TESTIMONY AND FORECAST OF

GRF REVENUES AND PUBLIC ASSISTANCE SPENDING

FOR THE FY 2006 - FY 2007 BIENNIAL BUDGET

TESTIMONY BY LSC FISCAL STAFF
FEBRUARY 14, 2005

LEGISLATIVE SERVICE COMMISSION TESTIMONY

TABLE OF CONTENTS

Forecast of GRF Revenues and Public Assistance Spending For the FY 2006-FY 2007 Biennial Budget

Testimony before the House Finance and Appropriations Committee

February 14, 2005

Testimony of LSC Staff by
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With assistance from other LSC Tax and Human Services Fiscal Staff

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Chairman Calvert and members of the House Finance and Appropriations Committee, I am here today to present the forecasts of the staff of the Legislative Service Commission (LSC) for fiscal years (FYs) 2005, 2006, and 2007. This testimony and the other information in your packet includes an overview of the economy and an outlook on future economic performance, forecasts for GRF revenues, and forecasts for expenditures in the Medicaid and TANF (Temporary Assistance for Needy Families) programs.

The estimates provided today assume current law continues throughout the next biennium. As better information on the Executive's tax and human services proposals becomes available, we will augment these baseline forecasts with information on those proposals.

Summary

LSC forecasts total tax revenue to be $18.4 billion in FY 2005, $17.8 billion in FY 2006, and $18.5 billion in FY 2007. Our forecasts for tax revenues are slightly higher (0.7%) for the next two fiscal years than those in the executive budget. While, the difference in our forecast for the current fiscal year (FY 2005) is negligible, the estimated tax revenue differences between the Office of Budget and Management's (OBM's) baseline forecast and LSC's baseline forecast for FY 2006 and FY 2007 are $96.8 million and $160.6 million, respectively.

LSC's baseline forecasts of Medicaid shows total expenditures (before offsets) to be approximately $10.6 billion in FY 2005, $11.9 billion in FY 2006, and $12.9 billion in FY 2007. Our estimated expenditures are 0.3% below OBM's baseline forecast for FY 2006 and 1.1% below their forecast for FY 2007. The estimated expenditure differences are shown in the following table:

	State	Federal	Total
FY 2006	$ 13.0 million	$ 19.2 million	$ 32.2 million
FY 2007	$ 54.5 million	$ 80.7 million	$ 135.2 million

In FY 2006, the difference between LSC's forecast and OBM's forecast is $32.2 million, of which $13.0 million is state share. In FY 2007, the difference between the two forecasts is $135.2 million, of which $54.5 million is state share.

The Economy

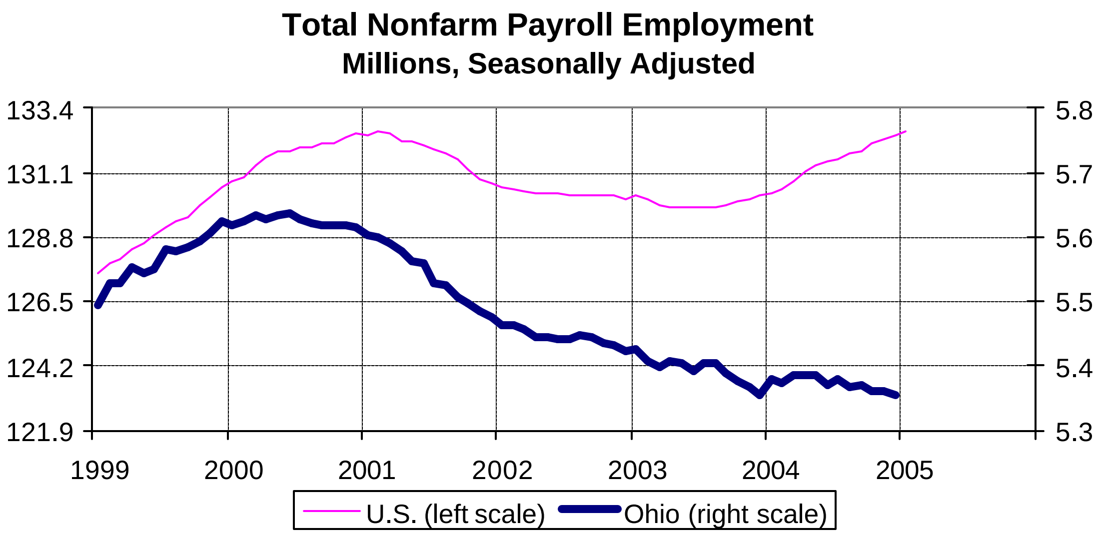
In calendar year 2004 the U.S. economy grew at a rate of 4.4% — the strongest growth since 1999 — and was led by consumer spending and the housing market. This growth was significantly augmented by an upturn in business capital spending, which was in part stimulated by a temporary acceleration in the depreciation schedule for business fixed investments. However, for the next two years, Global Insight (a leading national forecasting firm) anticipates slightly slower growth in consumption, housing, and government spending. Although at a slower pace, leadership in the expansion is thus expected to shift to business capital spending and also to exports. With consumption and the housing market slowing somewhat, the U.S. growth rate is also expected to slow to 3.5% in FY 2005, 3.1% in FY 2006, and 3.2% in FY 2007.

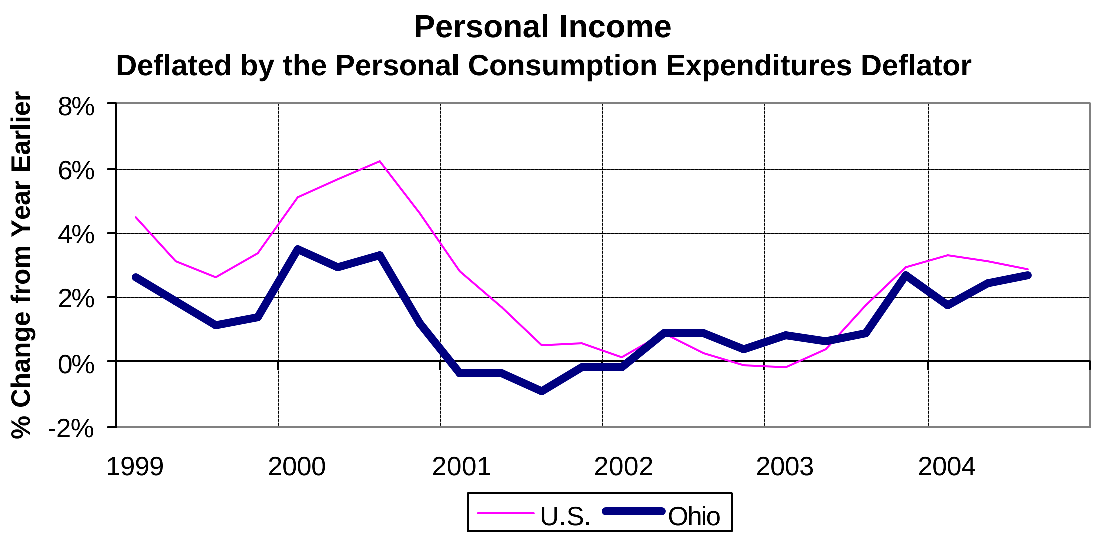
This slower but steady growth with business investment and exports leading the way is expected to also have the advantage of helping to reduce the foreign trade imbalance.

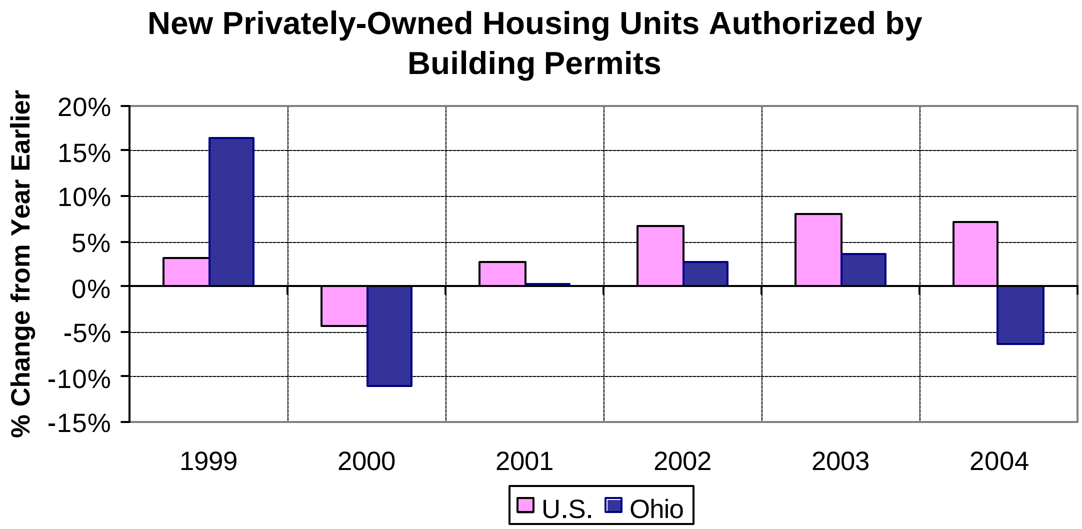
The latest Federal Reserve "Beige Book," which summarizes economic activity through early January, and presents its analysis by region, said that the U.S. economy was growing in 11 of the 12 regions of the country. The exception was the Cleveland Federal Reserve District, which includes Ohio. For this region economic conditions were characterized as "mixed." There are several factors that could be presented to fill out the meaning of the term "mixed." Some of them are:

- Ohio's economy trailed the nation's in the recession four years ago, has continued to lag in the recovery since then, and probably will continue to trail that of the nation.

- Payroll employment here turned down nearly a year ahead of the nation, and in December 2004 was barely above its recession low of a year earlier. In contrast, nationwide payroll employment rose to a new all-time high in January. (See chart.)
- Personal income growth was weaker in Ohio than nationwide ahead of and during the recession, and in the upturn since mid-2003 (although in the latter period the difference was smaller). (See chart.)
- Housing permits rose more slowly in Ohio than nationwide during 2002 and 2003, and fell here last year in contrast with continued growth in the U.S. (See chart.)







Nevertheless, Ohio's economy is expanding, and we expect it to continue to do so. Consider the following factors:

- Gross state product history from the US. Bureau of Economic Analysis shows recovery in 2002 from the 2001 recession, and expansion in 2003.
- Real personal income in Ohio has been growing through third quarter 2004 (latest actual).
- Weakness in employment resulted in part from exceptional growth of productivity. Now, however, productivity growth appears to be slowing, which will tend to result in more employment growth, but may also tend to feed into higher inflation. Total Consumer Price Index (CPI) inflation is expected to slow this year, however, because last year's jump in energy prices is not forecast to be repeated.
- Capital spending is likely to continue to grow, which will tend to support Ohio's producers of various types of equipment as well as the state's suppliers to original equipment manufacturers.
- The decline in the value of the dollar, particularly against currencies of our European trading partners, may help Ohio's exports.
- Consumer spending likely will continue to grow particularly if employment begins to pick up as it is expected to do.

- Employment growth is likely to be concentrated in the service sector, particularly health care and business services, which includes temporary workers. Manufacturing employment is expected to show a small rise.

Finally, the forecasts of key economic variables produced by the Governor's Council of Economic Advisors and by Global Insight provide much of the basis for LSC's revenue and public assistance expenditure forecasts. The forecasts by Global Insight are made on a monthly basis, whereas the Governor's Council last met in November.

Since November, Global Insight's forecasts have been showing stronger growth nationwide and in Ohio. U.S. Real Gross Domestic Product (GDP) growth was revised up 0.1% for both FY 2006 and FY 2007, and growth in Ohio Personal Income was revised up 0.6% for FY 2006 and 0.5% for FY 2007. The following table presents forecasted changes in several of the economic variables in the forecasts of both the Governor's Council of Economic Advisors and Global Insight. These stronger growth figures are reflected in LSC's forecast of higher tax revenues, especially the revenues from the income tax.

Economic Variables
Forecast for FY 2006-2007
Annual Percentage Change (except where noted)

	FY 2006		FY 2007	
	GCEA	**GI**	**GCEA**	**GI**
Real GDP	3.4%	3.1%	3.3%	3.2%
Consumer Price Index	2.1%	1.5%	2.3%	2.0%
U.S. Personal Income	5.2%	5.3%	5.0%	5.4%
Ohio Personal Income	4.7%	4.9%	4.9%	4.9%
U.S. Unemployment Rate (%)	5.3%	5.2%	5.2%	5.2%
Ohio Unemployment Rate (%)	5.7%	6.1%	5.6%	6.0%

GCEA: Governor's Council of Economic Advisors, November 2004

GI: Global Insight, Ohio forecast January 2005, U.S. forecast February 2005

There are, of course, always risks that economic forecasts must consider. Chief among the negative possibilities is another spike in oil prices caused by increased demand and/or a disruption of oil supplies. Another negative possibility is a continued increase in the foreign trade imbalance, which if it goes too far could accelerate the decline in the value of the dollar to the point of stimulating excessive inflation and thus upsetting the bond and housing markets.

On the positive side, high productivity gains could continue, foreign growth could be stronger than anticipated, business investment could continue at a stronger rate, and oil prices could drop more than expected. If those factors combine, growth would be stronger and sustainable, much the way it was in the recovery after the recession of the early 1990s.

Global Insight sees a 20% chance for the negative scenario and also a 20% chance for the positive scenario occurring. Within the last few weeks other issues such as the debate over Social Security funding and nuclear proliferation have taken on a significance that ultimately could impact economic performance depending on how they play out. Of course, many as yet un-thought of things could also happen.

Revenue Forecasts

LSC expects Ohio's economic growth to support revenue growth. However, revenue growth depends on both economic growth and the tax structure. The LSC forecasts for FY 2006 and FY 2007 assume a return to the statutory tax structure. The state sales tax rate returns to 5%, income tax brackets are indexed starting tax year 2005, the income tax on trusts ends, and the local government funds freeze ends. The return to the statutory tax structure will act to reduce GRF revenues.

LSC forecasts total tax revenue to be $18.4 billion in FY 2005, $17.8 billion in FY 2006, and $18.5 billion in FY 2007. We mention a few details here regarding our forecast of revenues in each of these years and how it differs with the Executive's forecast; additional details of the forecasts for the state's revenue sources are included in your packet.

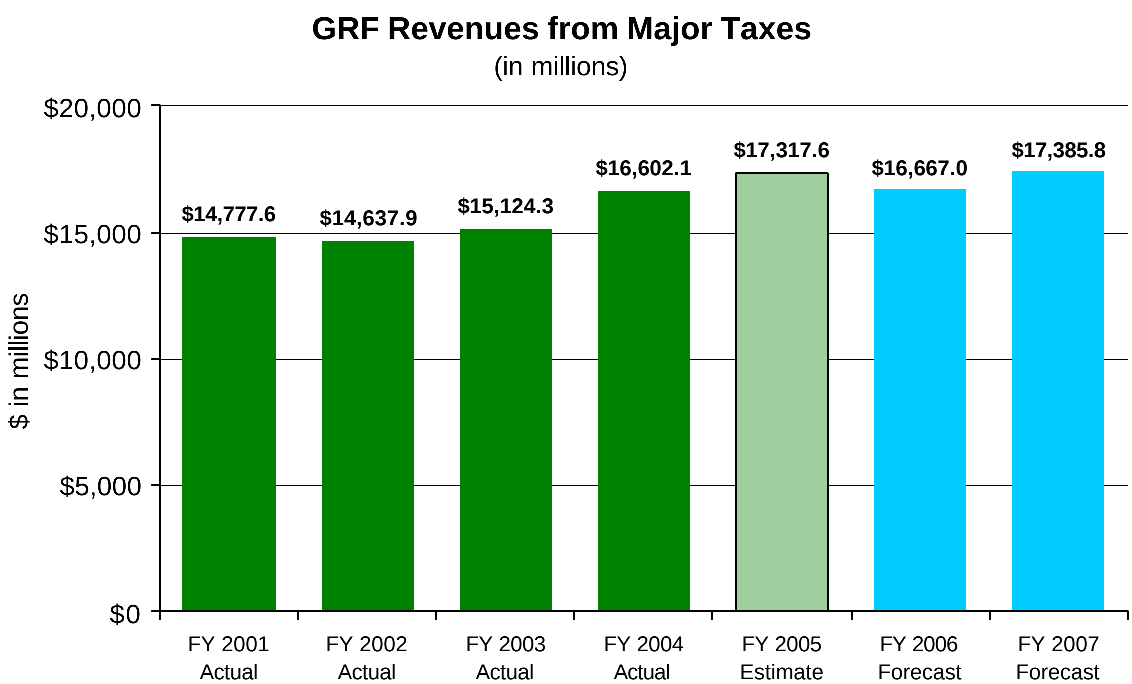
For FY 2005, LSC estimates that tax revenue will be $19 million lower than the OBM estimates made at the start of the fiscal year. The Executive's revised estimate for FY 2005 reduces total tax revenue by $18 million.

For FY 2006, LSC forecasts that tax revenue under statutory law will fall by $652 million (3.5%). The Executive forecasts that under statutory law tax revenue will fall by $749 million (4.1%) in FY 2006. The fall is due to the return of the sales tax rate to 5%. LSC forecasts a $985 million (12.6%) reduction in revenue from the sales tax; the executive forecasts a $1,072 million (13.6%) reduction. Revenues from taxes other than the sales tax increase by $334 million (3.1%) in the LSC forecast and $323 million (3.1%) in the Executive forecast.

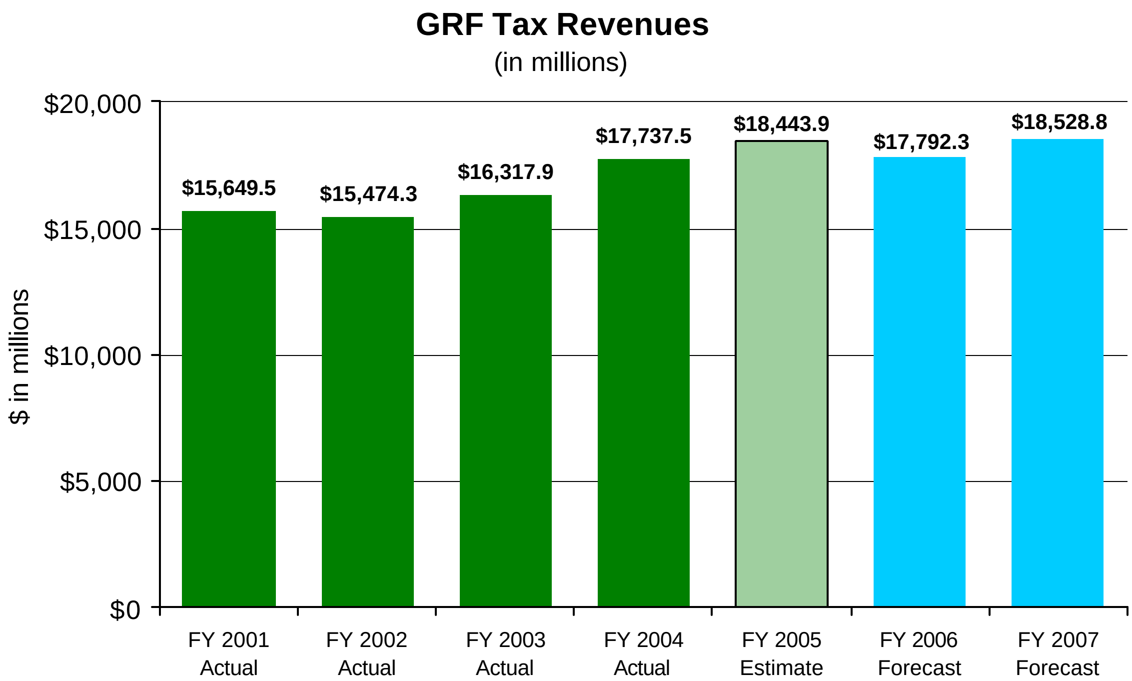
For FY 2007, LSC forecasts that tax revenue under statutory law will increase by $736 million (4.1%). The Executive forecasts that tax revenue will increase by $673 million (3.8%).

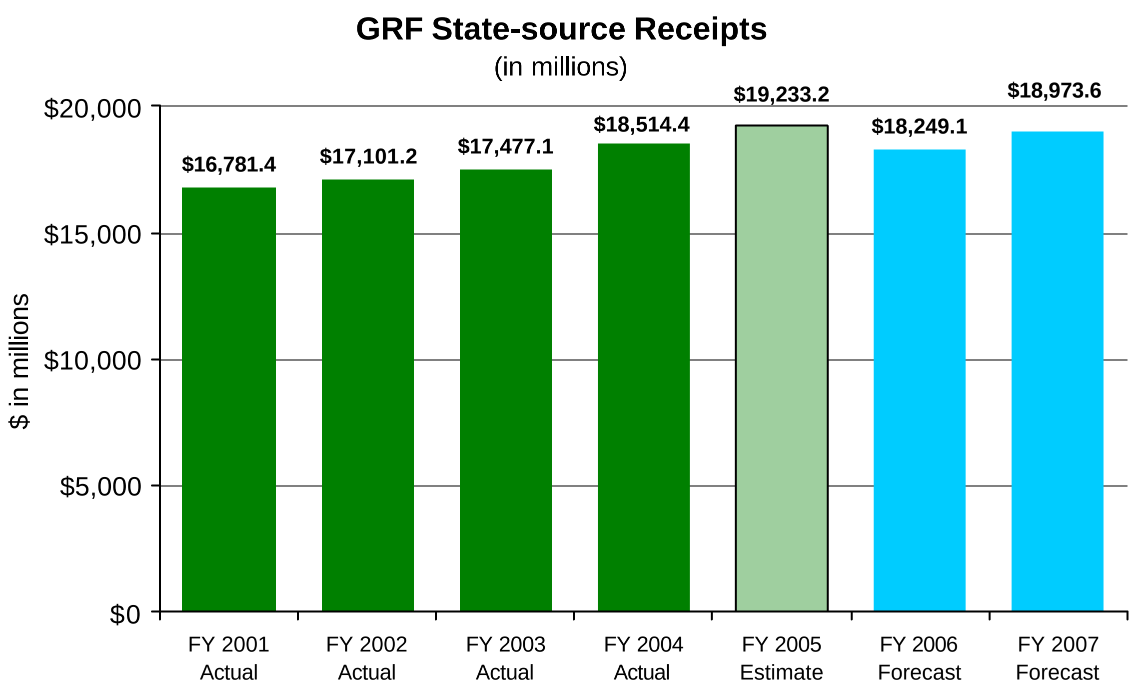
For the FY 2006-2007 biennium, LSC forecasts that GRF tax revenue will be $140 million (0.4%) higher than revenue for the FY 2004-2005 biennium. The Executive forecasts a decrease of $118 million (0.3%). Under the LSC forecast, revenue from the sales tax is forecasted to be $1,430 million (9.3%) lower and revenue from the personal income tax is forecasted to be $1,406 million (8.9%) higher. Under the executive's forecast, revenue from the sales tax will be $1,513 million (9.8%) lower and revenue from the personal income tax will be $1,282 million (8.1%) higher.

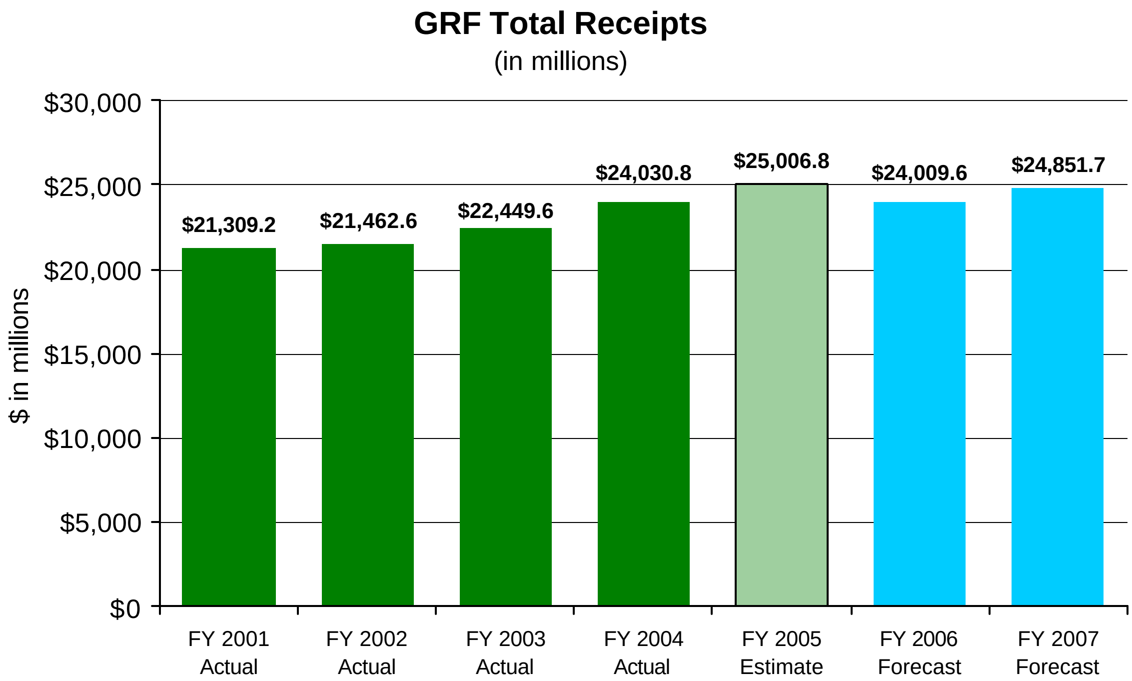
The following four charts provide overviews of total GRF receipts and key subtotals. The first chart presents the forecast of GRF revenues from major taxes,[1] the second chart presents the forecast of all GRF tax revenues, the third chart adds the forecast for nontax receipts, and the fourth chart adds federal grants that are included in the GRF, which are mostly Medicaid grant funds.



[1] 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. In addition to providing revenue for the GRF, these taxes contribute to the Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGRAF), and the Library and Local Government Support Fund (LLGSF). GRF revenue from these taxes was increased by the local government funds freeze. These taxes account for approximately 70% of total GRF revenue and 90% of state-source GRF revenue.


GRF Tax Revenues
(in millions)
$ in millions
$20,000
$15,000
$10,000
$5,000
$0
$15,649.5
$15,474.3
$16,317.9
$17,737.5
$18,443.9
$17,792.3
$18,528.8
FY 2001 Actual
FY 2002 Actual
FY 2003 Actual
FY 2004 Actual
FY 2005 Estimate
FY 2006 Forecast
FY 2007 Forecast


GRF State-source Receipts
(in millions)
$ in millions
$20,000
$15,000
$10,000
$5,000
$0
$16,781.4
$17,101.2
$17,477.1
$18,514.4
$19,233.2
$18,249.1
$18,973.6
FY 2001 Actual
FY 2002 Actual
FY 2003 Actual
FY 2004 Actual
FY 2005 Estimate
FY 2006 Forecast
FY 2007 Forecast



Public Assistance Expenditure Forecasts

Medicaid

Medicaid has many funded programs within the state budget including waiver programs such as PASSPORT and others designed to provide care in a home or community-based setting. To the extent that these programs allow people to avoid institutionalization, they also divert expenditures from the 600-525, Health Care/Medicaid, line item to other places within the state budget. These waivers are growing pieces of Ohio's medical assistance for low-income individuals, and should be seen as a part of the overall medical care policies and expenditures for the state. However, expenditures for these waiver programs are capped at the level at which they are appropriated. In contrast, traditional Medicaid is an entitlement program. In other words, the state must provide federally mandated services to all those who meet the eligibility criteria. Therefore, in order to get an idea of what level of appropriations will be needed to fund the traditional Medicaid program in Ohio, we forecast the caseload and expenditures each biennium.

***Medicaid Expenditures*.** As noted above in the summary, for the upcoming biennium, LSC's baseline forecast for Medicaid expenditures is approximately $11.9 billion in FY 2006 and $12.9 billion in FY 2007. These figures, however, do not include offsetting revenues in the program. After including offsetting revenues, total payments from the 525 line item are expected to be approximately $10.6 billion in

FY 2006 and $11.6 billion in FY 2007, with the state share being $4.3 billion and $4.7 billion, respectively.

