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# **Finance Advisory Committee**

## **Revenue and Budget Update**

**January 26, 2023**



# Key Points of the January Baseline

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- After a 17% increase in FY 22, General Fund revenue growth is expected to moderate to 7.5% in FY 23 and 2% in FY 24.
- The state will have a large 1-time balance of \$1.8 Billion in FY 24 but the balance declines to \$1 Million by FY 25.
- We have substantial capacity for 1-time budget proposals, but ongoing initiatives would create a shortfall in FY 25.
- Our comments today focus on revenues – for more insight into the overall budget, please see our Appropriations Committee presentations.

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# Forecasting State Revenues

# Retail TPT and Withholding Slowed in the 1<sup>st</sup> Half of FY 23

- But Contracting Did Accelerate

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	<b>(% Growth)</b>	
	<b><u>FY 22</u></b>	<b><u>FY 23 YTD</u></b>
TPT Retail/Remote	13.7%	6.4%
TPT Contracting	10.5%	21.6%
Withholding	12.4%	4.8%

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# January 4-Sector “Consensus”: Much Slower Growth in FY 24 & FY 25

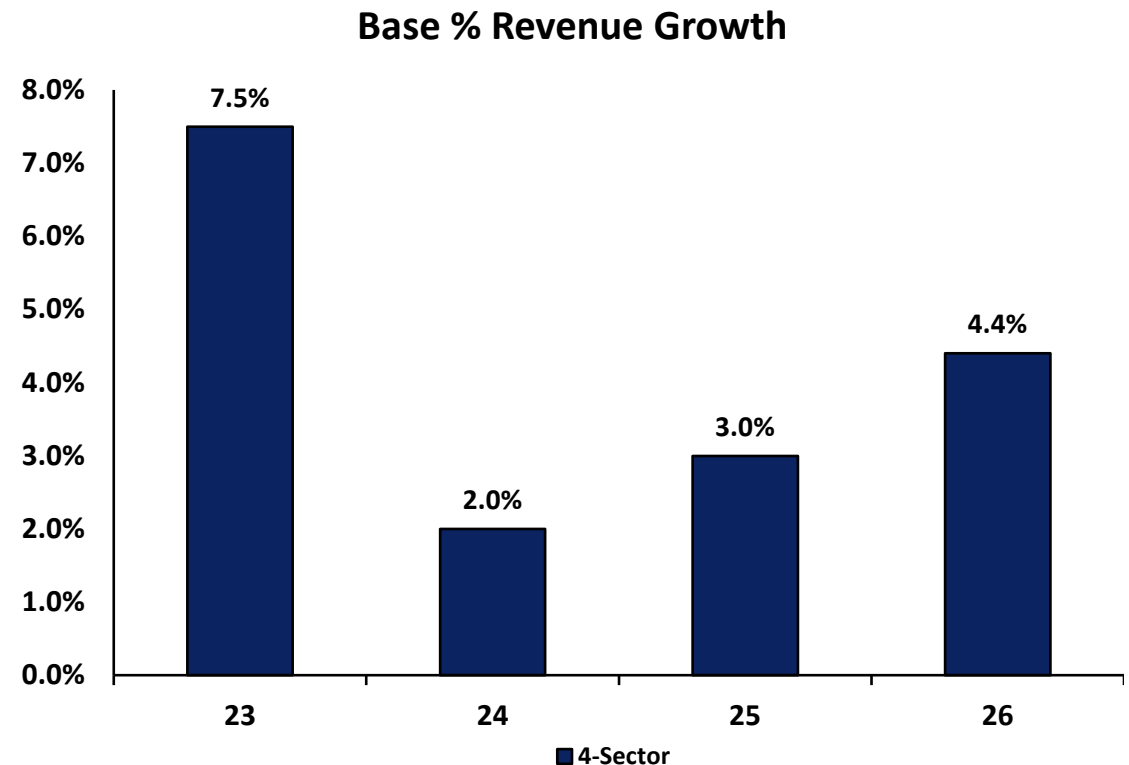
- With Moderate Recovery in FY 26

## 4-Sector Components

- Finance Advisory Committee
- UA model – base forecast
- UA model – more cautious
- JLBC Staff

## Other Considerations

- Rates are Prior to Enacted Tax Cuts
- With Tax Cuts, FY 23 & FY 24 net growth is negative

