Missouri's Budget Issues

October 2010

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How Are Things In Missouri Right Now?

- **Terrible!!! But maybe improving slightly.**
- **State revenues were down -9.1% at the end of FY 2010 after falling 7.0% in FY 2009.**
- **Conventional wisdom is Missouri follows the country into recession, and then follows it out. It appears that is happening in this recession.**
- **The problem is that the country is not sprinting out of the recession.**

FY 2010 General Revenue Picture

FY 2010—12 Months Revenue

Individual Income Tax	-9.1% for FY 2010
Corporate Income/Franchise	-19.6% for FY 2010
Sales Tax	-4.5% for FY 2010
Source: Missouri FY 2010 Revenue Report	Total revenue decline -9.1%

FY 2010 Downward Slide

- **The consensus revenue estimate has been falling like a rock.**
- **July 2009 estimate -1.0%**
- **October 2009 estimate -4.0%**
- **January 2010 estimate -6.4%**
- **March 2010 estimate -9.6%**
- **OA announced final revenues: -9.1%**

The Disturbing Trend in State General Revenue Collections

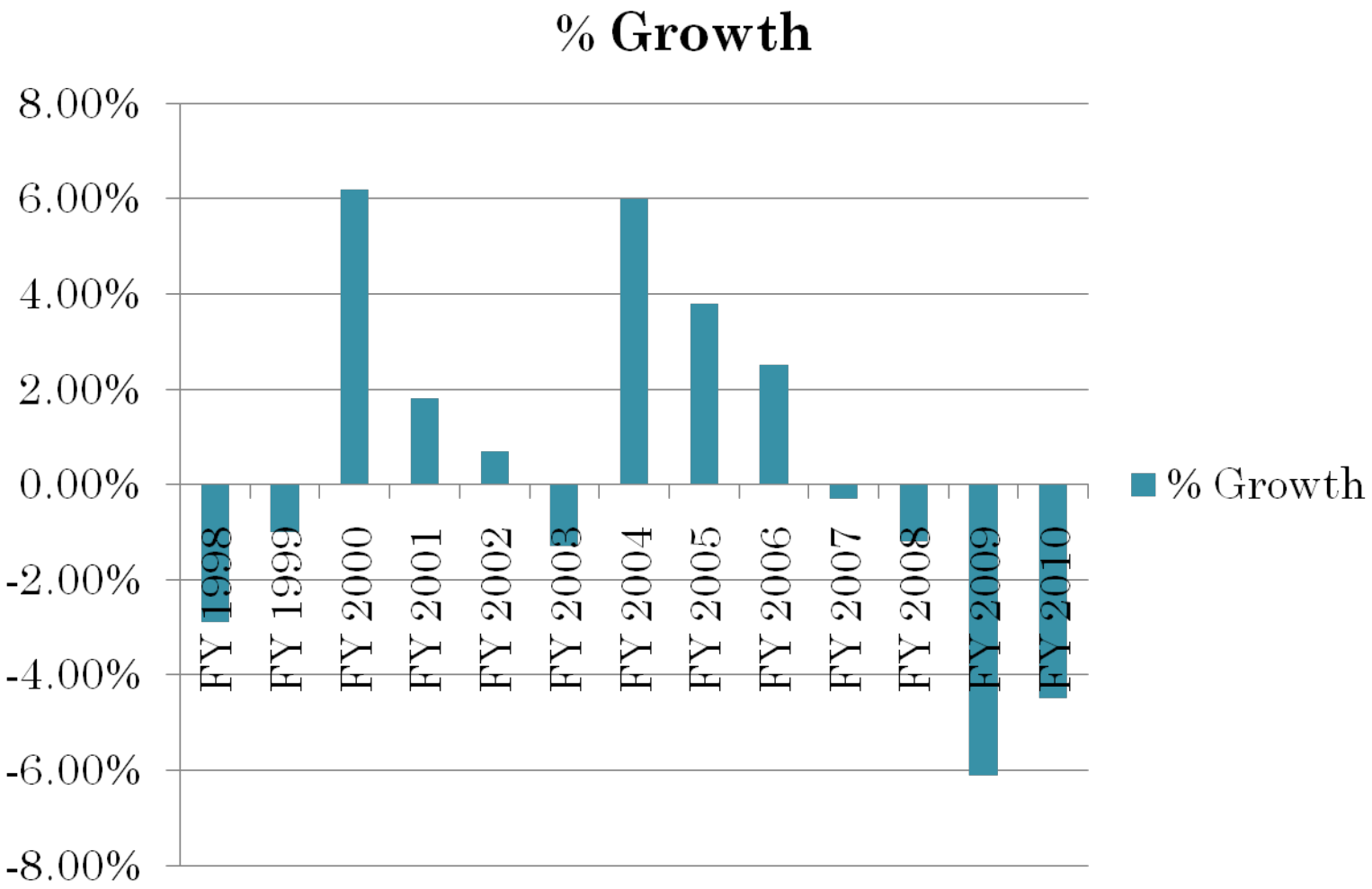
Number of negative revenue growth years for fiscal years from FY 1975 through FY 2001

