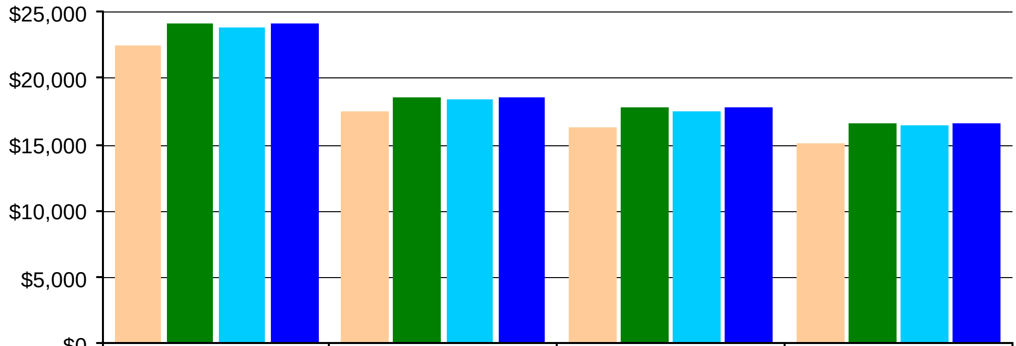
Compared to the *revised* estimates, total GRF revenue was $177.2 million (7.2%) above estimate in June and state-source revenue was $197.5 million (10.2%) above estimate. Total tax revenue was $191.0 million (11.7%) above estimate and revenue from the major taxes was $129.6 million (8.3%) above estimate. FY 2004 total GRF revenue was $174.2 million (0.7%) above the revised estimate and state-source revenue was above estimate by $158.7 million (0.9%). Total tax revenue was $191.6 million (1.1%) above estimate and revenue from the major taxes was $198.2 million (1.2%) above estimate. Revenue from the personal income tax was $310.2 million above its revised estimate for FY 2004, but revenue from the sales tax was $104.4 million (1.4%) below estimate.

FY 2004 GRF revenue was up 7.0% compared to FY 2003. State-source revenue was up 5.9% and revenue from federal grants was up 10.9%, partly due to one-time revenue. Total tax revenue was up 8.7% and revenue from the major taxes was up 9.8%. Total GRF revenue was up $1,581.2 million compared to FY 2003, but if sales tax receipts (up $1,132.6 million) and federal grants (up $544.0 million) are not counted, state-source revenue from sources other than the sales tax was down $95.4 million (0.9%). This lackluster performance of the other revenue sources is a reflection of the performance of Ohio's economy and was expected. If revenues had equaled their original estimates, state-source revenue from sources other than the sales tax would have been $111.3 million (1.0%) less than in FY 2003. If revenues had equaled their revised estimates, the shortfall would have been -$358.5 million (-3.2%). Chart 1 compares FY 2004 revenues with FY 2003 revenues and FY 2004 estimates, original and revised. Revenues for FY 2004 were between the original and revised estimates. This is an indication that although Ohio's economy may not be performing as well as hoped for when the FY 2004-2005 budget was passed, it is not performing as poorly as feared earlier this year when the revenue estimates were revised.

Personal Income Tax

The GRF received $902 million in revenue from the personal income tax in June. This amount was $154.8 million (20.7%) above the original estimate. The $629.1 million in revenue collected through withholding was $18.2 million (3.0%) above estimate. Quarterly estimated payments

Chart 1: GRF Revenue
(in millions)



	Total GRF Revenue	Total GRF Revenue less Federal Grants	Revenues from Total Taxes	Revenues from Major Taxes
FY 2003	$22,449.6	$17,477.1	$16,317.9	$15,124.3
FY 2004 Original Estimate	$24,106.5	$18,601.6	$17,803.2	$16,617.0
FY 2004 Revised Estimate	$23,856.6	$18,355.7	$17,545.9	$16,403.9
FY 2004 Actual	$24,030.8	$18,514.4	$17,737.5	$16,602.1

of $242.5 million were $2.5 million (1.0%) below estimate.[3] Refunds totaled $7.8 million in June. This total was $85.2 million (91.6%) below estimate. Refunds paid out in June were less than expected because annual returns were processed more quickly than expected. Most of the processing of annual returns was completed in May, largely due to increased electronic filing of returns. Distributions to the three local government funds supported by the income tax were $60.5 million less than estimated. This large variance was due to the timing of the booking of the "clawback" provision of the local government fund freeze and balanced out the variance for May.[4]

GRF revenue from the personal income tax was $155.3 million (20.8%) above the revised estimate for June. Withholding was $22.2 million (3.7%) above estimate, quarterly estimated payments were $8.9 million (3.8%) above estimate, and refunds were $68.4 million (89.7%) below estimate.

For FY 2004, GRF revenue from the personal income tax totaled $7,696.9 million. The total was $94.9 million (1.2%) above the original estimate. Withholding was $13.6 million (0.2%) above estimate. Quarterly estimated payments were $18.6 million (1.5%) below estimate, revenue from the tax on trusts was $7.5 million (14.2%) above estimate, and refunds were $37.2 million (3.4%) below estimate. For the fiscal year, revenue from the personal income tax was $310.2 million (4.2%) above the revised estimate. Withholding was $37.3 million (0.5%) above estimate, quarterly estimated payments were $30.4 million (2.6%) above the revised estimate, and revenue from the tax on trusts was $9.9 million (19.7%) above estimate. Refunds were $69.1 million (6.1%) below the revised estimate.

Income tax revenue continues to show just slight growth. For FY 2004, GRF revenue from the personal income tax was up by 3.7% compared to FY 2003. Withholding was up by 3.7%. Withholding reflects the condition of Ohio's labor market, and the growth in withholding provides some indication that Ohio's labor market is improving. Quarterly estimated payments were down by 3.8% compared to a year earlier and revenue from the tax on trusts was down 5.0%.

Sales and Use Tax

Revenues from the sales and use tax were below estimates in June. Total sales and use tax revenues in the month were $640.3 million, $60.0 million (8.6%) below original estimate. Auto and nonauto sales and use tax receipts were $8.6 million (8.0%) and $51.3 million (8.7%)

below estimate, respectively. Total sales and use tax receipts in June 2004 were $79.2 million (14.1%) above sales and use tax revenues in the same month last year. The performance of the sales and use tax weakened in the last two months of FY 2004. At the end of April the sales and use tax was tracking estimates, but at the end of June revenues were $104.4 million (1.4%) below estimates.[5] Sales and use tax receipts were $1,132.6 million (17.7%) higher than FY 2003 tax receipts. The increase in sales and use tax revenue is primarily due to a 20% increase in tax rates as the tax increased from 5% to 6% of the purchase price in July 2003. Based on tax collections, consumers spent $2.4 billion (1.9%) less on taxed goods and services in FY 2004 than in FY 2003.

Nonauto Sales and Use Tax

The nonauto sales and use tax in June 2004 was below estimates for a third consecutive month. In March 2004, this tax source was 4.6% above estimates. In April and May 2004, nonauto sales and use tax revenues were 1.5% and 6.5% below projected revenues, respectively. In June 2004, nonauto sales and use tax receipts were $541.0 million, $51.3 million (8.7%) below estimates. Tax receipts partly reflect taxable retail sales activity in the prior month and also taxable retail sales during that month.[6] Compared to nonauto sales and use tax revenues a year ago, tax receipts for the month were $80.1 million (17.4%) above revenues in June 2003. FY 2004 nonauto sales and use tax receipts were $6,407.7 million, $87.7 million (1.4%) below original estimate and $77.3 million (1.2%) below revised estimate. Compared to receipts in FY 2003, nonauto sales and use tax receipts in FY 2004 increased $975.9 million (18.0%). Based on nonauto sales and use tax collections for the year, consumers spent $1.8 billion (1.7%) less in *taxed* nonauto goods and services in FY 2004 than in FY 2003.

Chart 3 presents nonauto sales and use tax revenues in the last five fiscal years. From $5,092 million in FY 2000, nonauto sales and use tax receipts grew to $6,408 million in FY 2004. Although nonauto sales and use tax receipts rose, the performance of the nonauto sales and use tax remained feeble during this period. Nonauto sales and use tax revenue grew in FY 2003 and in FY 2004 due to tax law changes, not from growth in the taxable base. Nonauto sales tax revenue declined about 0.3% in FY 2002 and grew 6.2% in FY 2003. Without the added revenues from the Ohio Tax Amnesty[7] and the change in the tax

Chart 2: FY 2004 Nonauto Sales Tax Variance from Estimates
(in millions)

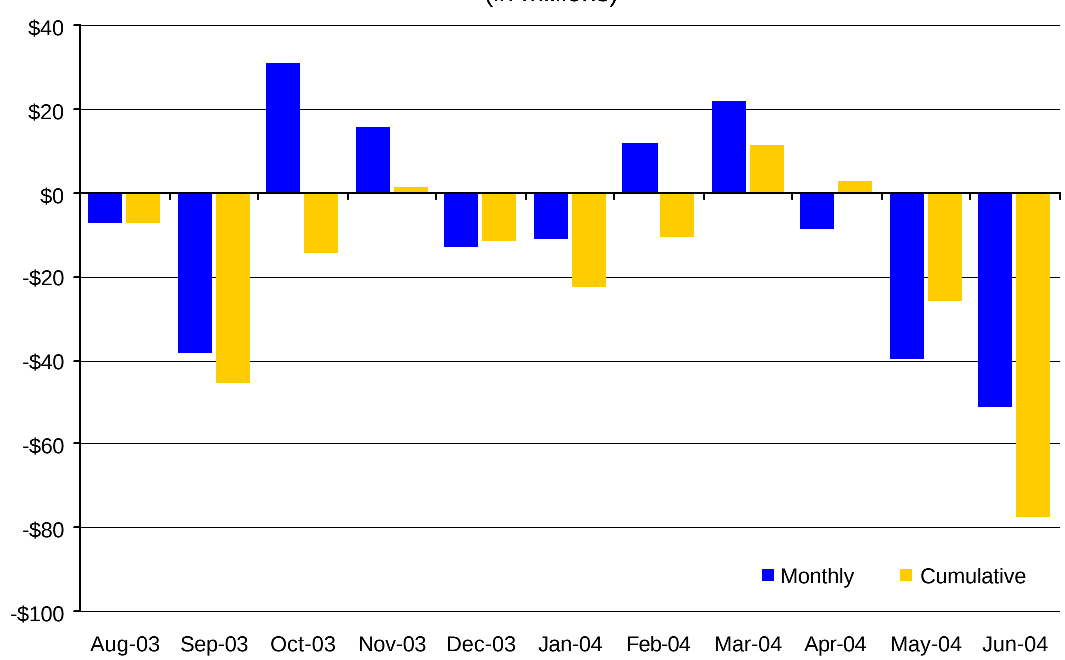


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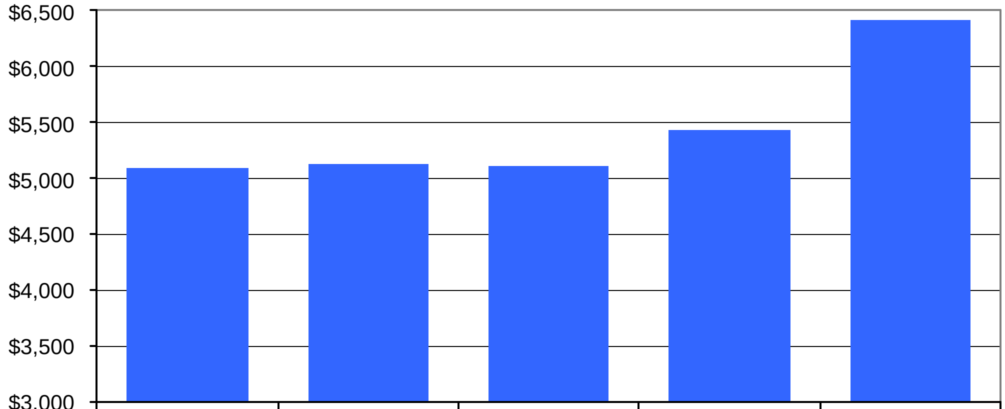
Chart 3: Nonauto Sales and Use Tax Revenues
FY 2000-FY 2004 (in millions)



	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$5,092	$5,124	$5,110	$5,432	$6,408

treatment of leases from H.B. 405,[8] nonauto sales and use tax receipts in FY 2002 would have declined about 2.1% from FY 2001 revenues. After subtracting the additional tax revenues received from the acceleration of sales and use tax payments, nonauto sales and use tax revenues grew only by about 1% in FY 2003. The growth in revenue in FY 2004 resulted from the rate increase from 5% to 6% on July 1, 2003 applied to a smaller taxable base.

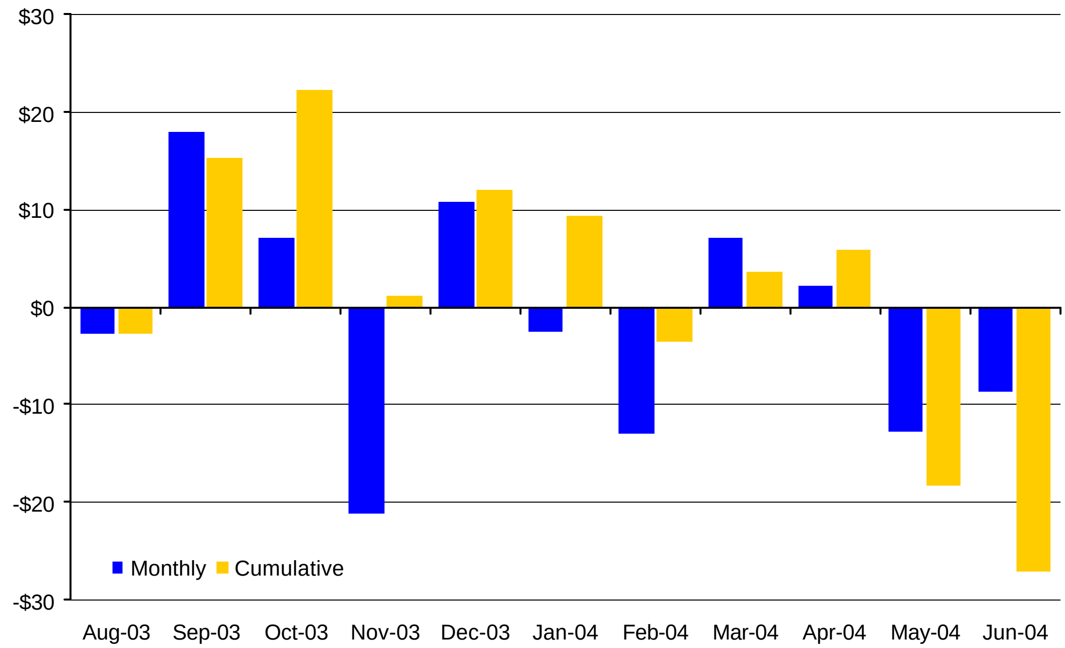
Auto Sales Tax

Auto sales and use tax receipts were $99.2 million in June 2004, $8.6 million (8.0%) below original estimate. The clerks of court generally make auto tax payments on each Monday for taxes collected during the preceding week on motor vehicles, watercraft, and outboard motors titled.[9] Therefore, auto tax receipts to the state for a month largely reflect vehicles sold and titled during that month. Compared to revenues a year ago in the same month, auto sales tax receipts in June 2004 were $0.9 million (0.9%) lower than receipts in FY 2003. At the 5% sales tax rate, June 2004 auto sales tax revenue would have been about $82.7 million, $17.4 million (17.3%) less than June 2003 receipts. FY 2004 auto sales and use tax receipts were $1,122.9 million, $15.4 million (1.4%) below original estimate and $27.1 million (2.4%) below revised estimate. These tax receipts were also $156.7 million (16.2%) higher than receipts in FY 2003. Based on auto sales and use tax collections, consumers spent approximately $607.3 million (3.1%) less on motor vehicles, outboard motors, and watercraft in FY 2004 than in FY 2003.

Auto sales tax revenues generally reflect overall economic conditions, growth in vehicle unit sales, change in the stock of automobiles, price changes, and the level of manufacturers' incentives. In FY 2004, although overall economic conditions in Ohio may have not been favorable to growth in auto tax receipts, other drivers of auto sales have all been positive, particularly auto incentives. Auto sales during the fiscal year confirmed that the level of auto sales, at least in the short-term, is linked to the push or pullback of incentives by automakers.

