Office of Budget and Management
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Amended Substitute House Bill 153
Conference Committee Testimony
on the FY 2012-2013 Operating Budget

Timothy S. Keen, Director
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Mr. Chairman, members of the Conference Committee, thank you for the opportunity to testify today on HB 153, the FY 2012 and 2013 biennial operating budget for the State of Ohio.

We are well on the way to passage of a historic budget that meets Governor Kasich's goals of returning Ohio to firm financial footing and reforming operations of state and local government in order to restore Ohio's economic competiveness and set the stage for future job growth.

The Governor is pleased with the time and effort both chambers have devoted to review and refine the Executive Budget proposal over the past three months.

Both versions of the bill eliminate the $7.7 billion structural imbalance identified in January; without raising taxes, while preserving the personal income tax cut that took effect on January 1st of this year. Both versions of the bill increase state formula support for primary & secondary and higher education, adopt our proposed Medicaid reforms and cost-containment strategy, and contain many other significant reforms in other state and local government programs.

The Administration looks forward to working with the Conference Committee to resolve the outstanding issues and differences between the various versions of the bill over the next two weeks.

Today, I will present the Administration's revised GRF revenue estimates, as well as the latest Medicaid projections. I will also review the condition of the GRF as FY 2011 comes to a close, and offer the Administration perspective on a budget framework for the Conference Committee.

FY 2011 Year End

Before I turn to the specifics of the revised economic forecast, revenue projections and Medicaid projections, I would like to address OBM's projected FY 2011 year-end status for the GRF.

Based on results year-to-date, FY 2011 tax revenues will be significantly above the original budget estimates in place at the start of the fiscal year. Specifically, OBM estimates FY 2011 GRF tax revenues of $17,731 million, which is approximately $1.0 billion above the original budget estimates reported in the Monthly Financial Report. It should be noted that much of this additional tax revenue has already been accounted for in the updated March estimates that were part of the Executive Budget. A strong personal income tax filing season explains much of the variance between the Executive Budget estimate and the FY 2011 projection that I am presenting today. Attachment 1 displays all three of the projections that I just referenced – the original FY 2011 budget estimates that are reported in the Monthly Financial Report, the updated OBM estimates prepared for the Executive Budget, and the OBM Conference Committee revenue estimates.

As I have previously stated, due to the structure of the current FY 2010-2011 budget, which assumed a number of FY 2011 obligations being pushed off until FY 2012, as well as a number of additional budget issues or problems that we have identified since January, much of this tax revenue overage is needed to ensure that we end FY 2011 in balance. Specifically, we intend to make the June payments to Medicaid managed care plans and ICFsMR, as well as make the June higher education state share of instruction payments, in June rather than delaying them until FY 2012, as was originally planned in the current budget framework. Also, the July 1st payroll will be processed normally in June rather than delayed until FY 2012, as was previously assumed in the current budget framework. There are other spending issues that require additional funding, such as higher-than-originally-estimated property tax relief payments. Furthermore, there are also a number of non-tax revenue items, such as investment earnings, that are not performing as well as originally estimated. A complete list of these items is displayed on Attachment 2.

After meeting all of these FY 2011 obligations as well as transfers of surplus revenue already programmed into HB 153, and after accounting for the statutorily required one-half of one percent ending fund balance, OBM estimates that the state will end the fiscal year with approximately $187 million in unobligated GRF balance. It is the position of the Kasich Administration that this estimated surplus be used to begin to replenish the Budget Stabilization Fund (BSF). Currently the BSF contains a balance of $1.78, down from the slightly more than $1.0 billion balance that existed prior to the end of FY 2009.

Economic Forecast

In preparation for the revenue revision that I am presenting today, a meeting of the Governor's Council of Economic Advisors was held May 18th. As you may recall, the Council met approximately three months earlier, in February, at which time it presented a forecast that projected a continuation of the unusually sluggish recovery that we have experienced through

2010. In the intervening three months, economic performance has slowed as a result of a number of adverse factors that included a jump in oil prices, severe weather and flooding in the South and Midwest, and supply chain disruptions brought about by the earthquake and tsunami in Japan. During this period, the national economy experienced weaker than expected GDP and employment growth. While the Council's February forecast identified most of the risks to the forecast as being to the "upside," by May more of the economic risks were described as being on the "downside."

