OBM

TESTIMONY ON THE FY 2006-2007 BIENNIAL OPERATING BUDGET SENATE FINANCE AND FINANCIAL INSTITUTIONS COMMITTEE

THOMAS W. JOHNSON, DIRECTOR

APRIL 12, 2005

Chairman Carey, Ranking Member Roberts, and members of the Senate Finance and Financial Institutions Committee, thank you for the opportunity to present to you Governor Taft's FY 2006-2007 biennial operating budget.

The Office of Budget and Management worked long and hard with cabinet directors and others to put together a balanced, responsible budget for the state of Ohio. The product of this work is the lowest GRF growth budget Ohio has seen in 40 years.

As you know, this is the fourth operating budget the Taft Administration has presented to you. This budget continues the priorities Governor Taft has emphasized throughout his tenure as Governor, by advancing comprehensive tax reform, by supporting job creation, and by enabling success for Ohio's children through support for primary, secondary, and higher education. It accomplishes all this while significantly restraining the growth of government spending.

In this budget, we continue to manage state government conservatively. Many of you know the unprecedented steps we have taken over the course of the last several years to balance the budget in challenging economic times, but I'd like to take a few minutes to highlight them to underscore their significance. Over the last four years:

- We've cut $1.4 billion in spending from the operating budget.
- We've closed six state institutions.
- We've reduced the state workforce by more than 3,000 employees.

- We've reduced the state vehicle fleet by 12%.
- We negotiated the most conservative contract ever with state employees; and
- We've worked to control the growth of the Medicaid program.

The cost cutting measures we have employed throughout this administration have been difficult, but agency directors have worked hard and managed through challenging times. As with our current budget, however, the proposal before you offers little relief to these agencies. Governor Taft's budget recommends spending levels at or below current levels for many agencies. Overall GRF spending is held to 1.1% growth in FY 2006 and 2.3% in FY 2007.

BOND RATING AGENCIES

In addition to these historically low spending levels, the Governor's proposal includes other mechanisms to strengthen the state's financial footing. As I shared with you when I testified in support of the capital bill, since the 2001 economic downturn, 14 states have had their credit ratings downgraded by one or more of the rating agencies. Ohio has not had its credit rating downgraded, and the Executive Budget proposal continues to address the major issues deemed important by the bond rating agencies.

- It restores structural balance;
- It reflects a balance between on-going revenue and on-going expenditures;
- It contains limited use of one-time revenue; and
- It includes a provision for a deposit into the rainy day fund should circumstances permit.

ECONOMIC AND REVENUE ASSUMPTIONS

Before I highlight Governor Taft's spending recommendations, I must talk about the economic and revenue assumptions upon which these recommendations are based. The economic forecast was made in January, with input from the Governor's Council of Economic Advisors, which met last November. As it traditionally does in June, the Office of Budget and Management will present the Governor and the Legislature with updated revenue estimates for the next biennium for the budget conference committee negotiations.

The Outlook

The economy is moving in the right direction, just not fast enough. Ohio and much of the Great Lakes region have lagged the rest of the nation, as business here has responded less vigorously to the fiscal and monetary stimulus that have spurred the national recovery.

When the Governor's Council of Economic Advisors met in November to consider the economic outlook nationally and in Ohio, the consensus was for slow to moderate economic growth into calendar year (CY) 2007.

After reaching 4.4% in 2004, real GDP growth is projected to decrease to 3.4% in both CY 2005 and CY 2006. The reluctance of businesses to add workers; the war in Iraq; high oil prices; and rising interest rates all have raised doubts about our ability to sustain economic growth.

The Council anticipates that Ohio employment will grow 1.1% on average in CY 2005 and 1.4% in CY 2006. The Ohio unemployment rate, which was 6.1% in November 2004, is projected to fall to 5.8% on average in CY 2005 and 5.6% in CY 2006.

Despite solid income growth, consumer-spending growth is also expected to slow. U.S. personal income growth is projected to average just over 5.0% annually through CY 2006. Ohio personal income is projected to rise less rapidly than at the national level – by 4.7% in both CY 2005 and CY 2006.

Risks to the Outlook

Nine of the ten business cycle recessions since World War II have corresponded with large spikes in the price of oil. (The exception was the 1960 recession.) The economy is more flexible today than in the past, and we use energy more efficiently. However, oil prices are at a point that they could begin to threaten U.S. or world economic growth.

A second risk is a sharp depreciation in the U.S. dollar or an unexpected rise in inflation that would prompt an abrupt rise in interest rates. The Federal Reserve has so far raised short-term interest rates in small steps, and widespread confidence in the Fed has kept long-term rates down. A loss of confidence in the dollar or the Fed could result in higher interest rates and a downturn in housing construction, motor vehicle production and capital spending – three areas of the economy that have been critical to growth since the 2001 recession.

