INVESTING IN Ohio's FUTURE
BUDGET OF THE STATE OF OHIO | FISCAL YEARS 2020 - 2021

**Amended Substitute House Bill 166**

**Main Operating Budget for Fiscal Years 2020 - 2021**

*Conference Committee Testimony*

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Mr. Chairman, members of the Conference Committee, thank you for the opportunity to testify today on Amended Substitute House Bill 166, the fiscal years 2020 and 2021 Biennial Operating Budget. Governor DeWine appreciates the time and effort that you and all members of the House of Representatives and the Senate have given to the development of Ohio's next budget.

## UPDATE ON FY 2019 REVENUES

Since my testimony before the Senate Finance Committee on April 24, April and May revenues have exceeded previous projections. General Revenue Fund (GRF) tax revenues in total exceeded the Financial Report estimate by $414 million in April and by $66 million in May, bringing the year-to-date overage to $617 million, or 3.0 percent. This is already more than double the Blue Book overage of $255 million that we estimated in March relative to the start-of-the-fiscal year Financial Report estimate. This extremely strong performance of GRF tax revenues, driven by a very large overage in April income tax collections (an "April surprise" in the lexicon of revenue estimators), illustrates that OBM's approach to revenue forecasting continues to be responsibly conservative.

As has been anticipated and largely planned since April revenues were realized, OBM's revised fiscal year 2019 total GRF tax revenue forecast is $359 million above the Blue Book forecast, with all but $8 million of that revision accounted for by the sales tax, income tax, and commercial activities tax. The details by tax category are available in the attachment to my testimony this afternoon. These updated revenues will result in a fiscal year 2019 year-end General Revenue Fund balance equivalent to that currently included in the legislature's fiscal year 2020-2021 budget plan as passed by both the House and the Senate.

## UPDATE ON THE ECONOMY

The revenue forecasts for the introduced budget were based on the January 2019 IHS baseline forecasts for the national and Ohio economies. Our revised Conference

Committee revenue forecast has as its underpinning the April 2019 IHS baseline forecasts. While the May IHS forecast is available, OBM chose to use the April baseline because its forecast of Ohio wage and salary income, a key variable in our sales and income tax forecasting models, was more conservative than the May baseline.

The general tenor of the IHS forecast for the national economy is similar to what it was in January: as tax cut and federal spending stimulus wears off, economic growth is expected to slow toward its long-term trend, falling to roughly 2 percent in calendar year 2020 and 2021. Real GDP growth in calendar year 2019 is expected to be somewhat stronger than was collectively thought in January, in part because of strong first quarter growth of 3.2 percent, and in part because of stronger growth in labor productivity over the last four quarters. In fact, productivity growth at an annual rate of 2.4 percent over the past four quarters, the strongest since 2010, creates some upside risk to the forecast in 2020-2021. If faster productivity growth could be sustained, potential GDP growth would be higher, and a reversion to long run potential might result in growth above 2 percent.

The IHS forecast of the probability of recession is currently at 35 percent. This is somewhat higher than it was in January, but the baseline forecast still anticipates continued moderate growth.

The 3.2 percent GDP growth reported for the first quarter of 2019 was a reacceleration from the 2.2 percent growth in the fourth quarter of 2018, rather than a further slowdown as was widely anticipated. Final sales, which exclude the impact on GDP from inventories, rose 2.5 percent, after rising 2.1 percent in the fourth quarter. Year-over-year growth in real GDP also improved to 3.2 percent compared with the comparable quarter in 2018, up from 3.0 percent previously. This was the fastest growth since the second quarter of 2015.

At the state level, the Bureau of Economic Analysis (BEA) released state GDP data on May 1st. Ohio's real GDP growth in calendar year 2018 was 1.8 percent, above the growth rates in 2015-2017, which were 1.2 percent, 0.7 percent, and 1.6 percent respectively. Ohio's growth rate was just below the Great Lakes region average of 2.2 percent.

