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Missouri General Revenue Report, Fourth Quarter FY 2011

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After falling by 6.9 percent in Fiscal Year (FY) 2009 and another 9.1 percent in FY 2010, Missouri's net General Revenue (GR) collections increased by 5.9 percent in FY 2011, halting the sharp decline in net GR collections that occurred over the last two years. Furthermore, the net GR total of $7.18 billion is $159.2 million above the FY 2011 Consensus Revenue Estimate (CRE), providing the state with much needed revenues in the aftermath of multiple natural disasters.

However, it is important to note that the revenue decline of FYs 2009 and 2010 is the **largest sustained decline since the Great Depression of the 1930s.** As context, even with 5.9 percent growth, **the FY 2011 net GR total of $7.18 billion was $827.7 million less than the $8.003 billion the state collected in FY 2008**, and was even below the $7.3 billion collected in FY 2006.

Overview of Fiscal Year 2011Missouri General Revenue

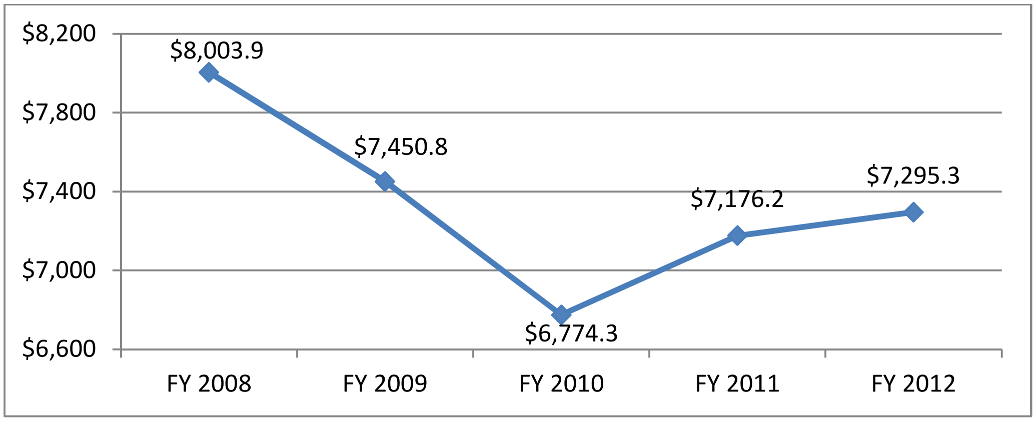
For the quarter ending June 30th, net GR collections rose 4.8 percent, marking five consecutive quarters of revenue growth. While both the national and state economic recoveries remain slow, it is now probable that the worst of this recent revenue decline has ended.

However, the 5.9 percent overall general revenue growth seen in FY 2011 was due almost completely to the fact that GR Tax Refunds for the year declined by 9 percent (refunds were about $165 million below their expected level). Gross individual income tax grew only 2.7 percent for the year, slightly below forecast. Furthermore, despite a strong showing in June, gross sales and use tax grew at 1.0 percent for the year and was nearly $21 million under forecast.

While revenue growth of 5.9 percent is a vast improvement over the last two years, by any historical standard, the Missouri revenue and budget outlook is under much strain. With the national economic recovery still proceeding at a slow pace and uncertainty with respect to the federal budget, the state budget outlook is guarded at best. In addition, revenue losses associated with the state tax cuts enacted over the last four years are scheduled to grow.

A review of total net GR collections over the last five years shows that even if the state achieves the revenue estimate for the new fiscal year, FY 2012 will remain ***$709 million*** **below FY 2008 revenue collections**.

Figure 1: Net General Revenue Collections, in Millions, FY 2008 – FY2012[1]



Over the last few months, the federal budget and the level of the federal budget deficit have become the subject of much debate. It is important to emphasize that if it not were for substantial revenues accruing to the state as a result of the *American Recovery and Reinvestment Act* (approximately $2.8 billion for fiscal years 2009 through 2012), **Missouri would be facing a budget crisis in FY 2012 and beyond of much greater magnitude.**

Detailed Revenue Analysis:

Gross Individual Income Tax (IIT) collections in June of 2011 grew 5.4 percent over June of last year, resulting in a fiscal year-to-date growth rate of 2.7 percent.