Caseloads. The total number of persons eligible for Medicaid grew by approximately 9% from 1.55 million in FY 2003 to 1.64 million in FY 2004. The total number of eligibles is estimated to reach 1.72 million in FY 2005 (approximately a 5% increase over FY 2004). LSC forecasts that the number of persons eligible for Medicaid will continue to grow to 1.77 million in FY 2006 (approximately a 3% increase), before falling to 1.75 million in FY 2007 (approximately a 1.2% decrease).

Poor labor market conditions associated with the recent recession have been the primary driving force behind the growth in total caseload. An additional factor behind the recent growth in caseload has been the CHIP-II program expansion that began on July 1, 2000. The CHIP-II program covers uninsured children under age 19 in families with incomes between 150% and 200% of the federal poverty guidelines (FPG). The eligible population for CHIP-II grew by 17.1% in FY 2003 before slowing to 7.7% in FY 2004, a rate more comparable to the other categories of eligibility.

LSC forecasts that the overall Covered Families and Children (CFC) caseload, which includes Healthy Families, Healthy Start, CHIP-I, and CHIP-II will peak in the first half of FY 2006, and begin to drop in the third quarter of FY 2006 as the labor market in Ohio experiences the recovery.

CFC eligibles access their health care benefits through either the traditional fee-for-service system or the Medicaid managed care program. The Medicaid managed care program has three different enrollment categories: mandatory, voluntary, and preferred option. In FY 2001, the state introduced the preferred option to Medicaid managed care. Under preferred option, recipients are automatically enrolled in managed care if they fail to select the traditional fee-for-service. This policy has pushed up the HMO penetration rate from approximately 28% in FY 2001 to 39% in FY 2004. LSC's baseline forecast assumes that the HMO penetration rate will continue to rise due to the preferred option. But it is expected to rise more slowly to approximately 41% or 42% for FY 2006 and FY 2007.

Growth in the Aged, Blind, and Disabled (ABD) caseload decelerated in FY 2004, but early signs for FY 2005 suggest that growth may accelerate again. Those eligible due to disability are the largest single subcategory within the ABD category of eligibility. LSC forecasts the number of ABD eligibles to grow by 4.3% from FY 2004 to FY 2005, with growth decelerating to 4.2% in FY 2006 and 3.0% in FY 2007.

Costs. Medicaid program costs are estimated separately for each of the nine major expenditure categories: long-term care (nursing facilities and Intermediate Care Facilities for the Mentally Retarded), hospitals (inpatient and outpatient), physician services, prescription drugs, health maintenance organizations (HMOs), Medicare buy-in, waiver, all other care, and DA Medical. After forecasting changes in the caseload, a cost per Medicaid recipient is projected. The cost per recipient is itself broken down into two components: the average number of claims per recipient, called the "utilization rate," and the average cost per claim submitted. The average cost per claim depends heavily on overall health care inflation — Medicaid spending on health care services that are market driven significantly outweighs program payments to providers that are tied to fee schedules. In addition, payment rates for long-term care, inpatient hospital care, and prescription drugs are statutorily connected to market place trends. Consequently Medicaid, like any other third party payer, is very susceptible to market forces.

I will briefly highlight our forecast of costs for the three largest Medicaid expenditure categories: nursing facilities, hospitals, and prescription drugs. These three categories combined represent approximately two-thirds of total Medicaid spending in the 600-525 line item.

Payments to nursing facilities are based on cost reports. Nursing facilities annually submit cost reports to Department of Job and Family Services (JFS), which are used to calculate facility-specific per diems for the following state fiscal year. The per diem rates are then adjusted quarterly to account for differences in each resident's needs — known as the "case-mix adjustment."

The biennial budget act for FY 2004 and FY 2005 temporarily suspended the statutory per diem rate formula and established a cap on growth in the per diem rates. For FY 2004, the mean total per diem rate for all nursing facilities in the state, weighted by Medicaid days, after applying the cap was $156.84. Department of Job and Family Services officials report that the mean would have been approximately $164.11 if the statutory formula had been followed. For FY 2005, the equivalent figure after applying the cap is estimated to be $159.31, while JFS officials indicate that the mean would have been approximately $170.58 under the statutory formula.

The per diem rates are forecast to average $183.89 during FY 2006 and $192.17 in FY 2007. The FY 2006 per diem rate forecast represents an increase of 7.6% over the JFS estimate of the statutory formula per diem for FY 2005, and the FY 2007 forecast represents an increase of 4.5% over the FY 2006 average. Estimated expenditures for Nursing Home Services are $3.18 billion in FY 2006 and $3.34 billion in FY 2007. The rise in the state's per diem is fueled by heightened acuity levels, increased capital costs, and to a larger extent, elevated direct care costs.

JFS is amending rules to update and provide a more current weighting of the relative weights for Diagnostic Related Groups (DRG) used in the prospective payment system for hospital services, and to require annual recalibration updates thereafter. The Department estimates that the recalibration of the relative weights for DRGs will result in a decrease in reimbursement for hospital services. Thus, the growth rate in spending for hospital care is projected to be approximately 8% from FY 2005 to FY 2006, and 10% from FY 2006 to FY 2007. Estimated expenditures for inpatient and outpatient hospital services are $2.3 billion in FY 2006 and $2.5 billion in FY 2007. The Ohio Administrative Code requires an annual inflationary update to inpatient rates; however, outpatient rates are based on a fee schedule that is not automatically inflated.

Expenditures for Prescription Drug Services were $1.80 billion and represented approximately 18% of expenditures from the 525 line item in FY 2004. Offsetting the prescription drug services expenditures was the prescription drug rebate of $455.4 million in FY 2004.

LSC expects prescription drug spending growth to decelerate but to still be one of the fastest growing health sectors. Growth in drug spending peaked in FY 2001 at 25%, slowed to 17% in FY 2004, and is projected to decelerate to 13% growth in FY 2005. Growth is projected to be 16% in FY 2006 and 14% in FY 2007. The high growth rate of FY 2001 was associated with increases in utilization, price, and the number of eligibles.

TANF

With the introduction of the federal Temporary Assistance for Needy Families (TANF) program in 1996 and Ohio's implementation of that program with the Ohio Works First (OWF) and the Prevention, Retention, and Contingency (PRC) programs in 1997, the purpose of cash assistance was changed from an entitlement program to a block grant program with temporary benefits designed to assist people as they move to the workforce. While the number of cash assistance recipients in Ohio began to drop before welfare reform was implemented, as the economy improved in the mid-1990s, OWF's stronger participation requirements and PRC's short-term assistance efforts accelerated the reduction in Ohio's cash assistance caseload. Today, Ohio's cash assistance caseload is about 87,750 assistance groups, one-third of the caseload peak experienced in March 1992.

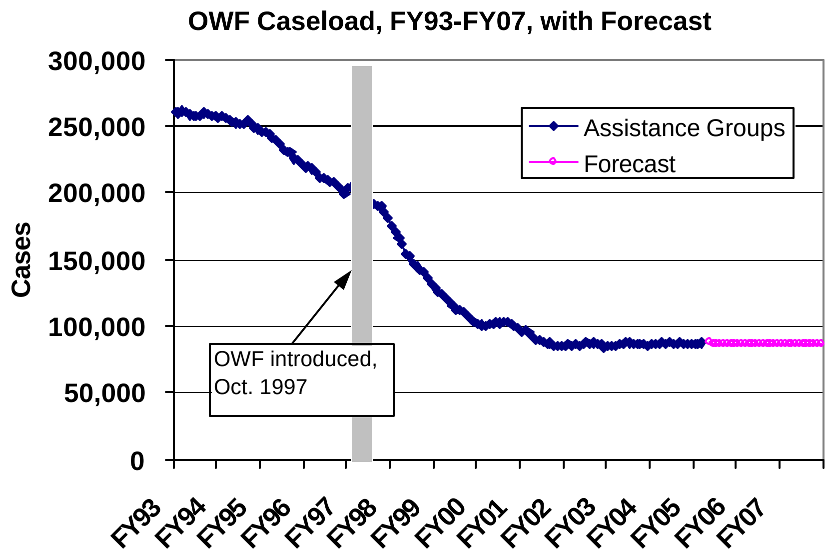
Ohio's annual TANF block grant award from the federal government is approximately $728 million. Ohio is required to meet an annual minimum maintenance of effort (MOE) requirement of $390.8 million.

One of the consequences of the block grant funding arrangement is that reductions in recipient caseloads reduce the amount of "baseline" cash benefits, thus leaving more funds available for other TANF-related program services or activities. If TANF grant funds go unspent in a particular year, the federal legislation provides that "a State may reserve amounts paid to the State under [this legislation] for any fiscal year for the purpose of providing, without fiscal year limitation, assistance under the State program funded under [this legislation].'[2] At the end of FFY 2004 (September 30, 2004), Ohio's TANF balance was $836.1 million, with $505.2 million reported as unliquidated obligations, and $330.9 million as the unobligated balance. Accordingly, Ohio has enough unobligated TANF reserve funds to pay for more than one year of cash benefit payments at current benefit levels. These figures do not include funds that have been transferred to the Social Services Block Grant, but which had not yet been spent as of that date. The unspent balance is held at the federal level, and is available to be spent on cash benefits or on other services or activities during the period in which the funds may be obligated.

TANF Reauthorization. TANF was extended in its current form on September 30, 2004, its eighth extension since it was originally set to expire in 2002. The latest news from Washington indicates that there is growing momentum to act on reauthorization in March before the latest extension expires. To what extent there will be programmatic changes in the reauthorization act is unclear at this point, however, several proposals have garnered support from both the President and the Congress, making some alterations in the current TANF program more likely. Possible modifications to the legislation include: raising work participation requirements to 40 hours a week, increased child care funding with or without state match requirements, and stagnant TANF block grant levels.

TANF/OWF Forecast. As the chart detailing the trend in the OWF combined caseload indicates, the number of OWF (formerly ADC) cases experienced a long-term decline as Ohio and the nation recovered from the recession of the early 1990s. The rate of decline was strong prior to the implementation of OWF, but the rate of decline clearly accelerated around the time of the introduction of OWF.

[2] H.R. 3734, Personal Responsibility and Work Opportunity Reconciliation Act of 1996, sec. 404 (e).



Several important demographic changes also developed in conjunction with the decline in the overall caseload. One of the most significant developments in the changing demographics of TANF recipients in Ohio is the increase in the number of "child only" cases. These cases occur when adults in the household are ineligible for TANF benefits or they are recipients in other programs such as supplemental security income (SSI). Data indicates that in Ohio the relationship of nonrecipient adults in the households where "child only" cases occur is most often that of the catch-all category of "other relative," followed by grandparent, natural or foster parent, sibling, nonrelatives, and step parents.[3] Such cases are exempt from time limits and work requirements. "Child only" cases in December 2004 comprised nearly half (47.4%) of the total caseload. Because the children in these cases remain eligible until age 18 and they are not subject to adult participation requirements, they form a stable core of the OWF caseload.

LSC expects the total number of TANF cases (or assistance groups) to decrease in FY 2006 to an average of 86,514 monthly cases from a FY 2005 average of 86,919. Assuming current benefit levels do not change, the decline in the total number of TANF cases will result in approximately $2.3 million less being spent on TANF cash benefits in FY 2006 than LSC estimates for FY 2005 expenditures. The total spending on cash benefits is forecast to be $315.0 million for FY 2006.

[3] U.S. Department of Health and Human Services, Administration for Children and Families, Office of Planning, Research and Evaluation, "Characteristics and Financial Circumstances of AFDC Recipients" FY 1996, Table 33.

The decline in the number of TANF cases is expected to continue into FY 2007. The monthly average of cases is expected to decline to 86,162, representing a decrease in spending for TANF cash benefits of $3.5 million for the year. That estimate brings total spending for cash benefits, assuming current eligibility and benefit levels, to $311.5 million for FY 2007.

TANF/OWF - LSC Baseline Estimates

	FY 2005	FY 2006	FY 2007
Average monthly cases	86,919	86,514	86,162
Total cash benefits (millions)	$317.3	$315.0	$311.5

The TANF cash benefits are paid from line items 600-410, TANF State; 600-658, Child Support Collections; and 600-689, TANF Block Grant. The Executive has recommended FY 2006 total funding for the combination of these three line items at $1,055.9 million. The total recommended funding level for these three line items in FY 2007 is $1,081.3 million.

Funding cash benefits for FY 2006 at the forecast level of $315.0 million, and at $311.5 million for FY 2007 leaves $740.9 million in FY 2006 and $769.8 million in FY 2007 from these three line items for employment services, work activities, PRC services, transitional services, direct payments from TANF federal funds for child day care,[4] and other allowable activities.

A more detailed presentation of the Public Assistance Expenditure Forecasts is also contained in your packet.

Thank you for your kind attention. Let me just say in closing that the estimates and forecasts that we have presented are based on sound economic principles and forecasting models. Situations do change, however, and we will update this information as any new information becomes available. I and the people who actually did the hard work in preparing this forecast, and who are sitting behind me, will be happy to answer any questions that you might have.

[4] In addition to receiving funds directly from the TANF federal block grant, child care receives funding from other sources.

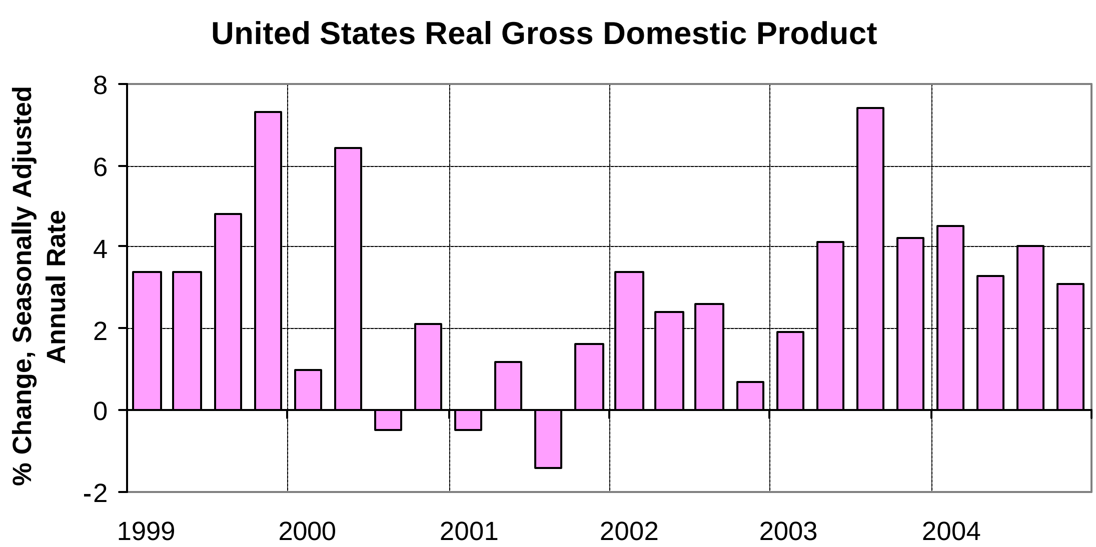
Economic Conditions and Outlook

State of the Economy

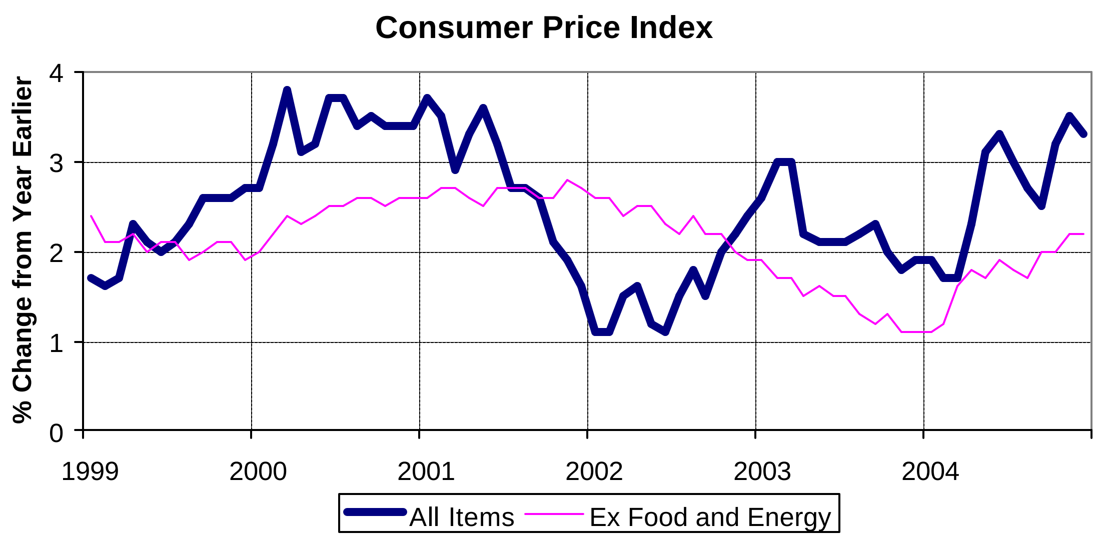
The nation's economy has been growing for over three years, following the recession in 2001. Ohio's economy by some measures began to slow earlier, in 2000, and recovery here has been slower and more halting than in other parts of the country.

National

The pace of United States economic growth picked up in mid-2003, as growing consumer spending and a robust housing market were increasingly augmented by a vigorous upturn in business capital spending. Tax cuts, accelerated depreciation, and historically low interest rates supported the expansion. Rising business sales and growing confidence contributed to a resumption of inventory building, but inventories in much of the economy remain lean relative to sales. Federal military outlays expanded to pay for the war on terrorism. Tight budgets generally constrained state and local spending, though improving economies particularly in the South and West are easing these constraints for some states. Growing foreign economies boosted American exports, but rising demand in this country for products made abroad pushed up imports. Sharply higher energy prices contributed to a record trade deficit.

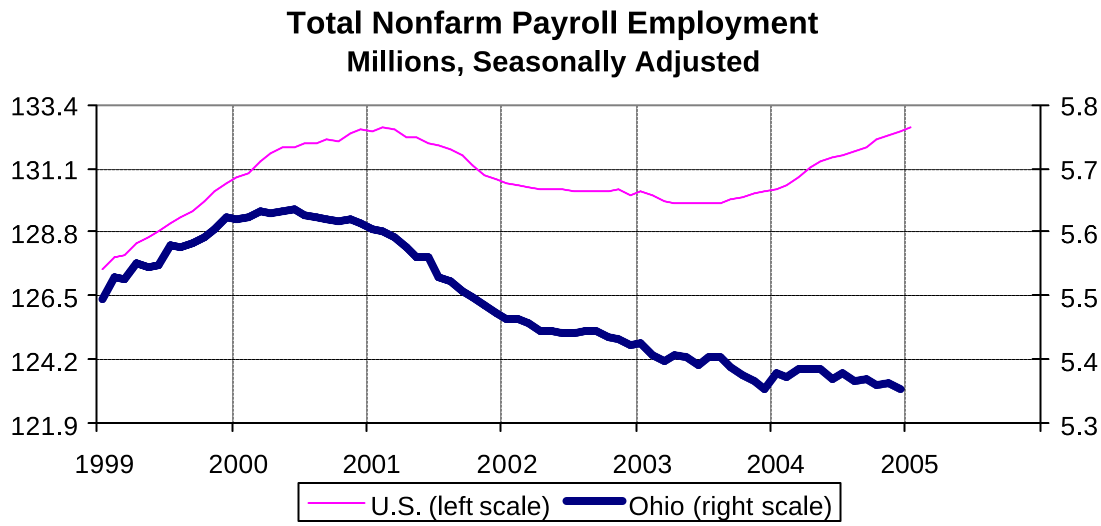


With economies around the globe expanding, notably the Chinese and American economies, commodity prices were pushed upward in the three years following the 2001 recession. These price pressures affected not only energy but also metals and a variety of crude materials. At the finished goods and services level, inflation in the United States has picked up but remains subdued, held down in part by exceptional gains in productivity in recent years. Excess capacity in product and labor markets also restrained increases in finished product prices. Rapid productivity gains are now slowing. Over the past few years, reports from businesspeople have indicated a shift from being constrained in many cases by competitive conditions from passing along cost increases to increasingly being able to raise prices. In 2003, America's central bank, concerned about the risk of deflation, lowered its short-term policy interest rate, the federal funds rate, to a 40-year low of 1%. Beginning in mid-2004, the Federal Reserve began raising this interest rate, to its current target of 2.5%. Longer-term interest rates, though up from cyclical lows for higher-quality credits, remain conducive to business and household borrowing and spending.



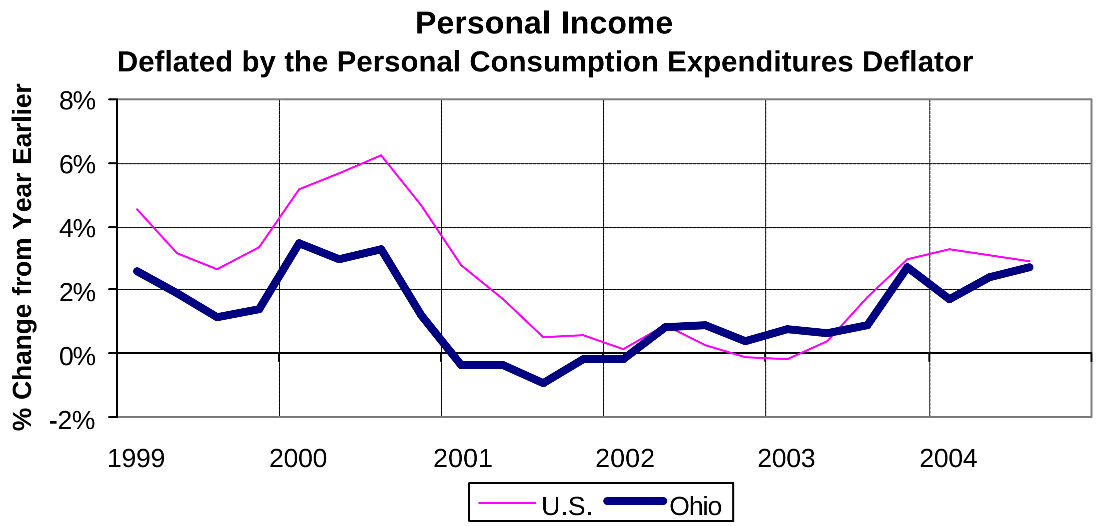
Ohio

This state's economy, by some measures, slowed earlier than the country as a whole. Total nonfarm payroll employment in Ohio peaked and began declining in 2000, ahead of the nation. Payroll employment nationwide peaked in 2001. In both the state and the nation, employment has been held down by the strong productivity gains of recent years, as companies increasingly have been able to produce more output with less labor input per unit of output. Also, payroll employment does not include self-employed persons, a group that has at times grown rapidly during the recovery. Payroll employment nationwide began to recover in the second half of 2003, rose more strongly in 2004, and reached a new all-time high in January 2005. In Ohio, payroll employment continued to decline to a low at the end of 2003, recovered in the first five months of 2004, then turned back down to a new cyclical low at the end of 2004.

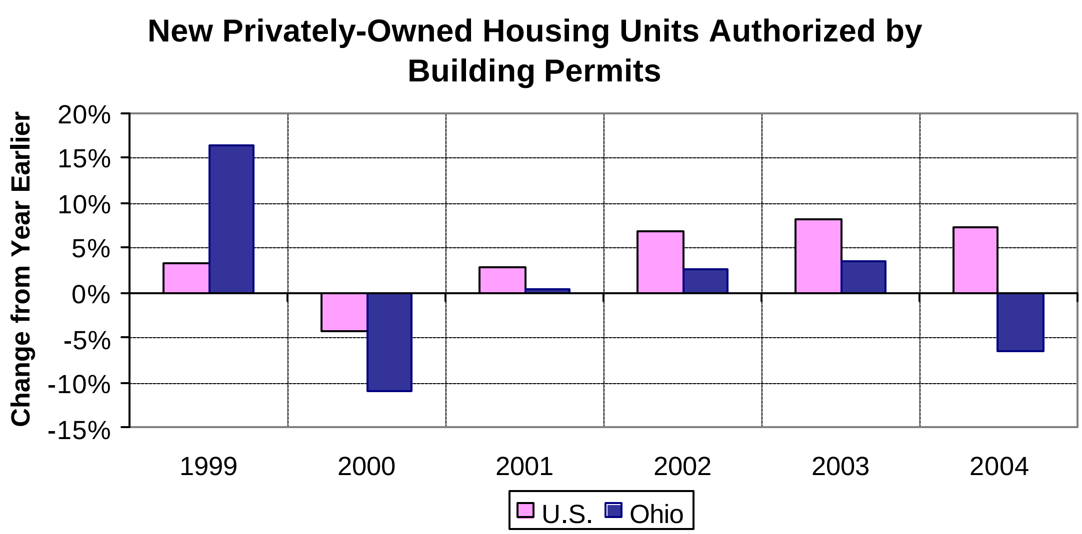


Unemployment as a percent of the labor force, in the nation and in Ohio, continued to rise following the end of the 2001 recession. The unemployment rate peaked in 2003 then began to decline. For the nation, the unemployment rate in January fell to its lowest level since 2001. But in Ohio, unemployment climbed in the second half of last year to more than 380,000 in November, highest in more than a decade, and the unemployment rate here reached a new cyclical peak before falling back at year-end.

Growth of personal income in Ohio slowed in 2000 and 2001 ahead of the nation. The rise in personal income barely kept ahead of inflation in 2002 and early 2003. In the second half of 2003, growth of personal income strengthened, nationwide and in Ohio, with the rise in income in this state somewhat slower than that nationwide.



Ohio has not fully shared in the housing construction boom of the past few years. Spurred by low mortgage interest rates, housing construction strengthened in the state and elsewhere in the country in 2002 and 2003. But in 2004, residential building continued to expand in other parts of the country, while in Ohio permits for new residential building fell.



Economic Forecasts

Predictions for the economic outlook from forecasting firm Global Insight and from the Governor's Council of Economic Advisors are shown in the following tables. The Global Insight forecasts for the nation are from the company's February 2005 release. That firm's forecasts for Ohio were released in January. The Governor's Council of Economic Advisors' forecast is the consensus outlook from a November 2004 meeting of that group. Quarterly changes shown below are from the preceding quarter; annual changes are from the preceding calendar year's annual average to the annual average for the calendar year indicated.

U.S. Gross Domestic Product

Continued growth of the U.S. economy in 2005 through 2007 is projected by Global Insight and the Governor's Council of Economic Advisors. The pace of expansion is expected to slow from 4.4% in 2004, the strongest rise since 1999.

Table 1 Real GDP Growth

	2005				2006				2007			
Forecast	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	percent change at annual rate											
Global Insight	3.6	3.7	3.3	2.5	2.9	3.6	3.3	3.1	3.0	3.5	3.1	3.3
Global Insight	3.5				3.1				3.2			
Economic Advisors	3.2	3.4	3.4	3.4	3.4	3.2	3.3	3.4	3.4	3.2		
Economic Advisors	3.4				3.4							

U.S. Inflation

The rise in the general price level, as measured by the consumer price index, is likely to be less rapid than in 2004, when it rose 2.7%, unless oil prices again surge upward.

Table 2 U.S. Consumer Price Index Inflation

	2005				2006				2007			
Forecast	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	percent change at annual rate											
Global Insight	1.6	0.7	1.0	2.1	1.4	1.6	1.8	2.1	2.0	2.0	2.0	2.2
Global Insight	2.0				1.6				2.0			
Economic Advisors	2.2	2.3	1.8	2.0	2.2	2.4	2.1	2.1	2.4	2.5		
Economic Advisors	2.3				2.1							

U.S. Personal Income

Nationwide personal income is forecast to continue to grow during 2005 through 2007. In the table below, income growth in the current quarter is slow because of a large one-time payment in December 2004. U.S. personal income rose 5.4% in 2004.

