



Office of Budget and Management

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GOVERNOR KASICH'S EXECUTIVE BUDGET RECOMMENDATIONS FOR FISCAL YEARS 2018 AND 2019

TESTIMONY OF DIRECTOR TIMOTHY S. KEEN, OFFICE OF BUDGET AND MANAGEMENT

SENATE FINANCE COMMITTEE May 3, 2017

Chairman Oelslager, Ranking Member Skindell, Vice Chair Manning, and members of the Senate Finance Committee, my name is Tim Keen, and I am Director of the Office of Budget and Management. I am pleased to be with you again today to talk about the proposed budget for fiscal years 2018 and 2019. Having appeared before you on April 5th to present testimony and discuss Governor Kasich's Executive Budget recommendations, today I will focus on developments that have occurred since that time, specifically: i) OBM's preliminary assessment of the likely revenue revisions for Conference Committee; ii) April and FY 2017 to-date revenue performance; and iii) a few items of note from the house-passed version of House Bill 49.

GRF REVENUE FORECAST FOR FY 2018 AND 2019

As you may recall when I was before you a month ago, I stated that it was my expectation that, as we entered conference committee, OBM would likely revise downward the GRF revenue estimates for fiscal years 2018 and 2019. Traditionally, GRF revenues are revised at the time of conference committee to reflect actual revenue performance through May, which includes most of the key income tax filing season, and to inform final budget deliberations and funding decisions. During my earlier

appearance, several members of this committee asked if I could provide a more specific estimate of the downward revenue revision. At that time, I noted that any such reforecast would need to reflect actual revenue performance through the key months of April and May. After committee and upon further consideration of these questions, OBM and Taxation undertook a preliminary revenue assessment exercise believing that, given the magnitude of the potential budget impact, such a preliminary assessment would enable a more targeted and proactive response. Based on this preliminary work, OBM determined that revenues would decline by at least \$400 million per year. Legislative leaders were briefed on our assessment and together the Governor, Speaker and President decided that given the magnitude of the likely downward adjustment we should immediately get to work on this problem.

On Thursday, April 13th, Governor Kasich, Speaker Rosenberger, and Senate President Obhof and I had a press conference to announce to the public that revenues are expected to be lowered by at least \$400 million per year and our intention to work together throughout the remainder of the budget process to take the necessary steps to account for the expected revenue reductions and pass a balanced budget that would be signed into law by June 30th.

Let me be clear about my comments with regards to the preliminary assessment of the revenue revisions for Conference Committee -- OBM has not yet made an official, comprehensive re-estimation of revenues. But based on the fact that our revenues have been falling short for the last 15 months and have underperformed even the revised expectations made at the time of the Executive Budget, we believe the forthcoming official reforecast will reflect revenue reductions of at least \$400 million per

year. OBM is still working on revising the FY 2018-2019 GRF revenue forecasts for conference committee. We continue to work with IHS, the national econometric firm that provides us with economic forecasts, to develop an Ohio economic forecast that is informed by what has happened to Ohio revenues over the past 15 months and that will appropriately hedge against the revenue risk for the next two fiscal years. We continue to work with the Department of Taxation on reviewing our forecasting models and testing them against FY 2016 and FY 2017 actual results. We are monitoring income tax results from the federal government and from other states to put our own performance in a broader context. Similarly, we are tracking the sales tax performance of other states to see how our experience compares and, in those cases where we differ from other states, to identify the factors that might be causing our differences. In short, there is a large volume of work still being done to finalize the FY 2018-2019 revenue forecasts, but we expect that when that work is completed in early June, the overall result will be broadly consistent with the preliminary assessment that we shared with legislative leadership. Now let us turn to a review of April and FY 2017 to-date GRF revenue.

FY 2017 GRF REVENUE FORECAST

Let me begin by saying, April revenues were broadly in line with OBM's current expectations, with the income tax performing slightly better than expected but the non-auto sales tax performing modestly worse. Both April and FY 2017 to-date revenue performance remain broadly consistent with our new expectations and our general assessment that the FY 2018-2019 revenue forecasts will need to be reduced by \$400 million or more per year still stands.

