OHIO LEGISLATIVE SERVICE COMMISSION

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Baseline Forecasts of GRF Tax Revenues and Medicaid Service Expenditures for the FY 2026-FY 2027 Biennial Budget

Testimony Before the House Finance Committee

February 4, 2025

Chair Stewart, Vice Chair Dovilla, Ranking Member Sweeney, and members of the House Finance Committee, I am Wendy Zhan, Director of the Legislative Service Commission (LSC). I am here to testify on LSC's baseline forecasts for General Revenue Fund (GRF) tax revenues and Medicaid service expenditures for fiscal years 2025 through 2027. The forecasts were developed by LSC's Legislative Budget Office (LBO). These baseline forecasts are developed pursuant to the current Revised Code tax structure and current law and administrative policies on Medicaid. They do not reflect the effects of any proposed tax or Medicaid policy changes in the executive budget. I will briefly summarize our forecasts in my testimony. The accompanying forecast book provides more detailed information on the current state and forecast of the economy and forecasts of GRF tax revenues and Medicaid service expenditures.

The economy

The outlook for state government revenues is greatly influenced by the course of Ohio's economy and the economy of the nation. In developing our revenue forecasts, LBO economists have relied on the baseline economic forecasts released by Moody's Analytics in December. Overall, the U.S. economy has continued to expand and employment has continued to increase. Inflation, as measured by the year-over-year percent change in the consumer price index for all urban consumers, has fallen to levels closer to 3.0% from its peak of 9.1% in June of 2022. Lower inflation has led to the Federal Reserve cutting interest rates by one full percentage point between September and December 2024, but there are indications that the pace of rate cuts will slow in 2025 if inflation remains above the Federal Reserve's 2% target. Moody's economic forecast predicts a modest increase in inflation this year with a return to its current level by the end of the next biennium.

Real GDP is the broadest measure of economic activity. Nationwide, real GDP has been growing at a moderate pace since fiscal year 2023. Growth is expected to continue over the biennium, averaging 2.5% in the current fiscal year, but slowing to 1.8% in fiscal year 2026 and 1.6% in fiscal year 2027. Ohio's real GDP growth has been somewhat slower than the national rate and is expected to average 2.0% in the current fiscal year, 1.2% in fiscal year 2026, and 1.1% in fiscal year 2027.

Personal income is expected to follow a similar pattern. Moody's forecasts personal income growth for the nation of 4.7% in the current fiscal year but slowing somewhat to 4.6% in fiscal year 2026 and 4.4% in fiscal year 2027. Likewise, Ohio personal income is forecast to grow 4.6% in the current fiscal year, but slowing to 4.3% in fiscal year 2026 and 4.1% in fiscal year 2027.

Several factors could alter the economic outlook and the baseline forecasts presented here. Moody's December baseline economic forecasts consider the U.S. economy in a fundamentally strong place and poised for another good year in 2025. But they regard growth in the coming year as challenged by economic policies that may result in some combination of higher inflation and interest rates, as well as diminished economic growth. So, as you consider our tax revenue projections, please remember that economic forecasts are inherently uncertain, 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 revenue forecast could prove too optimistic regarding economic growth in the nation and Ohio. Alternatively, it could be too pessimistic.

Revenue forecasts

As stated earlier, the LBO baseline forecasts for the next biennium assume the current Revised Code tax structure, which includes various changes enacted in H.B. 33 of the 135th General Assembly. So, for example, the personal income tax forecast reflects condensing the nonbusiness income tax brackets to two and lowering the marginal tax rate for the higher bracket to 3.5% beginning in 2024. The commercial activity tax forecast reflects the exclusion of the first $6 million of taxable gross receipts beginning in 2025. Similarly, the baseline forecasts assume the Public Library Fund (PLF) and the Local Government Fund (LGF) will each receive 1.7% of total GRF tax receipts during the next biennium, which is the percentage established in the Revised Code.

Table 1. LBO Baseline GRF Tax Revenue Forecasts (After Distributions to the PLF and LGF)

	FY 2025	FY 2026	FY 2027
Total	$28,500.4 million	$29,460.9 million	$30,230.9 million
Dollar Growth	$555.9 million	$960.6 million	$769.9 million
Percent Growth	2.0%	3.4%	2.6%

Table 1 summarizes LBO's baseline GRF tax revenue forecasts. As seen from the table, for fiscal year 2025, LBO estimates total GRF tax revenue, after distributions to the two local government funds, to be $28.5 billion, which is an increase of $555.9 million, or 2.0%, from the previous fiscal year.

For fiscal year 2026, LBO forecasts total GRF tax revenue to be $29.5 billion, an increase of $960.6 million, or 3.4%, from fiscal year 2025. Major GRF taxes are generally forecast to grow faster in the first year of the biennium, as economic growth in that year is expected to be stronger. There is a projected increase of 3.8% in total sales and use tax revenue in fiscal year 2026, driven by solid income growth and retail sales activity that is consistent with historical norms. In addition, prices of new motor vehicles are predicted to increase while used vehicle values decline during fiscal year 2026, following the substantial increase in average prices in the last few years, resulting in a slight increase in the forecast for auto sales and use tax revenue. Income tax revenue is forecast to increase 5.3% in fiscal year 2026, which is driven by wage gains. Nonwage income is also expected to grow, led by taxable business income and capital gains. The commercial activity tax is forecast to decline by 4.3% in the same fiscal year but that is entirely attributable to tax policy rather than any contraction in the tax base.

