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Forecast of GRF Revenues and Medicaid Expenditures for the FY 2012-FY 2013 Biennial Budget

Testimony before the House Finance and Appropriations Committee

March 16, 2011

Chairman Amstutz and members of the House Finance and Appropriations Committee, I am Mark Flanders, Director of the Legislative Service Commission (LSC). I am here to testify on LSC's forecasts for General Revenue Fund (GRF) revenues and Medicaid expenditures in fiscal years 2011 through 2013. The information in the accompanying LSC forecast book includes an overview and forecast for the economy, forecasts of GRF revenues, and forecasts of expenditures in the Medicaid Program. These are baseline forecasts, LSC's predictions for revenues and expenditures if current law were to remain unchanged throughout the next biennium.

Summary – Comparison of LSC and Executive Budget Baseline Forecasts

LSC forecasts somewhat higher baseline GRF revenues for the biennium than are forecast for the executive budget. The forecast is higher in both of the fiscal years.

The differences between LSC's forecasts of total GRF receipts and those in the executive budget are summarized in the table below. The differences in this testimony are presented as LSC's forecast minus the executive's, so a negative number corresponds to LSC forecasting lower revenue. LSC's forecast for the biennium is \$164.5 million greater than OBM's. Four tables that are attached to this testimony provide more detailed forecast comparisons for fiscal years 2011 through 2013 and for the FY 2012-FY 2013 biennium as a whole.

FY 2011	-\$147.4 million	-0.5%
FY 2012	\$22.8 million	0.1%
FY 2013	\$141.7 million	0.5%

LSC forecasts baseline Medicaid expenditures to be lower for FY 2011, FY 2012, and FY 2013 than are forecast in the executive budget. The differences between LSC's

forecasts of Medicaid expenditures and those in the executive budget are summarized in the table below.

FY 2011	-\$62.1 million (-\$18.6 million state share)	-0.45%
FY 2012	-\$65.8 million (-\$23.9 million state share)	-0.44%
FY 2013	-\$195.6 million (-\$70.3 million state share)	-1.24%

Tax revenues and Medicaid expenditures are dependent in part on developments in the economy. In the rest of my testimony, I will focus on these topics, starting with the economy.

The Economy

Recovery in the nation's economy has been underway since mid-year 2009. Estimates of economic growth in Ohio also show the recovery beginning in the second half of 2009. But growth has been slow for the nation, and even slower in Ohio, leaving large numbers of people still unemployed. The recession of 2007 to 2009 was the longest and deepest recession of the post-World War II period. In Ohio, 418,000 (7.7%) jobs were lost between December 2007 and December 2009, and the unemployment rate rose to a peak of 10.6% in 2009 and early 2010. As of January, Ohio had gained back 63,000 (1.3%) jobs from the December 2009 low, and the statewide average unemployment rate had declined to 9.4%.

When I testified before this Committee two years ago, the economy was still in recession, and considerable uncertainty existed regarding when the recession would end and how deep it would ultimately be. Venerable, previously solid financial institutions had gone out of business, been absorbed by other financial institutions, or become de facto wards of the federal government. Each month brought hundreds of thousands of additional layoffs. The General Motors and Chrysler bankruptcies still lay ahead.

Today, in contrast, the U.S. and Ohio economies are growing. Further expansion is widely thought to lie ahead. Financial markets are functioning in a more normal manner. Economies abroad are growing as well, providing markets for American and Ohio exports. The exceptional degree of uncertainty regarding the economic outlook that prevailed two years ago appears to have eased.

Having said this, I would note also that economic forecasts are inevitably subject to some degree of uncertainty. Unanticipated shocks could derail the recovery. The mounting instability in the Middle East, which has pushed the price of crude oil to levels not seen since September 2008, could potentially result in weaker growth or a renewed downturn, if conditions deteriorate sufficiently. Other adverse developments, not currently foreseen, could undermine the economic outlook. Alternatively, the

baseline forecast could prove too conservative regarding economic growth in the nation and Ohio.

In developing a GRF revenue forecast, LSC economists have relied on the economic forecasting firm Global Insight for the economic predictions that underlie those revenue forecasts. Specifically, we have used Global Insight's February baseline forecasts for the nation and Ohio as the sources for input or explanatory variables in the models.

As is detailed in the accompanying forecast materials, this forecast shows national inflation-adjusted gross domestic product, the broadest measure of economic activity, growing at about a 3.1% annual rate on average in the three years through the end of 2013. Ohio's economy also continues to grow over this period, but not as rapidly as the U.S. These growth rates are strong enough to bring down unemployment, but only slowly. By the end of 2013, the average unemployment rate nationwide falls to 7.6%. Ohio's statewide average unemployment rate falls to 8.3% by the fourth quarter of 2013.

