Budget Footnotes

A Newsletter of the Ohio Legislative Service Commission — September 2008

Status of the GRF

Highlights

— *Wendy Zhan, Associate Director, 614-728-4814*

In response to continued weakness in state revenues, on September 10 Governor Strickland announced an additional $540.1 million budget adjustment for FY 2009, including $198.4 million in spending reductions and $341.7 million in various cash management actions. The Office of Budget and Management is currently revising its revenue and spending estimates for FY 2009. These revised estimates, when they become available, will be used in future issues of *Budget Footnotes*.

Through August 2008, total GRF sources of $4,049.7 million were $192.0 million (4.5%) below the estimate made prior to the September 10 announcement:

- Tax revenues were $167.3 million (6.0%) below estimate.
  - Revenue from the personal income tax was below estimate by $101.6 million (8.5%).
  - Revenue from the sales and use tax was below estimate by $61.9 million (4.5%).
- State-source receipts, 95% of which were made up by tax revenues, were below estimate by $178.1 million (6.2%). Federal grants were below estimate by $13.9 million (1.0%).
- Compared to FY 2008, tax revenues were down 4.0% and state-source receipts were down 5.1%.

Through August 2008, GRF uses totaled $5,587.4 million:

- GRF program expenditures amounted to $5,198.4 million, $363.1 million (7.5%) above FY 2008, largely due to the delay of the final FY 2008 Medicaid payment ($434 million) to July 1, 2008.
- GRF Medicaid expenditures totaled $2,270.6 million, $15.5 million (0.7%) below estimate.

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Table 1: General Revenue Fund Sources
Preliminary Actual vs. Estimate
Month of August 2008
($ in thousands)
(Based on OBM Monthly Financial Report)

	Actual	Estimate*	Variance	Percent
STATE SOURCES				
TAX REVENUE				
Auto Sales	$87,317	$85,888	$1,430	1.7%
Nonauto Sales and Use	$545,469	$563,691	-$18,221	-3.2%
Total Sales and Use Taxes	$632,786	$649,578	-$16,792	-2.6%
Personal Income	$543,866	$564,081	-$20,215	-3.6%
Corporate Franchise	$3,083	$2,481	$602	24.2%
Public Utility	$47,387	$42,575	$4,812	11.3%
Kilowatt Hour Excise	$16,534	$14,399	$2,135	14.8%
Commercial Activity Tax**	$0	$0	$0	---
Foreign Insurance	-$39	$0	-$39	---
Domestic Insurance	$53	$0	$53	---
Business and Property	$293	$220	$73	32.9%
Cigarette	$86,319	$84,996	$1,323	1.6%
Alcoholic Beverage	$5,216	$4,985	$231	4.6%
Liquor Gallonage	$3,184	$3,093	$91	3.0%
Estate	$1,040	$800	$240	30.0%
Total Tax Revenue	$1,339,722	$1,367,208	-$27,486	-2.0%
NONTAX REVENUE				
Earnings on Investments	$0	$0	$0	---
Licenses and Fees	$6,481	$5,347	$1,134	21.2%
Other Revenue	$4,459	$6,700	-$2,241	-33.4%
Total Nontax Revenue	$10,940	$12,047	-$1,107	-9.2%
TRANSFERS				
Liquor Transfers	$0	$12,000	-$12,000	-100.0%
Budget Stabilization	$0	$0	$0	---
Other Transfers In	$0	$400	-$400	-100.0%
Total Transfers In	$0	$12,400	-$12,400	-100.0%
TOTAL STATE SOURCES	$1,350,662	$1,391,655	-$40,993	-2.9%
Federal Grants	$550,731	$561,621	-$10,891	-1.9%
TOTAL GRF SOURCES	$1,901,392	$1,953,276	-$51,884	-2.7%

* Estimates of the Office of Budget and Management.

**Commercial activity tax receipts in FY 2009 are non-GRF.

Detail may not sum to total due to rounding.

Table 2: General Revenue Fund Sources
Preliminary Actual vs. Estimate
FY 2009 as of August 31, 2008
($ in thousands)
(Based on OBM Monthly Financial Report)

	Actual	Estimate*	Variance	Percent	FY 2008	Percent Change
STATE SOURCES						
TAX REVENUE						
Auto Sales	$175,091	$178,973	-$3,881	-2.2%	$175,985	-0.5%
Nonauto Sales and Use	$1,148,835	$1,206,846	-$58,011	-4.8%	$1,152,953	-0.4%
Total Sales and Use Taxes	$1,323,927	$1,385,819	-$61,892	-4.5%	$1,328,938	-0.4%
Personal Income	$1,087,027	$1,188,637	-$101,610	-8.5%	$1,187,344	-8.4%
Corporate Franchise	$29,753	$32,481	-$2,728	-8.4%	-$6,648	-547.5%
Public Utility	$47,387	$42,575	$4,812	11.3%	$41,642	13.8%
Kilowatt Hour Excise	$22,642	$22,659	-$17	-0.1%	$61,444	-63.1%
Commercial Activity Tax**	$0	$0	$0	---	$0	---
Foreign Insurance	-$98	$0	-$98	---	$16	-704.7%
Domestic Insurance	-$558	$0	-$558	---	$41	-1461.7%
Business and Property	$246	$253	-$6	-2.6%	$281	-12.4%
Cigarette	$104,362	$109,025	-$4,664	-4.3%	$113,130	-7.8%
Alcoholic Beverage	$10,521	$10,900	-$379	-3.5%	$10,588	-0.6%
Liquor Gallonage	$6,069	$6,234	-$165	-2.6%	$5,939	2.2%
Estate	$1,082	$1,100	-$18	-1.7%	$160	576.1%
Total Tax Revenue	$2,632,360	$2,799,684	-$167,324	-6.0%	$2,742,874	-4.0%
NONTAX REVENUE						
Earnings on Investments	$0	$0	$0	---	$0	---
Licenses and Fees	$12,452	$11,450	$1,002	8.7%	$13,176	-5.5%
Other Revenue	$10,466	$10,404	$62	0.6%	$7,981	31.1%
Total Nontax Revenue	$22,918	$21,854	$1,064	4.9%	$21,157	8.3%
TRANSFERS						
Liquor Transfers	$15,000	$24,000	-$9,000	-37.5%	$39,000	-61.5%
Budget Stabilization	$0	$0	$0	---	$0	---
Other Transfers In	$5,065	$7,900	-$2,835	-35.9%	$15,386	-67.1%
Total Transfers In	$20,065	$31,900	-$11,835	-37.1%	$54,386	-63.1%
TOTAL STATE SOURCES	$2,675,343	$2,853,438	-$178,095	-6.2%	$2,818,416	-5.1%
Federal Grants	$1,374,399	$1,388,299	-$13,900	-1.0%	$1,075,719	27.8%
TOTAL GRF SOURCES	$4,049,742	$4,241,737	-$191,996	-4.5%	$3,894,135	4.0%

* Estimates of the Office of Budget and Management.

**Commercial activity tax receipts in FY 2009 are non-GRF.

Detail may not sum to total due to rounding.

Revenues

— *Jean J. Botomogno, Senior Economist, 614-644-7758*

Overview

Year-to-date total GRF sources were $192.0 million (4.5%) below estimate.

For the month of August 2008, total GRF sources of $1,901.4 million (Table 1) were $51.9 million (2.7%) below the estimate made by the Office of Budget and Management in July 2008.[1] State-source receipts of $1,350.7 million were $41.0 million (2.9%) below estimate while federal grants[2] of $550.7 million were $10.9 million (1.9%) below estimate. The poor performance in August follows a dismal July when total GRF sources were $137.1 million (6.0%) below estimate. Compared to FY 2008, total GRF sources this month were $263.2 million (12.2%) below August 2007's level, due mostly to a decrease of $197.7 million (26.4%) in federal grants. State-source receipts were down $65.6 million (4.6%).

Public utility was the only GRF-source tax that performed above estimate in the first two months of FY 2009, by $4.8 million (11.3%).

Through August, year-to-date GRF sources for FY 2009 were $4,049.7 million, $192.0 million (4.5%) below estimate (Table 2). State-source receipts of $2,675.3 million were $178.1 million (6.2%) below estimate. Federal grants of $1,374.4 million were $13.9 million (1.0%) below estimate. Compared to FY 2008, FY 2009 year-to-date total GRF sources were up by $155.6 million (4.0%). Year-to-date state-source receipts were down by $143.1 million (5.1%). Federal grants, however, were up by $298.7 million (27.8%), from higher spending in the state's Public Assistance and Medicaid programs. This higher spending was primarily due to a timing issue related to the final FY 2008 Medicaid payment.