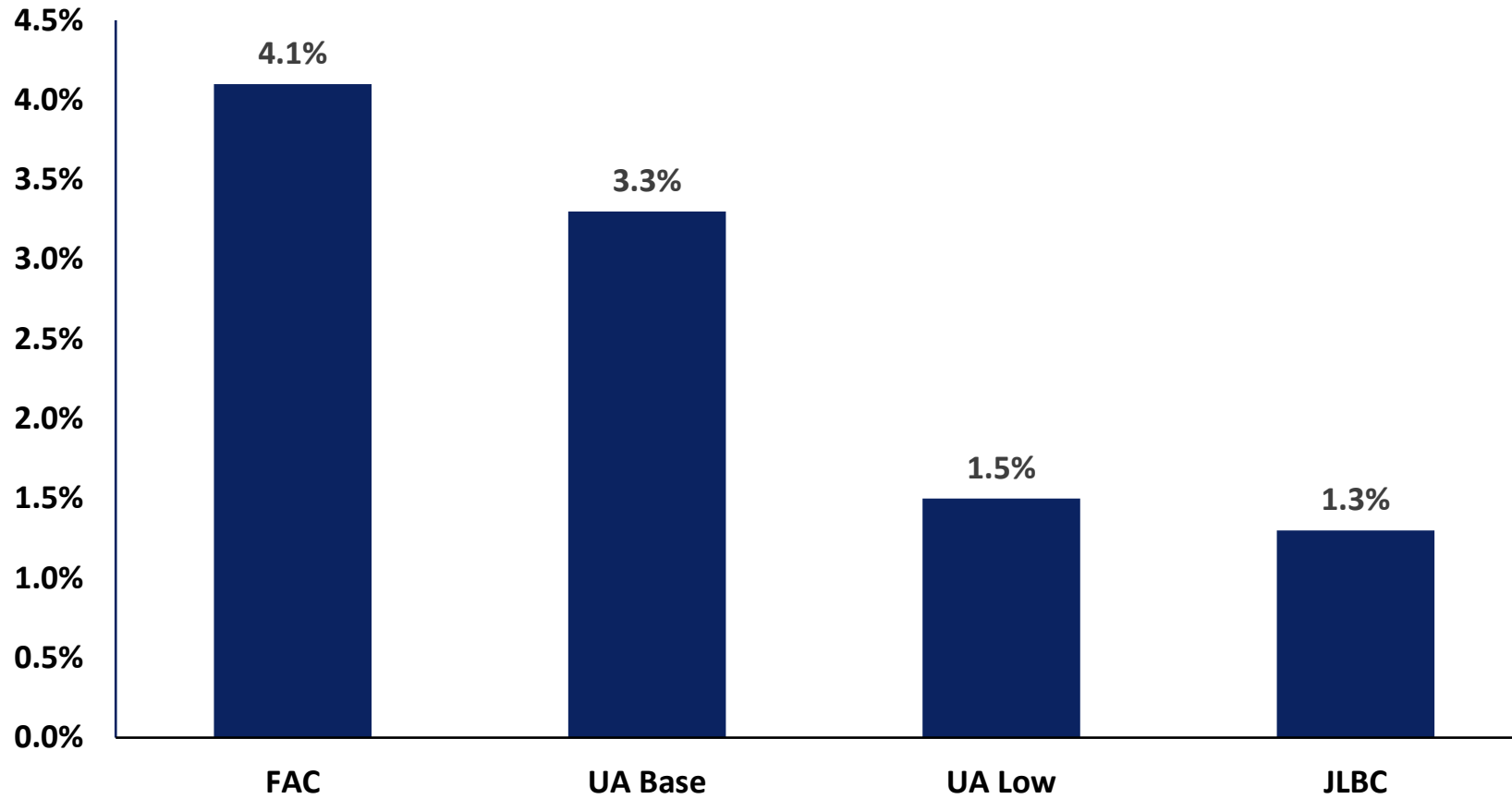


Excludes balance forward, one-time transfers, tax law changes and urban revenue sharing

