Baseline Forecast of GRF Revenues and Medicaid Expenditures for the FY 2020-FY 2021 Biennial Budget

Testimony before the Senate Finance Committee

April 24, 2019

Chair Dolan, Vice-Chair Burke, Ranking Member Sykes, 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 service expenditures in fiscal years 2019 through 2021. The forecasts were developed by LSC's Legislative Budget Office (LBO) division. The information in the accompanying LBO forecast book includes an overview and forecast for the economy, forecasts of GRF tax revenues, and forecasts of Medicaid expenditures. These are baseline forecasts, LBO's predictions for revenues and expenditures as if current law were to remain unchanged throughout the next biennium.

Comparison of LBO and executive budget baseline revenue forecasts

LBO economists forecast somewhat lower baseline GRF tax revenues for the current fiscal year and the next biennium than are forecast for the executive budget. The differences between LBO's forecasts and those in the executive budget are summarized in the table below. The differences are presented as LBO's forecast minus the executive's, so the negative numbers indicate a lower LBO forecast for each year.

Summary of LBO and OBM Baseline GRF Tax Revenue Forecast Differences			
	FY 2019	FY 2020	FY 2021
Dollar difference	-$196.7 million	-$347.3 million	-$160.9 million
Percent difference	-0.9%	-1.5%	-0.7%

GRF tax revenues have been above estimate in this fiscal year through March, but the positive variance narrowed in the winter months. Reduction of withholding rates for the income tax has lowered the growth of tax receipts this year. Going forward, changes in the economy will have substantial effects on tax revenues.

The economy

The outlook for state government revenues is greatly influenced by the course of Ohio's economy and the economy of the nation. U.S. economic expansion was strong through much of last year, but recent economic indicators have been mixed. Ohio's economy also continued to expand last year, but growth in recent years has been slower than that of the nation. If the economic expansion that began in June 2009 continues past June 2019, this expansion would be the longest in U.S. history, according to statistics from the National Bureau of Economic Research. The economic forecast on which LBO based our revenue projections does have the expansion continuing through the upcoming biennium.

The broadest measure of economic activity is inflation-adjusted gross domestic product (real GDP). Nationwide, real GDP continued to grow through last year's fourth quarter, and increased by 2.9% in all of 2018, its strongest rise since 2015. Ohio's real GDP growth last year averaged 2.2%, at an annual rate, in the first through third quarters, the latest actual data published by the federal government.

Some recent economic indicators have been softer, though the expansion remains on track. Nationwide payroll employment rose 180,000 per month during the first quarter of 2019, down from 223,000 monthly during 2018. Industrial production, the output of the country's factories, mines, and utilities, fell during the first quarter, by 0.3% at an annual rate, with the manufacturing component of the index falling by 1.1% at an annual rate. Retail sales fell by 0.2% in February, but rebounded to 1.6% growth in March; retail sales for the first quarter were 2.9% higher than during the first quarter of 2018. In Ohio, total payroll employment in March was about 39,800 higher than in March 2018, and private sector payroll employment grew by 43,900 over the year. Growth of total employment in the state last year was originally reported to have been higher but was revised downward substantially. Unemployment rates in the nation and the state remain low; Ohio's rate was 4.4% in March, matching the lowest rate since 2001.

In developing our revenue forecasts, LBO economists have relied on IHS Economics for the economic predictions that underlie the forecasts. Specifically, we have used the company's February baseline forecasts for the nation and Ohio as the sources for most input or explanatory variables in our models. Those forecasts are for the economic expansion in the nation and Ohio to continue at a moderate pace. As is detailed in the accompanying forecast materials, this forecast shows national real GDP continuing to grow during the period corresponding to state FY 2020 and FY 2021, at about a 2% annual rate on average, down from 2.8% growth in FY 2019. Ohio's real GDP is also predicted to continue growing through the end of the forecast period, but more slowly than in FY 2019. Ohio's growth is seen continuing to trail that of the nation. Personal income in Ohio, in current dollars not adjusted for inflation, is forecast to grow faster, by 4.1% in FY 2020 and 3.6% in FY 2021. Inflation, measured by the consumer price index, is projected to be near 2% through the upcoming biennium.