These risks include continued higher food and energy prices, a tightening of monetary policy that results in higher interest rates, a disruption in financial markets tied to the sovereign debt crisis in Europe, a continued erosion of housing prices and wealth, and continued slow adjustment of the labor market to post-recession conditions. Despite these risks, the revised forecast still calls for continued growth, albeit at a slow pace relative to historical recoveries and expansions, and even slower growth in the near term than the January forecast. But given these low growth levels, the economy is much more vulnerable to shocks or disruptions that could push us into recession.

The OBM economic forecast for the Conference Committee is the Global Insight May 2011 baseline, adjusted to reflect the consensus of the Governor's Council of Economic Advisors, that while the economy will avoid recession, the CY 2011 slowdown currently underway will be more severe than recognized by Global Insight.

The impact of weaker recent performance and greater downside risk to the near-term forecast can be seen in two key economic variables. Looking first at a very broad indicator of overall economic health, U.S. real GDP growth in the May 2011 Global Insight baseline forecast has been reduced to 2.7 percent in CY 2011 from 3.2 percent in the January baseline forecast.

The May baseline pegs CY 2012 growth at 2.9 percent, unchanged from the January forecast, but also reduces the CY 2013 growth figure to 2.8 percent from January's 3.1 percent. While these differences in growth may not seem large, by CY 2013 they amount to a difference of over $100 billion in real GDP between the January and May forecasts.

In addition, the June 2011 Global Insight baseline forecast, which was released too late for us to use as the official basis for our revenue forecast, reduced near-term real GDP growth further still. CY 2011 growth was revised downward to 2.5 percent and CY 2012 growth was revised downward to 2.7 percent. This takes another $50 billion out of projected U.S. real GDP by CY 2013. I believe that the adjustments the administration made to the May 2011 baseline in some degree anticipated the further erosion of the baseline forecast in June.

The second key variable to discuss is Ohio wage and salary income. Wage and salary income is both the most important driver of employer withholding collections, which make up approximately 85% of net personal income tax revenues, and a significant factor in sales tax revenues. For this indicator I turn to the Governor's Council of Economic Advisors and its consensus forecast. The February 2011 forecast of the Council for wage and salary income in Ohio for both fiscal years 2012 and 2013 was 4.0 percent growth. At the May meeting of the Council, that forecast was revised downward to 3.5 percent growth in FY 2012 and 3.6 percent growth in FY 2013. Again, while these revisions in growth rates may not seem that large, on a FY 2011 base of about $225 billion, a half-percent reduction in growth represents a loss of more than $1 billion in earned income.

Revised Revenue Estimates

Based on the economic forecast I have described above, the Office of Budget and Management, in conjunction with the Department of Taxation, has developed revised revenue estimates for Conference Committee. These revenue estimates are impacted by the assumption that economic growth in CY 2011 will be below the already slow growth rates experienced during the recovery to date. In calendar years 2012 and 2013, revenue projections are impacted by the assumption that the pace of expansion accelerates to the below-trend levels experienced prior to the current slowdown.

As a result of this revised economic forecast, OBM has applied a conservative approach in updating revenue estimates for the Conference Committee. Despite taking this more conservative approach, the Administration's policy-adjusted revenues for fiscal years 2012 and 2013 have increased relative to the estimates presented in the Executive Budget. The revised revenues, displayed on Attachment 3, project GRF tax revenues will be $49.5 million and $374.6 million higher in fiscal years 2012 and 2013, respectively. This growth relative to the Executive Budget estimates in FY 2012 is largely the result of an increase in the personal income tax and corporate franchise tax estimates, which combine to offset decreases in the two sales taxes as the soft patch in the current economic recovery is felt mostly in FY 2012. FY 2013 increases primarily due to the strength of the personal income tax, which when compared to the Executive Budget estimates has increased by $267.1 million. Also contributing substantially to the increase in the 2013 estimates is the non-auto sales tax, which – after a soft 2012 – is estimated to rebound and see growth of $76.9 million relative to the Executive Budget estimates. This results in year-over-year growth, in tax receipts of $901.6 million, or 5.1 percent, in

FY 2012 and $1.707 billion, or 9.2 percent, in FY 2013. Note that these growth rates are largely the result of policy changes contained in the bill and not underlying economic activity.

Non-tax revenues are also revised upward slightly in FY 2012 and by $8.2 million in FY 2013. This brings total GRF revenue, including federal, to $49.9 million above the Executive Budget in FY 2012 and $382.8 million above the Executive Budget in FY 2013.