See Appendix A and B

# FY 24 4-Sector Reflects Recession Uncertainty

FY 24 Base Revenue Growth Forecast



# Forecasters' Assessment of Recession Risk

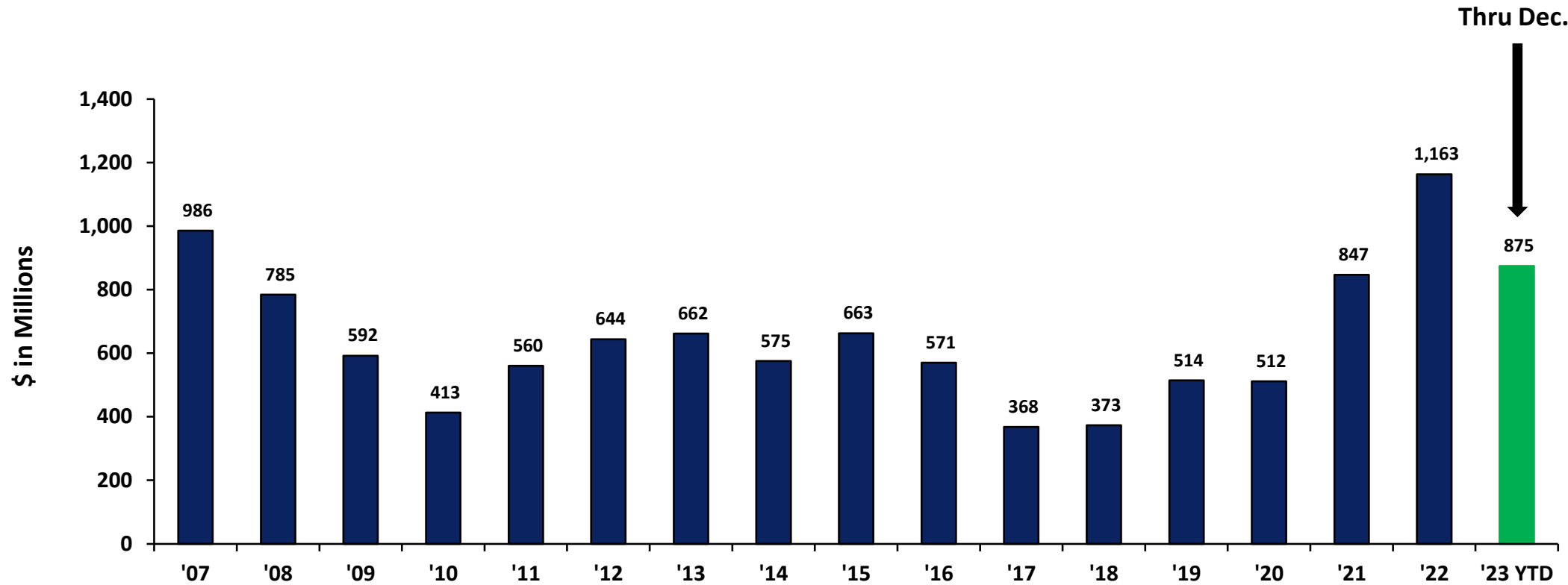
## - Difficult to Translate into AZ General Fund Impact

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- National Association for Business Economics (NABE)
  - 57% of respondents believe probability of a recession starting in CY 2023 is greater than 50%
- Bloomberg's Monthly Survey of Economists
  - Survey respondents see a 70% risk of recession in CY 2023
- IHS Markit Forecasting
  - Risk of recession in CY 2023 is 80%

# Example of a Recession Risk: Corporate Income Tax

- Given the Cyclic Nature of CIT, Recent Rapid Growth Poses Significant Downside Risk