Table 3 U.S. Personal Income Growth

	2005				2006				2007			
Forecast	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	percent change at annual rate											
Global Insight	1.3	5.1	5.3	4.8	5.6	5.4	5.5	5.0	5.5	5.7	5.6	5.6
Global Insight	5.0				5.3				5.5			
Economic Advisors	4.8	5.2	4.9	5.2	5.4	5.2	4.8	5.5	4.6	5.2		
Economic Advisors	5.1				5.2							

Ohio Personal Income

Income to persons who reside in Ohio is also projected to continue to grow during the next three years, at a rate somewhat slower than the national average. Ohio personal income increased an estimated 4.5% last year.

Table 4 Ohio Personal Income Growth

	2005				2006				2007			
Forecast	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	percent change at annual rate											
Global Insight	2.0	4.9	5.0	4.7	4.8	4.9	4.7	4.8	4.9	5.1	5.1	5.1
Global Insight	4.4				4.8				4.9			
Economic Advisors	3.8	5.2	4.0	5.0	4.7	4.9	4.0	5.0	5.4	5.0		
Economic Advisors	4.7				4.7							

U.S. Unemployment Rate

Unemployment nationwide as a share of the labor force remains at or near the January level of 5.2% throughout the three-year forecast horizon.

Table 5 U.S. Unemployment Rate

	2005				2006				2007			
Forecast	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	percent of the labor force											
Global Insight	5.3	5.2	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Global Insight	5.2				5.2				5.2			
Economic Advisors	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.2	5.2	5.2		
Economic Advisors	5.3				5.3							

Ohio Unemployment Rate

The unemployment rate in Ohio declines during the forecast period in both the Global Insight and Governor's Council of Economic Advisors forecasts. Unemployment in the state averaged 6.3% of the labor force in the fourth quarter of last year.

Table 6 Ohio Unemployment Rate

	2005				2006				2007			
Forecast	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	percent of the labor force											
Global Insight	6.4	6.3	6.2	6.2	6.1	6.0	6.0	6.0	6.0	6.0	6.1	6.1
Global Insight	6.3				6.0				6.0			
Economic Advisors	6.0	5.9	5.8	5.7	5.7	5.7	5.6	5.6	5.6	5.6		
Economic Advisors	5.8				5.6							

Revenue Forecasts

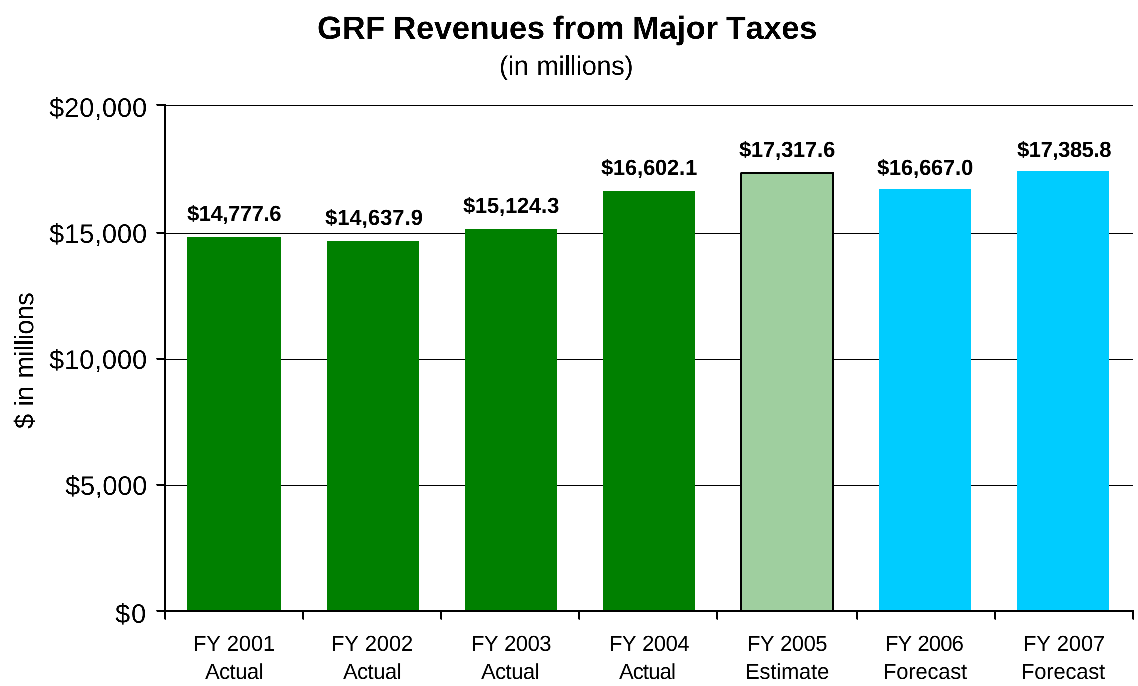
LSC expects Ohio's economic growth to support revenue growth. However, revenue growth depends on both economic growth and the tax structure. The LSC forecasts for FY 2006 and FY 2007 assume a return to the statutory tax structure: the state sales tax rate returns to 5%, income tax brackets are indexed starting tax year 2005, the income tax on trusts ends, and the local government funds freeze ends. The return to the statutory tax structure will act to reduce GRF revenues.

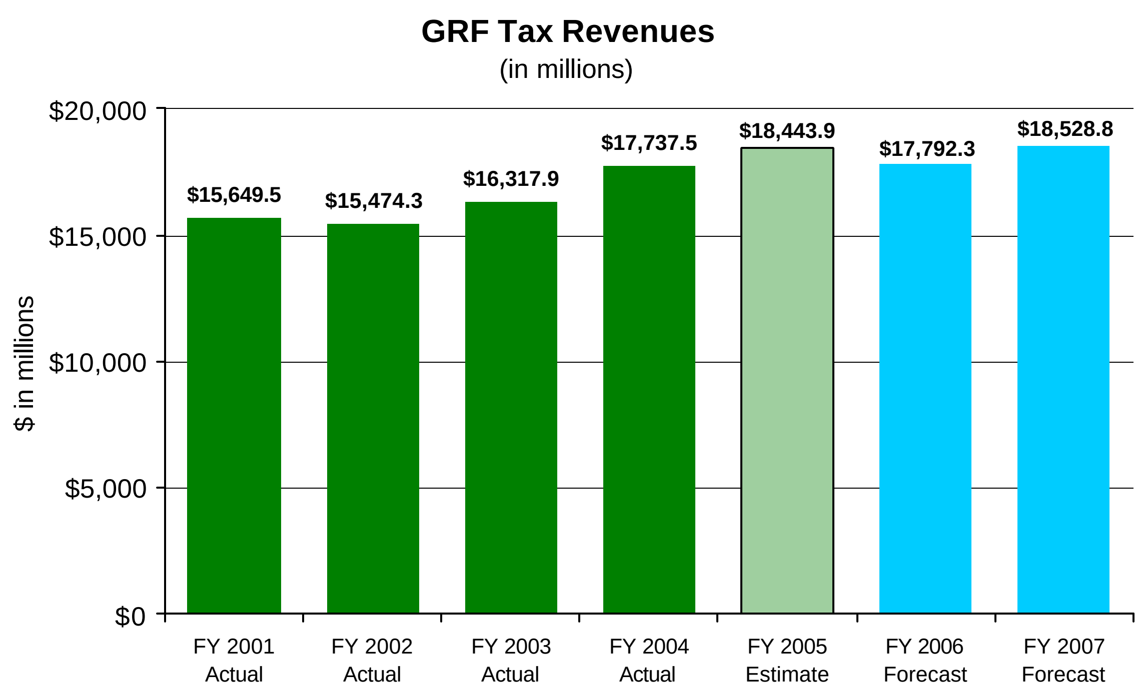
Tax revenue under statutory law is forecasted to fall by $652 million (3.5%) in FY 2006. The fall is primarily due to the return of the sales tax rate to 5%. Revenues from taxes other than the sales tax are forecasted to increase by $334 million (3.1%) in FY 2006. Income tax revenue is forecasted to increase by $260 million (3.2%), corporate franchise tax revenue is forecasted to increase by $45 million (5.1%), and revenue from the public utility excise tax is forecasted to increase by $37 million (30.1%).

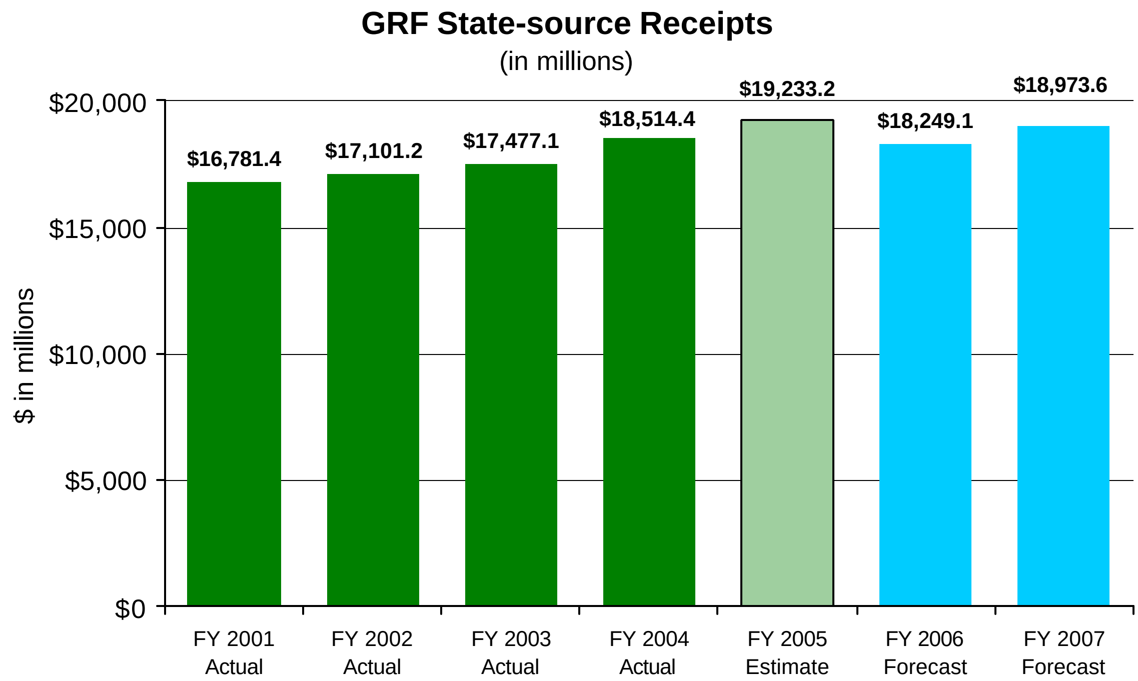
Tax revenue under statutory law is forecasted to increase by $736 million (4.1%) in FY 2007. Income tax revenue is forecasted to increase by $463 million (5.5%), sales tax revenue is forecasted to increase by $226 million (3.8%), and corporate franchise tax revenue is forecasted to increase by $25 million (2.6%).

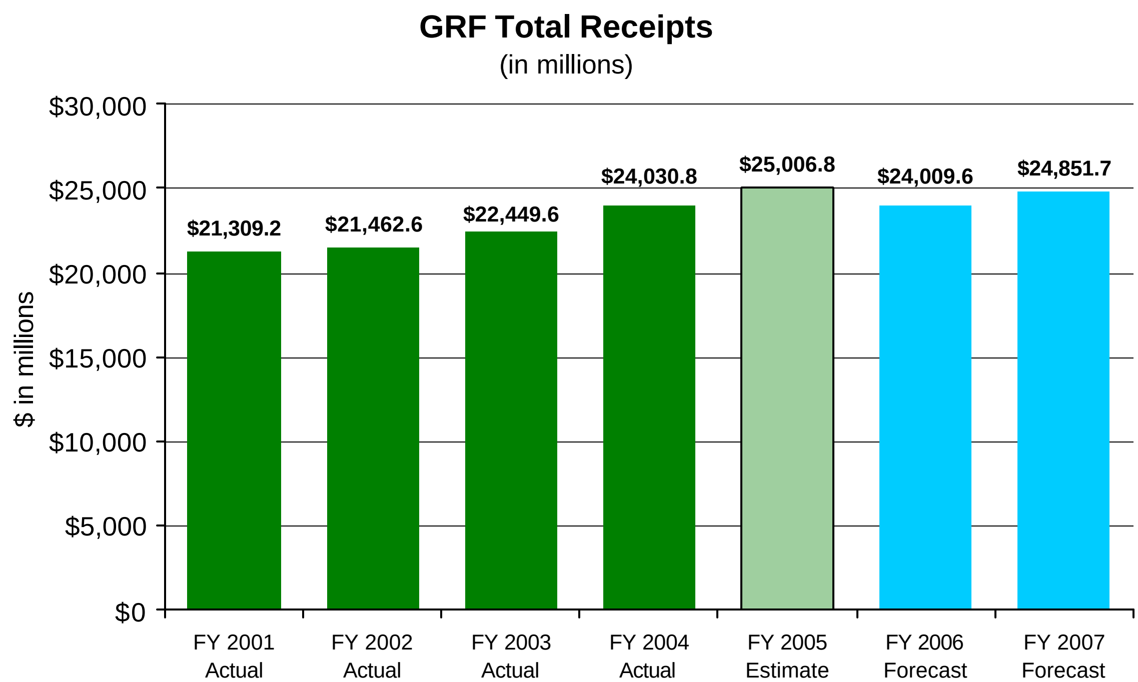
Compared to the FY 2004-2005 biennium, GRF tax revenue for the FY 2006-2007 biennium is forecasted to be $140 million (0.4%) higher. Revenue from the sales tax is forecasted to be $1,430 million (9.3%) lower, and revenue from the personal income tax is forecasted to be $1,406 million (8.9%) higher.

The following charts provide overviews of total GRF receipts and key subtotals. 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. In addition to providing revenue for the GRF, these taxes contribute to the Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGRAF), and the Library and Local Government Support Fund (LLGSF). GRF revenue from these taxes was increased by the local government funds freeze. These taxes account for approximately 70% of total GRF revenue and 90% of state-source GRF revenue.


GRF Revenues from Major Taxes
(in millions)
$ in millions
$20,000
$15,000
$10,000
$5,000
$0
$14,777.6
$14,637.9
$15,124.3
$16,602.1
$17,317.6
$16,667.0
$17,385.8
FY 2001 Actual
FY 2002 Actual
FY 2003 Actual
FY 2004 Actual
FY 2005 Estimate
FY 2006 Forecast
FY 2007 Forecast


GRF Tax Revenues
(in millions)
$ in millions
$20,000
$15,000
$10,000
$5,000
$0
$15,649.5
$15,474.3
$16,317.9
$17,737.5
$18,443.9
$17,792.3
$18,528.8
FY 2001 Actual
FY 2002 Actual
FY 2003 Actual
FY 2004 Actual
FY 2005 Estimate
FY 2006 Forecast
FY 2007 Forecast


GRF State-source Receipts
(in millions)
$ in millions
$20,000
$15,000
$10,000
$5,000
$0
$16,781.4
$17,101.2
$17,477.1
$18,514.4
$19,233.2
$18,249.1
$18,973.6
FY 2001 Actual
FY 2002 Actual
FY 2003 Actual
FY 2004 Actual
FY 2005 Estimate
FY 2006 Forecast
FY 2007 Forecast


GRF Total Receipts
(in millions)
$ in millions
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$0
$21,309.2
$21,462.6
$22,449.6
$24,030.8
$25,006.8
$24,009.6
$24,851.7
FY 2001 Actual
FY 2002 Actual
FY 2003 Actual
FY 2004 Actual
FY 2005 Estimate
FY 2006 Forecast
FY 2007 Forecast

FY 2005 Revenue Estimates

	Original Aug 2004	OBM Feb 2005	change	LSC Feb 2005	change	LSC minus OBM
TAX REVENUE						
Auto Sales	$1,115.7	$1,100.0	-$15.7	$1,095.3	-$20.4	-$4.7
Nonauto Sales & Use	$6,750.0	$6,780.0	$30.0	$6,750.0	$0.0	-$30.0
Total Sales & Use Taxes	$7,865.7	$7,880.0	$14.3	$7,845.3	-$20.4	-$34.7
Personal Income	$8,103.2	$8,153.2	$50.0	$8,119.1	$15.9	-$34.1
Corporate Franchise	$900.0	$820.0	-$80.0	$888.2	-$11.8	$68.2
Public Utility	$104.7	$110.0	$5.3	$123.0	$18.3	$13.0
Kilowatt-Hour Excise	$343.0	$341.0	-$2.0	$342.0	-$1.0	$1.0
Total Major Taxes	**$17,316.6**	**$17,304.2**	**-$12.4**	**$17,317.6**	**$1.0**	**$13.4**
Foreign Insurance	$237.0	$244.0	$7.0	$232.1	-$4.9	-$11.9
Domestic Insurance	$170.0	$174.0	$4.0	$168.4	-$1.6	-$5.6
Business & Property (DIT)	$30.0	$30.0	$0.0	$30.0	$0.0	$0.0
Cigarette	$551.0	$548.0	-$3.0	$551.0	$0.0	$3.0
Alcoholic Beverage	$57.0	$57.0	$0.0	$57.0	$0.0	$0.0
Liquor Gallonage	$31.0	$31.5	$0.5	$31.7	$0.7	$0.2
Estate	$70.0	$56.0	-$14.0	$56.1	-$13.9	$0.1
Total Other Taxes	$1,146.0	$1,140.5	-$5.5	$1,126.3	-$19.7	-$14.2
Total Tax Revenue	**$18,462.6**	**$18,444.7**	**-$17.9**	**$18,443.9**	**-$18.7**	**-$0.8**
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$24.0	$24.0	$0.0	$18.9	-$5.1	-$5.1
Licenses and Fees	$62.4	$62.4	$0.0	$60.0	-$2.4	-$2.4
Other Revenue	$147.0	$157.0	$10.0	$157.0	$10.0	$0.0
Nontax State-Source Revenue	$233.4	$243.4	$10.0	$235.9	$2.5	-$7.5
TRANSFERS						
Liquor Transfers	$107.0	$117.0	$10.0	$117.0	$10.0	$0.0
Budget Stabilization	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Other Transfers In	$285.8	$436.4	$150.6	$436.4	$150.6	$0.0
Total Transfers In	$392.8	$553.4	$160.6	$553.4	$160.6	$0.0
TOTAL GRF before Federal Grants	**$19,088.8**	**$19,241.5**	**$152.7**	**$19,233.2**	**$144.4**	**-$8.3**
Federal Grants	$5,773.6	$5,773.6	$0.0	$5,773.6	$0.0	$0.0
TOTAL GRF SOURCES	**$24,862.4**	**$25,015.1**	**$152.7**	**$25,006.8**	**$144.4**	**-$8.3**

FY 2006 Revenue Forecasts

	OBM	LSC	difference	percent	Growth from FY 2005 OBM	Growth from FY 2005 LSC
TAX REVENUE						
Auto Sales	$913.0	$940.0	$27.0	3.0%	-17.0%	-14.2%
Nonauto Sales & Use	$5,895.0	$5,920.0	$25.0	0.4%	-13.1%	-12.3%
Total Sales & Use Taxes	$6,808.0	$6,860.0	$52.0	0.8%	-13.6%	-12.6%
Personal Income	$8,390.0	$8,379.5	-$10.5	-0.1%	2.9%	3.2%
Corporate Franchise	$870.0	$933.5	$63.5	7.3%	6.1%	5.1%
Public Utility	$145.0	$160.0	$15.0	10.3%	31.8%	30.1%
Kilowatt-Hour Excise	$328.5	$334.0	$5.5	1.7%	-3.7%	-2.3%
Total Major Taxes	**$16,541.5**	**$16,667.0**	**$125.5**	**0.8%**	**-4.4%**	**-3.8%**
Foreign Insurance	$255.0	$233.8	-$21.2	-8.3%	4.5%	0.7%
Domestic Insurance	$182.0	$170.9	-$11.1	-6.1%	4.6%	1.5%
Business & Property (DIT)	$30.0	$30.1	$0.1	0.3%	0.0%	0.3%
Cigarette	$537.0	$543.0	$6.0	1.1%	-2.0%	-1.5%
Alcoholic Beverage	$57.5	$57.5	$0.0	0.0%	0.9%	0.9%
Liquor Gallonage	$32.5	$32.1	-$0.4	-1.2%	3.2%	1.3%
Estate	$60.0	$57.9	-$2.1	-3.5%	7.1%	3.2%
Total Other Taxes	$1,154.0	$1,125.3	-$28.7	-2.5%	1.2%	-0.1%
Total Tax Revenue	**$17,695.5**	**$17,792.3**	**$96.8**	**0.5%**	**-4.1%**	**-3.5%**
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$40.0	$21.6	-$18.4	-46.0%	66.7%	14.3%
Licenses and Fees	$62.4	$61.9	-$0.5	-0.8%	0.0%	3.2%
Other Revenue	$149.0	$149.0	$0.0	0.0%	-5.1%	-5.1%
Nontax State-Source Revenue	$251.4	$232.5	-$18.9	-7.5%	3.3%	-1.4%
TRANSFERS						
Liquor Transfers	$113.0	$113.0	$0.0	0.0%	-3.4%	-3.4%
Budget Stabilization	$0.0	$0.0	$0.0	na	na	na
Other Transfers In	$111.3	$111.3	$0.0	0.0%	-74.5%	-74.5%
Total Transfers In	$224.3	$224.3	$0.0	0.0%	-59.5%	-59.5%
TOTAL GRF before Federal Grants	**$18,171.2**	**$18,249.1**	**$77.9**	**0.4%**	**-5.6%**	**-5.1%**
Federal Grants	$5,760.5	$5,760.5	$0.0	0.0%	-0.2%	-0.2%
TOTAL GRF SOURCES	**$23,931.7**	**$24,009.6**	**$77.9**	**0.3%**	**-4.3%**	**-4.0%**

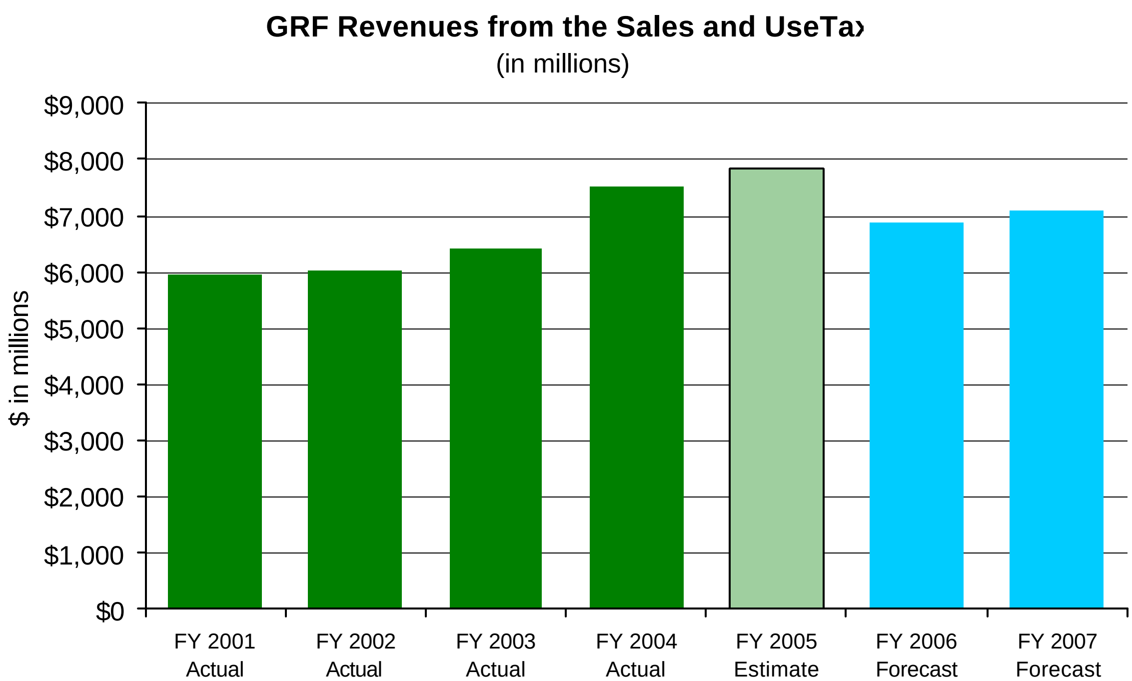
FY 2007 Revenue Forecasts

	OBM	LSC	difference	percent	Growth from FY 2006 OBM	Growth from FY 2006 LSC
TAX REVENUE						
Auto Sales	$905.0	$938.1	$33.1	3.7%	-0.9%	-0.2%
Nonauto Sales & Use	$6,185.0	$6,147.9	-$37.1	-0.6%	4.9%	3.8%
Total Sales & Use Taxes	$7,090.0	$7,086.0	-$4.0	-0.1%	4.1%	3.3%
Personal Income	$8,741.7	$8,842.8	$101.1	1.2%	4.2%	5.5%
Corporate Franchise	$890.0	$958.0	$68.0	7.6%	2.3%	2.6%
Public Utility	$149.0	$158.0	$9.0	6.0%	2.8%	-1.3%
Kilowatt-Hour Excise	$333.0	$341.0	$8.0	2.4%	1.4%	2.1%
Total Major Taxes	**$17,203.7**	**$17,385.8**	**$182.1**	**1.1%**	**4.0%**	**4.3%**
Foreign Insurance	$265.0	$245.5	-$19.5	-7.4%	3.9%	5.0%
Domestic Insurance	$190.0	$179.0	-$11.0	-5.8%	4.4%	4.7%
Business & Property (DIT)	$30.5	$30.4	-$0.1	-0.3%	1.7%	1.0%
Cigarette	$526.0	$536.5	$10.5	2.0%	-2.0%	-1.2%
Alcoholic Beverage	$58.0	$57.8	-$0.2	-0.3%	0.9%	0.5%
Liquor Gallonage	$33.0	$32.6	-$0.4	-1.2%	1.5%	1.6%
Estate	$62.0	$61.1	-$0.9	-1.5%	3.3%	5.5%
Total Other Taxes	$1,164.5	$1,142.9	-$21.6	-1.9%	0.9%	1.6%
Total Tax Revenue	**$18,368.2**	**$18,528.8**	**$160.6**	**0.9%**	**3.8%**	**4.1%**
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$60.0	$23.8	-$36.2	-60.3%	50.0%	10.2%
Licenses and Fees	$62.4	$64.0	$1.6	2.6%	0.0%	3.4%
Other Revenue	$149.0	$149.0	$0.0	0.0%	0.0%	0.0%
Nontax State-Source Revenue	$271.4	$236.8	-$34.6	-12.7%	8.0%	1.8%
TRANSFERS						
Liquor Transfers	$110.0	$110.0	$0.0	0.0%	-2.7%	-2.7%
Budget Stabilization	$0.0	$0.0	$0.0	na	na	na
Other Transfers In	$98.0	$98.0	$0.0	0.0%	-11.9%	-11.9%
Total Transfers In	$208.0	$208.0	$0.0	0.0%	-7.3%	-7.3%
TOTAL GRF before Federal Grants	**$18,847.6**	**$18,973.6**	**$126.0**	**0.7%**	**3.7%**	**4.0%**
Federal Grants	$5,878.1	$5,878.1	$0.0	0.0%	2.0%	2.0%
TOTAL GRF SOURCES	**$24,725.7**	**$24,851.7**	**$126.0**	**0.5%**	**3.3%**	**3.5%**