Throughout this fiscal year, the underperformance in GRF tax revenues has been centered on the personal income tax and the non-auto sales tax, and April continued that trend. GRF tax revenues for the month were \$159.1 million, or 7.8%, below estimates. Almost all the shortfall was in the income tax, which was \$106.7 million below estimate, and the non-auto sales tax, which was \$44.5 million below estimate. All other tax sources combined were \$7.9 million below estimate. The story is the same for the fiscal year; GRF tax revenues are \$773.7 million, or 4.2%, below estimate, with the income tax and the non-auto sales tax accounting for \$756.7 million of that shortfall. All other tax sources combined are \$17.0 million below estimate.

The April shortfall in the income tax was again driven by refunds, which were \$82 million above estimate, bringing the fiscal year variance up to \$353 million. All other payment categories were a combined \$24.7 million below estimate. Monthly withholding, which had been consistently running at about 3% below estimate throughout FY 2017, modestly exceeded the estimate in April. The other significant source of the April shortfall was payments of tax due, which were \$29.7 million below the estimate of \$493.4 million.

While the income tax, despite falling far short of estimate, performed at least somewhat better in April than OBM had feared, the non-auto sales did not. The non-auto sales tax fell \$44.5 million, or 5.3%, below estimate. April collections were only 0.3% above a year ago. This follows a small year-over-year decline in March, so for the last two months, sales tax collections have been essentially flat compared to last year. These

two months of weak growth have caused the year-over-year change in collections to fall to just 1.9% as of the end of April. The year-to-date shortfall in the non-auto sales tax has grown from \$120 million to \$202 million over the last two months.

Since January of 2016, the non-auto sales tax has had one month each quarter that fell well short of estimate, leading to a shortfall for the entire quarter that has varied from 0.9% to 2.8%. The exception to this pattern were the third and fourth quarters of CY 2016: the third quarter had no big negative variance, while the fourth quarter had two, falling back to back in October and November. OBM's executive budget estimates assumed that this pattern would continue in the last quarter of FY 2017. The April shortfall may confirm this hypothesis if May and June results are close to the estimate; if one of those months has another big negative variance, then the non-auto tax will end up performing somewhat worse than expected for FY 2017.

COMMENTS ON HOUSE BILL 49

The Governor firmly believes that balanced budgets, restrained spending and reduction of the state tax burden have been the most important factors in helping Ohio create 460,000 private sector jobs. Strong and stable finances send a clear signal to the public and the business community that Ohio offers a stable and predictable place to operate a business.

The Governor appreciates the willingness of Speaker Rosenberger and President Obhof to immediately get to work to address the challenge of reduced available resources over the upcoming biennium. The Administration appreciated the opportunity to engage with Speaker Rosenberger and Chairman Smith as they developed the

House version. The Administration is pleased that the House took the necessary first steps towards addressing the projected revenue reductions that we expect to be needed at the start of conference committee. There is still work to be done as the budget works through the process and the Administration looks forward to working with President Obhof this committee and the Senate as you continue to work toward the enactment of a balanced budget for fiscal years 2018 and 19.

Finally let me make a few comments about the House passed version of the budget. As you know, the House gave final approval of their version of the bill yesterday. There are literally hundreds of changes that have been made to both permanent and uncodified law and appropriation levels as contained in the bill as introduced. These changes will take some time for the Administration to fully review and evaluate so I can only offer a few preliminary comments today.

PRIMARY AND SECONDARY EDUCATION

The Governor's executive budget proposal made one change to the foundation formula which the House adopted. The executive budget proposed a guarantee that took into account student population, the House maintained this proposal. Our proposal had a restrained cap which the House slightly modified. The House increased the foundation amounts and capacity aid amounts.

In my previous testimony I discussed at length the importance a funding formula that efficiently and effectively distributes dollars to districts based on capacity and enrollment. The House budget reflects those considerations.