For FY 2011 overall, individual income tax withholding, the largest component of IIT,[2] grew 3.1 percent. However, as Figure 2 demonstrates, for the quarter ending June 30th, withholdings rose only 1.9 percent relative to this quarter last year (perhaps reflecting sluggish employment, which will be discussed later). Although the quarter grew compared to the previous year, the growth rate dropped significantly compared with the previous quarter, marking the second consecutive quarter in which the growth rate for IIT withholding declined compared to the previous quarter. Given the importance of IIT withholding, this could be a troublesome development if the trend continues.

Figure 2: Missouri Individual Income Tax Collections
Missouri Individual Income Tax Collections Growth Rates Fiscal Years 2007-2010[3]

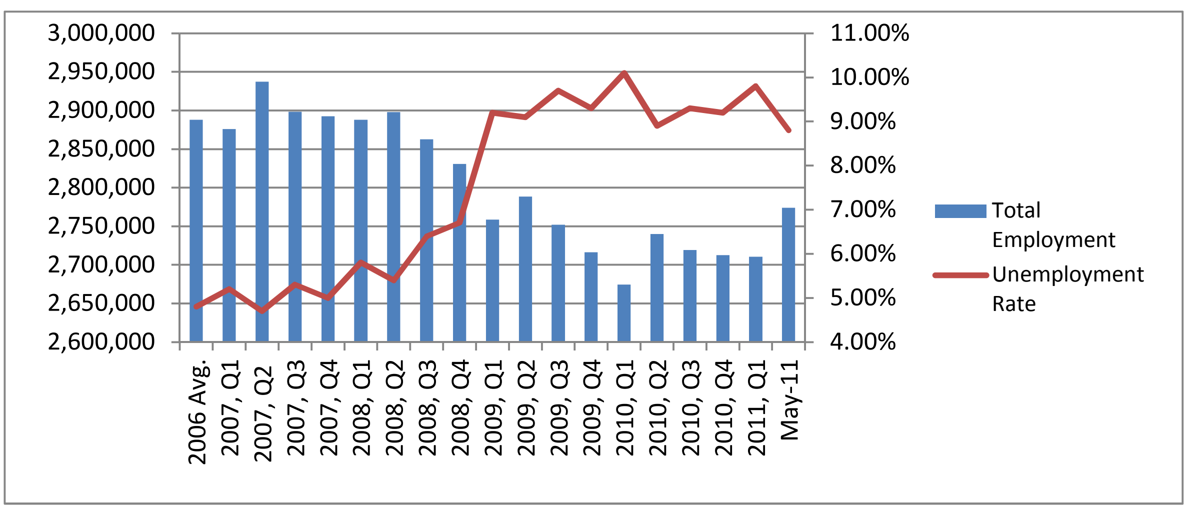
Year and Quarter	Individual Income Tax Withholding Percent Change versus Same Quarter Previous Year
2007. Quarter 3	5.2%
2007. Quarter 4	8.2%
2008. Quarter 1	7.4%
2008. Quarter 2	2.8%
Total FY 2008	**6.0%**

[1] Data from the Missouri Office of Administration
[2] IIT consists primarily of withholdings, declarations/estimated payments, and final payments/remittances. As reflected in Figure 9, remittances declined 1.8% in FY 2011.
[3] IBID #1

Year and Quarter	Individual Income Tax Withholding Percent Change versus Same Quarter Previous Year
2008. Quarter 3	3.2%
2008. Quarter 4	9.0%
2009. Quarter 1	-2.8%
2009. Quarter 2	-5.5%
Total FY 2009	**0.9%**
2009. Quarter 3	-4.9%
2009. Quarter 4	-11.8%
2010. Quarter 1	-1.8%
2010. Quarter 2	2.5%
Total FY 2010	**-4.3%**
2010. Quarter 3	1.6%
2010. Quarter 4	5.0%
2011. Quarter 1	3.7%
2011. Quarter 2	1.9%
FY 2011 to date	**3.1%**

Fortunately, in the most recent quarter, declarations/estimated payments grew 11.7 percent to finish the year up 4.5 percent. However, in the near future, the outlook for this tax source is guarded at best because the state's employment remains sluggish. In May of 2011, total employment in Missouri stood at 2,773,760, only about 23,000 jobs greater than in May of 2010, in which 2,750,896 Missourians were employed. As Figure 3 illustrates, the current unemployment rate of 8.8 percent is only slightly better than the 9.0 percent rate of a year ago.