The actions of automakers and auto dealers suggest that incentives are not going away anytime soon as they are committed to battle to maintain or gain market share. When incentives declined, sales dropped and the inventory of unsold vehicles increased. When incentives increased substantially, sales bounced back. The share of more expensive light trucks (including sport utility vehicles) in the number of vehicles sold has increased every year, which helps tax revenues. From approximately 50% of light vehicles sold nationwide in FY 2000, light trucks' share

Chart 4: FY 2004 Auto Sales Tax Variance from Estimates
(in millions)



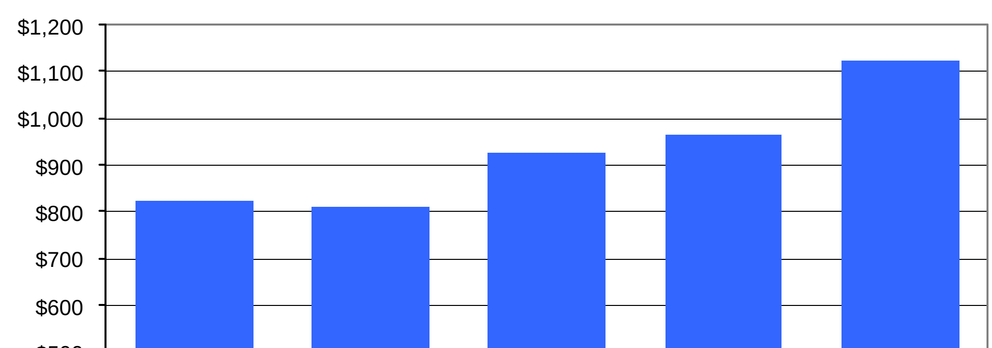
is now approximately 54% of sales. The average transaction price of vehicles sold is also increasing, with more than a third of vehicles selling at prices greater than $25,000.

Chart 5 presents auto sales and use tax receipts from FY 2000 to FY 2004. For the first time in several years, auto sales tax receipts finished the year below expectations. In anticipation of the tax rate increase, customers accelerated auto purchases into June 2003, which depressed tax receipts in the first two months of FY 2004. Auto sales and use tax receipts grew 14.1% in FY 2002 (mainly as a result of purchase incentives after the September 11, 2001, attacks), and 4.4% in FY 2003. Auto sales and use tax receipts grew 16.2% in FY 2004, due only to the 20% tax rate increase from 5% to 6% of the purchase price.

Estimated Taxable Sales in FY 2004

Exhibit 1 shows FY 2004 estimated taxable sales compared with taxable sales in FY 2003. The sales and use tax rate was increased to 6%

Chart 5: Auto Sales and Use Tax Revenues
FY 2000-FY 2004 (in millions)



	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$822	$811	$925	$966	$1,123

on July 1, 2003, up from 5%. Taxable sales were obtained by dividing sales and use tax receipts by the corresponding tax rate. Exhibit 1 presents, based on actual tax receipts, an estimate of the change in the sales and use tax base on which tax is collected. It shows that the FY 2004 sales and use tax taxable base may have shrunk 1.9% compared to the taxable base in FY 2003. This result is unsurprising because of the behavioral impact of a tax increase on taxpayers (consumption generally falls as a result of a price or tax increase). The decline of the taxable base reflects both the effect of the tax increase and the performance of the Ohio economy during the year.

Nonauto taxable sales and auto taxable sales declined 1.7 % and 3.1%, respectively. Based on research by the Department of Taxation, between $20 million and $40 million in potential FY 2004 auto tax revenues was transferred into FY 2003 due to shifting of purchases of automobiles into FY 2003. Subtracting the effect of this shift in the timing of purchases of autos noted above, growth in auto taxable sales might have been flat or slightly negative this fiscal year. The nonauto taxable base declined despite the sales tax base expansion in Am. Sub. H.B. 95. The current biennial budget act added several services to the nonauto sales and use tax base. This expansion of the base was expected to provide up to $122 million in GRF sales tax revenues in FY 2004. Therefore, without the tax base expansion, the decrease in nonauto taxable base might have been larger than shown in Exhibit 1.

Legislative Changes Affecting the Sales and Use Tax

H.B. 204 postponed the effective date of the application of destination-based sourcing of sales from January 1, 2005 to July 1, 2005. However, the act also allowed any vendor to switch to destination-based sourcing anytime after January 1, 2005 and before July 1, 2005. Once the switch is made, the vendor is not allowed to revert back to the origin-based sourcing of sales. This change has a minimal fiscal effect, although the six-month transition period during which vendors use different sourcing of sales might create some practical issues in the administration of the sales and use tax in the Department of Taxation.

Corporate Franchise Tax

Corporate franchise tax receipts in June 2004 were $99.3 million, $35.9 million (56.6%) over original estimate and $36.0 million (56.9%) above revised estimate. Revenues in June almost reversed the negative variance through May 2004, which was due in part to timing issues related to the May 31 due date of tax returns. At the end of May 2004, corporate franchise tax receipts were $36.8 million (4.9%) below the revised estimate. At the end of June corporate franchise tax revenues totaled $809.2 million, $16.2 million

Exhibit 1: Sales Tax Collections and Estimated Taxable Sales

Sales and Use Tax Collections, July through June 2004 (in millions)

	Auto Sales Tax	Nonauto Sales Tax	Total
FY 2003	$966.1	$5,431.7	$6,397.8
FY 2004	$1,122.9	$6,407.7	$7,530.6
Growth ($)	$156.8	$975.9	$1,132.7
Growth (%)	16.2%	18.0%	17.7%

Estimated Taxable Sales, Based on Tax Collections (in millions)

	Auto Sales Tax	Nonauto Sales Tax	Total
FY 2003	$19,322.3	$108,634.6	$127,956.9
FY 2004	$18,715.0	$106,794.5	$125,509.5
Growth ($)	-$607.3	-$1,840.1	-$2,447.4
Growth (%)	-3.1%	-1.7%	-1.9%

(2.0%) above original estimate and $0.8 million (0.1%) below revised estimate. Corporate franchise tax receipts were also $61.9 million (8.3%) above FY 2003 revenues. Corporate franchise tax revenues in a given fiscal year generally reflect corporate profits in the prior calendar year. The franchise tax for tax year 2004 (generally FY 2004) is based upon the taxpayer's activity during its taxable year ending in CY 2003. Revenues from the corporate franchise tax improved for the second consecutive fiscal year. After declining 22.2% in FY 2002, corporate franchise tax revenues grew 4.9% in FY 2003 and 8.1% in FY 2004. This turnaround in corporate franchise tax revenues mirrors improving nationwide corporate profits.

Nationwide measures of corporate profits indicate that profits grew in the last two calendar years. (Measures of Ohio corporate profits are unavailable.)[10] Corporate profits increased 17.4% and 18.3% in CY 2002 and CY 2003, respectively.[11]

Looking at various industries, growth in corporate profits was widespread in CY 2003. Nationally, except for the wholesale trade sector, where profits declined 7.5%, corporate profits[12] grew 31.8% in the manufacturing sector, 10.9% in the utility sector, 4.4% in the retail industry, and 5.4% in the financial industry. The turnaround was pronounced in the transportation and warehousing sector, which lost $2.3 billion in CY 2002 and gained $11.9 billion in CY 2003. Losses narrowed in the information industry, which lost $20.2 billion in CY 2002 and $5.4 billion in CY 2003. Chart 7 presents corporate franchise tax revenues and their share of total GRF tax revenues in the last few years.

Prior to the last two fiscal years, corporate franchise tax revenues had declined in each of the preceding 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. The turnaround in corporate franchise tax revenue began in FY 2003 with corporate franchise tax receipts of $747.2 million and continued this fiscal year with receipts at $809.2 million. As the amount of revenue from this tax source decreased and total GRF tax receipts increased, the relative contribution of the corporate franchise tax to total GRF tax revenue also shrank. From 8.2% of total GRF tax revenue in FY 1998, the contribution of the corporate

Chart 6: FY 2004 Corporate Franchise Tax Variance from Estimates
(in millions)

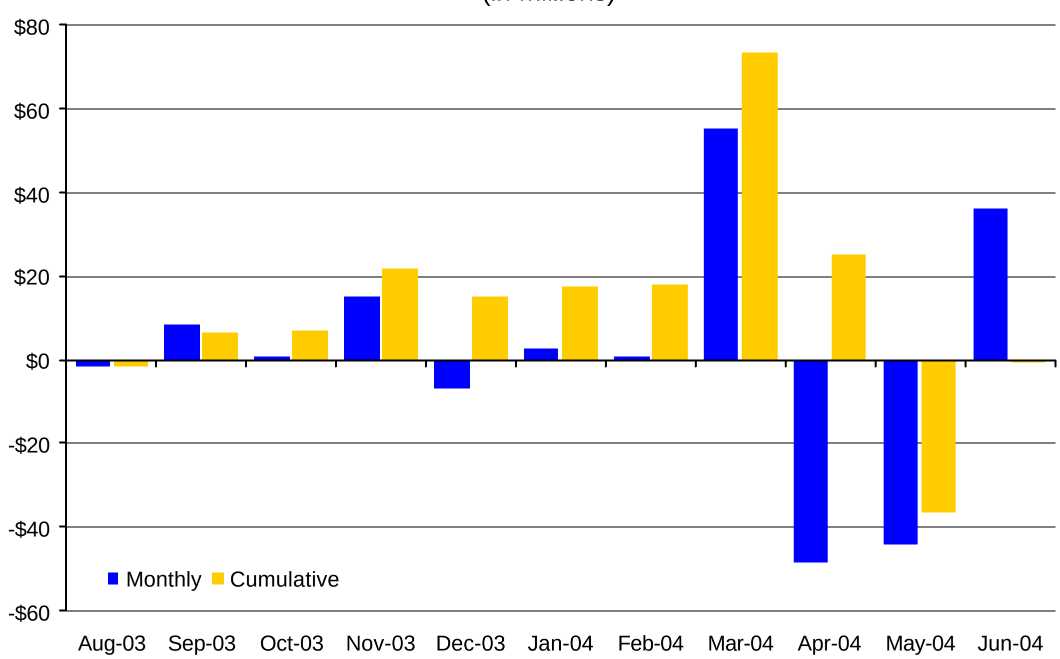
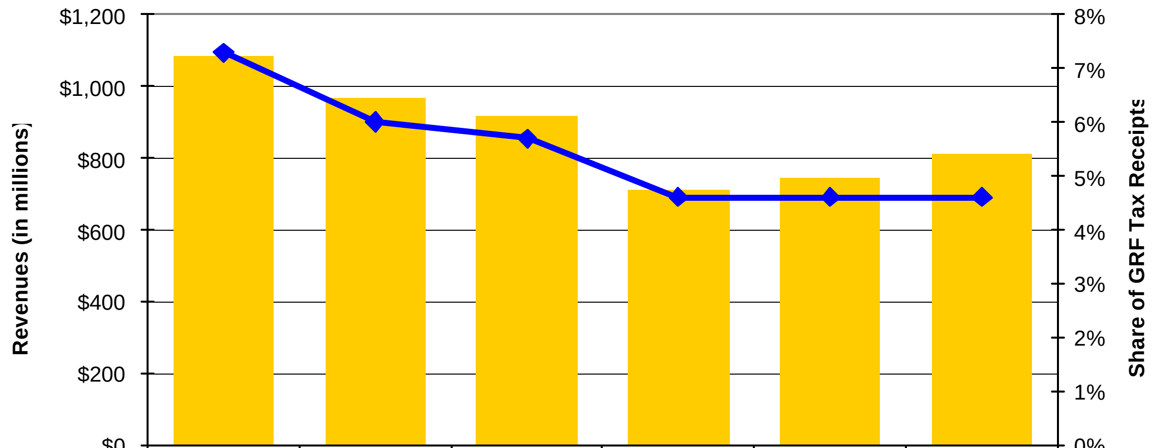


Chart 7: Corporate Franchise Tax Revenues and Share of GRF Tax Receipts



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$1,084.1	$969.4	$915.3	$712.3	$747.2	$809.2
Share	7.3%	6.0%	5.7%	4.6%	4.6%	4.6%

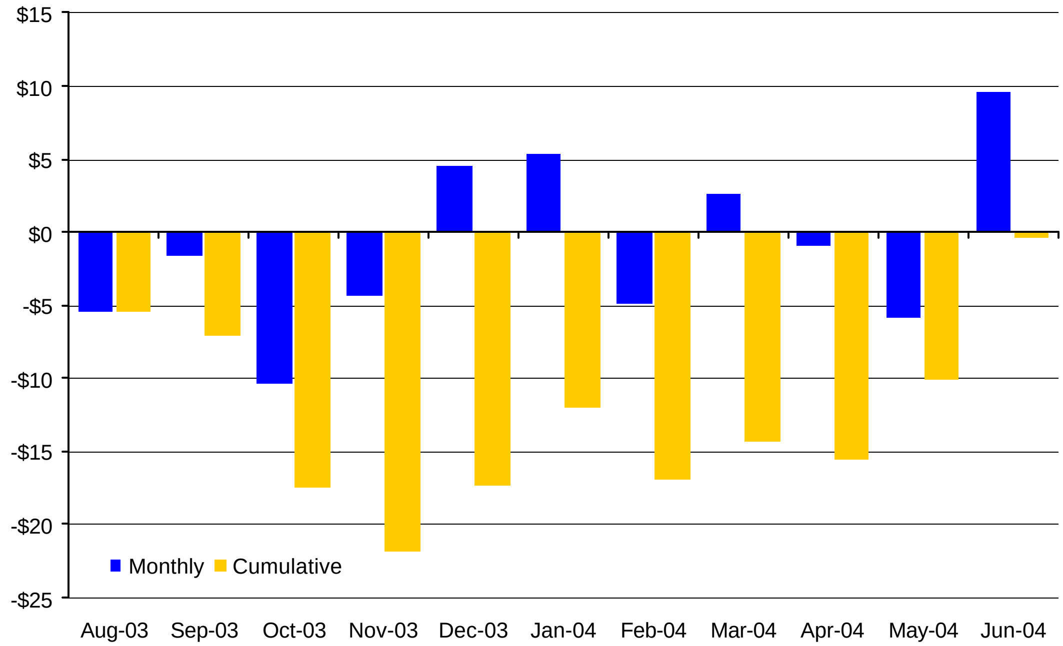
franchise tax to GRF fell to 4.6% of GRF tax revenues in FY 2002. Despite higher corporate franchise tax receipts in the last two fiscal years, its share of GRF tax receipts remained at about 4.6% in FY 2003 and FY 2004. Corporate franchise tax receipts improved, but GRF tax revenues also increased, primarily through higher cigarette tax receipts in FY 2003 and higher sales tax receipts in FY 2004.

Cigarette and Other Tobacco Products Tax

Cigarette and other tobacco products tax receipts in June 2004, at $57.2 million, were $9.6 million above estimate.[13] Certain payments in tax returns filed in May were recorded as June receipts. Compared to receipts a year ago, June 2004 receipts were $5.5 million (10.6%) higher than June 2003 receipts. However, revenues in June 2003 were reduced by a tax refund of $6.6 million to cigarette dealers and wholesalers who had overpaid their floor inventory tax. The floor tax is the additional tax (31 cents per pack) on cigarettes in inventory when the tax on cigarettes was increased to 55 cents per tax July 1, 2002. Those cigarettes in inventory had the "old" stamp of 24 cents per pack. Excluding this refund, revenues this month would have been $1.1 million (2.0%) less than in June 2003. FY 2004 revenues were $557.5 million, $2.5 million (0.4%) below original estimate and $0.5 million (0.1%) less than revised estimate. These receipts were $42.4 million (7.1%) below FY 2003 receipts, which included $35.3 million in floor tax receipts. Excluding the floor tax receipts, FY 2004 revenues were $7.1 million (1.3%) less than FY 2003 revenues.