FY 2006-2007 Biennium Forecast

	OBM	LSC	difference	percent	Growth over FY 2004-2005 OBM	Growth over FY 2004-2005 LSC
TAX REVENUE						
Auto Sales	$1,818.0	$1,878.1	$60.1	3.3%	-18.2%	-15.3%
Nonauto Sales & Use	$12,080.0	$12,067.9	-$12.1	-0.1%	-8.4%	-8.3%
Total Sales & Use Taxes	$13,898.0	$13,946.0	$48.0	0.3%	-9.8%	-9.3%
Personal Income	$17,131.7	$17,222.3	$90.6	0.5%	8.1%	8.9%
Corporate Franchise	$1,760.0	$1,891.5	$131.5	7.5%	8.0%	11.4%
Public Utility	$294.0	$318.0	$24.0	8.2%	-12.6%	-9.0%
Kilowatt-Hour Excise	$661.5	$675.0	$13.5	2.0%	-2.7%	-0.9%
Total Major Taxes	**$33,745.2**	**$34,052.8**	**$307.6**	**0.9%**	**-0.5%**	**0.4%**
Foreign Insurance	$520.0	$479.3	-$40.7	-7.8%	9.6%	3.6%
Domestic Insurance	$372.0	$349.9	-$22.1	-5.9%	9.4%	4.7%
Business & Property (DIT)	$60.5	$60.5	$0.0	0.0%	1.0%	1.0%
Cigarette	$1,063.0	$1,079.5	$16.5	1.6%	-3.8%	-2.6%
Alcoholic Beverage	$115.5	$115.3	-$0.2	-0.2%	1.8%	1.6%
Liquor Gallonage	$65.5	$64.7	-$0.8	-1.2%	5.0%	3.4%
Estate	$122.0	$119.0	-$3.0	-2.5%	1.5%	-1.1%
Total Other Taxes	$2,318.5	$2,268.2	-$50.3	-2.2%	1.9%	0.3%
Total Tax Revenue	**$36,063.7**	**$36,321.1**	**$257.4**	**0.7%**	**-0.3%**	**0.4%**
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$100.0	$45.4	-$54.6	-54.6%	138.3%	23.1%
Licenses and Fees	$124.8	$125.9	$1.1	0.9%	10.9%	14.3%
Other Revenue	$298.0	$298.0	$0.0	0.0%	-13.6%	-13.6%
Nontax State-Source Revenue	$522.8	$469.3	-$53.5	-10.2%	4.7%	-4.6%
TRANSFERS						
Liquor Transfers	$223.0	$223.0	$0.0	0.0%	-5.1%	-5.1%
Budget Stabilization	$0.0	$0.0	$0.0	na	na	na
Other Transfers In	$209.3	$209.3	$0.0	0.0%	-75.1%	-75.1%
Total Transfers In	$432.3	$432.3	$0.0	0.0%	-59.8%	-59.8%
TOTAL GRF before Federal Grants	**$37,018.8**	**$37,222.7**	**$203.9**	**0.6%**	**-2.0%**	**-1.4%**
Federal Grants	$11,638.6	$11,638.6	$0.0	0.0%	3.1%	3.1%
TOTAL GRF SOURCES	**$48,657.4**	**$48,861.3**	**$203.9**	**0.4%**	**-0.8%**	**-0.4%**

Sales and Use Tax

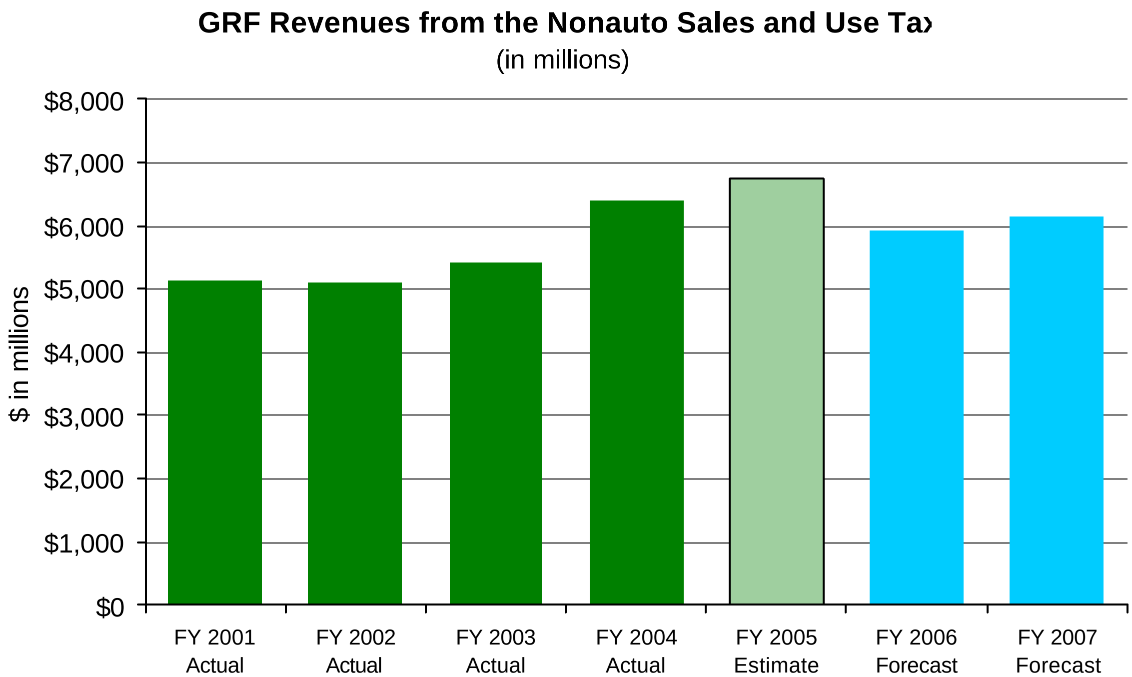


	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$5,935.6	$6,037.9	$6,397.9	$7,530.6	$7,845.3	$6,860.0	$7,086.0
Growth	0.4%	1.7%	6.0%	17.7%	4.2%	-14.2%	3.3%

Under statutory law, the state sales and use tax is levied at a rate of 5% on retail sales of tangible personal property, rental of some tangible personal property, and selected services. Am. Sub. H.B. 95, the current budget act, temporarily increased the tax rate to 6% for FY 2004 and FY 2005. The forecast assumes that on July 1, 2005, the sales and use tax rate will return to 5%. Major exemptions to the sales and use tax include: food for human consumption off the premises where sold, newspapers and magazine subscriptions sent by second class mail, motor fuel (taxed separately), packaging and packaging equipment, prescription drugs and medical supplies, property used primarily in manufacturing or used directly in mining or agriculture, and there is a credit for trade-ins on new motor vehicles. Under statutory law, the revenue collected is disposed of as follows: 95.2% to the General Revenue Fund, 4.2% to the Local Government Fund, and 0.6% to the Local Government Revenue Assistance Fund. For FYs 2002-2005 the distributions to these three local government funds have been frozen under temporary law at their FY 2001 levels.

For forecasting purposes, the tax is separated into two parts: auto and nonauto. Auto sales and use tax includes revenue collected from the sale of automobiles and trucks. Nonauto sales and use tax includes all other sales and use tax collections. Auto taxes arising from auto leases are paid immediately at the lease signing and mostly recorded under the nonauto tax, instead of the auto tax. The level of auto sales has become dependent on the level of incentives provided by manufacturers and dealers. The incentives have also changed the way consumers decide whether to purchase or lease their vehicles. As the share of vehicles leased and manufacturers' incentives have varied over the years, the auto tax has become more volatile. Also, those changes have affected the nonauto sales tax because taxes arising from leases are recorded under the nonauto sales tax. Total sales and use tax receipts have been generally flat in the last few years, except for additional tax revenues from legislative tax changes.

Nonauto Sales Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$5,124.1	$5,110.4	$5,431.7	$6,407.7	$6,750.0	$5,920.0	$6,147.9
Growth	0.6%	-0.3%	6.3%	18.0%	5.3%	-12.3%	3.8%

The forecast for the nonauto sales and use tax is based on a regression of quarterly nonauto sales and use tax revenues against Ohio personal disposable income, housing starts, and manufacturing employment. A dummy variable was used to account for the tax rate increase.

An analysis of nonauto sales and use tax receipts in the last few years indicates that the performance of the nonauto sales and use tax is showing encouraging signs of improvement after several years of negative or sub par growth. Nonauto sales and use tax revenues declined 0.3% in FY 2002 and grew 6.3% in FY 2003. Without the added revenues from the Ohio Tax Amnesty (Am. Sub. H.B. 94, 124th General Assembly),[5] and the change in the tax treatment of auto leases (Am. Sub. H.B. 405, 124th General

[5] 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.

Assembly),[6] nonauto sales and use tax receipts in FY 2002 would have declined about 2% from FY 2001 revenues. After subtracting the additional revenues from the acceleration of sales and use tax payments in the last quarter of FY 2003 (H.B. 40, 125th General Assembly),[7] nonauto sales and use tax revenues would have grown by about 1% in FY 2003.

Am. Sub. H.B. 95 (125th General Assembly) made numerous changes to sales and use tax laws. Most notably, the budget act temporarily increased the sales and use tax rate from 5% to 6% on July 1, 2003. H.B. 95 also expanded the sales and use tax base by imposing the tax on new services effective August 1, 2003, and by eliminating certain small exemptions. Sales of the following services became taxable: storage facilities (not including parking), selected personal care services (skin care, tanning, manicures, pedicures, application of cosmetics, etc.), satellite broadcasting, dry cleaning and laundry (not including coin operated), delivery charges, snow removal, intrastate transportation of persons (not water transportation), vehicle towing, and local telecommunication services (which became taxable January 1, 2004).

Revenue growth in FY 2004 is the result of the tax rate increase, but the taxable base declined 1.7%, unsurprising after a tax rate increase. With the apparent end of the recession and the tax base expansion, the nonauto sales and use tax is poised for a turnaround in FY 2005, with a growth rate more in line with long-term trend growth. The decrease in revenue in FY 2006 is due to the tax rate going back to the statutory rate of 5%.

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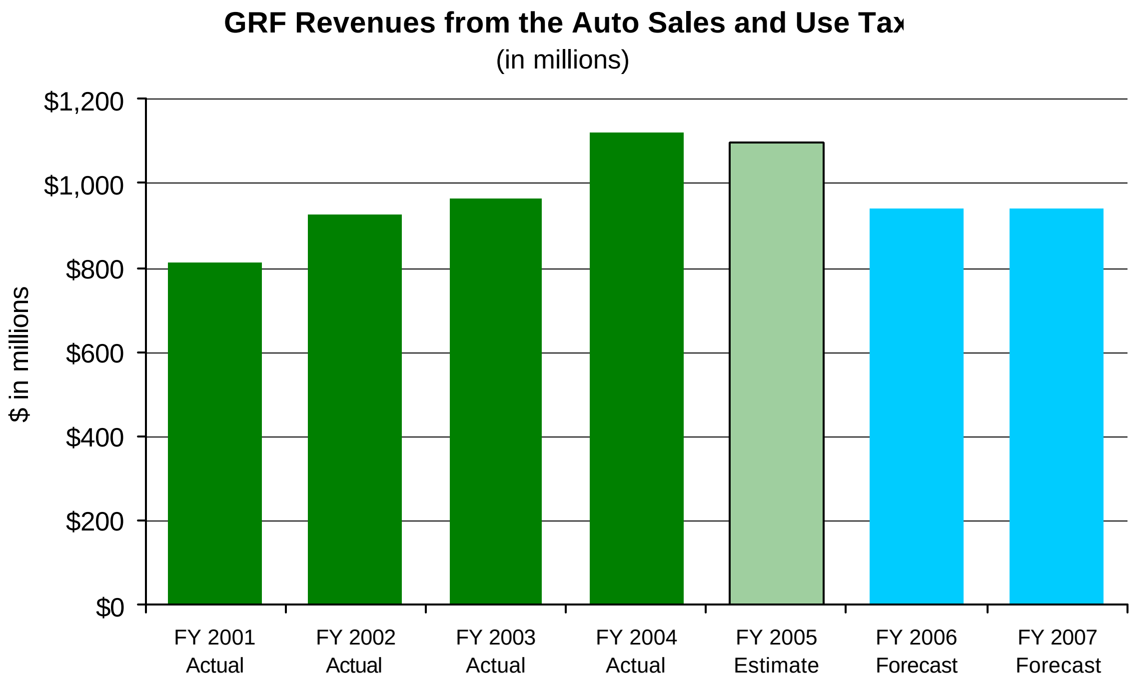
[6] Am. Sub. H.B. 405 changed to the way Ohio sales and use tax is applied to the lease of motor vehicles, watercraft, outboard motors, and aircraft. Prior to H.B. 405, the tax was collected each month, based on the monthly lease payments. With H.B. 405, the entire tax is collected at the time the lease is consummated and applied to the total amount that would be paid throughout the term of the lease. Car, motorboat, and aircraft leases are mostly included in the nonauto sales tax base, rather than the auto sales tax base.

[7] Am. Sub. H.B. 40 changed the historical patterns 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.

Auto Sales and Use Tax

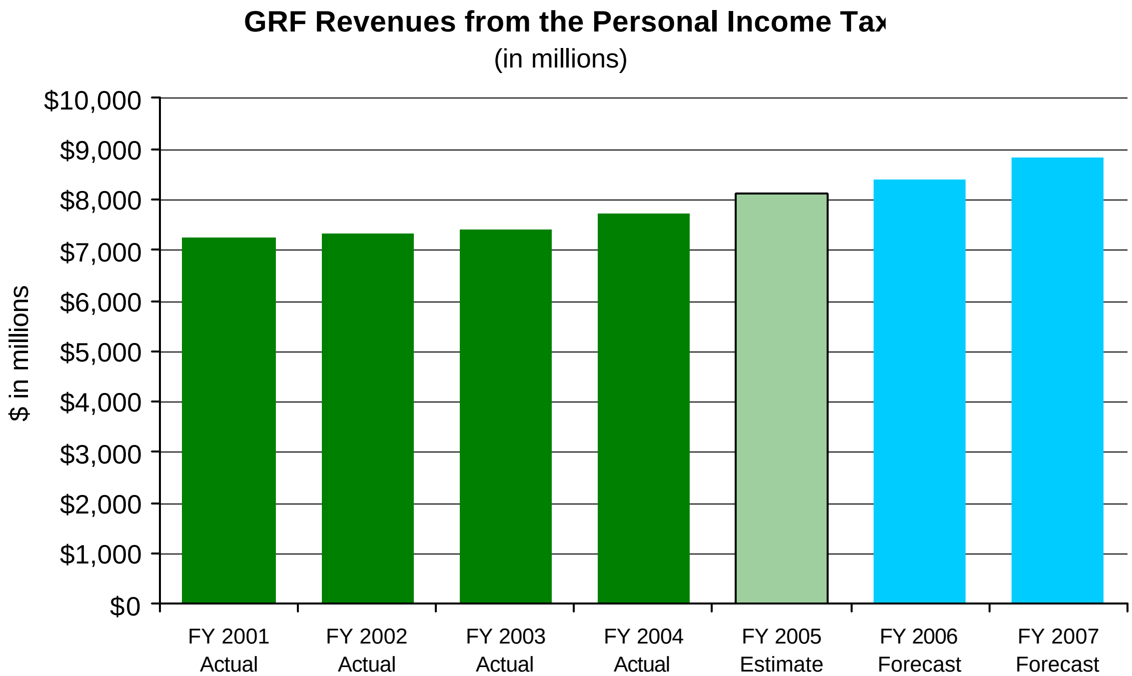


	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$811.5	$927.5	$966.2	$1,122.9	$1,095.3	$940.0	$938.1
Growth	-1.2%	14.3%	4.2%	16.2%	-2.5%	-14.2%	-0.2%

The forecast for the auto sales and use tax is based on a regression of auto sales tax revenues against expected consumer spending on new autos and light vehicles. Sales of auto and light truck sales have become dependent on the level of incentives provided by dealers and manufacturers. The incentives have also changed the way consumers decide whether to purchase or lease their vehicles. As incentives have varied over the years, the auto sales and use tax has become more volatile. As a result, revenue growth for this tax source is tied to auto incentives. However, the effectiveness of those incentives appears increasingly limited in Ohio.

Although auto sales and use tax revenues grew in FY 2002 and FY 2003, registrations of new auto and light trucks were flat or declined. Revenue growth in FY 2004 was due to the increase in the tax rate, although the auto taxable base decreased about 3.1%. Growth in auto sales and use tax revenues will probably be negative in FY 2005 due to a further shrinkage of the auto taxable base. Through December 2004, the auto taxable base has declined by about $560 million in FY 2005 compared to the same period in FY 2004. Auto sales and use tax revenues will further decline in FY 2006 from the tax rate returning to 5%. It is also expected that customers will delay certain auto purchases into FY 2006 to benefit from the rate decrease.

Personal Income Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$7,263.4	$7,304.1	$7,420.7	$7,696.9	$8,119.1	$8,379.5	$8,842.8
Growth	0.4%	0.6%	1.6%	3.7%	5.5%	3.2%	5.5%

The Personal Income Tax is levied on Ohio taxable income (the amount reported as federal adjusted gross income (FAGI) to the U.S. Internal Revenue Service plus or minus adjustments). After these adjustments are made, a taxpayer's tax liability before credits is obtained by applying Ohio's graduated tax rates to the taxpayer's Ohio taxable income. Certain credits may be subtracted from this amount to arrive at the taxpayer's final tax liability.

Major additions to FAGI in the determination of Ohio adjusted gross income include: state and local bond interest (except Ohio governments), and federal bond interest exempt from federal tax but subject to state tax. Major subtractions include: federal bond interest, disability and survivors' benefits included in FAGI, compensation earned in Ohio by residents of reciprocity states, social security and railroad retirement benefits included in FAGI, and state and municipal tax refunds.

Ohio taxable income is obtained by subtracting personal exemptions from Ohio adjusted gross income. Taxpayers may claim an exemption for the taxpayer, the taxpayer's spouse (if filing a joint return), dependent children, and others to whom the taxpayer provides support and claims on the taxpayer's federal return. For tax year 2004, the personal and dependent exemption is $1,300. This amount is indexed for inflation and is expected to increase each year.

The taxpayer's tax liability before credits is obtained by applying graduated rates to the taxpayer's Ohio taxable income. Ohio's statutory tax rates range from 0.743% on the first $5,000 of Ohio taxable income to 7.5% on Ohio taxable income in excess of $200,000. The Income Tax Reduction Fund (ITRF) can reduce these rates. The ITRF tax rebate mechanism is structured to give unanticipated surpluses back to taxpayers. If there is no surplus, there is no rate reduction. Tax rates were last reduced for tax year 2000. Also, beginning in tax year 2005, the income brackets will be indexed for inflation.[8]

Major credits available to taxpayers include: the personal exemption credit of $20 per exemption, the senior citizen credit of $50 per return, the retirement income credit, the child and dependent care credit, various business credits, the displaced worker training credit, the political contribution credit, the adoption credit, and the joint filer credit for two working spouses (graduated based on income with a maximum credit of $650).

Under statutory law the revenue collected from the Personal Income Tax is distributed as follows: 89.5% to the General Revenue Fund, 4.2% to the Local Government Fund, 0.6% to the Local Government Assistance Fund, and 5.7% to the Library and Local Government Support Fund. For FYs 2002 - 2005 the distributions to these three local government funds have been frozen under temporary law at their FY 2001 levels.

The estimated revenues for FYs 2005 - 2007 are based on the results of a model of revenue collections. The model works with the four components of tax collections. These components are: employer withholding (partial-weekly, monthly, quarterly, and annual returns), individual taxpayer (quarterly estimated payments and annual returns), other collections (Attorney General collections, assessments, and bad checks), and

[8] In July of each year, beginning in 2005, the tax commissioner shall adjust the income brackets by multiplying the percentage increase in the gross domestic product deflator computed that year by each of the income amounts resulting from the adjustment in the preceding year, adding the resulting product to the corresponding income amount resulting from the adjustment in the preceding year, and rounding the resulting sum upward to the nearest multiple of $50. For example, if the percentage change in the GDP deflator in 2004 was 2.1% the lower end of each tax bracket would be increased by 2.1%. The upper end of the lowest bracket is currently $5,000. Assuming a 2.1% increase the upper end of this bracket would be $5,150, and the lower end of the highest tax bracket would increase from $200,000 to $204,200.

refunds. The data was organized on a fiscal year basis. Withholding was assumed to be a function of Ohio wage and salary income. The individual taxpayer component was assumed to be a function of the S&P 500 index (used to represent U.S. stock markets), and combined Ohio nonwage and proprietors' income. Other collections were assumed to be a function of the same variables as for the individual taxpayer component plus a trend variable. Refunds were assumed to be a function of gross collections (employer withholding + individual taxpayer + other collections), the value of the personal and dependent exemption, and the ITRF percentage rate cut. Forecasted values of the explanatory variables were taken from the Global Insight January 2005 release.

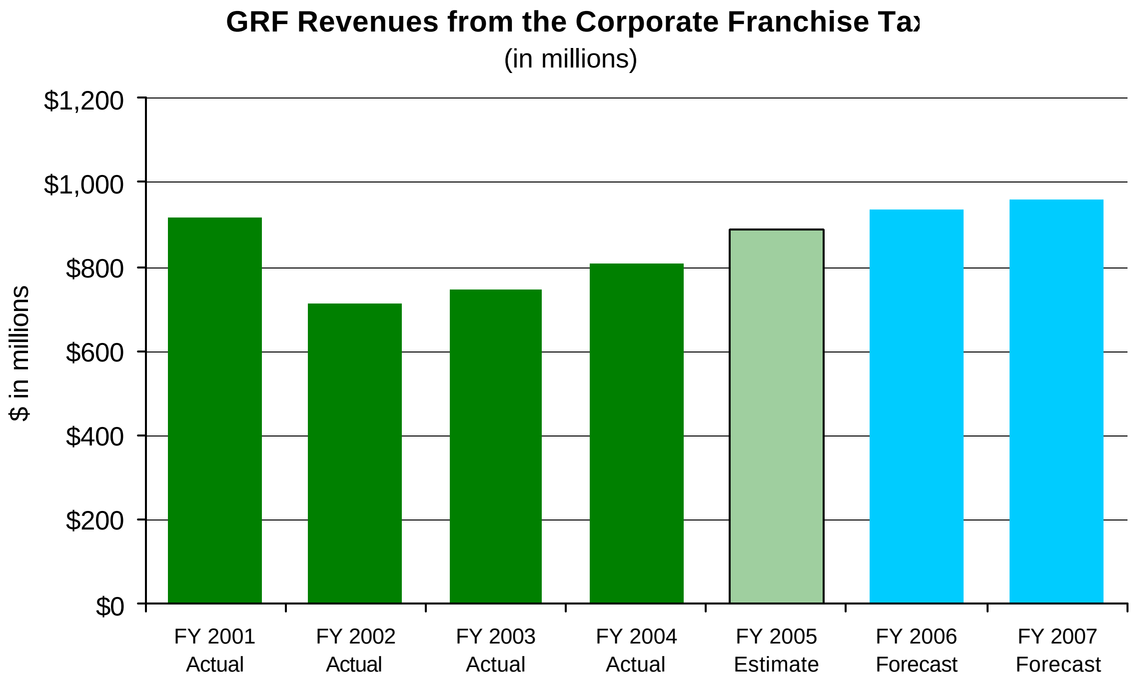
Through January, FY 2005 GRF revenues from the Personal Income Tax are 3.9% greater than estimate, and 9.4% above FY 2004 levels. Gross collections are 2.8% above estimate and 7.3% above FY 2004 levels. Net collections are 3.4% above estimate and 8.3% above FY 2004 levels. This trend is expected to continue throughout the second half of the fiscal year.

The original FY 2005 estimate for GRF revenues from the Personal Income Tax was $8,103.2 million, a 5.3% increase over FY 2004 revenues. The new FY 2005 estimate is $8,119.1 million, a 0.2% increase over the original estimate, and 5.5% greater than FY 2004 revenues. For FY 2006 and FY 2007 GRF revenues should continue to increase. It is projected that Personal Income Tax revenue will grow by 5.4% in FY 2006 and 5.5% in FY 2007.

There are changes in the tax laws that may affect future receipts from the Personal Income Tax. In accordance with Am. Sub. S.B. 261 of the 124th General Assembly, the income tax brackets will be indexed for inflation starting in tax year 2005. Since most of the impact from this change will most likely be from refunds, the effects will first occur in FY 2006. The estimated loss in revenue for FY 2006 is $60 million. The loss will increase exponentially each year. The projected loss in revenue for FY 2007 will be $116 million and $260 million in FY 2008.

Another tax law change is the expiration of the trust tax, which is set to expire on June 30, 2005. The trust tax is a tax on undistributed income from a complex trust. Under statutory law certain trusts are treated as taxable entities. The tax is levied on the trust, and amounts included in the adjusted gross income of the beneficiaries are not taxable. This trust tax is set to expire on June 30, 2005. Once the tax expires distributions to beneficiaries will once again be taxable. The loss of revenue from the expiration of the trust tax is estimated to be approximately $40 million per fiscal year, starting in FY 2006.

Corporate Franchise Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$915.3	$712.3	$747.2	$809.2	$888.2	$933.5	$958.0
Growth	-5.6%	-22.2%	4.9%	8.3%	9.8%	5.1%	2.6%

The corporate franchise tax (CFT) is levied on corporations doing business in Ohio. The franchise tax has two bases: the net worth base (generally determined as net book value of assets minus the net carrying value of liability) and the net income base (generally, the Ohio portion of federal taxable income with exclusions and additions as required by statute). Differing tax rates apply to each tax base. The corporate taxpayer calculates its Ohio tax liability under the two bases and pays the higher of the two tax liabilities. Different rules apply to financial institutions, "qualifying" holding companies, and certain "high-technology" startup companies.

Between FY 1999 and FY 2002, CFT revenue growth was negative as a result of Am. Sub. H.B. 215 (122nd General Assembly), and the last economic recession. H.B. 215 decreased the net worth tax rate from 5.82 mills to 4 mills, and capped the net worth tax liability at $150,000 for each corporation. Corporate net profits plunged during the economic downturn. The full impact of the net worth tax changes decreased the cushioning effect the net worth tax base has had on franchise tax revenues when Ohio entered the last recession. Also, more and more new firms are taking advantage of alternative forms of business organization (such as limited liability company) that are not generally subject to the corporate franchise tax. This limits revenue growth from the taxation of business income. Instead, this net business income is taxed under the personal income tax from pass-through entities, which has helped contribute to increased volatility in that tax.

Am. Sub. H.B. 95 (125th General Assembly) enacted significant franchise tax changes pertaining to the allocation and apportionment of the income of multistate corporations to Ohio. The corporation franchise tax liability for interstate corporations is based on the portion of their net income or net worth that is allocated or apportioned to Ohio. Prior to H.B. 95, a company would allocate certain types of statutory-listed income whether or not the income was part of the company's active trade or business. H.B. 95 adopted the distinction between "business" and "nonbusiness" income used by many other states in the Uniform Division of Income for Tax Purposes Act (UDITPA).[9] Generally, "business" income will be apportioned to Ohio according to the same three-factor formula, and "nonbusiness" income may be entirely allocated either to Ohio or to another state. These changes expanded the corporation franchise net income tax base and increased growth of CFT revenues in FY 2005.

LSC derives its forecasts of baseline CFT revenues primarily from projections of U.S. corporate profits. Also, a regression of Ohio net income tax liability against actual profits from nonfinancial firms was used in the forecast. Forecasted net income tax liability estimates were supplemented with estimates of tax liability from the net worth tax and from financial institutions to develop baseline CFT revenues for FY 2006 and FY 2007. Finally, some adjustments were made for tax changes in the last few years.

