

# MISSOURI'S BUDGET ISSUES

PRESENTED TO

FRIENDS OF GEORGE K. BAUM

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James R. Moody & Associates

# Purpose of the Presentation

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- What is happening with the federal stabilization dollars?
- Help analyze what the next few years look like for state revenues.
- The two questions most asked are (1) when do the federal stabilization funds run out, and (2) what happens when that occurs
- What actions Governor Nixon will probably take in the next fiscal year to avoid falling off of the cliff when the federal stabilization dollars expire

# The State of the States

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- The severe economic downturn has left many states with major fiscal problems. Missouri is no exception.
- Missouri and other states are using federal stabilization dollars to prop up a major shortfall in state general revenues.
- Many other states plan on exhausting two years of stabilization federal funds in one year.
- The revenue picture keeps getting worse for the Nixon administration.
- One question is will Missouri grow out of this fiscal crisis in the next few years?—There is only one answer--**No**

# How Are Things In Missouri Right Now?

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- **Not Good!!!**
- **State revenues are down 10% after the first quarter, after falling 7% last fiscal year.**
- **Conventional wisdom is Missouri follows the country into recession, and then follows it out. It appears that is happening in this recession.**
- **Don't confuse the stock market with the economy. The stock market has bounced back some; the Missouri economy has not.**
- **Look for unemployment to stay high for the next year.**

# *The Disturbing Trend in State General Revenue Collections*

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**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 (FY 2010 estimated)**

**Four**

# FY 2010 General Revenue Picture

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## FY 2010 First Quarter Revenues

Individual Income Tax Withholdings	-4.9% first qtr, -6.1% for September
Ind. Income Tax Estimated Filers	-23.4% for first quarter
Sales Tax	-6.7% for first qtr, -10.6% for September
Source: Missouri FY 2010 Revenue Report	

## FY 2010 Outlook

- FY 2009 ended with -7% revenue growth.
- FY 2010 does not look much better—probably -6% to -8% GR growth.
- The Governor's October budget withholdings are based on a -4% revenue estimate, as opposed to a -1% original estimate. The -4% estimate appears optimistic.
- Every 1% shortfall is equal to \$73 million.

# Governor Nixon's FY 2010 Budget Actions Taken On October 28, 2009

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- Over \$200 million of General Revenue budget reductions.
- A -4% revenue growth rate is very optimistic. It was probably utilized to balance with the \$200 million cut, which is what the administration was willing to do right now.
- In the last nine months of FY 2010 Missouri will begin to compare monthly growth rates with very bad revenue months from a year ago. Hopefully that will help in stalling the slide seen in the first quarter of FY 2010.
- Look for further budget reductions in January.

# Federal Stabilization Dollars

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- 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, and few are talking about solutions because few admit that there is a problem. Governor Nixon has begun to address the problem through line-item vetoes and withholdings.
- 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 is just being pushed out a year or two by using stabilization dollars.

# Comments From Former CBO Director

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- The Obama administration is hoping unemployment bottoms out in June 2010.
- There is no real discussion of a second federal stabilization package in Washington right now. If one happens it would likely be late 2010.

# Benjamin Bernanke, Federal Reserve Chairman

## June 3, 2009

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- *From the Wall Street Journal* , **“Federal Reserve Chairman Benjamin Bernanke Wednesday urged lawmakers to commit to reducing the nearly \$2 trillion budget deficit, warning that the government cannot borrow indefinitely to meet the growing demand on its resources.”**
- A second federal stimulus package would require additional revenues or additional borrowing. Right now it appears no second package will appear, for the reasons Bernanke indicated in June.

# Missouri Planned Receipt and Expenditure of Federal Stabilization Dollars

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	Receipt (in millions)	Expenditure (in millions) After Governor's Reductions
FY 2009	\$451.0	\$256.0
FY 2010	\$1,349.0	\$1,001.0
FY 2011 (or 2012)	\$521.0	\$1,064.0
Total	\$2.321	\$2.321
Source: Missouri Budget Office		

# Federal Stabilization Dollars in the FY 2010 State Budget

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	TAFP (in millions)	After Veto (in millions)	Vetoed (in millions)
Operating Bills (HB 1-13)	\$783.5	\$775.6	(\$7.7)
Stimulus (HB 21)	\$84.7	\$84.7	\$0
Capital Improvements (HB 22)	\$381.3	\$305.2	(\$76.1)
Total	\$1,249.3	\$1,165.5	(\$83.8)
Source: Missouri Budget Office			

# Withholdings in FY 2010 To Balance The Budget

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General Revenue	\$108.7 million
Budget Stabilization Fund	\$164.0 million
Federal and Other	\$52.3 million
Total	\$325.0 million
Source: Missouri Budget Office	

# The Near Future

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- **Withholdings will have to become core cuts.**
- **More core cuts will be necessary.**
- **Government as we know it is going to have to change.**
- **The money to support what we are doing is not there.**
- **Additional federal stimulus dollars utilized in FY 2010 will move up cuts to FY 2011.**
- **Governor Nixon will determine how much of this occurs in FY 2011 or FY 2012.**
- **Absent a second stabilization package, FY 2012 is an absolute disaster.**