Despite the fact that U.S. economic growth has not yet slowed as expected, OBM plans to continue our conservative practice and not change the underlying assumption that economic growth, across the nation and at home Ohio, will slow over the upcoming biennium. Ohio wage and salary income growth, which as I have emphasized before is a critical factor in our income tax and sales tax forecasting models, is projected by IHS to slow from 5.3 percent in the current quarter to 3.3 percent by the end of fiscal year 2021.

The main downside risks to the baseline forecast are probably fairly well known to those who have been following the economic news: international trade disruption and monetary policy.

Economists with whom we have spoken have emphasized that it is not only the actual tariffs that have been put in place by the U.S. and its trading partners that create a drag on economic growth, but also the uncertainty about the future direction of tariffs and non-tariff trade barriers, uncertainty that prevents individual businesses and entire markets from adapting to new trading frameworks.

On the monetary policy front, there is fierce debate about the appropriate level of short-term interest rates, and what moves the Federal Reserve should make next. There is opportunity for a policy mistake in either direction, by leaving rates too high to support the ongoing expansion or by leaving rates too low to head off an acceleration in inflation.

The Federal Reserve's job is never easy, but this is a particularly difficult juncture. Economic fundamentals remain strong, although job growth has recently slowed. Consumer confidence remains high, and the National Federation of Independent Business (NFIB) Small Business Optimism Index bounced back to historically high levels in May. But there are also surveys that have turned negative, including Moody's Global Business Confidence Index, Duke University's quarterly survey of CFOs, and Morgan Stanley's business conditions index. These negative results seem to be largely the result not of a downturn in current conditions, but of fear about where business conditions are headed, which are in turn largely driven by concerns about trade and supply chains. The Federal Reserve must decide how much stimulus might be necessary based on expectations of negative consequences that have not yet materialized. Having said that, the Federal Reserve – unlike some other central banks – does have room to cut interest rates or restart quantitative easing, if needed.

Table 1 shows the April IHS baseline forecasts of key economic variables and is an update to the table from my testimony to the House Finance Committee in March, which contained the January IHS baseline forecasts.

**History and Apr-2019 IHS/Global Insight Baseline Forecast of Key Economic Variables, FY 2016-2021**

Annual percent change unless otherwise indicated

| Output | FY 2016 Actual | FY 2017 Actual | FY 2018 Actual | FY 2019 Estimate | FY 2020 Forecast | FY 2021 Forecast |
|---|---|---|---|---|---|---|
| U.S. Real GDP | 1.8 | 1.9 | 2.6 | 2.8 | 2.1 | 2.0 |
| Ohio Real GDP | 0.2 | 1.5 | 1.5 | 2.1 | 1.5 | 1.2 |
| **Income** | | | | | | |
| U.S. nominal personal income | 3.5 | 3.4 | 4.5 | 4.4 | 4.4 | 4.6 |
| Ohio nominal personal income | 2.8 | 2.6 | 3.5 | 4.2 | 4.2 | 3.9 |
| Ohio nominal personal income ** | 2.8 | 2.6 | 3.5 | 4.2 | 4.0 | 3.9 |
| Ohio nominal wage and salary income | 3.0 | 3.1 | 3.4 | 4.4 | 3.9 | 3.3 |
| Ohio nominal wage and salary income (adjusted) ** | 3.0 | 3.1 | 3.4 | 4.4 | 3.7 | 3.3 |
| **Employment** | | | | | | |
| U.S. nonfarm employment | 1.9 | 1.7 | 1.5 | 1.7 | 1.3 | 0.7 |
| Ohio nonfarm employment * | 1.3 | 1.0 | 0.6 | 0.8 | 0.7 | 0.05 |
| U.S. unemployment rate (percentage) | 5.0 | 4.7 | 4.1 | 3.7 | 3.6 | 3.8 |
| Ohio unemployment rate (percentage) | 4.9 | 5.1 | 4.7 | 4.6 | 4.3 | 4.4 |
| **Consumer Spending** | | | | | | |
| U.S. real personal consumption expenditure | 3.0 | 2.6 | 2.5 | 2.6 | 2.2 | 2.7 |
| U.S. nominal personal consumption expenditure | 3.6 | 4.2 | 4.4 | 4.5 | 4.4 | 4.7 |
| U.S. retail and food service sales | 2.6 | 3.7 | 5.1 | 3.5 | 3.5 | 3.7 |
| Ohio retail and food service sales | 0.5 | 2.4 | 4.9 | 2.6 | 2.5 | 2.6 |
| U.S. light vehicle sales (millions of units) | 17.52 | 17.28 | 17.23 | 17.03 | 16.71 | 16.56 |
| U.S. light vehicle average price (thousands) | $31.41 | $32.24 | $32.98 | $33.33 | $34.59 | $36.15 |

