

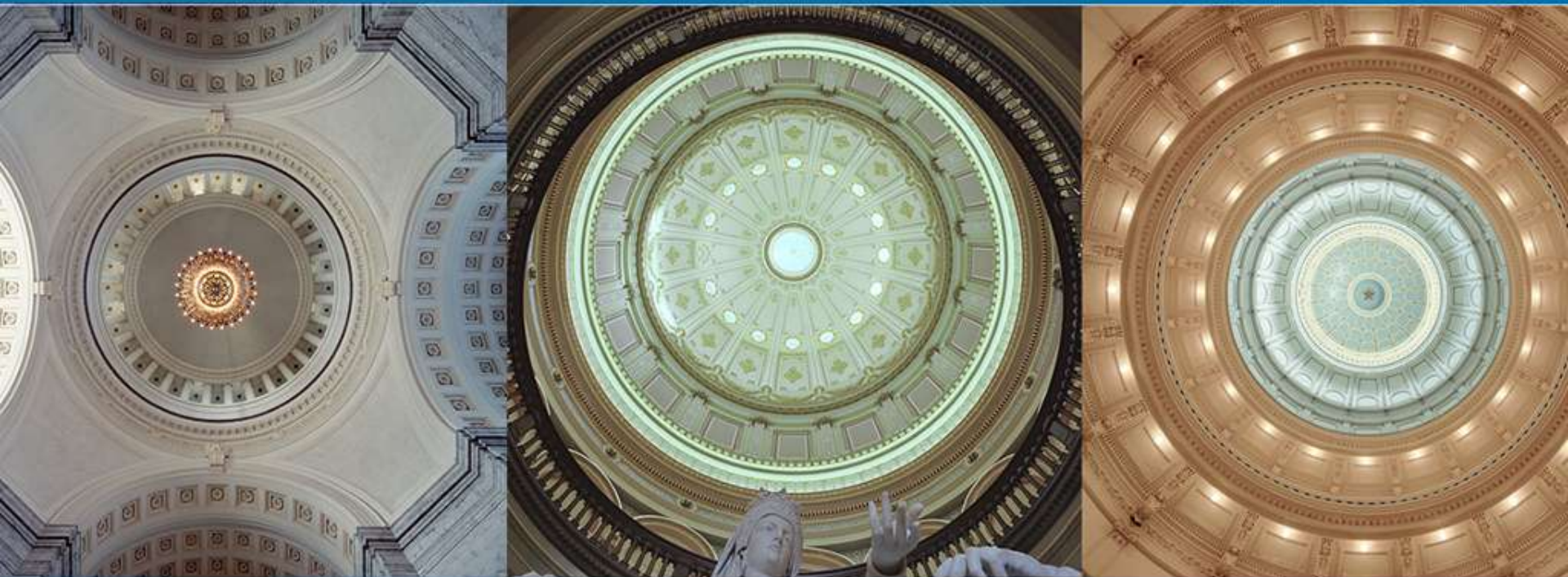


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# State Budget & Tax Update July 2011



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# Overview

- State budgets are recovering, but they are not recovered:
  - Nationally, year-end balances are stabilizing.
  - Modest tax growth is projected for FY 2012.
  - States face ongoing budget challenges.
- The total state budget gap: \$527.2 billion (FY 2008-FY 2013 est.).



