



General Revenue Growth Triggers, and Factors for Comparison

Arkansas Tax Reform and Relief Legislative Task Force

September 26-27, 2018

Arkansas Department of Finance and Administration



Outline for Discussion

1. Growth Rates of Revenues and Indicators
2. Issues of Volatility
3. Issues of Triggers
4. A Word About Recessions
5. RSA Budgeting

Overview of Factors for Growth Comparisons

Growth and Volatility Overview

- Economic Growth and Inflation

• Inflation (CPI) Change	5-year avg. 1.4%	10-yr avg. 1.6%	20-yr avg. 2.2%
• Population Estimate	5-year avg. 0.4%	10-yr avg. 0.5%	20-yr. avg. 0.7%
• Personal Income	5-year avg. 3.0%	10-yr avg. 3.1%	20-yr. avg. 4.3%
• Wage Income	5-year avg. 3.0%	10-yr avg. 2.4%	20-yr. avg. 3.6%

- Actual General Revenue Growth

• Gross General	5-year avg. 1.6%	10-yr avg. 1.9%	20-yr avg. 3.3%
• Net Available	5-year avg. 1.8%	10-yr avg. 2.0%	20-yr avg. 3.1%

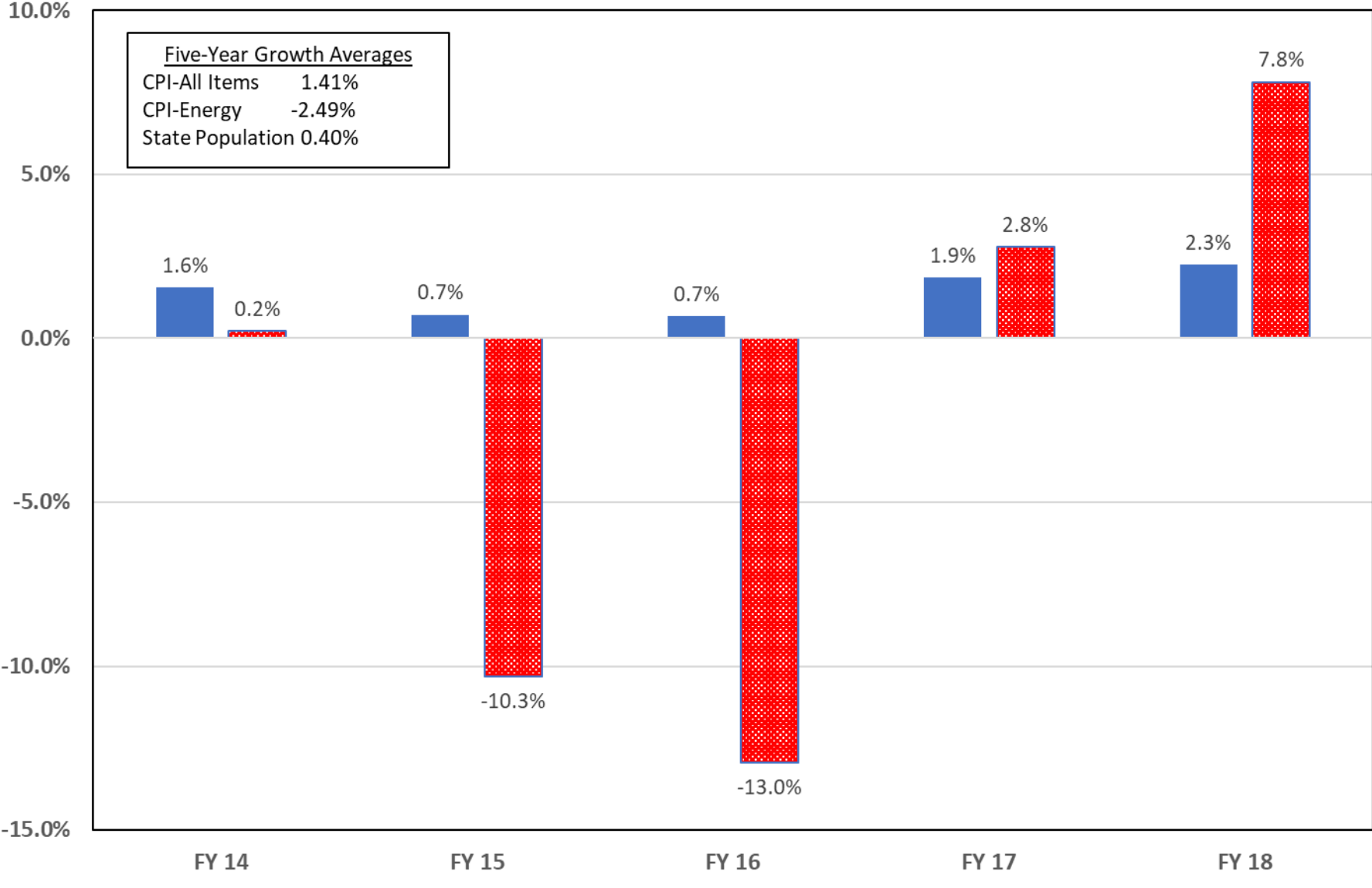
Overview of Factors for Growth Comparisons

Average Annual Growth

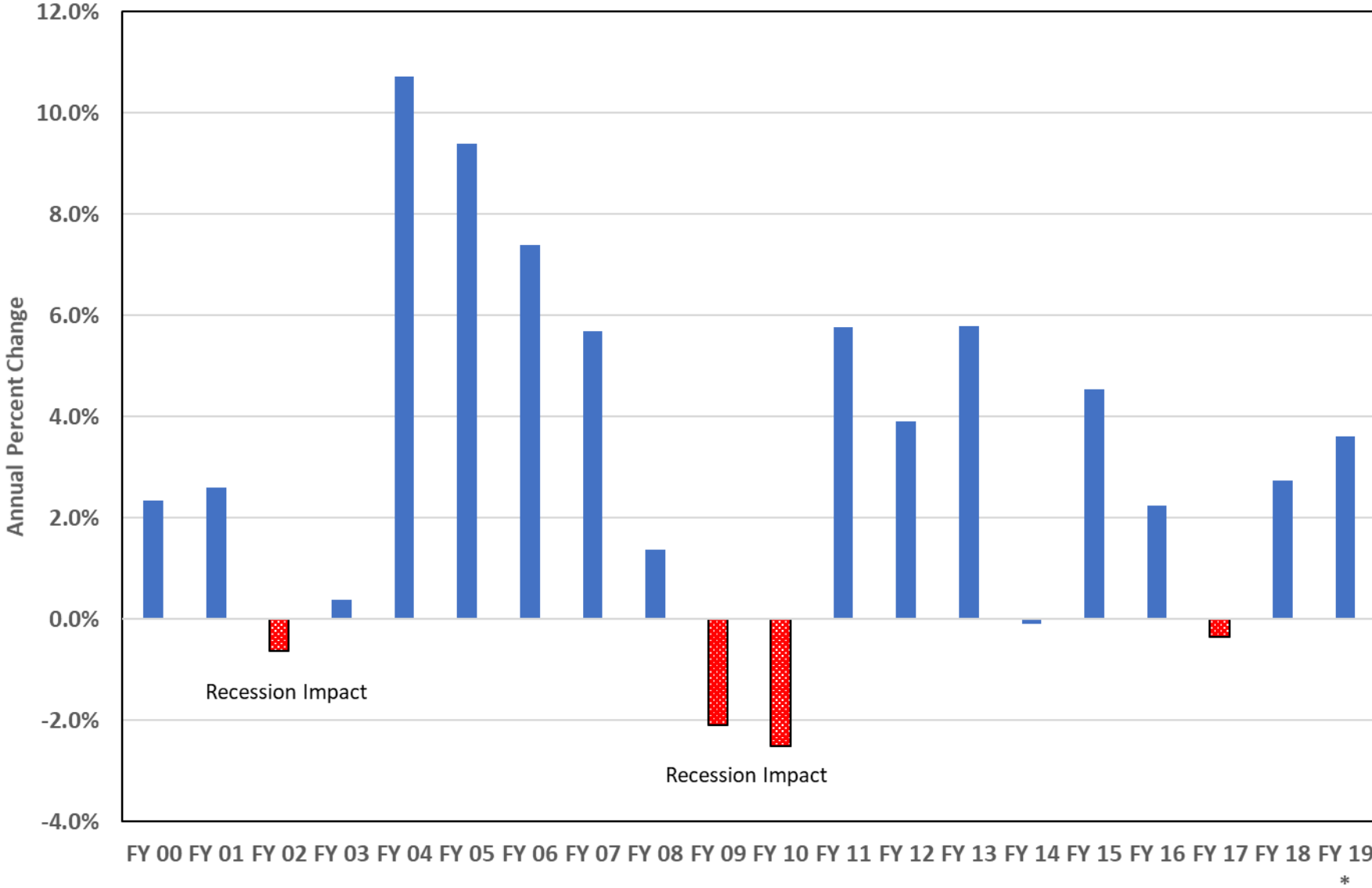
- Gross Collections Unadjusted for Tax Policy Changes
 - Last Five Years \$102.5 million
 - Last Ten Years \$115.2 million
 - Non-Recession Years (FY 11 – 18) \$162.0 million
 - Non-Recession Years (FY 03 – 08) \$271.9 million
- Net Available Unadjusted for Tax Policy Changes
 - Last Five Years \$93.6 million
 - Last Ten Years \$96.6 million
 - Non-Recession Years (FY 11 – 18) \$146.5 million
 - Non-Recession Years (FY 03 – 08) \$215.1 million
- Net Available Adjusted for Tax Policy Changes
 - Last Five Years \$146.9 million