The consensus forecast of sustained, but slower economic growth, translates into moderate revenue growth for the state's General Revenue Fund for FYs 2006-2007.

TAX REFORM

The revenue estimates included in Governor Taft's budget are also based upon a comprehensive tax reform package – a package that encourages job creation and capital investment; has business and individuals pay their fair share of taxes; and creates a structure where our revenue growth keeps pace with the economy.

The Governor's reform package addresses three problem areas in our system – the Personal Income Tax, Corporate Franchise Tax, and the Tangible Personal Property Tax. This package:

- Largely phases out the tangible personal property tax that discourages investment.
- It phases out the corporate franchise tax – where rates are too high - but because corporations have aggressively looked for loopholes, our collections are low.
- It replaces these two tax sources with a broad-based commercial activity tax based upon sales; and
- It reduces the personal income tax by 21% over 5 years.

While the package eliminates or reduces some taxes and raises others, overall the state will collect $800 million less over the next two years than we would under the current structure.

This package, the details of which Commissioner Wilkins will be sharing with you later today, is critical not only to this budget, but also to the economic future of our state.

LOCAL GOVERNMENT FUNDS

The Executive Budget also proposes to limit growth of distributions from the three local government funds. It continues the current freeze on local government funds, and beginning in January 2006, proposes to decrease the monthly distributions by varied percentages. The reductions are as follows:

- Counties and cities – 20%
- Townships and villages – 10%; and
- Libraries – 5%

These reductions are based upon a local government's reliance on state aid relative to its general and special revenue funding.

- Based upon 2002 data, in Butler County, where the LGF represents 7.8% of the county General Fund, a 20% reduction translates to an overall reduction of 1.6% to the county General Fund.
- In Columbus, where the LGF represents approximately 9.0% of the General Fund, a 20% reduction translates to an overall reduction to the city General Fund of 1.9%.

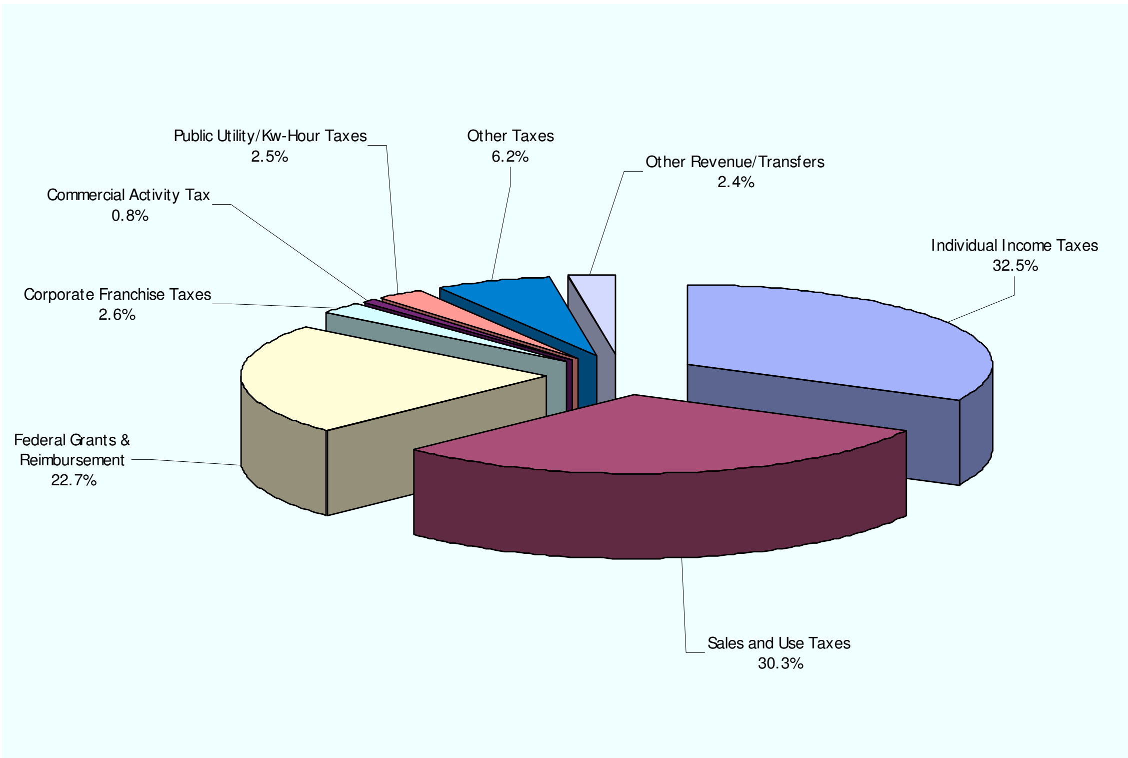
Given that the fiscal year of local governments runs with the calendar year, the additional reductions are delayed until January 2006 to protect current fiscal year budgets. It is important to note that even with the reductions I've just outlined, the state will distribute more than $1 billion per year to local governments.