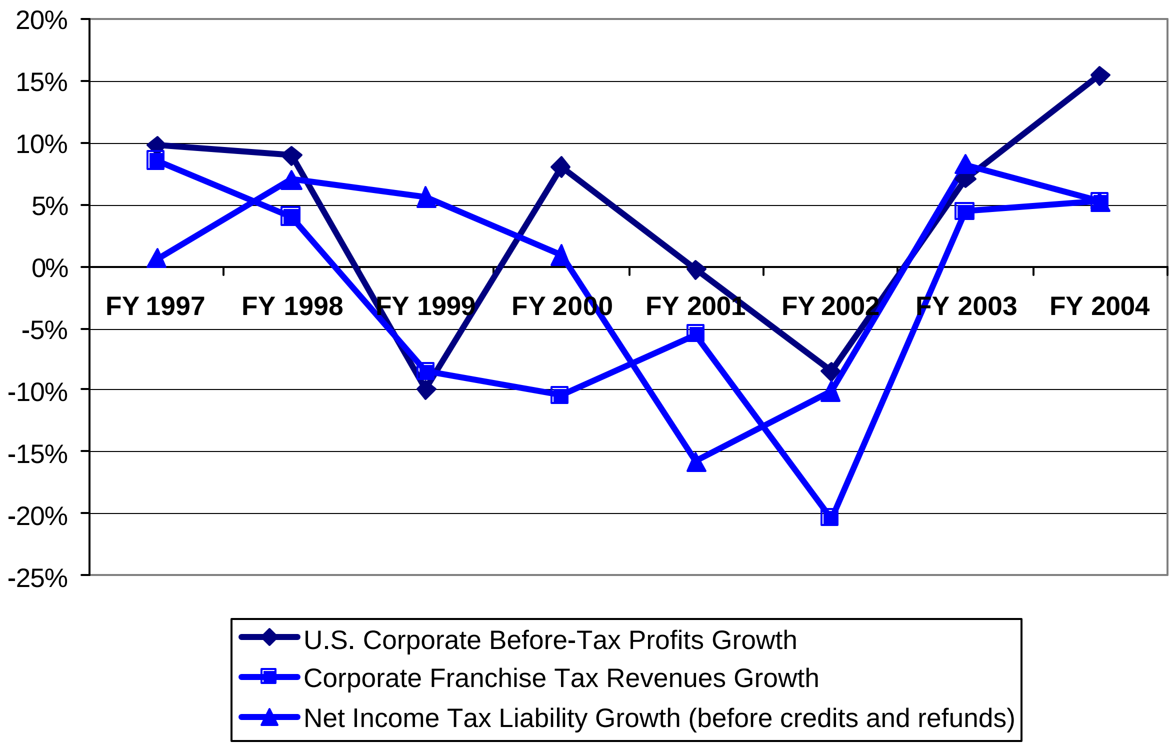
Translating a corporate profits forecast into a franchise tax forecast is not straightforward because of the dual base of the franchise tax (net worth or net income), the fact that corporations often have taxable years that do not coincide with calendar years, and corporations' decisions on the timing and use of statutory tax credits. Other peculiarities of the franchise tax such as the net operating loss deduction, and annual changes in federal and state tax law make forecasting this tax challenging. Particularly, Ohio "decoupled" from two federal tax legislation changes regarding the "bonus depreciation" (Am. Sub. S.B. 261, 124th General Assembly) and "qualifying IRS section

[9] UDITPA defines "business income" as income, including gains or loss, arising from transactions and activities in the regular course of the taxpayer's trade or business, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts for the taxpayer's regular trade or business operations. "Nonbusiness income" means all income other than business income and may include, but is not limited to, compensation, rents and royalties from real or tangible property, capital gains, interest, dividends and distributions, patent and copyright royalties, and lottery winnings, prizes, and awards.

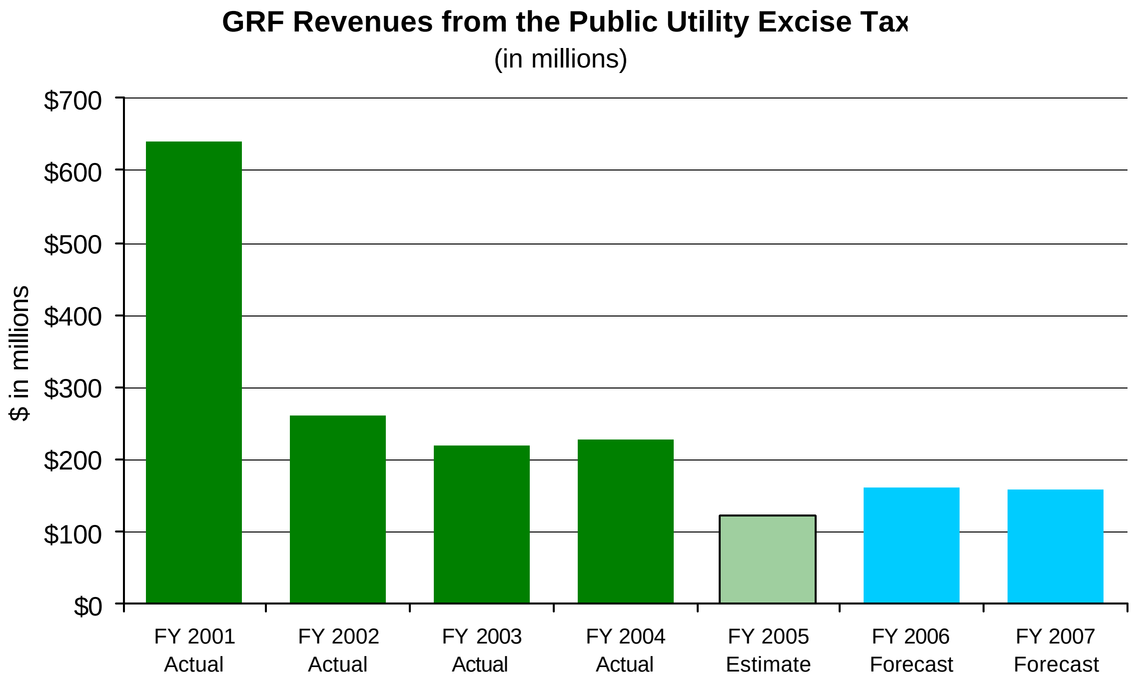
179 expenses" (Am. Sub. H.B. 95, 125th General Assembly) to reduce the impact of those federal laws on CFT revenues.

Corporate franchise tax revenues in a fiscal year generally reflect the previous calendar year corporate profits. Corporate franchise tax revenues grew in FY 2003 and FY 2004 from high growth rates in corporate profits in CY 2002 and CY 2003. Legislated changes from Am. Sub. H.B. 95 will help improve revenue growth in FY 2005. Then, corporate franchise tax revenue growth will decrease in FY 2006 and FY 2007 as expected corporate profits growth declines in CY 2005 and CY 2006. Forecasted estimates of corporate profits from Global Insight (a national forecasting firm) and the Governor's Council of Economic Advisers were the basis for the franchise tax forecast.

Growth in corporate franchise tax revenues and corporate profits



Public Utility Excise Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$640.5	$260.1	$218.7	$226.4	$123.0	$160.0	$158.0
Growth	-0.2%	-59.4%	-15.9%	3.6%	-45.7%	30.1%	-1.3%

The public utility excise tax — also known as the gross receipts tax — is a tax on the intrastate revenues of public utilities. The tax is levied on natural gas utilities, pipeline companies, heating companies, waterworks, and water transportation companies. All companies subject to the tax pay a tax of 4.75% of gross receipts except pipeline companies, who pay a tax of 6.75% of gross receipts.

The significant fall in revenue from the tax in FY 2002 is attributable to the removal of electric companies from the tax by Am. Sub. S.B. 3 of the 123rd General Assembly. The tax receipts lost because of dropping electric companies from this tax were intended to be replaced by corporate franchise tax payments and by payments under the newly created kilowatt-hour tax, which was created by S.B. 3. Similarly, the anticipated fall in revenue in FY 2005 is attributable to removal of telephone companies from the tax by Am. Sub. H.B. 95 of the 125th General Assembly. This reduction in tax receipts was intended to be replaced by corporate franchise tax payments and by payments under the sales tax. The significant increase in revenue forecast for FY 2006 is due primarily to the assumed return to the statutory distribution of revenue under the tax. The freeze in local government funds' shares of the tax provided by H.B. 95 froze payments to the local government funds from this tax at a level when both electric companies and telephone companies were paying the tax. Therefore, returning the tax to its statutory formula would lead to a significant increase in the GRF share of tax revenues; an estimated increase of over $28 million in FY 2006.

With the departure of electric companies and telephone companies, natural gas utilities will contribute approximately 97% of the revenue collected under this tax. Because all other utility companies will account for under 3% of receipts under the tax, the discussion that follows will be restricted to the assumptions underlying the forecast for the receipts from natural gas companies.

Natural gas utilities paid $149.8 million under the tax in FY 2004. The tax is paid by utilities, not marketers. Nonutility companies that sell gas on a retail basis under the Choice Program do not pay the tax, but they are supposed to collect sales tax on their sales. Most industrial customers are in practice exempt from the sales tax due to the exemption for direct use in manufacturing. Participation in the Choice Program has fallen somewhat recently; as of November 2004, 37.0% of residential customers statewide were enrolled in a Choice Program compared with 42.9% in December 2003. Similarly, 39.1% of commercial customers were enrolled in a Choice Program in November 2004, down slightly from 42.3% in December 2003. Thus the share of natural gas residential customers still subject to the tax (i.e., those not enrolled in a Choice Program) in November was 110.4% of the share subject to the tax in December 2003, and the corresponding share of commercial customers was 105.6%. Taking an appropriate weighted average of these shares, the share of natural gas customers subject to the tax increased by approximately 8.8% during this period. This implies that tax revenues attributable to natural gas companies will be about this percentage higher in FY 2005 than they would have been with no change in Choice Program participation.

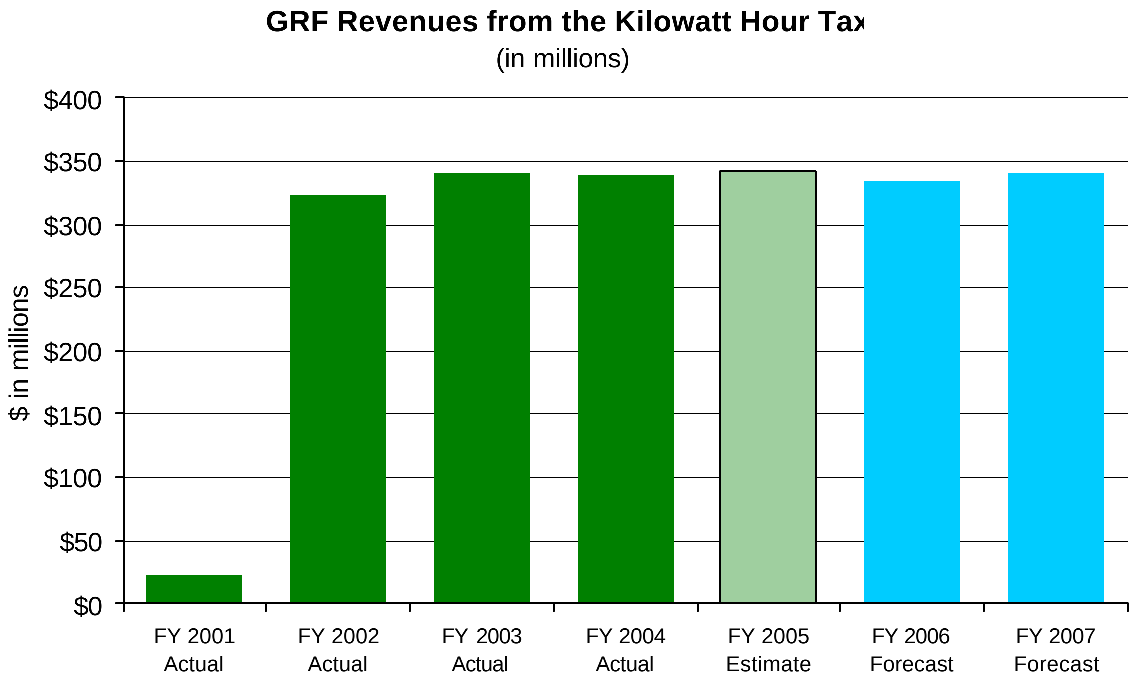
Officials with the Public Utility Commission of Ohio indicate that the recent reduction in Choice Program participation is likely due to specific circumstances involving certain suppliers and government aggregators. They believe that the number of suppliers is sufficient to expect that the reduction in participation does not represent the beginning of a trend. Therefore, participation in the Choice Program is projected to resume its trend prior to the recent unusual circumstances, i.e., to begin to increase slightly each year. The forecast assumes the Choice Program participation increases by 2% in calendar year 2005 (affecting FY 2006 revenues) and by an additional 2% in 2006 (affecting FY 2007 revenues). While LSC economists believe that enrollment increases in Choice Programs are the most likely outcome over the next two years, unexpected news could swing customers away from them, or accelerate the recent enrollment trend, in a dramatic fashion. That would change receipts for this tax, but it should be balanced by changes in sales tax receipts in the opposite direction.

Even more than the effects of enrollment in a Choice Program, the receipts from the tax depend on changes in the market price of natural gas and the volume of gas used. Forecasts of these changes are taken from the Global Insight (formerly DRI-WEFA) economic forecast for the U.S. published in January 2005. The following table presents the Global Insight forecasts of natural gas demand (volume) and price changes nationwide between the first quarter of the preceding calendar year to the first quarter of the year shown in the table:[10]

Global Insight forecast of changes in U.S. natural gas prices, volumes used		
Year	**Price**	**Volume**
2005	12.8%	-1.1%
2006	-3.5%	-0.1%
2007	-5.4%	0.4%

[10] The U.S. Energy Information Administration (EIA) forecasts that natural gas prices will rise by about 3% from 2005 to 2006, and that natural gas demand will increase by 3.0% in 2005 and by an additional 2.1% in 2006. Therefore, basing the revenue forecast on the Global Insight economic forecast may be somewhat conservative, in the sense of producing a slightly lower revenue forecast than would be produced by basing it on the EIA forecast of energy demand and prices. One reason for preferring the Global Insight forecast is that both demand and prices are forecast on a quarterly basis rather than an annual basis.

Kilowatt-Hour Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$22.8	$323.3	$339.9	$339.0	$342.0	$334.0	$341.0
Growth	NA%	1,317.8%	5.1%	-0.3%	0.9%	-2.3%	2.1%

The kilowatt-hour tax was created by S.B. 3 of the 123rd General Assembly, and revenues from the tax began to be received in May 2001. The tax is levied on distribution companies, which remain regulated, and which include the tax in the rates that they charge for distributing electricity. The tax rate depends on the volume of electricity used by the customer. There are three distinct marginal tax rates, $.00465 per kilowatt-hour (kWh) for the first 2,000 kilowatt-hours consumed in a month, $.00419 per kWh for the next 13,000 kilowatt-hours consumed, and $.00363 per kWh for all kWhs consumed over 15,000. Very large users, those that use over 45 million kWhs per year, have the option of self-assessing, which enables them to pay a still-lower rate.

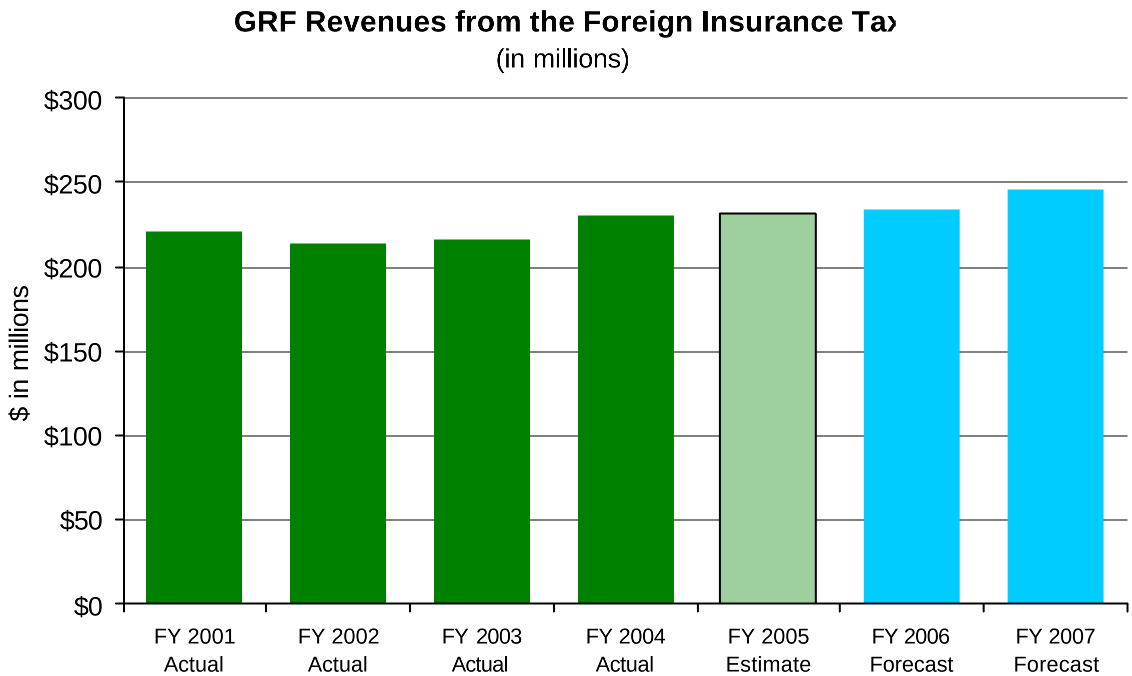
Because of the relative newness of the tax, there is little historical data on revenues to use in forecasting future revenues. In addition, data on electricity usage from the Energy Information Administration (EIA) within the U.S. Department of Energy are provided by customer classes — residential, commercial, and industrial — that do not correspond precisely to the classifications used to determine the tax rate as described above. On the other hand, the tax base is one that grows fairly steadily and is not directly affected by possibly volatile swings in prices, a factor that is helpful for forecasting.

The revenue for FY 2005 through January has grown by 0.2% over the corresponding period in FY 2004. This growth rate is assumed to accelerate slightly toward the long-run growth in electricity demand, 1.8% per year, forecast by the EIA. Global Insight, an economic forecasting firm, projects national growth in electricity demand of just under 1.6% in the first and second quarters of calendar year 2005 compared with the corresponding quarters of 2004. The FY 2005 revenue estimate was obtained by applying the Global Insight forecast of growth in electricity demand for these two quarters to the revenue yielded in FY 2004 during the corresponding quarters. Similarly, the forecast for FY 2006 and 2007 applies Global Insight's forecast of quarterly growth rates in national electricity demand to historical revenue figures to produce growth estimates of approximately 2.3% for FY 2006 and 2.1% for FY 2007. Revenues, and the growth rate, for FY 2006 are adjusted assuming a return to the statutory distribution of revenues from the tax, which results in the fall in revenue indicated in the table.

Relying on a national forecast implicitly assumes that electricity demand in Ohio grows at rates similar to national rates. Other approaches to forecasting revenue under the tax were tried, and the alternative methods generally yielded very similar results. Among the alternative methods used was one that adjusts for Ohio's slower growth historically in residential and commercial use of electricity as compared with the nation as a whole coupled with Ohio's unusually large sales of electricity to industrial users.[11]

[11] Average annual growth in electricity usage in Ohio by both residential and commercial customers between 1990 and 2002 was 2.4%, compared with a national average of 3.1% and 3.9%, respectively. Also, industrial sales accounted for about 39% of Ohio's retail sales of electricity in 2002, while the comparable ratio for the U.S. as a whole was about 28%.

Foreign Insurance Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$220.6	$214.3	$216.4	$230.5	$232.1	$233.8	$245.5
Growth	-12.6%	-2.8%	0.9%	6.5%	0.7%	0.7%	5.0%

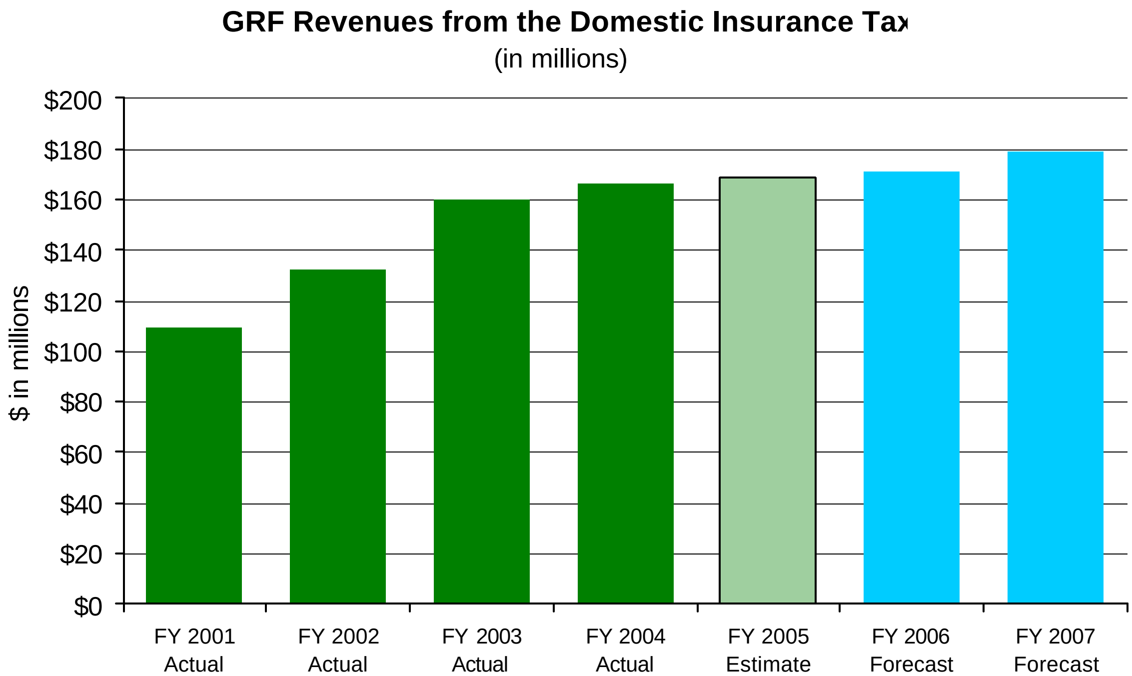
A new tax structure, created by Am. Sub. H.B. 215 of the 122nd General Assembly, was implemented in FY 2003 after a five-year phase-in period. Under the new structure foreign insurance companies, i.e., insurance companies that are headquartered in a state other than Ohio, generally pay a tax of 1.4% of premiums. Foreign insurance companies that are health insuring corporations (HICs) pay a tax of 1.0% of premiums. The new tax structure is the same as the current structure under the domestic insurance tax.

The decreases in revenues from this tax in FY 2001 and FY 2002 are primarily due to the phase-in to the new tax structure. In FY 2002, foreign insurance companies paid a tax of 1.62% of premiums, so that the new rate of 1.4% of premiums represents a straightforward decrease in the tax rate. This decrease is partially offset by an increase in the retaliatory tax that some foreign insurance companies pay. This retaliatory tax rate applies instead of the normal 1.4% rate for any insurance company headquartered in a state that levies a tax rate on Ohio insurance companies higher than the 1.4% that Ohio otherwise imposes on foreign insurance companies. As Ohio lowered the tax rate applied to foreign insurance companies, more of those companies ended up paying the tax at the retaliatory rate. The retaliatory portion of this tax certified to the Treasurer of State increased from $72.4 million in FY 2001 to $112.5 million in FY 2002. This approximately $40 million increase in the retaliatory tax went a long way toward offsetting the reduction in the normal tax rate.

The forecast is based on a combination of regression analysis and trend analysis. Several regression specifications found that revenue under the tax is negatively related to short-term interest rates, specifically to six-month Treasury bill rates. These empirical results confirm the theoretical expectation that rising interest rates increase an insurance company's earnings on investing the premiums it collects, thus allowing the company to generate the same income on lower premium levels. This result is illustrated by recent experience: tax revenues grew at a rate significantly above the long-term growth rate, after adjusting for changes in tax rates, during FY 2002 through FY 2004. The average (adjusted) growth rate in tax revenues from FY 1992 to FY 2004 was 5.0% per year. Adjusted revenue growth in FY 2002 was 10.4%, in FY 2003 growth was 16.8%, and in FY 2004 it was 6.5%. During the corresponding period short-term interest rates fell from 3.3% to 1.1%. Short-term interest rates rose to 1.6% in 2004, and are widely predicted to continue rising in 2005 and 2006. Global Insight, an economic forecasting firm, projects that the six-month Treasury bill rate will rise from 1.6% in 2004 to 3.0% in 2005 and 3.5% in 2006.

Several regression specifications predicted negative growth in revenue under this tax due to the predicted rising interest rates. But aside from the negative growth that accompanied lowering tax rates from FY 1998 to FY 2003, falling revenue under this tax is rare: only two other years saw negative growth between FY 1976 and FY 2004. Due to this feature of historical experience with the tax, the growth rate for FY 2005 and FY 2006 is projected to equal the average growth rate under the tax during the last period of significantly rising interest rates (FYs 1996 - 1998): 0.7%. In FY 2007, as interest rates are predicted to rise more moderately, the growth rate for revenues under the tax is projected to return to its long run average rate of 5.0%.

Domestic Insurance Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$109.3	$132.4	$160.1	$165.9	$168.4	$170.9	$179.0
Growth	24.0%	21.2%	20.9%	3.6%	1.5%	1.5%	4.7%

The domestic insurance tax is levied on premiums collected by insurance companies headquartered in Ohio. The tax is generally 1.4% of premiums; the primary exception is domestic insurance companies that are health insuring corporations (HICs) which pay 1.0% of premiums. This tax structure is the same as the current foreign insurance tax structure.

The current tax structure was created in Am. Sub. H.B. 215 of the 122nd General Assembly. The high rates of revenue growth shown in the table for fiscal years 2001, 2002, and 2003 were primarily due to those years phasing-in the new tax structure; FY 2003 was the first year for which the new structure was in place. Prior to the enactment of H.B. 215 this tax had a dual base: domestic insurance companies (other than HICs) paid the lower of a rate based on premiums collected or a rate based on their capital and surplus. While the tax rate was higher under the old structure, many companies paid the tax based on their capital and surplus because it yielded a lower tax liability. The result is that revenues under the tax increased rapidly during the phase-in of the new tax structure.[12] Because the tax changed from a dual base to a single base, revenue growth patterns before FY 2003 provide no useful guide to future revenue patterns.

Historical revenue patterns under the foreign insurance tax should provide a better guide to future revenue patterns under this tax, since the foreign insurance tax has had a tax base of premiums since it was established. The primary problem in using those patterns as a guide for this tax is that the breakdown of premiums collected by line of business differ significantly between domestic insurance companies and foreign insurance companies. For example, fire and casualty insurance premiums were the base for about 72% of the tax revenues certified for collection by the Superintendent of Insurance in May 2004 from domestic insurers, while that line of business contributed just 58% of the tax revenues certified for collection from foreign insurers.[13] Given the recent changes in the tax structure described above, however, the best approach to forecasting revenues under the domestic insurance tax is probably to introduce suitable modifications into the growth forecast for revenue from the foreign insurance tax.

As described further in the section on the foreign insurance tax, regression analysis of those revenues indicates that short-term interest rates are significant factors underlying revenue growth: higher interest rates yielding slower growth and lower interest rates yielding faster growth. Most economic forecasters are predicting that short-term interest rates will continue to rise in 2005 and 2006. Regression analysis of premiums collected by line of business indicate that life and health insurance premiums (which are more important to the foreign insurance tax) are more responsive to short term interest rates than fire and casualty premiums (which are relatively more important for this tax). Since interest rates are predicted to rise, this implies that the growth rate for the domestic insurance tax should be somewhat higher than that for the foreign insurance tax in FYs 2005 and 2006. Accordingly, growth in this tax is forecast to be 1.5% each year, compared to the 0.7% growth forecast each year for the foreign insurance tax.

In FY 2007 growth in revenue from the foreign insurance tax is projected to return to its long-term growth rate as increases in interest rates begin to moderate. Data compiled by the Ohio Department of Insurance on total premiums collected by line of business indicate that the long-term growth rates for premiums are higher for both HICs

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[12] Ohio companies that operate in other states may have realized a fall in their overall tax burden, however, as the higher rates paid to Ohio may have reduced their tax payments to some other states under the retaliatory tax many states, including Ohio, impose. The retaliatory tax is described in the **"*Foreign insurance tax*"** section.