Annual Inflation in Fiscal Years and Five-Year Averages

■ CPI- All Items ■ CPI- Energy

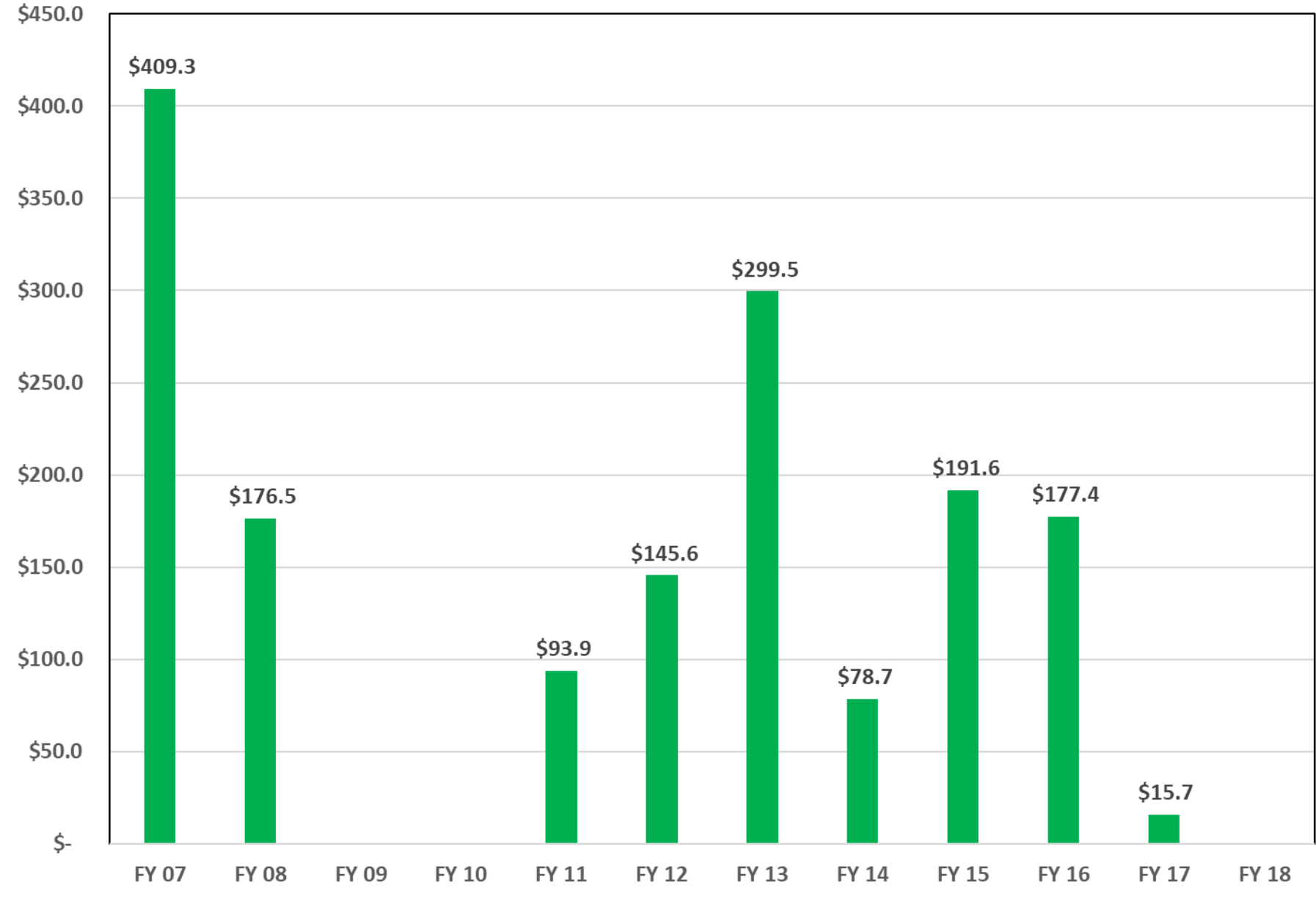


Net Available General Revenue Collections



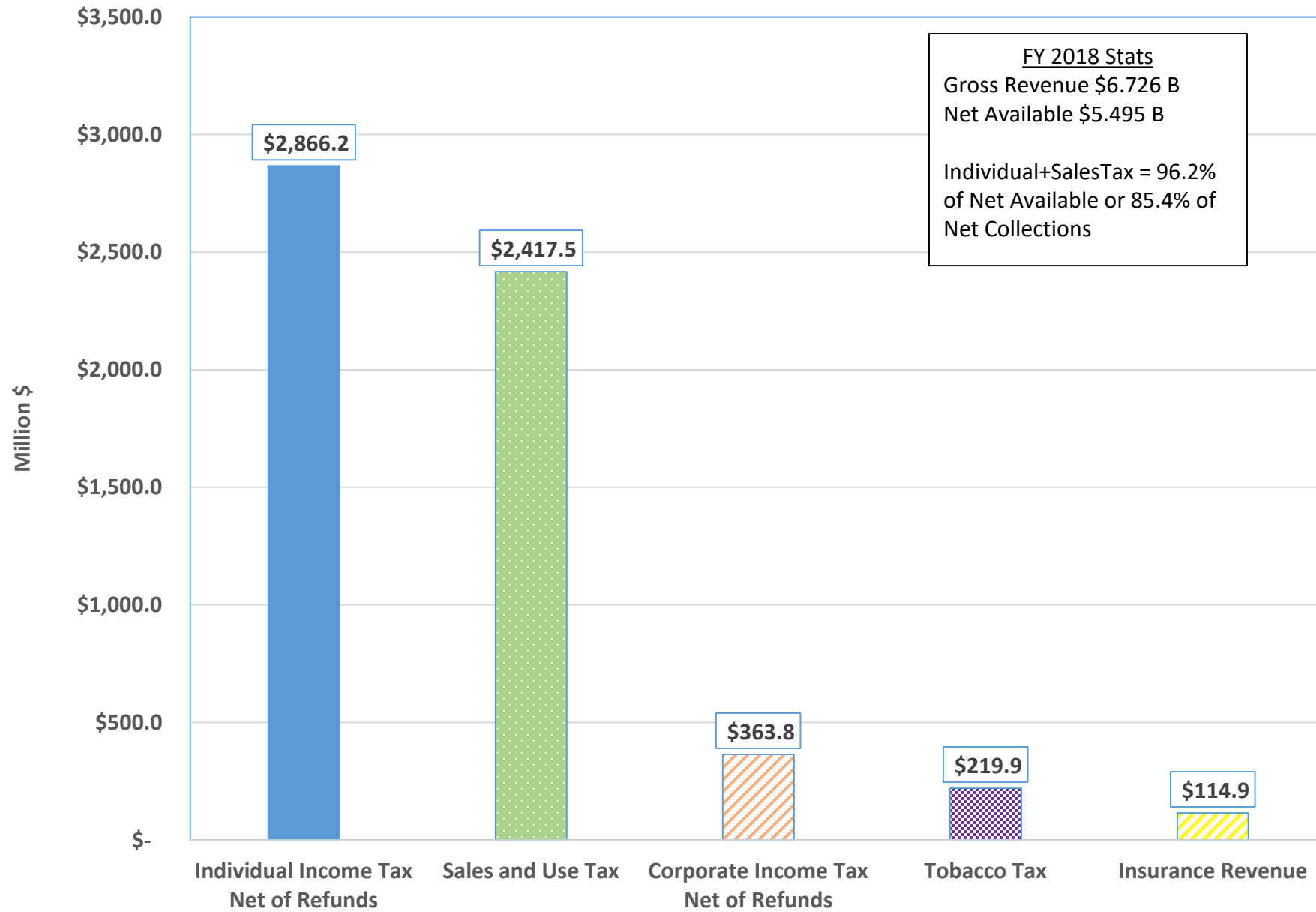
* Projected

History of Surplus Amounts Above Full-Funding RSA Levels