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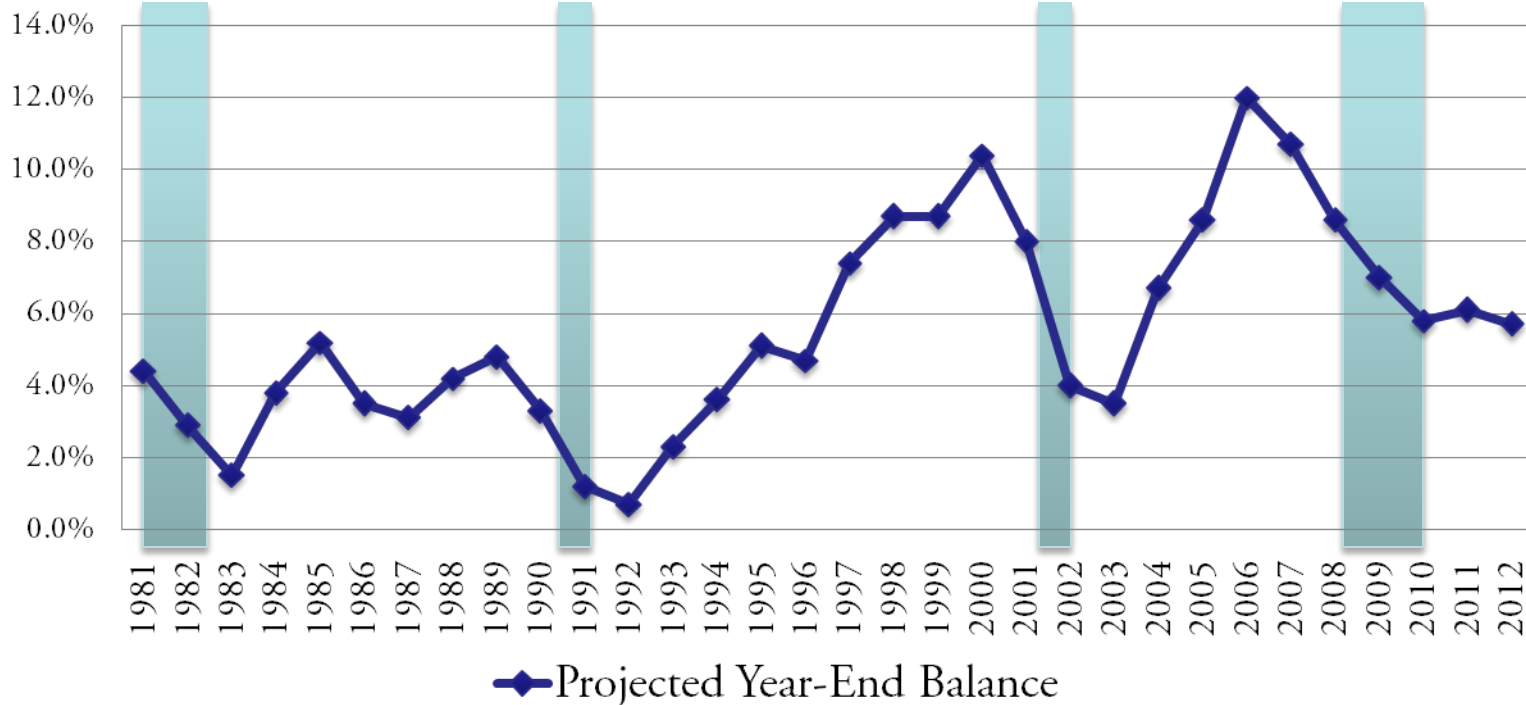
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# State Year-End Balances