Figure 3: Missouri Employment Trends 2006 through 2011[4]



[4] U.S. Bureau of Labor Statistics

Figure 4 more closely examines recent trends in Missouri wage and salary growth. The data that now includes the first quarter of 2011 shows very modest growth over the last four quarters.

Figure 4: Missouri Wage and Salary Growth[5]

Calendar Year/Quarter	MO Wages & Salaries (Millions)	Percent Change versus Same Quarter Previous Year
2007. Quarter 1	$112,656	4.3%
2007. Quarter 2	$114,428	5.2%
2007. Quarter 3	$115,200	5.7%
2007. Quarter 4	$117,317	6.3%
2008. Quarter 1	$118,175	4.9%
2008. Quarter 2	$119,630	4.5%
2008. Quarter 3	$118,441	2.8%
2008. Quarter 4	$123,757	5.5%
2009. Quarter 1	$115,572	-2.2%
2009. Quarter 2	$114,968	-3.9%
2009. Quarter 3	$114,603	-3.2%
2009. Quarter 4	$114,074	-7.8%
2010. Quarter 1	$113,876	-1.5%
2010. Quarter 2	$114,977	0.1%
2010. Quarter 3	$116,001	1.2%
2010. Quarter 4	$116,169	1.8%
2011. Quarter 1	$116,861	2.6%

IIT displayed solid improvement for FY 2011 as a whole. Unfortunately, the lack of robust job growth along with the decline in the withholding growth rates for IIT over the last six months is a cause of concern. A key to any sustained recovery in overall state GR collections will be a sustained turnaround in this area because IIT accounted over 65 percent of the Missouri GR fund in FY 2010.

Sales and Use Tax collections[6] rose 8.7 percent in June, which brought the FY 2011 overall growth rate to 1.0 percent. In recent years, sales tax collection growth has often behaved erratically month to month, making it is useful to look at the quarterly growth numbers.

For the quarter ending June 30th, sales taxes grew 2.0 percent relative to this same quarter last year. While this growth rate is low, it does represent two straight quarters of improvement. Nonetheless, the overall sales tax situation remains grim. With the national economic recovery proceeding at a slow and uneven pace, it would seem reasonable to expect little improvement in this area anytime soon.

[5] U.S. Department of Commerce, Bureau of Economic Analysis

[6] Please note that in this and subsequent reports, all Sales tax will be considered as "Regular" sales. Since July of 2008, all Motor Vehicle Sales tax has been allocated to Highways and Transportation.

Moreover, while state level data on the growth of Internet sales is not available, the U.S Census reports that national e-commerce retail sales rose from about $39.2 billion in the 1st quarter of 2010 to $46 billion in the 1st quarter of 2011, a growth of 17.5 percent.[7] It is likely that enhanced Internet retail shopping is a factor in the slow growth in Missouri Sales tax collections.

Figure 5: Missouri Sales Tax Growth Rates Fiscal Years 2008-2010[8]

