Baseline Forecast of GRF Revenues and Medicaid Expenditures for the FY 2016-FY 2017 Biennial Budget

Testimony before the Senate Finance Committee

April 21, 2015

Chair Oelslager, Vice-Chair Coley, Ranking Member Skindell, and members of the Senate Finance 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 2015 through 2017. The information in the accompanying LSC forecast book includes an overview and forecast for the economy, forecasts of GRF tax revenues, and forecasts of expenditures in the Medicaid program. These are baseline forecasts, LSC's predictions for revenues and expenditures as if current law were to remain unchanged throughout the next biennium.

Summary – Comparison of LSC and Executive Budget Baseline Forecasts

For FY 2015, LSC projects $28.7 million (0.1%) more in GRF tax revenue than the executive estimate made by the Office of Budget and Management (OBM). For the upcoming biennium, LSC also forecasts somewhat higher baseline GRF tax revenues than are forecast for the executive budget. The forecast is higher in both of the fiscal years. LSC projects $268 million more in GRF tax revenue in FY 2016, due primarily to the income tax. This difference represents 1.2% of the budget forecast. For FY 2017, LSC projects $117 million more in tax revenue, about 0.5% greater than the OBM forecast.

LSC projects total state and federal shares of Medicaid service expenditures for FY 2015 to be $287 million lower than the executive estimate; state share expenditures are estimated to be $13 million lower in the same year. LSC also forecasts baseline Medicaid service expenditures to be lower for both FY 2016 and FY 2017 than the executive forecasts. LSC projects lower total expenditures of $258 million in FY 2016 and $336 million in FY 2017 and lower state share expenditures of $41 million in FY 2016 and $113 million in FY 2017. The state share differences for fiscal years 2015 through 2017 are being impacted by the recent Medicaid expansion related to the

Affordable Care Act (ACA), which is 100% federally funded through the first half of FY 2017. For the second half of FY 2017, the federal and state shares of the ACA expansion are 95% and 5%, respectively. The ACA expansion population represents the largest difference between LSC's and the executive's forecasts. As a result, the differences between LSC's state shares and the executive state shares may look somewhat different from what the total state and federal shares comparisons appear to indicate.

Tax revenues and Medicaid service 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

The outlook for state government revenues is greatly influenced by the course of Ohio's economy and the economy of the nation. The broadest measure of economic activity is inflation-adjusted gross domestic product (real GDP). Nationwide, real GDP strengthened in the second and third quarters of last year, with growth in the third quarter, at a 5.0% annual rate, the strongest in any quarter since 2003. Growth slowed in the fourth quarter, but for all of 2014, real GDP rose 2.4%, its highest growth for a full year since 2010. The pace of economic growth appears to have slowed further in this year's first quarter but is expected to pick up for the rest of 2015.

With the economy growing, both Ohio and the U.S. have added to employment. From the low point following the 2007-2009 recession, Ohio nonfarm payroll employment has increased more than 380,000 jobs, an increase of 7.7%. Nationwide, payroll employment has grown about 11.5 million jobs from the low about five years ago, an 8.9% increase. In the latest year, through March 2015, nonfarm payroll employment in the U.S. grew 2.3% and in Ohio grew 1.5%. Job gains have been fairly widespread among economic sectors, for the nation and Ohio.

The employment growth has brought down the unemployment rate. In Ohio, unemployment as a percent of the labor force fell to 5.1% in December, its lowest level since 2001, and remained at that rate through March. Nationwide, the unemployment rate in February and March was 5.5%, lowest since 2008. The declines in these unemployment rates are a result not just of the job gains but also of lower rates of participation in the labor force, as more people of working age are neither employed nor looking for work.

LSC's forecasts are based on our expectation that the economic expansion will continue, at a moderate pace, but a number of risks could alter the course of that expansion. Sharply lower prices for crude oil and for gasoline and other products based on petroleum are expected to be a net plus, overall, for the U.S. economy, which is still a net importer of crude oil. But the impact varies greatly among parts of the economy, with gains for most consumers and industries but losses for sectors and regions closely tied to the oil industry. Recent escalation of the value of the dollar in foreign exchange markets is making U.S. exports more expensive for buyers abroad and increasing the attractiveness for U.S. purchasers of buying imported goods and services. This shift in relative prices could slow economic activity in this country, perhaps by more than is reflected in the economic forecast that underlies LSC's revenue forecasts. Other potential risks include the possibility of fiscal gridlock in Washington and economic difficulties in Europe.

As you consider our projections, then, please remember that economic forecasts are inevitably uncertain things, just like any other attempt to predict the future. We are confident in our methodology, but we know that the forecast will be wrong in some respects and to some degree. Our baseline forecast could prove too optimistic regarding economic growth in the nation and Ohio. Alternatively, it could be too pessimistic.

In developing our forecasts, LSC economists have relied on the economic consulting firm Global Insight for the economic predictions that underlie the forecasts. Specifically, we have used Global Insight's December baseline forecasts for the nation and Ohio as the sources for input or explanatory variables in our models.