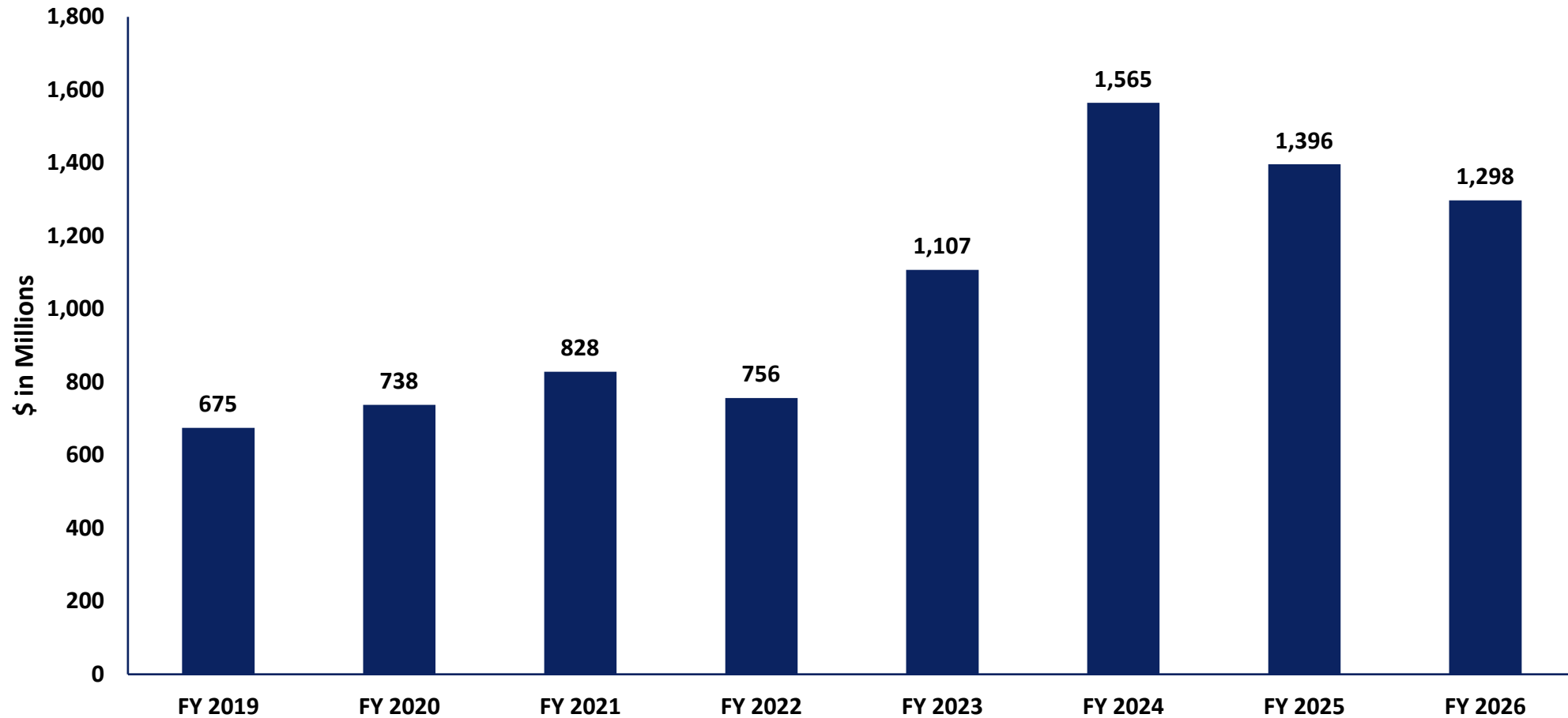


State's 56% YTD Growth Compares to 9% Federal Increase



# Urban Revenue Sharing – FY 2019 through FY 2026

- % Share of Income Taxes Grows from 15% to 18% in FY 24



# JLBC – Executive Revenue Differences

- Combined '23/'24 Difference is Small; Executive is Less in '24 & '25

<u>FY</u>	<u>(\$ in M)</u> <u>Exec &lt; JLBC</u>
'23	555
'24	(493)
'25	(218)
'26	(238)

- #s Exclude New Executive Tax Cuts. Executive proposes:
  - A new Child Tax Credit
  - TPT exemptions for feminine hygiene products and child diapers

# Executive Proposes New \$100 Child Tax Credit

- Supplements Existing \$100 Dependent Tax Credit

	<u>Current Dependent Tax Credit</u>	<u>Executive Proposal</u>
Credit Amount	\$100 < 17 years old \$25 ≥ 17 years old	\$100 < 17 years old
Income Threshold	\$200,000/\$400,000 Single/Married	\$20,000/\$40,000 Single/Married
Refundable	No	Yes
Cost	\$145.4 million in FY 22	\$50.0 million in FY 2024

# Executive Proposes to Add 2 New TPT Exemptions

- JLBC and Executive Scoring Significantly Different

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\$ in Millions

	<u>Executive</u>	<u>JLBC</u>
Feminine Hygiene Products	24	4
Child Diapers	<u>16</u>	<u>6</u>
<b>Total</b>	<b>40</b>	<b>10</b>

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- Details of the JLBC Staff cost estimate can be found in the Fiscal Note for SB 1033