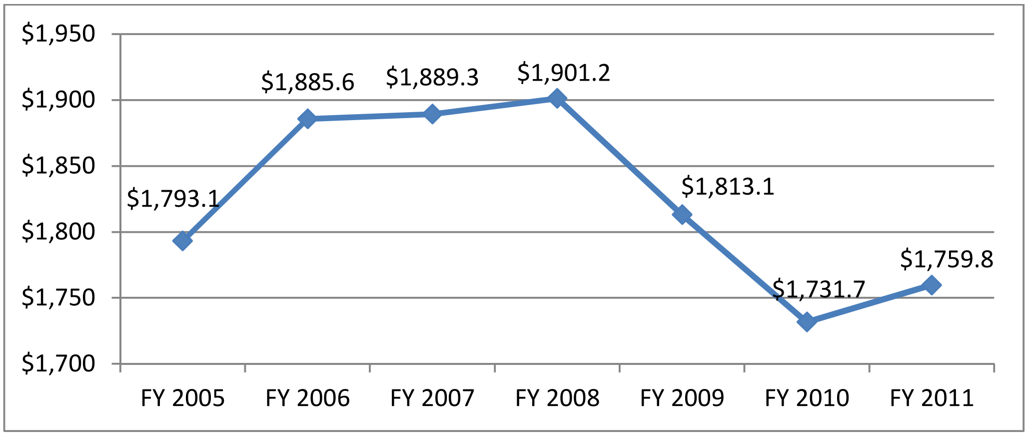
Year and Quarter	Regular Sales and Use Tax Percent Change versus Same Quarter Previous Year
2007. Quarter 3	4.0%
2007. Quarter 4	-0.3%
2008. Quarter 1	-2.9%
2008. Quarter 2	-2.0%
Total FY 2008	**-0.4%**
2008. Quarter 3	-2.3%
2008. Quarter 4	-2.5%
2009. Quarter 1	-5.2%
2009. Quarter 2	-8.3%
Total FY 2009	**-4.6%**
2009. Quarter 3	-6.7%
2009. Quarter 4	-6.9%
2010. Quarter 1	-6.8%
2010. Quarter 2	1.3%
Total FY 2010	**-4.9%**
2010. Quarter 3	2.4%
2010. Quarter 4	-1.8%
2011. Quarter 1	1.6%
2011. Quarter 2	2.0%
FY 2011 to date	**1.0%**

As illustrated in Figure 6, for FY 2011, even with modest growth, net regular sales tax has fallen by $141 million since FY 2008 and is well below the level *attained in FY 2005*. See below for the latest quarterly trends in sales tax growth.

[7] U.S. Census Website: www.census.govt/retail/mrts/www/data/pdf/ec_current.pdf

[8] IBID #1

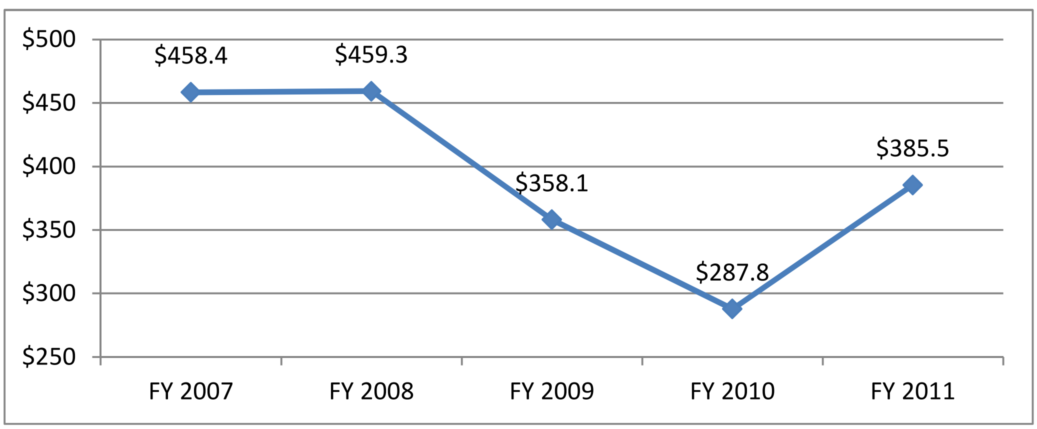
Figure 6: Net Sales Tax Collection, in Millions, FY 2005-FY 2011[9]



Corporate Income and Franchise Tax gross collections fell 8.4 percent in June, but completed FY 2011 overall with an increase of 7.0 percent. Corporate tax refunds declined about 29 percent for the year, allowing for 34 percent net corporate tax growth – a substantial improvement over FY 2010, in which net corporate taxes fell nearly 20 percent.

While strength in this area good news, it must be tempered with some caution. Corporate collections and refunds have a strong tendency to show major fluctuations over relatively short periods. A strong quarter may not be indicative of the longer term trend. In addition, over the last two years, state corporate tax collections fell quite sharply. As Figure 7 demonstrates, even with the strong rebound seen in FY 2011, the state may still be years away from returning to the FY 2008 level for this tax.

