



# OBM

Ted Strickland  
Governor

J. Pari Sabety  
Director

**Testimony of Director J. Pari Sabety**  
**Senate Finance Committee**  
**Wednesday, November 19, 2008**

Chairman Carey, Ranking Member Cafaro and members of the committee. My name is Pari Sabety and I am the Director of the Office of Budget and Management. It is my pleasure to appear before you once again to discuss the current state of Ohio's economy, its impacts on our current two year budget and upcoming FY2010-2011 budget. As you know, Ohio's economy has been negatively impacted by the significant events we are all experiencing in the national economy. As any one of us that has opened our 401(K) statement knows, we are experiencing exceptional conditions. Nationally, experts believe that we are facing a deep national, if not global, recession, and a frozen credit market. Leading this recession are consumers who are reluctant to buy. The added complication of a freeze in credit markets means that companies also are starved for the capital they need for expansions and job creation.

We've seen this in Ohio's budget over the past two years in very clear ways. We introduced HB119, a budget that was balanced in March 2007. By May 2007, we already were seeing enough erosion in national economic conditions and in our state's projected revenues, to subtract almost \$250 million from the budget in conference committee. To date, while implementing HB119's priorities, we have made cash and budget moves to remove almost \$1.3 billion from the budget through the close of FY2009. We continue to monitor the state's economic performance carefully to assure that we are taking early and decisive action to keep our budget balanced.

While the months ahead will be difficult, it seems that the fiscal year 2010-2011 budget will be even more challenging. The state has been facing stiff economic headwinds for almost two years already: volatile peaks in energy prices, a housing market in crisis, the collapse of the credit markets, consumer confidence in a downwards spiral and turmoil in the equity markets here and overseas have taken their

toll on Ohio's economy. Ohio's high exposure to manufacturing, particularly the struggling domestic auto industry limits our outlook. Contraction in the labor market is expected to persist through 2009 before recovering in 2010. Major economists now conclude that the nation has been in a recession for a year already, and it is likely to continue for another year. And this national recession is being felt strongly in Ohio.

- Ohio has lost jobs at the same pace that the national economy has been shedding jobs. And many of our communities are reeling. In the past 6 months; DHL has ceased US operations; GM, Ford and Chrysler are all asking the Federal government for loan or grant assistance.
- Ohio banks and companies are experiencing a significant credit freeze. Bank credit has declined at a precipitous rate not seen in the last 40 years. Companies like Goodyear have had to turn to credit markets to make payroll. This is indeed dangerous. As I am sure you have heard from businesses throughout your districts, without access to credit, companies cannot grow or invest, thus moving our economy forward.
- Ohio's workers are feeling the pinch. Withholding taxes—one of two reliable indicators of the "real time" status of our state's economy—have gone negative, with several months of negative year-over-year performance in this fiscal year. Ohio's income and sales tax revenues have been volatile, and the risk to those two revenue sources is on the downside.
- The Labor Department released new figures on first time unemployment claims on November 13, showing that initial claims had risen to 516,000 for the week ending November 8<sup>th</sup>, matching the number of claims filed in September 2001. This increase in first time claims along with the increase seen in the unemployment rate, which was revised upward to 6.5 percent last week, is a significant negative sign regarding the employment situation. Typically, employment levels tend to rise following a recession, and with current predictions being that the US has just entered a recession and that negative growth will continue through the first half of 2009 the employment situation is likely to worsen further. Since December 2007 the US has lost 1.2 million jobs nationally; 520,000 of those jobs were lost within the last 60 days. Over the past year, Ohio lost 17,600 jobs, 3400 of them in September alone.

- And Ohio's consumers have grown cautious. Consumer confidence is at a level below the levels achieved in the 1980-1982 recession. October retail sales declined by 2.8%, the largest amount since November 2001. The decline was spurred by a substantial drop in automobile sales which fell 2.2%. As consumer spending accounts for nearly two-thirds of gross domestic product (GDP) in the United States, such a dramatic decline will most likely result in negative GDP growth for the current quarter. Should GDP growth for the current quarter turn out to be negative, the US would then fall under the typical definition of a recession, two consecutive quarter of negative GDP growth, as GDP growth declined 0.3 percent in the third quarter. Additionally, such a large decline in retail sales will only further negatively impact sales tax collections, which were already coming in well below their 2007 levels.
- Consumers are rightfully cautious. The housing crisis has taken one trillion dollars out of household wealth in the US over the last year alone. And every 1 penny decrease in consumer wealth translates into a nickel less consumer spending. When consumer spending falls, our economy suffers.
- The National Association of Realtors (NAR) released updated figures on November 7 for their forward looking pending home sales index which showed a 4.6 percent drop in September falling in three of the four regions, and rising only in the West. The index is considered a leading indicator because it is based on pending home sales, which are home sales that have a signed contract but have not been closed. The index was up strongly in August, and was appropriately followed by increases in both new and existing home sales. Overall, the index is still 1.6 percent above its September 2007 level, which suggests that we are currently in a period of prolonged stabilization, according to Lawrence Yun, Chief Economist at the NAR.