Tax revenues of $2,632.4 million in the first two months of FY 2009, accounting for 98.4% of total year-to-date state-source receipts, were $167.3 million (6.0%) below estimates. Through August, only the public utility tax was above expectation, by $4.8 million (11.3%). All other taxes performed poorly, including underages of $101.6 million (8.5%) in the personal income tax, $61.9 million (4.5%) in sales and use taxes, $4.7 million (4.3%) in the cigarette and other tobacco products tax, and $2.7 million (8.4%) in the corporate franchise tax. The performances of the personal income and sales and use taxes, which are the two largest tax revenue sources, are particularly worrisome as they accounted for $163.5 million of the $167.3 million shortfall in tax revenues. (These two tax sources contributed 86% of total tax revenues and 80% of state-source receipts in FY 2008.) Compared to FY 2008, FY 2009 year-to-date total tax revenues were down by $110.5 million (4.0%), including a negative variance of about $100 million for the personal income tax alone.

Year-to-date tax revenues were $167.3 million (6.0%) below estimate.

Through August, FY 2009 nontax revenues and transfers in of $43.0 million were $10.8 million (20.0%) below estimate. Nontax revenues totaled $22.9 million, $1.1 million (4.9%) above estimate, and transfers in were $11.8 million (37.1%) below

[1] The Office of Budget and Management is currently revising its revenue estimates for FY 2009 to take into account the $540.1 million shortfall announced on September 10. The new estimates, when they become available, will be reflected in future issues of *Budget Footnotes*.

[2] These are federal reimbursements deposited into the GRF for programs such as Medicaid and Temporary Assistance for Needy Families (TANF). The amount received depends on expenditures for human services programs that require federal participation.

estimate. FY 2009 nontax revenues and transfers in were $32.6 million (43.1%) below totals in those categories in FY 2008. While nontax revenues were up $1.8 million (8.3%), transfers in were $34.3 million (63.1%) below transfers in in FY 2008, mostly because no transfers in occurred in the month of August in FY 2009.

Personal Income Tax

Personal income tax revenue was below estimate by $101.6 million (8.5%) in July and August combined.

The GRF received a total of $1,087.0 million from the personal income tax in July and August 2008. This amount was $101.6 million (8.5%) below estimate, and $100.3 million (8.4%) below FY 2008 receipts. Personal income tax revenue is equal to gross collections after subtracting both refunds and distributions to the local government funds. Gross collections are the sum of withholding, quarterly estimated payments,[3] trust payments, payments associated with annual returns, and miscellaneous payments. The table below summarizes FY 2009 year-to-date income tax revenue variances and annual changes by components. Employer withholding reflects real time labor conditions. Therefore, the dismal performance of employer withholding in both July and August is of concern. Revenue from employer withholding was below estimate by $63 million in July 2008 and $49 million in August 2008. Also, it was down by about $114 million when compared to FY 2008 withholding revenue. Although some of the shortfall is due to lower tax rates this fiscal year, the personal income tax base has remained flat compared to last year.

FY 2009 Year-to-date Income Tax Revenue Variances and Changes by Component

Category	FY 2009 Variance		Changes from FY 2008	
	Amount ($ in millions)	Percentage (%)	Amount ($ in millions)	Percentage (%)
Withholding	$111.8 below	-8.5%	-$114.2	-8.6%
Quarterly Estimated Payments	$2.1 below	-6.2%	-$2.1	-6.2%
Trust Payments	$3.1 below	-71.6%	-$3.1	-71.6%
Annual Return Payments	$4.2 above	21.3%	$4.2	21.3%
Miscellaneous Payments	$5.1 above	64.6%	$4.9	60.5%
Gross Collections	**$107.6 below**	**-7.8%**	**-$110.3**	**-7.9%**
Less Refunds	$1.5 above	-2.2%	$17.5	-20.8%
Less Local Government Fund Distribution	$4.5 above	-3.5%	- $7.5	6.4%
Income Tax Revenue	**$101.6 below**	**-8.5%**	**-$100.3**	**-8.4%**

Sales and Use Tax

Sales and use tax revenue was below estimate by $61.9 million (4.5%) in July and August combined.

General economic conditions continue to restrain spending on taxable items, leading to a poor performance of the sales and use tax in the first two months of FY 2009. In July 2008, sales and use tax revenues were $45.1 million (6.1%) below estimate, and $10.2 million (1.4%) below July 2007 receipts. In August 2008, the sales and use tax revenues of $632.8 million were $16.8 million (2.6%) below estimate, but $5.2 million

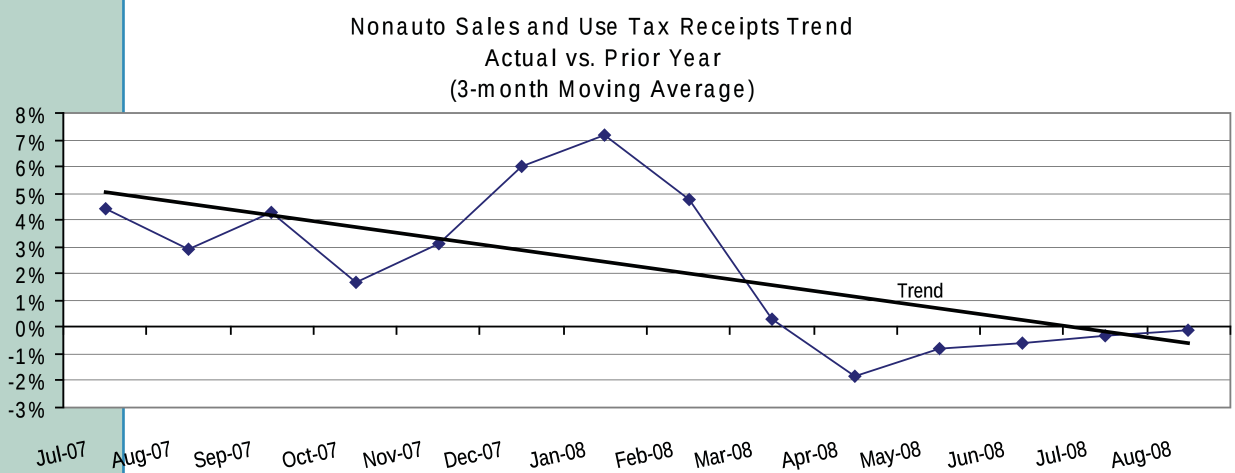
[3] Quarterly estimated payments are made by taxpayers who expect to be underwithheld by more than $500. Payments are due on or before April 15, June 15, and September 15 of the tax year and January 15 of the following year. These payments are usually made by taxpayers with significant nonwage income.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

(0.8%) above receipts in August 2007. Through August, FY 2009 total sales and use tax revenues of $1,323.9 million were $61.9 million (4.5%) below estimate, and also $5.0 million (0.4%) below FY 2008 receipts through August 2007.

For analysis and forecasting, the sales and use tax is separated into two parts: auto and nonauto. Auto sales and use tax collections[4] arise from the sale of motor vehicles; taxes arising from auto leases are mostly recorded under the nonauto tax, along with taxes arising from nonauto sales.

Nonauto Sales and Use Tax

The performance of the nonauto sales and use tax has been mediocre during the first eight months of 2008. Receipts of $1,148.8 million in the first two months of FY 2009 were $58.0 million (4.8%) below estimate, and also $4.1 million (0.4%) below receipts in FY 2008. Consumers spent a higher share of their income on food, gasoline, and healthcare, which are nontaxable under the sales and use tax. Spending supported by the housing industry and mortgage equity withdrawals has weakened considerably. Reduced activity in residential and nonresidential construction decreases spending on taxable "big ticket" items such as appliances and furniture. Declines in equity withdrawals curtail spending on housing-related remodeling and expenditures. Consumer fundamentals (primarily employment, unemployment, wage growth, and income gains),[5] which determine nonauto sales and use tax receipts, continue to be soft and show little sign of improvement. The broader economic weakness is causing consumers to shift their spending to nontaxed necessities. Nonauto sales and use tax receipts have consistently been below both estimate and prior-year receipts in the last six months. The graph below, which compares monthly receipts with prior year receipts in the same period, indicates a persistent downward trend in nonauto sales and use tax receipts. (The graph shows a three-month moving average which smoothes the monthly variation and provides a better indication of trends.)



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[4] The clerks of court generally make auto sales and use tax payments on Monday for taxes collected during the preceding week on motor vehicles, watercraft, and outboard motors titled. Therefore, auto sales and use tax receipts largely reflect vehicles sold and titled during the month.

[5] Recent trends in employment have not been favorable, the unemployment rate increased, wage growth slowed, and real disposable income growth has been anemic.

Auto Sales and Use Tax

Receipts in July and August 2008 totaled $175.1 million, $3.9 million (2.2%) below estimate. Similar to the nonauto sales and use tax, auto sales and use tax receipts weakened considerably at the start of 2008, and a resurgence in vehicle sales and the tax may be unlikely in the near term. Through August, FY 2009 year-to-date receipts were down $0.9 million (0.5%) compared to receipts in FY 2008 through August 2007. Although they have receded of late, high gasoline prices are still weighing on light truck sales. Nationwide, sales of light vehicles (autos and light trucks) through August of FY 2009 were 14.3% below unit sales in the corresponding period in FY 2008. Sales of auto and light trucks declined about 4% and 24%, respectively. The drag on the auto tax base from high gasoline prices and current economic conditions may continue in the next few months, if the consumer retrenchment persists.