Figure 7: Corporate Income and Franchise Tax Collections, in Millions[10]



The sub-components of this tax demonstrate the irregularity of revenue from this source. While declarations increased 8.4 percent for FY 2011 overall, final payments/franchise rose a more modest 4.7 percent.

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[9] IBID #1
[10] IBID #1

Moreover, the corporate tax outlook is complicated by several factors. In April, Governor Nixon signed Senate Bill 19, which will eliminate the Corporate Franchise over the next five years. The law is expected to reduce collections in this area by about $25 million in FY 2012. In addition, the federal tax law signed into law by President Obama in December 2010 allows more rapid deductions for business investment expenses. The *Center on Budget and Policy Priorities* estimates that this will reduce Missouri revenues by $143 million over two years.[11] Even with a stronger economy, the state is not likely to see much growth in corporate taxes in the next few years.

Other Revenue Sources: Notable developments in the smaller revenue sources include:

General Revenue Interest earnings continue to decline. For all of FY 2011, earnings were about $7.3 million, a decline of 41 percent. With interest rates expected to remain extremely low, this source is not likely to generate much revenue over the coming months.

County Foreign Insurance collections rose 8.8 percent for all of FY 2011, a strong rebound from the 4.7 percent *decline* in this tax that was seen in FY 2010 overall. However, collection from this source fell 8.2 percent in the just completed quarter compared to this quarter last year.

General Revenue Refunds: Perhaps the most important development in June and in FY 2011 overall was the sharp decline in GR refunds. For FY 2011, general revenue refunds declined 9.0 percent. **This decline is the primary reason why net GR collections were $159 million ahead of forecast.**

Refunds in all major categories declined. While GR refunds were expected to grow more slowly in FY 2011 than in recent years, there was little reason to expect a drop of this magnitude. At least part of the reason for the decline was the improvement in the economy in calendar year 2010 relative to calendar year 2009. As the stock market improved,[12] investors were able to realize monetary gains that may not have been reflected in their income tax withholding or in their estimated payments. Upon completing their tax returns, many may found themselves with greater income tax liability than anticipated, which in turn would lead to receiving a smaller tax refund.

In addition, corporate taxpayers have some discretion as to when they utilize tax credits. As a result, corporate refund growth can be quite erratic on a month to month basis. Unfortunately, there is no data available with which to research the prevalence of these factors. Looking ahead, it would be reasonable to assume that the decline in GR refunds was due in part to a better economy, but that a continuation of GR refunds at this level is unlikely.

Summary and Outlook

After experiencing severe declines in net GR in FY 2009 and FY 2010, net GR collections grew by 5.9 percent in FY 2011, allowing collections to exceed the consensus revenue estimate by $159 million. However, much of the growth was due to declining refunds, which may not be part of a long term trend. Moreover, IIT withholding only grew 3.1 percent, and Sales and Use tax grew only 1.0 percent.

The fact remains that FY 2011 net GR collections were <u>below the net GR collections of FY 2006</u>.

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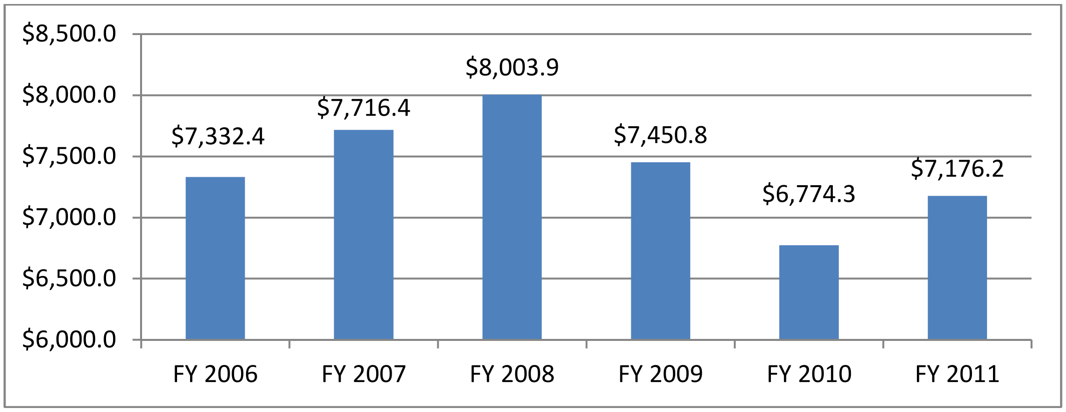
[11] "Business Expensing Proposal Would Add to State Fiscal Problems" by Nicholas Johnson and Ashali Singham-*Center on Budget and Policy Priorities (www.cbpp.org/cms/index/cfm?fa=view+id=3344)*