# What Do The Next Few Years Look Like For General Revenue?

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FY 2006	<b>\$7.33 billion (actual)</b>	9.25%
FY 2007	\$7.72 billion (actual)	5.24%
FY 2008	\$8.00 billion (actual)	3.73%
FY 2009	\$7.45 billion (actual)	(7.01%)
FY 2010	<b>\$6.93 billion (estimated)</b>	(2.77%)
FY 2011	\$7.27billion (estimated)	5.0%

# Comparing FY 2006 to FY 2010

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· FY 2006 GR Operating Approps	\$7.14 billion
· FY 2006 Net General Revenue	\$7.33 billion
· FY 2010 GR Operating Approps (including stabilization funds)	\$8.58 billion
· FY 2010 Net General Revenue	\$6.93 billion

# Net Individual Income Tax

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State Fiscal Year	Net Receipts (in thousands)	% Change
2004	\$3,713,169	
2005	\$4,007,924	8%
2006	<b>\$4,482,747</b>	10.6%
2007	\$4,824,492	7.1%
2008	\$5,109,824	6.3%
2009	\$4,757,317	(6.9%)
2010	<b>\$4,400,000 (estimated)</b>	(7.6%)
2011	\$4,620,000 (estimated)	5.0%

# Major Tax Changes That Impacted Individual Income Tax

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Change	Foregone Revenue	Year
Increased personal exemption	\$155 million	1999
State taxation of pensions	\$127 million	2007
Dependent deduction	\$68 million	1998
Inheritance tax (federal law)	\$160 million	Phased out over four years in the early 2000's
Sources: Fiscal Note (HB 444), Moody 2001 Report		

# Major Foregone Sales Tax To GR Due To Exemptions or Earmarks

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Tax Exemption	Foregone Revenues	Year
Prescription drugs	\$190.3 million	1980
Motor vehicle sales tax	\$110 million	2005 to 2009
Food	\$210.4 million	1997
Domestic utilities	\$192.4 million	1980
Manufacturing sales tax	\$70 million	1998
Internet sales	???	

# Tax Credits Taken Against Various Tax Categories—FY 2009

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Individual Income Tax	\$371.6 million
Corporate Income Tax	\$84.8 million
Corporate Franchise Tax	\$7.8 million
Insurance Premium Tax	\$72.2 million
Fiduciary and Financial	\$33.6 million
Withholding	\$17.6 million
Source: Missouri Budget Office	Total \$587.7 million

# Tax Credits Redeemed By Program In FY 2009

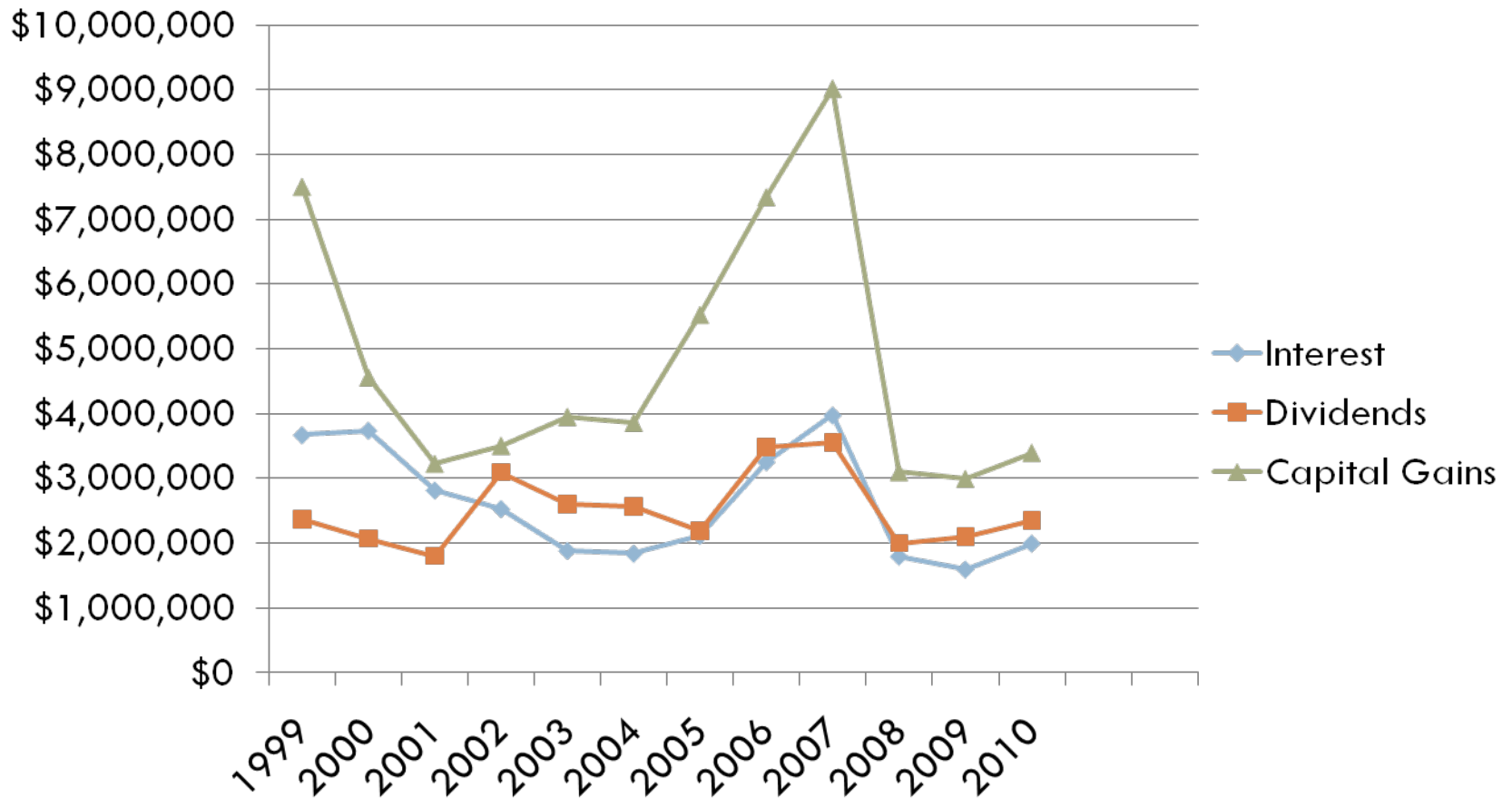
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Historic Preservation	\$186.4 million
Senior Citizen Property Tax	\$118.6 million
Low Income Housing	\$106.0 million
Brownfield Remediation	\$29.2 million
Infrastructure Development	\$26.9 million
Other	\$120.7 million
Source: Missouri Budget Office	Total \$587.7 million

