OHIO LEGISLATIVE SERVICE COMMISSION

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Baseline Forecast of GRF Tax Revenues and Medicaid Expenditures for the FY 2022-FY 2023 Biennial Budget

Testimony before the House Finance Committee

February 4, 2021

Chair Oelslager 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 forecasts for General Revenue Fund (GRF) tax revenues and Medicaid service expenditures in fiscal years 2021 through 2023. The forecasts were developed by LSC's Legislative Budget Office (LBO). These are baseline forecasts, meaning that LBO economists made these forecasts assuming no changes to the current Revised Code tax structure throughout the next biennium. 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. U.S. economic expansion was strong through February of last year, but the COVID-19 outbreak caused severe economic dislocation, starting in March. Despite decreases in employment and wide swings in Ohio gross domestic product, federal income support via the CARES Act and other legislation succeeded in raising the aggregate personal income of Ohioans for 2020 compared with 2019. The economic forecast on which LBO based our revenue forecast projects continuing recovery through the upcoming biennium.

Inflation-adjusted gross domestic product (real GDP) is the broadest measure of economic activity. Nationwide, real GDP declined sharply in the second quarter of 2020, but recovered strongly in the third quarter and continued to grow in the fourth quarter; it decreased by 3.5% in all of 2020. The pattern of Ohio's real GDP growth last year mirrored the national pattern, falling sharply in the second quarter and recovering strongly in the third, which is the latest quarter with actual data published by the federal government. Ohio's real GDP in the third quarter was 3.5% below the peak in the fourth quarter of 2019.

Labor market dislocations due to the pandemic were substantial in 2020 and though employment has partially recovered, it remains well below the level of February 2020. Nationwide payroll employment declined 140,000 in December after growing since April. Industrial production, the output of the country's factories, mines, and utilities, grew 1.6% in December, though that was largely due to production by utilities; manufacturing output grew just 0.9%. Retail sales fell slightly in December from November's level, but were 2.9% above the December 2019 level. In Ohio, total payroll employment fell by 11,500 (0.2%) in December and was about 350,000 below December 2019. Most of that employment loss has been in service industries, particularly the leisure and hospitality sector, which has seen a 125,400 reduction since last year accounting for over one-third of the total job loss. Unemployment rates in the nation and the state have edged lower in recent months but remain higher than before the pandemic.

In developing our revenue forecasts, LBO economists have relied on IHS Markit, a leading economic forecasting firm, for the macro economic forecasts. Specifically, we have used the company's December baseline forecasts for the nation and Ohio as the source 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 during the period corresponding to state FY 2022 and FY 2023. As is detailed in the accompanying forecast book, for the upcoming biennium, IHS Markit's December baseline forecast shows national real GDP continuing to grow, at about a 3.4% annual rate on average, up from 1.0% growth in FY 2021. Ohio's real GDP is also predicted to continue growing during this period, but at a slower average annual rate of about 2.9%. Personal income is forecast to grow during the same period, by about a 2.8% annual rate on average for the nation and about 2.4% on average for Ohio. The unemployment rate is anticipated to average around 4.8% annually for the nation and 5.2% annually for Ohio in the next biennium. Both are lower than the projected annual rates of 7.0% for the nation and 6.8% for Ohio for the current fiscal year. Inflation, measured by the consumer price index, is projected to be around 2.3% through the upcoming biennium.

A number of risks could alter the course of the current expansion. A possible resurgence of the COVID-19 pandemic and any potential set-back in vaccinations could lead to increased labor market dislocations again. The experience of 2020 is instructive, as few foresaw the possibility of the pandemic, and its economic consequences, during the time when the current biennial budget was put together. Exports could be reduced due to events abroad. Though the United Kingdom's exit from the European Union seems to have been accomplished with minimal dislocations, there remains considerable tension between the U.S. and China over trade issues, and some trading partners may have less access to vaccines than the U.S., with negative consequences for their importing U.S.-made goods. As always, there is the possibility of unforeseen geopolitical risks.

As you consider our tax revenue projections, then, 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 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 2022 and FY 2023 assume the current Revised Code tax structure. So, for example, the personal income tax forecast reflects the 4.0% reduction in income tax rates enacted in H.B. 166 of the 133rd General Assembly. But our baseline forecasts assume the Public Library Fund (PLF) and the Local Government Fund (LGF) would each receive 1.66% of GRF tax receipts during the next biennium, which is the percentage established in the Revised

Code. A temporary provision of H.B. 166 increases these two funds' shares of GRF tax receipts during the current biennium to 1.70% for PLF and 1.68% for the LGF.