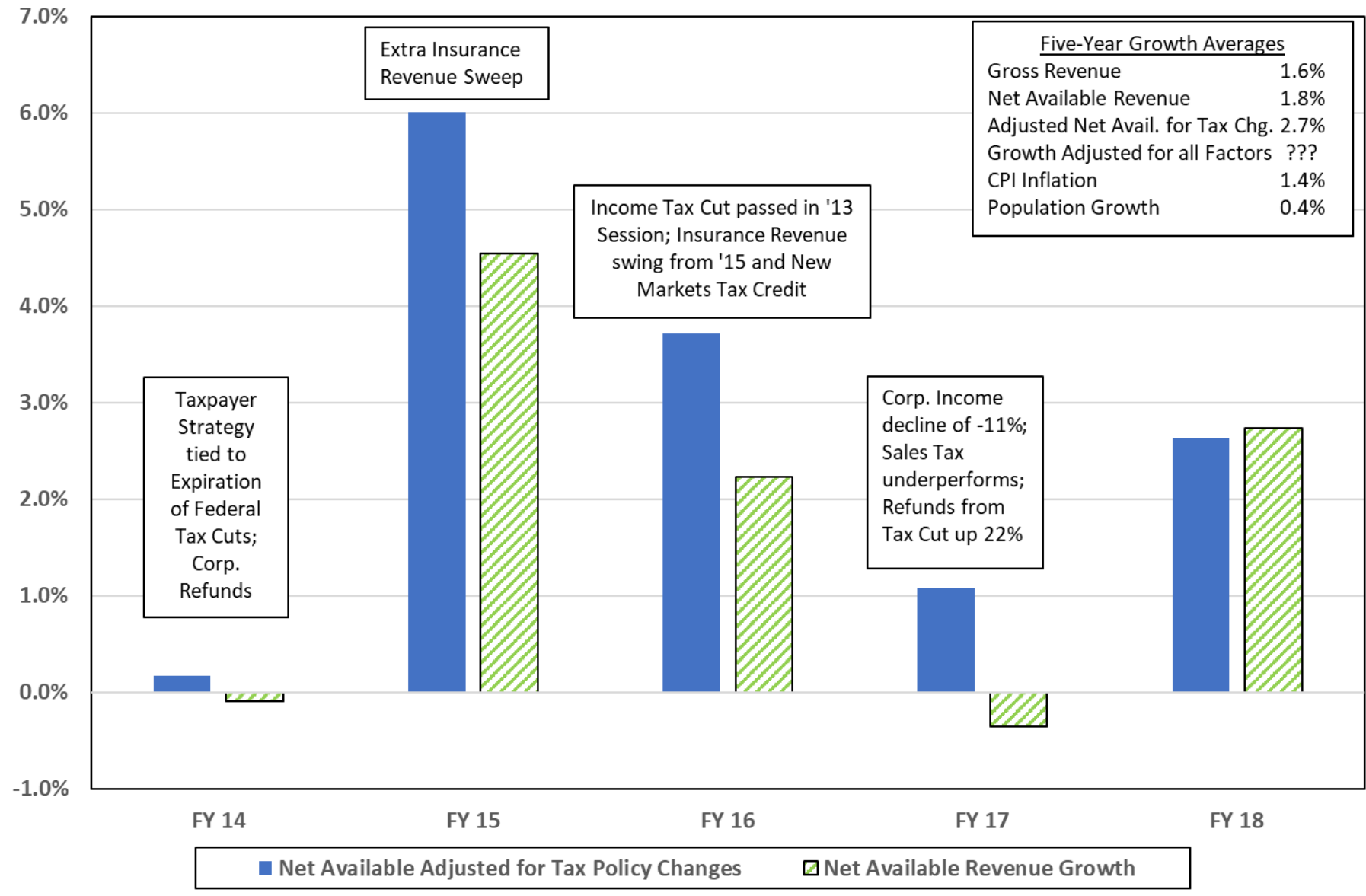


General Revenue Growth Comparisons

The Top Five Revenue Sources for General Revenue, FY 2018



Annual Percentage Change in Net Available Revenue with Adjusted Growth Rate and Other Factors