GRF REVENUE ESTIMATES

The Executive Budget is based upon estimates of total GRF receipts of $25.5 billion in FY 2006 (a 1.8% increase over FY 2005) and $25.9 billion in FY 2007 (a 1.6% increase over FY 2006). The chart on the next page shows revenue projections contained in the Executive Budget for each of the state's major tax sources. The House has selected different revenue estimates, not reflected in these charts, that I will comment on later in my testimony.

Total GRF Estimated Revenues – Executive Budget
By Major Tax Source

FY 2006-2007 Operating Budget
Total General Revenue Fund Estimated Revenues
Biennium Total $51,330.7 million



(Dollars in Millions)

	Estimated Revenue				
Revenue Source	**FY 2005**	**FY 2006**	**% Change**	**FY 2007**	**% Change**
Individual Income Taxes	$ 8,153.2	$ 8,291.0	1.7 %	$ 8,400.4	1.3 %
Sales and Use Taxes	$ 7,880.0	$ 7,604.3	-3.5 %	$ 7,957.9	4.7 %
Federal Grants & Reimbursement	$ 5,773.6	$ 5,760.5	-0.2 %	$ 5,878.1	2.0 %
Corporate Franchise Taxes	$ 820.0	$ 734.0	-10.5 %	$ 604.9	-17.6 %
Commercial Activity Tax	$ -	$ 220.0		$ 205.0	-6.8 %
Public Utility/Kw-Hour Taxes	$ 451.0	$ 628.0	39.2 %	$ 640.9	2.1 %
Other Taxes	$ 1,140.5	$ 1,612.0	41.3 %	$ 1,564.5	-2.9 %
Other Revenue/Transfers In	$ 796.8	$ 607.7	-23.7 %	$ 621.4	2.3 %
Total	$ 25,015.1	$ 25,457.5	1.8 %	$ 25,873.1	1.6 %

Numbers may not add to total due to rounding

Source: Ohio Office of Budget and Management, February 2005

EXECUTIVE BUDGET OVERVIEW

While I can assure you this Executive Budget was crafted through a number of very difficult choices, I believe it is based upon principles the General Assembly and taxpayers can support. As I stated earlier in my testimony, we demonstrate good stewardship of tax dollars by restraining government spending and putting the state on solid financial footing; we invest in priorities and support the government services the citizens of Ohio expect us to provide.

RECOMMENDED APPROPRIATIONS - EXECUTIVE BUDGET

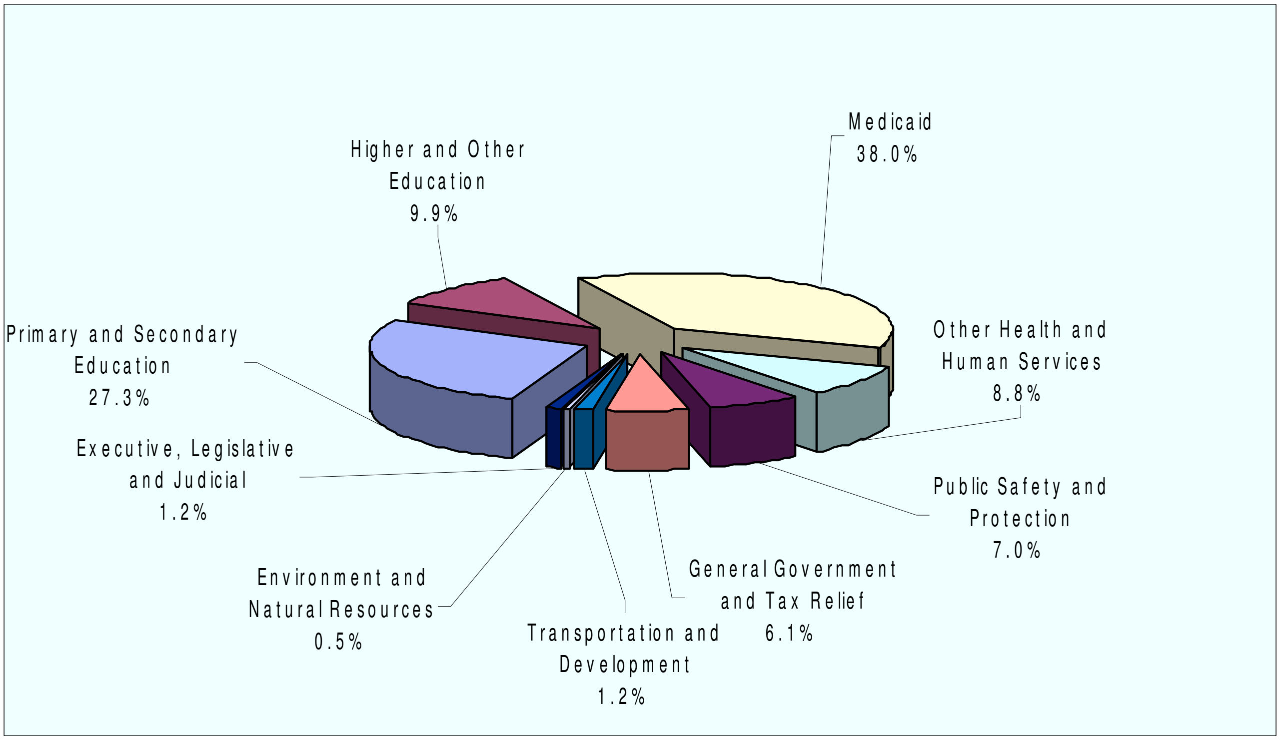
Recommended GRF appropriations in FY 2006 are $25.4 billion, a 1.1% increase over FY 2005 and $26.0 billion in FY 2007, a 2.3% increase over FY 2006.