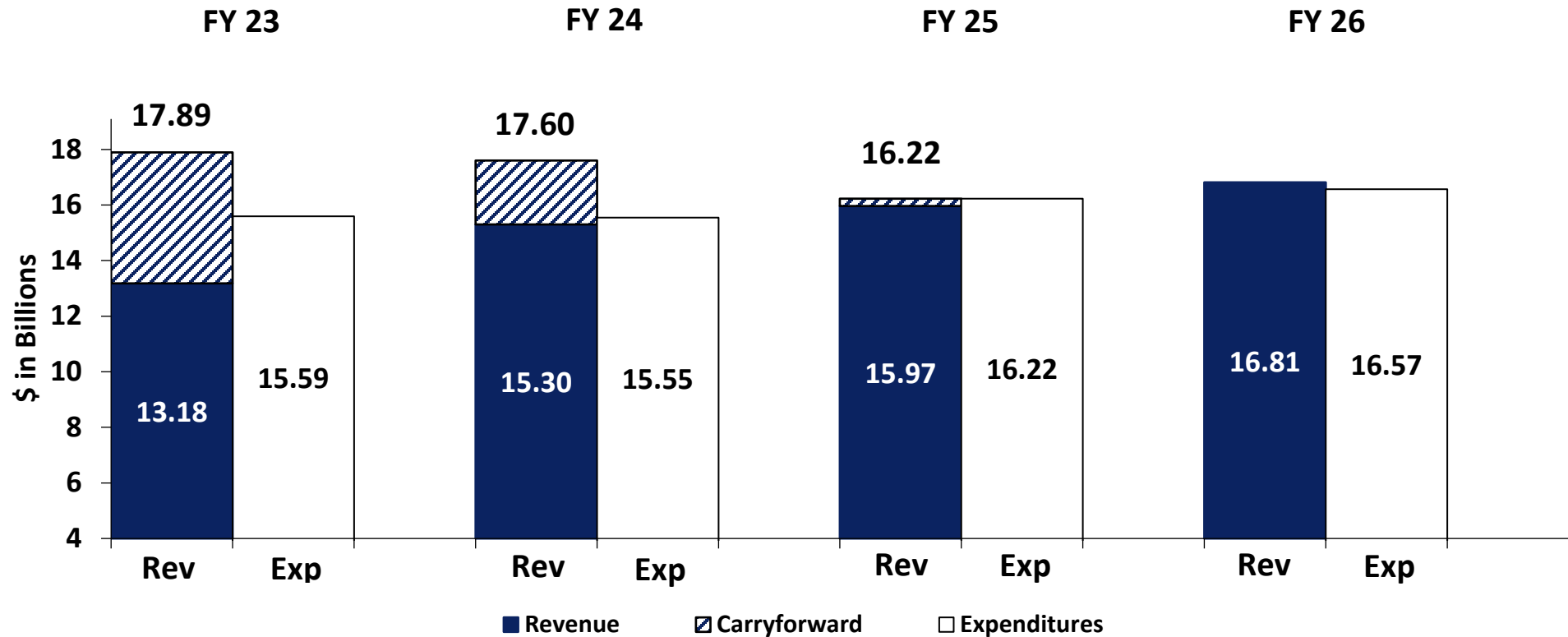
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# Projected Ending Balances

Excludes \$1.4 B in Budget Stabilization Fund

# Available Balances: \$1.8 B for One-Time Initiatives Only

- Any Ongoing Initiatives Would Create FY 25 Shortfall
- FY 25 Initially Was \$(260) M Short; Solved by Using Part of FY 24 Surplus



Cash Balance

**\$2.3 B**

**\$1.8 B \***

**\$1 M**

**\$242 M**

\* This amount is after \$260 M is carried into FY 25 to resolve that year's shortfall.