Zero

Number of negative revenue growth years for fiscal years from FY 2002 through FY 2010

<u>Four</u>

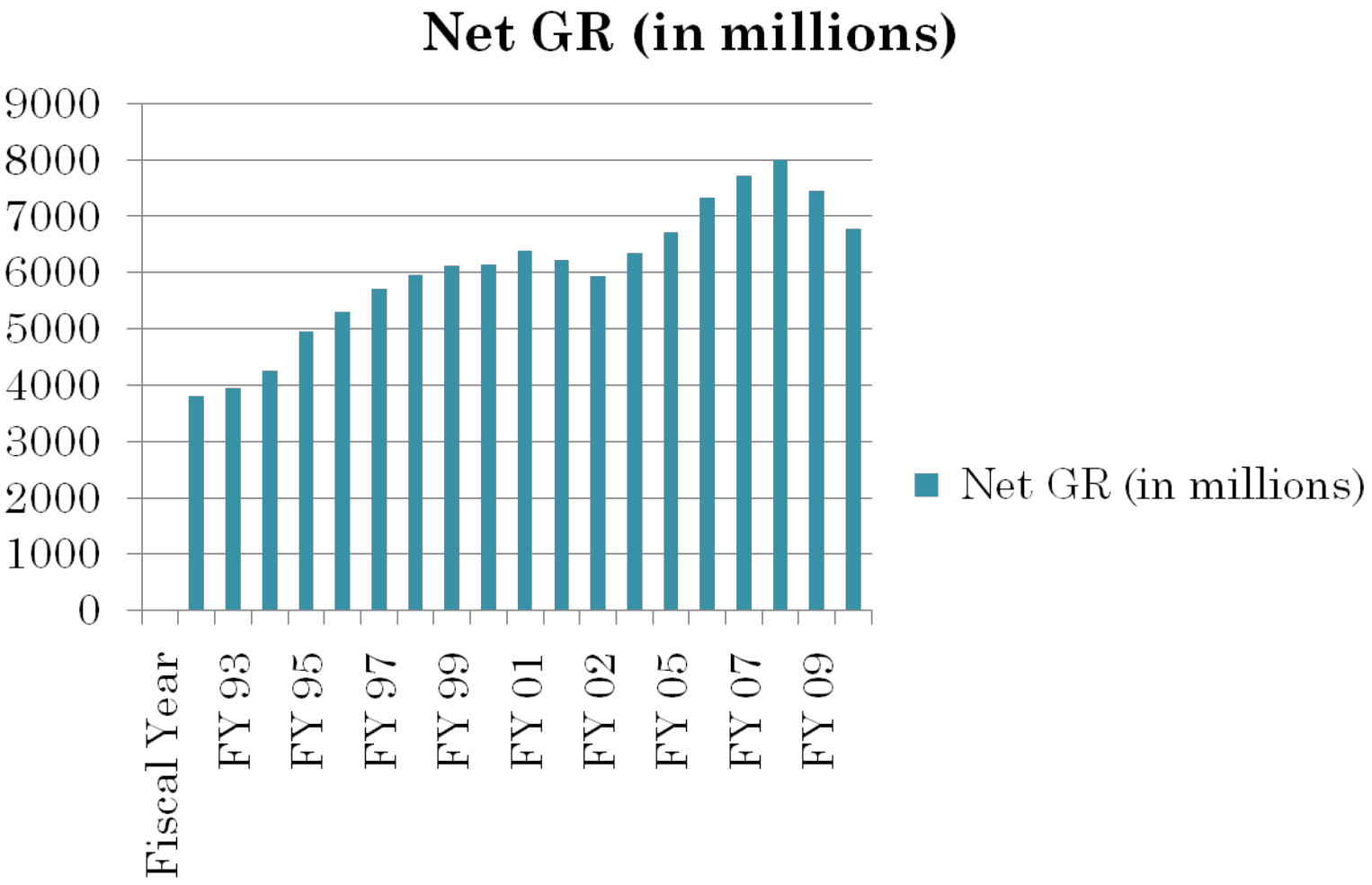