* FY 2019 is OBM's forecast based on performance year-to-date

** indicates variables from a forecast reduced below the baseline

**Table 1**

## REVISED FY 2020-2021 GRF TAX REVENUE FORECASTS

As stated earlier in my testimony, fiscal year 2019 tax revenues are now expected to end the year 1.6 percent, above the Blue Book forecasts. However, the upward revisions are not as large for fiscal year 2020 or 2021. For fiscal year 2020, OBM’s updated total GRF tax revenue forecast is $116 million above the March Blue Book forecast. For fiscal year 2021, the updated total tax forecast is $73 million above the Blue Book.

One factor behind the smaller adjustments in fiscal years 2020 and 2021 is the adoption of an expanded earned income tax credit (EITC) in the transportation budget, which was passed after the Blue Book was released, and is expected to reduce income tax revenues by about $40 million per year. But there are more significant factors at work in the revisions in both the income tax and the commercial activity tax (CAT).

OBM expects income tax revenues to exceed the Blue Book forecast by $280 million (3.3 percent) in fiscal year 2019, but the forecasts for fiscal years 2020 and 2021 rise by only $56 million (0.6 percent) and $34 million (0.4 percent), respectively. The explanation for these diminishing gains relative to the Blue Book forecasts rests primarily on our expectations for non-wage income and thus for the income tax payment streams other than employer withholding.

Data from the IRS on the components of taxable income are a primary source used in non-wage income tax estimation. However, the data are available with a significant lag. Only later this summer the IRS will release taxable year 2017 data, but in order to explain what we observe in fiscal year 2019, we need to estimate taxable year 2018 data. Furthermore, OBM must forecast income in taxable years 2019 and 2020 in order to forecast tax collections in fiscal years 2020 and 2021.

Based on estimates from other states that have early return data to examine, Ohio business income tax schedules, and estimates from the Congressional Budget Office (CBO), OBM believes that capital gain income increased by more than 20 percent in taxable year 2018, contributing to very strong fiscal year 2019 tax revenues. OBM also estimates that dividends, proprietor income, and profits of S corporations and partnerships all showed strong growth in taxable year 2018. For taxable years 2019 and 2020, OBM expects growth in dividends, proprietor income, and profits to be much slower. We forecast that gains will show an outright decline in 2019, followed by a modest rebound in 2020. These reduced expectations for non-wage income mean that we actually expect slower growth in income tax revenues in fiscal years 2020 and 2021 than in the Blue Book forecast, although the fiscal year 2019 jumping off point for those forecasts is higher. Taken together, these factors yield modest increases in income tax revenues compared to the Blue Book for fiscal years 2020 and 2021.