Revenue Forecasts

The LSC baseline forecasts for FY 2012 and FY 2013 assume the current Revised Code tax structure. Among the notable implications of that is that the reduction in income tax rates that is scheduled to take effect for tax year 2011 is assumed to be implemented, affecting FY 2012 receipts. As you may recall, this is the reduction in tax rates originally enacted by H.B. 66 of the 126th General Assembly that was subsequently delayed by H.B. 318 of the 128th General Assembly. Also, the GRF is assumed to begin to receive a share of the commercial activity tax (CAT): 5.3% of the revenue in FY 2012 and 10.6% in FY 2013. Finally, the share of GRF tax receipts transferred to the Public Library Fund (PLF) is assumed to revert to 2.22%, from the 1.97% share it received during the current biennium due to a temporary law provision of H.B. 1 of the 128th General Assembly.

For FY 2011, LSC estimates total GRF tax revenue to be \$17.24 billion, after distributions to the local government funds. This is \$503 million more than the September 2010 estimate by the Office of Budget and Management (OBM). LSC estimates that this expected positive variance in revenues will be partially offset by shortfalls in earnings on investments, which combined with revenues from license fees are estimated to be \$72 million below the September OBM estimate.

For FY 2012, LSC forecasts total GRF tax revenue to be \$17.84 billion, a \$606 million (3.5%) increase from FY 2011. Economic growth forecast by Global Insight is expected to lead to moderate growth in most tax sources. Income tax revenue is forecast to grow by 3.8% due to improved labor markets, proprietors' income, and income from investments, but the growth is restrained due to the assumed reduction in

tax rates. Revenue is expected to decline from the cigarette tax, due to the continuation of a long-term trend. And revenue from the kilowatt hour tax is also expected to decline, though this is due to the fact that growing allocations to the PLF are debited in part against this tax.

For FY 2013, LSC forecasts total GRF tax revenue to increase to \$18.83 billion. While this represents growth of \$985 million (5.5%) from FY 2012, it is worth noting that this is still about \$592 million less than tax revenue received in FY 2008. Revenue growth is forecast to continue for most taxes, again with the exception of the cigarette tax.

Tax revenue for the biennium is forecast to be \$36.67 billion. That is approximately \$3.20 billion greater than tax revenue during the current biennium.

Medicaid Expenditure Forecast

Medicaid services are an "entitlement" for individuals who meet eligibility requirements. This means that if eligible for Medicaid, the individual is guaranteed the benefits and the state is obligated to pay for them. It is for this reason that the executive and LSC forecast Medicaid expenditures.

With the exception of rate increases for certain primary care physician services in 2013 required in the recent federal health care reform, the LSC baseline forecast assumes no new changes in Medicaid policy for the upcoming biennium. All Medicaid figures that I am about to present are "all funds," also referred to as combined state and federal dollars.

For FY 2011, LSC estimates the total number of individuals who will be eligible for Medicaid to be 2.17 million, a 6.7% increase over FY 2010. For FY 2011, Medicaid expenditures are projected to be \$13.9 billion.

For FY 2012, LSC forecasts the Medicaid caseload will grow by 78,756 to 2.25 million, a 3.6% increase over FY 2011. For FY 2012, Medicaid expenditures are estimated to be \$14.9 billion, a \$1.0 billion (7.3%) increase from FY 2011.

For FY 2013, LSC forecasts the Medicaid caseload will increase by 28,072 to 2.28 million, a 1.3% increase over FY 2012. For FY 2013, Medicaid expenditures are projected to be \$15.8 billion, a \$935 million (6.3%) increase from FY 2012.

Historically, caseloads continue to rise as the economy recovers from a recession. In addition, factors such as poor labor market conditions, recent policies designed to increase enrollment and retention, and new programs and eligibility expansions implemented during the last few fiscal years all contribute to the expected increase in the Medicaid caseload in the upcoming biennium.

The increases in Medicaid expenditures are being driven primarily by the caseload growth and increases in monthly per member costs; however, there are some

specific factors impacting particular expenditure categories. For example, managed care expenditures are forecast to increase by \$486 million in FY 2012 and by \$423 million in FY 2013. These increases are due to a combination of growth in the caseload and growth in the managed care capitation rates. Milliman, the state's contracted actuary, projects that the managed care capitation rates will grow annually by 6.4% for the Aged, Blind, and Disabled population and by 5.7% for Covered Families and Children for calendar years 2012 and 2013.