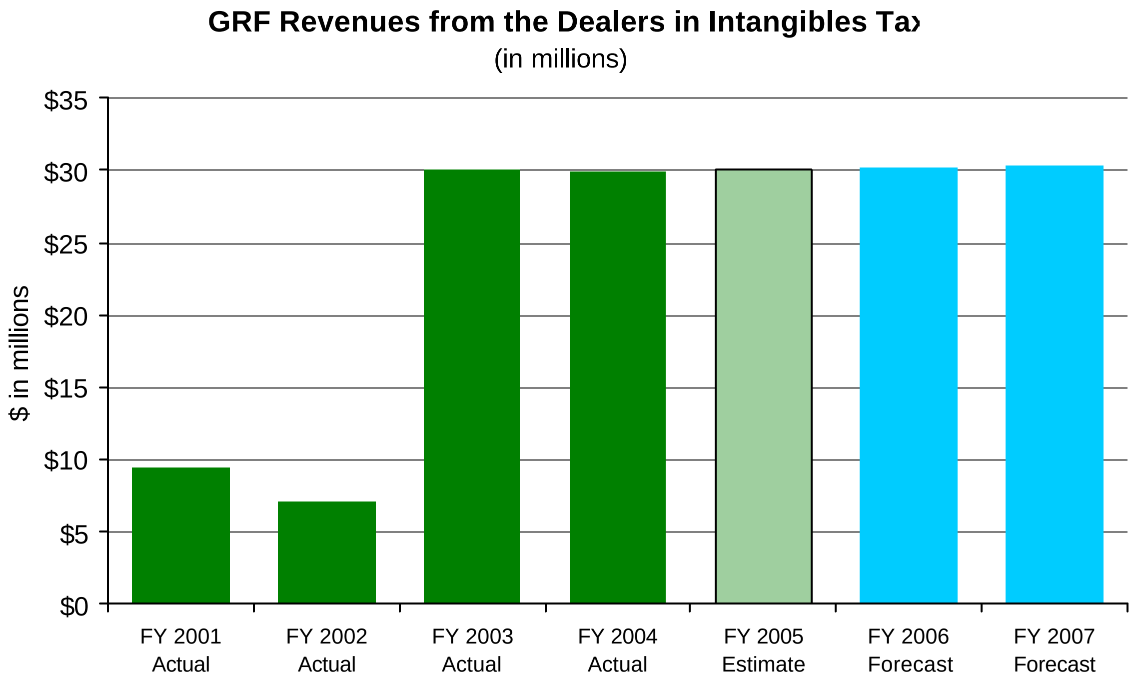
[13] Domestic insurance companies also pay a higher proportion of their tax based on premiums collected by HICs. Foreign insurance companies pay a larger share of their taxes based on life and health insurance premiums.

(8.8% per year from 1979 to 2003) and life and health insurers (8.0%) than they are for fire and casualty insurers (6.8%). Averaging these growth rates appropriately[14] separately for each tax implies that the long-term growth rate for the domestic insurance tax would be lower than the long-term rate for the foreign insurance tax.

For the foreign insurance tax the forecast assumed a long-term growth rate of 5.01% per year, which was the average growth rate from FY 1992 to FY 2004 after adjusting for changes in tax rates. The adjustment derived from the differences in lines of business indicates that the long-term growth rate for domestic insurers would be slightly over 94% of the long-term rate for foreign insurers. Applying this adjustment factor to the 5.01% growth rate for foreign insurers yields a long-term growth rate for domestic insurers of 4.72%, which is the projected growth rate for revenues from this tax for FY 2007.

[14] Averaging the growth rates appropriately for each tax means taking a weighted average of the growth rates of premiums for each line of business, with the weights being the share that that line of business generates in tax revenue under each tax. The 6.8% growth for fire and casualty insurance premiums would, for example, have a weight of about 72% for the domestic insurance tax and a weight of about 58% for the foreign insurance tax.

Dealers in Intangibles Tax



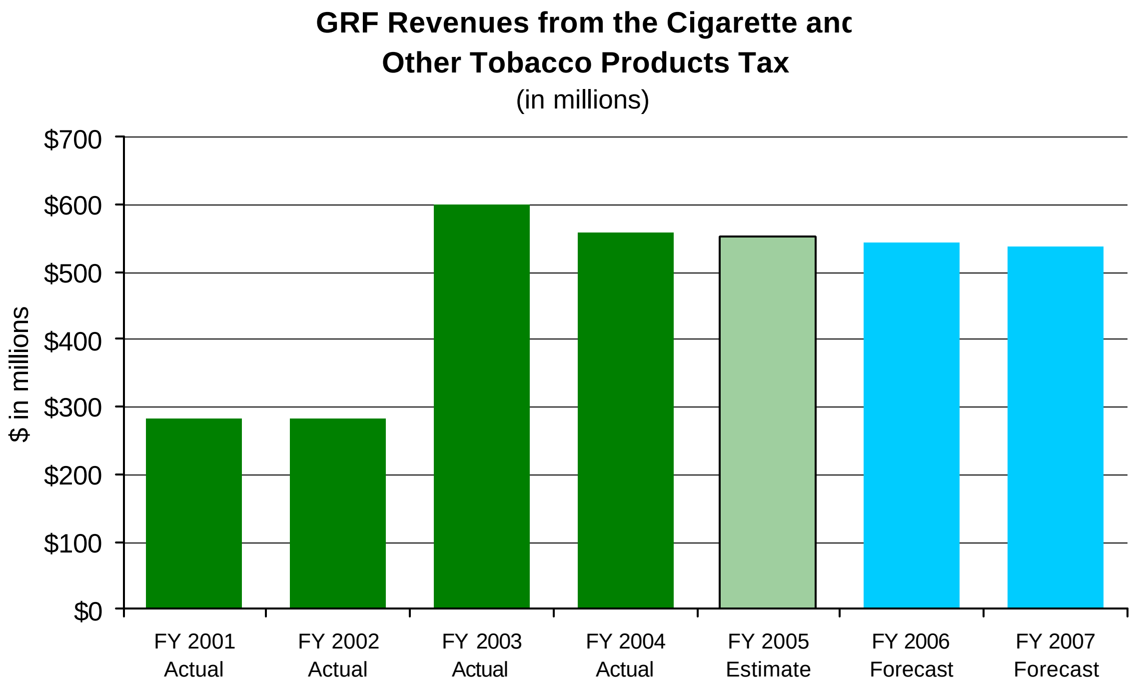
	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$9.5	$7.1	$30.0	$29.9	$30.0	$30.1	$30.4
Growth	9.5%	-25.3%	322.5%	-0.3%	0.3%	0.4%	0.8%

Ohio law provides for the taxation of shares and capital employed by dealers in intangibles. The tax, which is known as the Dealers in Intangibles Tax, is imposed on businesses (excluding financial institutions and insurance companies) engaged in lending money, buying and selling notes, mortgages and other evidences of indebtedness, and firms buying and selling securities. The tax rate is 8 mills of the values of shares or capital employed by the dealers. The distribution of receipts from this tax depends on the type of taxpayer.

For "nonqualifying" dealers, a share of the revenue from this tax, 3 mills, is deposited in the General Revenue Fund. The remainder, 5 mills, is distributed to the counties. All taxes paid by "qualifying dealers" are credited to the GRF. Am. H.B. 405 (124th General Assembly) tightened the eligibility requirements for dealers and expanded the tax base to include "qualifying" dealers. A "qualifying" dealer is a dealer that is a member of a "controlled group" of which a financial institution or insurance company is also a member. This change increased revenues under this tax in FY 2003.

Tax policy changes have been the main cause of significant revenue fluctuations for this tax over the years. Otherwise, revenue growth from this tax source has been essentially flat. The forecast for FY 2006 and FY 2007 is based on an assumed growth rate of 1% in the tax liability of qualifying dealers, and no growth in the tax liability of nonqualifying dealers. Dealers in intangibles tax revenues will be highly dependent on investments by financial institutions and insurance companies in their subsidiaries dealers.

Cigarette and Other Tobacco Products Tax



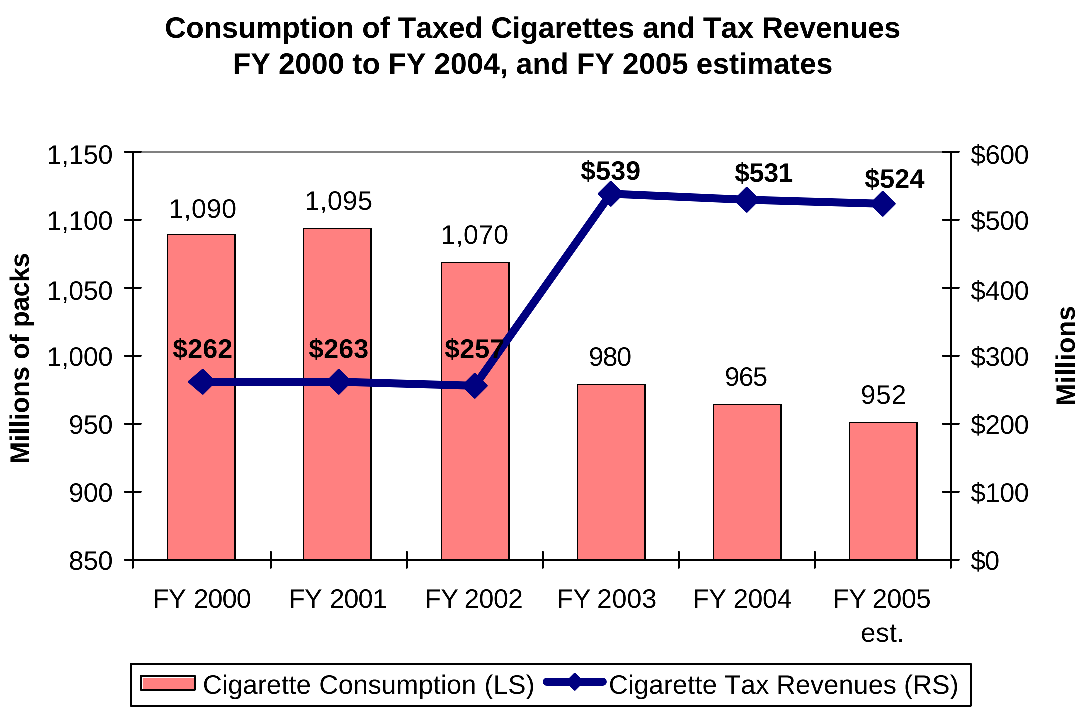
	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$282.5	$281.3	$599.9	$557.5	$551.0	$543.0	$536.5
Growth	-1.8%	-0.4%	113.3%	-7.1%	-1.2%	-1.5%	-1.2%

The cigarette and other tobacco products tax is levied on cigarettes, cigars, chewing tobacco, snuff, smoking tobacco, and other tobacco products. Cigarettes are taxed at a rate of 55 cents per package of 20 cigarettes. Other tobacco products are taxed at 17% of their wholesale price. Revenue collected from the tax is deposited into the General Revenue Fund.

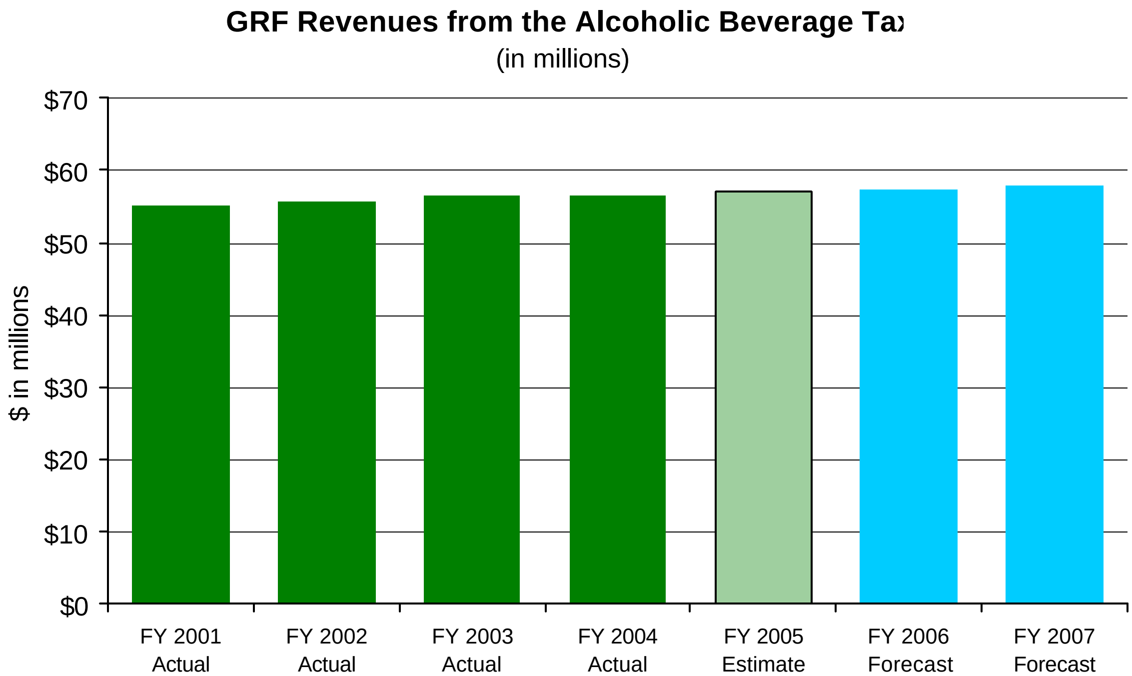
Am. Sub. S.B. 261 increased the tax rate on cigarettes from 24 cents per pack of 20 cigarettes to 55 cents per pack on July 1, 2002. The tax rate on other tobacco products was unchanged. Prior to the rate increase, revenues from taxed cigarettes were generally 91% to 93% of receipts from the tax on cigarette and other tobacco products. Revenues from the other tobacco products provided between 7% and 9% of the tax receipts. After the tax rate increase, the tax base of the other tobacco products became a much smaller share of the total cigarette and other tobacco product tax base, between 4% and 5% of total tax receipts.

The forecast for the cigarette and tobacco product tax is primarily based on trend analysis of the consumption of both cigarettes and other tobacco products. It is expected that smokers will continue to make downward adjustments to their consumption of taxed cigarettes for various reasons, including health. Some cigarette consumers switched to other tobacco products, which have increased tax revenues from that source 4% to 5% per year. The long-term annual decline in cigarette consumption, which has been between 1% and 2%, is expected to continue. Additional factors, such as increases in cigarette prices, increases in the share of nontaxed cigarettes (smuggling and Internet purchases), and smoking bans in public places in various communities may create an even steeper decline in consumption of taxed cigarettes in future years.

The chart below provides estimated cigarette consumption and tax revenues from FY 2000 through FY 2004, and estimated revenues in FY 2005. Revenues in the chart exclude receipts from the tax on other tobacco products. Also, FY 2003 revenues exclude $35.3 million from the tax on cigarettes in inventory when the rate was raised on July 1, 2002.



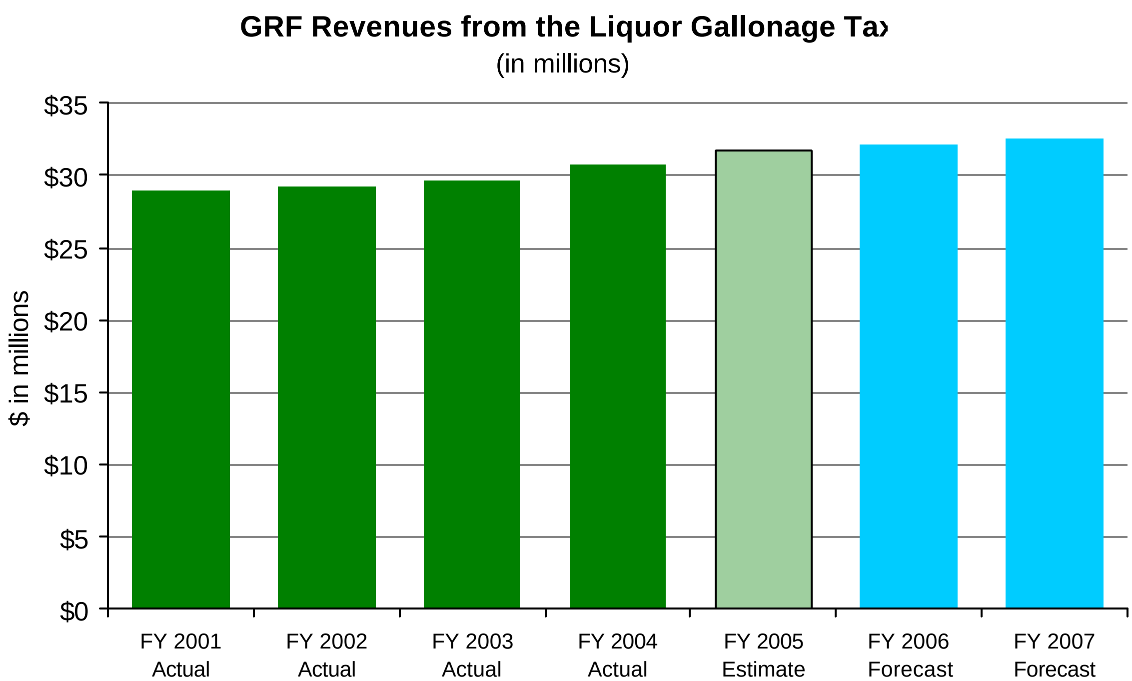
Alcoholic Beverage Tax



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$55.0	$55.7	$56.6	$56.5	$57.0	$57.5	$57.8
Growth	-0.5%	1.3%	1.5%	-0.2%	1.0%	0.8%	0.5%

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 for bottles and cans with less than 12 ounces (about 10 cents for a six-pack of 12 ounce containers). Wine containing less than 14% alcohol by volume is taxed at 32 cents per gallon (about 5.4 cents for a standard 750 ml bottle). Wine with between 14% and 21% alcohol by volume is taxed at $1.00 per gallon (or 17.0 cents for a standard 750 ml bottle). Mixed beverages are taxed $1.20 per gallon (or 20.4 cents for a standard 750 ml bottle). Major exemptions to the tax are sacramental wine, sales to the federal government, and sales in interstate commerce. Revenue is deposited in the General Revenue Fund with two exceptions. One percent of the tax is deposited in the Beverage Tax Administration Fund and 5 cents per gallon of wine is deposited into the Ohio Grape Industries Special Account. The forecast for the alcoholic beverage tax revenue is based on a trend analysis of the contribution of each alcoholic beverage to the tax base in the last few years.

Liquor Gallonage Tax

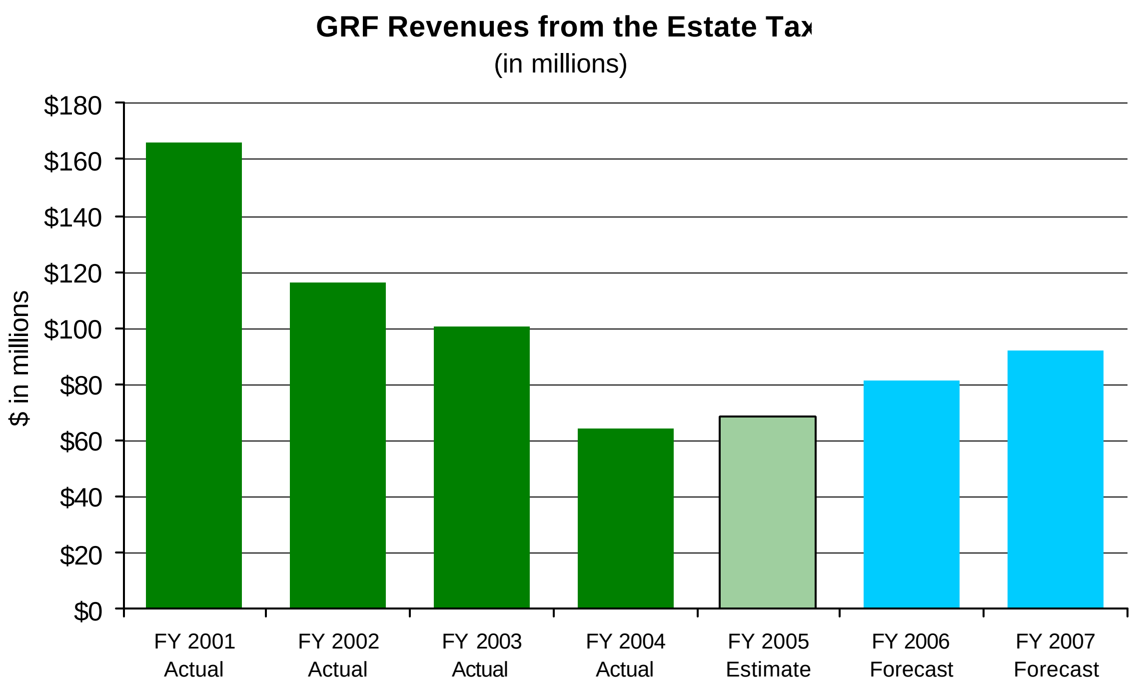


	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$29.0	$29.3	$29.7	$30.8	$31.7	$32.1	$32.6
Growth	3.2%	1.0%	1.4%	3.7%	3.0%	1.3%	1.3%

The Liquor Gallonage Tax is levied at the rate of $3.38 per gallon of spirituous liquor. This is the equivalent of 57.6 cents per standard 750 ml bottle. Revenue from this tax is deposited into the General Revenue Fund.

Important determinants of alcohol consumption slowly change over time. The secular decline in overall per capita consumption appears to have reversed in the last few years. The relative importance of other variables such as disposable income as a determinant of demand for liquor may have increased. Also, a larger selection of spirituous liquor brands and the removal of certain restrictions on Sunday liquor sales (Sub. S.B. 164, 125th General Assembly) will sustain small year-over-year increases in tax receipts. The forecast of liquor gallonage tax is based on trend analysis of wholesale and retail gallonage sales of liquor in Ohio.

Estate Tax



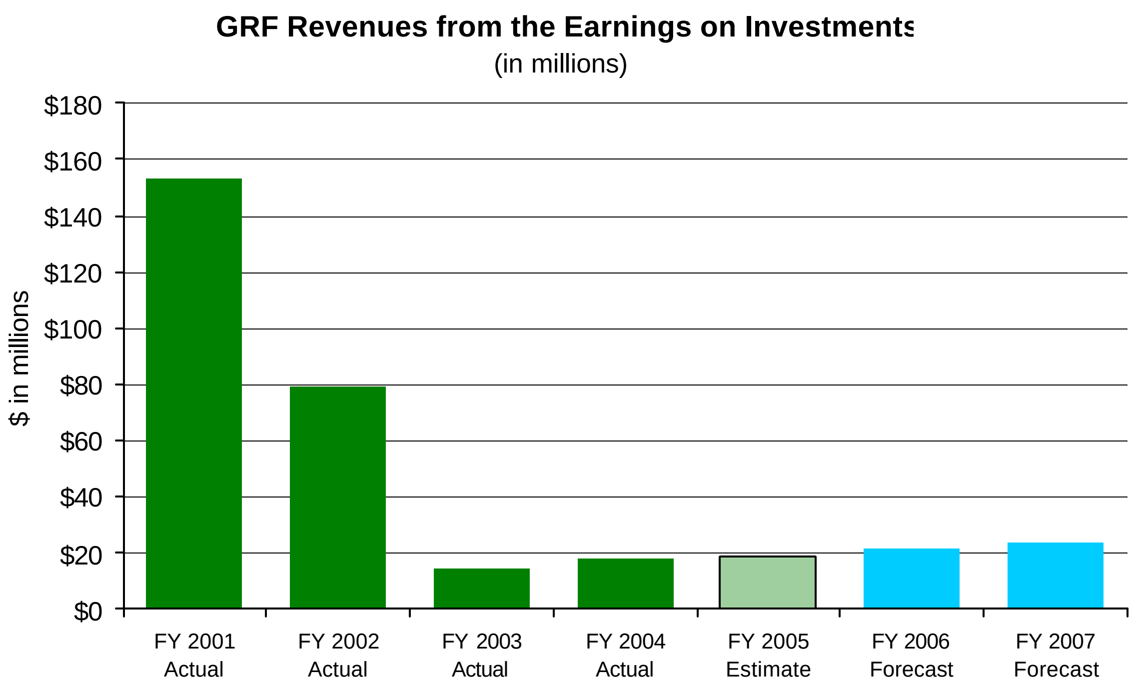
	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$166.0	$116.3	$100.8	$64.2	$68.8	$81.3	$91.8
Growth	18.6%	-29.9%	-13.3%	-36.3%	7.2%	18.2%	12.9%

The forecast for the estate tax is based on historical trend analysis and assumptions on economic conditions. Estate tax revenues are estimated to increase from $64.2 million in FY 2004 to $68.8 million in FY 2005. In FY 2006 and FY 2007, estate tax revenues are estimated to increase to $81.3 million and $91.8 million, respectively.

The estate tax is one of the more volatile state revenue sources as the estate of a very wealthy individual can account for a significant amount of the total state estate tax revenues. Estate tax returns are filed within nine months of a person's date of death. However, an automatic six months extension is granted to all estates. Estate tax payment is due at the expiration of nine months from the date of death to the county treasurer where the estate tax return was filed. The tax is progressive with rates ranging from 2% of the taxable estate to 7% of the value of the taxable estate over $500,000. Estates with dates of death on or after January 2002 receive a $13,900 credit, which effectively exempts the first $338,333 of estate value from taxation. The municipal corporation or township of origin receives 80% of the revenue and the GRF receives the remaining 20%, less the cost of local administration for estates with dates of death on or after January 1, 2002.

The estate tax is assessed upon the total assets owned by a decedent (either solely or in conjunction with another person) who was a resident of Ohio at time of death. The tax due is based on the net value of the decedent's estate. This net value is based on the gross value minus the debts and administration expenses of the estate. The gross value is made up of all assets, such as real estate, bank accounts, stocks, bonds, etc. The debts and administration expenses include funeral costs, attorney and executor fees, and outstanding bills in the name of the decedent. Ohio also allows an unlimited marital deduction that allows property to pass from one spouse to another without taxation for dates of death on and after July 1, 1993. This can result in no estate tax on property passing to a surviving spouse.

Earnings on Investments



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$153.3	$79.0	$14.2	$18.0	$18.9	$21.6	$23.8
Growth	25.1%	-48.5%	-82.0%	26.8%	5.1%	14.2%	10.0%

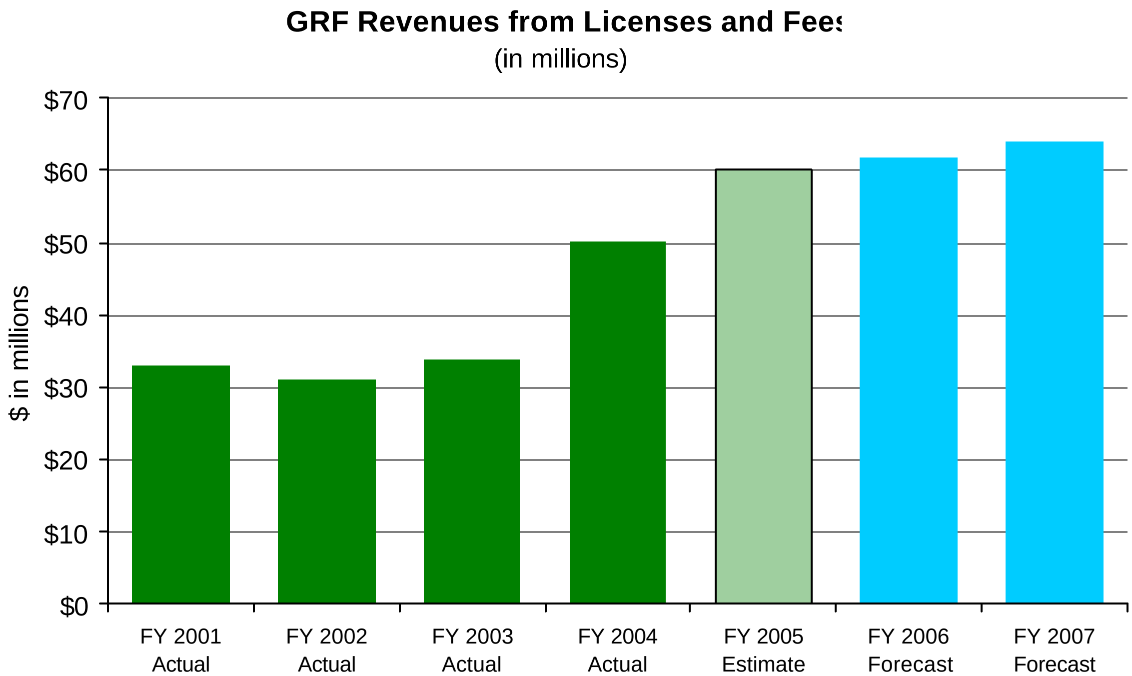
In FY 2005, earnings on investments are estimated to increase slightly to $18.9 million from $18 million in FY 2004 because of increasing interest rates on short and medium-term investment instruments and higher estimated fund balances than in previous fiscal years. Earnings are expected to rebound in both FY 2006 and FY 2007 as interest rates increase and estimated fund balances increase. In FY 2006, earnings on investments are estimated to increase from $18.9 million to $21.6 million. In FY 2007, earnings on investments are estimated to increase by 10% to $23.8 million.