Recommended appropriations for all funds total $53.1 billion in FY 2006 and $54.6 billion in FY 2007.

	FY 2006	**% Change**	**FY 2007**	**% Change**
GRF	$25.4 billion	1.1%	$26.0 billion	2.3%
All Funds	$53.1 billion	3.3%	$54.6 billion	2.7%

The chart on the next page summarizes GRF recommendations, by major spending category, included in the Executive Budget.

FY 2006-2007 Executive Budget
Total General Revenue Fund Recommended Appropriations
Biennium Total $51,319.8 million



(Dollars in Millions)

Spending Category		FY2005 Estimate		FY 2006	% Change		FY 2007	% Change
Primary and Secondary Education	$	6,765.8	$	6,906.3	2.1%	$	7,096.3	2.7%
Higher and Other Education	$	2,493.7	$	2,503.7	0.4%	$	2,552.5	1.9%
Medicaid	$	9,574.9	$	9,575.9	0.0%	$	9,923.7	3.6%
Other Health and Human Services	$	2,080.7	$	2,238.4	7.6%	$	2,264.6	1.2%
Public Safety and Protection	$	1,743.6	$	1,784.6	2.4%	$	1,818.3	1.9%
General Government and Tax Relief	$	1,653.5	$	1,602.2	-3.1%	$	1,526.8	-4.7%
Transportation and Development	$	305.3	$	311.6	2.1%	$	329.8	5.8%
Environment and Natural Resources	$	154.6	$	135.4	-12.4%	$	133.1	-1.7%
Executive, Legislative and Judicial	$	307.6	$	305.5	-0.7%	$	311.1	1.8%
Total	**$**	**25,079.5**	**$**	**25,363.6**	**1.1%**	**$**	**25,956.2**	**2.3%**

Note: Numbers may not add to total due to rounding
Source: Ohio Office of Budget and Management, February 2005

JOBS AND ECONOMIC DEVELOPMENT

The Governor's number one priority in this budget is tax reform – tax reform that creates jobs and grows our tax base into the future. In addition to the tax reform package, the Governor's proposal contains a number of other job creation and economic development initiatives. Specifically, this budget continues the:

- <u>Worker Guarantee Program</u> – The Executive Budget provides $3 million per year for this program that provides state match funding to assess, screen, and train employees for companies creating 100 or more new jobs.
- <u>Ohio Investment in Training Program</u> – Through an investment of $17.2 million per year, the Governor's budget supports customized training to new and expanding businesses.
- <u>The Third Frontier Initiative</u> – The Executive budget supports core programs for the Governor's Third Frontier Initiative – currently a $1.1 billion, ten-year program of investment in new research, product and process innovation, and job creation. To further this commitment, in November, we'll be asking Ohio voters to approve a special bond issue to advance the goals of the Third Frontier.
- <u>Ohio Business Development Coalition</u> – The Governor's budget provides $5 million per year for this non-profit entity to promote and market the advantages of doing business in Ohio.

PRIMARY AND SECONDARY EDUCATION

Education continues to be a priority for Governor Taft. This is certainly clear in the Governor's support for primary and secondary education. Funding has increased by more than 56% during his administration.

We have made great progress with our K-12 system by implementing recommendations of the Governor's commissions on teaching and student success. We've established an educational system based upon clear expectations and assessments of progress, and we've recognized the importance of teachers by investing in recruitment, preparation and professional development. It was clear to the Governor, however, that we needed to take additional steps to ensure that funding to school districts is provided in a way that allows districts to implement practices that foster student achievement.