# Final Thoughts

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- Given the economic uncertainty, our revenue estimates will likely change considerably as we go through the FY 24 budget process.
- In addition, we will be monitoring income tax collections:
  - First returns filed under phase 1 of the income tax reduction
  - Standard withholding rate changed from 2.7% to 2.0% in January
- The FAC will meet again this spring once we re-evaluate our forecast

## STAFF OF THE JOINT LEGISLATIVE BUDGET COMMITTEE

Director.....	Richard Stavneak
Office Manager.....	Linda Monsanto
Deputy Directors.....	Stefan Shepherd
.....	Jack Brown
Chief Economist.....	Hans Olofsson
Assistant Directors.....	Micaela Larkin
.....	Patrick Moran
.....	Rebecca Perrera
Principal Fiscal Analysts.....	Morgan Dorcheus
.....	Geoffrey Paulsen
Senior Fiscal Analysts.....	Ryan Fleischman
.....	Jordan Johnston
.....	Maggie Rocker
Economists.....	Ben Newcomb
Fiscal Analysts.....	Nate Belcher
.....	Chandler Coiner
.....	Cameron Mortensen
Senior Administrative Assistant / JLBC Clerk.....	Kristy Paddack
Administrative Assistant / JCCR Clerk.....	Jennifer Burns



# Appendix A: 4-Sector Forecast

	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>
<b>Sales Tax</b>				
JLBC Forecast	6.7%	2.5%	4.2%	4.7%
UA – Low	6.4%	0.7%	2.9%	4.4%
UA – Base	7.2%	2.9%	4.3%	4.8%
FAC	7.6%	5.0%	4.6%	6.3%
Average:	<b>7.0%</b>	<b>2.8%</b>	<b>4.0%</b>	<b>5.1%</b>
<b>Individual Income Tax with Deferral</b>				
JLBC Forecast	5.5%	1.0%	-0.4%	2.1%
UA – Low	5.7%	2.5%	4.7%	5.2%
UA – Base	6.1%	4.3%	5.5%	5.6%
FAC	5.0%	3.3%	4.3%	4.5%
Average:	<b>5.6%</b>	<b>2.8%</b>	<b>3.6%</b>	<b>4.4%</b>
<b>Corporate Income Tax</b>				
JLBC Forecast	6.8%	-3.8%	1.4%	2.6%
UA – Low	12.0%	-2.7%	3.3%	5.1%
UA – Base	13.9%	0.5%	4.0%	5.4%
FAC	15.5%	3.9%	4.5%	7.1%
Average:	<b>12.0%</b>	<b>-0.3%</b>	<b>3.4%</b>	<b>5.2%</b>
<b>Insurance Premium Tax</b>				
JLBC Forecast	3.3%	-0.7%	-0.6%	2.8%
UA – Low	4.5%	-0.5%	2.9%	3.1%
UA – Base	5.3%	1.1%	4.3%	4.1%
FAC	5.9%	4.4%	4.5%	3.9%
Average:	<b>4.7%</b>	<b>1.1%</b>	<b>2.8%</b>	<b>3.5%</b>

JLBC Weighted Average	<b>6.0%</b>	<b>1.3%</b>	<b>1.7%</b>	<b>3.3%</b>
UA Low Weighted Average	<b>6.4%</b>	<b>1.5%</b>	<b>3.7%</b>	<b>4.8%</b>
UA Base Weighted Average	<b>7.1%</b>	<b>3.3%</b>	<b>4.8%</b>	<b>5.2%</b>
FAC Consensus Weighted Average	<b>6.9%</b>	<b>4.1%</b>	<b>4.5%</b>	<b>5.5%</b>
“Big-4” Weighted Average	<b>6.6%</b>	<b>2.5%</b>	<b>3.7%</b>	<b>4.7%</b>
Consensus Weighted Average	<b>7.5%</b>	<b>2.0%</b>	<b>3.0%</b>	<b>4.4%</b>

\* Represents ongoing revenue adjusted for small revenue categories.