Corporate Franchise Tax

Through August, FY 2009 year-to-date receipts from the corporate franchise tax (CFT) were $29.8 million, $2.7 million (8.4%) below estimate. An unexpected payment of $42 million boosted receipts in July 2008. Activities under this tax from July to December are generally refunds, tax payments due to audit findings, late payments, and other tax reconciliations. The main CFT payments are due January 31, March 31, and May 31. As part of the five-year phase-out of the CFT enacted in H.B. 66 of the 126th General Assembly, nonfinancial corporations will pay 20% of their full tax liability in FY 2009 and no tax in FY 2010.

Cigarette and Other Tobacco Products Tax

Through August, FY 2009 receipts from the cigarette and other tobacco products tax were $104.4 million, $4.7 million (4.3%) below estimate. Revenues from taxed cigarettes were $97.4 million and revenues from the tax on other tobacco products were $7.0 million. FY 2009 year-to-date revenue from the cigarette and other tobacco products tax was down $8.8 million (7.8%) from receipts in FY 2008. Sales of taxed cigarettes contributed $8.0 million to the shortfall. Revenue from the tax on other tobacco products declined $0.8 million.

Commercial Activity Tax

The commercial activity tax (CAT) has been phasing in since FY 2006. Through FY 2011, revenues from the CAT are earmarked for reimbursing school districts and other local governments for the phase-out of local taxes on most tangible personal property.[6] CAT taxpayers pay 80% of their liability in FY 2009, and beginning in FY 2010 the tax will be fully phased in. In July, CAT receipts were $32.6 million, $6.3 million (24.9%) above estimate. In August, receipts of $281.0 million were $16.7 million (6.3%) above estimate. FY 2009 year-to-date receipts totaled $313.6 million, $23.0 million (7.9%) above estimate, and also $104.2 million (49.8%) above receipts in FY 2008, primarily due to a higher tax rate this fiscal year.

Year-to-date (non-GRF) CAT receipts were $23.0 million (7.9%) above estimate.

[6] CAT receipts are distributed to the School District Tangible Property Tax Replacement Fund (70%) and to the Local Government Tangible Property Tax Replacement Fund (30%).

46% of year-to-date GRF program spending was for Public Assistance and Medicaid; 25% for Primary, Secondary, and Other Education.

Table 3: General Revenue Fund Uses
Preliminary Actual vs. Prior Year
Month of August 2008
($ in thousands)
(Actual based on OAKS reports run September 22, 2008)

PROGRAM	Actual	August 2007	Variance	Percent
Primary, Secondary, and Other Education	$631,153	$842,471	-$211,318	-25.1%
Higher Education	$243,357	$177,692	$65,665	37.0%
Total Education	$874,510	$1,020,164	-$145,653	-14.3%
Public Assistance and Medicaid	$959,409	$958,634	$775	0.1%
Health and Human Services	$93,301	$124,341	-$31,040	-25.0%
Total Welfare and Human Services	$1,052,710	$1,082,974	-$30,264	-2.8%
Justice and Public Protection	$131,124	$142,428	-$11,304	-7.9%
Environment and Natural Resources	$7,878	$5,648	$2,230	39.5%
Transportation	$941	$2,590	-$1,650	-63.7%
General Government	$19,167	$28,457	-$9,290	-32.6%
Community and Economic Development	$8,227	$9,485	-$1,259	-13.3%
Capital	$0	$0	$0	---
Total Government Operations	$167,337	$188,609	-$21,273	-11.3%
Tax Relief and Other	$136,965	$91,417	$45,548	49.8%
Debt Service	$38,692	$28,825	$9,867	34.2%
Total Other Expenditures	$175,657	$120,242	$55,415	46.1%
Total Program Expenditures	$2,270,214	$2,411,989	-$141,775	-5.9%
TRANSFERS				
Budget Stabilization	$0	$0	$0	---
Other Transfers Out	$171,866	$266,883	-$95,017	-35.6%
Total Transfers Out	$171,866	$266,883	-$95,017	-35.6%
TOTAL GRF USES	$2,442,080	$2,678,872	-$236,792	-8.8%

Detail may not sum to total due to rounding.

Table 4: General Revenue Fund Uses
Preliminary Actual vs. Prior Year
FY 2009 as of August 31, 2008
($ in thousands)
(Actual based on OAKS reports run September 22, 2008)

PROGRAM	Actual	FY 2008*	Variance	Percent
Primary, Secondary, and Other Education	$1,287,837	$1,447,990	-$160,153	-11.1%
Higher Education	$423,303	$424,914	-$1,611	-0.4%
Total Education	$1,711,140	$1,872,904	-$161,764	-8.6%
Public Assistance and Medicaid	$2,398,893	$1,964,949	$433,945	22.1%
Health and Human Services	$266,801	$263,559	$3,242	1.2%
Total Welfare and Human Services	$2,665,694	$2,228,507	$437,187	19.6%
Justice and Public Protection	$412,853	$402,928	$9,924	2.5%
Environment and Natural Resources	$19,101	$20,597	-$1,496	-7.3%
Transportation	$2,135	$3,266	-$1,131	-34.6%
General Government	$61,925	$59,162	$2,762	4.7%
Community and Economic Development	$16,635	$13,489	$3,146	23.3%
Capital	$0	$0	$0	---
Total Government Operations	$512,648	$499,443	$13,205	2.6%
Tax Relief and Other	$150,086	$92,460	$57,627	62.3%
Debt Service	$158,851	$141,987	$16,863	11.9%
Total Other Expenditures	$308,937	$234,447	$74,490	31.8%
Total Program Expenditures	$5,198,419	$4,835,301	$363,117	7.5%
TRANSFERS				
Budget Stabilization	$0	$0	$0	---
Other Transfers Out	$388,959	$287,945	$101,014	35.1%
Total Transfers Out	$388,959	$287,945	$101,014	35.1%
TOTAL GRF USES	$5,587,378	$5,123,246	$464,132	9.1%

*Includes July and August 2007.
Detail may not sum to total due to rounding.

Expenditures*

— *Philip A. Cummins, Economist, 614-387-1687***

Overview

GRF program expenditures in the first two months of FY 2009 were $363.1 million (7.5%) above a year earlier, primarily due to the delay of the final FY 2008 Medicaid payment of $434 million into July 1, 2008.

Tables 3 and 4 show GRF uses for August and for FY 2009 through August, respectively. GRF uses consist primarily of program expenditures but also include transfers out. In August, GRF program expenditures totaled $2,270.2 million, $141.8 million (5.9%) less than in August a year earlier. For the first two months of FY 2009, GRF program expenditures totaled $5,198.4 million, $363.1 million (7.5%) above total GRF program spending in the comparable period a year earlier. Much of the year-to-date increase in GRF program expenditures is attributable to increased outlays for Medicaid due to a timing issue. Spending in the Public Assistance and Medicaid program category in the first two months of FY 2009 was $433.9 million (22.1%) higher than a year earlier, primarily because of the delay of the final FY 2008 Medicaid payment of $434 million into July 1, 2008, the first day of FY 2009.

Among other program categories, year-to-date expenditures for Primary, Secondary, and Other Education were $160.2 million (11.1%) lower than a year earlier. Three school foundation payments posted to the OAKS system in August 2007 instead of the usual two. Spending for Tax Relief and Other in July and August was $57.6 million (62.3%) higher than a year earlier. This rise likely reflects in part increased reimbursements from the state to school districts and other local governments for the homestead exemption expansion under H.B. 119 beginning in tax year 2007 and payable in 2008. Year-to-year variances were smaller in other program categories.

As indicated above, on September 10 Governor Strickland announced a $540 million budget adjustment. This is in addition to the $733 million cutback announced in January. The additional cutbacks are in response to continued weakness in state revenues and in a broad range of economic indicators. New cutbacks will include spending reductions of 4.75% for many state agencies, with some programs and agencies exempted or subject to lesser cutbacks. These spending reductions are projected to lower outlays by $198.4 million through June 30, 2009. The balance of the budget adjustment, $341.7 million, is to be achieved through various cash management actions. As a result of this budget adjustment, the Office of Budget and Management estimates for state spending for FY 2009 are being revised. The revised estimates, when they become available, will be used in future editions of *Budget Footnotes*.

Medicaid

Year-to-date Medicaid outlays were 0.7% below estimate.

As shown in Table 5, GRF Medicaid expenditures in August were $907.7 million, $18.5 million (2.0%) under the estimate provided by the Ohio Department of Job and Family Services. For the fiscal year-to-date, outlays of $2,270.6 million were $15.5 million (0.7%) under estimate. Medicaid is exempted from the spending cutbacks announced by the Governor. This program accounts for about 95% of outlays in the Public Assistance and Medicaid program category.

Expenditures for the Managed Care, Nursing Facilities, and Hospitals categories accounted for 72% of GRF Medicaid spending for the month. In August, expenditures for Managed Care plans totaled $349.3 million ($251.4 million for Covered Families and Children populations and $98.0 million for the Aged, Blind, and Disabled populations), accounting for about 38% of GRF Medicaid expenditures. Expenditures on the Nursing Facilities category accounted for 24% ($218.0 million), and expenditures on the Hospitals categories accounted for 10% ($64.5 million for Inpatient Hospitals and $28.1 million for Outpatient Hospitals).