as a Percentage of General Fund Spending

## FY 1981 - FY 2012



\*45 states reporting for FY 2009

Source: NCSL survey of state legislative fiscal offices, various years



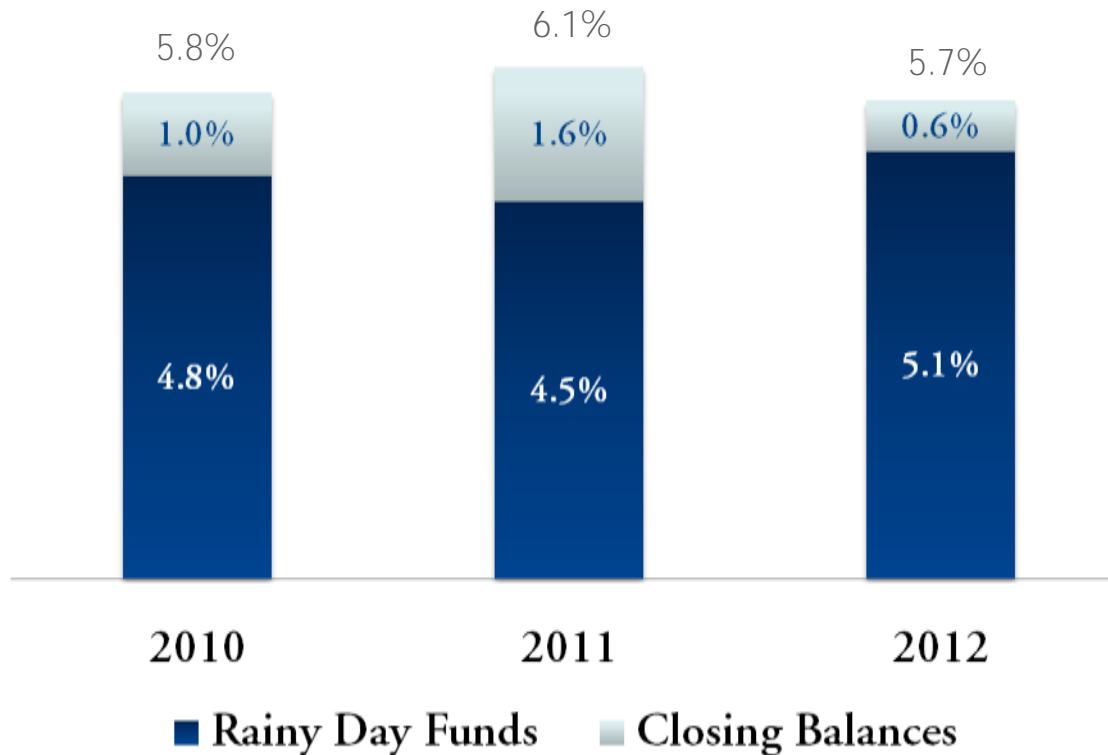
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# State Year-End Balances

as a Percentage of General Fund Spending





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# Rainy Day Funds in FY 2011

- A few states hold the bulk of rainy day funds:
  - Alaska: \$13.7 billion
  - Massachusetts: \$1.2 billion
  - New York: \$1.2 billion
  - Texas: \$5 billion
  - Wyoming: \$1 billion
  