The CAT forecast revisions are, at least in broad outline, similar to the income tax revisions. The forecast revision for fiscal year 2019 is $56 million (3.6 percent), but the gains relative to the Blue Book diminish to $32 million (2.0 percent) and $19 million (1.2 percent) in fiscal years 2020 and 2021, respectively. The story behind these revisions is one of the tension between growing taxable revenues (also known as “taxable gross receipts”) and increasing tax credits. Stronger than expected economic growth in fiscal year 2019 has pushed up gross taxable revenues by an estimated 6.3 percent. In concert with slower growth in the economy, that taxable revenue growth is expected to decelerate to 4.1 percent in fiscal year 2020 and 3.1 percent in fiscal year 2021. However, growth in bottom-line (post-credit) GRF CAT revenues is expected to be much slower, only 1.2 percent per year, because tax credits are expected to grow almost 8 percent per year. This actually represents a slight slowing from the average 10 percent growth in tax credits against the CAT over the past 5 years.

Among the large GRF taxes, the revisions in the sales tax forecasts are the simplest and require the least explanation. The non-auto sales tax forecast is $6 million higher than the Blue Book in fiscal year 2019, increasing slightly to $16 million higher in fiscal year 2020 and $7 million higher in fiscal year 2021. The revised forecast calls for the same pattern of continued but slowing growth in fiscal years 2020 and 2021, as did the Blue Book forecast, with income growth decelerating but revenue growth stabilized by strong growth in collections from out-of-state sellers.

The auto sales tax forecast revisions are upward in fiscal year 2019, by $9 million, but slightly downward in fiscal year 2020 and fiscal year 2021, where the forecast decreases by $7 million and $10 million, respectively, compared to the Blue Book. OBM expects the same general pattern for auto sales as in the Blue Book forecast: small declines in new unit sales, but with an increase in average prices, and a change in the purchase mix toward higher priced light trucks and away from cars. The small downward revisions in fiscal years 2020 and 2021 simply reflect a little less optimism about price growth than in the Blue Book.

The fiscal years 2020-2021 forecasts of several other tax sources were also updated. Modest upward adjustments to energy-related taxes (public utility, natural gas consumption, petroleum activity) were driven by stronger than previously expected fiscal year 2019 performance, although the kilowatt-hour tax forecast was slightly reduced due to weaker than anticipated fiscal year 2019 revenue. Similarly, fiscal years 2020-2021 cigarette tax revenues are now forecasted to be slightly lower than in the Blue Book because the fiscal year 2019 outcome is expected to be modestly lower than earlier estimates. Finally, the updated biennial forecasts for the foreign insurance tax are larger than those for the Blue Book, based on a fiscal year 2019 outcome anticipated to be $15 million higher than the March estimate. Altogether, the change in fiscal year 2020 forecasts for all secondary tax sources (that is, all taxes except sales tax, income tax, and CAT) is +$20 million relative to the Blue Book. In fiscal year 2021, the change in the forecasts of secondary tax sources is +$22 million.

As was noted earlier in my testimony regarding our updated fiscal year 2019 forecast, not all of the forecasted tax revenue increases are available to be utilized through additional legislative action, as the current version of the budget bill has allocated some of this anticipated increase to partially finance priority initiatives, including potential tax reforms.

## REVISED MEDICAID ESTIMATES – UPDATING BASELINE PROJECTIONS

The Executive Budget contains the appropriations necessary to fund the projected costs of the Medicaid program for the upcoming biennium. The projections can be divided into two parts: the estimated costs of the existing program, or the baseline; and the estimated costs or savings of any new proposals.

The “baseline” portion is the projected cost of the program under current law. While the Executive Budget, and the versions passed by each chamber of the General Assembly, have all contained a number of reform items, my purpose today is to provide you with information about the Administration’s updates to our baseline projections based upon more recent information.

The updated baseline projection for all funds Medicaid spending has increased by $1.2 billion over the biennium, of which $74.4 million is GRF State share ($47.3 million in fiscal year 2020 and $27.1 million in fiscal year 2021). The increase is principally federal because a significant portion of the increase is attributable to changes within populations with a higher federal match rate.