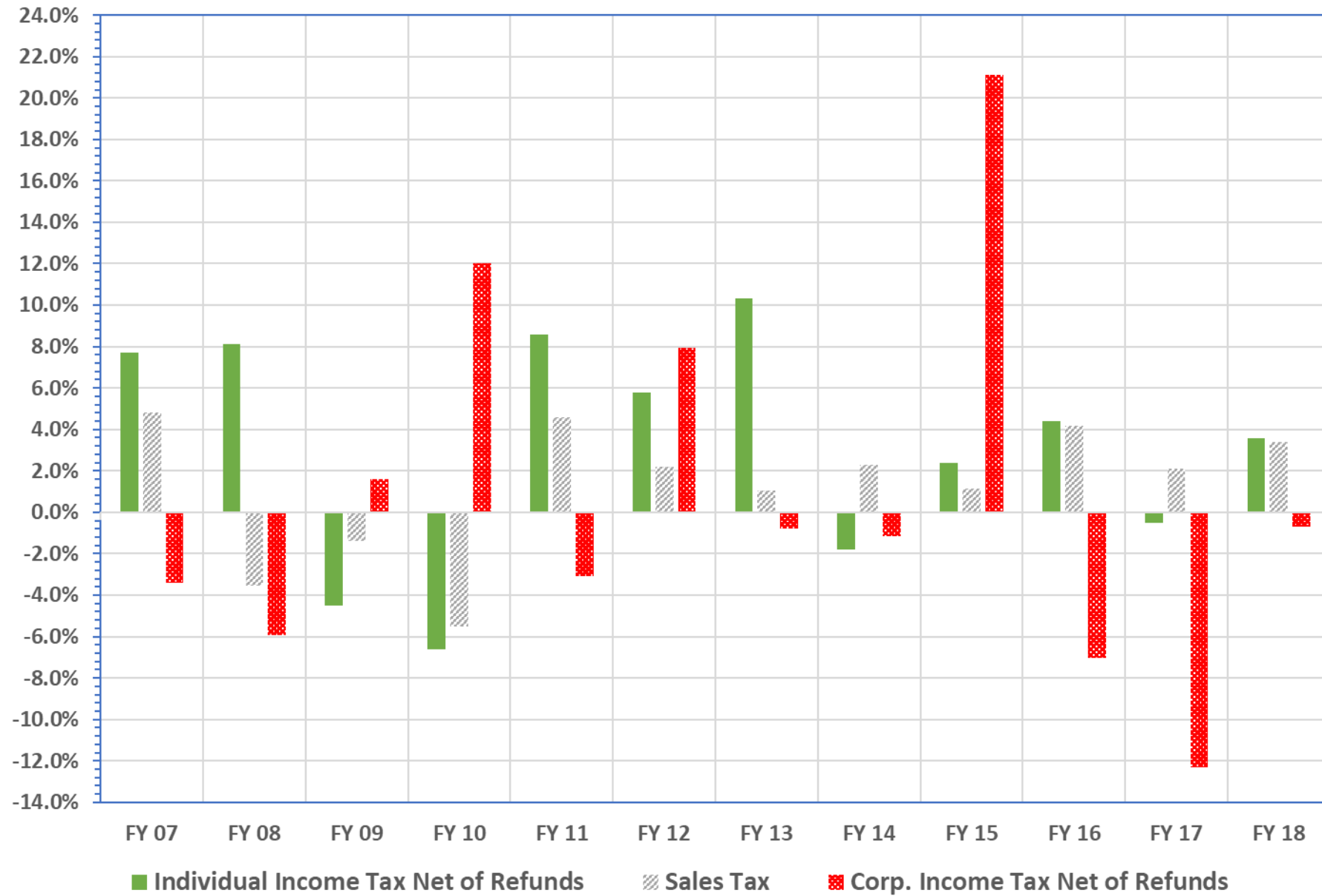
Outline for Discussion

2. Issues of Volatility

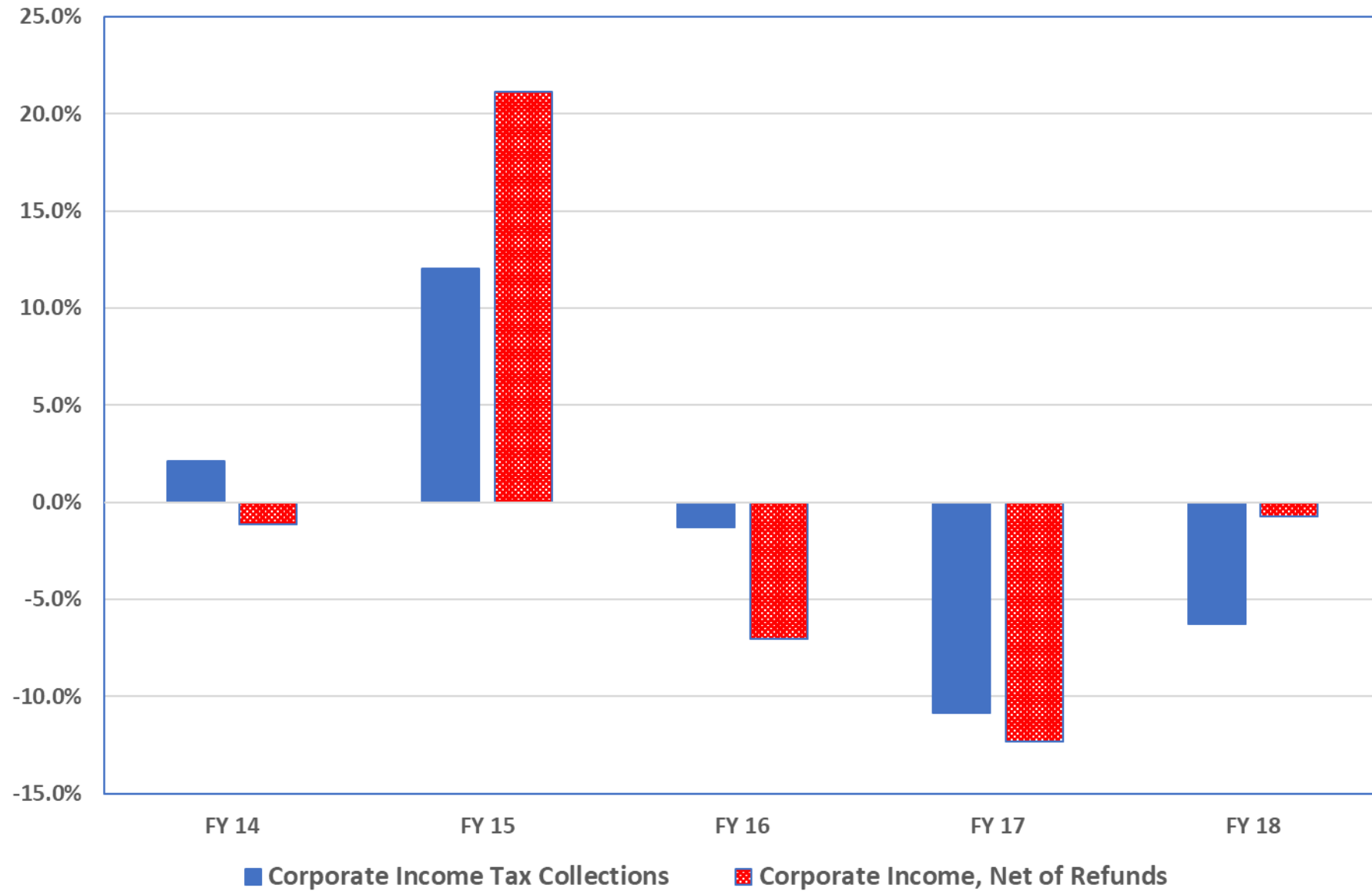
Overview of Factors for Growth Comparisons

- Economic Growth and Economic Cycles
- Tax Policy Change Effects
- Corporate Tax Revenue Volatility
- Insurance Revenue Volatility from Current Law 23-61-710 (c)
- All Other Factors Impacting Revenue Growth (Federal Tax Changes and Taxpayer Strategy, Incentives Program Effects, Refund Claims and Court Settlements, Other)