- Together, these states account for 75% of all rainy day funds



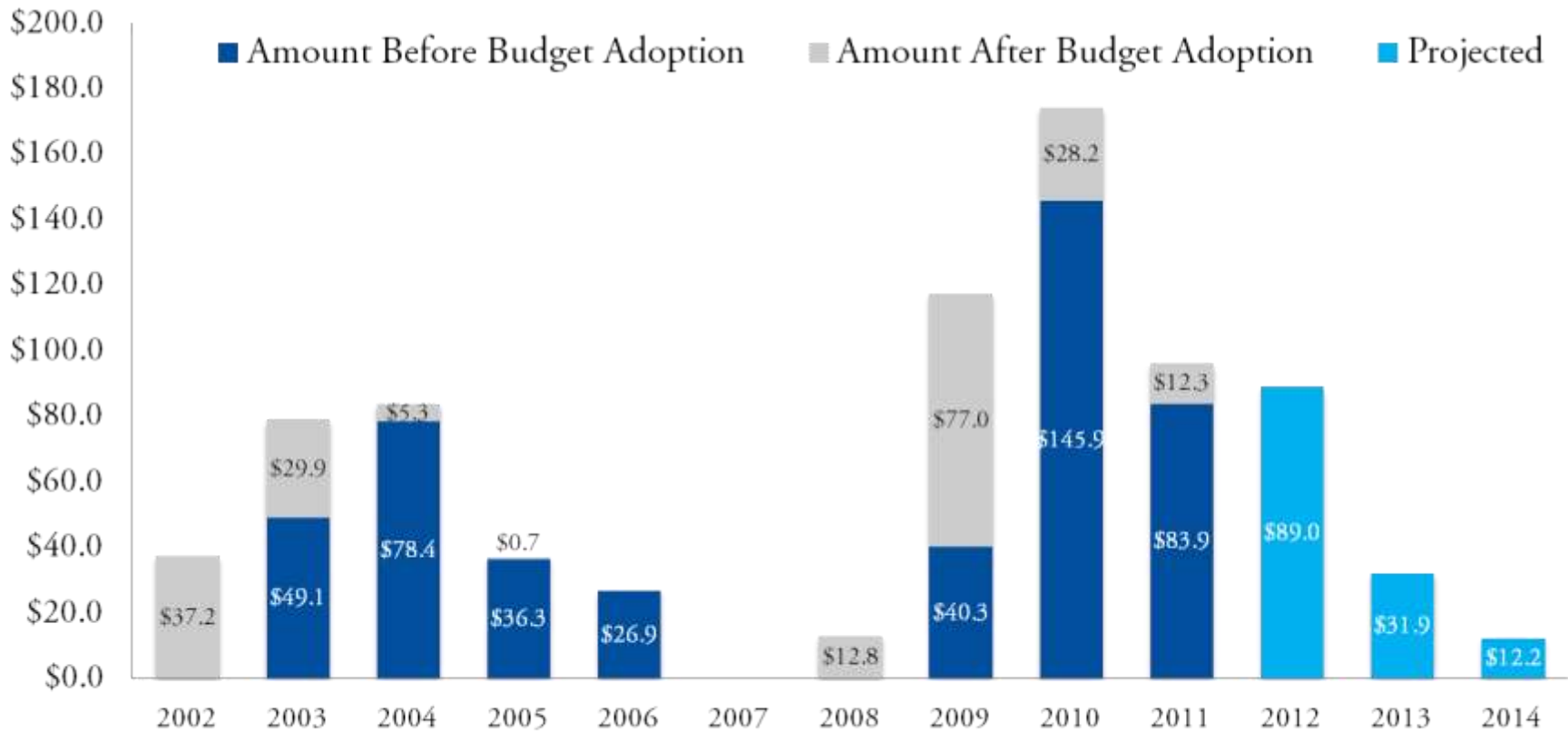


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## Projected FY 2002-2014 Budget Gaps (projected) as a Percentage of General Fund Budget