MEDICAID

The executive budget proposed creating a new Medicaid Managed Long-Term Services and Supports (MLTSS) program. This new program would complete Ohio's transition out of government-run fee-for-service and move all remaining Medicaid populations into private sector managed care plans. Managed care has proven to be very successful in improving health outcomes and containing cost in other areas of the Medicaid program. For example, a recent evaluation of the MyCare Ohio program shows that better care coordination for Medicare-Medicaid enrollees reduced high cost nursing facility utilization four percent (2014-2015) and decreased capitation rates 6.8 percent from January 2015 to December 2016 while fee-for-service spending remained flat over the same period. The House chose to prohibit us from moving in this direction until 2021 and we feel this is a lost opportunity to improve quality and reduce cost in the Medicaid program. The Administration proposed that upon the adoption of the MLTSS program that we would make an adjustment to the payment schedule for all managed care which would cover the transitional costs of going from fee for service to managed care. As introduced, the MLTSS proposal is budget neutral. However, the House chose to assume that delaying MLTSS until 2021 would result in cost savings in SFY 2019. The Administration does not believe it is appropriate to assume these savings from the change in the payment schedule without the adoption of MLTSS. We urge the Senate to restore the executive MLTSS proposal to complete Ohio's exit from government-run fee-for-service and ensure that Ohio taxpayers benefit from the significant future savings that are expected to result from managed care long term services and supports.

The House passed budget reduced the Department of Medicaid program appropriations across three funds and line items by over \$5 billion dollars, one-fifth of program spending, in each fiscal year. The amendment permits the Director of Medicaid to request appropriation authority from the Controlling Board, not more than once every six months, outlines conditions of release and states that Controlling Board *may* authorize expenditures if those conditions are met. Essentially, the amendment provides contingent funding for the ongoing Medicaid entitlement program. This amendment certainly creates a challenge for us by creating uncertainty in funding the program. Payments to nursing facilities, hospitals and other Medicaid providers would be at risk every six months. We are very concerned that putting provider payments at risk in the middle of a fiscal year and could undermine the efficient and reliable operation of the Medicaid program, and urge the Senate to remove this provision.

However, I also want to be clear that the Administration wants to work with the General Assembly to advance the priority program reforms. For example, we agree that a fair work requirement would improve the program. The Administration also welcomes the opportunity to work with the General Assembly to ensure complete accountability in the management of the Medicaid program. This collaboration already puts Ohio ahead of most states in terms of the efficient administration of the program.

We look forward to working with the Senate on these issues, and building on our already strong record of implementing reforms that improve health outcomes and overall health system performance while also holding down costs for taxpayers.

DEPARTMENT OF REHABILITATION AND CORRECTIONS (DRC)

The Department of Rehabilitation and Corrections is the fourth largest agency recipient of this budget. We introduced HB 49 with a very restrained operating budget for DRC that depended on a proposal known as T-CAP ("Targeting Community Alternatives to Prison") that would divert significant numbers of non-violent offenders out of the state prison system and into community care. Note that Ohio is one of only seven remaining states where felony 5 offenders are committed to state prison. Treating and serving Ohioans convicted of low level offenses, many of whom are addicted, is twice as effective at about one-third the cost of sending someone to prison. The House has made a series of changes to the T-CAP proposal and we continue to work to understand the intent and impact of those changes. It is important to understand that the ultimate level of funding provided to DRC is directly tied our ability to divert low-level, non-violent offenders from prison. We look forward to working with the Senate to refine the T-CAP proposal and establish an appropriate level of funding to both provide needed community grants that support diversion and to safely and securely operate Ohio's 27 adult correctional institutions.

CONCLUSION

Mr. Chairman, members of the committee, I appreciate the opportunity to be with you again today. The Administration looks forward to working with you as the Senate considers Amended Substitute House Bill 49. At this time, I am happy to answer any questions you may have.