Annual Volatility in Major Revenue Sources, FY 07 to FY 18

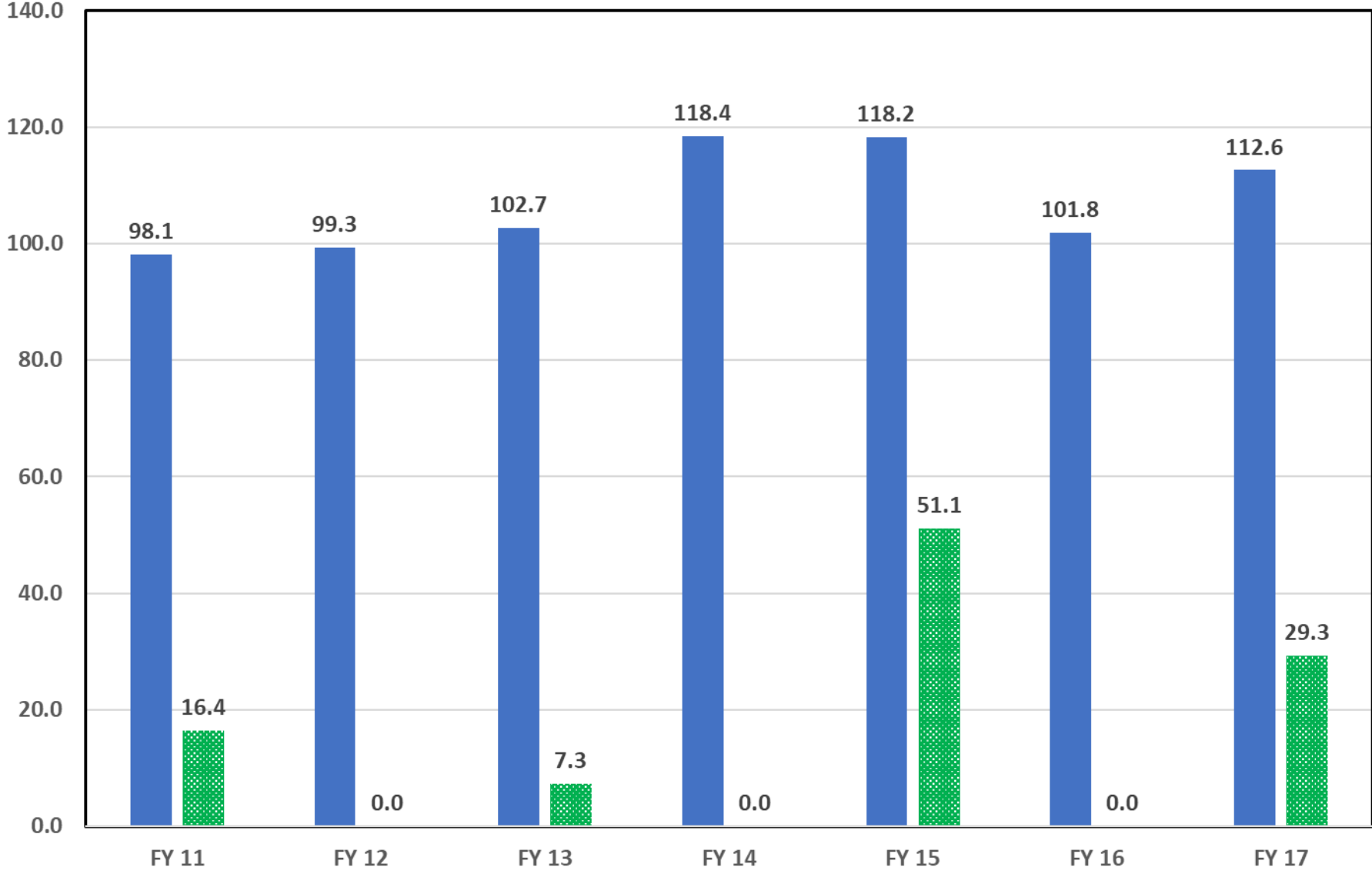


Annual Percent Change in Corporate Income Tax Collections and Revenues Net of Refunds

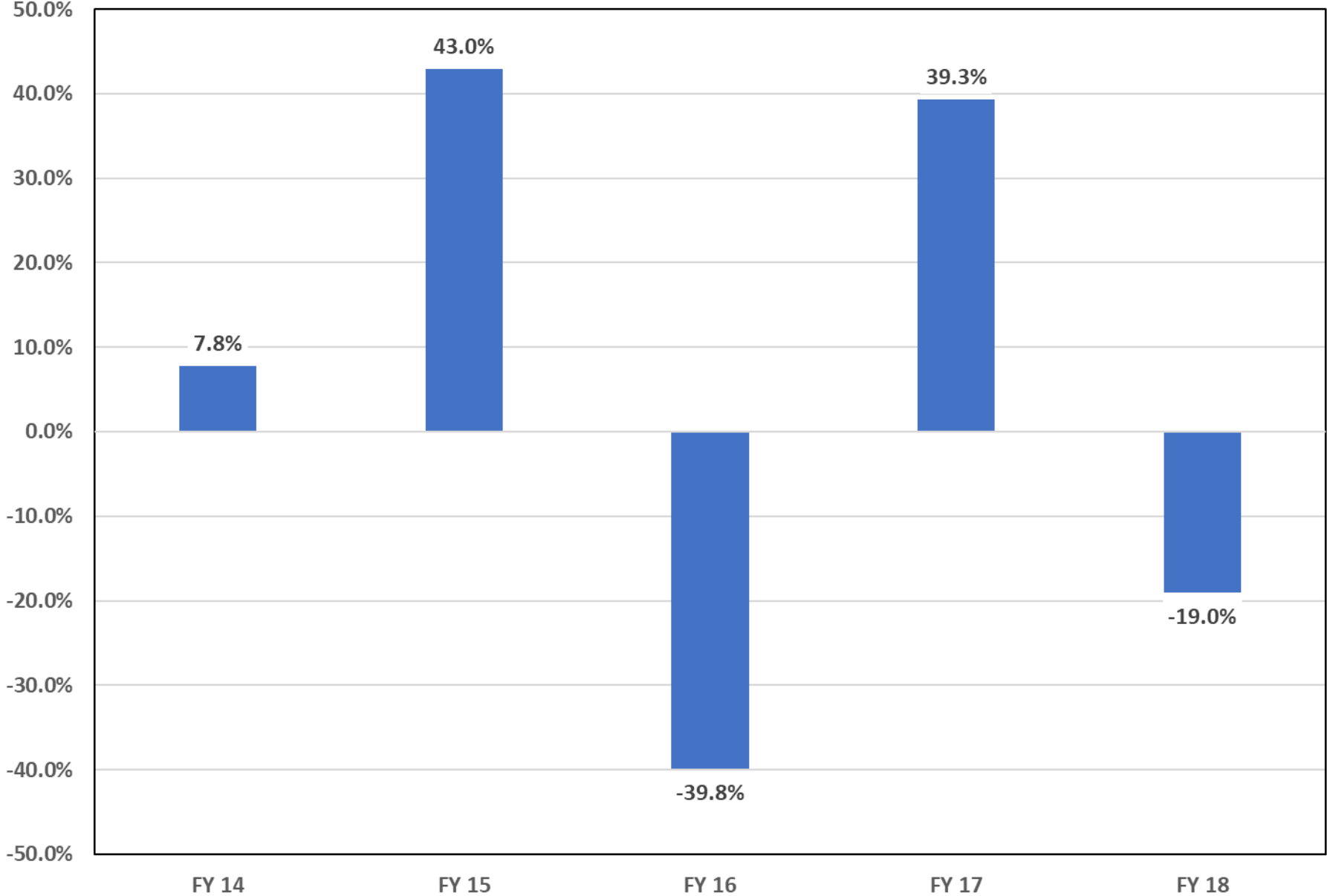


Insurance Revenue Transfers to General Revenue by Fiscal Year

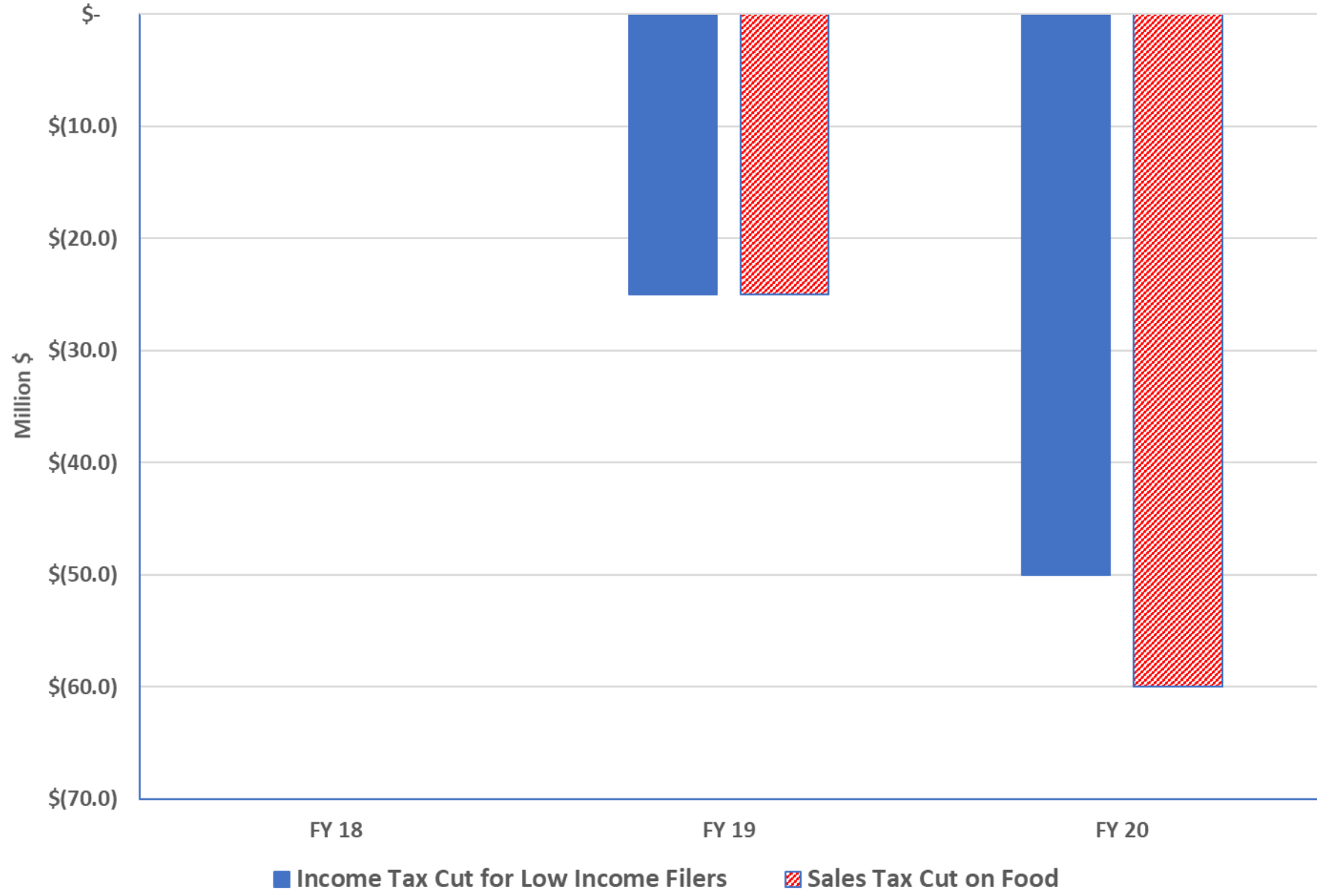
■ Insurance Revenue - Excluding Trust Fund Transfers ■ Insurance Trust Fund Transfers to Gen. Rev.