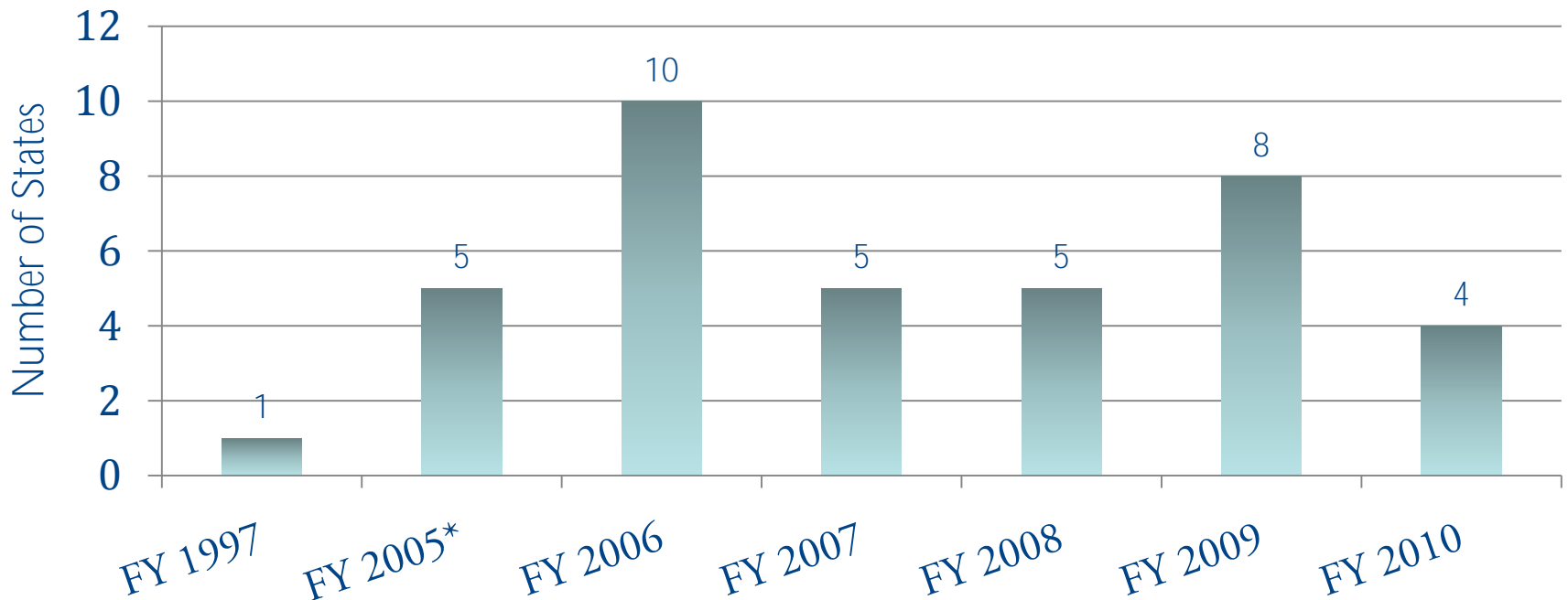


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## FY 2011 General Fund Spending Most Closely Matches...