Preliminary

5/3/2017

Table 1
 GENERAL REVENUE FUND RECEIPTS
 ACTUAL FY 2017 VS ESTIMATE FY 2017
 (\$ in thousands)

REVENUE SOURCE	MONTH				YEAR-TO-DATE			
	ACTUAL APRIL	ESTIMATE APRIL	\$ VAR	% VAR	ACTUAL Y-T-D	ESTIMATE Y-T-D	\$ VAR	% VAR
TAX RECEIPTS								
Non-Auto Sales & Use	791,719	836,200	(44,481)	-5.3%	7,626,008	7,828,400	(202,392)	-2.6%
Auto Sales & Use	121,625	124,700	(3,075)	-2.5%	1,136,967	1,143,000	(6,033)	-0.5%
Subtotal Sales & Use	913,343	960,900	(47,557)	-4.9%	8,762,975	8,971,400	(208,425)	-2.3%
Personal Income	781,906	888,600	(106,694)	-12.0%	6,260,845	6,815,200	(554,355)	-8.1%
Corporate Franchise	(24)	0	(24)	N/A	3,371	0	3,371	N/A
Financial Institutions Tax	26,873	33,200	(6,327)	-19.1%	132,595	165,100	(32,505)	-19.7%
Commercial Activity Tax	45,554	39,500	6,054	15.3%	1,005,554	1,027,500	(21,946)	-2.1%
Petroleum Activity Tax	0	0	0	N/A	5,014	4,900	114	2.3%
Public Utility	264	0	264	N/A	72,566	73,900	(1,334)	-1.8%
Kilowatt Hour	30,290	32,400	(2,110)	-6.5%	302,806	288,900	13,906	4.8%
Natural Gas Distribution	3,314	3,900	(586)	-15.0%	35,459	36,300	(841)	-2.3%
Foreign Insurance	(2,235)	(1,000)	(1,235)	-123.5%	334,535	316,700	17,835	5.6%
Domestic Insurance	1,012	0	1,012	N/A	1,170	600	570	95.0%
Other Business & Property	0	0	0	N/A	(678)	0	(678)	N/A
Cigarette and Other Tobacco	72,779	75,300	(2,521)	-3.3%	740,042	733,500	6,542	0.9%
Alcoholic Beverage	4,509	4,300	209	4.9%	47,366	45,300	2,066	4.6%
Liquor Gallonage	3,887	3,600	287	8.0%	38,673	37,300	1,373	3.7%
Estate	86	0	86	N/A	580	0	580	N/A
Total Tax Receipts	1,881,558	2,040,700	(159,142)	-7.8%	17,742,871	18,516,600	(773,729)	-4.2%
NON-TAX RECEIPTS								
Federal Grants	780,466	802,098	(21,632)	-2.7%	9,803,375	10,511,932	(708,557)	-6.7%
Earnings on Investments	13,261	8,700	4,561	52.4%	37,303	25,900	11,403	44.0%
License & Fees	2,224	2,565	(341)	-13.3%	58,468	55,575	2,893	5.2%
Other Income	430	705	(275)	-39.0%	45,974	45,955	19	0.0%
ISTV'S	1	0	1	N/A	9,132	8,800	332	3.8%
Total Non-Tax Receipts	796,382	814,068	(17,686)	-2.2%	9,954,252	10,648,162	(693,910)	-6.5%
TOTAL REVENUES	2,677,940	2,854,768	(176,828)	-6.2%	27,697,123	29,164,762	(1,467,639)	-5.0%
TRANSFERS								
Budget Stabilization	0	0	0	N/A	0	0	0	N/A
Liquor Transfers	0	0	0	N/A	0	0	0	N/A
Transfers In - Other	4,018	9,800	(5,782)	-59.0%	96,862	41,600	55,262	132.8%
Temporary Transfers In	0	0	0	N/A	0	0	0	N/A
Total Transfers	4,018	9,800	(5,782)	-59.0%	96,862	41,600	55,262	132.8%
TOTAL SOURCES	2,681,958	2,864,568	(182,610)	-6.4%	27,793,985	29,206,362	(1,412,377)	-4.8%