[12] The Standard & Poors Index of 500 Stocks, a widely watched stock market barometer, rose 19.5 percent in 2010 relative to 2009.

Figure 8: Missouri Net General Revenue Collections, in Millions, FY 2006 – FY 2011[13]



MISSOURI FY 2011 NET GENERAL REVENUE STILL BELOW FY 2006 LEVEL

Erosion of the state tax base still leaves the state with inadequate revenues even in an improving economy. Even if the state is able to average net GR growth of 3.0 percent beginning in FY 2012 and beyond**, the state would not see net GR collections attain the $8.0 billion plateau reached in FY 2008** ***until FY 2015***. Despite the clear positives in the current revenue situation, the state budget outlook is still grim. It is unlikely that the state will be able to adequately fund the GR budget without some actions to enhance revenues.

(See next page for the June and FY 2011 General Revenue Collection table)

[13] IBID #1

Figure 9: June GR Collections and Refunds[14]

Tax Source	June FY 10	June FY 11	Percent Change	FY 2010	FY 2011	Percent Change
Individual Income						
Withholding	326,363	339,442	4.0	4,224,014	4,353,813	3.1
Declarations	112,316	123,643	10.1	570,479	596,277	4.5
Remittances	16,389	16,772	2.3	660,486	648,514	(1.8)
Fiduciaries	416	456	9.6	28,808	34,293	19.0
Total	**455,494**	**480,314**	**5.4**	**5,483,884**	**5632,978**	**2.7**
Sales and Use						
Regular	158,927	172,770	8.7	1,791,664	1,809,697	1.0
Total	**158,927**	**172,770**	**8.7**	**1,791,664**	**1,809,697**	**1.0**
Corporate Tax						
Declarations	75,690	71,781	(5.2)	310,311	336,457	8.4
Remittances & Corp Franchise	9,214	5,966	(35.3)	191,863	200,389	4.7
Total	**84,904**	**77,747**	**(8.4)**	**502,174**	**537,296**	**7.0**
Estate	41	612	1392.7	264	2,118	702.3
Interest	2,926	711	(75.7)	12,319	7,268	(41.0)
Liquor	3,079	2,487	(19.2)	27,947	25,351	(9.3)
Beer	794	714	(10.1)	8,287	8,223	(0.8)
County Foreign Insurance	35,364	23,701	(33.0	194,198	211,208	8.8
Federal Reimbursements	4,588	10,922	138.1	62,736	129,165	105.9
All other revenues	9,946	7,641	(23.2)	160,078	149,863	(6.4)
Gross GR collections	**756,062**	**777,618**	**2.9**	**8,243,551**	**8,513,168**	**3.3**
GR Refunds						
Individual Income	209,145	32,756	(84.3)	1,050,239	992,679	(5.5)
Corp. Income& Franchise	28,800	12,657	(56.1)	214,418	151,764	(29.2)
Senior Citizen Property	6,834	3,057	(55.3)	118,595	114,887	(3.1)
Sales	10,094	2,929	(71.0)	59,964	49,875	(16.8)
All other	9,035	1,831	(79.7)	26,011	27,740	6.6
Total GR Refunds	**263,908**	**53,230**	**(79.8)**	**1,469,227**	**1,336,945**	**(9.0)**
Net General Revenue	**492,154**	**724,388**	**47.2**	**6,774,324**	**7,176,221**	**5.9**

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[14] IBID #1