N/A= Massachusetts, North Dakota and West Virginia, N/R or unknown= 10 states

\* Includes Puerto Rico

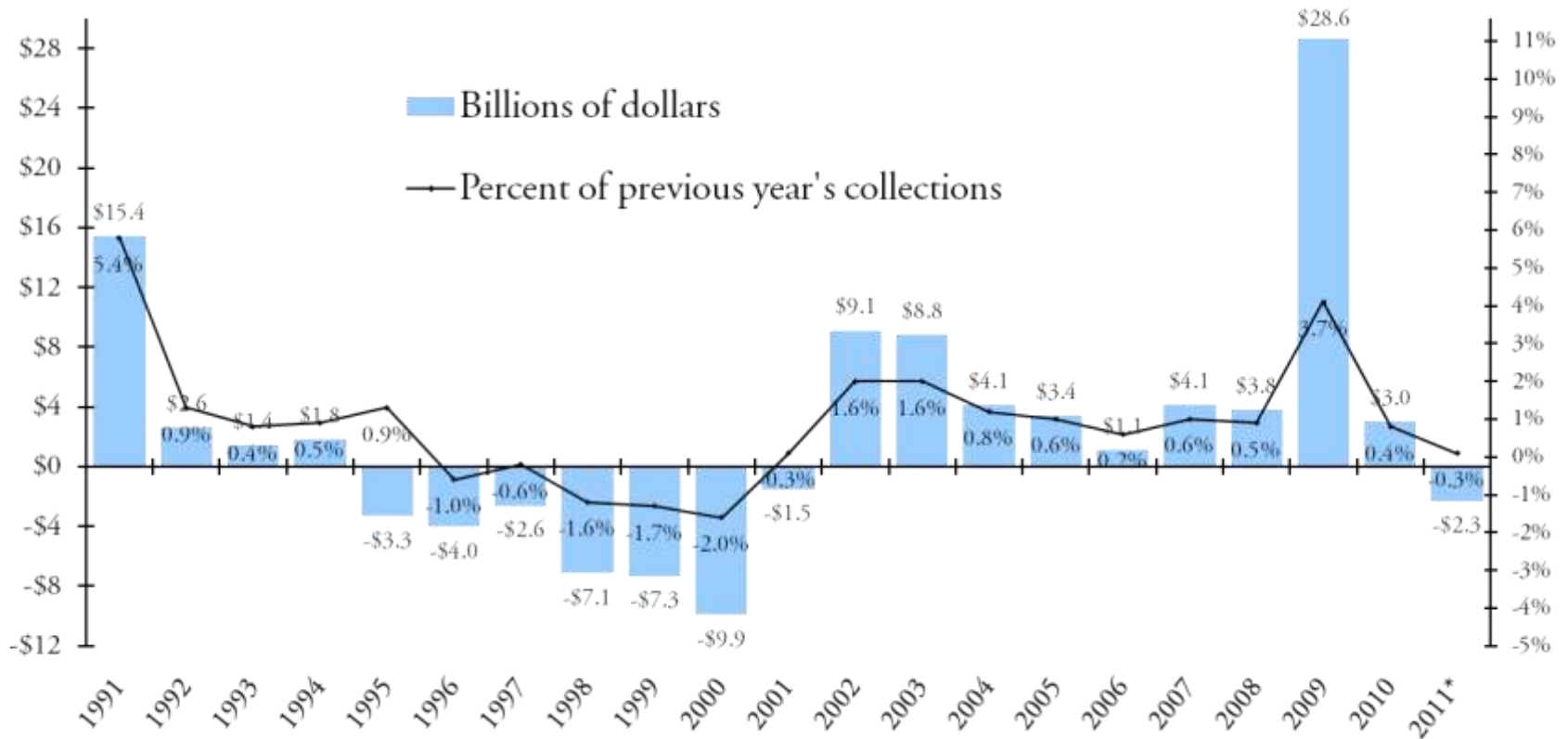


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# Net State Tax Changes by Year of Enactment 1991-2011



\* 2011 figures are preliminary and do not include Massachusetts, New Hampshire and Pennsylvania.

Source: NCSL survey of legislative fiscal offices, various years.





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# Tax Trends in 2011

- Allowed temporary tax increases to expire.
- Focused on reforming/reducing business taxes.
- Continued removing exemptions and credits.
- Raised health care provider assessments.



# Expiration of Temporary Taxes

- California: Expiration of income, sales and car tax increases (\$8 billion).
- New York: December expiration of income tax surcharge on high-income taxpayers (\$1.7 billion).
- North Carolina: Expiration of income and sales tax rate increases (\$1.2 billion).
- Delaware (\$6.9 million) and Maryland (\$55 million).
- Without the expiration of temporary taxes, there was a net tax increase of \$9.0 billion in 2011 (largely accounted for by Illinois and Connecticut).



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# Reducing Business Taxes

- Michigan tax reform:
  - Eliminated the Michigan Business Tax and replaced it with a 6% corporate income tax (with only a small business credit).
  - Imposed income tax on pension and retirement income and eliminated special exemptions and most tax credits.
- Delaware cut gross receipts, bank franchise and gas & electric utility taxes.
- North Dakota cut the corporate income tax rate.
- Florida raised the corporate income tax standard exemption from \$5,000 to \$25,000.
- Indiana and Arizona will phase-in corporate income tax cuts.



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# Other Tax Cuts

- Ohio resumed a previous rate cut that was suspended in 2010.
- North Dakota cut personal and corporate income tax rates.
- Maine lowered personal income tax rates.
- New York exempted clothing items under \$55 until Mar. 31, 2012; after that the exemption amount rises to \$110.
- Arkansas and West Virginia lowered the sales tax rate on groceries.
- New Hampshire cut the cigarette tax.



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# Base Broadening

- Connecticut expanded the sales tax base to more services including pet grooming, spa services, cosmetic surgery, motor vehicle towing, yoga and non-prescription medicine.
- Rhode Island expanded the sales tax base to include non-prescription medicine, digital downloads and travel & tour company products.
- California and Texas modified some definitions to capture more sales tax on remote transactions.
- Hawaii removed some general excise tax exemptions.
- Kansas repealed various business-related sales tax exemptions.



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# Raised Health Care Provider Assessments

- Indiana: \$450 million from new 2.7% hospital assessment and a 1.5% increase in the current health facility quality assessment.
- Connecticut: \$400 million by imposing a new tax on hospital net revenue and a new resident day user fee for certain facilities.
- Idaho raised both hospital and nursing home assessments.
- Maryland and Oklahoma adopted new hospital assessments.
- Other states that raised these assessments include Colorado, Maine, Nebraska, North Carolina, Ohio, Oregon, Rhode Island, Utah, Vermont, Virginia and West Virginia.





