LBO Testimony

Forecast of Revenues and Public Assistance

Before The Conference Committees

On H.B. 282 and H.B. 283

Biennial Budgets

Dennis Morgan, Legislative Budget Officer ***June 15, 1999***

Members of the Conference Committees on H.B. 282 and H.B. 283, I am here today to present the Legislative Budget Office's (LBO) updated forecasts for the FY 2000-2001 biennium. This includes revenues, including lottery profits, as well as our forecasts for the Medicaid, Temporary Assistance for Needy Families (TANF), and the Disability Assistance (DA) program.

Our forecasts project higher resources (the net of higher revenues, lower lottery profits, and additional Human Services spending) for the forecast period of:

FY 2000	$ 221.0 million
FY 2001	$ 126.8 million forescast Lottery Profits

Before we begin to look at the detail supporting these numbers, as well as our forecast of human service caseload numbers, I would like to briefly discuss a number of issues that I feel the committee should keep in mind as it considers FY 2000-2001 biennium.

The Economy

As I have stated in nearly every testimony I have given, any consideration of the state's revenue forecast must begin with a discussion of the national economy. And as I've have said twice earlier this year, the watchwords for the economy and our forecast have to be uncertainty and caution.

By nearly any measure the U.S. economy is strong and is almost certain to set the longevity record for economic expansions. There are no immediate weaknesses that forecasters can point to, although there are obvious concerns about the limits of worker availability and possible wage inflation. At the same time, this expansion has defied the rules of economics, at least as they have been generally defined over the last fifty years.

This uncertainty is captured quite well in Alan Greenspan's comments from early last month. In discussing whether or not this economy constituted a new era in economics, he stated "We are far more likely, instead, to be experiencing a structural shift similar to those that have visited our economy from time to time in the past. These shifts can have profound effects, often overriding conventional economic patterns for a number of years, before those patterns begin to show through again over the longer term."

Greenspan went on to state that there was "compelling, if not conclusive" evidence that a significant contributor to the length of this expansion has been improvements in labor productivity by technological innovations. He went on to quote various industry securities analysts who project increasingly higher five-year earnings growth and no decrease in expectations for productivity acceleration.

He said also that demand for workers has exceeded population growth since the mid 1990s, and that "We cannot judge with precision how far this level can decline without sparking upward pressures on wages and prices. Accelerating productivity may have appeared to break the link between labor market conditions and wage gains in recent years, but it cannot have changed the law of supply and demand."

Greenspan further added, should productivity growth "level out or actually falter because additional technology synergies fail to materialize, or because output per hour has been less tied to technology in the first place, inflationary pressures could reemerge, possibly faster than some currently perceive feasible..… History counsels us that sharp changes in direction are rarely, if ever anticipated."

Y2K

I won't repeat all my concerns about the Y2K issue that I discussed in my earlier testimony, but I believe a note of caution is still in order. As the Gartner Group has stated, "much of the world's technology will experience some level of failure." What is not known, and is probably not knowable, is what the consequences will be.

Certain trends are clear. The more industrialized nations are more prepared than emerging countries. The larger the industry or company, the more likely they are to be prepared. The federal government's remediation efforts are far ahead of local governments. Within sectors, the financial services industry seems to be more prepared than others. Lagging sectors include farming, construction, medical and law practices, and the retail and hospitality sectors.

Both Gartner and Wharton Econometrics cite supply chain problems as a significant Y2K related issue of concern to their analysts. Gartner has evaluated countries by the distribution and the severity of potential Y2K failures. For Category 1 countries, like the United States, Canada, and the United Kingdom, they evaluate the risks to imports and exports as isolated and severe.

Again, the consequences of all this are unclear. But it does add another element of uncertainty to the economy and to our forecast. Remember also that the event horizon for Y2K extends through the year 2001.

Congressional Actions

A number of years ago, the U.S. Congress passed the Budget Enforcement Act (BEA) in an effort to repair the federal budget process. The BEA put separate caps on domestic and military spending and put in place a process, whereby all non-emergency spending that exceeded the caps had to be offset by reductions in other spending programs or increased taxes

In the proposed federal budget, the wall between the caps on domestic and military spending disappear. So the appropriations for the two areas will compete against each other. For example, spending for military pay raises could be offset by reductions in domestic spending.

As you have seen in the news in the recent weeks, Congress has been unable to act on the 13 appropriations bill because proposed spending would significantly exceed these budget caps. The President's budget proposed a significant increase in spending and offset that with proposed additional revenues, much of it from additional cigarette taxes. Congress in unlikely to act on this proposal. At the same time, staying under the caps will require significant cuts in domestic programs or defense spending. Again leading to Congressional deadlock.

Many people have suggested that Congress may bypass these caps by declaring many of their proposals "emergency" spending. However, there has been significant Congressional backlash from the so-called "emergency" spending that took place in the last Congress, so it's not at all clear how this deadlock will be resolved. As we monitor the actions of Congress we are going to have to watch closely the impact on domestic spending and state "administrative" monies (Medicaid) and money on reserve (TANF) at the federal level, as these are likely to be seen as possible offsets to other spending desired by Congress.

Revenues

The only significant difference we have in our revenue forecast is in the Personal Income tax. From our original estimate at the beginning of the budget process, we estimate additional income tax revenues of $261 million for FY 2000 and $191 million for FY 2001. This represents a significant dollar difference compared to the executive's forecast. However, when you look at the percentage growth assumed by this forecast, we believe the estimate is realistic. This forecast is based on assumed growth of 6.1% in FY 2000 and 5.6% growth in FY 2001.

Somewhat offsetting the higher growth in revenues is our estimates of lower lottery profits. We estimate profits $25 million lower the first year and $59 million lower the second year than now used in the budget.

Human Services

Our Human Services' baseline forecasts have been modified from our original baseline forecasts, and reflect an increase in state GRF of $22.52 million across the biennium. We estimate the need for additional spending in Medicaid of $8.32 million (state GRF) for the biennium. This is a result of additional inpatient and waiver expenditures. We have adjusted our Disability Assistance numbers due to drug costs and this increases spending by $4.72 million in FY 2000 and $9.48 million FY 2001. TANF baseline forecasts for the biennium call for $680.1 million for cash assistance as compared to a March baseline forecast of $713.5 million.

Summary

To summarize, we forecast an additional $347.8 million is available to the conference committee over our original forecast and the spending levels in the Senate passed version of H.B. 283.