<u>Revised Medicaid Estimates</u>

I would like to thank the members of the General Assembly for accepting the overall framework of our proposed Medicaid program and for improving it in several instances. As you know, Governor Kasich's creation of the Office of Health Transformation has led to a comprehensive review of the program across all related agencies, which in turn has generated the significant reform proposals contained in House Bill 153. While the Medicaid program is budgeted across multiple line items, which in the Executive Budget totaled $18.8 billion in FY 12 and $19.9 billion in FY 2013, I would like to focus today on the GRF 600525, Health Care/Medicaid line item in the Department of Job and Family Services, which has been the traditional focus regarding budget forecasts.

The Executive Budget recommended appropriations for the 600525 line item in the amount of $11.815 billion in FY 2012 and $13.171 billion in FY 2013. These estimates reflected projected costs of the program, assuming adoption of our proposed reforms. As is tradition, based upon more recent caseload numbers and other factors, we have updated our estimates from the Executive Budget Medicaid projections for Conference Committee, as shown in Attachment 4. We now project that the Executive Budget, as introduced, would require appropriations in

600525 of $11.811 billion in FY 2012 and $13.206 billion in FY 2013, which is a reduction of $4.0 million in FY 2012 and an increase of $34.5 million in FY 2013.

What is most relevant to note today, however, is our projected appropriation need for 600525 based upon House Bill 153 as amended by the General Assembly. Both the House and Senate versions of the bill included some changes to the Executive framework, such as supplemental funding for the PASSPORT program and the policy concerning the prior authorization restrictions for certain prescription drugs.

Using our updated projections, and incorporating our estimates of the policy changes made by the Senate, we estimate that the appropriation levels needed to fund the Senate version of the bill are $11.891 billion in FY 2012 and $13.344 billion in FY 2013. However, in part because the Senate used the Legislative Service Commission's March baseline estimates, the bill as passed by the Senate contains GRF spending levels of $11.805 billion in FY 2012 and $13.076 in FY 2013. Therefore, we believe it is necessary to increase appropriations in the As Passed by the Senate bill by $86.1 million ($31.1 million state share) in FY 2012 and by $268.0 million ($98.0 million state share) in FY 2013. We look forward to discussing our revised Medicaid projections during Conference Committee deliberations to ensure adequate funding for the program through the next biennium.

Administration's Perspective on a Budget Framework for the Conference Committee

The Governor has been pleased with the cooperative working relationship we have enjoyed with both houses of the General Assembly during the budget process to date. We look forward to a continued productive engagement with the legislature as members of the Conference Committee work to resolve the difference between versions of the bill. The

Administration stands ready to provide whatever assistance or information this Committee requires to complete its business. To that end, I would like to share the Administration's perspective on the budget framework for the work of the Conference Committee.

Having now provided the Committee with OBM's updated GRF revenues and Medicaid projections, I believe it might be helpful to integrate this information into the appropriation and non-tax revenue assumptions used by the General Assembly to date. My intention is to illustrate the impact of the OBM revisions on the work of the Conference Committee. In this calculation, I use the Senate-passed appropriation levels and non-tax revenue policy assumptions, not because they are the preference of the Administration, but because they incorporate many of the changes made in the House and reflect the most recent legislative action.

Adoption of the OBM revised revenues, along with Senate revenue policy assumptions and use of Senate appropriations using the Administration's revised Medicaid projects, in FY 2012 results in the need to reduce appropriation levels (or make other policy changes) that total $15 million. In FY 2013, this results in available resources totaling $33 million.

Essentially, the use of OBM revisions presented today supports Senate-passed appropriation levels and policy choices, and little more.

Given the fact that the economy is currently experiencing growth levels below the long-term trend and we have entered a period of slowdown from these already slow levels, the Administration would urge the Committee to be conservative in the adoption of both revenue estimates and Medicaid estimates.

With regard to spending levels, we would suggest a framework constructed around conservative revenue and Medicaid projection estimates, with the intent to limit spending to Senate-passed appropriation and resource allocation levels.

As mentioned earlier in my testimony, the Administration supports a Budget Stabilization Fund deposit with available FY 2011 year-end balances, consistent with the Executive Budget framework and current law. The current balance of the BSF is $1.78. Given the unsettled economic outlook, use of unexpected FY 2011 revenues to begin to rebuild the BSF is an appropriate course of action.