In addition to the caseload updates recommended by the Department of Medicaid for the upcoming biennium, we are now experiencing higher average managed care costs for some populations. The Department of Medicaid’s actuaries have reviewed the rates associated with behavioral healthcare redesign and found that the rates were not resulting in expected utilization and spending, requiring rate adjustments to address reduced access in key areas. These changes are included in this update to ensure access and program efficiency.

Counterbalancing some of these increases, savings were also realized in our updated projections. This includes an increase in the federal medical assistance percentages, also known as the FMAP. Fiscal year 2021 projections include an increase in the FMAP from 63.17 percent to 63.4 percent, which will allow the state to draw down additional federal funding.

## GOVERNOR DEWINE’S PRIORITIES

Upon reviewing the budget as passed by the House and as passed by the Senate, Governor DeWine and Lt. Governor Husted appreciate your shared commitment to investing in Ohio’s families and children, our local communities, workforce and innovation, our state’s natural resources, and in guiding our citizens to recovery from addiction and its impacts. You have shown a true dedication to our future and for continuing to make Ohio a great place to live, work, and raise a family.

## CONCLUSION

Mr. Chairman, members of the Committee, my sincere thanks for the opportunity to address you today. Each member of the Cabinet and I stand ready to provide any assistance and information you may require as you work to finalize the budget bill. I would be happy to answer any questions.

**Attachment 1**

**General Revenue Fund Baseline Revenues**
**Fiscal Year 2019**
dollars in millions

| Revenue Source | Mar-2019 Executive Budget | Jun-2019 Conference Committee | Conference vs. Executive $ Change |
|---|---|---|---|
| Non-Auto Sales & Use | $9,050.0 | $9,056.0 | $6.0 |
| Auto Sales & Use | $1,501.4 | $1,510.0 | $8.6 |
| Subtotal Sales & Use | $10,551.4 | $10,566.0 | $14.6 |
| | | | |
| Personal Income | $8,600.0 | $8,880.0 | $280.0 |
| | | | |
| Corporate Franchise | $0.0 | $1.6 | $1.6 |
| Financial Institutions Tax | $211.0 | $203.5 | ($7.5) |
| Commercial Activity Tax | $1,564.6 | $1,620.9 | $56.3 |
| Petroleum Activity Tax | $8.0 | $10.0 | $2.0 |
| Public Utility | $138.0 | $143.0 | $5.0 |
| Kilowatt Hour Tax | $353.0 | $345.3 | ($7.7) |
| Natural Gas Consumption | $69.5 | $75.9 | $6.4 |
| Foreign Insurance | $277.0 | $292.0 | $15.0 |
| Domestic Insurance | $289.6 | $289.6 | $0.0 |
| Other Business & Property Tax | $0.0 | $0.0 | $0.0 |
| Cigarette and Other Tobacco | $927.4 | $921.1 | ($6.3) |
| Alcoholic Beverage | $55.0 | $55.0 | $0.0 |
| Liquor Gallonage | $49.0 | $49.0 | $0.0 |
| Estate | $0.0 | $0.1 | $0.1 |
| **Total Taxes** | **$23,093.5** | **$23,453.0** | **$359.5** |
| | | | |
| Earnings on Investments | $100.0 | $107.3 | $7.3 |
| Licenses and Fees | $58.3 | $64.1 | $5.8 |
| Other Income | $74.7 | $71.6 | ($3.1) |
| Interagency Transfers (ISTVs) | $15.8 | $16.4 | $0.6 |
| **Total Non-Tax Revenue** | **$248.8** | **$259.4** | **$10.6** |
| | | | |
| **Transfers In** | **$309.6** | **$295.6** | **($14.0)** |
| | | | |
| **Total Sources Excluding Federal Grants** | **$23,651.9** | **$24,008.0** | **$356.1** |