To that end, the Governor's FY 2006-2007 budget begins implementation of the funding recommendations made by the Governor's Blue Ribbon Task Force on Financing Student Success. Most of the Task Force recommendations required changes to the Foundation Program, the formula by which most funding to school districts is provided. The Executive Budget proposes funding for Foundation Program line items totaling $6.15 billion in FY 2006 (2.5% above FY 2005) and $6.29 billion in FY 2007 (2.3% above FY 2006). Highlights of the Task Force recommendations in the Executive Budget include:

Base Cost Funding

- Base Cost Per Pupil - The proposed operating budget increases the FY 2005 base cost per-pupil amount. The base cost per-pupil equals $5,328 in FY 2006 (3.1% above FY 2005) and $5,489 in FY 2007 (3.0% above FY 2006).

- Additional Base Inputs - An additional $48.4 million in FY 2006 and $63.6 million in million in FY 2007 is added to the base for professional development, to support student intervention, and to move districts toward the use of data in decisions.
- Cost of Doing Business Factor - The Executive Budget proposes that the cost of doing business factor be eliminated, in favor of targeting resources in a more appropriate way.

Poverty-based Assistance

A guiding principle behind the work of the Task Force was the belief that state resources should be distributed to districts and students who are most in need. The Executive Budget includes funding for a number of initiatives aimed at supporting those districts facing the challenges associated with poverty. Proposed funding for poverty-based assistance totals $434.1 million in FY 2006 (27.6% above FY 2005) and $481.0 million in FY 2007 (10.8% above FY 2006).

Parity Aid

The Executive Budget provides funding of $455.1 million in FY 2006 and $514.6 million in FY 2007 for parity aid. This increases the phase-in percentage to 80% in FY 2006 and 85% in FY 2007 for Ohio's poorest school districts.

Transitional Aid

In addition, because of the number of significant changes to the Foundation formula, Transitional Aid is provided to guarantee that districts receive 100% of prior year total funding in FY 2006 and 98% in FY 2007.

Phasing out Tangible Personal Property Tax

As you know, the Executive Budget proposes phasing out school district reliance on the tangible personal property tax - a tax on machinery, equipment, and inventory. Districts will be held harmless from revenue losses until FY 2011 through a combination of increased Foundation Program funding, and direct payments from a newly imposed Commercial Activity Tax. In fact, the Governor's budget proposes that the state spend $390 million in the next two years to hold schools and local governments harmless from this loss.

Other Education Initiatives

- Ohio Choice Scholarships – The Governor's budget creates Ohio Choice Scholarships in FY 2007, providing $3,500 scholarships for students who attend persistently failing schools, enabling them to choose a more successful chartered, nonpublic school. These scholarships not only offer another route for student success, but also encourage the administration and teaching staff of a failing school to improve upon their students' academic performance.
- Ohio School Facilities Commission – The Executive budget supports the work spearheaded by the Ohio School Facilities Commission by providing financial assistance to school districts to help them maintain their new facilities. The budget includes a provision to equalize a school district's one-half mill maintenance set aside to the statewide per pupil average of $59,025 per pupil.
- Student Success Commission – The Governor's budget recommendations include funding to continue our progress in academic content standards, curriculum models, and local accountability. This budget contains $198.4 million over the biennium for Student Success Initiatives.
- Teaching Success Commission – The FY 2006-2007 budget also continues to advance the goals of the Commission for Teaching Success by providing $95.8 million over the biennium for teacher preparation, recruitment, retention, and professional development.

HIGHER EDUCATION

The Governor's FY 2006-2007 Executive Budget funds implementation of key recommendations made by the Commission on Higher Education and the Economy to improve alignment of student preparation in the primary and secondary years with the pursuit of higher education. This budget expands college access and readiness programs for pre-college students throughout the state, and addresses financial barriers to higher education. The Governor's proposal supports:

- Tuition Caps – The Governor recommends improving access to higher education by limiting tuition growth at Ohio's public colleges and universities to 6% per year. An additional 3% growth is permitted only for the purpose of providing students with need-based financial aid.
- Ohio College Opportunity Grant – A new program, the Ohio College Opportunity Grant, will be phased in over four years to align the state's needs-based college grant program with federal Pell Grant standards and expand eligibility to an additional 11,000 students. This budget expands access to higher education for more families by eliminating the tuition tax deduction and reinvesting those dollars in the Ohio College Opportunity Grant. Additionally, the new program increases the maximum grant award for students attending public institutions from $2,190 under the current Ohio Instructional Grant to $2,496, an increase of 14%.
- Ohio's Partnership for Continued Education – Funding of $300,000 is provided in each fiscal year to support a P16 council that will work to create a single comprehensive education system – from early childhood through adulthood.