# Missouri Major Unearned Income

(in thousands, calendar years)

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# What Do Interest, Dividends, and Capital Gains Look Like for the Next Few Years?

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- There is little reason for optimism.
- Dividends look slow to recover. Corporations are not doing well.
- Interest rates are still low from historic rates of return. They are inching up but not quickly. If interest rates rise rapidly, it could hurt the economic recovery when it occurs.
- Capital gains, if they mirror the early 2000's, will take a few years to recover.
- Without a significant kick from these three sources, general revenue will depend on sales tax (terrible for a number of years) and individual income tax.

# What About Borrowing From The Rainy Day Fund?

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- Any borrowing from the Rainy Day Fund has to be repaid with interest within three years.
- The Rainy Day Fund makes more sense in dealing with “emergencies” and is not well suited for a budget shortfall.
- Such borrowing would simply put off cuts for programs where there is not enough current revenue.
- This borrowing really does not address any long term solutions, but like the stabilization funding masks the underlying problem.
- The Rainy Day Fund is also the cash flow fund. It appears all of the funds will be need for cash flow.

# *The Decade of the 2000's Negative Revenue Growth*

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- FY2002                    -2.8%
- FY 2003                   -4.5%
- FY 2009                   -7.0%
- FY 2010                   -6% to -8% (estimated)

# *The Decade of the 2000's Positive Revenue Growth*

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	<b>% Growth</b>	<b>\$ Growth</b>
<b>FY 2004</b>	<b>7.08%</b>	<b>\$419 M</b>
<b>FY 2005</b>	<b>5.76%</b>	<b>\$365 M</b>
<b>FY 2006</b>	<b>9.25%</b>	<b>\$620 M</b>
<b>FY 2007</b>	<b>5.24%</b>	<b>\$384 M</b>

# *Why Did We Think We Were Rich?*

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Calendar Year 2006 growth in interest, dividends, and capital gains subject to Missouri income taxes—

**\$3.95 billion**

Calendar Year 2007 growth in interest, dividends, and capital gains subject to Missouri income taxes—

**\$2.41 billion**

**The growth over the two years (taxed at 6%) would equal \$382 million in what were viewed as ongoing tax revenues**

# *What Is Happening In Since Calendar Year 2007*

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Actual interest, dividends and capital gains for which  
Missouri taxes the income—Calendar Year 2007

**\$16.5 billion**

Estimated interest, dividends and capital gains for which  
Missouri taxes the income—Calendar Year 2008

**\$6.9 billion**

**Difference--\$9.6 billion subject to taxes at roughly 6%  
equals a loss of \$576 million from these sources in  
one tax year**

# The Longer Term Future and the Jobs Paradigm

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- The jobs market is suffering. Traditional manufacturing jobs that have been lost will be hard to replace.
- If state revenues are highly variable due to fluctuations in the stock market, the state general fund will swing wildly when there are volatile conditions in the stock market
- With a weak general revenue base, major growth will only come through capital gains, interest and dividend growth, or some strategy to create jobs.
- The decade of the 2000s has shown this to be true.
- Missouri's future economic well-being will be tied to new jobs, and these jobs will be in bio-sciences and higher tech jobs. Attracting these jobs may require investment.
- What strategy do we use to invest when we have no revenues to support investment?