Ohio Legislative Service Commission

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Updated Forecast of Revenues and Public Assistance Before The Conference Committee On The FY 2002 - 2003 Biennial Budget

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Mr. Chairman, members of the Conference Committee on House Bill 94, I am here today to present the Legislative Service Commission's (LSC) updated forecast for the FY 2002-2003 biennium. This testimony and the attachments provide information on the forecasts for revenues and caseloads.

Included in today's information are tables comparing the executive forecasts with our forecasts. Please note that in our testimony we compare a current law, baseline estimate of Medicaid to the executives baseline forecast. The final revenue forecast of federal reimbursement for state Medicaid spending varies considerably with the policy choices made by the conference committee, and we will update out forecast and reimbursement numbers as we proceed through the committee process.

Summary

Our forecasts for tax revenues for this fiscal year and the upcoming biennium are lower than those in the executive forecast. These estimated GRF tax revenue differences are shown below.

FY 2001	$	- 55.5 million
FY 2002	$	- 123.0 million
FY 2003	$	-152.2 million

In comparison to our January forecast, we have lowered our current revenue forecasts by $298 million in the current fiscal year, and by $503 million in FY 2002 and by $ 524 million in FY 2003

Our baseline forecast on Medicaid expenditures compared to the updated executive baseline forecast is shown below.

	State	Federal	Total
FY 2002	$ 2.5 million	$ 6.0 million	$ 8.5 million
FY 2003	$ 50.9 million	$ 123.8 million	$ 174.7 million

The Economy

At this moment, the economy is poised between recovery and recession. In fact, one of the forecasting firms that we subscribe to forecasts a 45% probability of a recovery and a combined 45% probability of a mild or moderate recession. As you look at the available economic data, you can find information that supports either argument, recovery or recession. However, both OBM's forecast and ours assume recovery. The primary cause for the differences in our forecasts is our assumption of a somewhat slower recovery.

The Data.

Light vehicle sales have dropped significantly this calendar year. Yet at the same time, they remain at a relatively high, but perhaps unsustainable, level of sales. In order to maintain these sales rates, manufacturers have offered high and expensive sales incentives that have cut into profits. On the other hand, this means a lot of Ohioans are still employed producing these vehicles. As you look at consumer confidence, both short term and long-term consumer confidence levels have dropped this spring, but these confidence levels are still comparatively high and retail sales growth remains steady. In addition, home sales are strong (until yesterday's report) and the production of durable goods remains at average levels.

While the consumer seemingly still spends with confidence, business executives have expressed a relatively high level of pessimism about the business outlook this year and suggest that business investment will be at relatively low levels. Other indicators in the economy would also lead you to believe that there is little incentive for businesses to invest in their operations this year - productivity has dropped, but remains relatively strong; inflation and wage pressures remain in check; worker shortages have eased; and capacity utilization is low. However, while the outlook for business investment this year is questionable, which is a concern as this is usually a good leading indicator of economic activity, this appears to be the only weak fundamental in the U.S. economy.

This pessimism about the business outlook also points to another related downside risk to the forecast, which is how the current profit squeeze might affect consumer confidence. Many analysts suggest that corporate profits will experience negative numbers for the next quarter or two. And many profits reports may be accompanied by announcements of downsizing and layoffs. To date, these announcements don't appear to have affected consumer spending patterns, but if the drumbeat of corporate bad news continues, will the consumer finally succumb?

Another complicating factor for the forecast is that national economic data and trends are sometimes at variance with the performance of the various business sectors in Ohio. For example, observers described the recession of the early 1990s as a "bi-coastal" recession. The east and west costs were hit hard, while the middle part of the county, including Ohio, weren't that severely affected. This economic downturn appears to have reversed itself, as the manufacturing sector of the U.S. economy (Ohio and the other industrial states) appear to be the hardest hit.

As the economy late last year responded to the increased Federal Reserve Board rate increases, and the energy shock, the biggest impediment to responding to these new business variables appeared to be high inventory levels that were being carried by businesses. But as business slowly accumulated inventory in the boom of the late 1990s, they also developed mechanisms to respond rapidly to the changes.

Highly computerized inventory systems, not available even five years ago, allow for relatively quick adjustments, permitting the impact of business orders to be rapidly passed upstream to suppliers of parts and raw materials. In fact, one of the major unknown variables important to Ohio's economy is the question of whether or not manufacturing has gotten rid of its excess inventory and whether or not manufacturing has turned the corner into recovery.

Uncertainty then is the watchword of this forecast. This was clearly reflected in a speech last evening by Alan Greenspan, the Chairman of the Federal Reserve Board stated that "The period of sub-par economic growth is not yet over, and we are not free of the risk that economic weakness will be greater than currently anticipated."

Revenue Estimates

GRF tax revenues are projected to fall $55.5 million below the OBM estimates for the current year (FY 2001) and below the OBM estimates by $123.0 million in FY 2002 and $152.2 million in FY 2003. These estimates assume the executive proposed local government funds freeze. The freeze is recalculated based on the LSC estimates by source. Each of the three funds has a particular set of tax sources and percentages of revenue that feeds each of the funds.

We have lowered our personal income tax revenue estimate from January of this year by $167 million in the current fiscal year and by $244 million in fiscal year 2002 and by $220 million in fiscal year 2003. We lowered our revenue estimates because of the continuing bad news about the economy in general and specifically projections of lower income growth and lower capital gains.

These trends are documented in the monthly reports turned out by the U. S. Bureau of Economic Analysis. This is also reflected in the slowing of the withholding portion of the state personal income tax

We have also lowered our estimate of sales tax revenues by $88 million in the current fiscal year and by $295 million in fiscal year 2002 and by $356 in fiscal year 2003. This as well reflects the general turn down in the economy and slowing in consumer spending.

