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

Testimony before the House Finance and Appropriations Committee

February 10, 2009

Chairman Sykes and members of the House Finance and Appropriations 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 revenues, and forecasts of expenditures in the Medicaid and Ohio Works First programs. The baseline forecasts provided today assume current law continues throughout the next biennium.

Summary

LSC forecasts somewhat higher baseline GRF revenues for the biennium than are forecast in the executive budget. This is the net effect of a lower forecast for FY 2010 and a higher forecast for FY 2011.

The differences between LSC's forecasts of total GRF receipts and those in the executive budget are presented 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 $244.2 million (0.4%) greater than OBM's.

FY 2009	- $173.7 million	-0.6%
FY 2010	- $226.9 million	-0.8%
FY 2011	+ $471.1 million	1.6%

LSC forecasts baseline Medicaid expenditures to be slightly higher for FY 2009, but lower for FY 2010 and FY 2011 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 2009	+ $10.8 million (+ $4.3 million state share*)	+ 0.1%
FY 2010	- $36.5 million (- $14.6 million state share*)	- 0.3%
FY 2011	- $34.9 million (- $14.0 million state share*)	- 0.3%

* Assumes 40% state share

LSC forecasts baseline Ohio Works First (OWF) cash assistance expenditures to be higher for FY 2009 and for the FY 2010-FY 2011 biennium than are assumed in the executive budget. The LSC estimates of OWF expenditures differ from the executive by the following amounts:

FY 2009	+ $25.2 million	+ 7.0%
FY 2010	+ $62.6 million	+ 15.4%
FY 2011	+ $57.6 million	+ 13.9%

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, starting with the economy.

The Economy

The U.S. economy has been in recession since December 2007. Since the recession began, Ohio's unemployment rate has increased from 5.8% to 7.8%, representing an increase of 117,500 in the number of Ohio workers who are unemployed. Worsening labor market conditions and turmoil in financial markets have led to slower growth in personal income and other economic measures. While economic weakness may have begun largely in residential construction and related financial markets, the onset of recession means that it has spread throughout the economy.

Tax revenue depends on the state of the economy. Forecasts of tax revenue and human services expenditures are accordingly dependent on future developments in the economy. The economy has been in recession for 14 months now. While there is no end in sight to the challenges facing the economy, it might be informative to know that the length of recessions typically has not been much longer than we have experienced so far in this recession. Since World War II the longest economic contractions have lasted 16 months, from November 1973 to March 1975, and again from July 1981 to November 1982.

Each recession is different from its predecessors, however. I do not mean to suggest that the current recession will end in the next few months. It is currently unknown when the recession will end, and how fast Ohio's economy will recover from it. Reputable economic forecasters disagree with each other about the timing of the next upturn, but none of which we are aware are projecting recovery during the first half of calendar year 2009. Assumptions about the severity of the economic downturn and the timing of the recovery are perhaps the principal sources of disagreement between the OBM and LSC forecasts.

LSC's revenue forecast is based on the "pessimistic" forecast issued in January by Global Insight, an economic forecasting firm. That forecast sees Ohio's economy, like that of the nation, shrinking through calendar year 2009 and resuming growth in the first quarter of 2010, followed by growth at less than 2.0% on an annual basis until the third quarter of 2010. Ohio's unemployment rate is forecast to increase steadily to a peak of 11.3% in the second quarter of 2010 before beginning to decline; it is forecast to be 10.5% or higher through the entire biennium. The economic forecast used by LSC is similar, at least for some of the key variables in the forecast, to the baseline forecast issued by Moody's economy.com, which is one of the reasons for our economists relying on it. The forecast book includes much more detail about the economic forecast.

We are all hoping that this forecast is overly pessimistic, and it could be. The Federal Reserve has implemented a very expansionary monetary policy over the last year, and has introduced a number of new lending programs that are intended to ensure that banks, and financial markets generally, are able to resume providing credit more normally. The federal government implemented one fiscal stimulus package in the second quarter of 2008, and a second federal stimulus package is in the legislative process as this is written. Numerous other governments around the world are also implementing expansionary fiscal policies, which could provide support to American exports. Both fiscal and monetary policies have delayed effects on the economy, meaning that measures implemented months ago, or even a year ago, are likely still having effects today. So there is substantial policy stimulus to the economy in place, which may help the economy resume growth sooner than expected.

But there are also very serious risks to the economy, so that it is possible that the economic forecast used is too optimistic. Living in Ohio, we have to recognize the risks to the automotive industry. Despite General Motors and Chrysler recently receiving government support to get through a cash problem, it may not be enough to prevent the industry from experiencing worse dislocations in the next year or two than are projected by Global Insight. This may happen if consumers do not resume purchasing cars and trucks in numbers closer to those of 2005 and 2006. A related risk is availability of credit to consumers and businesses. If creditworthy borrowers are unable to access credit for car purchases, mortgages, or business loans, that could increase the severity and length of the downturn. Even if credit is available, if interest rates were to rise (increasing the cost of credit) significantly, that could lead to the same result. The Federal Reserve has less influence over long-term interest rates than it has over short-term rates, and long-term rates could rise because of increasing federal deficits generally or, more specifically, if foreign countries that are large purchasers of American debt reduce their purchases.