For fiscal year 2027, LBO forecasts total GRF tax revenue to be $30.2 billion, an increase of $769.9 million, or 2.6%, from the previous fiscal year. Revenue from the total sales and use tax is expected to increase 1.9% in fiscal year 2027. The personal income tax is forecast to grow by 3.8% and the commercial activity tax is forecast to increase by 3.7%. The forecasts of these major taxes reflect the effects of moderate economic expansion and the accompanying growth in Ohioans' incomes.

Comparison of LBO and executive baseline tax revenue forecasts

Table 2 summarizes the differences between the LBO and executive baseline GRF tax revenue forecasts. The differences are presented as LBO's forecast minus the executive's forecast, so the positive numbers indicate a higher LBO forecast and the negative numbers indicate a lower LBO forecast.

Table 2. Summary of LBO and OBM Baseline GRF Tax Revenue Forecast Differences

	FY 2025	FY 2026	FY 2027
Dollar Difference	$57.6 million	-$158.7 million	-$351.0 million
Percent Difference	0.2%	-0.5%	-1.1%

As seen from the table, compared with the executive's forecast, LBO's forecast is higher for the current fiscal year but lower for both fiscal years 2026 and 2027. For fiscal year 2025, the difference amounts to $57.6 million, or 0.2%. For the next biennium, the overall difference is $509.7 million, or 0.8%. As stated earlier, LBO economists forecast total GRF tax revenue to increase by 3.4% in fiscal year 2026 and 2.6% in fiscal year 2027, in comparison with a growth rate of 4.1% in fiscal year 2026 and 3.2% in fiscal year 2027 under the executive baseline forecast. However, the executive forecast started with a somewhat lower fiscal year 2025 base. Essentially, compared with the executive forecast, LBO economists anticipate slightly higher revenue growth during the second half of the current fiscal year but a slightly slower acceleration of growth over the next biennium.

Medicaid service 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 both LBO and the executive forecast Medicaid caseload and expenditures.

Medicaid caseload is driven by several factors. The pandemic had a major effect on caseloads from 2020 to 2024. During the public health emergency, the federal government tied additional funding to a suspension of eligibility redeterminations and associated disenrollments. Ohio restarted redeterminations in May 2023, and over the following 19 months saw caseloads decline by over half a million, or 15.3%. Given the increase during the pandemic of over 800,000 cases, the net change from February 2020 to December 2024 was an increase of about 255,000 cases, representing an annualized growth rate of about 2.0% during that period.

For the next biennium, LBO economists expect Medicaid caseload to largely remain at the current level. The total number of persons enrolled in Ohio Medicaid is forecast to increase by fewer than 3,000 (0.1%) in fiscal year 2026 and by about 9,000 (0.3%) in fiscal year 2027.

For fiscal year 2026, LBO's baseline forecast for Medicaid service expenditures, excluding administrative expenditures, is $44.1 billion in combined state and federal dollars. This is a $3.3 billion, or 8.0%, increase from estimated service expenditures of $40.8 billion for fiscal year 2025. For fiscal year 2027, combined state and federal Medicaid service expenditures are projected to be $46.6 billion. This is a $2.5 billion, or 5.6%, increase from fiscal year 2026.

Table 3 summarizes the differences between the LBO and executive baseline forecasts for Medicaid service expenditures. Again, the differences are presented as LBO's forecast minus the executive's forecast, so the negative numbers indicate a lower LBO forecast and the positive numbers indicate a higher LBO forecast.

Table 3. Summary of LBO and Executive Baseline Medicaid Service Expenditure Forecast Differences

	FY 2025	FY 2026	FY 2027
Dollar Difference	-$190.6 million	$17.1 million	-$538.6 million
State Share	*-$55.5 million*	*$4.9 million*	*-$153.2 million*
Percent Difference	-0.6%	0.1%	-1.5%

As seen from the table, compared with the executive baseline forecast, LBO's baseline forecast is lower for fiscal years 2025 and 2027 but slightly higher for fiscal year 2026. For fiscal year 2025, the difference amounts to $190.6 million, or 0.6%, in combined federal and state expenditures. The difference in the state share of those expenditures is $55.5 million. For the next biennium, in dollar terms, the net difference is $521.5 million in total expenditures and $148.3 million in the state share of those expenditures. In percentage terms, the total forecast difference is just under 0.8% over the biennium. The differences between the two forecasts are largely influenced by somewhat different estimates in per member per month costs.

Chair Stewart and members of the Committee, thank you for the opportunity to present the LSC forecasts. The staff and I would be happy to answer any questions that you may have.