- College Readiness & Access – The Ohio College Access Network (OCAN) will receive $600,000 in FY 2006 and $700,000 in FY 2007 in new funding to expand upon current programming, and reach into counties that are currently underserved, but have significant need for college access and readiness programs.
- High School Improvement – The Executive budget provides $9.3 million in FY 2006 and $12.5 million in FY 2007 to support High School Improvement initiatives that promote new models to fully prepare high school students for the world of work and college. These initiatives include:
    - Early College High Schools: Partnerships between high schools and higher education so that high school students from urban settings have an opportunity to earn college credit toward an associates.
    - High School Transformation Initiative: The conversion of existing large, urban high schools into small, personalized high schools for improved teaching and learning.
    - Project Lead the Way: Pre-engineering high school curriculum to support students interested in pursuing engineering professions and stimulate the growth of career pathways that meet business and industry workforce needs.

SUPPORTING SENIORS AND FAMILIES

Governor Taft's commitment to the seniors and families of this state is evident through a number of initiatives. Examples include:

- PASSPORT – GRF funding of $112 million in FY 2006 (8.0% above FY 2005) and $121 million in FY 2007 (8.0% above FY 2006) is provided to help fund the state's PASSPORT waiver.
- Assisted Living – The Governor's proposal creates an assisted living waiver in FY 2007 to offer another, less costly option to nursing home care. The waiver will be available statewide to eligible Medicaid recipients who would be moving from a nursing home, PASSPORT or Choices waiver, or the Home Care waiver. The waiver will serve up to 1,800 people.
- TANF – Ohio's TANF spending plan totals $2.7 billion for the FY 2006-2007 biennium. Through these funds the state provides public assistance focused on employment, personal responsibility, and sustained self-sufficiency. In our plan, additional funding is provided to:
  - Increase the Ohio Works First cash benefit by 10%;
  - Expand eligibility for subsidized child care from 150% to 185% of the federal poverty level;
  - Fund a limited number of state and county demonstration projects to test promising prevention and intervention strategies for high-risk, hard-to-serve populations; and
  - Fund an Early Learning Initiative for low-income 3 and 4 year olds.
- Behavioral Health Services for Children – The Governor's budget also contains language and funding to support an area of grave concern to us all – providing appropriate services and supports to children with serious behavioral health problems and their families. Through a

variety of funding sources, this budget commits more than $25 million each fiscal year to improve access and quality.

MEDICAID

Medicaid is the largest single program in the state, accounting for nearly 40% of the state's general revenue fund (GRF) spending. Medicaid provides health care coverage to one in every eight Ohioans, including low-income working parents and their children, elders, and people with disabilities. One in four children and one in four seniors over the age of 85 receive services funded through the Medicaid program.

Without any changes to current law, the baseline growth in Medicaid is over 10% per year (see chart).

	FY 05	**FY 06**	**Change**	**FY 07**	**Change**
Total ODJFS Medicaid Services	$10.6 billion	$11.9 billion	12. 8%	$13.0 billion	9.3%
GRF (both federal and state shares)	$9.6 billion	$10.7 billion	11.4%	$11.7 billion	10.0%

In order to support some of the key services that I have just discussed, such as primary and secondary education and higher education, Medicaid spending must be restrained. The administration has proposed implementing several strategies to limit the growth of Medicaid spending. Many of these steps are consistent with recommendations of the Ohio Commission to Reform Medicaid. Specifically, this budget:

- Expands managed care statewide for covered families and children;
- Reduces and freezes provider rates, and
- Reduces optional services and eligibility.

The Executive Budget reduces nursing facility rates by 3.0% in FY 2006 and freezes them in FY 2007. It also removes the automatic rate increases for these providers from statute to ensure we are investing our resources in a way that reflects consumer demand and offers greater choices for Ohio families.

Combined, these cost management initiatives reduce projected GRF spending (both federal and state shares) by $813 million in fiscal year 2006 and $1.5 billion in fiscal year 2007.

Even with aggressive cost containment, the state will spend $10.9 billion in FY 2006 and $11.1 billion in FY 2007 to maintain a health care safety net for 1.8 million Ohioans and to provide invaluable services for children.

Medicare Part D

Before I leave the topic of Medicaid, I'd like to say a few words about Medicare Part D, a federal program that will impact Medicaid spending in the upcoming biennium. Enacted in 2003, Medicare Part D changes how prescription drugs are funded for dual-eligible individuals, those who qualify for both Medicare and Medicaid. Currently, the state pays for these drugs, and we are reimbursed by the federal government - just as we are for other Medicaid services. Beginning in January 2006, however, this will change. Under Medicare Part D, the federal government will pay for these drugs directly and charge the state a premium for our "fair share" of the costs. I wanted to bring this to your attention, because inclusion of Medicare Part D in the Medicaid appropriation distorts overall growth rates. In order to get an "apples to apples" comparison, you must remove Medicare Part D from the equation. When you do this, GRF appropriations for Medicaid grow by 2.9% in FY 2006 and 4.3% in FY 2007.