The calculations for the forecast were based on interest rate estimates and the average state funds balance that will be available for investment. The Treasurer of State is responsible for managing the state's portfolio and investing state funds.

All state funds are invested conservatively with safety of funds as the number one investment priority. State law and investment policy provide an outline on the state investment objectives, delegation of authority, asset diversification policy, including specific types of allowable investments. Some of the allowable instruments are short-term and medium-term fixed-income instruments such as United States Treasury securities, federal agency obligations, and highly rated commercial paper. Some of the instruments that are not allowable for state fund investment are domestic or international equities, real estate, and venture capital.

All earnings on investments from state funds are credited to GRF unless stated otherwise in the Ohio Revised Code.

Licenses and Fees



	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Forecast	FY 2007 Forecast
Revenue	$32.9	$31.1	$33.7	$50.2	$60.0	$61.9	$64.0
Growth	-2.3%	-5.5%	8.3%	49.0%	19.7%	3.2%	3.3%

The General Revenue Fund benefits from a number of licenses and fees that are either completely or partially deposited into the GRF. LSC estimates licenses and fees will produce $60.4 million in revenues for FY 2005, $62.3 million in FY 2006, and $64 million in FY 2007.

The two largest contributors of license and fee revenue have traditionally been the license fees deposited by the Department of Insurance and liquor permits deposited by the Department of Commerce. Motor vehicle licenses, fees and license revenues deposited by the Environmental Protection Agency, and various business licenses also contribute revenues to the GRF.

The increase in revenue for FY 2004 and the estimated increase for FY 2005 can largely be attributed to fee increases in Am. Sub. H.B. 87 and Am. Sub. H.B. 95 of the 125th General Assembly. The fee increases accounted for approximately $14.5 million in revenue for FY 2004, and it is estimated that the fee increases will account for $17.5 million of the FY 2005 revenues.

The revenue projections for FY 2006 and 2007 are based on expected growth in Ohio's gross state product, which is a measure of a state's total output, and do not reflect any fee changes that may occur over the next two fiscal years.

Public Assistance Expenditures
Health Care/Medicaid

Overview

The Office of Ohio Health Plans in the Department of Job and Family Services (ODJFS) operates several state and federally funded programs providing health care coverage to certain low-income and medically vulnerable people of all ages: Medicaid, the State Children's Health Insurance Program (SCHIP, created by the Social Security Act as Title XXI), the Hospital Care Assurance Program (HCAP, also created by the Social Security Act as Title XXI), and the state Disability Assistance Medical program (DA Medical).

Medicaid, the largest health program in Ohio, was created by the Social Security Act as Title XIX, and became law in 1965. Medicaid is an entitlement program and is a state-federal partnership, which jointly funds the provision of adequate medical care to eligible needy persons. In this partnership, the federal government establishes broad national guidelines, and each state determines its own eligibility requirements, determines the scope of services, sets payment rates for services, and administers its program.

SCHIP allows Ohio to provide health care coverage to children who were not previously eligible for Medicaid and whose family income is below 200% of the federal poverty guideline (FPG). Through HCAP, hospitals are reimbursed for some of their costs of providing medical care to persons below 100% of FPG. The DA Medical program is state funded and provides limited medical coverage to persons who are not eligible for a federally funded program.

In Ohio, Medicaid and SCHIP provided health care coverage to slightly over 1.6 million Ohioans every month in Fiscal Year (FY) 2004. These programs apply to people in the following four distinct insurance markets: children in families with incomes at or below 200% of FPG; pregnant women with incomes at or below 150% of FPG; parents at or below 100% of the FPG; and low-income elderly and persons with disabilities of all ages, commonly referred to as Aged, Blind, and Disabled (ABD). Many consumers with disabilities have medical needs so extensive that commercial plans would deem them "uninsurable."

Even though Medicare provides coverage for most of Ohio's elderly population, many of these individuals are "dually eligible," and Medicaid supplements their Medicare benefits by providing Medicaid coverage for services such as prescription medications and long-term care. Medicaid also provides assistance with Medicare premiums, copayments, and deductibles to certain low-income seniors.

Although other state agencies provide Medicaid services, the vast majority of Medicaid spending occurs within the budget of ODJFS. Recognized by the federal government as Ohio's single Medicaid agency, ODJFS provides long-term care and basic medical services with state and federal moneys through GRF line item 600-525, Health Care/Medicaid. Beginning in FY 2003, the 600-525 line item is not only used to fund Medicaid, but also SCHIP, and DA Medical.[15] In addition to the funding from the GRF, several provider tax programs and other special revenues are used to pay for Medicaid services.[16]

The federal financial share of Ohio's Medicaid program changes every federal fiscal year. In accordance with federal law, the federal government shares in the states' cost of Medicaid at a matching rate known as the FMAP (Federal Medical Assistance Percentage). The FMAP is calculated for each state based upon the state's per capita income in recent years relative to the entire nation. The general description of how this cost-sharing mechanism works has traditionally been as follows: for every one dollar Ohio spends on Medicaid, the federal government gives Ohio 59 cents. However, while the majority of the spending in line item 600-525, Health Care/Medicaid, is reimbursed at the FMAP, a few items, primarily contracts, are reimbursed at 50%, and all family planning services are reimbursed at 90%. In addition, about 15% of Medicare buy-in premiums receive no federal reimbursement. Lastly, the State Children's Health Insurance Plan (SCHIP) is reimbursed at an enhanced FMAP of about 71%.

Forecast Summary

The total number of persons eligible for Medicaid grew by 5.74% from 1,551,530 in FY 2003 to 1,640,637 in FY 2004. The total number of eligibles is estimated to reach 1,720,848 in FY 2005, a 4.89% increase over FY 2004. LSC forecasts that the number of persons eligible for Medicaid will continue to grow to 1,771,015 in FY 2006, a 2.92% increase, before falling to 1,750,318 in FY 2007, a 1.17% decrease.

Spending within the 525 line item can generally be placed into one of nine major categories: long-term care (nursing facilities, or NFs, and Intermediate Care Facilities for

[15] Prior to FY 2003, spending for part II of SCHIP was funded through line item 600-426, and spending for DA medical was funded through line item 600-511.

[16] Provider tax programs refer to assessments on hospitals, as well as bed taxes on nursing facilities and intermediate care facilities for the mentally retarded. The programs serve as a mechanism by which to draw additional federal reimbursement. Other special revenues include funds for the Disproportionate Share Hospital (DSH) offset and drug rebates.

the Mentally Retarded, or ICFs/MR), hospitals (inpatient and outpatient), physician services, prescription drugs, health maintenance organizations (HMOs), Medicare buy-in, waiver, all other care, and DA Medical.

LSC projects an increase in health care expenditures in FY 2006 of 12.34% or $1,303 million in combined state and federal GRF dollars, with a state share increase of $526 million. For FY 2007, LSC projects total health care expenditures will go up by another 8.41%, or $998 million in combined state and federal GRF dollars, with a state share increase of $402 million.

These projections do not include the impacts of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), which includes Medicare Part D. Those impacts will be discussed in LSC's Department of Job and Family Services - Medicaid redbook.

Eligibility

While individuals can become eligible for Medicaid programs that are funded out of the 525 line item by meeting any one of many sets of eligibility criteria, all of these various eligibility groups can be categorized into seven major types: Aged, Blind, and Disabled (ABD); Qualified Medicare Beneficiaries (QMBs); Specified Low-Income Medicare Beneficiaries (SLMBs); Healthy Families (HF); Healthy Start (HS); Children in families with incomes at or below 150% of the FPG known as CHIP-I; and Children in families with incomes between 150% and 200% of the FPG known as CHIP-II. Generally, Healthy Families, Healthy Start, CHIP-I, and CHIP-II are grouped as Covered Families and Children (CFC). Each of these groups will be discussed briefly in turn.

ABD. The ABD eligibility group is loosely based on the Supplemental Security Income (SSI) program. Although SSI eligibility generally leads to Medicaid eligibility in most states, Ohio and 11 other states exercise what is known as the "spend-down" option. In other words, Ohio has opted to use a more restrictive income test than that incorporated in the eligibility guidelines of the SSI program (100% of the FPG); however, once individuals who do not meet the initial ABD income test spend an amount on medical care such that their income after medical expenses is at or below the more restrictive ABD income level of about 63% of the FPG, they "spend down" to Medicaid eligibility for the month. This allows individuals who have expensive medical needs, but who may have incomes over the SSI level, to receive Medicaid coverage for the remainder of the month.

The ABD eligibility group is the most costly of the seven groups. Not only do ABD eligibles generate more costly acute care services than the other groups, almost all of the Medicaid long-term care recipients come from the ABD eligibility group. Growth over the next biennium is expected to be stable.

QMBs and SLMBs. The following two eligibility groups, Qualified Medicare Beneficiaries (QMBs) and Specified Low-income Medicare Beneficiaries (SLMBs), are created by a federal mandate that states' Medicaid programs must "buy-in" to Medicare coverage for certain individuals. QMBs have incomes below 100% of the FPG, and Medicaid must pay for their Medicare premiums, copayments, and deductibles.[17] For SLMBs, Medicaid covers the Medicare Part B premiums only for those with incomes between 100% and 120% of the FPG. Premiums for both of these eligibility groups (and for Medicare-eligible ABD eligibles for whom the state chooses to buy-in to Medicare)[18] are reflected in the Medicare buy-in service category. The copayments and deductibles of QMBs are reflected in the appropriate service categories, which Medicare covers.

Healthy Start. Children up to age 19 and pregnant women, whose families' incomes are below 150% of the FPG, are Medicaid eligible through the Healthy Start program.

Healthy Families. Apart from Healthy Start eligibles, Medicaid provides health care to other families and children. Prior to the enactment of the federal Personal Responsibility and Work Opportunity Act of 1996, which created the TANF program (implemented in Ohio as Ohio Works First) to provide income maintenance services to low-income families, recipients of Aid to Dependent Children (ADC) were automatically eligible for Medicaid. Although TANF severs the link between cash assistance and Medicaid eligibility, a provision of the federal law requires states to provide Medicaid coverage to families who meet guidelines for ADC eligibility as they were on July 16, 1996. In fact, federal law mandates that eligibility for a state's Medicaid program cannot be more restrictive than the ADC guidelines that existed in each state on July 16, 1996. "Ohio has designed OWF and made the allowable modifications to the July 1996 ADC plan in order to meet Ohio's goal that all OWF cash assistance recipients also automatically receive Medicaid. In addition, in some instances where OWF is more restrictive than the July 1996 ADC rules, individuals who will not be eligible to receive cash will be eligible for Medicaid under the Low-Income Families group which uses the

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[17] The QMB grouping in the eligibility table refers only to those QMB individuals who do not "spend down" to ABD eligibility. Because many individuals who are initially eligible for Medicaid through the QMB program spend down to ABD eligibility during the month, the reported QMB population is understated.

[18] Under Medicare, eligibility is not limited to age alone. Eligibility is also based on work history (individual's payroll deductions while they were working, similar to Social Security qualifications). Ohio's Medicaid program buys into Medicare for Medicaid eligibles who do not have the necessary work history.

July 1996 ADC policy."[19] These Low-Income Families, who would have previously received cash assistance, continue to grow as a subset of an eligibility group referred to as Healthy Families.

In addition to individuals who meet eligibility guidelines for 1996 ADC cash assistance, Medicaid eligibility is given to individuals who no longer meet ADC eligibility guidelines due to increased income, but previously received OWF cash assistance. Transitional Medicaid eligibles receive an additional six months of health care coverage that can be extended for an additional six months if monthly income is less than or equal to 185% of the FPG. Families whose incomes exceed ADC guidelines due to the collection, or increased collection, of child or spousal support payments receive Medicaid coverage for four months and are referred to as Extended Medicaid. As a subset of Extended Medicaid, coverage is provided to individuals eligible for Title IV-E foster care and other miscellaneous groups.

CHIP-I. The Balanced Budget Act of 1997 added a sixth eligibility group to the Medicaid population that Ohio funds out of the 525 line item. The Act created the State Children's Health Insurance Program (CHIP), Title XXI of the Social Security Act, giving states another option to initiate or expand health care to uninsured low-income children. The program affords states increased flexibility in designing and implementing CHIP programs and provides states a higher federal reimbursement rate than under the regular Medicaid program. Prior to the passage of the Federal Balanced Budget Act of 1997, which included CHIP, Ohio included in its biennial budget a children's health insurance expansion for children up to the age of 19 in families at or below 150% of the FPG. Combining the state's initiative with the federal CHIP opportunity, Ohio submitted a CHIP State Plan to the Center for Medicare and Medicaid Services (CMS, formerly known as the Health Care Financing Administration, or HCFA) to implement a Medicaid expansion under CHIP. CMS approved Ohio's CHIP State Plan on March 23, 1998 – making Ohio the fifth state approved to draw down CHIP funding. Ohio implemented its children's health insurance plan (CHIP-I) by expanding Healthy Start, to include Medicaid coverage for low-income children up to age 19, in families at or below 150% of the FPG.

CHIP-II. Am. Sub. H.B. 283 of the 123rd General Assembly, the main budget act, appropriated funds for the Children's Health Insurance Plan II (CHIP-II) under Title XXI, for uninsured children under age 19 in families with incomes between 150% and 200% of the FPG. CHIP-II commenced on July 1, 2000.

[19] Source: Ohio Medicaid Report, December 1998, Ohio Department of Human Services.

Caseload Forecast

Total Caseload. The total number of persons eligible for Medicaid grew by 5.74% from 1,551,530 in FY 2003 to 1,640,637 in FY 2004. The total number of eligibles is estimated to reach 1,720,848 in FY 2005, a 4.89% increase over FY 2004. LSC forecasts that the number of persons eligible for Medicaid will continue to grow to 1,771,015 in FY 2006, a 2.92% increase, before falling to 1,750,318 in FY 2007, a 1.17% decrease.

The last time the Medicaid program had major expansions was in July 2000. At that time, ODJFS implemented two expansions. First, coverage was extended to parents with enrolled children for families with incomes at or below 100% of the FPG under the Healthy Families program. Second, ODJFS rolled out CHIP-II, expanding Healthy Start eligibility to uninsured children from families with incomes between 150% and 200% of the FPG. No program expansions were implemented during the current (FYs 2004-2005) biennium or the preceding biennium. The forecast assumes that no program expansions will be implemented during the coming biennium.

Poor labor market conditions associated with the recent recession (which officially ended for the nation as a whole in late 2001) have been the primary driving force behind the growth in total caseload. An additional factor behind the recent growth in caseload has been the CHIP-II program expansion. The eligible population for CHIP-II grew by 17.10% in FY 2003 before slowing to 7.67% in FY 2004, a rate more comparable to the other categories of eligibility.

Covered Families and Children. LSC forecasts that the overall CFC caseload will peak in the first half of FY 2006, and begin to drop in the third quarter of FY 2006 as the economy begins to recover. This forecast is based on a statistical model of the relationship between the Healthy Families caseload and the unemployment rate. Forecasts of future unemployment rates used for the caseload forecast are taken from the October 2004 economic forecast for Ohio by Global Insight.

Aged, Blind, and Disabled. Growth in the ABD caseload decelerated in FY 2004, but early signs for FY 2005 suggest that growth may accelerate again. Those eligible due to disability are the largest single subcategory within the ABD category of eligibility. The Social Security Administration forecast acceleration in the number of blind or disabled recipients of federally administered SSI benefits starting in CY 2003 in its *Annual Report of the Supplemental Security Income Program* released in May 2004. While this forecast is for a national figure, statistical analysis conducted by LSC staff indicates that growth in Ohio's disabled and blind caseload is highly correlated with this national data historically. LSC forecasts the number of ABD eligibles to grow by 4.33%

from FY 2004 to FY 2005, with growth decelerating to 4.19% in FY 2006 and 3.01% in FY 2007. The Aged subcategory is projected to increase at average historical rates.

HMO Penetration. Although Ohio has contracted with HMOs since the late 1970s to provide care for certain Medicaid eligibles, the use of capitated rates was not given major emphasis in Ohio's program until the state received an 1115 demonstration waiver in January 1995. As one initiative of the federally approved OhioCare proposal, the state was given the freedom to require mandatory HMO enrollment of CFC Medicaid eligibles. Ohio Medicaid's experience with mandatory enrollment on a large scale began in 1996, with the implementation of the waiver. However, despite a concerted effort to attract new plans, the program (as in the other areas of the country) has been plagued by limited interest and other obstacles. Counties with mandatory enrollment have dropped from a high of ten (Butler, Cuyahoga, Franklin, Hamilton, Lorain, Lucas, Montgomery, Stark, Summit, and Wood) to four (Cuyahoga, Stark, Lucas, and Summit).

CFC eligibles access their health care benefits through either the traditional fee-for-service system or the Medicaid managed care program. The Medicaid managed care program has three different enrollment categories: mandatory, voluntary, and preferred option. In FY 2001, the state introduced the Preferred Option. Under Preferred Option, recipients are automatically enrolled in managed care if they fail to select the traditional fee-for-service option. This policy has pushed up the HMO penetration rate[20] from 27.93% in FY 2001 to 39.44% in FY 2004.

LSC's baseline forecast assumes that the HMO penetration rate will continue to rise due to the Preferred Option. But it is expected to rise more slowly to approximately 41 or 42% for FY 2006 and FY 2007. In other words, about 41 or 42% of all Covered Family and Children consumers are expected to enroll in a Medicaid HMO during the next biennium, absent any new policy initiatives.

Medicaid Program Cost Forecast

Medicaid program costs are estimated separately for each of the nine major expenditure categories described in the ***"Forecast Summary"*** section. After forecasting changes in the caseload, a cost per Medicaid recipient is projected. The cost per recipient is itself broken down into two components: the average number of claims per recipient, called the "utilization rate," and the average cost per claim submitted. The average cost per claim depends heavily on overall health care inflation — Medicaid spending on health care services that are market driven significantly outweighs program payments to providers that are tied to fee schedules. In addition, payment rates for long-term care,

[20] Penetration is the number of managed care eligible divided by total Covered Family and Children eligibles.

inpatient hospital care, and prescription drugs are statutorily connected to market place trends. Consequently Medicaid, like any other third party payer, is very susceptible to market forces.

Generally speaking, the forecast of average cost per claim in each category of care under Medicaid starts with historical data on costs per claim. To project whether increases in costs per claim would accelerate or decelerate, LSC used the Global Insight forecast of inflation, as measured by the price deflator for consumer expenditure — medical care (PCE-MC), as a baseline. This baseline was then adjusted separately for each category of care. For those categories for which there is a corresponding subcomponent of the CPI, that subcomponent is used to make the adjustment. Some of the subcategories of care that are lumped under the All Other Care component of Medicaid spending do not have a corresponding subcomponent of the CPI, and in those cases the assumption regarding inflation was based on the PCE-MC with no adjustments.

Historical relationships between the number of eligibles in each eligibility group and the number of claims they generate in each category of service allow for the calculation of utilization rates. By applying forecasts of utilization rates to forecasts of the number of eligibles, an estimated number of claims can be calculated.

Due to the delayed submissions of claims by providers and delays in processing payments, claims are not always paid in the same quarter in which services are given to Medicaid eligibles. In fact, it is generally the case that providers are not completely reimbursed for all of the services they give to Medicaid eligibles until well over a year following the date of service. Thus, it is necessary to make the distinction between the date of service and the date of payment.

Because disbursements from the 525 line item reflect the payment of claims and not the provision of services, it is necessary to incorporate the appropriate payment lags when estimating spending from the 525 line item.

In short, forecasting Medicaid spending involves the estimation of the number of Medicaid eligibles in each month. Then it is necessary to estimate the demand each eligibility group will have for each major category of service. The next step is to estimate the relevant cost per claim. Taken together these estimates can be used to predict the cost of services in a given period (in this case, quarterly). However, disbursement estimates reflect the payment of claims — so it is necessary to apply the appropriate payment lags before the estimates are complete.

***Nursing Facilities*.** Expenditures for nursing facilities' services were $2.71 billion and represented approximately 27.58% of expenditures from line item 525 in FY 2004.

Payments to nursing facilities are based on cost reports. Nursing facilities annually submit cost reports to ODJFS, which are used to calculate facility-specific per diems for the following state fiscal year. In other words, each fiscal year's per diem rates are based on cost reports from the preceding calendar year. The per diem rates are then adjusted quarterly to account for differences in each resident's needs — known as the "case-mix adjustment."

The FY 2004-2005 biennial budget act temporarily suspended the statutory per diem rate formula and established a cap on growth in the per diem rates for FY 2004 and FY 2005. For FY 2004, the mean total per diem rate for all nursing facilities in the state, weighted by Medicaid days, after applying the cap was $156.84. Department of Job and Family Services officials report that the mean would have been approximately $164.11 if the statutory formula had been followed. For FY 2005, the equivalent figure after applying the cap is estimated to be $159.31, while ODJFS officials indicate that the mean would have been approximately $170.58 under the statutory formula.

LSC also offers the following more general observation on some of the important dynamics surrounding nursing facilities and their costs of care. In this country, for various reasons related to demography, lifestyles, the physical environment, medical care, and so forth, people are living longer and the size of the aging population is growing. As a result, there is a larger pool of people that might require the more intensive level and more costly form of care associated with a nursing facility stay and for longer periods of time as well. Alternative forms of care like PASSPORT, which allow some people with a nursing home level of care to live in the community, aid in constraining the acceleration of nursing facility care costs. From the perspective of nursing facilities, this means that the medical conditions of those people occupying their beds these days are generally more acute than was previously the case. This rise in acuity level alone would increase the nursing facility's cost of doing business and the state's per diem has grown to reflect that reality.

In summary, the rise in the state's per diem is fueled by heightened acuity levels, increased capital costs, and to a larger extent, elevated direct care costs. The forecast assumes that the statutory formula is resumed in FY 2006 and FY 2007. The per diem rates are forecast to average $183.89 during FY 2006 and $192.17 in FY 2007. The FY 2006 per diem rate forecast represents an increase of 7.6% over the ODJFS estimate of the statutory formula per diem for FY 2005, and the FY 2007 forecast represents an increase of 4.5% over the FY 2006 average. Estimated expenditures for Nursing Home Services are $3.18 billion in FY 2006 and $3.34 billion in FY 2007.

Inpatient and Outpatient Hospital Services. Expenditures for Inpatient and Outpatient Hospital Services were $1.95 billion and represented approximately 19.84% of expenditures from the 525 line item in FY 2004.

ODJFS is amending rules to update and provide a more current weighting of the relative weights for Diagnostic Related Groups (DRG) used in the prospective payment system for hospital services, and to require annual recalibration updates thereafter. The Department estimates that the recalibration of the relative weights for DRGs will result in a decrease in reimbursement for hospital services.

The Ohio Administrative Code requires an annual inflationary update to inpatient rates; however, outpatient rates are based on a fee schedule that is not automatically inflated. Health economists are predicting increased health care inflation in the coming years. In addition, demand for more and expanded health care services continues to push up the costs. LSC's projection is that hospital spending growth will slow to 7.87% in FY 2006 due to the impact of the hospital recalibration, and move to 9.95% in FY 2007, as both use and price are anticipated to grow.

Physician Services. The cost estimates for Physician Services reflect the historical costs of providing medical care. The growth rate in spending is projected to be 5.99% from FY 2004 to FY 2005, 8.68% from FY 2005 to FY 2006, and 6.89% from FY 2006 to FY 2007. Estimated expenditures for Physician Services are $688.1 million in FY 2006 and $735.5 million in FY 2007.

Prescription Drugs. Expenditures for Prescription Drug Services were $1.80 billion and represented approximately 18.28% of expenditures from the 525 line item in FY 2004. Offsetting the prescription drug services expenditures was the prescription drug rebate of $455.4 million in FY 2004.

LSC expects prescription drug spending growth to decelerate but to still be one of the fastest growing health sectors. Growth in drug spending peaked in FY 2001 at 25.08%, slowed to 16.84% in FY 2004, and is projected to decelerate to 13.17% growth in FY 2005. Growth is projected to be 15.96% in FY 2006 and 13.93% in FY 2007. The high growth rate of FY 2001 was associated with increases in utilization, price, and the number of eligibles.

Medicare Buy-In. During September 2004, the U.S. Department of Health and Human Services (HHS) announced increases in Medicare premiums, coinsurance, and deductible costs that result in increases in Medicaid spending in calendar year 2005. The Medicare Part A premium increases 9.3% over the 2004 level and the Medicare Part B premiums increases 17.4%.

The cost estimates for Medicare Buy-In Services reflect the historical trend and the above policy changes. The growth rate in spending is projected to be 23.13% from FY 2004 to FY 2005, 14.00% from FY 2005 to FY 2006, and 6.55% from FY 2006 to FY 2007. Estimated expenditures for Medicare Buy-In Services are $226.7 million in FY 2006 and $241.6 million in FY 2007.

Health Care Spending (ALI 600-525 Only)
Table 1

Service Category	FY 2004	FY 2005		FY 2006		FY 2007	
	Actual	Estimated	% Change	Estimated	% Change	Estimated	% Change
Long Term Care	$3,151,206,177	$3,209,023,721	1.83%	$3,654,898,762	13.89%	$3,834,587,403	4.92%
Nursing Facilities	$2,709,358,490	$2,763,155,804	1.99%	$3,178,723,713	15.04%	$3,342,871,469	5.16%
ICF/MRs	$441,847,687	$445,867,917	0.91%	$476,175,049	6.80%	$491,715,934	3.26%
Hospitals	$1,948,373,488	$2,133,104,386	9.48%	$2,300,918,372	7.87%	$2,529,847,825	9.95%
Inpatient	$1,343,533,049	$1,454,973,773	8.29%	$1,534,604,584	5.47%	$1,680,925,658	9.53%
Outpatient	$604,840,439	$678,130,613	12.12%	$766,313,788	13.00%	$848,922,167	10.78%
Physicians	$597,405,355	$633,175,859	5.99%	$688,112,790	8.68%	$735,501,705	6.89%
Prescription Drugs	$1,795,101,223	$2,031,575,195	13.17%	$2,355,778,731	15.96%	$2,683,937,819	13.93%
HMO	$1,021,073,246	$1,089,212,524	6.67%	$1,208,792,969	10.98%	$1,279,628,281	5.86%
Medicare Buy-In	$161,514,543	$198,871,376	23.13%	$226,721,245	14.00%	$241,571,334	6.55%
Waiver	$198,082,600	$222,013,634	12.08%	$240,826,793	8.47%	$261,536,360	8.60%
All Other Care	$867,979,653	$959,543,820	10.55%	$1,110,159,784	15.70%	$1,212,272,728	9.20%
DA Medical	$81,661,526	$84,506,719	3.48%	$77,745,958	-8.00%	$83,095,453	6.88%
Total	**$9,822,397,811**	**$10,561,027,232**	**7.52%**	**$11,863,955,405**	**12.34%**	**$12,861,978,909**	**8.41%**
Other Revenue Offset	$909,500,595	$974,995,942		$1,234,010,311		$1,267,931,829	
525 Total Payment	**$8,912,897,216**	**$9,586,031,290**	**7.55%**	**$10,629,945,094**	**10.89%**	**$11,594,047,080**	**9.07%**
Federal Share	$5,206,914,554	$5,695,423,079		$6,337,278,360		$6,919,638,241	
State Share	$3,705,982,662	$3,890,608,211		$4,292,666,733		$4,674,408,839	

Note:
1. This table only includes health care spending through Department of Job and Family Services' 600-525 line item. It includes spending for Medicaid, CHIPI, CHIPII, and DA Medical.
2. The forecast is the LSC baseline forecast, which assumes no change in the state health care policies and program for the upcoming biennium.
3. "Other Revenue Offset" includes revenue from drug rebates, franchise fees, and DSH payments.
4. "All Other Care" includes services such as dental care, home health care, and other practitioners, and includes various contracts.
5. The FMAP rate used here is a blended FMAP.