Public Assistance

Medicaid. In January, our estimates of Medicaid costs (from line item 600-525) over the biennium were $7.3 billion in fiscal year 2002 ($3.0 billion in state share) and $8.0 billion in fiscal year 2003 ($3.3 billion in state share). Our updated estimates are slightly higher, at $7.4 billion for FY 2002 ($3.0 billion state share) and $8.1 billion for FY 2003 ($3.3 billion state share).

The primary reason for the increase is that we have revised upward our forecast of the Healthy Family caseload growth. The revision is substantial—over 100,000 eligibles each year—because the income threshold for parents to become eligible for coverage was raised effective July of 2000, making early forecasts especially uncertain. Part of this increase is simply a shift of classification, however, as the children of newly-eligible parents become reclassified as Healthy Family eligibles, rather than Healthy Start eligibles (therefore the increase in caseload within the overall Medicaid program is smaller than the Healthy Family caseload increase would make it appear). The cost increase due to this increase in Healthy Family caseload is partially offset by a modest downward revision in our forecast of the Aged, Blind, and Disabled (ABD) caseload.

Another change in our forecast worth noting is in the assumed percentage of Covered Families & Children (CFC) eligibles that enroll in an HMO—a percentage usually referred to as the HMO penetration rate. Our prior forecast assumed the penetration rate would be approximately 29% in each fiscal year of the biennium. A program change implemented by JFS to encourage HMO enrollment led us to assume the rate increases from our revised FY01 estimate of approximately 28.25% to approximately 30.5% in FY03.

The net effect of these assumption changes is to increase costs for inpatient hospital care and for HMOs by more than we originally forecast. Costs for Intermediate Care Facilities for the Mentally Retarded, and for most fee-for-service categories are now projected to increase by less than originally forecast. Most of the changes from our initial forecasts in the various cost categories are less than $10 million per fiscal year. The largest changes are for inpatient hospital care (increased by a little over $50 million in each fiscal year), for physician payments (decreased by about $23 million in FY 2002 and by $34 million in FY 2003), and, of course, for HMO payments (increased by approximately $47 million in FY02 and $89 million in FY03).

The revised forecast of nursing facility payments is slightly higher than our original forecast, by just under $2 million, or 0.05%, in FY02 and just under $14 million, or 0.51%, in FY03, despite the downward revision in ABD caseload mentioned above. The upward revision is due to recent claims experience; we have not altered our forecast of nursing facility *per diem* rates.

Temporary Assistance for Needy Families (TANF)

With the funding for TANF having been transformed into a block grant you might wonder why we continue to forecast caseloads and cash assistance expenditures. There are a number of reasons, including the fact that these are used in forecasting Medicaid, and that expenditures for cash assistance dictate the amount of federal block grant and state Maintenance of Effort (MOE) moneys that are available for TANF services such as education and training, Prevention, Retention, and Contingency (PRC), transportation, child care, etc.

Clearly the purpose of cash assistance has changed from an entitlement program to one with a temporary focus designed to assist people as they move to the work force. In addition, the ancillary services provided with TANF dollars are meant to develop a strong workforce and put in place supports that will allow individuals to fully participate in employment and to enhance their income potential. Under that philosophy, we have imposed time limits, the effect of which began to be felt in October of 2000, and strict work requirements, which are now in place and enforced with a system of sanctions.

In order to carry out the workforce development focus, we have available to us approximately $728 million per year in federal TANF block grant funds, and we are obligated to provide state funding to meet our federally mandated MOE level of $417 million. Ohio also has determined that $75 million of the federal block grant funds in each year will not be appropriated, but will be left at the federal level as a reserve for use in an economic downturn. However, because of lower spending levels, more grant funds were left unappropriated. The budget recommended by the executive leaves $135 million unappropriated each year from the TANF block grant, the same level as the current year.

That said, where are caseloads now, and where are they going? The cash assistance caseload steadily declined from the spring of 1992 to the fall of 1999 when it began to level off somewhat, and now has a pattern of fairly slow decline. We anticipate the average monthly caseload in FY 2001 to be about 90,700 assistance groups. We are projecting a decline in FY 2002 of 2.4 percent and in FY 2003, a further reduction of 2.6 percent. This equates to cash grant funding of $327.4 million in FY 2002 and $319.0 million in FY 2003.

Therefore, for FY 2002 we will have available $728 million in federal funds, plus $401 million in state dollars (for a total of $1,129 million), less the $135 million left on reserve, less the $330.5 million for cash assistance, and less $53.0 million earmarked in the state's MOE for child care, thus leaving $613.6 million for administration, work, education and training activities, PRC, transitional services, and other activities. For FY 2003, a similar calculation yields $622.0 million for services and activities other than cash grants and a portion of the child care expenditures.

At the end of FFY 2000, Ohio's TANF reserve was $721.7 million.

Disability Assistance

Disability Assistance (DA) is a wholly state and county funded program, which provides cash and medical assistance to persons not eligible for TANF or SSI. Ohio has divided that program into two components - DA Cash, and DA Medical. There are no time limits, and all those receiving cash benefits also receive medical benefits-currently about 11,700 recipients. An additional 1,500 or so individuals currently receive medical benefits only.

The DA cash and medical recipient caseloads both exhibited a steady decline until the fall of 1999. Since then, the cash assistance caseload has been increasing slowly and the medical caseload has been declining slowly. LSC forecasts that these trends will continue at the same pace and that the inflation rate in medical costs, especially for prescription drugs, will push costs up for the medical caseload despite a slightly smaller number of recipients. This will result in an increase of $8.6 million in the first year of the biennium and $11.9 million in the second year.

In closing Mr. Chairman, my colleagues and I stand ready to answer any questions the committee may have.