Exhibit 2 presents the contributions of the two excise taxes to GRF revenues in the last three years. Ninety-five percent of the cigarette and other tobacco products tax revenues ($530.3 million) were from the excise tax on cigarettes. The excise tax on other tobacco products, 17% of the wholesale price, contributed $27.2 million (5.0%) of the tax receipts. Remarkably, tax receipts from the tax on other tobacco products is increasing but appears not to have benefited from the increase in the cigarette tax. Growth in other tobacco products tax receipts has been similar before and after the cigarette tax rate increase. Growth in those receipts was 5.1% in FY 2001 and 5.8% in FY 2002. In FY 2003 and FY 2004, other tobacco products tax receipts grew 5.1% and 5.8%, respectively.

Chart 8: FY 2004 Cigarette Tax Variance from Estimates
(in millions)



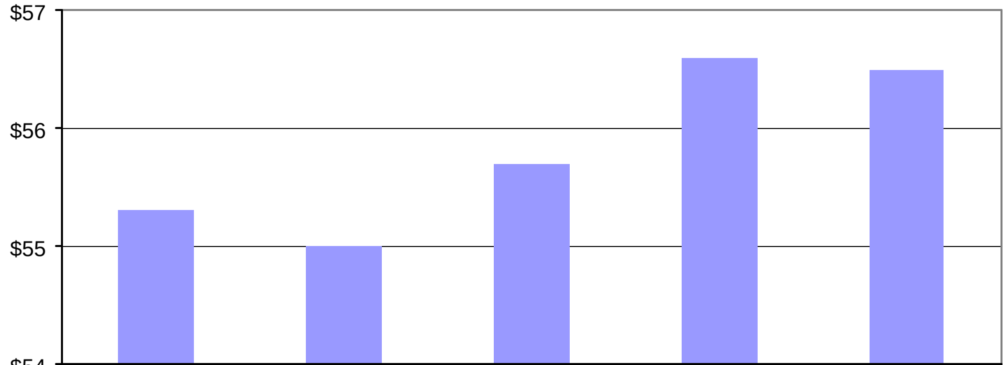
Generally, cigarette consumption declines on average 1% to 2% each year.[14] The rate of increase was expected to decrease consumption substantially and increase tax avoidance strategies by Ohio consumers in FY 2003 and also in FY 2004.[15] However, several factors may have limited the decline in consumption of Ohio-taxed cigarettes in the two years following the tax rate increase. Based on tax receipts, consumption of Ohio-taxed cigarettes declined 187.5 million packs in FY 2003 (16.0%) to about 979.8 million packs, down from approximately 1,167 million packs in FY 2002. However, at the beginning of FY 2003, based on the floor tax receipts, approximately 113.8 million packs were in inventories of cigarette dealers. Thus, the decrease in consumption of Ohio-taxed cigarettes was approximately 6.3% in FY 2003. Based on tax receipts, consumption of Ohio-taxed cigarettes fell about 15.0 million packs (1.6%) in FY 2004, which is in line with historical trends in the decline of tobacco consumption (1% to 2% per year).

In CY 2002 and CY 2003, all bordering states except Kentucky increased their tax rates on cigarettes. This helped mitigate the decline in consumption of taxed cigarettes in Ohio. The tax rate on cigarettes in Ohio is the lowest in the region except for Kentucky and is identical to that of West Virginia. On July 1, 2002, Indiana increased its rate to $0.555 per pack of 20 cigarettes, up $0.155. On July 15, 2002, the tax on a pack went up by $0.40 to $1.00 per pack in Pennsylvania. The tax rate in Michigan became $1.25 per pack on August 1, 2002, up $0.75 per pack. On May 1, 2003, West Virginia increased its rate to $0.55 per pack, up from $0.38 per pack. Kentucky's rate remains at $0.03 per pack, where

Exhibit 2: Cigarette and Other Tobacco Products Tax, FY 2002-FY 2004

	FY 2002	FY 2003	FY 2004
Total Revenue (in millions)	$281.3	$601.0	$557.6
Share of Revenue			
Cigarette Excise Tax	91.3%	89.8%	95.1%
Cigarette Floor Tax	0.0%	5.9%	0.0%
Other Tobacco Products Excise Tax	8.7%	4.3%	4.9%

Chart 9: Alcoholic Beverage Tax Revenue
FY 2000-FY 2004 (in millions)



	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$55.3	$55.0	$55.7	$56.6	$56.5

it has stood for decades. Cigarette stamping in Ohio may have limited the amount of smuggling or bootlegging that occurs when prices are raised. Also, most consumers purchase their cigarettes by the pack or the carton. To save money through tax avoidance, smokers would have to buy large amounts of cigarettes. If purchasing via the Internet, consumers have to pay shipping and handling charges, which increases the cost of avoiding the Ohio tax.

Alcoholic Beverage Tax

Alcoholic beverage tax receipts in FY 2004 were $56.4 million, lagging the original estimate by $3.5 million (5.9%) and the revised estimate by $2.5 million (4.3%). Tax receipts from this revenue source were $0.1 million (0.2%) less than FY 2003 revenues. The alcoholic beverage 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% alcohol by volume is taxed at 32 cents per gallon. Wine between 14% and 21% alcohol by volume is taxed at $1.00 per gallon. Mixed beverages are taxed at $1.20 per gallon.[16] Major exemptions to the tax are sacramental wine, sales to the federal government, and sales in interstate commerce. Most tax revenue is deposited into the General Revenue Fund.[17] Chart 9 presents alcoholic beverage tax receipts for the last five fiscal years. Overall, this tax source has grown slowly, on average less than 1.0% annually between FY 2000 and FY 2004. Beer and malt beverages generate the bulk of tax receipts, about 84%. The next largest source of revenue is the tax on wines, at about 9% of total tax receipts. Mixed beverages contribute about 5% of total tax revenues. Contributions to tax receipts from vermouth, sparkling wines, and cider are small and have been declining each year.

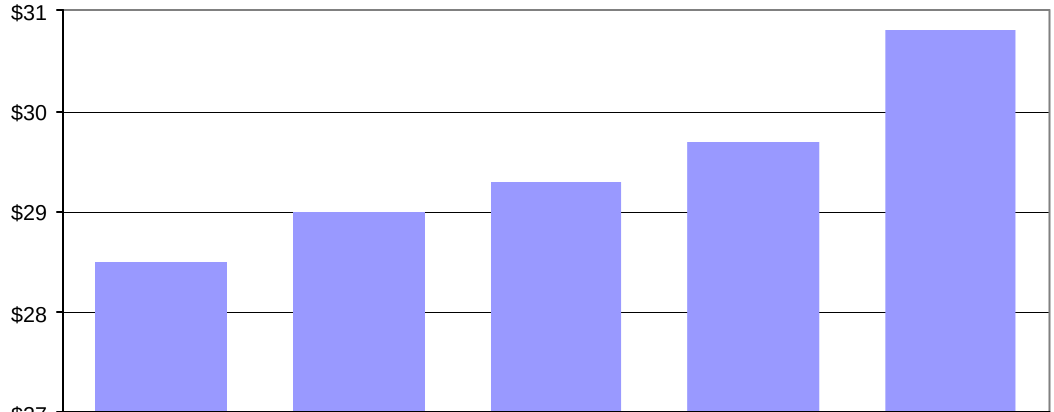
Liquor Gallonage Tax

Liquor gallonage tax receipts were $30.8 million in FY 2004, $0.9 million (2.9%) above original estimate and $1.9 million (6.5%) better than the revised estimate. Revenues from this tax source were higher than FY 2003 receipts by $1.1 million (3.8%). 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 Chart 10.

Public Utility Excise Tax and Kilowatt Hour Tax

The GRF received $226.4 million from the public utility excise tax (PUET) in FY 2004, an increase of $7.8 million (3.6%) compared with FY 2003 revenue. The kilowatt hour (KWH) tax raised $339.0 million for the GRF in FY 2004, a decrease of $0.9 million (0.3%) compared to FY 2003.

Chart 10: Liquor Gallonage Revenue
FY 2000-FY 2004 (in millions)

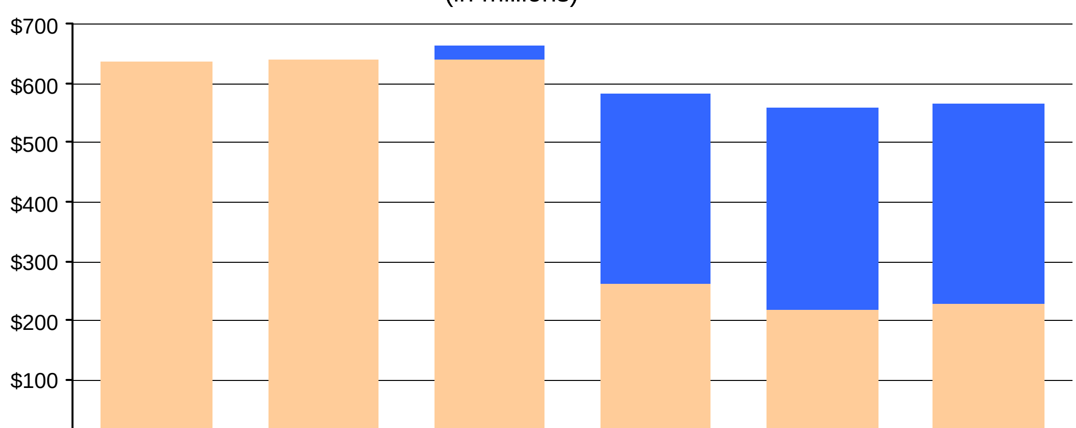


	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$28.50	$29.00	$29.30	$29.70	$30.80

The KWH tax is a relatively new tax, as can be seen in Chart 11, having been established by Am. Sub. S.B. 3 of the 123rd General Assembly. The tax was established to replace revenue lost as a result of S.B. 3 exempting electric companies from the PUET as part of the electric restructuring provided by that act. Chart 11 shows the combined revenue from the two taxes. The total collected under the two taxes has declined by $97.9 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.

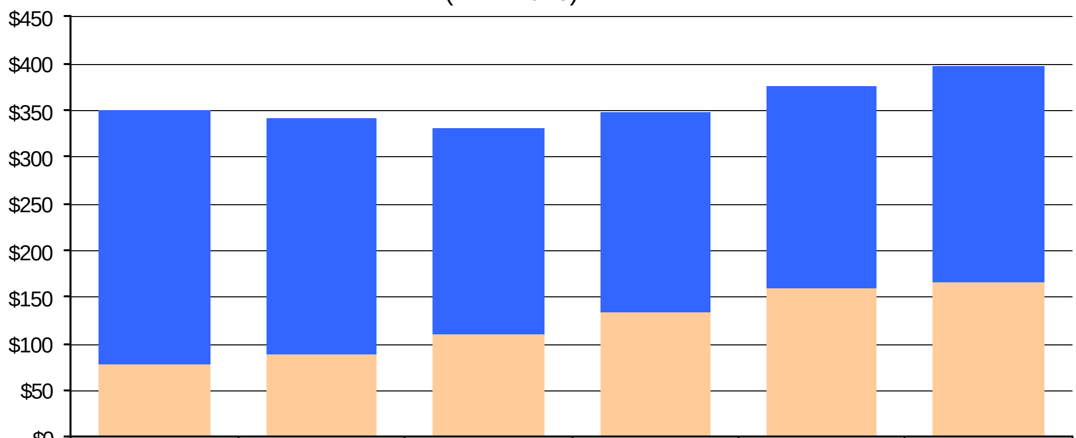
Revenues under the PUET were $11.0 million (5.1%) higher than OBM's original estimate and $7.8 million (3.3%) below the revised estimate. The amount paid by telephone companies under the tax fell by $14.9 million in FY 2004, but this was more than made up by an increase of $22.0 million paid by natural gas companies. The most likely reason for the higher revenues paid by natural gas companies is that natural gas prices have been higher than expected. Data from the U.S. Energy Information Administration indicate that the price of natural gas for Ohio's residential customers in December and January was over 20% higher than during the corresponding months of the previous year.[18] The price differential had fallen below 15% in February and remained there through March, the most recent month for which data are available.

Chart 11: Utility Taxes
(in millions)



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
KWH Tax	$0.0	$0.0	$22.8	$323.3	$339.9	$339.0
PUET	$637.6	$642.1	$640.5	$260.1	$218.7	$226.4

Chart 12: Insurance Taxes
(in millions)



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Foreign	$271.6	$252.3	$220.6	$214.3	$216.4	$230.5
Domestic	$77.5	$88.2	$109.3	$132.4	$160.1	$165.9

Revenues paid by telephone companies under the PUET have fallen in recent years due to an erosion of market share for the companies subject to the tax. These companies, called incumbent local exchange carriers, have lost market share to cellular companies and to competitive local exchange carriers not subject to the PUET. Am. Sub. H.B. 95 provided that local telephone companies will be exempted from PUET starting in FY 2005, and be subjected instead to the sales tax and the corporate franchise tax. One reason for the change is to eliminate the current difference in the tax treatment of companies that are in direct competition with each other. Since incumbent local exchange carriers are the source of approximately half the revenue collected under PUET, this change means that revenue under PUET will be cut roughly in half in FY 2005. The revenue loss should be offset, in whole or in part, by subjecting the companies to the sales tax and the corporate franchise tax.

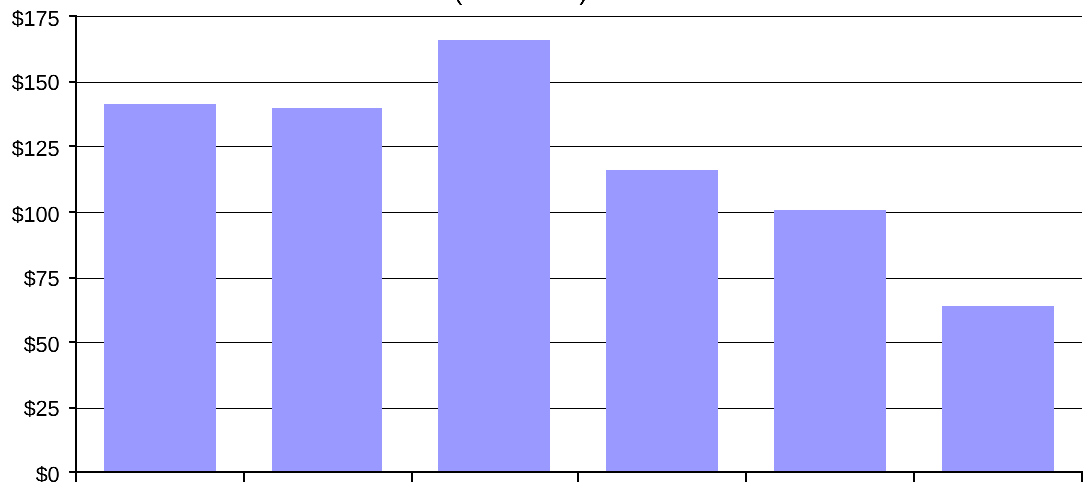
Revenues under the KWH tax were $33.9 million (9.1%) lower than the original estimate and $1.0 million (0.3%) above the revised estimate. The original estimate projected growth of about 9.7% compared with FY 2003. This growth rate is significantly higher than the 1.8% long-run trend rate of growth in electricity usage projected by the federal Energy Information Administration in *Annual Energy Outlook 2004* (Early Release). As explained in the January 2004 issue of *Budget Footnotes*, the very high growth rate implied by the OBM estimate led LSC economists to believe that the original estimate resulted from an incorrect treatment of the effects of the local government fund freeze contained in H.B. 95.

Insurance Taxes (Domestic and Foreign)

The domestic insurance tax, which is paid by insurance companies headquartered in Ohio, raised $165.9 million for the GRF in FY 2004, while the foreign insurance tax, which is paid by insurance companies headquartered in other states, raised $230.5 million. Revenues from the domestic tax grew by 3.6% in FY 2004, while revenues from the foreign tax grew by 6.6%. FY 2004 was the second 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% of premiums for health insuring corporations (HICs) and 1.4% of premiums for other insurers.

Growth rates in revenue collected under the two taxes were quite different between FY 1999 and FY 2003, as is clear in Chart 12. During

Chart 13: Estate Tax
(in millions)



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$141.5	$140.0	$166.0	$116.3	$100.8	$64.2

those fiscal years the differences were attributable primarily to the tax changes made in H.B. 215.[19] The difference in growth rates was much smaller in the most recent year, since the transition period for the H.B. 215 changes ended last year. There are two reasons for the growth rates to differ under the two taxes in the most recent year. First, the importance of the various lines of business differs between domestic and foreign insurance companies. For foreign insurance companies, life insurance is a more important line of business, while fire and casualty insurance and HICs are more important lines of business for domestic insurers. Since industry premiums for the different lines of business grow at different rates, the total premiums collected by domestic and foreign insurers grow at different rates.