**Revised on 9/22/2008.*

***Todd A. Celmar, Economist, 614-466-7358, contributed to the Medicaid section of this report.*

Table 5: Medicaid Spending in FY 2009
($ in thousands)

Medicaid (600-525) Payments by Service Category	August Actual	August Estimate	August Variance	August Percent Variance	Year to Date Actual thru Aug	Year to Date Estimate thru Aug	Year to Date Variance	Year to Date Percent Variance
Nursing Facilities	$217,969	$217,524	$445	0.2%	$428,745	$428,300	$445	0.1%
ICFs/MR	$45,086	$46,721	-$1,635	-3.5%	$88,119	$89,754	-$1,635	-1.8%
Inpatient Hospitals	$64,538	$72,744	-$8,206	-11.3%	$173,120	$181,326	-$8,206	-4.5%
Outpatient Hospitals	$28,080	$26,444	$1,636	6.2%	$60,530	$58,894	$1,636	2.8%
Physicians	$23,921	$22,673	$1,248	5.5%	$53,526	$52,278	$1,248	2.4%
Prescription Drugs	$34,267	$35,625	-$1,358	-3.8%	$75,823	$77,181	-$1,358	-1.8%
ODJFS Waivers	$24,184	$25,957	-$1,773	-6.8%	$53,329	$55,102	-$1,773	-3.2%
MCP - CFC	$251,371	$255,736	-$4,365	-1.7%	$736,118	$740,482	-$4,364	-0.6%
MCP - ABD	$97,955	$98,843	-$888	-0.9%	$344,813	$345,701	-$888	-0.3%
Medicare Buy-In	$25,127	$25,931	-$804	-3.1%	$50,178	$50,982	-$804	-1.6%
All Other	$73,864	$77,255	-$3,391	-4.4%	$163,037	$163,399	-$362	-0.2%
DA Medical	$886	$950	-$64	-6.7%	$2,026	$2,090	-$64	-3.1%
Total Payments	$887,248	$906,403	-$19,155	-2.1%	$2,229,364	$2,245,489	-$16,125	-0.7%
Offsets								
Drug Rebates	-$147	-$227	$80	-35.2%	-$234	-$315	$81	-25.7%
Revenue and Collections	-$2	-$175	$173	-98.9%	-$1	-$174	$173	-99.4%
ICF/MR Franchise Fees	$0	$0	$0	N/A	$0	$0	$0	N/A
NF Franchise Fees	$0	$0	$0	N/A	$0	$0	$0	N/A
IMD/DSH Payments	$0	$0	$0	N/A	$0	$0	$0	N/A
MCP Assessments	$0	$0	$0	N/A	$0	$0	$0	N/A
Health Care Federal	$0	-$402	$402	-100.0%	$0	-$402	$402	-100.0%
Total Offsets	-$149	-$804	$655	-81.5%	-$235	-$891	$656	-73.6%
Total 600-525 (net of offsets)	$887,099	$905,599	-$18,500	-2.0%	$2,229,129	$2,244,598	-$15,469	-0.7%
Medicare Part D (600-526)	$20,599	$20,608	-$9	0.0%	$41,461	$41,469	-$8	0.0%
Total GRF	$907,698	$926,207	-$18,509	-2.0%	$2,270,590	$2,286,067	-$15,477	-0.7%
Total All Funds	$907,847	$927,011	-$19,164	-2.1%	$2,270,825	$2,286,958	-$16,133	-0.7%

Source: Ohio Department of Job & Family Services.

ICFs/MR - Intermediate Care Facilities for the Mentally Retarded
ODJFS - Ohio Department of Job and Family Services
MCP - Managed Care Plan
CFC - Covered Families and Children
ABD - Aged, Blind, and Disabled
DA Medical - Disability Medical Assistance
NF - Nursing Facilities
IMD/DSH - Institutions for Mental Disease/Disproportionate Share

Issue Updates

University System of Ohio Launches Textbook Initiatives

— Mary E. Morris, Budget Analyst, 614-466-2927

The University System of Ohio recently introduced three initiatives designed to make college textbooks more affordable. The initiatives resulted from a Textbook Affordability Symposium in April 2008, which opened a dialogue among textbook publishers, postsecondary educators, and administrators. In August, the University System launched its new e-textbook portal for students to access electronic versions of course textbooks. The portal web page features e-textbooks sold by CourseSmart, an online textbook publisher, at approximately 50% of the cost of a new print textbook. Students of Ohio's public institutions receive an additional 10% off the sale price of each electronic textbook. According to the Board of Regents, this agreement costs the state nothing.

In addition to e-textbooks, the University System announced the development of two programs designed to encourage faculty innovation in textbook affordability. The Textbook Affordability Grants program will award as many as five $50,000 grants to faculty teams for developing collections of free course materials for students. The Faculty Innovator Awards program will award $1,000 to each of ten faculty members with the most innovative methods for developing and using inexpensive digital course materials. Both programs will grant awards in FY 2009.

Ohio Can! Go to College Grants Awarded

— Mary E. Morris, Budget Analyst, 614-466-2927

The Ohio College Access Network (OhioCAN) recently identified the recipients of the Ohio Can! Go to College grants, totaling $7.3 million. The Ohio Can! Go to College program is among the collaborative efforts of OhioCAN, the Board of Regents, and the Department of Education, to attract and assist students who might not otherwise consider postsecondary education. The goal of the grants is to increase higher education enrollment in the state by approximately 23,000 students; a step toward the ten-year 230,000-student increase in enrollment proposed in the Chancellor's strategic plan. Competitive grants were awarded to 24 public and private educational institutions and organizations, each of which will work with other organizations to leverage awards with private donations. Collectively, participants have pledged to raise $90.8 million in private donations that will be used to help new students attend Ohio institutions and provide more opportunities for internships and work experience. In addition to the grant funds, the Board of Regents and OhioCAN will use $1.2 million for administration and fundraising support, including the hiring of an employee devoted to helping Ohio's community colleges raise private donations. Funding for the grant program and its administration comes from GRF appropriation item 235434, College Readiness and Access.

Ohio Can! Go to College Grant Awards			
Grant Recipient	**Grant Amount**	**Additional Amount to be Raised**	**Students to be Helped**
Inter-University Council of Ohio	$1.0 million	$10.0 million	1,666
Ohio Association of Community Colleges	$1.0 million	$8.0 million	2,625
The Ohio College Access Network*	$0.8 million	$20.0 million	5,000
Ohio Public Universities	$1.4 million	$25.3 million	5,370
Ohio Private Universities	$0.7 million	$7.5 million	995
Other Education Organizations	$2.4 million	$20.0 million	7,339
Total	**$7.3 million**	**$90.8 million**	**22,995**

* OhioCAN's grant is tentative, pending approval of the Board of Regents.

State Advisory Committee on the Transfer of Adult Career-Technical Programs Issues Recommendations

— Mary E. Morris, Budget Analyst, 614-466-2927

The State Advisory Committee on the Transfer of Adult Career-Technical Programs recently issued its recommendations for the transfer of Ohio's adult workforce education programs from the Department of Education to the Board of Regents. The recommendations and the transfer are mandated by H.B. 119 and complement the restructuring of Ohio's workforce development programs as outlined in Executive Order 2008-05S. The Department of Education will transfer the Adult Basic and Literacy Education (ABLE) and Adult Workforce Education (AWE) programs to the Board of Regents. ABLE currently provides adults with the resources to pursue education and improve their social and work skills through basic literacy and training. AWE provides career training, guidance, job placement, and transitional services. In FY 2007, ABLE enrolled 47,462 individuals in adult basic education programs and AWE enrolled 16,117 adults in workforce career development programs. Combined state and federal appropriations for these two programs are approximately $48 million in FY 2009.

With the transfer to the Board of Regents, ABLE and AWE will become transitional programs for adult learners looking to prepare for credential-earning education. These two programs, along with other adult career-technical programs, will incorporate new "stackable certificates" to link basic education and college-level coursework. The stackable certificates initiative offers various competency-based, low-cost, noncredit, and credit-bearing modules and courses with a goal of leading to a certificate for a participant who can then use the certificate to pursue additional post-secondary education. The transfer of ABLE and AWE is scheduled to be completed by January 1, 2009.

Enrollment in Early Learning Initiative Increased by 18% in FY 2008

— Todd A. Celmar, Economist, 614-466-7358

From FY 2007 to FY 2008, the average number of children enrolled in the Early Learning Initiative (ELI) increased by 18%, from 10,180 to 12,044. Two programmatic changes made by the Ohio Department of Job and Family Services (ODJFS) likely account for much of the enrollment increase. Beginning in FY 2008, ODJFS removed the work requirement for parents whose children participate in ELI and lengthened the eligibility redetermination period from six to twelve months.

Removal of the parental work requirement increases the number of eligible children and lengthening of the redetermination period allows any child who is eligible at the beginning of the school year to continue attendance for the entire year regardless of changes in the family income level.