# Appendix B: January FAC Forecast '22 – '24

FORECAST REVENUE GROWTH								
(\$ in Thousands)								
	ACTUAL FY 2022	% CHANGE PRIOR YR	FORECAST FY 2023	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR	FORECAST FY 2024	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR
Sales and Use	7,208,853.5	15.4%	7,710,847.8	7.0%	501,994.2	7,925,320.8	2.8%	214,473.0
Income - Individual	7,530,010.7	15.3%	6,452,914.5	-14.3%	(1,077,096.2)	5,909,733.4	-8.4%	(543,181.1)
- Corporate	1,163,468.9	37.4%	1,303,569.9	12.0%	140,101.0	1,299,718.8	-0.3%	(3,851.1)
Property	26,787.4	19.7%	24,805.2	-7.4%	(1,982.3)	24,259.5	-2.2%	(545.7)
Luxury - Tobacco	20,941.2	-6.8%	20,731.7	-1.0%	(209.4)	20,524.4	-1.0%	(207.3)
- Liquor	43,720.7	-2.3%	45,163.5	3.3%	1,442.8	44,034.4	-2.5%	(1,129.1)
Insurance Premium	707,654.0	14.8%	741,267.6	4.7%	33,613.6	749,340.8	1.1%	8,073.3
Other Taxes	16,301.4	6.5%	17,344.7	6.4%	1,043.3	18,420.0	6.2%	1,075.4
Subtotal - Taxes	16,717,737.8	16.5%	16,316,644.8	-2.4%	(401,093.0)	15,991,352.1	-2.0%	(325,292.7)
<b>Other Non-Tax Revenues:</b>								
Lottery	183,680.2	75.4%	175,812.1	-4.3%	(7,868.1)	188,150.7	7.0%	12,338.6
Gaming Revenue	10,437.0	N/A	33,586.0	221.8%	23,149.0	22,938.6	-31.7%	(10,647.4)
Licenses, Fees and Permits	40,600.8	4.3%	43,970.7	8.3%	3,369.9	46,940.5	6.8%	2,969.8
Interest	46,383.0	5118.2%	300,000.0	546.8%	253,617.0	270,000.0	-10.0%	(30,000.0)
Sales and Services	30,351.5	16.5%	33,234.9	9.5%	2,883.4	36,093.1	8.6%	2,858.2
Other Miscellaneous	155,770.7	4.4%	163,578.1	5.0%	7,807.5	177,344.2	8.4%	13,766.0
Transfers and Reimbursements	168,356.1	29.5%	101,039.8	-40.0%	(67,316.3)	60,568.5	-40.1%	(40,471.3)
Disproportionate Share Revenue	87,833.5	3.5%	84,478.0	-3.8%	(3,355.5)	75,853.5	-10.2%	(8,624.5)
Subtotal - Other Non-Tax	723,412.8	29.7%	935,699.7	29.3%	212,286.9	877,889.0	-6.2%	(57,810.6)
<b>Net Ongoing Revenue</b>	<b>17,441,150.6</b>	<b>17.0%</b>	<b>17,252,344.4</b>	<b>-1.1%</b>	<b>(188,806.2)</b>	<b>16,869,241.1</b>	<b>-2.2%</b>	<b>(383,103.3)</b>
Urban Revenue Sharing (URS)	(756,388.3)	N/A	(1,106,958.7)	N/A	(350,570.4)	(1,564,826.3)	N/A	(457,867.7)
<b>Net Ongoing Revenue w/ URS</b>	<b>16,684,762.3</b>	<b>18.5%</b>	<b>16,145,385.8</b>	<b>-3.2%</b>	<b>(539,376.6)</b>	<b>15,304,414.8</b>	<b>-5.2%</b>	<b>(840,971.0)</b>
<b>One-Time Financing Sources:</b>								
Water Infrastructure Repayment	20,000.0	N/A	0.0	-100.0%	(20,000.0)	0.0	N/A	0.0
Attorney General Settlement	0.0	N/A	77,250.0	N/A	77,250.0	0.0	-100.0%	(77,250.0)
Withholding Revenue Loss	0.0	N/A	(700,000.0)	N/A	(700,000.0)	0.0	N/A	700,000.0
TPT Diversions	0.0	N/A	(2,287,489.6)	N/A	(2,287,489.6)	0.0	N/A	2,287,489.6
Newly Enacted Tax Reductions	0.0	N/A	(50,000.0)	N/A	(50,000.0)	0.0	N/A	50,000.0
Other One-Time Revenue Changes	0.0	N/A	(3,500.0)	N/A	(3,500.0)	0.0	N/A	3,500.0
Subtotal - One-Time Financing Sources	20,000.0	N/A	(2,963,739.6)	N/A	(2,983,739.6)	0.0	N/A	2,963,739.6
<b>Subtotal - Revenues</b>	<b>16,704,762.3</b>	<b>18.3%</b>	<b>13,181,646.2</b>	<b>-21.1%</b>	<b>(3,523,116.2)</b>	<b>15,304,414.8</b>	<b>16.1%</b>	<b>2,122,768.6</b>
Balance Forward	894,636.0	140.2%	4,709,446.0	426.4%	3,814,810.0	2,296,811.1	-51.2%	(2,412,634.9)
<b>Total - Resources</b>	<b>17,599,398.3</b>	<b>21.5%</b>	<b>17,891,092.2</b>	<b>1.7%</b>	<b>291,693.8</b>	<b>17,601,225.9</b>	<b>-1.6%</b>	<b>(289,866.3)</b>