MANAGING LIMITED RESOURCES

The FY 2006-2007 Executive Budget reduces or flat funds the majority of the state's GRF funded agencies, consolidates functions or activities of several state agencies, and holds down the costs of one of the fastest growing programs in state government—Medicaid. Of the state's 68 GRF funded agencies, 36 will either remain at FY 2005 GRF levels or decrease their reliance on GRF funding.

The FY 2006-2007 Executive Budget was developed through careful scrutiny of state programs and activities. Funding increases reflect investments in key priorities and support for essential state services.

INSTITUTIONAL AGENCIES

Approximately, 10% of our overall GRF spending is dedicated to supporting the state's institutional agencies. As in every other area of government, the recommendations included in the Governor's proposal for the departments of Rehabilitation and Correction, Youth Services, Mental Health and Mental Retardation and Developmental Disabilities are tight. They are conservative but adequate to support the services we're expected to provide.

- <u>Department of Rehabilitation and Corrections</u> - GRF funding for the Department of Rehabilitation and Correction is $1.48 billion in FY 2006 (2.6% above FY 2005) and $1.50 billion in FY 2007 (1.7% above FY 2006). Executive Budget recommendations fund 32 institutions including inmate medical and mental health services, as well as parole operations and community correction programs. Currently no institutional closures are planned.

- Department of Youth Services - GRF funding for the Department of Youth Services is $244.5 million in FY 2006 (4.0% above FY 2005) and $252.3 million in FY 2007 (3.2% above FY 2006). Increases in funding are targeted to address issues with the female and sex offender populations.
- Department of Mental Health - GRF funding for the Department of Mental Health increases by approximately 3.0% in each year of the biennium to maintain inpatient capacity, essential community services, and improve children's services.
- Department of Mental Retardation and Developmental Disabilities - GRF funding for the Department of Mental Retardation is relatively flat over the biennium reflecting the closing of two institutions and a transition to community-based care.

MORE EFFICIENT GOVERNMENT

In addition to significantly restraining agency spending, this budget consolidates functions of several state agencies to realize cost savings, improve accountability and better align activities with agency missions. I'd like to share a few examples. Specifically, the Governor's proposal:

- Merges the functions of the Office of Criminal Justice Services into a division of the Department of Public Safety;
- Advances accountability and operational efficiencies by consolidating the administrative functions of 27 professional regulatory boards under the umbrella agencies of Commerce, Health and Public Safety;

- Transfers two worker safety programs from the Department of Commerce to the Bureau of Workers' Compensation (BWC), as found in the recently enacted BWC operating bill; and
- Consolidates the School Net and the Ohio Educational Telecommunications Network Commissions. We expect to see a final proposal in the coming weeks from the work group for this consolidation.

HOUSE ACTIONS

As you know, the House is finishing its work on House Bill 66. Meanwhile, the Governor's Office and OBM continue to work with the House and the latest version of the bill to understand changes made to the Executive Budget. From the analysis completed to-date, the Governor's Office and OBM are very grateful for the support the House has given to the Executive Budget and are pleased to say the House's actions continue a majority of the Governor's vision for Ohio. We are specifically pleased that the House retained the major provisions of the Governor's tax reform package, which is vital for Ohio's economic prosperity. However, there are a few areas of concern with the actions being taken by the House, which we believe will require additional work.

TAX REFORM

The House's support for Governor Taft's tax reform package is appreciated. The tax reform proposal seeks to reduce the burden on investment, encourage capital formation, increase productivity, and encourage growth in employment and income. However, the administration feels that the tax exemptions afforded by the House to certain groups work against the guiding principles of a quality tax system; specifically the principles of tax equity and simplicity. Respectfully, we request the Senate to reconsider the House-added exemptions.

REVENUE PROJECTIONS

The Executive Budget estimates that GRF sources, excluding federal grants, will total $19.7 billion in FY 2006 and $19.9 billion in FY 2007. The comparable estimates developed by LSC are $60.0 million greater in FY 2006 and $126.2 million greater in FY 2007. For the biennium, there is a 0.47% difference between the OBM and LSC estimates. The variation in the two sets of estimates is due to differences in sales tax, personal income tax, and corporate franchise tax estimates. OBM prefers the more conservative estimates presented in the Executive Budget, although we recognize that LSC presented a reasonable set of estimates as well. The chart below illustrates the differences between the OBM and LSC revenue estimates:

in millions	**FY 2006**			**FY 2007**		
	OBM	**LSC**	**Difference**	**OBM**	**LSC**	**Difference**
GRF – Excluding Federal	$19,697.0	$19,757.0	$60.0	$19,995.0	$20,121.2	$126.2

PRIMARY AND SECONDARY EDUCATION

As I mentioned, the Governor incorporated the recommendations of the Blue Ribbon Task Force on Financing Student Success in his proposal for primary and secondary education funding in FY 2006 and 2007, which implements the building blocks funding model. While the House adopted most of the funding model for FY 2007, we recommend beginning the new plan in FY 2006 in order for the state's resources to be targeted to the districts that need it most.