Launched in FY 2006, ELI is a program jointly administered by ODJFS and the Ohio Department of Education (ODE) that provides child care and educational services to eligible children in low-income families. To be eligible, children must be between three and five years old and not enrolled in kindergarten. Annual family income may not exceed 185% of the federal poverty guideline ($32,560 for a family of three in FY 2008).

From FY 2007 to FY 2008, expenditures for ELI increased 20% from $95 million to $114 million. In both of these years, however, expenditures remained under the annual appropriation of $128 million. Expenditures for ELI services are disbursed by ODJFS to ELI providers from Ohio's TANF Block Grant.

Six Districts Removed from Fiscal Emergency or Watch During FY 2008

— Andy Plagenz, Budget Analyst, 614-728-4815

During FY 2008, three school districts were removed from fiscal emergency status and three districts were removed from fiscal watch status. These two designations and a third, fiscal caution, are applied to school districts deemed to be operating under a certified or anticipated deficit or failing to meet other fiscal or budgetary guidelines established by the State Superintendent of Public Instruction and the Auditor of State. As of June 30, 2008, there were 7 districts remaining in fiscal emergency, 10 under fiscal watch, and 18 under fiscal caution. The 6 districts removed and the 17 districts remaining in either fiscal emergency or fiscal watch are listed in the following tables.

School Districts in Fiscal Emergency in FY 2008	
District Name	**County**
Removed from Fiscal Emergency	
Barnesville Exempted Village	Belmont
Shelby City	Richland
Struthers Local	Mahoning
Remain in Fiscal Emergency as of June 30, 2008	
Southern Local	Meigs
East Cleveland City	Cuyahoga
East Liverpool City	Columbiana
Springfield City	Clark
Youngstown City	Mahoning
Springfield Local	Summit
Federal Hocking Local	Athens

School Districts in Fiscal Watch in FY 2008	
District Name	**County**
Removed from Fiscal Watch	
Cleveland Municipal	Cuyahoga
Sebring Local	Mahoning
London City	Madison
Remain in Fiscal Watch as of June 30, 2008	
Coventry Local	Summit
Niles City	Trumbull
Jefferson Township Local	Montgomery
Cloverleaf Local	Medina
Fairborn City	Greene
Marion City	Marion
Brookfield Local	Trumbull
Salem City	Columbiana
Mansfield City	Richland
Edison Local	Jefferson

Districts in fiscal emergency may qualify for an advance from the state's School District Solvency Assistance Fund. On June 2, 2008, the Controlling Board approved a $10.4 million advance from the School District Solvency Assistance Fund for the Youngstown City School District, the only district that received solvency assistance in FY 2008. The advance is to be repaid by the school district over the next two fiscal years. On August 11, 2008, the Jefferson Township Local School District in Montgomery County, which was in fiscal watch status at the end of FY 2008, was declared to be in fiscal emergency and became the first district to receive solvency assistance funds in FY 2009. The Controlling Board, at its August 18, 2008 meeting, approved an advance in the amount of $1.5 million that is expected to enable the district to remain solvent through November 2008.

Seven School Districts Save Almost $24 Million in Facilities Funding as a Result of H.B. 119 and H.B. 562 Provisions

— Edward Millane, Budget Analyst, 614-995-9991

In August 2008, the Controlling Board approved Classroom Facilities Assistance Program funding for 35 school districts. The local project share for 7 of these 35 districts was reduced by a total of $23.9 million (see table below) as a result of provisions in H.B. 562 and H.B. 119, both of the 127th General Assembly. Of these seven districts, six benefit from a H.B. 562 provision requiring that a student enrollment adjustment authorized in H.B. 119 be implemented one year sooner, in FY 2009 instead of FY 2010. This adjustment incorporates certain school districts' net gains in open enrollment students[1] into the calculation of per pupil valuation. A district's per pupil valuation largely determines the district's eligibility for facilities funding as well as its state and local shares of the total project cost. With a given amount of total taxable property value, a district's valuation per pupil is reduced by including additional students, making the district eligible for funding sooner, and for a greater state share. The local share of the seventh district, Westfall Local School District in Pickaway County, was lowered as a result of a H.B. 562 provision requiring corrections to errors in previously certified taxable values. These seven districts, as well as the other 28 districts approved for funding for FY 2009, now have one year to secure their local shares to begin their facilities projects.

Approximate Reduction in Local Share for Eligible Districts as a Result of H.B. 119 and H.B. 562

District Name	County	Provision Affecting School District	Approximate Reduction in Local Share ($ in thousands)
New Boston Local	Scioto	Open Enrollment	$7,104
Pettitsville Local	Fulton	Open Enrollment	$4,496
Franklin-Monroe Local	Darke	Open Enrollment	$4,218
Clay Local	Scioto	Open Enrollment	$2,739
Jefferson Township Local	Montgomery	Open Enrollment	$2,621
Western Reserve Local	Mahoning	Open Enrollment	$2,445
Westfall Local	Pickaway	Tax Correction	$315
		Total	**$23,938**

[1] These are students who attend a district other than the one in which they reside. Each school district in Ohio can choose to accept students from other districts under an open enrollment policy.

Job and Family Services Enrolls Disabled Workers in New Medicaid Program

— Todd A. Celmar, Economist, 614-466-7358

In the last quarter of FY 2008, ODJFS enrolled 456 individuals into the new Medicaid Buy-In for Workers with Disabilities Program, which opened April 1, 2008. The program, as authorized in H.B. 119 of the 127th General Assembly, allows disabled individuals to receive Medicaid services while working. The program is available to disabled persons whose annual income is no more than 250% of the federal poverty guideline ($26,000 in federal fiscal year 2008 for one individual). ODJFS estimates the net cost of the program at $25 million over the current biennium ($9 million state share) taking into account estimated revenue from premiums as discussed below. ODJFS expects the program to reach full enrollment of 7,300 participants after 18 months.

The program requires those with annual incomes of 150%-250% of poverty ($15,600 - $26,000 for one individual) to pay monthly premiums into the program on a sliding scale; those making less than 150% of poverty are not required to pay premiums. Of the 456 current enrollees, 216 (47%) are paying premiums. The premium is determined by subtracting the amount of monthly income at 150% of poverty ($1,300) from the worker's monthly income and then multiplying that number by 10%. For example, if a single worker has a monthly income of $1,800 (208% of poverty), that person's monthly premium would be $50.

$1,800 - $1,300 = $500

$500 x 10% = $50

Enrolled workers may deduct other qualified private medical insurance premiums from this amount, thereby reducing their monthly premium. ODJFS estimates that premium revenue will total $1.8 million over the biennium.

Retained Applicant Fingerprint Database Has Yielded 44 "Hits" Since September 2007

— Jamie L. Doskocil, Senior Budget Analyst, 614-447-8800

Since its inception in September 2007, the Retained Applicant Fingerprint Database (RAFD) has yielded 44 "hits" on the 25,000 school bus drivers currently in the system. RAFD "hits" are situations in which an individual in the database has been arrested for, convicted of, or pleaded guilty to an offense. As required by S.B. 97, S.B. 163, and H.B. 428, all of the 127th General Assembly, the Attorney General's Bureau of Criminal Identification and Investigation (BCII) established RAFD, a database of fingerprints of individuals on whom BCII has conducted criminal records checks to determine eligibility for employment, licensure, or approval for adoption or volunteer service by a public office. When the RAFD yields a "hit," the Superintendent of BCII is required to promptly notify the public office that employs, licenses, or approves the individual and that elects to receive such information. H.B. 428 specifically requires the Department of Education to participate in receiving these notifications. In addition to the information on school bus drivers, the RAFD will add information on other individuals in the future, including school teachers and foster care providers. To fund the RAFD operations, BCII has authority and plans to charge an initial fee of $5 for each individual entered into RAFD and a fee of $5 annually thereafter. Although operational, the RAFD is largely a manual system, with a more automated system expected to be completed in the next few months.

Department of Public Safety Awards Grants for Drug Law Enforcement

— Sara D. Anderson, Senior Budget Analyst, 614-728-4812

The Department of Public Safety's Division of Criminal Justice Services has awarded grants totaling $1.6 million over the FY 2008-FY 2009 biennium from the Drug Law Enforcement Fund (Fund 5ET0). Grants are to be used by local law enforcement agencies and local law enforcement task forces to support enforcement of state drug laws. As required by H.B. 119, the funds were transferred to Fund 5ET0 from the Attorney General's Charitable Foundations Fund (Fund 4180). The revenue deposited in Fund 4180 generally consists of fees and fines collected by the state from charitable organizations. The local entities that have been awarded grants as well as the total monetary amount awarded are summarized in the table below.