As is detailed in the accompanying forecast materials that served as part of the basis for LSC's projections, this forecast shows national real GDP growing at about a 2.6% annual rate during the period corresponding to state FY 2015, by 2.4% during FY 2016, and by 2.7% during FY 2017. Ohio real GDP also grows through the end of the forecast period, but more slowly. Personal income in Ohio, which is not adjusted for inflation, is forecast to grow faster, by 3.9% during the current fiscal year, by 3.8% during FY 2016, and by 4.4% during FY 2017. Inflation, measured by the consumer price index, increases to 2.1% in FY 2017 from 0.7% in the current fiscal year.

Revenue Forecasts

The LSC baseline forecasts for FY 2016 and FY 2017 assume the current Revised Code tax structure. Among the implications is that the personal income tax forecast reflects changes enacted in recent years including the small business deduction, the earned income credit, increased personal exemption amounts for lower income taxpayers, and means testing the personal exemption credit. The commercial activity tax (CAT) on receipts from motor fuel sales has been replaced by a separate tax, now known as the petroleum activity tax. This new tax reduced CAT receipts starting in FY 2014. The financial institutions tax, which replaced the corporate franchise and dealers in intangibles taxes in FY 2014, will be an ongoing source of revenue in FY 2016 and FY 2017. The estate tax, which no longer applies to estates of individuals who died on or after January 1, 2013, continued to yield revenue in FY 2014 and the current fiscal year but is forecast to yield no revenue in FY 2016 and FY 2017. Finally, 1.66% of GRF tax receipts are forecast to be transferred to each of the Local Government Fund and the Public Library Fund.

For FY 2015, LSC estimates total GRF tax revenue to be $21.24 billion, after distributions to the local government funds. This is almost $29 million higher than the current estimate by OBM.

For FY 2016, LSC forecasts total GRF tax revenue to be $22.56 billion, a $1.32 billion (6.2%) increase from FY 2015. 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 9.2% due to further improvement in labor markets, gains in proprietors' income, and income from investments, and to a scheduled reduction in the small business income deduction from 75% in tax year 2014 to 50% in tax year 2015. Revenue is expected to increase strongly from the nonauto sales tax, primarily due to increasing revenue from Medicaid health insuring corporations (HICs). A projected decline in cigarette tax revenue is due to the continuation of a long-term trend. A projected decline in revenue from the kilowatt-hour tax is due to weak growth in all funds revenue being more than offset by growing allocations to the Public Library Fund, which are debited in part against this tax.

For FY 2017, LSC forecasts total GRF tax revenue to increase to $23.42 billion, an increase of $863 million (3.8%) from FY 2016. Revenue growth is forecast to continue for most taxes. Cigarette tax revenues, however, continue to decline.

Tax revenue for the biennium is forecast to be $45.98 billion. That is approximately $4.6 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. Medicaid expenditures also comprise a significant portion of the state GRF budget. It is for these two reasons that the executive and LSC forecast Medicaid expenditures. LSC's baseline forecast shows the expected cost of this entitlement program given current policies.

All Medicaid figures that I am presenting are "all funds," also referred to as combined state and federal dollars. For FY 2015, Medicaid expenditures are projected to be $23.1 billion. For FY 2016, Medicaid expenditures are estimated to be $25.7 billion, a $2.6 billion (11.5%) increase from FY 2015. For FY 2017, Medicaid expenditures are projected to be $26.6 billion, an $883 million (3.4%) increase from FY 2016.

The total number of persons enrolled in Medicaid is expected to rise from an estimated 2.93 million in FY 2015 to 3.08 million in FY 2016, a 5.1% increase. The number of persons enrolled is estimated to reach 3.13 million in FY 2017, a 1.6% increase over FY 2016.

Medicaid caseload is driven by a number of factors. The business cycle is an important determinant, particularly for nondisabled adults and children. In addition, workers and their dependents may lose access to employer coverage because of unemployment, reduced employer contributions to health insurance, reduced eligibility for employer-sponsored insurance, and movement from full-time to part-time work. Some of these individuals may become eligible for and enroll in public coverage.

Changes in Medicaid policy can also impact caseload and expenditures. One of the most recent changes in policy has been the expansion of various Medicaid programs under the ACA. Beginning in 2014, the ACA increased access to health insurance through a coordinated system of "insurance affordability programs," including an optional expansion of Medicaid to all individuals under age 65 whose family income is at or below 138% of the federal poverty guidelines.

Much of the overall growth in LSC's forecasted Medicaid caseload and expenditures can be attributed to the ACA expansion. The latest available data shows that Ohio Medicaid has enrolled over 500,000 individuals in FY 2015, and LSC projects that number will increase to 623,000 in FY 2016 and 693,000 in FY 2017. The costs of the expansion are 100% federally reimbursable through calendar year 2016. Beginning in 2017, states will become responsible for 5% of the costs of covering the expansion population. This state share will increase to 6% in 2018, 7% in 2019, and 10% thereafter.

Chair Oelslager 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.

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