Preliminary
5/3/2017

Table 2
GENERAL REVENUE FUND RECEIPTS
ACTUAL FY 2017 VS ACTUAL FY 2016
(\$ in thousands)

REVENUE SOURCE	MONTH				YEAR-TO-DATE			
	APRIL FY 2017	APRIL FY 2016	\$ VAR	% VAR	ACTUAL FY 2017	ACTUAL FY 2016	\$ VAR	% VAR
TAX RECEIPTS								
Non-Auto Sales & Use	791,719	789,154	2,565	0.3%	7,626,008	7,487,296	138,712	1.9%
Auto Sales & Use	121,625	117,369	4,256	3.6%	1,136,967	1,109,618	27,349	2.5%
Subtotal Sales & Use	913,343	906,522	6,821	0.8%	8,762,975	8,596,914	166,061	1.9%
Personal Income	781,906	717,341	64,565	9.0%	6,260,845	6,444,653	(183,808)	-2.9%
Corporate Franchise	(24)	2,001	(2,024)	-101.2%	3,371	32,369	(28,998)	-89.6%
Financial Institutions Tax	26,873	30,341	(3,468)	-11.4%	132,595	159,981	(27,385)	-17.1%
Commercial Activity Tax	45,554	37,080	8,474	22.9%	1,005,554	996,871	8,683	0.9%
Petroleum Activity Tax	0	0	0	N/A	5,014	5,598	(584)	-10.4%
Public Utility	264	1	263	46605.5%	72,566	75,407	(2,842)	-3.8%
Kilowatt Hour	30,290	30,770	(480)	-1.6%	302,806	292,467	10,339	3.5%
Natural Gas Distribution	3,314	3,414	(100)	N/A	35,459	34,061	1,398	4.1%
Foreign Insurance	(2,235)	247	(2,482)	-1005.5%	334,535	317,187	17,348	5.5%
Domestic Insurance	1,012	51	961	1879.1%	1,170	565	605	107.1%
Other Business & Property	0	1	(1)	N/A	(678)	93	(771)	-831.9%
Cigarette and Other Tobacco	72,779	79,012	(6,232)	-7.9%	740,042	768,021	(27,979)	-3.6%
Alcoholic Beverage	4,509	3,106	1,404	45.2%	47,366	44,822	2,543	5.7%
Liquor Gallonage	3,887	3,693	194	5.2%	38,673	37,501	1,172	3.1%
Estate	86	681	(595)	-87.4%	580	1,613	(1,034)	-64.1%
Total Tax Receipts	1,881,558	1,814,260	67,298	3.7%	17,742,871	17,808,123	(65,252)	-0.4%
NON-TAX RECEIPTS								
Federal Grants	780,466	1,000,855	(220,389)	-22.0%	9,803,375	10,311,786	(508,411)	-4.9%
Earnings on Investments	13,261	9,587	3,674	38.3%	37,303	26,167	11,135	42.6%
License & Fee	2,224	1,856	368	19.8%	58,468	55,490	2,978	5.4%
Other Income	430	499	(69)	-13.8%	45,974	44,900	1,074	2.4%
ISTV'S	1	2	(1)	N/A	9,132	866	8,267	954.9%
Total Non-Tax Receipts	796,382	1,012,798	(216,417)	-21.4%	9,954,252	10,439,209	(484,957)	-4.6%
TOTAL REVENUES	2,677,940	2,827,059	(149,118)	-5.3%	27,697,123	28,247,332	(550,209)	-1.9%
TRANSFERS								
Budget Stabilization	0	0	0	N/A	0	0	0	N/A
Liquor Transfers	0	0	0	N/A	0	0	0	N/A
Transfers In - Other	4,018	898	3,120	347.4%	96,862	195,474	(98,612)	-50.4%
Temporary Transfers In	0	0	0	N/A	0	0	0	N/A
Total Transfers	4,018	898	3,120	347.4%	96,862	195,474	(98,612)	-50.4%
TOTAL SOURCES	2,681,958	2,827,957	(145,998)	-5.2%	27,793,985	28,442,806	(648,821)	-2.3%