Sales Tax Growth Since FY 1998



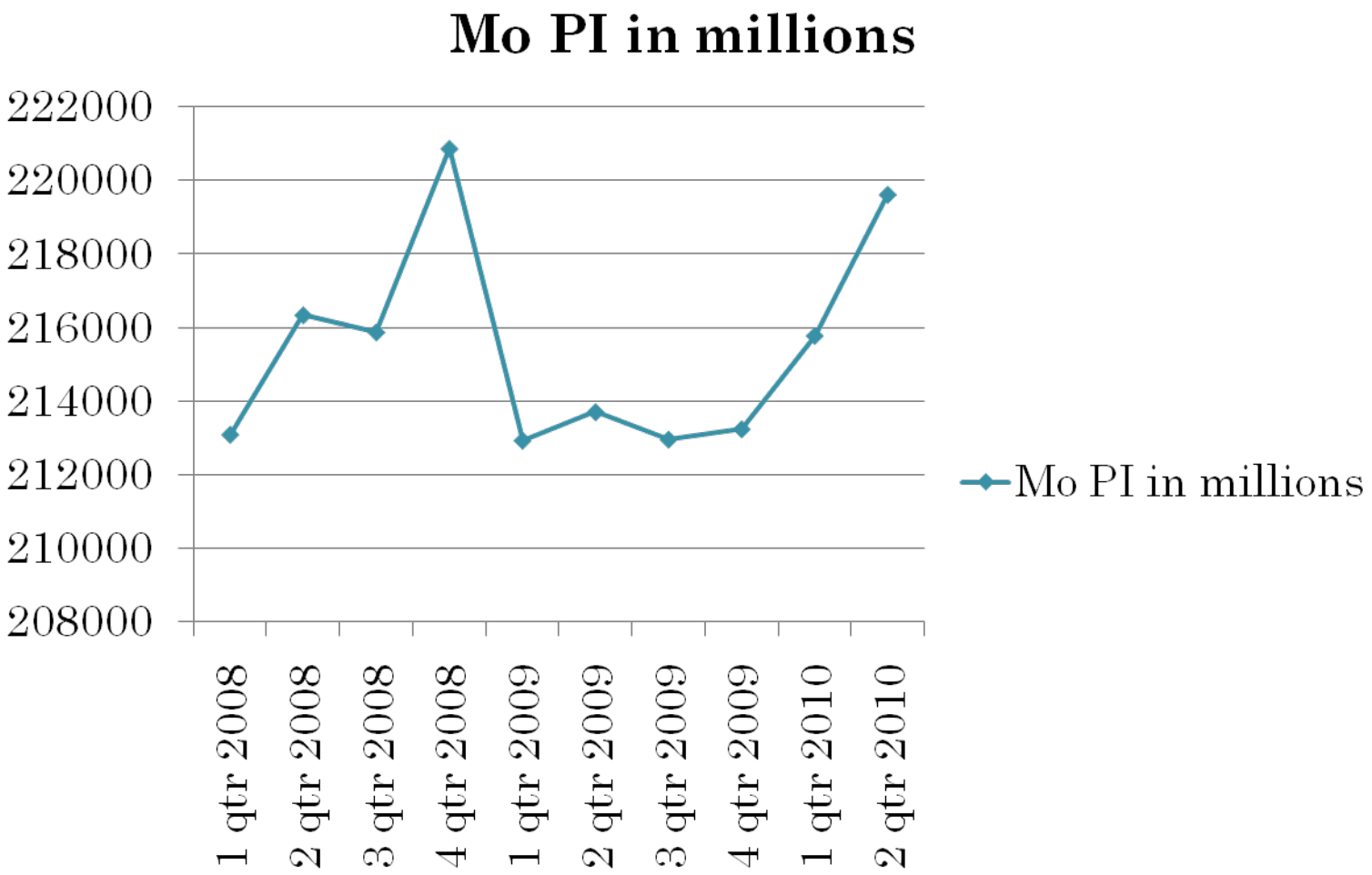
Sales Tax Decline In The Past Four Fiscal Years