Drug Law Enforcement Fund Grant Awards, FY 2008-FY 2009 Biennium			
Local Jurisdiction	**Amount**	**Local Jurisdiction**	**Amount**
Allen County	$49,627	Lawrence County	$39,630
Auglaize County	$40,938	Licking County	$68,511
City of Bedford	$43,432	Lorain County	$67,446
City of Cambridge	$39,630	City of Mansfield	$106,583
Clermont County	$53,864	Medina County	$46,352
City of Cleveland	$110,224	Ottawa County	$39,630
Columbiana County	$43,958	Ross County	$58,808
Defiance County	$49,620	Springfield Township	$47,059
Delaware County	$47,939	Stark County	$78,612
Fairfield County	$50,817	Summit County	$99,952
City of Fairview Park	$29,630	Trumbull County	$77,591
Greene County	$49,189	Warren County	$55,537
Lake County	$59,446	Wayne County	$56,546
City of Lakewood	$21,934	City of Youngstown	$67,496

Veterans' Services Consolidated Under Department of Veterans Services

— Nick Thomas, Budget Analyst, 614-466-6285

On August 18, 2008, the Controlling Board approved the transfer of $49.4 million in FY 2009 appropriations from the Ohio Veterans' Home and the Governor's Office of Veterans' Affairs to the newly created Ohio Department of Veterans Services (ODVS). This new department was created in May 2008 by S.B. 289 of the 127th General Assembly with the goal of improving services to the 962,000 veterans across the state. In addition to creating ODVS, the act gives the agency oversight responsibilities for county veterans' service commissions. ODVS also houses the Ohio War Orphan Scholarship Board, although funding for the scholarships, totaling $4.8 million in FY 2009, will continue to be administered and distributed by the Board of Regents. The consolidation affects 880 state employees, including 876 former employees of the Ohio Veterans' Home and 4 former employees of the Governor's Office of Veterans' Affairs.

Natural Resources to Use $5.5 Million to Expand Mine Safety Operations and Reduce Operations' Dependence on GRF Funding

— Brian Hoffmeister, Budget Analyst, 614-644-0089

On August 18, 2008, the Controlling Board approved a request by the Department of Natural Resources (DNR) to establish the Mine Safety Fund with a non-GRF appropriation of $5.5 million in FY 2009. This action was the result of S.B 323 of the 127th General Assembly, requiring DNR to establish the fund and appropriation using interest earnings transferred from the Coal Workers' Pneumoconiosis Fund (or the "Black Lung Fund") administered by the Bureau of Workers' Compensation (BWC).

The Mine Safety Fund will support the implementation of various recommendations proposed in 2006 by the Underground Mine Safety Task Force, including health inspections, new rescue and inspection equipment, rescue and safety training, certification of mine officials and mine medical responders, and the purchase or lease of mine rescue stations. In addition, the Mine Safety Fund will also reduce DNR's dependence on GRF funds for payroll costs associated with the program. Appropriations from the Mine Safety Fund will be used to pay for payroll costs for 20 existing staff previously paid through the Division of Mineral Resources Management's GRF operating funds, as well as the costs for 12 new staff, who have not yet been hired. Aside from approximately $2 million in payroll costs, an additional $2.25 million has been committed for several purchases and a lease, including a new mine rescue station and a new training facility. Interest earnings of the Black Lung Fund, however, are not intended as a permanent source of mine safety funding. S.B. 323 requires DNR to identify alternative revenues to support the program within five years.

Tracking the Economy

— *Ross Miller, Senior Economist, 614-644-7768*

Second quarter growth in U.S. real GDP was revised upward to 3.3%.

Overview

Labor market data continued recent negative trends in July and August, both nationally and (through July) in Ohio. The national unemployment rate rose from 5.5% in June to 5.7% in July and 6.1% in August, the highest rate seen since 2003. Similarly, Ohio's unemployment rate increased from 6.6% in June to 7.2% in July, the highest observed in Ohio since 1992. Data on payroll employment tell the same story from a different angle. Nevertheless, growth in real[1] gross domestic product (GDP) in the second quarter was estimated to be 3.3%–close to the economy's long run potential rate of growth, and a recession has not been officially declared as of this writing.

Net exports were easily the primary driver of economic growth in the second quarter, accounting for 3.1 percentage points of the 3.3% growth. The weak dollar has permitted a continuation of growth in the U.S. economy despite the loss of several hundred thousand jobs nationally so far this year. Unfortunately, economic growth has slowed in Japan and Western Europe, potentially limiting the ability of exports to continue to drive growth.

Weakness has spread into nearly all sectors of the economy, but residential construction and related financial markets continue to act as particularly significant brakes on economic growth. Residential construction has served as such a significant brake for so long that it has reduced its ability to continue to apply so much negative pressure on the economy.[2] In fact the drag on growth in the second quarter was about half the impact on growth during each of the preceding two quarters.

Net exports accounted for almost all of the second quarter GDP growth.

Financial markets, however, continue to suffer from the legacy of bad loans made in the last few years, and great uncertainty remains. One manifestation of this was the U.S. Treasury's announcement that the government would place Fannie Mae and Freddie Mac, two of the largest financial institutions in the country, under "conservatorship."[3] The government is, in effect, taking control of both institutions while providing up to $200 billion in capital if needed. Another manifestation was the 45% drop in the stock price of Lehman Brothers Holdings, Inc. on September 9. It is clear that the uncertainty in the markets has caused lenders to tighten lending standards, but most economists would argue that they needed at least some tightening. The question is whether lending to qualified borrowers will decrease, which could lead to significant falls in consumption and investment. The jury is still out on that question.

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[1] Economists use the term "real" to indicate that a variable, in this case gross domestic product, has been adjusted for inflation.

[2] Because this statement is specifically about the effect of residential housing construction on economic growth, it does not preclude future falls in volumes of home sales or in housing prices. Put another way, this is not a prediction that the national housing market, or Ohio's, will begin to recover this year.

[3] For more details, see the September 8, 2008 edition of the *Wall Street Journal*.

The National Economy

Production and Income

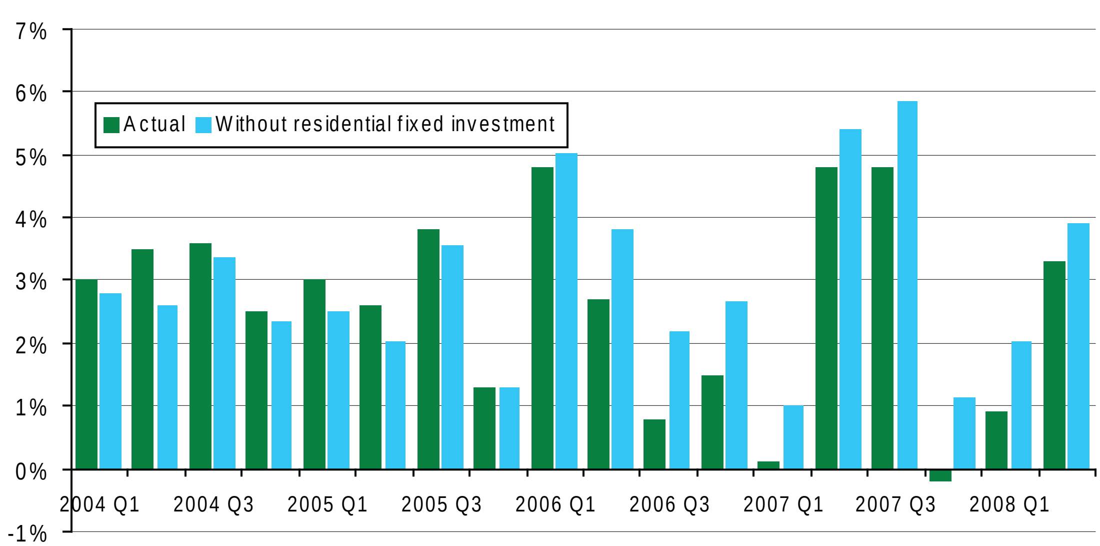
The U.S. Bureau of Economic Analysis (BEA) revised upward the estimate of U.S. real GDP growth for the second quarter of 2008 from (an annualized) 1.9% to 3.3%. Second quarter growth was significantly stronger than during the preceding two quarters: growth in the first quarter of 2008 was 0.9%, and growth in the fourth quarter of 2007 was 0.6%.

Net exports, which are made up of exports minus imports, contributed 3.10 percentage points to second quarter growth, accounting for nearly all of the GDP growth. The value of exports grew by an annualized 13.2%, while the value of imports decreased by 7.6%. Both exports and imports, then, contributed positively to real GDP growth. Most analysts attribute these positive contributions to the weak U.S. dollar, which makes American goods more affordable for foreign consumers. Recent data have shown economic growth slowing in Europe and Japan, which is likely to limit future contributions to U.S. growth from net exports.

Gross private domestic investment continued to act as a drag on the U.S. economy, subtracting 1.82 percentage points from growth in the second quarter. Positive contributions to growth came from consumer spending, which contributed 1.24 percentage points to growth, and government spending (0.76 percentage point). The drag created by investment is due to both residential fixed investment, which subtracted 0.62 percentage point from growth as the housing slump continued, and the change in private inventories, which subtracted 1.44 percentage points from growth. In contrast, nonresidential fixed investment contributed positively, if weakly, to growth.