Annual Percent Change in Insurance Revenue to General Revenue



Tax Cuts in Current Law



Outline for Discussion

3. Issues of Triggers

Tax Triggers and Rainy Day Funds: Selected States

	Trigger Benchmark	Status	FY 17 Rainy Day/Reserve Funds		Windfall Revenues Estimate from Federal Tax Reform
			\$	% of Expenditures	
Indiana	If rainy day fund exceeds 12.5% of budgeted spending (as a tax credit)	Current	\$1.47 B	9.5%	Yes - \$129 million
Iowa	Fixed Amount in FY 22 and growth exceeds 4% over prior year	Pending	\$605 M	8.3%	Yes - \$188.3 million
Kansas	Various (Corp. and Individual)	Repealed	\$0	0.0%	Yes - \$64.7 million
Missouri	Rev. exceeds highest of past 3 years by \$150 M	Current	\$294	3.2%	Yes - No Estimate
North Carolina	Corp. Inc. exceeds benchmark	Completed	\$1.83 B	8.3%	Yes - No Estimate
Oklahoma	Projections adequate to reduce rate on revenue neutral basis	Repealed	\$93 M	1.6%	Yes - No Estimate
Arkansas			\$123 M	2.3%	No - Nonconforming state
				\$126.6 M (FY18)	

Considerations

- Budget risk may be increased from tax triggers in a volatile revenue growth environment
- Tax trigger usage in other states requires complete analysis of the circumstances in those states
 - High reserve account balance
 - Windfall revenue gains from Federal Tax Reform or other sources (Iowa)
 - Other revenue enhancement circumstances as offsets (Indiana)
 - High population and income growth as backdrop (North Carolina, Colorado)

Outline for Discussion

4. A Word About Recessions

A Word About Recessions

The current expansion follows the weakest recovery in the modern record

Implications

- Delayed approach to full employment and peak consumption
- Delayed pattern of cost escalation for businesses
- Delayed formation of asset bubbles and poorly regulated financial instruments

What is different beyond just timing in the cycle?

Energy Markets	Residential Construction Market
Household Savings Rate	Business Competitiveness & Tax Reform
Inventory-to-Sales Ratio	Labor Force Participation
Trade Agreement Changes	Fiscal Stimulus Near Cycle Peak

Current Recession Probabilities

IHS Markit Inc. (Main Forecast Input Provider)

August 2018 Update

Baseline Forecast (65 % Probability)

- Gradual Fed interest rate increases in 2018 and 2019, peak GDP growth in '18 (2.9%) and '19 (2.7%)

Pessimistic Scenario (20% Probability)

- Two-Quarter Recession starting mid 2019, loss of confidence and business cuts back, slower investment, expansion ends at point matching the prior record

Optimistic Scenario (15% Probability)

- Higher household formation rate driving housing starts, consumer and business confidence improve, equity markets drive higher

Current Recession Probabilities

Other Recession Probabilities, Consensus, and Fed Comments

Federal Reserve Bank of NY (Short-term Indicator Index)

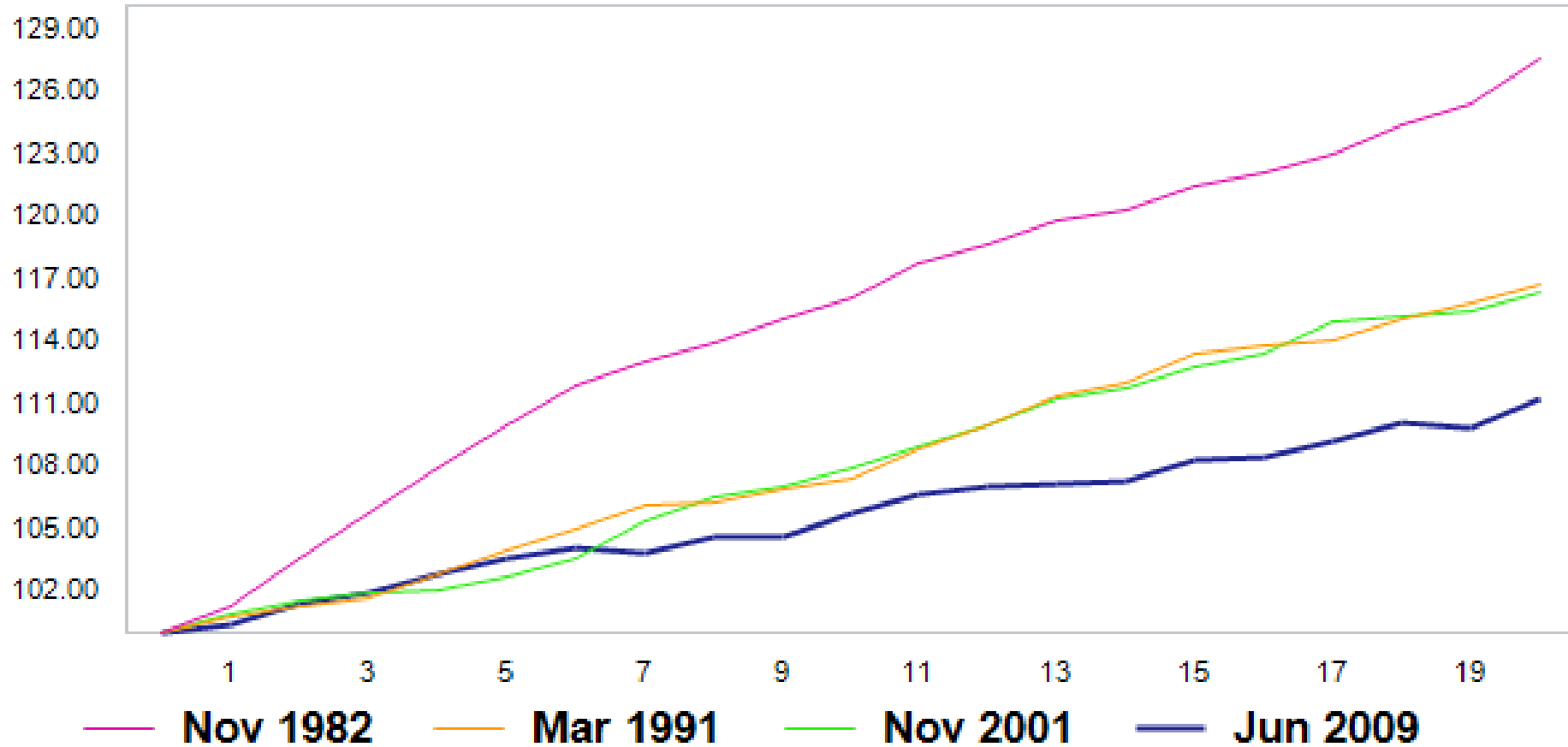
- 11.1% Probability Index for Recession in the Next 12 Months (August 2018)

