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Forecast of GRF Revenues and Public Assistance Expenditures For the FY 2010-FY 2011 Biennial Budget

Testimony before the Conference Committee on House Bill 1

June 11, 2009

Mr. Chairman and members of the Conference Committee, I am Mark Flanders, Director of the Legislative Service Commission (LSC). I am here today to present testimony on LSC's forecasts for fiscal years (FYs) 2009, 2010, and 2011. The information in the accompanying LSC forecast book includes an overview of the economy and an outlook on future economic performance, forecasts of General Revenue Fund (GRF) revenues, and forecasts of expenditures in the Medicaid and Ohio Works First programs. The forecasts for the next biennium are baseline forecasts, meaning that they include no changes to current law.

Summary

Revenues

GRF revenues in April and May were below estimates by substantial amounts, and Global Insight, the economic forecasting service on which LSC's February forecast relied, has revised downward its forecast of key economic variables for the upcoming biennium. After considering these factors, LSC is now projecting much lower revenue for the current fiscal year and for the biennium than we forecast in February. Specifically, we now expect GRF tax revenue during FY 2009 to be $17.20 billion, which is $661 million below our February forecast. The differences between LSC's current forecasts of GRF tax receipts and LSC's February forecasts are presented in the table below. The differences in this testimony are presented as the current forecast minus the February one, so a negative number corresponds to a revision downward in the forecast.

FY 2009	- $661.0 million	-3.7%
FY 2010	- $1,116.1 million	-6.6%
FY 2011	- $1,336.4 million	-7.6%

For the upcoming biennium, the total downward revision in GRF tax revenue is $2.45 billion. In addition to tax revenue, LSC forecasts GRF earnings on investments and revenue from licenses and fees. Revenue from these sources is now forecast to be less than February's forecast by $132 million for the biennium. So the total downward revision in GRF revenue for the next biennium is about $2.6 billion.

Medicaid

The revised forecast for Medicaid spending is $17.2 million (state share) higher in FY 2010 and $19.4 million (state share) higher in FY 2011. The revised forecast of the Medicaid caseload is about 27,000 individuals higher in FY 2010 and 57,000 higher in FY 2011. LSC forecasts additional Covered Families and Children (CFC) caseload of about 30,000 individuals in FY 2010 and 60,000 in FY 2011. The revised forecast for the Aged, Blind, and Disabled (ABD) caseload is about 3,000 lower in each fiscal year. Revisions in the CFC caseload forecast are generally attributable to an increase in the forecast of the number of unemployed Ohioans and the fact that the actual CFC caseload for recent months has tracked above the February forecast. On the other hand, the actual ABD caseload for recent months has tracked below the February forecast.

Ohio Works First

The revised forecast for the Ohio Works First (OWF) cash assistance program is $9.6 million higher in FY 2010 and $7.5 million higher in FY 2011 than the February forecast. The revised OWF assistance group caseload forecast is 3,400 additional cases per month in FY 2010 and 5,400 additional cases per month in FY 2011 compared with the February forecast. The revised caseload forecast is based on the inclusion of actual caseload data for the months of January through April as well as the expectation of a greater number of unemployed Ohioans.

The accompanying forecast book provides much greater detail about the LSC forecasts, and about the economy. In the remainder of this testimony, I will focus on the highlights regarding these topics.

The Economy

The U.S. economy has been in recession since December 2007. This recession is almost certain to be both the longest and the deepest since World War II. Since the recession began, Ohio's unemployment rate has increased from 5.8% to 10.2%, representing an increase of 263,000 in the number of workers who are unemployed. These numbers have gotten worse since my testimony before the House Finance and Appropriations Committee; at that time the most recently available report showed that Ohio's unemployment rate was 7.8%.

As the economic downturn accelerated in the fall, revenue to the state from the major tax sources began to decline on a year-over-year basis. In recent months, the year-over-year decline in revenue from the income tax has exceeded the reduction in tax rates that was implemented by H.B. 66 of the 126th General Assembly. In April, income tax revenue came in $623 million below the level of April 2008, a very large monthly shortfall. We will not know for certain the details regarding why that shortfall was so large for about two years, due to a time lag in publication of data from tax returns. However, we think the primary reason is a sharp fall in capital gains realizations, due to the substantial declines in financial markets during 2008. Revenues in May also performed poorly, mainly because the payrolls of Ohio employers, and thus income tax withholding, are shrinking notably.