## Other Tax Increases in 2011

- Illinois raised the personal income tax rate from 3% to 5% (\$6.6 billion, with a total tax increase of \$7.2 billion).
- Connecticut raised \$1.8 billion
  - Increased marginal tax rates and phased out the lowest tax bracket for certain taxpayers (\$893 million).
  - Eliminated some sales tax exemptions and expanded the base to include some services.
  - Extended the corporate income tax surcharge for two years and doubled the rate from 10% to 20%.
  - Raised taxes on health care providers, hotel rooms, rental cars and tobacco products.
- Nevada did not allow temporary taxes to expire in 2011 as scheduled.



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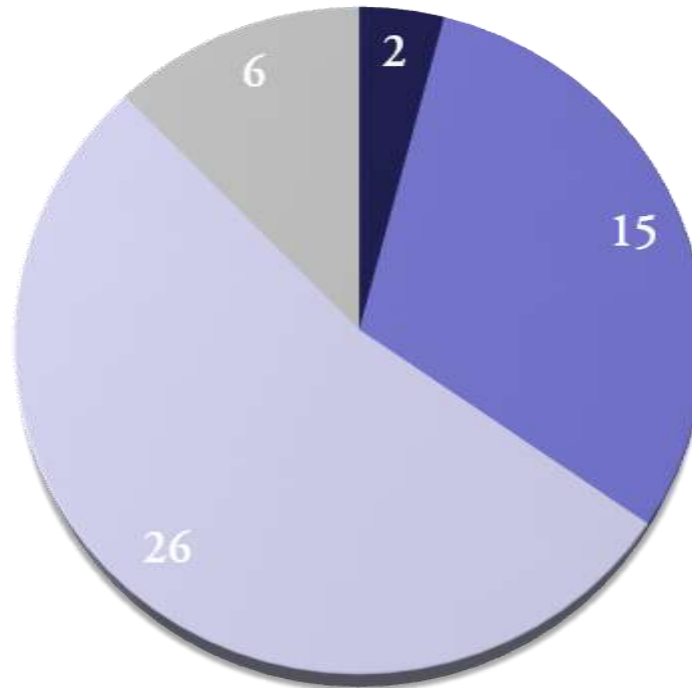
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# FY 2012 Tax Forecast