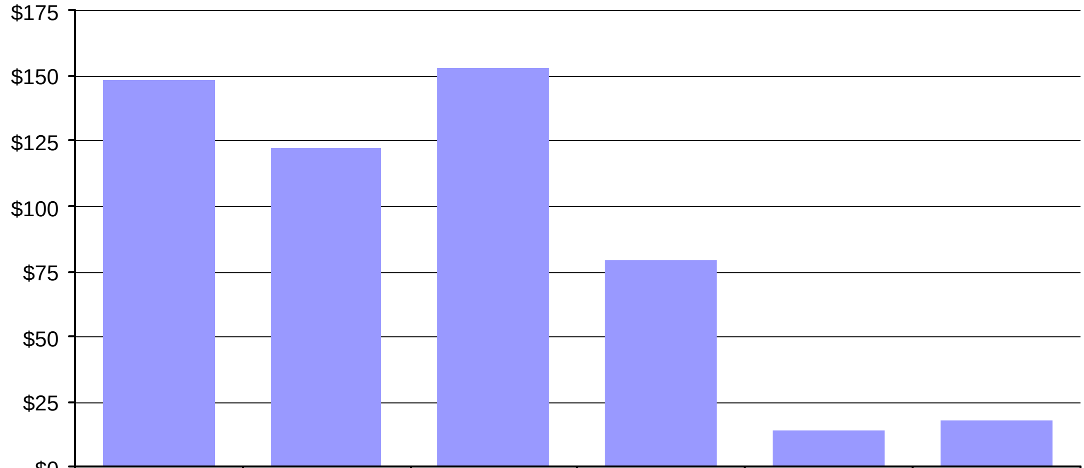
Second, the foreign insurance tax includes a so-called "retaliatory" tax component. Ohio, like many other states, taxes foreign insurers at the higher of the statutory rate (1.4% in Ohio) or the rate that the home state of the foreign insurer imposes on Ohio-based insurers.[20] This component of the foreign insurance tax is somewhat more difficult to forecast due to the dependence on other states' statutory tax rates. The amount of the retaliatory tax certified by the Department of Insurance increased from $148.2 million in FY 2003 to $180.8 million in FY 2004 (before credits), suggesting that growth in the retaliatory component contributed significantly to the faster overall growth for the foreign insurance tax.

The variance for the foreign insurance tax was $0.5 million (0.2%) over the original OBM estimate, while revenues for the domestic tax were $4.1 million (2.4%) below the estimate. The estimate for the foreign tax was thus remarkably accurate. The variance for the domestic tax, while larger, is still quite respectable and reflects growth in insurance premiums that was somewhat slower than expected.

Estate Tax

In FY 2004, Ohio collected $64.2 million in estate tax revenue, $41.0 million (38.9%) less than the original estimate, but just $0.8 million (1.2%) less than the revised estimate. FY 2004 revenues were 36.3% lower than FY 2003 revenues of $100.8 million. The estate tax is one of the more volatile state revenue sources. Low interest rates and the phase-in effect of the changes in estate tax valuations, credits, and disposition of revenue in S.B. 108 of the 123rd General Assembly were among the factors that affected estate tax revenue collections in FY 2004.

Chart 14: Earnings on Investment
(in millions)



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Revenue	$148.4	$122.5	$153.3	$79.0	$14.2	$18.0

Earnings on Investment

FY 2004 earnings on investment of $18.0 million were $7.0 million (28.1%) below original estimate and $8.6 million (32.2%) below the revised estimate. FY 2004 earnings on investment were up by $3.7 million (26.1%) from FY 2003 earnings on investment of $14.2 million.

Among the factors for the higher earnings on investment compared to the previous fiscal year were the increasing revenue collections available for investments and higher yields on fixed-income investments. In FY 2004 state revenues were higher than in FY 2003; therefore the amount of funds available for investment was higher. The improving economy helped push interest rates higher, increasing the return on fixed-income investments.

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[1] "Original" estimates for FY 2004 were made by the Office of Budget and Management in August 2003. These estimates were revised in March 2004.

[2] The "major taxes" are the personal income tax, the sales and use tax, the corporate franchise tax, the public utility excise tax, and the kilowatt-hour tax.

[3] Quarterly estimated payments are made by taxpayers who expect to be underwithheld by more than $500. Payments are due on or before April 15, June 15, and September 15 of the tax year and January 15 of the following year. These payments are usually made by taxpayers with significant nonwage income. This income often comes from investments, especially capital gains realized in the stock market. Most estimated payments are made by high-income taxpayers.

[4] The "clawback" provision is based on a comparison of the amounts credited to the local government funds under the freeze and the amounts that would have been credited to the funds in the absence of the freeze. The effect of the clawback is that the amounts credited to the local government funds are equal to the minimum of the amounts under the freeze or the amounts the funds would have received in the absence of the freeze.

[5] In June, up to $38 million that was previously credited to the state was distributed from GRF sales tax receipts to local governments for their share of sales tax revenues. This distribution reduced sales tax receipts in June and the fiscal year. State and local permissive sales taxes are collected at the same time for each taxable

transaction. Vendors generally determine the location of sales for distribution of the local share in the tax returns filed with the Department of Taxation. Certain tax returns do not provide for this information and timely distributions of the local share of sales tax revenues do not occur. Generally, permissive local tax revenues are distributed the month after the month of collection.

[6] Am. Sub. H.B. 40 changed the historical pattern of remittance of sales and use tax receipts starting in April 2003. Under prior law, monthly sales and use tax receipts reflected taxable transactions in the prior month. Under current law, certain large taxpayers must remit sales tax payments in the same month the transactions occur. Thus, monthly sales tax receipts reflect taxable transactions in both the current and the prior month.

[7] Am. Sub. H.B. 94 granted an amnesty for certain delinquent state taxes whereby outstanding tax delinquencies would be paid without payment of associated penalties and without payment of one-half of the accrued interest. Taxpayers had to apply for the amnesty between October 15, 2001 and January 15, 2002. The Ohio Tax Amnesty provided a boost of $16.3 million for the nonauto sales and use tax.

[8] 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. Most car, motorboat, and aircraft leases are included in the nonauto sales tax base, rather than the auto sales tax base.

[9] There might be instances where full tax remittance does not occur on schedule for certain counties. For example, in its monthly financial report of May 10, 2004, the Office of Budget and Management reported that one large county was not current with its payments.

[10] The relationship between Ohio corporate franchise tax receipts and measures of national corporate profits is not straightforward. The Ohio franchise tax has both a net worth tax base and a net income tax base, with corporations paying the higher of the two.

[11] The increases are in corporate profits with inventory valuation and capital consumption adjustment, 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. Profits from current production reflect depreciation charges and inventory changes calculated on an economic basis.

[12] The measure of corporate profits used here is before tax with an inventory valuation adjustment. BEA believes it is the best available measure of industry profits because estimates of the capital consumption adjustment by industry do not exist. This measure of profits is different from the one cited above.

[13] There was no revision to the estimate for June.

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

[15]Consumption of taxed cigarettes was estimated to decline up to 15% from the rate increase. 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.

[16] The corresponding tax rates are: 10 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% alcohol, 17 cents for a standard 750 ml bottle of wine with more than 14% alcohol, and 20.4 cents for a standard 750 ml bottle of mixed beverages.

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

[18] Similarly, commercial customers were paying over 20% more than they had the preceding year, while some industrial customers were paying over 30% more. Most deliveries of natural gas to industrial customers in Ohio were subject to long-term contracts, so only about 5% of deliveries were subject to this significant price increase.

[19] Taxes paid by domestic companies grew significantly during the transition years while taxes paid by foreign companies fell in several years. The higher Ohio taxes paid by domestic insurance companies were

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 fell even as they paid more taxes to Ohio. This reduction was not implemented intentionally by other states; it was an automatic result of applying the "retaliatory" tax that many states, including Ohio, impose while the tax rate that Ohio imposes on foreign insurance companies was falling.

[20] This is not as complicated as it may seem from this description. To illustrate, suppose that Pennsylvania imposes a tax of 2% on foreign insurers, including companies headquartered in Ohio, and suppose that Pennsylvania imposes a retaliatory tax. Then Pennsylvania would impose a tax rate of 2% on Ohio companies, since 2% is higher than Ohio's rate of 1.4%. Similarly, Ohio would impose a rate of 2% on Pennsylvania-based insurers (also because Pennsylvania's 2% rate is higher than Ohio's 1.4% rate). On the other hand, if Pennsylvania 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%) would be less than Ohio's foreign insurance tax rate (1.4%), and Ohio would begin to tax Pennsylvania companies at a rate of 1.4%.

Table 2
General Revenue Fund Revenue
Actual vs. Estimate
Month of June 2004
($ in thousands)

REVENUE SOURCE

TAX REVENUE	**Actual**	**Estimate***	**Variance**	**Percent**
Auto Sales	$99,249	$107,887	-$8,638	-8.0%
Nonauto Sales & Use	$541,028	$592,325	-$51,297	-8.7%
Total Sales	$640,277	$700,212	-$59,935	-8.6%
Personal Income	$901,961	$747,199	$154,762	20.7%
Corporate Franchise	$99,327	$63,441	$35,886	56.6%
Public Utility	$26,055	$31,400	-$5,345	-17.0%
Kilowatt Hour Excise Tax	$25,556	$26,103	-$547	-2.1%
Total Major Taxes	**$1,693,176**	**$1,568,355**	**$124,821**	**8.0%**
Foreign Insurance	-$2,897	$0	-$2,897	---
Domestic Insurance	$34,460	$3,200	$31,260	976.9%
Business & Property	$13,798	$1,734	$12,064	695.8%
Cigarette	$57,226	$47,600	$9,626	20.2%
Alcoholic Beverage	$4,951	$5,552	-$601	-10.8%
Liquor Gallonage	$2,547	$2,646	-$99	-3.7%
Estate	$14,770	$6,300	$8,470	134.4%
Total Other Taxes	$124,856	$67,032	$57,824	86.3%
Total Taxes	**$1,818,032**	**$1,635,387**	**$182,645**	**11.2%**
NONTAX REVENUE				
Earnings on Investments	$3,147	$6,750	-$3,603	-53.4%
Licenses and Fees	$3,254	$1,764	$1,490	84.5%
Other Revenue	$42,295	$49,500	-$7,205	-14.6%
Nontax Revenue	$48,695	$58,014	-$9,319	-16.1%
TRANSFERS				
Liquor Transfers	$9,000	$9,000	$0	0.0%
Budget Stabilization	$0	$0	$0	---
Other Transfers In	$262,663	$236,200	$26,463	11.2%
Total Transfers In	$271,663	$245,200	$26,463	10.8%
TOTAL REVENUE less Federal Grants	**$2,138,390**	**$1,938,601**	**$199,789**	**10.3%**
Federal Grants	$483,900	$504,233	-$20,333	-4.0%
TOTAL GRF REVENUE	**$2,622,290**	**$2,442,834**	**$179,456**	**7.3%**

* August 2003 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

Table 3
General Revenue Fund Revenue
Actual vs. Estimate
FY 2004
($ in thousands)

REVENUE SOURCE						
TAX REVENUE	**Actual**	**Estimate***	**Variance**	**Percent**	**FY 2003**	**Percent Change**
Auto Sales	$1,122,917	$1,138,300	-$15,383	-1.4%	$966,213	16.2%
Nonauto Sales & Use	$6,407,673	$6,495,400	-$87,727	-1.4%	$5,431,732	18.0%
Total Sales	$7,530,590	$7,633,700	-$103,110	-1.4%	$6,397,945	17.7%
Personal Income	$7,696,901	$7,602,000	$94,901	1.2%	$7,420,665	3.7%
Corporate Franchise	$809,172	$793,002	$16,170	2.0%	$747,196	8.3%
Public Utility	$226,446	$215,400	$11,046	5.1%	$218,678	3.6%
Kilowatt Hour Excise Tax	$338,961	$372,902	-$33,941	-9.1%	$339,853	-0.3%
Total Major Taxes	**$16,602,070**	**$16,617,004**	**-$14,934**	**-0.1%**	**$15,124,337**	**9.8%**
Foreign Insurance	$230,515	$230,000	$515	0.2%	$216,351	6.5%
Domestic Insurance	$165,902	$170,000	-$4,098	-2.4%	$160,126	3.6%
Business & Property	$29,893	$31,000	-$1,107	-3.6%	$30,000	-0.4%
Cigarette	$557,532	$560,000	-$2,468	-0.4%	$599,941	-7.1%
Alcoholic Beverage	$56,455	$60,000	-$3,545	-5.9%	$56,574	-0.2%
Liquor Gallonage	$30,870	$30,000	$870	2.9%	$29,737	3.8%
Estate	$64,242	$105,200	-$40,958	-38.9%	$100,811	-36.3%
Total Other Taxes	$1,135,409	$1,186,200	-$50,791	-4.3%	$1,193,540	-4.9%
Total Taxes	**$17,737,478**	**$17,803,204**	**-$65,726**	**-0.4%**	**$16,317,876**	**8.7%**
NONTAX REVENUE						
Earnings on Investments	$17,966	$25,000	-$7,034	-28.1%	$14,246	26.1%
Licenses and Fees	$50,152	$44,100	$6,052	13.7%	$33,667	49.0%
Other Revenue	$187,952	$209,000	-$21,048	-10.1%	$593,811	-68.3%
Nontax Revenue	$256,071	$278,100	-$22,029	-7.9%	$641,724	-60.1%
TRANSFERS						
Liquor Transfers	$118,000	$105,000	$13,000	12.4%	$115,000	2.6%
Budget Stabilization	$0	$0	$0	---	$115,423	-100.0%
Other Transfers In	$402,871	$415,300	-$12,429	-3.0%	$287,115	40.3%
Total Transfers In	$520,871	$520,300	$571	0.1%	$517,538	0.6%
TOTAL REVENUE less Federal Grants	**$18,514,420**	**$18,601,604**	**-$87,184**	**-0.5%**	**$17,477,138**	**5.9%**
Federal Grants	$5,516,383	$5,504,900	$11,483	0.2%	$4,972,430	10.9%
TOTAL GRF REVENUE	**$24,030,803**	**$24,106,504**	**-$75,701**	**-0.3%**	**$22,449,568**	**7.0%**

* August 2003 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

DISBURSEMENTS

*— Steve Mansfield**

For FY 2004, General Revenue Fund (GRF) expenditures (excluding transfers) totaled $23.8 billion, an increase of $1.2 billion (5.2%) from FY 2003 GRF spending. Actual spending differed from the Office of Budget and Management (OBM) estimate produced at the beginning of the year by $167.3 million. The bulk of the variance between actual spending and the estimate stemmed from three factors: (1) about $90.0 million in appropriations was cut by order of the Governor, (2) $167.7 million was lapsed through agencies spending less than the full amount of their appropriations and not encumbering the amounts not spent, and (3) a partial offset to these first two factors was provided through an appropriation increase of $80.0 million to the Department of Education.

A substantial part of the 5.2% increase in GRF expenditures consisted of Health Care/Medicaid expenditures, which were 11.3% higher in FY 2004 than in FY 2003. Although the appropriation for the Health Care/Medicaid program is made from the GRF, 58.7% of the total expenditure is made from federal funds. If these federal funds are excluded from the totals for both FYs 2003 and 2004, the GRF rate of growth is 3.1%. If we exclude Health Care/Medicaid expenditures entirely, we find that GRF expenditures in FY 2004 increased by $281.1 million (1.9%) over FY 2003 expenditures.

With these considerations in mind, the GRF growth rate is below the rate of growth in the consumer price index. From June 2003 to June 2004 the consumer price index for the Midwest region increased by 2.7%, while the increase for the nation as a whole was 3.3%. Excluding medical care, inflation for the nation as a whole for the year ending in June 2004 was 3.1%. Thus, Ohio's real spending on nonmedical goods and services actually went down in FY 2004.

Table 5 shows that several program categories had lower expenditures in FY 2004 compared to FY 2003. Percentage and dollar changes from FY 2003 to FY 2004 for the larger categories are given in Exhibit 1, below.