WSJ Survey (May 2018)

- Avg. probability within next 12 months 15%, majority predict 2020 recession
- Prior false predictions—2011, 2016
- “Recessions occur because of unforeseen shocks, so by definition there is no meaningful answer.” Daniel Bachman, Deloitte
- Fed Comments
 - “There is good reason to expect that this strong performance will continue,” J. Powell at Jackson Hole
 - *“Where is the episode in which inflation jumped from persistently too low to painfully out of control without allowing ample time for a sensible, moderate, and adequate policy response?” Jon Faust, economic adviser to Bernanke, Yellen, and Powell*
 - *Translation: Monetary policy should be less geared to unobservable benchmarks such as the natural unemployment rate and neutral interest rate, and more willing to “wait and see.” WSJ*

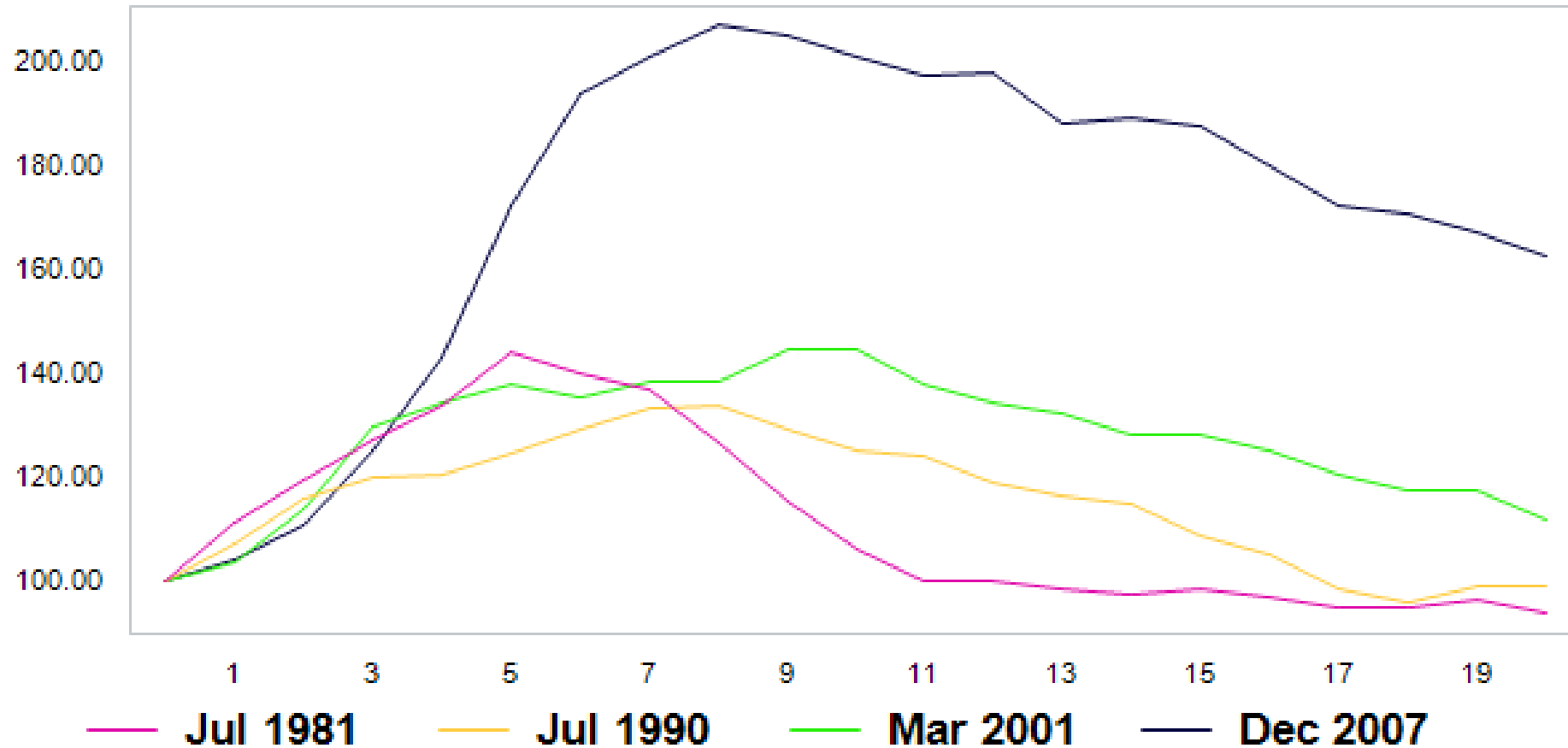
Cycle Comparisons of GDP Growth

20-Quarter Growth Path from Start of Expansion Cycle



Cycle Comparisons of U.S. Unemployment Rate

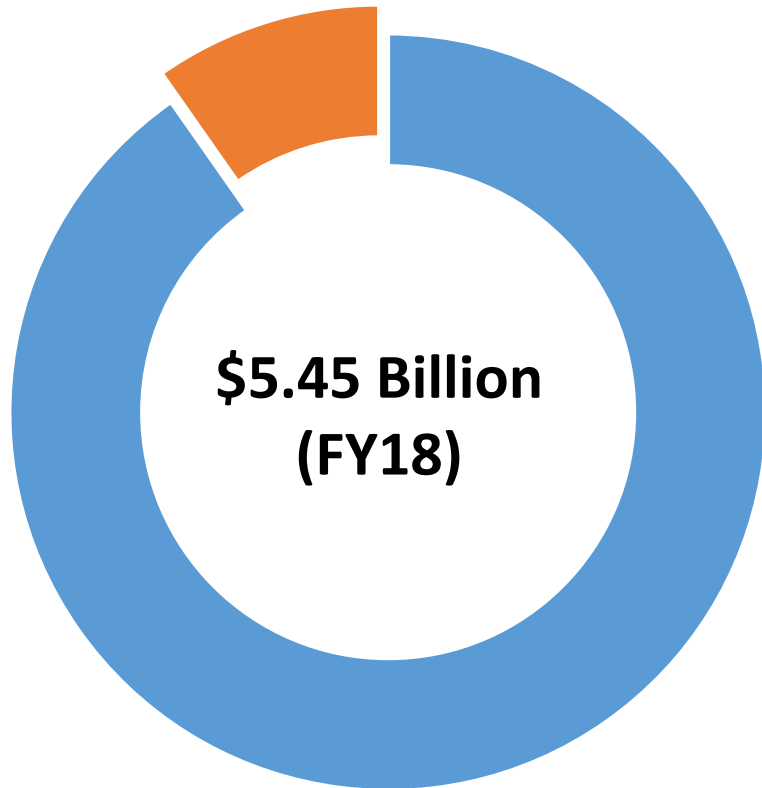
20-Quarter Growth Path from Peak of Prior Cycle