Expenditures for Intermediate Care Facilities for the Mentally Retarded (ICFs/MR) are expected to increase by \$86 million in FY 2012. Most of this increase is attributable to a fiscal management decision to push one payment to ICFs/MR from the end of FY 2011 to FY 2012.

Expenditures in the Prescription Drug category are estimated to increase by \$134 million in FY 2012 and by \$131 million in FY 2013. These increases are generally due to expected increases in utilization as well as increases in the cost per claim.

One last item of note is the projected spike in expenditures in the Physician category in FY 2013. The spike is largely due to rate increases required under the federal Patient Protection and Affordable Care Act of 2010. That Act mandates that Medicaid physician reimbursement rates for certain primary care services be at least 100% of the applicable Medicare rate in 2013 and 2014. The federal government will pay 100% of the incremental cost for those two years. In 2015, states will either have to pay their share of the higher reimbursement rates without the additional federal funding or reduce their rates. Ohio's Medicaid reimbursement rate for primary care is about 66% of Medicare rates.

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 may have.

FY 2011 Revenue Estimates

Millions of Dollars

GRF	Original	OBM		LSC		LSC Minus OBM
	Sept. 2010	March 2011	Change	March 2011	Change	
TAX REVENUE						
Auto Sales	\$893.2	\$960.0	\$66.8	\$950.0	\$56.8	-\$10.0
Nonauto Sales & Use	\$6,374.1	\$6,560.0	\$185.9	\$6,524.1	\$150.0	-\$35.9
Total Sales & Use Taxes	\$7,267.3	\$7,520.0	\$252.7	\$7,474.1	\$206.8	-\$45.9
Personal Income	\$7,567.6	\$7,900.0	\$332.4	\$7,806.9	\$239.3	-\$93.1
Commercial Activity	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Corporate Franchise	\$132.4	\$175.0	\$42.6	\$160.0	\$27.6	-\$15.0
Public Utility	\$180.0	\$125.0	-\$55.0	\$142.7	-\$37.3	\$17.7
Kilowatt Hour Excise	\$167.2	\$163.0	-\$4.2	\$161.3	-\$5.9	-\$1.7
Foreign Insurance	\$250.0	\$246.5	-\$3.5	\$254.0	\$4.0	\$7.5
Domestic Insurance	\$196.0	\$199.3	\$3.3	\$206.0	\$10.0	\$6.7
Business & Property	\$24.0	\$27.0	\$3.0	\$26.7	\$2.7	-\$0.3
Cigarette	\$794.0	\$842.5	\$48.5	\$851.6	\$57.6	\$9.1
Alcoholic Beverage	\$58.0	\$56.5	-\$1.5	\$56.0	-\$2.0	-\$0.5
Liquor Gallonage	\$36.0	\$37.0	\$1.0	\$37.0	\$1.0	\$0.0
Estate	\$60.5	\$57.0	-\$3.5	\$60.0	-\$0.5	\$3.0
Total Tax Revenue	\$16,733.0	\$17,348.8	\$615.8	\$17,236.3	\$503.3	-\$112.5
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	\$87.5	\$7.0	-\$80.5	\$9.1	-\$78.4	\$2.1
Licenses and Fees	\$62.0	\$62.0	\$0.0	\$68.5	\$6.5	\$6.5
Other Revenue	\$208.0	\$183.0	-\$25.0	\$183.0	-\$25.0	\$0.0
Nontax State-Source Revenue	\$357.5	\$252.0	-\$105.5	\$260.6	-\$96.9	\$8.6
TRANSFERS						
Liquor Transfers	\$136.3	\$136.3	\$0.0	\$136.3	\$0.0	\$0.0
Transfers In	\$360.5	\$360.5	\$0.0	\$360.5	\$0.0	\$0.0
Transfers In - Temporary	\$876.0	\$876.0	\$0.0	\$876.0	\$0.0	\$0.0
Total Transfers In	\$1,372.8	\$1,372.8	\$0.0	\$1,372.8	\$0.0	\$0.0
TOTAL GRF Before Federal Grants	\$18,463.3	\$18,973.6	\$510.3	\$18,869.7	\$406.4	-\$103.9
Federal Grants	\$8,370.9	\$8,312.8	-\$58.1	\$8,269.3	-\$101.6	-\$43.5
TOTAL GRF SOURCES	\$26,834.2	\$27,286.4	\$452.2	\$27,139.0	\$304.8	-\$147.4