A number of risks could alter the course of that expansion. The recent softness in several economic indicators could be a harbinger of more widespread economic weakness ahead. Alternatively, they could be distortions caused by the recently ended partial federal government shutdown as well as the impact of storms this winter. Growth in the economies of some of our trading partners has slowed, reducing demand for our exports. Considerable uncertainty exists regarding the terms of the United Kingdom's exit from the European Union.

The outcome of negotiations between the administration in Washington and China over trade between the two nations remains uncertain. As always, there is the possibility of unforeseen geopolitical risks.

As you consider our projections, then, please remember that economic forecasts are inevitably 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 forecast could prove too optimistic regarding economic growth in the nation and Ohio. Alternatively, it could be too pessimistic.

Revenue forecasts

The LBO baseline forecasts for FY 2020 and FY 2021 assume the current Revised Code tax structure. Among the implications is that the personal income tax forecast reflects changes enacted in recent years, including reduced tax rates, the business income deduction, the earned income credit, and increased personal exemption amounts for lower income taxpayers. The sales tax forecast reflects the exemption enacted in S.B. 8 of the 132nd General Assembly for optical devices, effective July 1, 2019, and a permanent three-day sales tax holiday enacted in S.B. 226 of the 132nd General Assembly. Finally, the Public Library Fund is projected to receive 1.66% of GRF tax receipts, down from 1.68% of such receipts currently, as a temporary provision of H.B. 49 that required use of the higher percentage expires.

For FY 2019, LBO estimates total GRF tax revenue to be $22.90 billion, after distributions to the local government funds. This is almost $197 million lower than the current estimate by OBM.

For FY 2020, LBO forecasts total GRF tax revenue to be $23.67 billion, a $772 million (3.4%) increase from FY 2019. Economic growth forecast by IHS Economics is expected to lead to moderate growth in most tax sources. Income tax revenue is forecast to grow by 4.4% due to further improvement in labor markets, gains in proprietors' income, and income from investments. Revenue is expected to increase 3.6% from the nonauto sales tax, reflecting steady but slow economic growth. Similarly, revenue from the commercial activity tax (CAT) is forecast to grow 2.5%, reflecting the economic growth forecast. A projected decline in cigarette tax revenue is due to the continuation of a long-term trend. A leveling off of revenue from the kilowatt-hour tax is due to weak growth in all funds revenue as well as growing allocations to the Public Library Fund, which are debited in part against this tax.

For FY 2021, LBO forecasts total GRF tax revenue to increase to $24.29 billion, an increase of $625 million (2.6%) from FY 2020. Revenue growth is forecast to continue for most taxes, with only receipts from the cigarette tax and the kilowatt-hour tax expected to decline further.

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 the executive and LBO forecast Medicaid service expenditures.

The differences between LBO's Medicaid forecasts and those in the executive budget are summarized in the table below. The differences are presented as LBO's forecast minus the executive's, so the negative numbers indicate a lower LBO forecast.

Summary of LBO and OBM Baseline GRF Medicaid Forecast Differences		
	FY 2020	**FY 2021**
Dollar difference	$253.3 million	-$109.9 million
State Share	*$69.1 million*	*-$54.8 million*
Percent difference	1.2%	-0.5%

The differences between LBO's and the executive's baseline projections are largely influenced by somewhat different forecasts for individuals who became eligible for Medicaid through the federal Affordable Care Act (ACA). The federal share for this group (Group VIII) is much higher than for many other individual groups covered by Medicaid.

For FY 2020, LBO's baseline forecast for Medicaid service expenditures (excluding administrative costs) is $26.75 billion in combined state and federal dollars. This is a $0.7 billion (2.7%) increase from estimated service expenditures of $26.06 billion for FY 2019. For FY 2021, combined state and federal Medicaid service expenditures are projected to be $27.82 billion, a $1.06 billion (4.0%) increase from FY 2020.

Medicaid caseload is driven by a number of factors. The business cycle is an important determinant, particularly for nondisabled adults and children. Based on economic projections and the overall trend, caseloads are projected to decrease over the biennium. The total number of persons enrolled in Medicaid is expected to decrease from an estimated 2.88 million in FY 2019 to 2.83 million in FY 2020, a 1.6% decrease, and then decrease to 2.80 million in FY 2021, a 1.1% decrease.

Chair Dolan 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.

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