**Attachment 2**

**General Revenue Fund Baseline Revenues**
**Fiscal Years 2020-2021**
dollars in millions

Baseline reflects several tax policy changes effective in fiscal year 2020, notably the expansion of the earned income tax credit and the sales tax exemption for optical goods; also reflects the repeal of the sales tax on internet access services effective in fiscal year 2021.

| Revenue Source | FY 2020, Mar-2019 Executive Budget | FY 2020, Jun-2019 Conference Committee | FY 2020, Conference vs. Executive $ Change | FY 2021, Mar-2019 Executive Budget | FY 2021, Jun-2019 Conference Committee | FY 2021, Conference vs. Executive $ Change |
|---|---|---|---|---|---|---|
| Non-Auto Sales & Use | $9,322.2 | $9,338.0 | $15.8 | $9,370.7 | $9,377.5 | $6.8 |
| Auto Sales & Use | $1,555.0 | $1,548.0 | ($7.0) | $1,601.8 | $1,592.0 | ($9.8) |
| Subtotal Sales & Use | $10,877.2 | $10,886.0 | $8.8 | $10,972.5 | $10,969.5 | ($3.0) |
| | | | | | | |
| Personal Income | $9,184.0 | $9,240.0 | $56.0 | $9,507.0 | $9,541.0 | $34.0 |
| | | | | | | |
| Corporate Franchise | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Financial Institutions Tax | $200.0 | $200.0 | $0.0 | $200.0 | $200.0 | $0.0 |
| Commercial Activity Tax | $1,608.4 | $1,640.0 | $31.6 | $1,639.6 | $1,659.0 | $19.4 |
| Petroleum Activity Tax | $8.0 | $10.0 | $2.0 | $8.0 | $10.0 | $2.0 |
| Public Utility | $135.0 | $140.0 | $5.0 | $135.0 | $140.0 | $5.0 |
| Kilowatt Hour Tax | $340.2 | $335.9 | ($4.3) | $333.6 | $330.1 | ($3.5) |
| Natural Gas Consumption | $69.5 | $77.9 | $8.4 | $69.5 | $79.4 | $9.9 |
| Foreign Insurance | $277.0 | $292.0 | $15.0 | $277.0 | $292.0 | $15.0 |
| Domestic Insurance | $301.2 | $301.2 | $0.0 | $313.2 | $313.2 | $0.0 |
| Other Business & Property Tax | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Cigarette and Other Tobacco | $909.4 | $903.2 | ($6.2) | $892.1 | $886.0 | ($6.1) |
| Alcoholic Beverage | $56.0 | $56.0 | $0.0 | $56.0 | $56.0 | $0.0 |
| Liquor Gallonage | $50.0 | $50.0 | $0.0 | $51.0 | $51.0 | $0.0 |
| Estate | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| **Total Taxes** | **$24,015.9** | **$24,132.2** | **$116.3** | **$24,454.5** | **$24,527.2** | **$72.7** |
| | | | | | | |
| Earnings on Investments | $110.0 | $110.0 | $0.0 | $130.0 | $120.0 | ($10.0) |
| Licenses and Fees | $58.3 | $58.3 | $0.0 | $58.8 | $58.8 | $0.0 |
| Other Income | $77.7 | $77.7 | $0.0 | $78.3 | $78.3 | ($0.0) |
| Interagency Transfers (ISTVs) | $13.2 | $13.2 | $0.0 | $9.0 | $9.0 | $0.0 |
| **Total Non-Tax Revenue** | **$259.2** | **$259.2** | **$0.0** | **$276.1** | **$266.1** | **($10.0)** |
| | | | | | | |
| **Transfers In** | **$250.9** | **$256.5** | **$5.6** | **$291.7** | **$295.1** | **$3.4** |
| | | | | | | |
| **Total Sources Excluding Federal Grants** | **$24,526.0** | **$24,647.9** | **$121.9** | **$25,022.3** | **$25,088.4** | **$66.1** |