The Governor also encourages the maintenance of adequate funding for Student Assessments to allow for continued development of both achievement and diagnostic tests. We understand the House Finance and Appropriations substitute bill has decreased funding available for the diagnostic tests which are an important assessment piece for the identification of specific areas of strengths and weaknesses for students to ensure continued progress.

The House substitute bill includes the aggressive implementation of a statewide school voucher program beyond that which was proposed in the Executive budget proposal. While the administration is supportive of the concept, we caution against the rate and scope of the House proposal given the uncertainty of the program's full potential impact.

While the House made adjustments for the anticipated higher ADM, both the Executive and House proposed budgets for the education foundation program are not based upon property valuations data that only recently has been updated by the Department of Taxation. Updated property valuations are expected to be lower than those used previously, thus increasing the state share for primary and secondary education. The potential impact of this revised data should be fully considered as the Senate deliberates.

HIGHER EDUCATION

We appreciate the House's support for the Executive Budget's funding levels for higher education. Based on the Higher Education Subcommittee of House Finance report, it appears that the House has collapsed several of Board of Regents appropriation line items into one line item for FY 2007, while a workgroup will redefine the allocation methodology for the State Share of Instruction. We recommend careful consideration of the various Challenge Programs, which aim to support the work of the Commission on Higher Education and the Economy.

MEDICAID

It is our understanding that the House has used the average of the Executive Budget and Legislative Service Commission (LSC) Medicaid caseload estimates. LSC's caseloads are lower than those used to prepare the Executive Budget and we encourage returning to the Executive Budget estimates. We continue to work with the House to better understand their estimates and the resulting impact to budget.

Additionally, the House increased nursing home funding by 3% over the Executive Budget. The House also chose to leave the nursing home reimbursement rate formula in state statute. In doing so, the funding level for nursing homes will continue to increase at an unaffordable rate. The administration asks that the Senate return nursing home funding to our recommended levels and remove the reimbursement rate formula from statute.

The Executive Budget proposed an assisted living waiver to provide another popular and less costly option to nursing home care. The House reduced the number of people served by the waiver and limited the facilities that may participate in this program. The administration asks that the Senate return to our initial plan.

Lastly, the administration supports the House concept of providing managed care for a sub-set of the Aged, Blind and Disabled (ABD) population. However, it is imperative that we acknowledge the scope and magnitude of this initiative. The administration is reviewing cost projections associated with this initiative, as well as the time and provider management tools the state would need to effectively implement this new plan.

INSTITUTIONAL AGENCIES

As I mentioned previously, the Executive Budget proposal for the Department of Rehabilitation and Correction is very limited, yet provides for the continued operation of 32 institutions as well as community correction programs. The administration is pleased that the House chose to maintain executive funding levels for the department.

Related to the Department of Mental Retardation and Developmental Disabilities, the House also removed language that would enable the state to lay the groundwork to convert the ICF/MR program to a waiver in FY 2008. The administration asks that this language be restored.

MORE EFFICIENT GOVERNMENT

The House merged 20 of the 27 professional regulatory boards. The administration asks that this be reconsidered and that all provisions regarding the regulatory board consolidation, as found in the Executive Budget, be enacted in hopes of studying and benefiting from potential operational efficiencies.

STATE PARKS

The Governor appreciates the consideration that the House has given to the operation and maintenance of Ohio's state parks, however the administration believes that the park system is better served by a dedicated, sustainable funding stream.

STRUCTURAL BALANCE

Finally, ensuring structural balance is a primary goal of the Taft Administration and we encourage the Senate to exercise caution when using one-time revenue, such as tobacco funds, for state programs.

Again, Governor Taft and OBM appreciate the House's hard work and will share any other concerns for actions taken by the House as we complete our analysis. The administration and OBM are thankful for the willingness of the House to engage us in their deliberations. We look forward to the same cooperative and constructive communication as the Senate begins its work.

CONCLUSION

Governor Taft's FY 2006-2007 biennial operating budget is a forward-looking proposal. It updates our tax structure to reflect our current economy thereby making Ohio a more attractive place for companies to invest. It puts the state on solid financial ground by balancing spending with on-going revenues. It conservatively provides for essential state services while investing in priorities that leverage progress for our future.

Mr. Chairman, members of the committee, I would be happy to answer any questions you may have.