A number of experts, including Chairman Bernanke of the Federal Reserve, have pointed to signs of impending economic recovery for the nation as a whole. Many commentators are expecting the national recovery to begin in the second half of 2009. Global Insight is in that group, expecting production to begin growing again in the third quarter. History suggests, though, that labor markets and Ohio's economy will take longer to begin to recover than national production. As I testified in February and in April, it cannot be known exactly when the recession will end, and how fast Ohio's economy will recover from it. Assumptions about the severity of the economic downturn and the timing of the recovery can make very significant differences in forecasts of revenues.

Concerning those assumptions, the economic forecast upon which we base today's testimony is significantly more pessimistic than that used earlier this year. Ohio's economy may not begin to recover until a year from now, and unemployment could peak above 12% during 2010. As I mentioned earlier, the forecast book includes much more detail about the economic forecast.

As in February, we are hoping that this forecast is overly pessimistic, and believe that it could be. There are a number of signs that expansionary fiscal and monetary policies are having their intended effects. Similarly, various signs point to a reduction in stress in the financial sector, meaning that the risk of a substantial reduction in credit availability may have receded since February.

But there remain very serious risks to the economy, so it is possible that the economic forecast used is too optimistic. We now know that both General Motors and Chrysler have entered bankruptcy. So far, that process appears to be moving smoothly, and data on May car sales indicate that consumers continue to purchase vehicles made by both companies. But significant uncertainty remains about the outcome of this process. The Center for Automotive Research published an analysis of the effects on the economy if the bankruptcies go smoothly and if significant obstacles arise during the process. They predict the job loss in Ohio related to the two bankruptcies could be as low as 6,000, or as high as 161,000 in CY 2009. The numbers reflect job losses not just at the two companies involved, but at many suppliers of the industry and at other firms dependent on the industry. Moreover, some economists believe that we are facing a second wave of borrower defaults that may destabilize financial markets again. While stock prices for a number of banks, and the recent announcement that some major banks are ready to repay government loans received in the fall, appear to argue against that view, it is still a possibility on the economic horizon.

We are facing great economic uncertainty at this time. LSC economists continue to think that the current level of uncertainty is greater than we have faced for many budgets.

Revenue Forecasts

For FY 2009, LSC estimates total GRF tax revenue to be $17.20 billion, after distributions to the local government funds. This is $661.0 million (3.7%) less than the February estimate. The shortfall is due primarily to a revision downward in personal income tax receipts by $546.6 million. Other notable downward revisions include the sales and use tax (by $122.6 million) and the domestic and foreign insurance taxes ($41.0 million in total). All of these revisions are due primarily to the revenue shortfalls since February.

For FY 2010, LSC forecasts total GRF tax revenue to decline to $15.81 billion, a $1.39 billion (8.1%) decrease from FY 2009, and $1.12 billion (6.6%) less than the February forecast. The downward revision in the forecast is due primarily to the income tax ($667.8 million) and the sales and use tax ($342.4 million). Revisions to these taxes are attributable both to the actual revenue weakness since February, and the shift in the underlying economic forecast. LSC forecasts a continuing decline in receipts from the cigarette tax, now the third-largest source of GRF tax revenue. The revision downward in forecast receipts from this tax is $52.8 million, due largely to including the effects on cigarette consumption of a federal tax increase that took effect April 1. The domestic and foreign insurance taxes are revised downward by a combined $47 million, due primarily to revenue shortfalls during FY 2009. Other changes to the forecast are relatively small.

For FY 2011, LSC forecasts total GRF tax revenue to be $16.22 billion, a $402.9 million (2.5%) increase from FY 2010, and a $1.34 billion (7.6%) revision downward since February. The revision downward is due primarily to the income tax ($782.1 million) and the sales and use tax ($457.4 million). Smaller revisions were made to the cigarette tax ($47.0 million) and the insurance taxes ($51 million). Revenue growth is forecast from FY 2010 to FY 2011 in both the personal income tax (by 4.0%) and the sales and use tax (2.1%). Stronger growth in these revenues is expected to more than offset the continued decline in collections of taxes on cigarettes and other tobacco products.

For the FY 2010-FY 2011 biennium, LSC forecasts total GRF tax revenue to be $32.03 billion, a decrease of $4.6 billion (12.6%) from the FY 2008-FY 2009 biennium.

Mr. Chairman and members of the Committee, thank you for the opportunity to present the LSC forecasts. My staff and I would be happy to answer any questions that you might have.

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