June's disbursements were $57.0 million over estimate for the month. 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 two program categories (Education and Tax Relief) registered positive disbursement variances for the month ($64.4 million and $55.6 million, respectively) and ended the year with disbursements exceeding the estimate. The Education category was over estimate by $44.5 million, and the Tax Relief program was over estimate by $10.8 million. In each case, as will be discussed in more detail below, this was the result of an increase in appropriation. The

Exhibit 1. Summary of FY 2004 Program Expenditures

Program Expenditure Category	$ Change (in millions)	FY 2003 Percentage Change
Primary and Secondary Education	$205	1.0%
Higher Education	-$5	-0.9%
Health Care/Medicaid	$909	11.3%
Temporary Assistance for Needy Families	$4	1.2%
Other Welfare	-$21	-4.6%
Human Services	$29	2.6%
Justice and Corrections	$37	2.0%
Other Government	-$22	-5.8%
Property Tax Relief	$29	2.3%
Debt Service	$79	30.7%

other two program categories (Government Operations and Welfare and Human Services) registered negative disbursement variances in June, as well as for the fiscal year (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's negative disbursement variance. Summary information about GRF disbursement activity is presented in Tables 4 and 5, and a detailed analysis of disbursement activity in the Health Care/Medicaid program is presented in Tables 6 and 7.

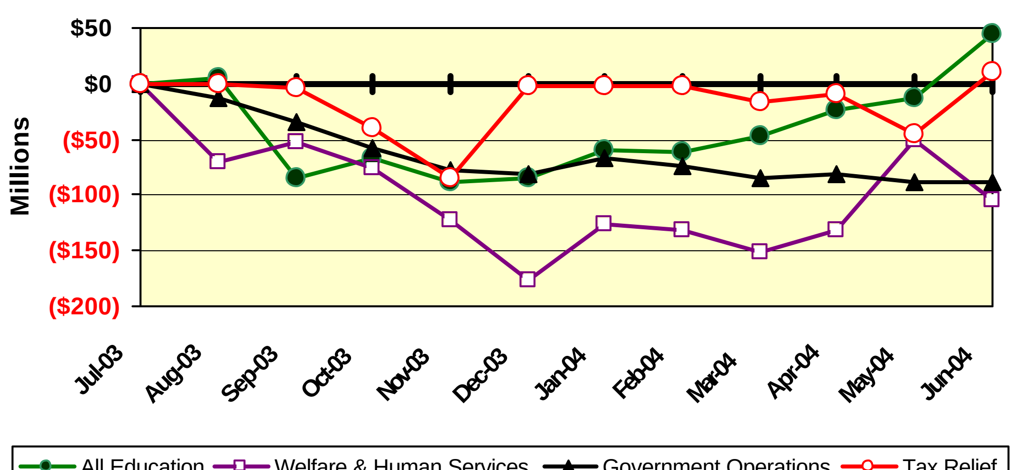
The state's other major program category, Debt Service, figures significantly in the FY 2004 disbursement story. In Table 5 we see that Debt Service ended FY 2004 $28.5 million under estimate. For the most part, this variance was the result of interest rates being lower than expected. When we look at the comparison with FY 2003, however, we see that FY 2004 Debt Service expenditures increased by $79.3 million. The bulk of this increase stems from a transfer of tobacco settlement funds to the GRF that would otherwise have been transferred to the Education Facilities Trust Fund. Bonds were then issued on behalf of the School Facilities Commission to make up for its loss of tobacco settlement revenue. As well, more general obligation bonds instead of special obligation bonds were issued for state college and university projects. Interest rates on general obligation bonds are lower than interest rates on special obligation bonds.

Welfare/Human Services (-$104.0 million)

With a negative disbursement variance of $53.1 million in June, the Welfare/Human Services category as a whole finished the fiscal year at $104.0 million below the estimate for the year to date. The largest contributors to the year's negative disbursement variance in this category were the Other Welfare subcategory ($65.4 million below estimate) and the Human Services subcategory ($33.0 million below estimate). The Health Care/Medicaid subcategory finished the year with a relatively small negative variance of $4.3 million from the total disbursement estimate of $8,917.2 million. The Temporary Assistance for Needy Families (TANF) program finished the year with a small positive variance of $194,000. The following paragraphs discuss the disbursements in the components of this category in more detail.

Job and Family Services. FY 2004 disbursements for the Department of Job and Family Services' operating expenses and subsidy programs (which are captured in the "Other Welfare" subcategory in Tables 4 and 5 and

Figure 1
GRF Disbursement Variances by Program Category, FY 2004



which exclude Medicaid, TANF, and Disability Assistance and are tracked as separate components of the Welfare and Human Services program category) were $65.4 million under the estimate. Budget reductions of approximately $15 million were ordered for this subcategory by the Governor in March. In addition, in June, the Controlling Board approved the transfer of $15.8 million from several line items in the Department's budget to line item 600-525, Health Care/Medicaid.

Line item 600-416, Computer Projects, with a negative variance of $32.6 million, was the largest single item contributing to the category's negative disbursement variance for the year. The reduction in spending stems from $5.2 million in budget reductions in March, a Controlling Board transfer of $9.8 million in June, and a lapse of $16.1 million. An additional $8.9 million lapsed during FY 2004 from encumbered FY 2003 funds. These reductions and lapses were accomplished largely through changes in timelines and rollout schedules for various computer projects at the state and county levels.

Line item 600-321, Support Services, contributed $18.1 million to the negative disbursement variance for the year. Spending from this line-item appropriation was reduced by $5.7 million as a result of the budget reductions that were ordered in March, and $6.6 million was transferred by the Controlling Board in June. In addition, the Department encumbered $4.3 million of this line item for use in FY 2005 and will lapse approximately $500,000 in FY 2004 appropriations and $1.0 million in appropriations encumbered from FY 2003.

Line item 600-440, Ohio's Best RX, established in Am. Sub. H.B. 311 of the 125th General Assembly, carried an appropriation of $10.0 million for start-up costs. Due to the late start date of the program, $9.9 million of the appropriation was transferred to FY 2005.

Line item 600-528, Adoption Services, was also a significant contributor to the negative disbursement variance for the year. The underspending in Adoption Services, which amounted to $9.2 million, stemmed in large part from a lower than expected rate of growth in the program, from a reduction in appropriation of $3.4 million, and from an encumbrance of $3.8 million of the FY 2004 appropriation.

Mental Health. The Department of Mental Health posted a negative year-end variance of $9.1 million. Of this total, $5.1 million resulted from budget reductions ordered in March. Almost all of the variance is traceable to the Department's largest GRF subsidy appropriation: line item 334-408, Community and Hospital Mental Health Services. Spending from this line-item appropriation was reduced by $4.3 million in March, and $2.6 million of the remaining appropriation was encumbered. Approximately half of this line item goes for hospital payroll and half goes for community mental health boards.

Line item 335-505, Local Mental Health Systems of Care, finished the year with a negative variance of $1.1 million. This appropriation, which is used by the state's 50 mental health boards for community mental health programs, was reduced by about $500,000; also, about $600,000 was unencumbered.

Health. The Department of Health posted a negative disbursement variance of $5.2 million. Of this total variance, $2.9 million resulted from budget reductions ordered by the Governor. The line item with the largest negative variance ($4.1 million) was 440-418, Immunizations. These unspent funds were encumbered. The variance in line item 440-418 is timing-related and happens every year in the process of ordering vaccines for the period of high usage that occurs just prior to the start of the school year. The three largest budget reductions were made in line items 440-451, Lab and Public Health Prevention Programs (approximately $585,000), 440-413, Healthy Communities (approximately $510,000), and 440-453, Health Care Quality Assurance (approximately $480,000). While the reductions in line items 440-451 and 440-453 were largely accomplished through personnel savings, the reduction in line item 440-413 was accomplished by eliminating Healthy Ohioan local grants. These grants would have funded behavior assessments or pilot projects related to building healthy communities.

Table 4
General Revenue Fund Disbursements
Actual vs. Estimate
Month of June 2004
($ in thousands)

USE OF FUNDS

PROGRAM	**Actual**	**Estimate***	**Variance**	**Percent**
Primary & Secondary Education (1)	$543,415	$478,979	$64,436	13.5%
Higher Education	$140,476	$147,630	-$7,154	-4.8%
Total Education	$683,891	$626,609	$57,283	9.1%
Health Care/Medicaid	$777,712	$817,993	-$40,281	-4.9%
TANF	$7	$0	$7	---
General/Disability Assistance	$498	$374	$124	33.1%
Other Welfare (2)	$22,467	$23,487	-$1,020	-4.3%
Human Services (3)	$40,786	$52,687	-$11,901	-22.6%
Total Welfare & Human Services	$841,469	$894,541	-$53,072	-5.9%
Justice & Corrections	$132,422	$131,603	$819	0.6%
Environment & Natural Resources	$5,426	$5,187	$239	4.6%
Transportation	$807	$831	-$24	-2.9%
Development	$12,638	$7,236	$5,402	74.6%
Other Government	$16,675	$23,930	-$7,255	-30.3%
Capital	$0	$412	-$412	-100.0%
Total Government Operations	$167,967	$169,200	-$1,233	-0.7%
Property Tax Relief (4)	$200,407	$144,800	$55,607	38.4%
Debt Service	$24,814	$26,402	-$1,588	-6.0%
Total Program Payments	**$1,918,549**	**$1,861,551**	**$56,997**	**3.1%**
TRANSFERS				
Local Govt Distribution	$0	$0	$0	---
Budget Stabilization	$0	$0	$0	---
Other Transfers Out	$1,294	$0	$1,294	---
Total Transfers Out	$1,294	$0	$1,294	---
TOTAL GRF USES	**$1,919,843**	**$1,861,551**	**$58,291**	**3.1%**

(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 2003 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

Table 5
General Revenue Fund Disbursements
Actual vs. Estimate
FY 2004
($ in thousands)

USE OF FUNDS

PROGRAM	Actual	Estimate*	Variance	Percent	FY 2003	Percent Change
Primary & Secondary Education (1)	$6,478,701	$6,417,700	$61,001	1.0%	$6,273,738	3.3%
Higher Education	$2,331,167	$2,347,664	-$16,496	-0.7%	$2,352,692	-0.9%
Total Education	$8,809,868	$8,765,364	$44,504	0.5%	$8,626,430	2.1%
Health Care/Medicaid	$8,912,897	$8,917,152	-$4,255	0.0%	$8,008,531	11.3%
TANF	$356,740	$356,740	$0	0.0%	$352,741	1.1%
General/Disability Assistance	$21,349	$22,839	-$1,490	-6.5%	$24,488	-12.8%
Other Welfare (2)	$442,038	$507,464	-$65,426	-12.9%	$463,159	-4.6%
Human Services (3)	$1,144,427	$1,177,393	-$32,967	-2.8%	$1,115,660	2.6%
Total Welfare & Human Services	$10,877,450	$10,981,588	-$104,138	-0.9%	$9,964,579	9.2%
Justice & Corrections	$1,864,950	$1,921,325	-$56,375	-2.9%	$1,828,110	2.0%
Environment & Natural Resources	$113,180	$116,742	-$3,562	-3.1%	$114,683	-1.3%
Transportation	$27,158	$26,572	$586	2.2%	$32,265	-15.8%
Development	$141,793	$143,682	-$1,889	-1.3%	$169,984	-16.6%
Other Government	$353,197	$377,977	-$24,780	-6.6%	$374,922	-5.8%
Capital	$0	$4,214	-$4,214	-100.0%	$0	---
Total Government Operations	$2,500,279	$2,590,512	-$90,234	-3.5%	$2,519,964	-0.8%
Property Tax Relief (4)	$1,313,229	$1,302,400	$10,829	0.8%	$1,283,826	2.3%
Debt Service	$337,853	$366,352	-$28,499	-7.8%	$258,529	30.7%
Total Program Payments	**$23,838,679**	**$24,006,217**	**-$167,538**	**-0.7%**	**$22,653,329**	**5.2%**
TRANSFERS						
Local Govt Distribution	$0	$0	$0	---	$0	---
Budget Stabilization	$0	$0	$0	---	$0	---
Other Transfers Out	$55,337	$26,200	$29,137	111.2%	$18,917	192.5%
Total Transfers Out	$55,337	$26,200	$29,137	111.2%	$18,917	192.5%
TOTAL GRF USES	**$23,894,016**	**$24,032,416**	**-$138,400**	**-0.6%**	**$22,672,246**	**5.4%**

(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 2003 estimates of the Office of Budget and Management.

Detail may not sum to total due to rounding.

Table 6
Health Care Spending in FY 2004
Medicaid, ALI 600-525
($ in thousands)

Service Category	June Actual	June Estimate	June Variance	June Percent Variance	Year-to-Date Spending Actual thru June	Year-to-Date Spending Estimate thru June	Year-to-Date Spending Variance	Year-to-Date Spending Percent Variance
Nursing Facilities	$176,754	$177,010	($257)	-0.1%	$2,431,566	$2,339,875	$91,691	3.9%
Payments	$229,525	$218,570	$10,955	5.0%	$2,709,358	$2,618,597	$90,761	3.5%
NF Franchise Fees Offset[1]	($52,771)	($41,560)	($11,211)	27.0%	($277,793)	($278,722)	$930	-0.3%
ICF/MR	$36,181	$35,408	$772	2.2%	$421,524	$420,788	$736	0.2%
Payments	$37,841	$37,077	$764	2.1%	$441,839	$441,368	$472	0.1%
ICF/MR Franchise Fees Offset	($1,661)	($1,669)	$9	-0.5%	($20,315)	($20,579)	$264	-1.3%
Inpatient Hospitals	$131,651	$129,152	$2,499	1.9%	$1,330,969	$1,347,878	($16,909)	-1.3%
Outpatient Hospitals	$60,960	$57,589	$3,371	5.9%	$596,387	$588,605	$7,781	1.3%
Physicians	$56,520	$58,571	($2,051)	-3.5%	$589,015	$591,316	($2,300)	-0.4%
Prescription Drugs	$179,222	$174,931	$4,291	2.5%	$1,777,734	$1,758,079	$19,655	1.1%
HMO	$82,601	$78,724	$3,877	4.9%	$997,645	$962,175	$35,471	3.7%
Medicare Buy-In	$14,566	$14,004	$562	4.0%	$161,515	$160,793	$722	0.4%
ODJFS Waiver[2]	$19,838	$23,419	($3,582)	-15.3%	$195,199	$225,771	($30,572)	-13.5%
All Other[3]	$84,101	$94,778	($10,677)	-11.3%	$868,283	$935,966	($67,683)	-7.2%
CHIP II[4]	$6,746	$6,270	$476	7.6%	$72,428	$66,660	$5,768	8.7%
DA Medical[5]	$6,000	$10,114	($4,114)	-40.7%	$81,662	$100,698	($19,037)	-18.9%
Total ALI 600-525	$855,139	$859,971	($4,832)	-0.6%	$9,523,926	$9,498,604	$25,322	0.3%
DSH Offset	$0	$0	$0		($116,210)	($120,719)	$4,509	
Drug Rebates	($77,428)	($41,978)	($35,449)		($457,891)	($420,951)	($36,940)	
FY 2002 Encumbrance	$0	$0	$0		($71,000)	($39,781)	($31,219)	
Prior Period ALI 600-525	$0	$0	$0		$34,073	$0	$34,073	
Total Health Care (Net of Offsets)	**$777,712**	**$817,993**	**($40,281)**	**-4.9%**	**$8,912,897**	**$8,917,152**	**($4,255)**	**0.0%**
Est. Federal Share[6]	$456,483	$480,127	($23,643)		$5,231,487	$5,233,985	($2,498)	
Est. State Share	$321,228	$337,866	($16,638)		$3,681,410	$3,683,167	($1,758)	

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 for FYs 2003 through 2005.
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 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. The federal madical assistance percentage (FMAP) used in this table is a blended rate of 58.70%.

Note: Due to accounting differences, the totals do not exactly match the amounts from Tables 4 and 5.

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

Mental Retardation and Developmental Disabilities. For FY 2004, the Department of Mental Retardation and Developmental Disabilities posted a negative disbursement variance of $14.9 million. Of this total variance, $3.3 million resulted from the ordered reduction in spending. There are three notable line items that account for most of the remainder of the variance. 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 $4.7 million; $4.4 million of this is encumbered. Line item 322-416, Waiver State Match, registered a negative disbursement variance of $4.6 million, and this has also been encumbered. Line item 322-416 funds the state share of two home and community-based Medicaid waivers. Line item 323-321, Residential Facilities Operations, supports personnel expenditures at the Department's developmental centers. Disbursements from this line item finished the year $3.5 million below the estimate, and $1.1 million of this was encumbered.