Outline for Discussion

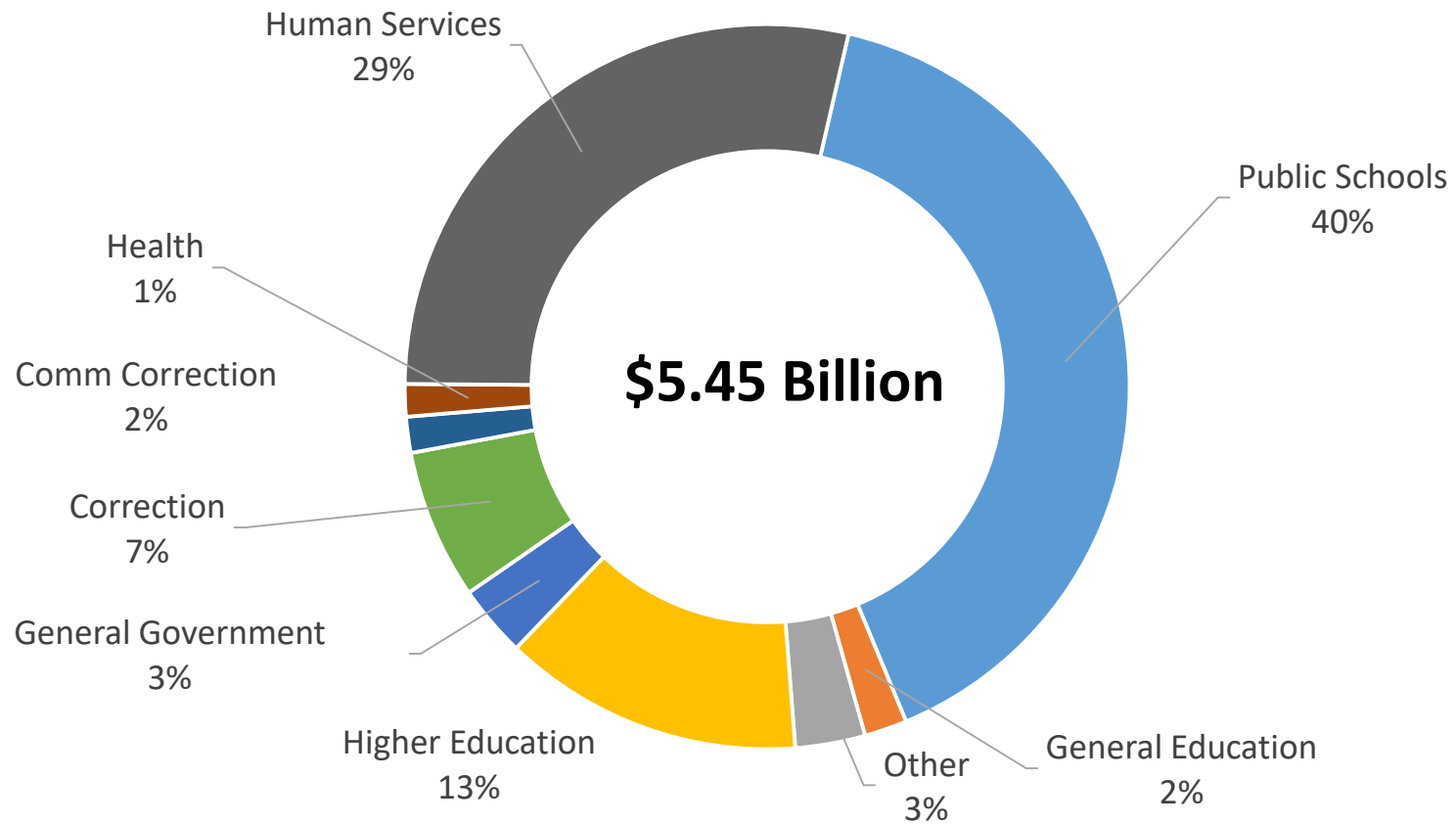
5. RSA Budgeting

The “Big Six” account for 90% of GR spending



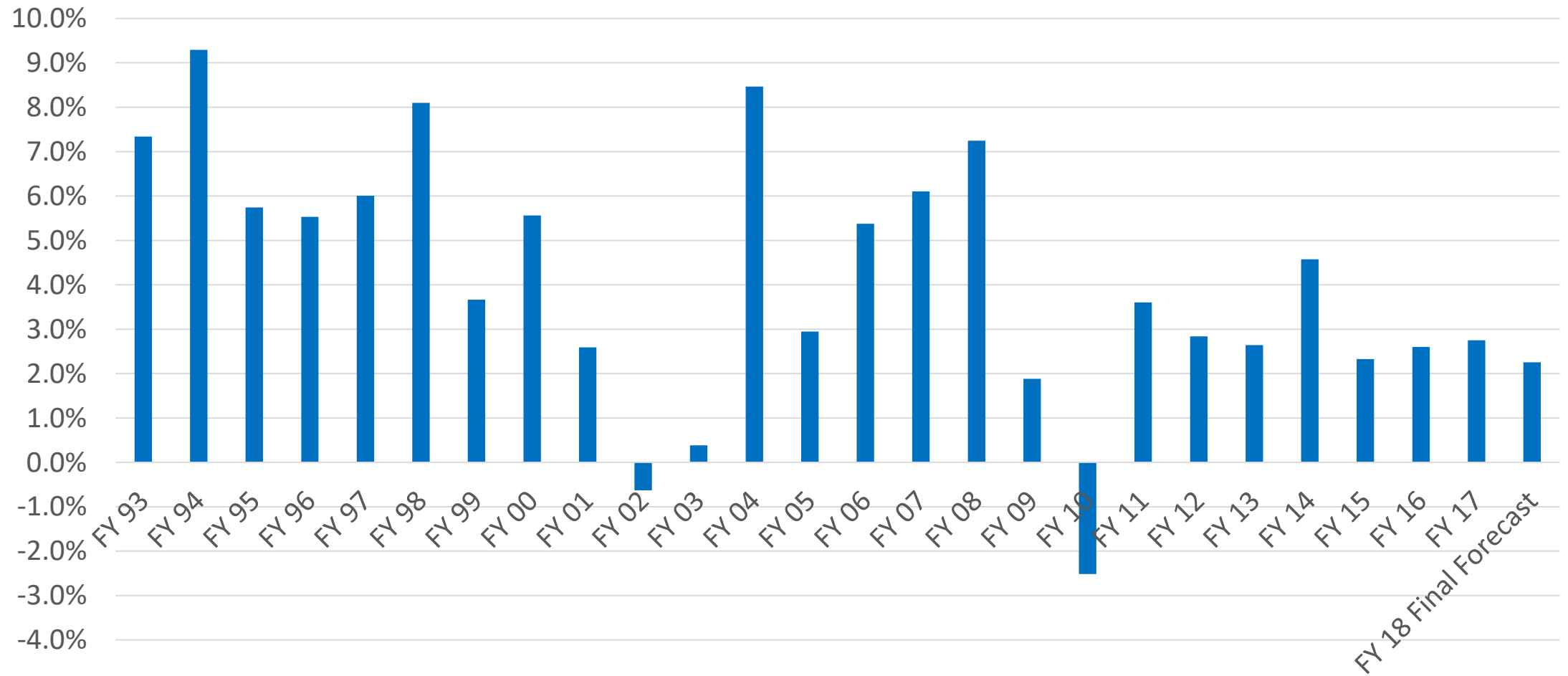
- Public School Fund
- Department of Human Services
- Department of Health
- Department of Correction
- Department of Community Correction
- Institutions of Higher Education

FY18 General Revenue Budget



Source: Forecast, FY18 Revenue Stabilization Act

Growth in Net Available General Revenue (w/o Surplus)



Drivers of changes in budget needs

- Public Schools
 - Increases in per-pupil funding amounts
 - Enrollment growth
 - Facilities funding requirements
- Medicaid
 - Medical cost inflation
 - Utilization
 - Enrollment
 - Federal Match Rates (both Traditional and Arkansas Works)
- Public Safety
 - Corrections
 - Law Enforcement

Budget and Forecast Timeline

- October 16th – November 15th
 - ALC/JBC Budget Hearings.
 - Presentation of individual agency budgets.
- November 14th
 - Official Forecast for FY20 and FY21 presented.
 - Balanced Budget Proposal for FY20 and FY21 presented.
- January – April
 - Legislative Session.
 - Enactment of the FY20 budget.

Conclusion

- Questions?