Mr. Chairman, I thank you the opportunity to address the Conference Committee today. At this time, I would be happy to answer any questions members of the Committee might have.

Attachment 1

General Revenue Fund Revenues

Fiscal Year 2011

(dollars in millions)

REVENUE SOURCE	July, 2010 Monthly Financial Report	March, 2011 Executive Budget	June, 2011 Conference Committee	Conference vs Executive $ Change	Conference vs MFR $ Change
Auto Sales & Use	893.2	960.0	967.3	7.3	74.1
Non-Auto Sales & Use	6,374.1	6,560.0	6,578.5	18.5	204.4
Total Sales & Use	7,267.3	7,520.0	7,545.8	25.8	278.5
Personal Income	7,567.6	7,900.0	8,176.5	276.5	608.9
Corporate Franchise	132.4	175.0	236.6	61.6	104.2
Commercial Activity Tax	0.0	0.0	0.0	0.0	0.0
Public Utility	180.0	125.0	125.3	0.3	(54.7)
Kilowatt-Hour Tax	167.2	163.0	154.0	(9.0)	(13.2)
Foreign Insurance	250.0	246.5	254.7	8.2	4.7
Domestic Insurance	196.0	199.3	198.8	(0.5)	2.8
Business & Property	24.0	27.0	25.7	(1.3)	1.7
Cigarette	794.0	842.5	848.0	5.5	54.0
Alcoholic Beverage	58.0	56.5	56.3	(0.2)	(1.7)
Liquor Gallonage	36.0	37.0	37.5	0.5	1.5
Estate	60.5	57.0	71.4	14.4	10.9
Total Tax Receipts	**16,733.0**	**17,348.8**	**17,730.6**	**381.8**	**997.6**
Earnings/Investment	87.5	7.5	7.5	0.0	(80.0)
Licenses and Fees	62.0	62.0	62.0	0.0	0.0
Other Income	188.0	163.0	163.0	0.0	(25.0)
ISTV's & IDC's	20.0	20.0	20.0	0.0	0.0
Total Non-Tax Receipts	357.5	252.5	252.5	0.0	(105.0)
Liquor Transfers	136.3	136.3	146.3	10.0	10.0
Transfers In - Other	360.5	360.5	258.5	(102.0)	(102.0)
Transfers In - Temporary	876.0	876.0	876.0	0.0	0.0
Total Transfers In	1,372.8	1,372.8	1,280.8	(92.0)	(92.0)
Total Sources w/o Fed	**18,463.3**	**18,974.1**	**19,263.9**	**289.8**	**800.6**
Federal Grants	8,370.9	8,312.8	8,419.4	106.6	48.5
TOTAL SOURCES	**26,834.3**	**27,286.9**	**27,683.4**	**396.5**	**849.1**

Prepared by the Office of Budget and Management June, 2011

Attachment 2

FY 2011 Budget Balancing Issues

Variance from Original (Monthly Financial Report) FY 2011 Estimates

(dollars in thousands)

Fiscal Year 2011 Projected Additional Tax Revenue	**997,659**
Revenue	**Amount**
Investment Earnings	(80,000)
Other Income - Court Costs	(25,000)
Federal Grants (underspending/estimate error)	(242,197)
Additional Federal - Medicaid June Payments	290,714
Total Revenue Variance	**(56,483)**
Transfers IN	
Cost Savings Days (Non-GRF)	(38,000)
Tobacco Interest Earnings on Securitization Proceeds	(22,000)
Rotary Raids	(30,000)
Liquor Transfers	10,000
KWH	(12,000)
Total Transfer Variance	**(92,000)**
Total Non-Tax Revenue & Transfers In Variance	**(148,483)**
Total Revenue Sources vs MFR	**849,176**
Spending	
Higher Ed Planned Lapses	127,500
Medicaid Managed Care and ICF/MR June Payments	463,909
July 1st Payroll (27th pay)	67,000
Medicaid (underspending relative to original estimate)	(171,848)
Tax Relief	74,500
DMH Disbursement Estimate Error	10,000
Debt Service Lapse	(18,600)
Controlling Board UC/ERI Fund Lapse	(35,500)
Total Spending Variance	**516,960**
Transfers OUT	
Year-End Transfers Out (Executive assumption)	50,000
CAT Subsidy State Aid Offset	111,000
Total Transfer Variance	**161,000**
Total Spending & Transfers Out Variance	**677,960**
Fund Balance Variance	**171,215**
Reduction of Projected MFR Ending Balance to Required Level	**15,491**
Projected Transfer to the Budget Stabilization Fund	**186,706**