Health Care/Medicaid. For FY 2004, the Health Care/Medicaid program (primarily line item 600-525) posted a $4.3 million negative disbursement variance. A total of $8,912.9 million was spent in this program in FY 2004. The estimate for FY 2004 for line item 600-525 had built into it a transfer of up to $18.6 million that the federal government made available through the Jobs and Growth Tax Relief Reconciliation Act of 2003 (H.R. 2). (See the May Disbursements report for more detail on these federal funds.) Total spending in the program increased by $904.4 million over FY 2003, an increase of 11.3%.

The average monthly number of eligibles in the program increased by 93,298 over FY 2003, a 6.0% increase. However, the average monthly number of health care eligibles in the program during FY 2004 was 6,236 below what was budgeted. Most of the reduction in anticipated eligibles was in the Aged, Blind, and Disabled (ABD) portion of the caseload. The ABD population in the Health Care/Medicaid program accounts for about 70% of the total costs in the program.

Table 7
FY 2004 to FY 2003 Comparison of Health Care Spending
($ in thousands)

Service Category	FY 2004 Yr.-to-Date as of June '04	FY 2003 Yr.-to-Date as of June '03	Dollar Change	Percent Increase
Nursing Facilities	$2,431,566	$2,331,438	$100,128	4.3%
Payments	$2,709,358	$2,591,745	$117,614	4.5%
NF Franchise Fees Offset[1]	($277,793)	($260,307)	($17,486)	6.7%
ICF/MR	$421,524	$408,925	$12,599	3.1%
Payments	$441,839	$429,244	$12,595	2.9%
ICF/MR Franchise Fees Offset	($20,315)	($20,319)	$5	0.0%
Inpatient Hospitals	$1,330,969	$1,260,304	$70,664	5.6%
Outpatient Hospitals	$596,387	$537,138	$59,248	11.0%
Physicians	$589,015	$525,625	$63,391	12.1%
Prescription Drugs	$1,777,734	$1,522,255	$255,479	16.8%
HMO	$997,645	$661,634	$336,012	50.8%
Medicare Buy-In	$161,515	$147,007	$14,508	9.9%
ODJFS Waiver[2]	$195,199	$170,771	$24,427	14.3%
All Other[3]	$868,283	$775,535	$92,748	12.0%
CHIP II[4]	$72,428	$57,660	$14,769	25.6%
DA Medical[5]	$81,662	$94,243	($12,581)	-13.3%
Total Health Care	**$9,523,926**	**$8,492,535**	**$1,031,391**	**12.14%**
DSH Offset	($116,210)	($136,354)	$20,144	
Drug Rebates	($457,891)	($348,745)	($109,146)	
Prior Year Encumbrance	($71,000)	($83,539)	$12,539	
Prior Period ALI 600-525	$34,073	$84,635	($50,562)	
Total Health Care (Net of Offsets)	**$8,912,897**	**$8,008,532**	**$904,366**	**11.29%**
Est. Federal Share[6]	$5,231,487	$4,700,664	$530,824	
Est. State Share	$3,681,410	$3,307,868	$373,542	

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 for FYs 2003 through 2005.
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 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. The federal madical assistance percentage (FMAP) used in this table is a blended rate of 58.70%.

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

When we look at the specific service categories of health care expenditures in Table 6, we see that payments in the Nursing Facilities category were over budget by $91.7 million. Over half of the variance in this category is traceable to higher than expected "bed days."

The Inpatient Hospitals category was under budget by $16.9 million. Part of the explanation for this variance is an adjustment to payments to children's hospitals, and part of the explanation is a stronger than anticipated use of health maintenance organizations (HMOs).

Correspondingly, we see in Table 7 that the growth rate in HMO expenditures increased by 50.8%, and, in Table 6, that expenditures in the HMO category were $35.5 million over the estimate. The policy of "preferred options" has had a great impact on HMO enrollments. The "preferred option" program exists in counties where there is voluntary enrollment in managed care plans. The program automatically enrolls recipients in managed care if they fail to select the traditional fee-for-service option.

Changes in eligibility explain the negative variances in both the ODJFS Waiver and DA Medical categories. Along with a high rate of inflation, a greater than anticipated prescription utilization rate (prescriptions per person) accounts for much of the $19.7 million variance in the Prescription Drugs category. The 25.6% growth rate in the CHIP II program (which provides

Medicaid coverage for children whose family income is between 150% and 200% of the federal poverty level) is due to the fact that most of this population receives services through HMOs, and this portion of the caseload has experienced strong growth.

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 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, the disbursement reports on line items 600-410 and 600-413 show a slight negative disbursement variance under $200. Total FY 2004 disbursements from these two components of Ohio's TANF Maintenance of Effort (MOE) requirement were $356.7 million, down by $16.0 million from FY 2003.

The Department disbursed or transferred to other programs a total of $662.6 million from federal TANF funds during FY 2004. In FY 2003 this figure was $703.9 million.

TANF cash assistance benefits paid during the fiscal year totaled $316.4 million, up $4.0 million from FY 2003. The average number of TANF cash assistance groups per month increased from FY 2003 to FY 2004 by 800 to stand at about 87,000. The average number of TANF recipients per month, however, decreased from FY 2003 to FY 2004 by 377 to stand at about 194,000. 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 almost 50% of all TANF cases.

Alcohol and Drug Addiction Services. FY 2004 disbursements in the Department of Alcohol and Drug Addiction Services were $1.8 million below estimate. The variance is almost completely due to the budget reductions ordered in March. The reductions were evenly distributed across the Department's three GRF line items. In terms of impact, the reduction in line item 038-401, Treatment Services, according to the Department, puts the appropriation very close to the minimum needed for meeting the maintenance of effort requirement to receive federal funds under the Substance Abuse Prevention and Treatment Block Grant program.

Aging. The Department of Aging finished FY 2004 with a negative disbursement variance of just over $900,000. Nearly $500,000 of the variance stemmed from the budget reductions ordered in March. Besides contributing about $175,000 to the reductions, spending for line item 400-414, Alzheimer's Respite, with the largest variance in the Department's budget, finished the year another $385,000 under the estimate.

Government Operations (-$90.2 million)

Disbursements for the Government Operations category for FY 2004 were $90.2 million under the estimate. The Department of Rehabilitation and Correction accounted for just over half of this amount with a negative variance of $47.0 million, the Judiciary/Supreme Court accounted for $9.9 million, and the Department of Youth Services accounted for $7.2 million. Offsetting positive disbursement variances were posted by the Department of Public Safety ($9.5 million), Court of Claims ($2.2 million), Department of Transportation (approximately $585,000), and Adjutant General (approximately $220,000). The remaining 30 agencies in the category each posted relatively small negative disbursement variances. The details of disbursements in the category will be discussed in the following paragraphs in order of their magnitude.

Rehabilitation & Correction. In FY 2004, the Department of Rehabilitation and Correction disbursed $47.0 million less than the estimate. Total appropriations to the Department were reduced by $12.9 million in March. Within the Department's budget, a total of $8.0 million was transferred by the Controlling Board from several line items to line item 505-321, Institutional

Medical Services, to cover increased medical costs (both increased medical inflation and a growing caseload of inmates with Hepatitis C are cited as reasons).

Over half of the negative disbursement variance for the year stems from line item 501-321, Institutional Operations, which was under the estimate by $27.4 million. This line item supports the operation of the state's 32 adult prisons. Line item 501-321 had an original appropriation of $848.6 million for the year. This was reduced by executive order by $7.4 million, and another $1.0 million was transferred. Most of the remaining negative variance in this line item reflects lower expenditures for personnel than had been anticipated. When the Lima Correctional Institution closed in July 2003, some staff positions were eliminated while other positions, particularly corrections officers, were to be moved to other northern institutions and paid with funds saved from the closing. With the closure delayed in the courts, personnel adjustments in the northern institutions did not occur, resulting in understaffing problems and lower than expected expenditures for salaries. Eventually the courts cleared the way and the Lima facility is now closed.

Development. The Department of Development finished FY 2003 with a negative disbursement variance that was just under $112,000. The Department's original GRF appropriation for FY 2004 was $100.3 million, from which $1.6 million was cut in the reductions made in March. From the remaining appropriation for FY 2004, the Department disbursed $48.6 million and encumbered $48.9 million. With this level of disbursement, how did the variance come in at a mere $112,000 under the estimate? The Department had, at the beginning of the fiscal year, encumbrances of $75.9 million from prior fiscal years going back to 1997, and disbursed $38.2 million of this in FY 2004. Thus, the Department disbursed a total of $86.8 million out of an estimated $86.9 million.

Looking at particular programs, and considering both current and prior-year funds, there are a number of offsetting variances of significance. Line item 195-515, Economic Development Contingency, was over estimate by $7.5 million, and line item 195-422, Third Frontier Action Fund, was over estimate by $1.6 million. Because funds are requested for projects on an as-needed basis, it is difficult for the Department to predict when the funds will be requested. In both of these circumstances, as in most cases, the companies awarded grants under these programs requested the funds faster than had been anticipated when disbursement estimates were developed.

Noteworthy items below estimate included line item 195-401, Thomas Edison Program ($2.8 million under estimate), line item 195-434, Investment in Training Grants ($2.2 million under estimate), line item 195-407, Travel and Tourism ($1.6 million under estimate), and line item 195-412, Business Development Grants ($0.9 million under estimate).

Public Works Commission. For FY 2004, the Public Works Commission posted a negative disbursement variance of $12.8 million. This disbursement variance is largely due to the timing of infrastructure and conservation project requests compared to available funding. The Public Works Commission receives approximately $120 million per fiscal year from the sale of capital improvement bonds and $37.5 million per fiscal year from the sale of conservation bonds. The debt service on these bonds, which includes payment of principal and interest, is typically paid from the GRF twice a year. Debt service payments may fluctuate with the carryforward of unused bonding authority and with the interest rate obtained at the time the bonds are issued.

Taxation. The Department of Taxation ended FY 2004 with a negative disbursement variance of $6.1 million, $3.7 million of which was due to a budget reduction in line item 110-321, Operating Expenses. The remainder of the variance is traceable to a lapse of $3.1 million, also from line item 110-321. These savings were largely accomplished through reduced personnel costs.

Administrative Services. Disbursements by the Department of Administrative Services in FY 2004 were $4.9 million less than estimated. Approximately $900,000 of this variance is due to the budget reductions. A little over $500,000 of the budget reductions were made in three computer services line items: 100-417, MARCS, 100-419, Network Security, and 100-421, OAKS Project Implementation. The MARCS line item funds costs related to backbone costs of the Multi-Agency Radio Communication System. The Network Security line item pays for the establishment, implementation, and proliferation of e-security initiatives throughout the state's network infrastructure. The OAKS Project Implementation line item is used to coordinate the creation of the Ohio Administrative Knowledge System that is being developed along with OBM, the Treasurer of State, and the Auditor of State.

Youth Services. The Department of Youth Services finished FY 2004 with a negative disbursement variance of $7.2 million. Of this total, $1.5 million is traceable to budget reductions ordered in March. The bulk ($4.6 million) of the remaining 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. All of the unspent funds in line item 470-401 were encumbered.

Judiciary/Supreme Court. In FY 2004, Judiciary/Supreme Court registered a $9.9 million negative disbursement variance. Part of this variance is the result of a voluntary $6.9 million reduction in spending from line item 005-321, Operating Expenses. The bulk of the savings in this line item was the result of a delay in occupying the Ohio Judicial Center building. Almost all of the rest of the negative variance was also in this line item, and $2.3 million of this has been encumbered.

Public Safety. The Department of Public Safety ended FY 2004 with a positive disbursement variance of $9.5 million. This was solely due to a transfer of $10.6 million from two special revenue funds of the Controlling Board to cover emergency services and relief related to flooding and tornados in Ohio.

Court of Claims. A positive disbursement variance of $2.0 million present in the budget of the Court of Claims is traceable to line item 015-402, Wrongful Imprisonment Compensation. Payments for the Ohio Wrongful Imprisonment Compensation program have, since its inception, been paid through the Court of Claims. However, line item 015-402 is never appropriated in the biennial budget bill. The line item's funds are transferred from the Controlling Board's budget on an as-needed basis to compensate individuals who have been judged wrongfully imprisoned in the state of Ohio. When a wrongful imprisonment judgment has been journalized in a court of common pleas, the Controlling Board, upon certification by the Court of Claims, transfers the sum necessary to the line item. The payments were provided to individuals who won wrongful imprisonment lawsuits against the state of Ohio. A disbursement made in November to an individual who was wrongfully incarcerated for almost ten years was the largest wrongful imprisonment payment in the history of Ohio's program.

Natural Resources. The Department of Natural Resources finished FY 2004 with a negative disbursement variance of $2.8 million for the year. Half of this variance is due to budget reductions and most of the remainder to payments from a debt service line item (725-413, OPFC Lease Rental Payments) that were lower than estimated by $1.5 million.

Attorney General. FY 2004 disbursement activity by the Attorney General was $2.4 million under estimate. The budget reductions ordered in March accounted for $2.3 million of the total variance. With a reduction of $1.2 million, line item 055-321, Operating Expenses, accounted for the largest part of the disbursement variance. Line item 055-406, Community Police Match and Law Enforcement Assistance, was reduced by $1.1 million. Line item 055-406 is used to provide grants to local law enforcement agencies and communities.

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 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 reductions.

Agriculture. For FY 2004, the Department of Agriculture had a negative disbursement variance of $1.7 million. Almost half of this variance resulted from March's budget reductions. Among the Department's GRF appropriation items, line item 700-401, Animal Disease Control, had the largest reduction, just over $300,000. The bulk of the remainder of the disbursement variance is accounted for by encumbrances in most of the Department's other GRF line items.

Public Defender. The Public Defender Commission finished FY 2004 with a negative disbursement variance of $1.4 million. Line item 019-501, County Reimbursement – Non-Capital Cases, accounts for all of the total variance for the year, as its appropriation was reduced by $1.4 million in March. This line item is used to reimburse counties for up to 50% of their costs of operating county public defender offices, joint county public defender offices, and appointed counsel systems.

Auditor. The Auditor of State posted total disbursements in FY 2004 that were $1.6 million below estimate. Of this variance, $1.4 million stemmed from the budget reductions ordered in March. The bulk of the reduction was absorbed by line item 070-321, Operating Expenses.

Environmental Protection Agency. The Environmental Protection Agency ended FY 2004 with a negative disbursement variance of nearly $900,000. Virtually all of the Agency's variance was the result of a budget reduction of $845,000. The cut was absorbed mostly through personnel savings in the Agency's several operating line items.

Transportation. For FY 2004, the Department of Transportation posted a positive disbursement variance of approximately $0.7 million. The largest contributor to the variance was line item 775-451, Public Transportation-State, which posted disbursements $2.1 million above estimate. The variance in this line item can be attributed to the early release of grant money for the Elderly and Disabled Fare Assistance Program. There were also some additional but smaller timing-driven positive variances in other grant programs in the Department. These positive variances were only partially offset with negative variances. In total, the Department disbursed $10.9 million from FY 2004 appropriations, $16.3 million from encumbrances from previous years, and encumbered $13.7 million from the FY 2004 appropriation of $25.0 million.

Governor. Disbursement activity in the Office of the Governor ended FY 2004 with a variance of $0.7 million. A budget reduction of approximately $200,000 was ordered in March. Approximately $475,000 of the appropriation for FY 2004 was allowed to lapse, most of which was from line item 040-321, Operating Expenses.

House. The House of Representatives posted a negative variance of $0.5 million. A voluntarily accepted budget reduction in the House's one GRF appropriation item accounts for all of the variance.

Senate. The Senate also posted a negative variance of $0.5 million. A voluntarily accepted budget reduction in the Senate's one GRF appropriation item accounts for most of the variance.

Arts and Sports Facilities Commission. The Arts and Sports Facilities Commission posted a negligible disbursement variance. However, one noteworthy item is that $1.9 million of an estimated $2.2 million encumbrance in line item 371-401, Lease Rental Payments, was allowed to lapse. This was due to an estimate for debt service that was higher than needed.