Compared to FY 2011 Estimates

## *State Distribution of Total Tax Growth*



### Total Tax Growth

■ ≥10%   ■ 5-9.9%   ■ 0.1-4.9%   ■ ≤0%

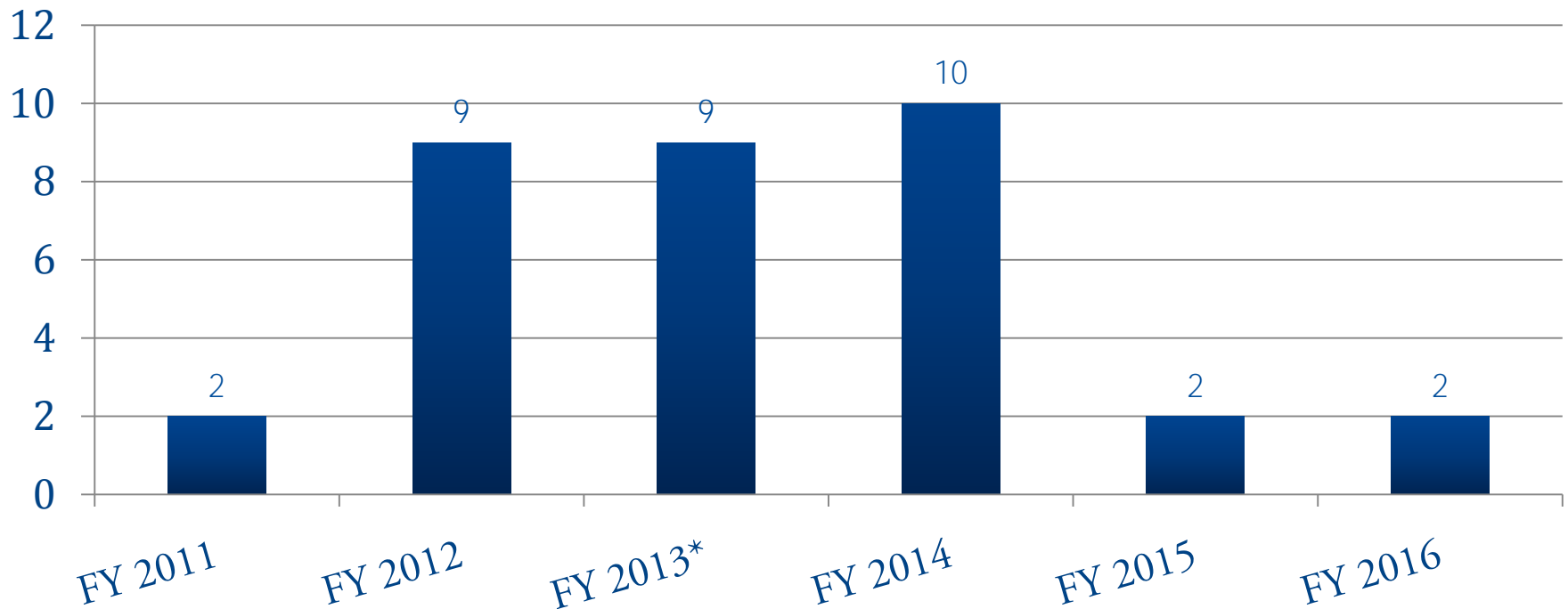


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# Projected Return to Peak Revenue Collections



N/A= North Dakota, N/R or unknown= 16 states

\* Includes Puerto Rico



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# FY 2012 State Budget Outlook: *Strengths*

- State revenue performance (39 states)
- Budget reserves (AK, IA, ME, NE)
- Strong visitor industry (HI)
- Agricultural economy (SD)





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# FY 2012 State Budget Outlook: *Challenges*

- Medicaid funding (14 states)
- Revenue performance (7 states)
- Impact of natural disasters (5 states)
- Strength of economic recovery (5 states)





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## *Challenge:* Strength of Economic Recovery

- "If the state's economy does not continue to recover as forecast, the pressures on the state budget may not be reduced." (CA)
- "Uncertainties in the economy are providing uncertainty to the revenue outlook." (CO)
- "The fragile economy may not be as resilient to mild economic shocks as thought when the forecast was produced in February 2011." (NC)





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## FY 2012 State Budget Outlook: *Challenges (Cont.)*

- Retirement system (5 states)
- Court challenges (4 states)
- Other health care costs (4 states)
- Federal budget (4 states)
- Job growth (3 states)
- TANF/human services (3 states)



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# FY 2012 State Budget Outlook

## *Challenges (Cont.)*

- K-12 education
- Fuel prices
- Structural budget imbalance
- Use of one-time money
- Debt service
- Lack of reserves
- Transportation
- Higher education enrollment
- Oil production
- Housing market



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# FY 2012 State Budget Outlook

## *Challenges (Cont.)*

- Employee concessions (CT)
- Ability to achieve budgeted savings:
  - "The FY 2012 budget relies on substantial savings to Medicaid. It is unclear whether or not these assumptions will be borne out." (MA)
  - "One budget challenge will be the realization of projected savings in Medicaid from managed care, generic drugs and provider rate cuts." (NC)



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# FY 2012 Overall Fiscal Outlook

- Stable (9 states)
- Positive/good (8 states)
- Cautiously optimistic (7 states)
- Improving (7 states)
- Cautious (5 states)
- Mildly concerned (3 states)
- Other: Fair, conservative, structural deficit, pessimistic





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# Conclusion

- The worst *maybe* behind most states:
  - State revenues are growing
  - State year-end balances are stabilizing
  - The overall fiscal outlook is improving
  
- A number of significant uncertainties loom:
  - Demands on state budgets
  - The strength and sustainability of economic recovery
  - The impact of federal actions on state budgets





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