Attachment 3

General Revenue Fund Revenue

FY2012 - 2013

(dollars in millions)

	Executive Budget 2012			Executive Budget 2013		
REVENUE SOURCE	**Blue Book March, 2011**	**Conference June, 2011**	*Dollar Change*	**Blue Book March, 2011**	**Conference June, 2011**	*Dollar Change*
Auto Sales & Use	1,005.0	976.7	(28.3)	1,053.0	1,050.4	(2.6)
Non-Auto Sales & Use	6,924.1	6,888.6	(35.5)	7,310.1	7,387.0	76.9
Total Sales & Use	7,929.1	7,865.3	(63.8)	8,363.1	8,437.4	74.3
Personal Income	8,098.0	8,178.8	80.8	8,624.1	8,891.2	267.1
Corporate Franchise	195.0	220.0	25.0	200.0	230.0	30.0
Commercial Activity Tax	363.2	372.5	9.3	735.0	758.5	23.5
Public Utility	140.0	134.7	(5.3)	162.5	144.9	(17.6)
Kilowatt-Hour Tax	317.1	316.3	(0.8)	345.9	340.5	(5.4)
Natural Gas Consumption	66.0	66.0	0.0	66.0	66.0	0.0
Foreign Insurance	252.1	252.1	0.0	260.0	260.0	0.0
Domestic Insurance	213.7	213.7	0.0	223.4	223.4	0.0
Business & Property	38.0	38.0	0.0	38.0	38.0	0.0
Cigarette	817.0	818.3	1.3	790.0	789.7	(0.3)
Alcoholic Beverage	56.5	56.5	0.0	56.5	56.5	0.0
Liquor Gallonage	37.0	37.0	0.0	37.0	37.0	0.0
Estate	60.0	63.0	3.0	63.0	66.0	3.0
Total Tax Receipts	**18,582.7**	**18,632.2**	49.5	**19,964.5**	**20,339.1**	374.6
Earnings/Investment	7.5	7.9	0.4	30.0	38.2	8.2
Licenses and Fees	62.0	62.0	0.0	62.0	62.0	0.0
Other Income	648.0	648.0	0.0	113.0	113.0	0.0
ISTV's & IDC's	15.0	15.0	0.0	15.0	15.0	0.0
Total Non-Tax Receipts	732.5	732.9	0.4	220.0	228.2	8.2
Liquor Transfers	69.5	69.5	0.0	0.0	0.0	0.0
Transfers In - Other	45.3	45.3	0.0	38.1	38.1	0.0
Transfers In - Temporary	0.0	0.0	0.0	0.0	0.0	0.0
Total Transfers In	114.8	114.8	0.0	38.1	38.1	0.0
Total Sources w/o Fed	**19,430.1**	**19,480.0**	49.9	**20,222.7**	**20,605.4**	382.8

Attachment 4

FY 2012-2013 GRF 600525, Health Care / Medicaid, Forecast Comparison

Executive Budget

	FY 2012			FY 2013		
	Executive Budget March, 2011	**Executive Estimate June, 2011**	**Variance**	**Executive Budget March, 2011**	**Executive Estimate June, 2011**	**Variance**
All Funds	*$11,814,893,179*	*$11,810,924,394*	*($3,968,785)*	*$13,171,301,005*	*$13,205,760,284*	*$34,459,279*
State Funds	$4,301,495,337	$4,299,926,962	($1,568,375)	$4,705,852,933	$4,720,014,596	$14,161,663
Federal Funds	$7,513,397,842	$7,510,997,432	($2,400,410)	$8,465,448,072	$8,485,745,688	$20,297,616

HB153 As Passed by Senate

	FY 2012			FY 2013		
	Senate Appropriation	**Executive Estimate of Senate version June, 2011**	**Variance**	**Senate Appropriation**	**Executive Estimate of Senate version June, 2011**	**Variance**
All Funds	*$11,805,172,995*	*$11,891,282,519*	*$86,109,524*	*$13,075,896,589*	*$13,343,858,360*	*$267,961,771*
State Funds	$4,297,729,447	$4,328,863,769	$31,134,322	$4,671,583,382	$4,769,562,850	$97,979,468
Federal Funds	$7,507,443,548	$7,562,418,750	$54,975,202	$8,404,313,207	$8,574,295,510	$169,982,303