Adjutant General. The Adjutant General finished FY 2004 with a positive disbursement variance in line item 745-409, Central Administration, that was a little over $200,000. The variance was merely the result of the estimates that had assumed that these funds would be encumbered. The payments from this line item were instead processed during the fiscal year.

Tax Relief ($10.8 million)

In June, tax relief payments totaled $200.4 million, $55.6 million over the estimate for the month, resulting in a $10.8 million positive disbursement variance for the fiscal year. This positive variance is most likely due to higher property valuations and higher homestead exemption payments than had been anticipated. These additional funds were appropriated by language in Section 104 of Am. Sub. H.B. 95 providing any additional funds that are necessary for the program.

The Property Tax Relief program, which carried an FY 2004 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.

Education ($44.5 million)

Disbursements in the Education category finished FY 2004 $44.5 million over the estimate. With a positive disbursement variance of $65.8 million, the Department of Education accounted for all of the category's positive disbursement variance. The variance was offset somewhat by a negative variance of $16.5 million posted by the Board of Regents and by some smaller negative variances in the budgets of other agencies in the category. This section discusses disbursements of these agencies and a few of the other small agencies in the category.

Department of Education. As just noted, the Department of Education finished FY 2004 with a positive variance of $65.8 million; $62.5 million of this positive variance was posted in June. Disbursements from appropriation line items affected by Average Daily Membership (ADM) figures were the main force behind this spending overestimate. ADM figures for FY 2004 came in about 7,000 students above estimate. Special education ADM for FY 2004 came in about 10,000 students above estimate. Also, business personal tangible property values fell more than had been anticipated. (When property values fall, state aid goes up.) For all these reasons, the Controlling Board approved the transfer of $32.8 million to this line item from other line items. In addition, Sub. H.B. 434 (the Tobacco Settlement Appropriations Act) increased the appropriation for this item by $80 million.

For FY 2004, the Governor's budget reductions for the Department of Education totaled $16.6 million. However, due to the higher than anticipated ADM count, $12.5 million of this cut was forgiven to help make up the shortage.

The Department entered FY 2004 carrying $56.9 million in GRF funds that had either been encumbered or were part of an available appropriation balance from prior fiscal years, some of which dated back to FY 2000. At the end of FY 2004, $42.6 million of this had been disbursed, $11.6 million remained encumbered, and $2.7 million was allowed to lapse.

Out of FY 2004 appropriations, several lines had funds encumbered. Total encumbrances were $50.0 million. The Department lapsed $9.0 million in FY 2004 appropriations.

Disbursements from line item 200-501, Base Cost Funding, were $109.6 million over estimate for the year. This appropriation item is the largest one in the Department's budget, with a total appropriation for FY 2004 of $4,397.1 million. The line item funds school districts according to the base cost formula developed by the General

Assembly to provide educational services to Ohio public school students.

Also adding to the positive disbursement variance in the Department of Education's budget was line item 200-502, Pupil Transportation, which is also part of the formula funding. Line item 200-502, finished FY 2004 with a positive disbursement variance of $25.2 million. As part of the transfers approved by the Controlling Board in May, $25.4 million was transferred to this line item to cover the shortfall that was apparent after the ADM data became available.

Line item 200-520, Disadvantaged Pupil Impact Aid (DPIA), posted for the year a negative disbursement variance of $28.8 million. This line item is used to provide funds to school districts that incur higher educational costs due to their higher concentrations of economically disadvantaged students. Most of these funds are distributed directly to school districts. In prior years, this distribution was based on formulas, but Am. Sub. H.B. 95 of the 125th General Assembly provided that districts receiving DPIA in FY 2003 receive a 2% annual increase in FY 2004 and FY 2005. This line item is one of several that together fund the state's formula aid obligation to school districts. In May, along with the other transfers, the Controlling Board approved the transfer of $27.3 million out of this line item to cover other formula obligations.

Line item 200-426, Ohio Educational Computer Network, finished FY 2004 $5.7 million under the estimate. These funds are used to maintain and provide technical assistance for a system of information technology throughout Ohio in support of the State Education Technology Plan. The bulk of the funds are used to support connecting public and state-chartered nonpublic schools to the state's education network, to each other, and to the Internet. The sum of $5.0 million was transferred from this line item to fund the formula line items. Of these transferred funds, $3.0 million was for a "Third Frontier" project intended to upgrade school connectivity to "T-1 connections."

Line item 200-525, Parity Aid, ended FY 2004 with its total disbursements for the year under estimate by $4.5 million. This line item provides state aid above the basic education level to eligible school districts and is part of the school funding formula appropriations. In May, the Controlling Board approved a transfer of $5.4 million out of this line, but in June $915,245 was transferred back due to another change in the ADM count.

Regents. The Board of Regents' total appropriations for FY 2004 were reduced by $10.7 million in March, and disbursements finished the year under estimate by $16.5 million. There are five appropriation items that figure prominently in the disbursement variance: line item 235-418, Access Challenge, line item 235-420, Success Challenge, line item 235-511, Cooperative Extension Service, line item 235-535, Ohio Agricultural Research and Development Center, and line item 235-599, National Guard Scholarship Program.

Line item 235-418, Access Challenge, helps to reduce tuition increases at the state's 56 designated access campuses, which include all university branch campuses, community and state community colleges, technical colleges, and a number of two-year programs at state universities. The funding from this line item is allocated to the different schools and campuses according to the number of their students pursuing General Studies curriculums. The appropriation for line item 235-418 was reduced in March by $2.9 million, which was the amount of its disbursement variance for the year.

Line item 235-420, Success Challenge, supports universities' efforts to promote successful degree completion by "at-risk" baccalaureate students and timely degree completion by all baccalaureate students. Funds from this line item are allocated according to a formula based on a campus' experience by these measures. The appropriation for line item 235-420 was reduced by $2.2 million, which was the amount of its disbursement variance for the year.

The appropriation for line item 235-511, Cooperative Extension Service, was reduced by $1.0 million in March. This was also the amount of its disbursement variance for the year. To absorb the reduction, the Extension Service closed one of its four district centers, froze all county hires, capped the number of field agents at 270 (down from 320), and is cutting support staff in all units at the state office.

Line item 235-535, Ohio Agricultural Research and Development Center, supports basic and applied research through The Ohio State University's Colleges of Food, Agricultural and Environmental Sciences, Human Ecology, Biological Sciences, and Veterinary Medicine. The appropriation for this line item was reduced by $1.4 million. Operational adjustments to this reduction were a series of layoffs, a hiring freeze, and elimination of some new initiatives.

Line item 235-599, National Guard Scholarship Program, ended the fiscal year with a negative disbursement variance of $1.9 million. Military deployments have resulted in lower than anticipated enrollments. Line item 235-599 also received an appropriation increase of $1.5 million through Am. Sub. H.B. 189 (the capital reappropriation act for the biennium ending June 30, 2006). These funds account for the $3.4 million encumbrance in the line item.

Ohio Arts Council. The Ohio Arts Council ended FY 2004 with a negative disbursement variance of approximately $850,000. Included in the estimate was a planned encumbrance of $5.9 million in line item 370-502, Program Subsidies, which will be used for payments to grant recipients in FY 2005. A budget reduction in this line item of $442,000 was the largest source of the variance.

Ohio School for the Deaf. The Ohio School for the Deaf had an FY 2004 negative disbursement variance of about $465,000. Roughly one-fifth of this variance was the result of the budget reductions ordered in March, while the remainder was the result of spending restraint, particularly in the School's personnel line item.

SchoolNet Commission. The SchoolNet Commission finished FY 2004 with a negative variance of $1.5 million. A little over $800,000 of the variance is accounted for by budget reductions ordered in March to the Commission's three GRF line items. Line item 228-406, Technical and Instructional Professional Development, had the largest variance at about $560,000 (which included a reduction of about $308,000, a lapse of about $145,000, and an encumbrance of $107,000).

Educational Telecommunications Network Commission. The Educational Telecommunications Network Commission posted a $1.4 million negative disbursement variance for FY 2004. The Commission experienced a $1.3 million budget reduction in March. A little over $1.0 million of the variance is traceable to line item 374-403, Ohio SONET, which had an initial appropriation of $2.0 million. 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. About $867,000 of the variance in line item 374-403 was encumbered, and $168,000 was a reduction in the appropriation.

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

Issues of Interest

LOTTERY TICKET SALES AND PROFIT TRANSFERS FOURTH QUARTER, FISCAL YEAR 2004

— *Jean Botomogno*

Ticket Sales

In the fourth quarter of FY 2004, total lottery ticket sales were $551.8 million, $6.5 million (1.2%) lower than ticket sales in the third quarter. On-line ticket sales[1] were $252.0 million (45.7% of quarterly sales) and Instant ticket sales were $299.8 million (54.3% of quarterly sales). Table 1 presents ticket sales by game in the fourth quarter of FY 2004. Mega Millions sales of $30.7 million in June 2004 were the second highest monthly sales on record. The fourth quarter also had the second lowest monthly Mega Millions sales on record in May 2004, at $9.9 million. The highest monthly sales were in February 2004 ($31.3 million), and the lowest monthly sales were in October 2003 ($9.4 million), both during this fiscal year. Also, the second half of FY 2004 had the two highest Mega Millions jackpots since Ohio joined the multistate game in May 2002. The jackpot reached $239 million in February 2004 and $294 million in June 2004.

Compared to fourth-quarter results a year ago, ticket sales were up $30.7 million (5.9%) in this fiscal year. Instant ticket sales grew $33.2 million (12.5%) and on-line ticket sales decreased $2.5 million (1.0%). Mega Millions sales grew $6.6 million (13.5%) and Pick 4 sales were up $4.3 million (11.2%). Except for Pick 3 sales, which were almost identical, quarterly sales of the other on-line games decreased from the fourth quarter of FY 2003. Super Lotto sales decreased

Table 1: Fourth-Quarter Ticket Sales by Game (in millions)

	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	On-line	Instants	Total
April	$34.6	$14.9	$1.8	$5.7	$10.1	$14.7	$81.8	$100.4	$182.2
May	$33.1	$14.4	$1.9	$5.5	$10.5	$9.9	$75.3	$101.8	$177.1
June	$32.2	$13.7	$1.9	$5.3	$11.1	$30.7	$94.9	$97.7	$192.6
Total	**$99.9**	**$43.0**	**$5.6**	**$16.5**	**$31.7**	**$55.3**	**$252.0**	**$299.8**	**$551.8**
Share	18.1%	7.8%	1.0%	3.0%	5.7%	10.0%	45.7%	54.3%	

Totals may not add up due to rounding.

Table 2: Quarterly Lottery Ticket Sales by Games in FY 2004 (in millions)

	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	On-line	Instants	Total
Q1	$98.2	$39.1	$6.5	$16.5	$39.4	$40.0	$239.7	$255.9	$495.6
Q2	$95.9	$40.6	$6.1	$16.5	$34.9	$41.1	$235.1	$314.1	$549.1
Q3	$102.8	$42.5	$6.4	$17.1	$38.1	$55.4	$262.3	$296.1	$558.4
Q4	$99.9	$43.0	$5.6	$16.5	$31.7	$55.3	$252.0	$299.8	$551.8
Total	$396.8	$165.2	$24.5	$66.6	$144.1	$191.8	$989.0	$1,165.9	$2,154.9
Share	18.4%	7.7%	1.1%	3.1%	6.7%	8.9%	45.9%	54.1%	

Totals may not add up due to rounding.

Table 3: Lottery Ticket Sales and Transfers to LPEF in FY 2004 (in millions)						
Quarter	Tickets Sales	Actual Transfers	Projected Transfers	Dollars Variance	Percent Variance	Transfers as a Percent of Sales
Q1	$495.6	$152.2	$154.7	-$2.5	-1.6%	30.7%
Q2	$549.1	$166.4	$166.0	$0.4	0.3%	30.3%
Q3	$558.4	$164.3	$156.5	$7.9	5.0%	29.4%
Q4	$551.8	$165.2	$160.7	$4.5	2.8%	29.9%
Total	$2,154.9	$648.1	$637.9	$10.2	1.6%	30.1%

Totals may not add up due to rounding.

$11.3 million (26.2%). Buckeye 5 sales dropped $1.4 million (7.8%), and Kicker sales were down $1.4 million (19.8%).

Table 2 shows quarterly ticket sales in FY 2004. Ticket sales were $495.6 million in the first quarter and then increased 10.8% to $549.1 million in the second quarter on the strength of "Holiday" Instant ticket sales. Ticket sales increased again 1.7% in the third quarter and then decreased 1.2% in the last quarter.

Transfers to the Lottery Profits Education Fund

Table 3 summarizes quarterly transfers from operations to the Lottery Profits Education Fund (LPEF). Transfers in the fourth quarter of FY 2004 were $165.2 million, up from $164.3 million in the third quarter. Transfers were $4.5 million (2.8%) higher than projected for the fourth quarter. Through December 2003, transfers from operations were $2.1 million below projected transfers. At the end of June 2004, FY 2004 transfers were $648.1 million, $10.2 million (1.6%) higher than projected transfers. The increase in amounts transferred was directly attributable to strong Mega Millions sales in February and June 2004. Third-quarter transfers were 5% higher than estimates, and fourth-quarter transfers were 2.8% greater than estimates. Total transfers from operations were about 30% of ticket sales. FY 2004 transfers were also $41.8 million (6.4%) higher than transfers from operations in FY 2003. A shortfall in transfers from operations in FY 2003 required a one-time $30 million transfer from the Lottery Profits Education Reserve Fund to the LPEF. Thus, transfers into LPEF in FY 2004 were $11.8 million higher than total transfers in FY 2003.

Year in Review

Table 4 compares total sales and sales by game in FY 2004 and FY 2003. Total ticket sales in FY 2004 were $2,154.9 million, $76.6 million (3.7%) higher than FY 2003 ticket sales. Although Mega Millions sales were strong in FY 2004, the increase in total ticket sales was entirely due to improved Instant ticket sales.

Compared to sales a year ago, Instant ticket sales surged $76.8 million (7.1%). On-line sales declined slightly, down $0.2 million. Among on-line games, only Mega Millions and Pick 4 gained sales over the previous year. Mega Millions sales increased $15.5 million (8.8%), and Pick 4 sales improved $11.0 million (7.2%). These gains were negated by the poor performance of the other on-line games. Kicker sales declined $2.7 million (10.0%). Super Lotto sales decreased $16.8 million (10.4%). Buckeye 5 sales declined $2.3 million (3.3%). Pick 3 sales dropped $5.1 million (1.3%).

The overall profitability of Lottery operations was hurt in FY 2003 by a combination of lower than expected Mega Millions sales, a higher share of Instant ticket sales, and a greater than anticipated decline in Super Lotto and Kicker sales. In FY 2004, Mega Millions sales were higher (and closer to expectations of $50 million per quarter), while the decline in sales of Super Lotto and Kicker was muted compared to that of the previous year. However, the sales of Instant tickets as a share of total tickets sold increased

Table 4: Ticket Sales by Games in FY 2004 and FY 2003 (in millions)									
Year	Pick 3	Pick 4	Kicker	Buckeye 5	Super Lotto	Mega Millions	On-line	Instants	Total
FY 2004	$396.8	$165.2	$24.5	$66.6	$144.1	$191.8	$989.0	$1,165.9	$2,154.9
FY2003	$401.9	$154.2	$27.3	$68.9	$160.8	$176.2	$989.3	$1,089.1	$2,078.4
$ Change	-$5.1	$11.0	-$2.7	-$2.3	-$16.8	$15.6	-$0.2	$76.8	$76.6
% Change	-1.3%	7.2%	-10.0%	-3.3%	-10.4%	8.8%	0.0%	7.1%	3.7%

Totals may not add up due to rounding.

to 54.1%, up from 52.4% in FY 2003. Chart 1 shows the contribution of various games to the increase in total ticket sales and gives the percentage change in sales from FY 2003 for each game.