We are facing great economic uncertainty at this time – probably more uncertainty than we have faced for many budgets. Uncertainty or no uncertainty, though, budgeting requires forecasts.

Revenue Forecasts

The LSC baseline forecasts for FY 2010 and FY 2011 assume the current Revised Code tax structure, including phase-in of the tax reform measures enacted in H.B. 66 of the 126th General Assembly. Most notably, the phase-out of the corporate franchise tax on nonfinancial corporations will be completed in FY 2010, and the final cut in personal income tax rates has been made for tax year 2009. Together with the weak economy, these tax changes imply decreases in state revenue in the near term.

For FY 2009, LSC estimates total GRF tax revenue to be $17.87 billion, after distributions to the local government funds. This is $179.4 million (1.0%) less than OBM's estimate.

For FY 2010, LSC forecasts total GRF tax revenue to decline to $16.93 billion, a $937 million (5.2%) decrease from FY 2009. This is due to the tax changes described above, and to the recession and its effects on the sales and use tax, the personal income tax, and the remaining corporate franchise tax on financial corporations. LSC also forecasts a continuing decline in receipts from the cigarette tax, now the third-largest source of GRF tax revenue. Other changes in tax revenue are relatively small. The LSC forecast is $146.4 million (0.9%) less than the OBM baseline forecast.

For FY 2011, LSC forecasts total GRF tax revenue to be $17.56 billion, a $627.5 million (3.7%) increase from FY 2010. The expected increase is driven by a return to growth in the personal income tax (by 5.1%) and the sales and use tax (3.6%). Stronger growth in these revenues is expected to more than offset the continued decline in collections of taxes on cigarettes and other tobacco products. The LSC forecast is $501.9 million (2.9%) more than the OBM baseline forecast.

Please note that the forecast was prepared prior to the recent reauthorization of the federal Children's Health Insurance Program, which includes an increase of 62 cents in the federal excise tax on cigarettes and various rate increases on other tobacco products, starting on April 1, 2009. This increase is likely to result in an additional decrease in the consumption of taxed cigarettes and in revenues from the state cigarette tax. Preliminary analysis of the federal legislation suggests that the revenue loss could range from $50 million to $55 million per year.

For the FY 2010-FY 2011 biennium, LSC forecasts total GRF tax revenue to be $34.48 billion, a decrease of $2.8 billion (7.5%) from the FY 2008-FY 2009 biennium.

Public Assistance Expenditure Forecasts

Medicaid

LSC's baseline forecast for Medicaid expenditures is approximately $12.8 billion in FY 2010 in combined state and federal dollars, an increase of 3.4% ($417.9 million). For FY 2011, LSC's baseline forecast is approximately $13.6 billion in combined state and federal dollars, representing an additional increase of 6.1% ($780.3 million).

LSC projects the total number of individuals who are eligible for Medicaid will reach 1.86 million in FY 2009 (a 5.9% increase), and increase to 1.97 million in FY 2010 (a 5.6% increase) and to 2.03 million in FY 2011 (a 3.4% increase).

The combination of worsening labor market conditions and the eligibility expansions required by H.B. 119, the budget bill for the current biennium, has resulted in increased rates of growth in the Medicaid caseload.

Ohio Works First

In FY 2008, the average monthly caseload of OWF assistance groups was 79,400. LSC estimates that OWF caseload will rise to an average of 85,400 in FY 2009, an increase of 8%. Into the next biennium, LSC forecasts caseloads to increase in FY 2010 to an average of 93,400 (a 9% increase from FY 2009) and to decrease slightly in FY 2011 to an average of 92,900 (a 1% decrease from FY 2010).

In FY 2008, the state spent $317 million for OWF cash assistance benefits. This spending consists of a blend of GRF money and federal dollars from the Temporary Assistance for Needy Families (TANF) block grant. LSC estimates that total OWF expenditures will be $358 million in FY 2009, an increase of 13% from FY 2008. Into the next biennium, LSC forecasts OWF expenditures to increase in FY 2010 to $406 million, an increase of 13% from FY 2009, and to increase in FY 2011 to $415 million, an increase of 2% from FY 2010.

The forecasted increases in expenditures are based on both the forecasted increase in caseload and a cost-of-living adjustment (COLA) that is required under Ohio law and is based on the COLA determined by the federal government for Social Security benefit recipients. In January 2009, the COLA was 5.8%, and the forecast assumes a 2.5% increase in January 2010 and a 2.8% increase in January 2011.

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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