Fiscal Year	Net Sales Tax (in millions)
FY 2006	$1,961.5
FY 2010	$1,731.7
Difference	**$229.8**
First 3 months FY 2011	**-1.8%**

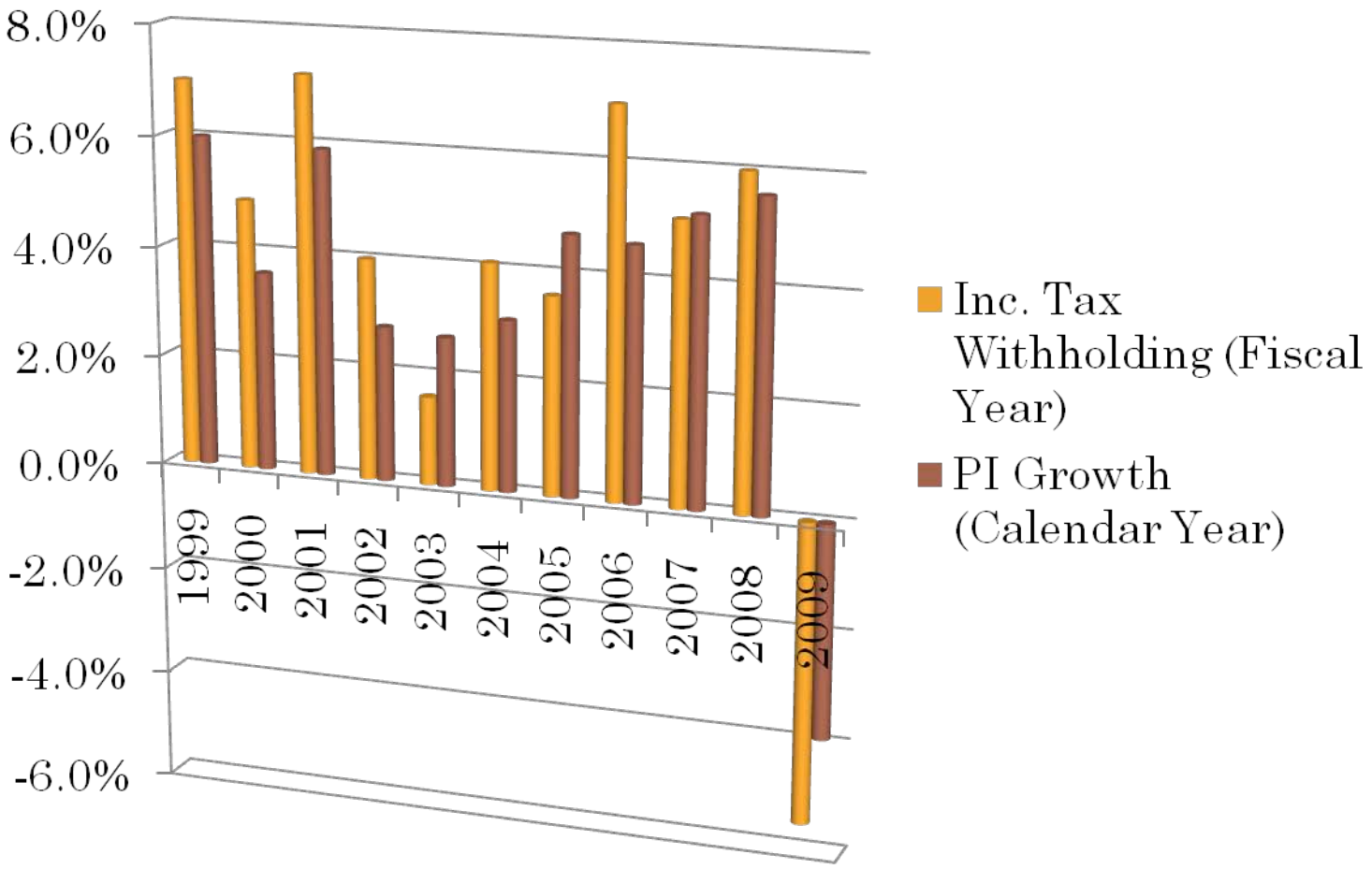
Net General Revenue Growth



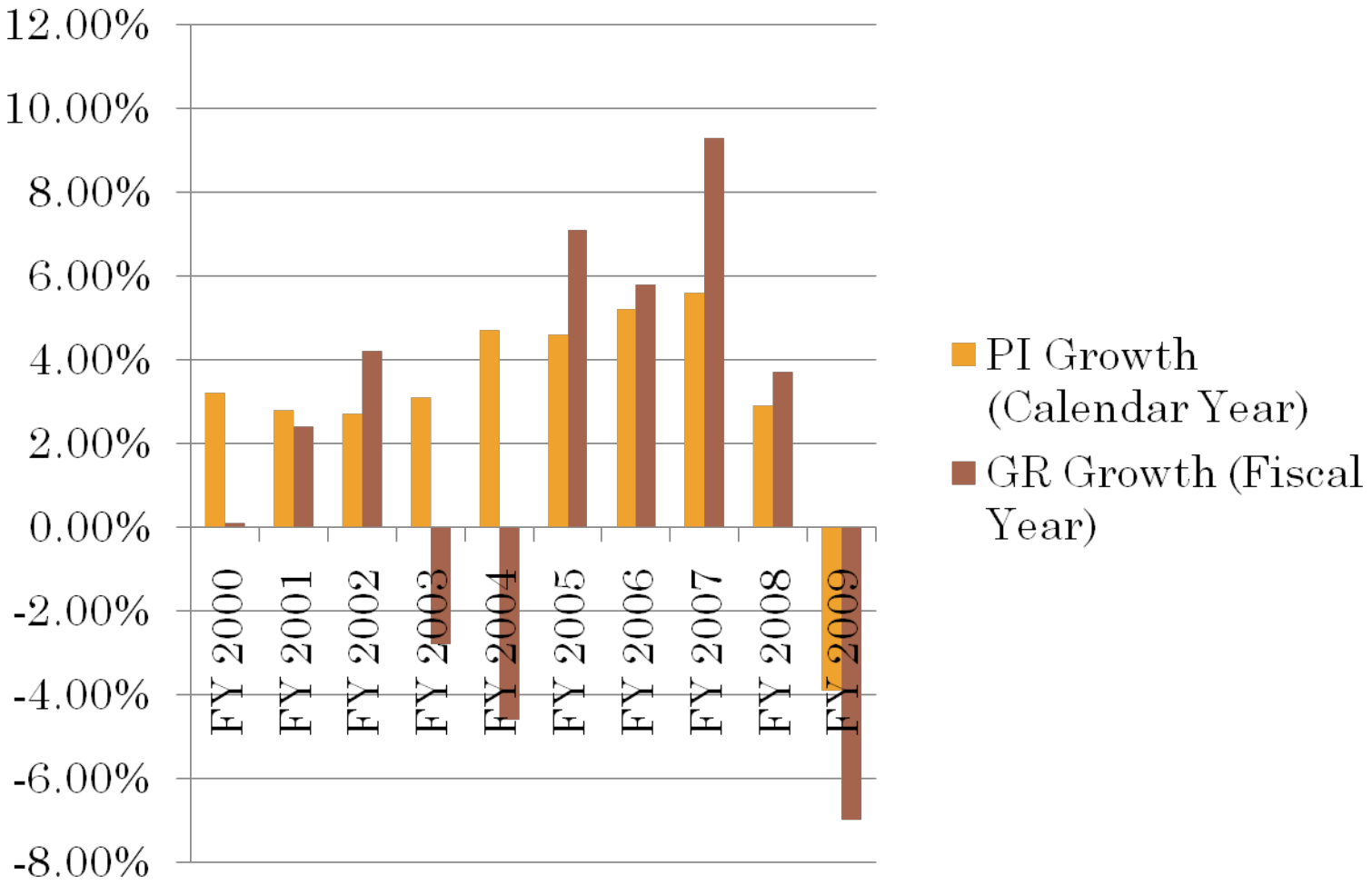
Missouri Personal Income



Income Tax Withholding Compared To Personal Income Growth

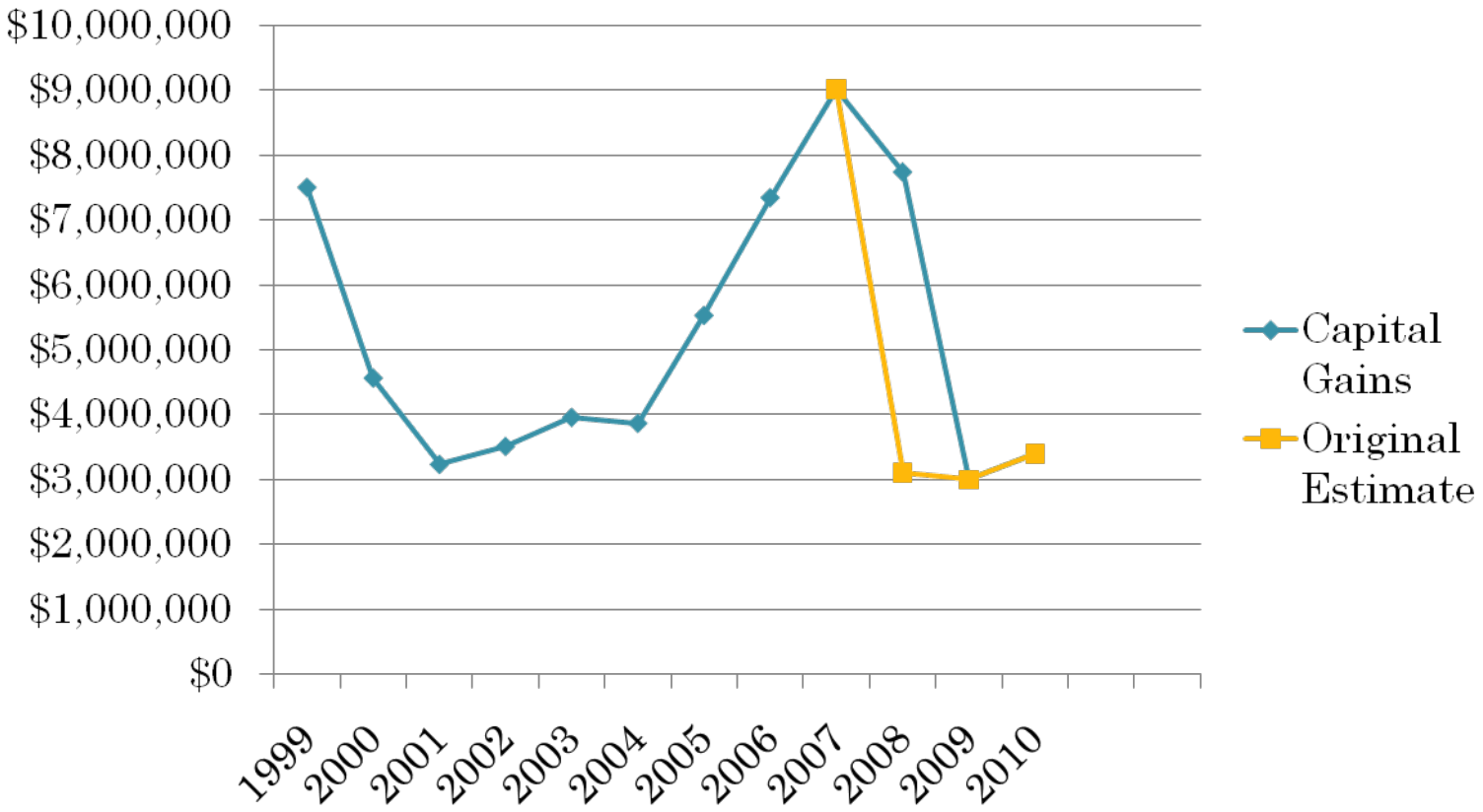


The Relationship of Personal Income and General Fund Growth



Missouri Capital Gains Subject To Income Tax

(in thousands, calendar years)



When Will We Grow?

- FY 2011 budget is predicated on growth of about 2% (after we have fallen 15.5%). Remember there was a one-time payment of over $100 million in December 2009.
- FY 2012 will be fortunate to have 3% to 4% growth. Governor currently talking 6% growth, but assumes major increase in capital gains receipts.
- Latest Missouri Personal Income numbers look better—reason for some optimism. Capital gains is not included in Missouri PI.
- We need to stop the sales tax bleeding. It is hard to grow when 24% of your budget is declining and not growing.
- When will capital gains grow? Depends on when losses play out? FY 2012 may be optimistic.
- Watch personal income growth. We will grow as it grows.