FY 2012 Revenue Forecasts

Millions of Dollars

GRF	LSC Minus OBM				Growth from FY 2011	
	OBM	LSC	Difference	Percent	OBM	LSC
TAX REVENUE						
Auto Sales	\$1,005.0	\$983.5	-\$21.5	-2.1%	4.7%	3.5%
Nonauto Sales & Use	\$6,845.0	\$6,744.5	-\$100.5	-1.5%	4.3%	3.4%
Total Sales & Use Taxes	\$7,850.0	\$7,728.0	-\$122.0	-1.6%	4.4%	3.4%
Personal Income	\$7,930.9	\$8,103.1	\$172.2	2.2%	0.4%	3.8%
Commerical Activity	\$78.0	\$77.9	-\$0.1	-0.1%	--	--
Corporate Franchise	\$195.0	\$165.0	-\$30.0	-15.4%	11.4%	3.1%
Public Utility	\$140.0	\$153.3	\$13.3	9.5%	12.0%	7.4%
Kilowatt Hour Excise	\$143.0	\$139.2	-\$3.8	-2.7%	-12.3%	-13.7%
Foreign Insurance	\$252.1	\$258.0	\$5.9	2.3%	2.3%	1.6%
Domestic Insurance	\$205.6	\$209.0	\$3.4	1.7%	3.2%	1.5%
Business & Property	\$27.0	\$27.0	\$0.0	0.0%	0.0%	1.1%
Cigarette	\$817.0	\$820.4	\$3.4	0.4%	-3.0%	-3.7%
Alcoholic Beverage	\$56.5	\$56.3	-\$0.2	-0.4%	0.0%	0.5%
Liquor Gallonage	\$37.0	\$37.9	\$0.9	2.4%	0.0%	2.4%
Estate	\$60.0	\$67.4	\$7.4	12.3%	5.3%	12.3%
Total Tax Revenue	\$17,792.1	\$17,842.5	\$50.4	0.3%	2.6%	3.5%
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	\$7.5	\$13.1	\$5.6	74.7%	7.1%	44.0%
Licenses and Fees	\$62.0	\$70.6	\$8.6	13.9%	0.0%	3.1%
Other Revenue	\$68.0	\$68.0	\$0.0	0.0%	-62.8%	-62.8%
Nontax State-Source Revenue	\$137.5	\$151.7	\$14.2	10.3%	-45.4%	-41.8%
TRANSFERS						
Liquor Transfers	\$139.0	\$139.0	\$0.0	0.0%	2.0%	2.0%
Transfers In	\$133.9	\$133.9	\$0.0	0.0%	-62.9%	-62.9%
Transfers In - Temporary	\$0.0	\$0.0	\$0.0	0.0%	-100.0%	-100.0%
Total Transfers In	\$272.9	\$272.9	\$0.0	0.0%	-80.1%	-80.1%
TOTAL GRF Before Federal Grants	\$18,202.5	\$18,267.1	\$64.6	0.4%	-4.1%	-3.2%
Federal Grants	\$8,202.3	\$8,160.4	-\$41.9	-0.5%	-1.3%	-1.3%
TOTAL GRF SOURCES	\$26,404.8	\$26,427.5	\$22.8	0.1%	-3.2%	-2.6%