Table 5 presents ticket sales and profit transfers in the last five fiscal years. Sales have increased since FY 2001, rising for a third consecutive year. After a decline of 10.7% in FY 2001, lottery ticket sales rose $63.1 million (3.2%) in FY 2002, $95.1 million (3.6%) in FY 2003, and $76.7 million (3.7%) in FY 2004. However, FY 2004 sales only returned to the level of sales achieved in FY 2000 and are still below the $2.3 billion in sales recorded in FY 1996. Sizable negative variances in transfers from operations occurred in FY 2001 ($53.2 million) and again in FY 2003 ($31.3 million). For the first time in recent years, in FY 2003, transfers were below 30% of ticket sales. (Am. Sub. H.B. 94 of the 123rd General Assembly removed a provision of law requiring that at least 30% of ticket sales be transferred to the LPEF.) Transfers as a share of ticket sales were again above 30% in FY 2004. Table 5 also shows that transfers in FY 2004 were significantly above projected transfers in the five-year period.

Payout to Winners and Profitability of Lottery Operations

The FY 2004 payout ratio for Instant games was about 65.2% while that of on-line games was

Chart 1: Change in Sales by Game, FY 2003 to FY 2004
(in millions)

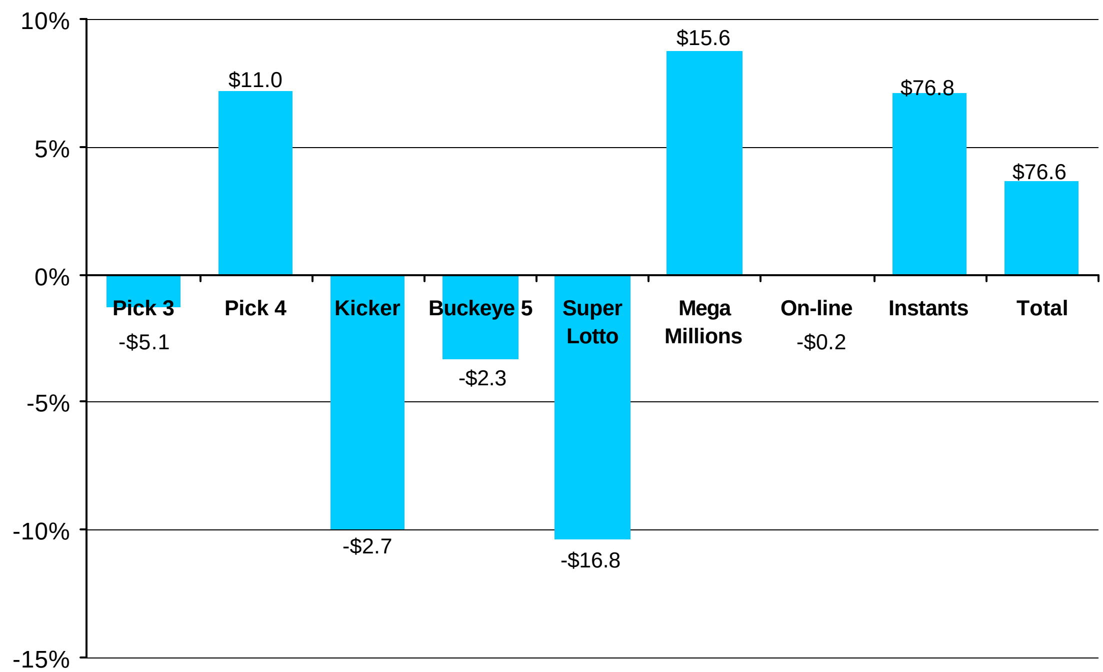


Table 5: Tickets Sales and Transfers to LPEF, FY 2000 to FY 2004
(in millions)

	Ticket Sales	Actual Transfers	Projected Transfers	Dollars Variance	Percentage Variance	Transfers as Percentage of Sales
FY 2000	$2,150.4	$661.0	$661.0	$0.0	0.0%	30.7%
FY 2001	$1,920.0	$612.0	$665.2	-$53.2	-8.0%	31.9%
FY 2002	$1,983.1	$610.1	$608.7	$1.4	0.2%	30.8%
FY 2003	$2,078.2	$606.4	$637.7	-$31.3	-4.9%	29.2%
FY 2004	$2,154.9	$648.1	$637.9	$10.2	1.6%	30.1%

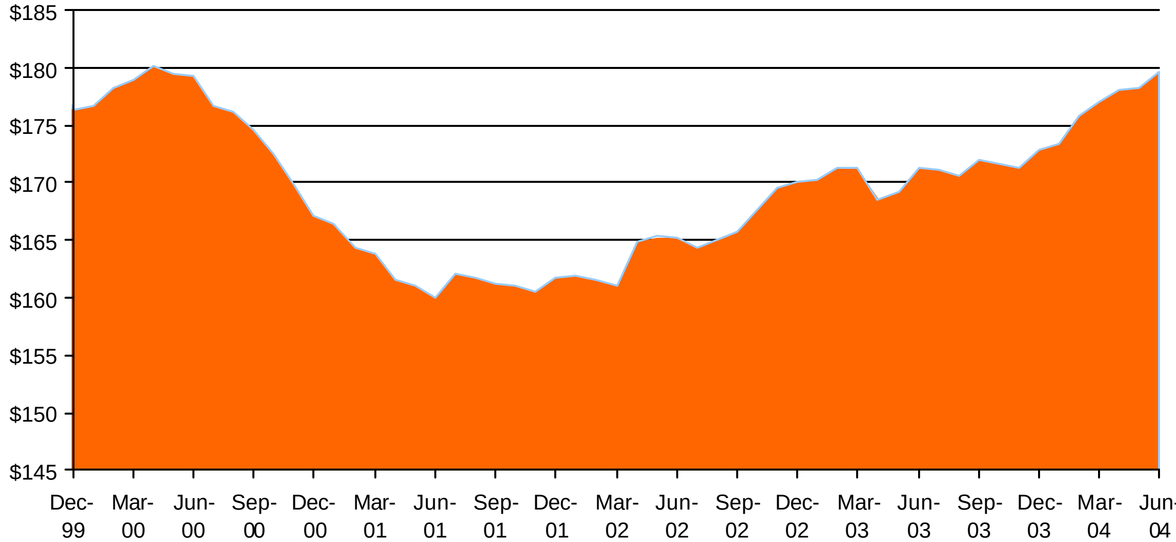
52.3%. Profit margins from operations are higher for on-line games. For a dollar of ticket sales, about 65 cents was returned to players who purchased Instant tickets, compared to 52 cents paid out for the purchase of on-line games. The overall payout ratio was 59.3%, half a percentage point higher than the FY 2003 payout ratio. Put another way, for an identical level of sales, the Ohio Lottery paid out more to players in FY 2004 than in FY 2003. However, although the profitability per dollar of sales of lottery operations declined in this fiscal year, overall profits increased due to higher total ticket sales.

Recent Monthly Ticket Sales Trends

Chart 2 shows the rise and fall of monthly lottery ticket sales from December 1999 to June 2004. At the apex of ticket sales, in FY 1996, monthly sales were about $192 million. Monthly sales have a seasonal pattern of increases in November and December, as well as rising with Super Lotto and Mega Millions jackpots. A 12-month moving average of sales removes seasonal variations and provides a true indication of sales trends. The graph shows that sales grew from the nadir of about $160 million in June 2001 to almost $180 million per month in June 2004. Over the last two years, monthly sales have been trending up despite occasional declines. A key factor to the improvement in sales has been the increase in instant ticket sales and the entry into Mega Millions in May 2002. Instant ticket sales grew 9.3% and 7.1% in the last two fiscal years from numerous high-priced games. One major objective of the Ohio Lottery in entering into Mega Millions was to reduce out-of-state spending by Ohioans on on-line multistate games such as Powerball by offering a similar "opportunity" to its players. It is plausible that the objective has been achieved because on-line sales, although not increasing, have been flat in the last two fiscal years. The question remains whether the Ohio Lottery will be able to continue to increase sales without introducing a new on-line game, or whether this growth will stall and sales will again start to decline.

[1] On-line games refers to Pick 4, Pick 3, Kicker, Buckeye 5, Super Lotto, and Mega Millions. These games are played via a terminal at a Lottery sales agent. Those terminals are linked to Ohio Lottery headquarters computers. On-line games does not refer to "Internet" lottery sales.

Chart 2: Lottery Ticket Sales
Monthly Sales (12-Month Moving Average)
(in millions)



Lottery Profits Education Fund Disbursements Fiscal Year 2004

— *Melaney Carter*

During FY 2004, transfers into Fund 017, the Lottery Profits Education Fund (LPEF), from the State Lottery Fund exceeded disbursements by $10.2 million. These excess funds will be transferred in FY 2005 into Fund 018, the Lottery Profits Education Reserve Fund (LPERF). The balance of the LPERF at the end of FY 2004 (before the transfer of excess FY 2004 funds) was $16.3 million. Funds from the LPERF can be transferred, with Controlling Board approval, into the LPEF if funds in the LPEF are not sufficient to meet the appropriation in any given year.

Disbursements from the LPEF totaled $637.9 million in FY 2004. These funds were disbursed through two appropriation items, 200-612, Base Cost Funding, and 200-682, Lease Rental, both in the Ohio Department of Education's budget. The table below summarizes appropriations and disbursements from the LPEF in FY 2004.

Base Cost Funding

The $606.1 million of lottery profits spending from 200-612, Base Cost Funding, was combined with GRF appropriation item 200-501, Base Cost Funding ($4,500.7 million), to fund the state school foundation aid program in FY 2004. This program provides the state's share of per pupil funding that guarantees $5,058 per pupil in state and local funding for FY 2004. 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 ($5,106.8 million) represented 54.8% of the Department of Education's FY 2004 disbursements.

Lease Rental

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. These funds are used to pay any debt service incurred by the Treasurer of State from the issuance of nongeneral obligation bonds to fund school building improvements. General obligation bonds for school building improvements are supported by GRF appropriation item 230-908, Common Schools G.O. Debt Service. Disbursements from this item totaled $91.9 million in FY 2004.

FY 2004 LPEF (017) Appropriation/Disbursement Summary

Agency	Fund	Line Item	Line Item Name	FY 2004 Appropriation	FY 2004 Disbursement
EDU	017	200-162	Base Cost Funding	$606,123,500	$606,123,500
EDU	017	200-682	Lease Rental	$31,776,500	$31,776,500
			Total LPEF	**$637,900,000**	**$637,900,000**

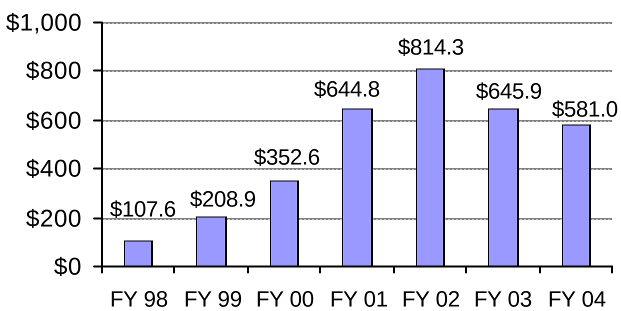
SCHOOL FACILITIES UPDATE, FISCAL YEAR 2004

— *Ed Millane*

The Ohio School Facilities Commission (OSFC) was created in 1997 by S.B. 102 of the 122nd General Assembly. Since its inception, the OSFC has disbursed almost $3.4 billion and has received appropriations through FY 2004 of $3.6 billion. Through its four major programs, the OSFC has served approximately 274 school districts. Since September 2000, over 200 new or renovated buildings have opened across Ohio with aid from state and local funds.

OSFC disbursements increased from $107.6 million in FY 1998 to a peak of $814.3 million in FY 2002 and then declined to $645.9 million in FY 2003 and to $581.0 million in FY 2004. Disbursements in FY 2004 were $64.9 million, or 10.0%, less than FY 2003. The decreases in FY 2003 and FY 2004 are largely due to the acceptance of a number of major urban districts into the Classroom Facilities Assistance Program (CFAP). The Accelerated Urban Initiative allowed the six major urban districts (Akron, Cincinnati, Cleveland, Columbus, Dayton, and Toledo) to be served under the CFAP in FY 2003.[1] The size and complexity of these districts require a longer lead time before building construction starts and funds are disbursed. Projects in these six districts are broken into multiple segments.[2] Except for Cleveland, which entered some of its segment two projects, all the other five major urban districts were at their segment one projects in FY 2004. In addition, state and local shares are spent simultaneously in these urban district projects, unlike the case with smaller districts, where the state share is disbursed before the local share. The majority of districts served under the CFAP prior to FY 2003 are small, low wealth districts.

OSFC Disbursements by Fiscal Year
($ in millions)

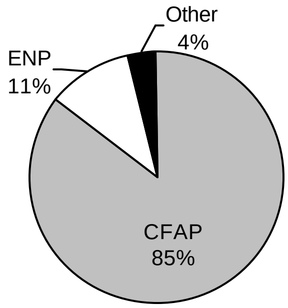


Of the $581.0 million disbursed in FY 2004, $496.9 million was disbursed through the CFAP. This was approximately $43.0 million, or 8%, less than the previous fiscal year. The Exceptional Needs Program (ENP) disbursed $62.4 million in FY 2004, which was approximately $27.0 million, or 30%, less than the previous fiscal year. Of the remaining $22.0 million disbursed during FY 2004, approximately $16.5 million was disbursed through federal programs.

In March 2004, the 125th General Assembly passed Sub. S.B. 189, the capital reappropriations act, which appropriated $522.6 million in bond money to the OSFC for the FY 2005-FY 2006 biennium. In May 2004, the OSFC also received a capital appropriation of $243.2 million for the FY 2005-FY 2006 biennium from Sub. H.B. 434, the tobacco settlement appropriations act of the 125th General Assembly. An additional appropriation is expected to be provided for this biennium in the upcoming capital appropriations bill. These funds will be used to finance the state share of school facilities projects that have already been or will be approved in the FY 2005-2006 biennium under various OSFC programs.

In FY 2004, 10 districts were approved to participate in the CFAP, bringing the total served by this program to 129 districts (including the six major urban districts that were approved under the Accelerated Urban Initiative). The total project cost of these 10 districts was $459.3 million, with a state share of $367.7 million (or 80.0%) and a local share of $91.6 million (or 20.0%). The OSFC expects to serve

FY 2004 Disbursements by Program



approximately 16 new districts in this program in FY 2005 at a total project cost of $612.9 million ($468.2 million or 76.4% state and $144.7 million or 23.6% local).

Only one school district was accepted to participate in the ENP in FY 2004. This brings the total number of school districts served by the ENP to 23.[3] 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 ENP 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 this district amounts to $45.9 million, or approximately 74.0% of the $62.0 million total cost. The OSFC expects to serve another five school districts under this program in FY 2005 at a total cost of $145.3 million ($92.1 million or 63.4% state and $53.2 million or 36.6% local).

In addition, the OSFC approved 32 school districts for participation in the Expedited Local Partnership Program (ELPP) in FY 2004, increasing the total number of school districts served by this program to 125. Under the ELPP, school districts are able to use local funds to begin their school facilities projects before becoming eligible for the CFAP. Once the school district becomes eligible under the CFAP, it will receive a credit for the local funds it has spent against its required local contribution under the CFAP. The state contribution for these 32 projects is estimated to be $668.5 million, or 37.0% of the total cost of $1.8 billion.

Finally, as required by Sub. H.B. 675 of the 124th General Assembly, OSFC has developed the Vocational Facilities Assistance Program (VFAP) to assist the 49 joint vocational school districts. The VFAP program will operate similarly to the CFAP. The OSFC has the authority to spend up to 2% of its annual appropriations for the VFAP program. According to the OSFC, three joint vocational school districts will be served under the VFAP in FY 2005. The state and local shares of these three projects are estimated to be $32.8 million (75.1%) and $10.9 million (24.9%), respectively, for a total cost of $43.7 million. The joint vocational school districts will also be able to participate in a slightly modified version of the ELPP program under which they will be able to use local funds for new construction or renovations prior to being eligible for the VFAP.

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[1] The other two major urban districts, Canton and Youngstown, had already been served. As a group, these eight districts are commonly referred to as Big Eight districts.

[2] Due to the complexity and size of six of the Big Eight districts, Akron, Cincinnati, Cleveland, Columbus, Dayton, and Toledo have had their projects separated into individual segments. For example, Cleveland has nine segments, of which the last segment of construction is not scheduled to begin until 2010.

[3] Three ENP districts also participated in the Expedited Local Partnership Program (ELPP), and they are included in the ELPP district count as well.