What Factors Will Make General Revenue Grow and The Budget Become Stable?

Look at these factors:

- **Missouri employment rate**
- **Personal income growth (1st two quarters of 2010 were very good)**
- **Stock market as an indicator of a return of capital gains and dividend income**
- **Interest rates increasing as source of interest income (but could hurt the economy)**
- **Sales tax growth (or lack thereof)**

Federal Stabilization Dollars

- **The federal stabilization dollars have given the citizenry and the General Assembly the impression Missouri is doing just fine.**
- **Missouri is not doing just fine. But problem resolution only begins after problem identification.**
- **The level of understanding in the "rank and file" General Assembly of the relationship between ongoing revenues and stabilization dollars is not good.**
- **The date of reckoning for the state budget has just being pushed out 12 to 18 months by using stabilization dollars.**
- **Every revenue shortfall brings the day of reckoning closer.**

The Enormous Imbalance In Appropriations vs. Collections

Fiscal Year 2006	Fiscal Year 2010
General Revenue Operating Expenditures **$7.14 billion**	General Revenue Operating Appropriations **$8.58 billion**
Net General Revenue Collections **$7.33 billion**	Net General Revenue Collections **$6.77 billion**
GR Collections in excess of GR Expenditures **$190 million**	GR Appropriations in excess of GR Collections **$1.81 billion**

How Will The Budget Gap Be Closed?

- **Significant spending cuts by Governor Nixon.**
- **$2.6 billion in stabilization funding (including new stabilization funds) have helped, but stabilization dries up in June 2011.**
- **FY 2012 budget balancing—rough numbers**

  Roughly $700 million gap

  $212 million stabilization

  $500 million in spending cuts/one time budget tricks

The Latest Federal Stabilization Dollars

- **Approximately $401 million in new dollars in two buckets:**

Enhanced Medicaid Match	**$212 million**
K-12 School Funding	**$189 million**

The K-12 funding must be distributed to schools in <u>this school year</u>.

The Two Sides Of The Equation

In Fiscal Years 2009 and 2010 Missouri lost 15.5% of general revenue

Missouri has not reduced spending by 15.5%, and the federal funds are going away

What About Raising Taxes?

- There are two layers of constitutional provisions that impact the raising of revenues. They are in Article X, Sections 16 to 24.
- The original Hancock Amendment, passed in 1980, limited Total State Revenue (TSR) under a formula tied to the growth in personal income.
- Missouri is currently $1.35 billion under the Hancock threshold (Fiscal Year 2008 state audit)
- The courts have determined that voter approved tax increases do not count against the original Hancock limitation. Therefore it is improbable that it will ever be breached.

Carnahan/Farm Bureau Constitutional Amendment

- **Passed in 1996, the so-called Carnahan/Farm Bureau amendment requires a second, more stringent test.**
- **Any major tax increase, as calculated under Article X, requires a vote of the people.**
- **A major tax increase is currently calculated as raising about $90 million on an annual basis.**
- **Such a tax increase could in theory come through the General Assembly, but in reality that is improbable.**
- **The only other alternative is the initiative petition process.**

How Much Would Various Revenue Enhancements Raise?

- **Sales Tax—In the neighborhood of $600 million for 1 cent increase. Local governments would probably oppose.**
- **Income Tax—1% increase (move the top rate from 6% to 7%)would yield about $900 million.**
- **Tobacco Tax—1 cent per pack would yield about $5.35 million, without adjusting for consumption drop as price rises.**
- **Enforcing sales tax on internet sales. At least $100 million, possibly as much as $200 million. Would also stop the bleeding.**

Summary of New Revenue Solutions

- Very unlikely unless very targeted with earmarks
- Difficult to do in this poor economic environment
- Initiative petition would be the only realistic option
- Would require a very expensive campaign with a very good message

Summary
(The Usual Rosy Moody Outlook)

- **Economic stability for the state budget is probably not until FY 2013 or more likely FY 2014.**
- **We need jobs, income growth and wealth growth before budget stability will occur.**
- **Is Missouri willing to address the internet sales question? If not nearly a quarter of general fund will continue to decline, not grow.**
- **Missouri has been more prudent than most other states, but that does not mean cash flow issues will not occur in the next 12 to 18 months.**