FY 2013 Revenue Forecasts

Millions of Dollars

GRF	LSC Minus OBM				Growth from FY 2012	
	OBM	LSC	Difference	Percent	OBM	LSC
TAX REVENUE						
Auto Sales	\$1,053.0	\$983.5	-\$69.5	-6.6%	4.8%	0.0%
Nonauto Sales & Use	\$7,182.0	\$7,012.9	-\$169.1	-2.4%	4.9%	4.0%
Total Sales & Use Taxes	\$8,235.0	\$7,996.4	-\$238.6	-2.9%	4.9%	3.5%
Personal Income	\$8,235.9	\$8,743.4	\$507.5	6.2%	3.8%	7.9%
Commercial Activity	\$158.0	\$159.7	\$1.7	1.1%	102.6%	105.1%
Corporate Franchise	\$200.0	\$172.0	-\$28.0	-14.0%	2.6%	4.2%
Public Utility	\$162.5	\$159.8	-\$2.7	-1.7%	16.1%	4.2%
Kilowatt Hour Excise	\$147.0	\$132.2	-\$14.8	-10.1%	2.8%	-5.0%
Foreign Insurance	\$260.0	\$268.0	\$8.0	3.1%	3.1%	3.9%
Domestic Insurance	\$208.8	\$216.0	\$7.2	3.4%	1.6%	3.3%
Business & Property	\$27.0	\$27.4	\$0.4	1.5%	0.0%	1.5%
Cigarette	\$790.0	\$788.7	-\$1.3	-0.2%	-3.3%	-3.9%
Alcoholic Beverage	\$56.5	\$56.5	\$0.0	0.0%	0.0%	0.4%
Liquor Gallonage	\$37.0	\$39.0	\$2.0	5.4%	0.0%	2.9%
Estate	\$63.0	\$68.6	\$5.6	8.9%	5.0%	1.8%
Total Tax Revenue	\$18,580.7	\$18,827.8	\$247.1	1.3%	4.4%	5.5%
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	\$30.0	\$38.9	\$8.9	29.7%	300.0%	196.9%
Licenses and Fees	\$62.0	\$73.0	\$11.0	17.7%	0.0%	3.4%
Other Revenue	\$68.0	\$68.0	\$0.0	0.0%	0.0%	0.0%
Nontax State-Source Revenue	\$160.0	\$179.9	\$19.9	12.4%	16.4%	18.6%
TRANSFERS						
Liquor Transfers	\$139.0	\$139.0	\$0.0	0.0%	0.0%	0.0%
Transfers In	\$138.9	\$138.9	\$0.0	0.0%	3.7%	3.7%
Transfers In - Temporary	\$0.0	\$0.0	\$0.0	0.0%	--	--
Total Transfers In	\$277.9	\$277.9	\$0.0	0.0%	1.8%	1.8%
TOTAL GRF Before Federal Grants	\$19,018.6	\$19,285.6	\$267.0	1.4%	4.5%	5.6%
Federal Grants	\$8,959.5	\$8,834.2	-\$125.3	-1.4%	9.2%	8.3%
TOTAL GRF SOURCES	\$27,978.1	\$28,119.8	\$141.7	0.5%	6.0%	6.4%

FY 2012 - FY 2013 Biennium Forecasts

Millions of Dollars

GRF	OBM	LSC	LSC Minus OBM	
			Difference	Percent
TAX REVENUE				
Auto Sales	\$2,058.0	\$1,967.0	-\$91.0	-4.4%
Nonauto Sales & Use	\$14,027.0	\$13,757.4	-\$269.6	-1.9%
Total Sales & Use Taxes	\$16,085.0	\$15,724.4	-\$360.6	-2.2%
Personal Income	\$16,166.8	\$16,846.5	\$679.7	4.2%
Commercial Activity	\$236.0	\$237.6	\$1.6	0.7%
Corporate Franchise	\$395.0	\$337.0	-\$58.0	-14.7%
Public Utility	\$302.5	\$313.1	\$10.6	3.5%
Kilowatt Hour Excise	\$290.0	\$271.4	-\$18.6	-6.4%
Foreign Insurance	\$512.1	\$526.0	\$13.9	2.7%
Domestic Insurance	\$414.4	\$425.0	\$10.6	2.6%
Business & Property	\$54.0	\$54.4	\$0.4	0.7%
Cigarette	\$1,607.0	\$1,609.1	\$2.1	0.1%
Alcoholic Beverage	\$113.0	\$112.8	-\$0.2	-0.2%
Liquor Gallonage	\$74.0	\$76.9	\$2.9	3.9%
Estate	\$123.0	\$136.0	\$13.0	10.6%
Total Tax Revenue	\$36,372.8	\$36,670.2	\$297.4	0.8%
NONTAX STATE-SOURCE REVENUE				
Earnings on Investments	\$37.5	\$52.0	\$14.5	38.7%
Licenses and Fees	\$124.0	\$143.6	\$19.6	15.8%
Other Revenue	\$136.0	\$136.0	\$0.0	0.0%
Nontax State-Source Revenue	\$297.5	\$331.6	\$34.1	11.5%
TRANSFERS				
Liquor Transfers	\$278.0	\$278.0	\$0.0	0.0%
Transfers In	\$272.8	\$272.8	\$0.0	0.0%
Transfers In - Temporary	\$0.0	\$0.0	\$0.0	0.0%
Total Transfers In	\$550.8	\$550.8	\$0.0	0.0%
TOTAL GRF Before Federal Grants	\$37,221.1	\$37,552.6	\$331.5	0.9%
Federal Grants	\$17,161.8	\$16,994.6	-\$167.2	-1.0%
TOTAL GRF SOURCES	\$54,382.9	\$54,547.2	\$164.3	0.3%