Medicaid Caseload by Eligibility Group
Table 2

Fiscal Year	ABD&CFC Total mo. avg.	ABD&CFC Total % change	ABD: Total ABD mo. avg.	Total ABD % change	ABD (no QMB) mo. avg.	ABD (no QMB) % change	QMB mo. avg.	QMB % change	SLMB mo. avg.	SLMB % change
1991	**1,108,464**		**232,629**		228,955		3,674			
1992	**1,232,398**	**11.18%**	**255,971**	**10.03%**	246,369	7.61%	9,602	161.38%		
1993	**1,270,110**	**3.06%**	**280,162**	**9.45%**	263,676	7.02%	16,067	67.32%	420	
1994	**1,294,972**	**1.96%**	**313,240**	**11.81%**	286,655	8.71%	20,191	25.67%	6,395	
1995	**1,284,005**	**-0.85%**	**345,304**	**10.24%**	309,576	8.00%	22,773	12.79%	12,955	102.58%
1996	**1,228,262**	**-4.34%**	**366,783**	**6.22%**	321,978	4.01%	22,736	-0.16%	22,069	70.35%
1997	**1,166,169**	**-5.06%**	**370,047**	**0.89%**	323,023	0.32%	23,791	4.64%	23,233	5.27%
1998	**1,096,115**	**-6.01%**	**365,493**	**-1.23%**	315,884	-2.21%	23,683	-0.46%	25,925	11.59%
1999	**1,095,716**	**-0.04%**	**373,158**	**2.10%**	314,855	-0.33%	23,538	-0.61%	34,764	34.09%
2000	**1,109,217**	**1.23%**	**372,357**	**-0.21%**	318,720	1.23%	23,635	0.41%	30,002	-13.70%
2001	**1,278,082**	**15.22%**	**376,885**	**1.22%**	323,150	1.39%	22,451	-5.01%	31,284	4.28%
2002	**1,419,856**	**11.09%**	**383,846**	**1.85%**	327,427	1.32%	20,800	-7.35%	35,619	13.86%
2003	**1,551,530**	**9.27%**	**401,254**	**4.53%**	341,507	4.30%	22,146	6.47%	37,601	5.56%
2004	**1,640,637**	**5.74%**	**411,815**	**2.63%**	353,316	3.46%	22,728	2.63%	35,771	-4.87%
2005*	**1,720,848**	**4.89%**	**429,637**	**4.33%**	366,745	3.80%	24,080	5.95%	38,812	8.50%
2006*	**1,771,015**	**2.92%**	**447,639**	**4.19%**	383,218	4.49%	25,141	4.41%	39,280	1.21%
2007*	**1,750,318**	**-1.17%**	**461,108**	**3.01%**	396,274	3.41%	26,255	4.43%	38,580	-1.78%

Fiscal Year	CFC: Total CFC mo. avg.	Total CFC % change	Healthy Families mo. avg.	Healthy Families % change	Healthy Start mo. avg.	Healthy Start % change	CHIP I / HS Exp mo. avg.	CHIP I / HS Exp % change	CHIP II mo. avg.	CHIP II % change
1991	**875,835**		828,828		47,007					
1992	**976,427**	**11.49%**	894,261	7.89%	82,166	74.80%				
1993	**989,948**	**1.38%**	880,786	-1.51%	109,162	32.86%				
1994	**981,732**	**-0.83%**	858,069	-2.58%	123,663	13.28%				
1995	**938,701**	**-4.38%**	808,875	-5.73%	129,826	4.98%				
1996	**861,479**	**-8.23%**	721,950	-10.75%	139,529	7.47%				
1997	**796,122**	**-7.59%**	662,403	-8.25%	133,719	-4.16%				
1998	**730,623**	**-8.23%**	580,827	-12.32%	137,912	3.14%	11,884			
1999	**722,558**	**-1.10%**	500,840	-13.77%	169,078	22.60%	52,640	342.96%		
2000	**736,860**	**1.98%**	481,064	-3.95%	185,127	9.49%	70,655	34.22%	14	
2001	**901,197**	**22.30%**	655,907	36.34%	140,865	-23.91%	81,822	15.81%	22,604	
2002	**1,036,010**	**14.96%**	774,752	18.12%	130,898	-7.08%	91,897	12.31%	38,464	70.16%
2003	**1,150,276**	**11.03%**	859,968	11.00%	142,946	9.20%	102,322	11.34%	45,041	17.10%
2004	**1,228,822**	**6.83%**	922,937	7.32%	148,710	4.03%	108,682	6.22%	48,494	7.67%
2005*	**1,291,211**	**5.08%**	983,542	6.57%	147,766	-0.63%	109,715	0.95%	50,188	3.49%
2006*	**1,323,376**	**2.49%**	1,008,858	2.57%	149,789	1.37%	113,118	3.10%	51,611	2.84%
2007*	**1,289,209**	**-2.58%**	981,935	-2.67%	146,734	-2.04%	110,306	-2.49%	50,234	-2.67%

* LSC baseline estimates

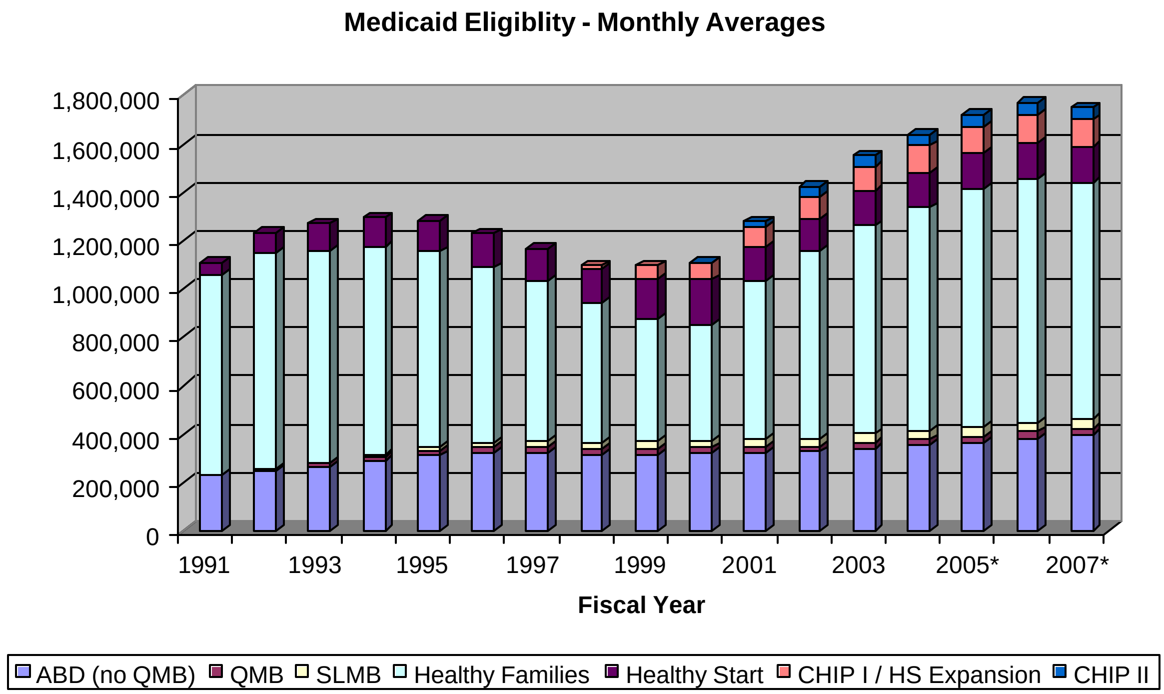
Covered Family and Children (CFC) Caseload: Fee-for-Service vs HMO
Table 3

	CFC							Healthy Families						
	Total		FFS		HMO		penetration	Total		FFS		HMO		penetration
SFY	mth avg	% change	mth avg	% change	mth avg	% change	(=HMO/TOT)	mth avg	% change	mth avg	% change	mth avg	% change	(=HMO/TOT)
1990	795,775		684,260		111,515		14.01%	779,937		668,752		111,185		14.26%
1991	875,835	10.06%	750,006	9.61%	125,829	12.84%	14.37%	828,828	6.27%	703,423	5.18%	125,406	12.79%	15.13%
1992	976,427	11.49%	842,914	12.39%	133,513	6.11%	13.67%	894,261	7.89%	761,156	8.21%	133,106	6.14%	14.88%
1993	989,948	1.38%	841,939	-0.12%	148,009	10.86%	14.95%	880,786	-1.51%	734,891	-3.45%	145,895	9.61%	16.56%
1994	981,732	-0.83%	812,600	-3.48%	169,133	14.27%	17.23%	858,069	-2.58%	694,186	-5.54%	163,883	12.33%	19.10%
1995	938,701	-4.38%	748,172	-7.93%	190,528	12.65%	20.30%	808,875	-5.73%	629,009	-9.39%	179,866	9.75%	22.24%
1996	861,479	-8.23%	607,327	-18.83%	254,153	33.39%	29.50%	721,950	-10.75%	488,206	-22.38%	233,744	29.95%	32.38%
1997	796,122	-7.59%	464,883	-23.45%	331,239	30.33%	41.61%	662,403	-8.25%	361,072	-26.04%	301,331	28.91%	45.49%
1998	730,623	-8.23%	399,575	-14.05%	331,048	-0.06%	45.31%	580,827	-12.32%	285,781	-20.85%	295,046	-2.09%	50.80%
1999	722,558	-1.10%	465,809	16.58%	256,750	-22.44%	35.53%	500,840	-13.77%	291,929	2.15%	208,911	-29.19%	41.71%
2000	736,860	1.98%	483,757	3.85%	253,103	-1.42%	34.35%	481,064	-3.95%	292,497	0.19%	188,568	-9.74%	39.20%
2001	901,197	22.30%	649,466	34.25%	251,731	-0.54%	27.93%	655,907	36.34%	455,704	55.80%	200,203	6.17%	30.52%
2002	1,036,010	14.96%	699,979	7.78%	336,031	33.49%	32.44%	774,752	18.12%	505,707	10.97%	269,044	34.39%	34.73%
2003	1,150,276	11.03%	745,030	6.44%	405,246	20.60%	35.23%	859,968	11.00%	540,374	6.86%	319,594	18.79%	37.16%
2004	1,228,822	6.83%	744,139	-0.12%	484,683	19.60%	39.44%	922,937	7.32%	540,920	0.10%	382,017	19.53%	41.39%
2005*	1,291,211	5.08%	765,266	2.84%	525,945	8.51%	40.73%	983,542	6.57%	566,582	4.74%	416,960	9.15%	42.39%
2006*	1,323,376	2.49%	774,715	1.23%	548,660	4.32%	41.46%	1,008,858	2.57%	576,322	1.72%	432,536	3.74%	42.87%
2007*	1,289,209	-2.58%	742,525	-4.16%	546,685	-0.36%	42.40%	981,935	-2.67%	554,817	-3.73%	427,117	-1.25%	43.50%

	Healthy Start							CHIP-I/HS						
	Total		FFS		HMO		penetration	Total		FFS		HMO		penetration
SFY	mth avg	% change	mth avg	% change	mth avg	% change	(=HMO/TOT)	mth avg	% change	mth avg	% change	mth avg	% change	(=HMO/TOT)
1990	15,837		15,508		330		2.08%							
1991	47,007		46,583	200.39%	423	28.39%	0.90%							
1992	82,166	74.80%	81,759	75.51%	407	-3.76%	0.50%							
1993	109,162	32.86%	107,048	30.93%	2,115	419.13%	1.94%							
1994	123,663	13.28%	118,414	10.62%	5,249	148.24%	4.24%							
1995	129,826	4.98%	119,164	0.63%	10,662	103.11%	8.21%							
1996	139,529	7.47%	119,121	-0.04%	20,408	91.41%	14.63%							
1997	133,719	-4.16%	103,811	-12.85%	29,908	46.55%	22.37%							
1998	137,912	3.14%	101,910	-1.83%	36,002	20.38%	26.11%	23,767		11,884				0.00%
1999	169,078	22.60%	130,114	27.68%	38,965	8.23%	23.05%	52,640	121.48%	43,766		8,874		16.86%
2000	185,127	9.49%	138,640	6.55%	46,486	19.30%	25.11%	70,655	34.22%	52,606	20.20%	18,049	103.39%	25.55%
2001	140,865	-23.91%	111,972	-19.24%	28,892	-37.85%	20.51%	81,822	15.81%	63,544	20.79%	18,279	1.27%	22.34%
2002	130,898	-7.08%	99,439	-11.19%	31,458	8.88%	24.03%	91,897	12.31%	67,297	5.91%	24,600	34.58%	26.77%
2003	142,946	9.20%	102,878	3.46%	40,068	27.37%	28.03%	102,322	11.34%	71,302	5.95%	31,019	26.09%	30.32%
2004	148,710	4.03%	100,908	-1.91%	47,802	19.30%	32.14%	108,682	6.22%	71,509	0.29%	37,173	19.84%	34.20%
2005*	147,766	-0.63%	98,361	-2.52%	49,405	3.35%	33.43%	109,715	0.95%	69,603	-2.67%	40,112	7.91%	36.56%
2006*	149,789	1.37%	97,596	-0.78%	52,193	5.64%	34.84%	113,118	3.10%	69,579	-0.03%	43,538	8.54%	38.49%
2007*	146,734	-2.04%	92,960	-4.75%	53,775	3.03%	36.65%	110,306	-2.49%	65,135	-6.39%	45,171	3.75%	40.95%

	CHIP II						
	Total		FFS		HMO		penetration
SFY	mth avg	% change	mth avg	% change	mth avg	% change	(=HMO/TOT)
1990							
1991							
1992							
1993							
1994							
1995							
1996							
1997							
1998							
1999							
2000			14				
2001	22,604		18,246		4,358		19.28%
2002	38,464	70.16%	27,535	50.91%	10,929	150.80%	28.41%
2003	45,041	17.10%	30,476	10.68%	14,565	33.27%	32.34%
2004	48,494	7.67%	30,802	1.07%	17,692	21.47%	36.48%
2005*	50,188	3.49%	30,962	0.52%	19,226	8.68%	38.31%
2006*	51,611	2.84%	31,218	0.83%	20,394	6.07%	39.51%
2007*	50,234	-2.67%	29,613	-5.14%	20,621	1.12%	41.05%

* LSC baseline estimates


Medicaid Eligiblity - Monthly Averages
1,800,000
1,600,000
1,400,000
1,200,000
1,000,000
800,000
600,000
400,000
200,000
0
1991
1993
1995
1997
1999
2001
2003
2005*
2007*
Fiscal Year
ABD (no QMB)
QMB
SLMB
Healthy Families
Healthy Start
CHIP I / HS Expansion
CHIP II

Temporary Assistance for Needy Families

Overview

The Temporary Assistance for Needy Families (TANF) program was created by the federal government in the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996. To accomplish the goals of TANF, Ohio developed and implemented two main programs that provide time limited cash assistance to needy families with children and also provide an array of services that furnish parents with work training and other supports to help them attain permanent self-sufficiency. Ohio's two main programs that are administered by the Department of Job and Family Services (JFS) are the Ohio Works First (OWF) program and the Prevention, Retention, and Contingency (PRC) program. In addition, Ohio also operates some specific programs in which TANF-eligible individuals receive services (TANF funds may fully or partially fund these programs). These include the Head Start program in the Department of Education, the TANF Family Planning program in the Department of Health, the AdoptOhio program in the Department of Job and Family Services, and the Substance Abuse, Treatment and Mentoring program in the Department of Alcohol and Drug Addiction Services.

The purposes of the program as it now exists are to:

- Provide assistance to needy families so that children may be cared for in their own home or in the homes of relatives.
- End the dependence of needy parents on government benefits by promoting job preparation, work, and marriage.
- Prevent and reduce the incidence of out-of-wedlock pregnancies and establish annual numerical goals for preventing and reducing the incidence of these pregnancies.
- Encourage the formation and maintenance of two-parent families.

TANF was extended in its current form on September 30, 2004, its eighth extension since it was originally set to expire in 2002. Whether there will be programmatic changes in its next scheduled appearance before Congress in March 2005 is unclear, however, several proposals have garnered support from both the President and the Congress, making some alterations in the current TANF program more likely. Possible modifications to the legislation include: raising work participation requirements to 40 hours a week, increased child care funding with or without state match requirements, and stagnant TANF block grant levels. Previous reauthorization attempts have increased the work participation requirement to 40 hours a week, from a current 20-hour-a-week requirement.

TANF

The PRWORA eliminated the Aid to Families with Dependent Children program (or AFDC; in Ohio this was called Aid to Dependent Children or ADC), the Job Opportunity and Basic Skills (JOBS) program, and the Family Emergency Assistance (FEA) program. Congress replaced these programs with the TANF program. Prior to TANF, under the AFDC program, the federal government provided states with open-ended matching funds for cash welfare payments to all families who qualified. Cash benefits were an "entitlement" and had no time limit. Under an entitlement, qualified recipients have a "right" to receive benefits and appropriations must be provided in case of a shortfall. In the old AFDC program the federal government reimbursed states for welfare spending between 50% and 80% — depending on per capita income. In Ohio this reimbursement averaged approximately 60% over the decade prior to PRWORA.

The focus of public assistance has now shifted from "entitlement" to temporary assistance that encourages self-sufficiency by requiring recipients to work or participate in a developmental activity. PRWORA established a five-year maximum lifetime limit on a family's receipt of federally funded cash benefits. The TANF program requires that states impose stricter work requirements on recipients than under AFDC, and eliminated all but a few of the exemptions from participation in work for adult welfare recipients. The PRWORA prescribes little in the way of eligibility requirements, while being very prescriptive in the amount of work activity required of adult TANF recipients. Exercising the flexibility that PRWORA allows, OWF further limits receipt of cash benefits to three years, with a possible hardship extension of two years, if a minimum of two years has passed since the last receipt of benefits.

Ohio's annual TANF block grant award of approximately $728 million is based on the amount of federal funds expended in federal fiscal year (FFY) 1994 for the three eliminated programs (AFDC, JOBS, and FEA). Ohio is required to meet a minimum maintenance of effort (MOE) requirement of 80% of what it spent in FFY 1994 on the three eliminated programs (80% of that amount is approximately $417 million). The MOE can be lowered to 75% ($390.8 million) if the state meets its participation requirement. Ohio currently meets the participation rate requirements. If the state fails to meet the MOE, its TANF grant for the next federal fiscal year will be reduced by the amount of the deficit, and the state will be required to increase its TANF spending by an amount equal to the penalty.

One of the consequences of the block grant funding arrangement is that reductions in recipient case loads reduce the amount of "baseline" cash benefits, thus leaving more funds available for other TANF related program services or activities. If TANF grant funds go unspent in a particular year, the PRWORA legislation provides that "a State may reserve amounts paid to the State under [this legislation] for any fiscal year for the purpose of providing, without fiscal year limitation, assistance under the State program funded under [this legislation].'[21] At the end of FFY 2004 (September 30, 2004), Ohio's TANF balance was $836.1 million, with $505.2 million reported as unliquidated obligations, and $330.9 million as the unobligated balance. These figures do not include funds that have been transferred to the Social Services Block Grant and the Child Care Development Fund, but which had not yet been spent as of that date. The unspent balance is held at the federal level and is available to be spent on cash benefits or on other services or activities during the period in which the funds may be obligated.

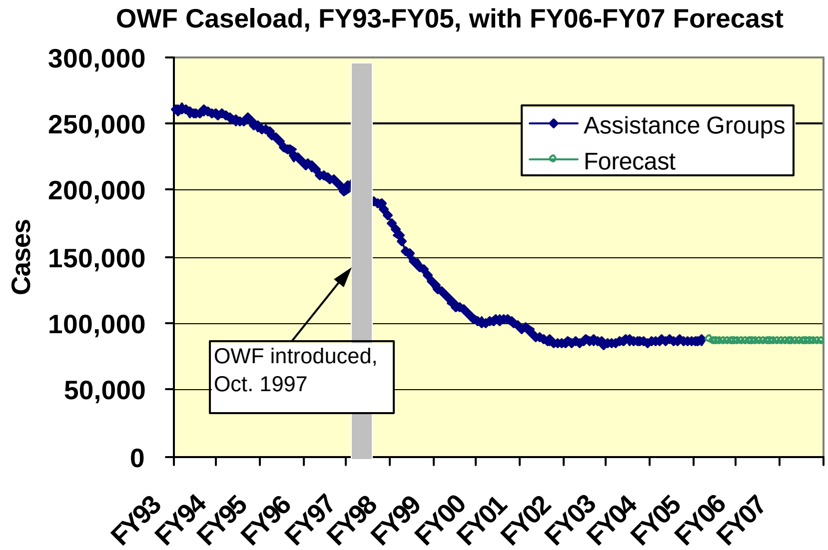
Another significant aspect of Ohio's welfare reform is that it "devolved" significant authority to counties to implement their own program of services without Ohio Administrative Code rules, but within the parameters of all applicable state and federal laws and regulations. Under Ohio's state-supervised/county-administered system, counties can design their own services in human service functions, including TANF, PRC, day care, transportation services for low-income workers, child support, children services, and employment and training activities. Until recent months, each county was also given various options to consolidate their funding, or maintain as separate the different allocation streams from the federal government. Am. Sub. H.B. 215 of the 122nd General Assembly granted the Department of Job and Family Services (then the Department of Human Services) the authority to make a "consolidated" funding option available to the counties that would combine 11 different funding streams into a single allocation that could be used for any of the purposes authorized by the 11 funding sources. Counties could spend on services as needed without regard of the origin of the funds so long as they stayed within their total allocation. Under this system, the Department of Job and Family Services would reconcile the county spending each year. All 88 counties opted for the full consolidation of their funding.

However, the consolidated allocation has been discontinued due to the announcement last year that the Department of Job and Family Services had not actually been performing a thorough reconciliation of the separate funding streams, but only a reconciliation of the consolidated payment system as a whole to balance expenditures by counties that exceeded their allocation with those that had not. The failure to develop a system that would reconcile the different funding streams resulted in TANF funds being spent from SFY 2000 through the first months of SFY 2005 for administrative costs in the Medicaid and Food Stamps programs, when state funds should have been used instead. Estimates of the funds needed to repay the TANF block grant ranged up to $280 million. The Department began to correct the structural deficiencies of the consolidated allocation system by replacing it with a new system termed Public Assistance Fund Linkages that retains some flexibility for counties but also limits the

[21] H.R. 3734, Personal Responsibility and Work Opportunity Reconciliation Act of 1996, sec. 404 (e).

funds to more narrowly defined sets of purposes. Reimbursement of the TANF allocation has begun with transfers proposed by the Department and approved by the Controlling Board. The capital bill included additional provisions for a funding mechanism to continue the process of compensating for misallocated funds. LSC expects that further corrective steps will be proposed in the budget bill.

TANF/OWF Forecast



As the chart detailing the trend in the OWF combined caseload indicates, the number of OWF (formerly ADC) cases has been in a long-term decline as Ohio and the nation recovered from the recession of the early 1990s. The rate of decline was strong prior to the implementation of OWF, but the rate of decline clearly accelerated around the time of the introduction of OWF.

Several important demographic changes also developed in conjunction with the decline in the overall caseload. One of the most significant developments in the changing demographics of TANF recipients in Ohio is the increase in the number of "child only" cases. These cases occur when adults in the household are ineligible for TANF benefits or they are recipients in other programs such as supplemental security income (SSI). Data indicates that in Ohio the relationship of nonrecipient adults in the households where "child only" cases occur is most often that of the catch-all category of "other relative," followed by grandparent, natural or foster parent, sibling, nonrelatives, and step parents.[22] Such cases are exempt from time limits and work requirements. The number

[22] U.S. Department of Health and Human Services, Administration for Children and Families, Office of Planning, Research and Evaluation, "Characteristics and Financial Circumstances of AFDC Recipients" FY 1996, Table 33.

of "child only" cases in December 2004 was 47.4% of the total caseload. Because the children in these cases remain eligible until age 18 and they are not subject to adult participation requirements, they form a stable core of the OWF caseload.

Another significant development in recent years is the return of previously time-limited adults to TANF cash assistance after the initial expiration of their 36-month time limit eligibility. An extension of benefits for hardship can occur anytime after the expiration. An extension for good cause can be offered only after a 24-month waiting period. In the last two years, since the first cases eligible for good cause extensions, there has been an increase of almost 50% in the number of adults receiving cash assistance after 36 months. January 2004 data show approximately 3,000 adults receiving cash assistance after 36 months. A continued increase in the number of cases making their way back onto assistance due to hardship or good cause could signal a bump in the number of cases funded by OWF. Each county determines criteria for which cases are eligible for hardship or good cause extensions.

LSC expects the total number of TANF cases (or assistance groups) to decrease in FY 2006 to an average of 86,514 monthly cases from a FY 2005 average of 86,919. Assuming current benefit levels do not change, the decline in the total number of TANF cases will result in approximately $2.3 million less being spent on TANF cash benefits in FY 2006 than LSC estimates for FY 2005 expenditures. The total spending on cash benefits is forecast to be $315.0 million for FY 2006.

The decline in the number of TANF cases is expected to continue into FY 2007. The monthly average of cases is expected to decline to 86,162, representing a decrease in spending for TANF cash benefits of $3.5 million for the year. That estimate brings total spending for cash benefits, assuming current eligibility and benefit levels, to $311.5 million for FY 2007.

TANF/OWF - LSC Baseline Estimates

	FY 2005	FY 2006	FY 2007
Average monthly cases	86,919	86,514	86,162
Total cash benefits (millions)	$317.3	$315.0	$311.5

The TANF cash benefits are paid from line items 600-410, TANF State; 600-658, Child Support Collections; and 600-689, TANF Block Grant. The Executive has recommended FY 2006 total funding for the combination of these three line items at $1,055.9 million. The total recommended funding level for these three line items in FY 2007 is $1,081.3 million.[23]

[23] Funds from administrative line items and county expenditures will be included in the state's MOE each year. The Executive has also recommended earmarks from the TANF Block

Funding cash benefits for FY 2006 at the forecast level of $315.0 million, and at $311.5 million for FY 2007 leaves $740.9 million in FY 2006 and $769.8 million in FY 2007 from these three line items for employment services, work activities, PRC services, transitional services, direct payments from TANF federal funds for child day care (in addition to receiving funds directly from the TANF federal block grant, child care receives funding from other sources), and other allowable activities.

Methodology

The forecast of TANF Assistance Groups was based on a regression of the TANF caseload against Ohio employment numbers in the manufacturing industry and in a selection of key service sector industries as its primary independent variables, together with a dummy variable used to indicate the initiation of welfare reform. This model, therefore, uses past data trends in the economy and recognizes the interaction of policy changes with the recipient count.

The TANF forecast is based on forecasts of the explanatory factors, manufacturing and service sector employment, under the assumption that the historical relationships in the model will continue into the future. Guided by economic forecasts, notably by Global Insight, LSC assumes no growth in Ohio's manufacturing sector employment over the coming biennium and only a slight expansion in service sector employment that will facilitate the employment of some TANF clients.

The total cash benefits for a fiscal year are based on the historical trend of the average cost per recipient over the last three biennia, projecting this model into the future, then multiplying the forecast cost per assistance group each month by the forecast of TANF assistance groups. This forecast assumes the continuation of current eligibility requirements and benefit levels.

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Grant (Fund 3V6) of up to $97,380,000 in FY 2006 and $116,256,000 in FY 2007 for the Early Learning Initiative.