LBO Baseline GRF Tax Revenue Forecasts (after distributions to PLF and LGF)			
	FY 2021	FY 2022	FY 2023
Total	$24,788.5 million	$25,236.8 million	$26,027.2 million
Dollar Growth	$2,165.3 million	$448.3 million	$790.4 million
Percent Growth	9.6%	1.8%	3.1%

As seen from the table above, for FY 2021, LBO estimates total GRF tax revenue, after distributions to the two local government funds, to be $24.79 billion, which is an increase of $2.17 billion (9.6%) from FY 2020. The estimated high growth rate in FY 2021 reflects the impact of the pandemic on FY 2020 total GRF tax revenue, which declined 3.7% from FY 2019, and the effect of various federal stimulus programs along with the effects of pent-up consumer demand and the shift from services to goods in consumer expenditures, among other factors.

For FY 2022, LBO forecasts total GRF tax revenue to be $25.24 billion, an increase of $448 million (1.8%) from FY 2021. For FY 2023, LBO forecasts total GRF tax revenue to be $26.03 billion, an increase of $790 million (3.1%) from FY 2022. Major GRF taxes are generally forecast to grow at a moderate rate during the upcoming biennium. The forecasted small decrease of 0.3% in income tax revenue in FY 2022 was due entirely to the delay in the tax year 2019 filing deadline that inflated income tax receipts for FY 2021. Income tax revenue is forecast to increase 4.2% in FY 2023. Revenue from the nonauto sales tax is expected to increase 3.9% in FY 2022 and 2.9% in FY 2023. Auto sales tax revenue is expected to decrease somewhat (-0.6%) in FY 2022 after estimated strong growth in FY 2021 (11.8%) and then resume moderate growth of 2.4% in FY 2023. The commercial activity tax (CAT) is forecast to grow 5.7% in FY 2022 and 3.2% in FY 2023, after an estimated decrease of 3.0% in FY 2021, reflecting the anticipated economic recovery after the pandemic. Cigarette tax revenue is projected to decline in both FY 2022 (-3.2%) and FY 2023 (-2.2%). This is due to the continuation of a long-term trend that was temporarily interrupted during the pandemic.

Comparison of LBO and executive budget baseline tax revenue forecasts

LBO economists forecast higher 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 positive numbers indicate a higher LBO forecast for each year.

Summary of LBO and OBM Baseline GRF Tax Revenue Forecast Differences			
	FY 2021	FY 2022	FY 2023
Dollar Difference	$494.1 million	$447.8 million	$390.3 million
Percent Difference	2.0%	1.8%	1.5%

The differences between LBO's forecast and the executive budget forecast for FY 2022 and FY 2023 are mainly due to the forecast difference for FY 2021. The forecasted growth rates for total GRF tax revenue for FY 2022 and FY 2023 are fairly similar between the two forecasts. As indicated earlier, LBO economists forecast total GRF tax revenue to increase by 1.8% in FY 2022 and 3.1% in FY 2023, in comparison with a growth rate of 2.0% in FY 2022 and 3.4% in FY 2023 under the executive budget baseline forecast. However, LBO economists anticipate FY 2021 total GRF tax revenue to grow 9.6% from FY 2020 compared with a growth rate of 7.4% in the executive budget forecast.

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 LBO and the executive 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 and the positive numbers indicate a higher LBO forecast.

Summary of LBO and OBM Baseline GRF Medicaid Forecast Differences			
	FY 2021	FY 2022	FY 2023
Dollar Difference	$19.1 million	-$446.1 million	$155.6 million
State Share	*$5.9 million*	*-$138.3 million*	*$48.2 million*
Percent Difference	0.1%	-1.7%	0.6%

The differences between LBO's and the executive's baseline projections are largely influenced by somewhat different assumptions on caseloads. For example, LBO assumes that the Medicaid caseload level will go up until the fall of 2021, while the executive assumes the caseloads will continue going up until the end of 2021.

For FY 2022, LBO's baseline forecast for Medicaid service expenditures (excluding administrative costs) is $33.24 billion in combined state and federal dollars. This is a $1.94 billion

(6.2%) increase from estimated service expenditures of $31.30 billion for FY 2021. For FY 2023, combined state and federal Medicaid service expenditures are projected to be $34.68 billion, a $1.44 billion (4.3%) increase from FY 2022.

Medicaid caseload is driven by a number of factors. The impact of the COVID-19 pandemic has played a major role on the caseloads since last year. Due to its high uncertainty, it is possible that the pandemic could have a material impact on the forecast presented here. Nonetheless, at this time the total number of persons enrolled in Medicaid is expected to increase from an estimated 3.1 million in FY 2021 to 3.3 million in FY 2022, a 5.6% increase, but decrease to 3.2 million in FY 2023, a 1.5% decrease from FY 2022.

Chair Oelslager 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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