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

Testimony before the Senate Finance and Financial Institutions Committee

April 14, 2009

Chairman Carey and members of the Senate Finance and Financial Institutions 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 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. The state shares in the table assume the enhanced Federal Medical Assistance Percentages (eFMAP) included in the federal stimulus act, the American Recovery and Reinvestment Act (ARRA). Ohio is to receive eFMAP revenue the last three quarters of FY 2009, all of FY 2010, and the first half of FY 2011. Because of the eFMAP, the need for state share GRF to fund the Medicaid Program is reduced.

FY 2009	+ $10.8 million (+ $3.4 million state share*)	+ 0.1%
FY 2010	- $36.5 million (- $9.9 million state share*)	- 0.3%
FY 2011	- $34.9 million (- $11.0 million state share*)	- 0.3%

* Assumes 31.85% state share for FY 2009, 27.07% for FY 2010, and 31.55% for FY 2011.

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.

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 9.4%, representing an increase of 221,000 in the number of Ohio workers who are unemployed. These numbers have gotten worse since my testimony before the House Finance and Appropriations Committee; at that time the most recent unemployment rate was 7.8%. 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, during the recession 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 16 months now, matching the lengths of the longest economic contractions the U.S. has experienced since World War II.[1] 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 before the second 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, 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 recently enacted the ARRA, the second fiscal stimulus package enacted in the last year. 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 receiving government support, 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. And Ford and Honda could be affected if the operations of auto parts companies are disrupted due to the problems at General Motors or Chrysler.

[1] The two recessions that lasted as long were from November 1973 to March 1975, and from July 1981 to November 1982.

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 elimination 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. It should be noted that, unfortunately, since the OBM estimate was made in December, the cumulative revenue shortfall has been $195.8 million.

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 personal income tax, the sales and use 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.

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.

Effects of Recent Federal Tax Changes

As you know, it has been the legislature's longstanding practice to use the same forecasts for the Senate's and House's deliberations on the budget bill. One of the primary reasons for this is the strongly held professional belief of economists that one or two months of additional data are not enough to give a true indication of how a forecast would change. Our testimony today continues this practice.

Nevertheless, since I testified in the House, two federal acts have changed tax laws in ways that will affect revenues received from Ohio's taxes, and we want to give you an indication of what those effects may be.

First, the ARRA made changes to the federal income tax, including to the determination of federal adjusted gross income (FAGI). Since FAGI is the starting point for determining Ohio income tax liabilities, the federal changes will have an impact on state revenue under the personal income tax. Second, the reauthorization of the Children's Health Insurance Program included an increase of 62 cents per pack in the federal cigarette tax and increases in levies for various tobacco products other than cigarettes. The increases, which went into effect on April 1, are expected to reduce consumer purchases of tobacco products, which will reduce revenue under Ohio's cigarette tax.

Regarding the changes made by the ARRA, our economists have identified three provisions that are likely to have a significant impact on state revenues. These provisions deal with the taxation of unemployment insurance benefits and the handling of certain business income and net operating losses. Department of Taxation officials have published an estimate of the total revenue loss from these three provisions of $56.3 million in FY 2010 and $9.8 million in FY 2011. Our economists have reviewed the approach used to produce the estimates and generally agree with it.

The federal tobacco tax increases were enacted shortly before LSC's House testimony in February. Our preliminary analysis, reported at that time (and found on page 39 of the forecast book), was that the federal changes would reduce revenue to the state from the sale of tobacco products by $50 million to $55 million per year. With more time to analyze the change, our updated estimate is that the change will reduce state receipts by $55 million in FY 2010 and about $52 million in FY 2011. The net revenue reduction in FY 2010 includes a revenue loss under the cigarette excise tax of $66.0 million and a gain of $11.0 million in the sales tax. Cigarette excise tax receipts are estimated to decrease by $63.0 million and sales tax receipts to increase by $10.6 million in FY 2011.

The table below provides a short description of the three ARRA income tax provisions and the tax increases on tobacco products, and estimates related to each change.

Description of Federal Tax Change	Estimated Revenue Changes (in millions)	
	FY 2010	FY 2011
Exclusion of up to $2,400 in unemployment insurance benefits	- $21.5	$0.0
Deferral of business income arising from indebtedness discharged by the reacquisition of a debt instrument	- $19.9	- $12.8
Extended carryback of 2008 net operating losses	- $14.9	+ $3.0
Tobacco tax increases, including a 62-cent increase in the cigarette tax	- $55.0	- $52.4
Total GRF revenue change	**- $111.3**	**- $62.2**

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 growth in the Medicaid caseload is the result of the combination of worsening labor market conditions and the eligibility expansions required by H.B. 119, the budget bill for the current biennium.

Ohio Works First

Spending for OWF cash assistance benefits 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), increase in FY 2010 to $406 million (an increase of 13% from FY 2009), and to $415 million in FY 2011 (an increase of 2% from FY 2010).

LSC estimates that OWF caseload will reach an average of 85,400 assistance groups per month in FY 2009 (an increase of 8%), increase in FY 2010 to an average of 93,400 (a 9% increase from FY 2009), and decrease slightly in FY 2011 to an average of 92,900 (a 1% decrease from FY 2010).

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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