The direct impact of what I have referenced has evidenced itself in our state revenues over the previous months. The underperformance in July and August of approximately \$167 million caused us to reduce revenue projections by \$540 million and make budget adjustments accordingly. Since then we saw 2.2% over performance in September exceeding the reduced estimates by almost \$35 million. October

revenue underperformed by \$96 million, about 6% less than projected. We will of course be watching revenue performance very closely each month as we meet our obligation to maintain a balanced budget.

The National Association of Business Economics (NABE) released an updated outlook on November 17 and Blue Chip Economic Indicators Survey was released on November 10. Both show that top economic analysts have become significantly more pessimistic in their economic outlook, believing that a recession is already underway and that it is likely to be deeper and longer than any downturn since the 1980s. The NABE panel expects GDP growth to decline by 2.6 percent in the current quarter, meaning that 2008 would see growth of only 0.2 percent for the year. Additionally, the panel expects unemployment to hit 7.5 percent by the end of 2009; it currently stands at 6.5 percent. The Blue Chip survey also showed that analysts expect the GDP to shrink during the current quarter as well as the first and possibly the second quarter of 2009, with positive growth resuming in the second half of 2009. The only bright spot in both reports was that inflation expectations were tampered down. The Blue Chips survey forecasted inflation to be 4.2 percent for the current year, down from 4.4 percent and 1.5 percent for 2009, down from 2.5 percent.

Let me take a few minutes to walk through where we are on agency spending in this fiscal year.

Together with the cooperation of many in this chamber, we passed HB119 as the lowest growth budget in Ohio in 42 years. Since passage, we have reduced budgets by 8% in the first round of budget cuts implemented by the Strickland Administration in February 2008. This is the reduced base amount from which agencies were requested by OBM to put together their fiscal year 2010-11 budget submissions.

Those were prepared at 90% and 95% of this reduced base amount. In April 2008 when OBM directed state agencies to submit their budget recommendations at this level, many hoped that request was overly pessimistic, myself included. Today, however, it is unlikely for me to envision a scenario where many

state agencies will be better off than the 90% request. As you know, in addition to the first budget cuts, we implemented another set of budget cuts of 4.75%, moving agency budgets at this time to about

87.25% of HB119 levels. In addition, we have sustained the hiring freeze and equipment freeze and used quarterly allotments to closely control agency spending.

There are though some positive signs:

- It appears from public comments that we can look forward to Congressional and Presidential action on state and jobs issues in the next few months. We are seeing strong leadership by Ohio's delegation in helping to shape a new stimulus package for passage in the near future.
- Housing problems may be beginning to right themselves, at least here in Ohio. Ohio's housing markets were not afflicted by the "bubble" seen on both coasts, so affordability is being restored here in Ohio at a faster pace. Nevertheless, for our state to fully recover and bring back a healthy housing market, there is a clear need for the Federal government to step in and focus on the foreclosure issues that are at the root of the current economic crisis. We look forward to their action to do so.
- Lastly, we remain hopeful that with new national leadership, Federal Reserve Bank and Treasury action will infuse new confidence into credit markets and incentivize them to provide needed resources for businesses and individuals to bring us back to recovery.

With the ongoing deterioration in revenues, the storm clouds we see on the horizon make it clear that we need to continue to act conservatively and tighten our belts to assure that we are maintaining a balanced budget, while extending a safety net for our citizens in these times of great economic distress. Clearly, the national economic crisis and its impact on our state will present ongoing challenges as we put together the 2010-2011 budget. We aim to meet those challenges as best we can. In these exceptional times, it is clear that a strong partnership between the legislative branch and the executive branch will be critical to navigating the rough waters ahead.

I would be happy to take questions from any members of the Committee.