The drag on growth from residential fixed investment began in the first quarter of 2006. The value of such investment has been falling at double-digit (seasonally adjusted annualized) rates since the second quarter of 2006. The contractionary effect of this subcomponent on GDP growth will almost surely lessen at some point in the

Growth Rate in Real U.S. GDP
Actual vs. Without Residential Fixed Investment



U.S. unemployment rate increased to 6.1% in August.

near future, if for no other reason than that past declines have decreased the relative size of this subcomponent of GDP. The chart on the preceding page shows real GDP growth and the role that residential construction has played in that growth. As shown here, residential construction aided economic growth during 2004 and 2005, but has served as a drag on growth since the first quarter of 2006.

Profits from current production decreased by $37.8 billion (2.4%) in the second quarter.[4] By comparison, profits fell by $17.6 billion in the first quarter. Domestic profits increased during the second quarter by $24.7 billion for financial corporations but decreased by $46.9 billion for nonfinancial corporations. Profits derived from the rest of the world decreased by $15.6 billion. Please note that these figures are not affected by the bonus depreciation provisions of the federal Economic Stimulus Act of 2008, since they are not based on depreciation accounting methods used for federal income tax returns.

Employment and Unemployment

The recent trend of decreasing payroll employment continued into July and August, with August representing the eighth straight monthly decline. U.S. nonfarm payroll employment fell by 84,000 in August, after seasonal adjustment, following a decline of 60,000 the preceding month. The number of jobs lost since December 2007 increased to 605,000, an average of nearly 76,000 jobs lost per month. Employment in goods-producing industries decreased by 57,000 in August; manufacturing, one of the sectors included in this category, lost 61,000 jobs for the month. Employment in service-providing industries decreased by an additional 27,000. Gains of 55,000 in the number of jobs in education and health services and 17,000 in government were more than offset by declines in employment in other services, including a decrease of 53,000 jobs in professional and business services.

The seasonally adjusted unemployment rate increased from 5.5% in June to 5.7% in July, and to 6.1% in August. The last time the U.S. unemployment rate was as high as 6.0% was October 2003, during the aftermath of the last recession; in fact the highest unemployment rate associated with that recession was 6.3%. Unemployment rates often continue to increase following the end of a recession; the peak unemployment rate associated with the last recession occurred in June 2003, although the recession officially ended in November 2001. The number of U.S. workers unemployed increased 592,000 to nearly 9.4 million in August, compared with slightly under 7.1 million unemployed workers in August 2007. The number of workers unemployed for longer than 27 weeks increased to nearly 1.9 million in August.[5]

Retail Sales

U.S. retail and food services sales[6] decreased by 0.1% in July, to a level 2.6% higher than July 2007. Among individual retail sectors, the most notable change from June to

[4] These figures are seasonally adjusted and annualized.

[5] Slightly less than one-third of the unemployed in August had been unemployed for fewer than five weeks. This ratio is typically at least one-third, marking a shift toward longer-term unemployment in recent months.

[6] Data on retail sales are adjusted for seasonal and trading day differences, but not for inflation.

July was a 2.4% decrease for motor vehicle and parts dealers. Excluding them, retail and food services sales increased by 0.4% for the month. And indeed, apart from them, most retail sectors experienced growth for the month, with the highest rates experienced by nonstore retailers (1.1%), furniture and home furnishings stores (1.0%), and electronics and appliance stores (0.8%). Gasoline stations also experienced 0.8% growth, but that was presumably due largely to gasoline price increases. The only retail sectors to have seen reductions in sales in July, other than motor vehicle and parts dealers, were sporting goods, hobby, book, and music stores and food services and drinking places, both of which experienced sales declines of 0.2%.

Taking a somewhat longer-term view of sales growth, total retail and food services sales for the three months ending in July 2008 were 2.7% greater than during the corresponding three months of 2007. Sales by motor vehicle and parts dealers fell by 9.2%; excluding them, retail sales increased 5.7%. The sharp drop in motor vehicle sales reflects both reduced unit sales and lower prices of vehicles sold as consumers shift their purchases toward smaller, more fuel-efficient vehicles. Apart from gasoline stations, whose sales are driven primarily by prices of gasoline and diesel fuel, the retail sectors with the highest sales growth on this basis were nonstore retailers, whose sales grew by 8.0%, food and beverage stores (5.6%), general merchandise stores (5.5%), and electronics and appliance stores (5.1%). Retail sectors that experienced declines in sales for the year included furniture and home furnishings stores (4.9%), department stores (2.0%), and building material and garden equipment and supplies dealers (1.8%).

Housing Markets and Construction Spending

U.S. housing starts decreased by 11.0% from June to July, falling below one million units on a seasonally adjusted annualized basis. The July figure of 965,000 was 29.6% below its level in July 2007. The numbers were mixed for the Midwest, as housing starts increased by 10.0% from June to July, but that still left them at a level 35.6% lower than the preceding July.

Data on building permits exhibited a similar pattern. The number of building permits issued nationally decreased by 17.7% from June to July, falling below the one million-unit level (annualized) for the fifth month in the last six. Compared with the preceding July, building permits were 32.4% lower. For the Midwest the monthly number of permits issued increased by 1.4%, but decreased compared with the year before by 27.9%.

As one would expect from the above statistics, construction spending in July was 0.6% below June's level (after seasonal adjustment), and 4.8% below the preceding July's level. Residential construction, which accounted for approximately one-third of total construction spending, was 2.1% below June's level and 27.1% below the preceding July. Public construction spending, which accounted for nearly 29% of total construction spending, provided some support for total construction spending; public construction spending increased by 1.4% from June to July, and by 8.1% over the preceding 12 months.

Manufacturing

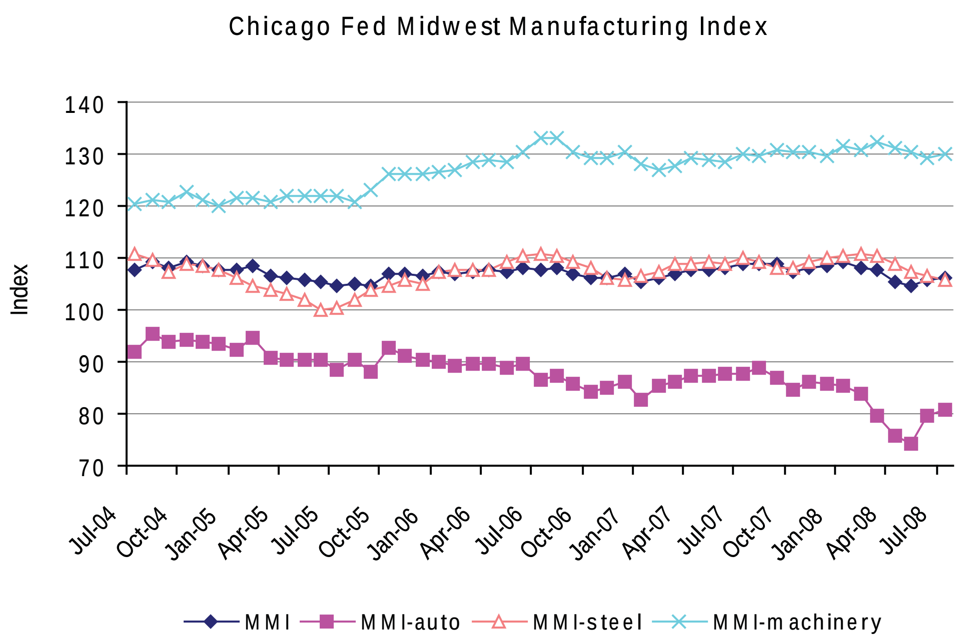
Shipments of manufactured goods increased by 2.1% to $465.3 billion in July, after seasonal adjustment. This was the sixth increase in the last seven months, and followed a solid (and revised) 1.9% increase in June, putting shipments at their highest level since the series was first stated on a North American Industrial Classification System (NAICS) basis in 1992. Shipments of manufactured durable goods increased 3.0% in July, to $219.4 billion, the third increase in the last four months. Both figures received a boost from transportation equipment, shipments of which increased by 3.8%. Much of that boost came from the aircraft subsector. Shipments of automobiles increased by 8.6%, partially offset by falls in shipments of light trucks and utility vehicles (3.6%) and heavy duty trucks (1.6%). Other sectors that experienced solid growth included primary metals, which increased by 3.7% continuing its recent strength, electrical equipment, appliances, and components (3.3%), and fabricated metal products (1.7%). Computers and electronic products increased by 9.0%, but growth in this sector has been more volatile recently—the strong growth number for July represented a reversal of sharp falls in preceding months. In contrast to the generally positive experience for the month, the machinery sector saw a 1.0% decline in shipments.

New orders for manufactured goods increased by 1.3% in July, and orders for durable goods increased by a matching 1.3%. The overall increase was the fifth consecutive monthly increase, putting overall new orders at their highest level since 1992, while the increase for durable goods was the third consecutive monthly increase. New orders for transportation equipment increased by 3.2%, but this was fully attributable to an increase in orders for aircraft. New orders grew for machinery (by 4.1%), primary metals (2.4%), and fabricated metal products (0.3%). New orders declined for electrical equipment, appliances, and components (5.9%), computers and electronic products (1.4%), and furniture and related products (1.4%).

The national data reported above are fairly current but applies to the entire U.S. economy. The Chicago Fed produces a Midwest Manufacturing Index (MMI) specific to its Federal Reserve district, which includes Michigan, northern Indiana, northern Illinois, southern Wisconsin, and Iowa. While Ohio is not in the Chicago district, Ohio's economy is more similar to that of the states that are in the district than it is to the national economy as a whole. So the MMI may provide a better idea of manufacturing conditions in Ohio than do the national data. The path of the MMI, and of its auto, steel, and machinery subcomponents, from July 2004 through July 2008 is shown in the accompanying chart.

The overall index shows little change during the period as a whole. None of the months shown experienced industrial production as much as 10% higher than it was in 2002, the base year for the index, but it did reach 9.2% higher in a couple of months since then, most recently in January of this year.

The index fell by 1.8% during the first seven months of 2008, with June and July helping to recover some lost ground. The magnitude of the decline in production varied significantly across manufacturing sectors. The auto sector index fell by 5.9% during this period, while the steel index fell by 3.8%; in contrast the machinery index rose by 0.3%. The improvements seen in June and July were due to the auto industry; the indexes for steel and machinery both fell slightly during those two months. Despite the



experiences of June and July, though, the longer term movements in the index suggest that the weak U.S. dollar provided more cushion for the steel and machinery industries than for the auto industry.

Inflation and Prices

The consumer price index for all urban consumers (CPI-U) increased by 0.8% from June to July, after seasonal adjustment. This was a large increase for a single month, and followed a very high 1.1% increase in June (which was the second highest in 26 years). But core inflation, as measured by the CPI-U excluding food and energy, was 0.3% for the most recent month. The implication is that either energy or food prices (or both) rose significantly during the month. As was the case in June, energy was the main culprit – the energy component of the index rose 4.0% for the month and itself accounted for approximately half of the overall increase. The index for food also contributed strongly, as it rose by 0.9% for the month. For the first seven months of 2008 the energy component has risen by 33.1% at a seasonally adjusted annual rate. Overall CPI-U increased 5.6% during the year ending in July; excluding food and energy prices, the index rose 2.5% for the year.

Inflation as measured by CPI-U has been accelerating since May. The annualized inflation rate over the three months ending in July was 10.6%, up from corresponding figures of 7.9% for June and 4.9% for May. The jumps in both the July and June figures were heavily influenced by energy prices. Annualized core inflation, which excludes food and energy prices, is correspondingly lower; over the three months ending in July it was 3.5%. This is still significantly above the level that many economists consider a range compatible with long run economic growth.

Price increases measured by the producer price index for finished goods have exhibited a similar acceleration in inflation. The index increased by 1.2% in July, after seasonal adjustment, and by 1.8% in June. That left the index 9.8% higher than the preceding July. As with CPI-U, the increase over the past year has been driven primarily by prices of energy and of food. Excluding these items the index increased by 0.7% from June to July, and by 3.5% over the last year.

Gasoline and diesel fuel prices, based on recent data from the U.S. Energy Information Administration, reached a peak in mid-July and then fell steadily. The average price for all grades of gasoline was about $4.10 per gallon nationally the week of July 14; since then the price declined to about $3.69 per gallon (as of September 8). Similarly, the average price of diesel fuel (all types) hit a peak of $4.76 per gallon on July 14, and fell to about $4.06 per gallon on September 8. The average price of gasoline in Ohio has followed a very similar path, with the average price peaking at $4.10 per gallon on July 14 before falling to $3.60 per gallon around the beginning of September. Generally speaking, the prices of these refined petroleum products have followed global market prices for petroleum. The spot price of oil[7] reached a peak over $140 per barrel the week of July 4, and has since receded to about $116.[8]

The Ohio Economy

Ohio's unemployment rate jumped to 7.2% in July.

Ohio's nonfarm payroll employment decreased by 11,600, or about 0.2%, in July, after seasonal adjustment. The decrease lowered Ohio's employment to slightly under 5.41 million. Service providing industries accounted for the bulk of the reduction in employment, with 9,100 fewer jobs for the month; goods-producing industries lost 2,500 jobs. Consistent with the decrease in payroll employment, Ohio's unemployment rate jumped from 6.6% in June to 7.2% in July, its highest reading since 1992. The number of unemployed Ohio workers increased from 394,000 to 430,000 for the month.

During the year ending in July, Ohio payroll employment fell by 13,300. This was the result of a decrease of 10,900 jobs in goods-producing industries and a decrease of 2,400 in services. Within the goods producing sector, manufacturing lost 5,600 jobs over the year, and construction lost 5,700. Declining service sectors, as measured by employment, were led by trade, transportation, and utilities, which fell by 4,700, followed by government (3,700), information (2,000), financial activities (1,800), and other services (1,800). In contrast, educational and health services added 10,200 jobs during the year, and professional and business services gained 1,100.

The Ohio Association of Realtors (OAR) reports that 67,092 homes were sold in Ohio during the first seven months of 2008, a decrease of 15.2% compared with the corresponding months of 2007. There is little indication of conditions beginning to improve: sales during the months of June and July were 14.9% below the corresponding months of 2007. The OAR reported that sales have returned to a level that would have been considered typical prior to 2003 (i.e., pre-boom in real estate). The average sales price during 2008 through July was $141,014, which was 7.2% below the corresponding level in 2007.

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[7] West Texas Intermediate grade crude oil.

[8] Oil is a globally traded commodity, the price of which is denominated in U.S. dollars around the world. The price decrease is due in part to an increase in the value of the dollar relative to other currencies. An additional factor may be that some governments, including China's and India's, have reduced subsidies that they provide for consumers of petroleum products. See article in July 9 issue of the *Wall Street Journal*.

The Federal Reserve's "Beige Book," released September 3, reported that economic activity in the Cleveland district[9] had weakened somewhat since mid-July. Factory output was described as "largely stable," though a sharp decline in automobile production in July was attributed to retooling related to the impending 2009 model year. District manufacturers "anticipate that orders will be relatively steady during the upcoming months." Although market conditions for residential builders remain depressed, commercial contractors report that business conditions have been "holding steady." Retailers reported some increase in sales compared with the preceding year, but this could be due to the impact of economic stimulus checks. Finally, Fed contacts in the freight hauling sector report weak demand, due primarily to customers in the automobile, consumer products, and housing industries.

Economic Forecast Update

Revenue forecasts that were made during the process of crafting the state's budget were based on forecasts of a number of national and Ohio-specific economic variables, including real GDP (both for the U.S. and for Ohio), Ohio personal income and wage disbursements, and unemployment rates. The forecasts used came from the economic forecasting firm Global Insight and from the Governor's Council of Economic Advisors. This update is intended to provide legislators with a sense of how the outlook for the economy has changed since the budget bill was enacted so that they may anticipate, at least in general terms, the implications for the budget.

Since the July edition of *Budget Footnotes*, Global Insight has updated both its national forecast and its forecast for Ohio. The table below presents forecasts of selected variables from each of its most recent forecasts. With FY 2008 now complete, this section will focus entirely on FY 2009. As the table shows, the September 2008 forecast of national values for FY 2009 are significantly less favorable than they were forecast to be for the budget. The forecast for U.S. real GDP growth is 2.1 percentage points lower than was forecast for the budget, for example.

Similarly, the July 2008 forecast for Ohio is consistently less favorable for Ohio's economy, and therefore for the state budget. The forecast growth in Ohio's real GDP during FY 2009 is now 2.1 percentage points lower than was forecast for the budget, and growth in Ohio personal income is now forecast to be 1.6 percentage points lower than it was. Note that both of these reductions in predicted growth are forecast to occur on top of somewhat slower growth during FY 2008 than was originally forecast. The average unemployment rate during FY 2009 is now forecast to be 1.3 percentage points higher than was originally forecast.

These revisions to the May 2007 forecast consistently point toward an Ohio economy that is less prosperous than was expected when the budget was crafted. The problems this has created for many working Ohio families are fairly well known. Similar problems are likely for the state's budget in FY 2009. Certainly the state's revenue experience during the first two months of the new fiscal year suggests that we are seeing these problems already.

[9] The Cleveland district includes all of Ohio, plus parts of Pennsylvania, West Virginia, and Kentucky.

Revisions to Global Insight Economic Forecast (selected variables, state fiscal year basis)				
	FY 2008		FY 2009	
Variable Name (national)	**Forecast for Budget**	**September 2008 Forecast**	**Forecast for Budget**	**September 2008 Forecast**
U.S. real GDP growth	2.3%	2.4%	3.2%	1.1%
U.S. personal income growth	5.5%	5.3%	5.6%	3.7%
U.S. CPI inflation	1.8%	3.7%	1.9%	4.2%
U.S. unemployment rate	4.8%	5.0%	4.8%	5.9%
Variable Name (OH)	**Forecast for Budget**	**July 2008 Forecast**	**Forecast for Budget**	**July 2008 Forecast**
Ohio real GDP growth	1.9%	1.2%	2.5%	0.4%
Ohio personal income growth	4.2%	3.9%	4.6%	3.0%
Ohio wage disbursements growth	3.2%	2.6%	3.8%	3.0%
Ohio unemployment rate	5.5%	5.8%	5.4%	6.7%