# Appendix B: January FAC Forecast '25 – '26

FORECAST REVENUE GROWTH						
(\$ in Thousands)						
	FORECAST FY 2025	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR	FORECAST FY 2026	% CHANGE PRIOR YR	\$ CHANGE PRIOR YR
Sales and Use	8,243,189.7	4.0%	317,868.9	8,660,647.3	5.1%	417,457.6
Income - Individual	6,112,745.3	3.4%	203,011.9	6,374,711.9	4.3%	261,966.6
- Corporate	1,343,290.9	3.4%	43,572.1	1,412,597.1	5.2%	69,306.3
Property	23,725.8	-2.2%	(533.7)	23,203.8	-2.2%	(522.0)
Luxury - Tobacco	20,319.2	-1.0%	(205.2)	20,116.0	-1.0%	(203.2)
- Liquor	46,500.3	5.6%	2,465.9	49,104.3	5.6%	2,604.0
Insurance Premium	770,498.5	2.8%	21,157.7	797,514.1	3.5%	27,015.6
Other Taxes	19,543.6	6.1%	1,123.6	20,716.3	6.0%	1,172.6
Subtotal - Taxes	16,579,813.2	3.7%	588,461.2	17,358,610.7	4.7%	778,797.5
<b>Other Non-Tax Revenues:</b>						
Lottery	198,622.1	5.6%	10,471.4	209,961.7	5.7%	11,339.6
Gaming Revenue	23,952.7	4.4%	1,014.1	25,017.6	4.4%	1,064.9
Licenses, Fees and Permits	48,912.0	4.2%	1,971.5	50,966.3	4.2%	2,054.3
Interest	146,000.0	-45.9%	(124,000.0)	87,000.0	-40.4%	(59,000.0)
Sales and Services	38,944.5	7.9%	2,851.4	41,670.6	7.0%	2,726.1
Other Miscellaneous	189,651.8	6.9%	12,307.7	199,452.0	5.2%	9,800.2
Transfers and Reimbursements	61,127.0	0.9%	558.5	61,705.1	0.9%	578.1
Disproportionate Share Revenue	75,583.9	-0.4%	(269.6)	75,901.9	0.4%	318.0
Subtotal - Other Non-Tax	782,793.9	-10.8%	(95,095.1)	751,675.1	-4.0%	(31,118.8)
<b>Net Ongoing Revenue</b>	<b>17,362,607.2</b>	<b>2.9%</b>	<b>493,366.1</b>	<b>18,110,285.8</b>	<b>4.3%</b>	<b>747,678.6</b>
Urban Revenue Sharing (URS)	(1,396,167.2)	N/A	168,659.1	(1,297,701.4)	N/A	98,465.8
<b>Net Ongoing Revenue w/ URS</b>	<b>15,966,440.0</b>	<b>4.3%</b>	<b>662,025.2</b>	<b>16,812,584.4</b>	<b>5.3%</b>	<b>846,144.4</b>
<b>One-Time Financing Sources:</b>						
Water Infrastructure Repayment	0.0	N/A	0.0	0.0	N/A	0.0
Attorney General Settlement	0.0	N/A	0.0	0.0	N/A	0.0
Withholding Revenue Loss	0.0	N/A	0.0	0.0	N/A	0.0
TPT Diversions	0.0	N/A	0.0	0.0	N/A	0.0
Newly Enacted Tax Reductions	0.0	N/A	0.0	0.0	N/A	0.0
Other One-Time Revenue Changes	0.0	N/A	0.0	0.0	N/A	0.0
Subtotal - One-Time Financing Sources	0.0	N/A	0.0	0.0	N/A	0.0
<b>Subtotal - Revenues</b>	<b>15,966,440.0</b>	<b>4.3%</b>	<b>662,025.2</b>	<b>16,812,584.4</b>	<b>5.3%</b>	<b>846,144.4</b>
Balance Forward	259,350.5	-88.7%	(2,037,460.6)	0.0	-100.0%	(259,350.5)
<b>Total - Resources</b>	<b>16,225,790.5</b>	<b>-7.8%</b>	<b>(1,375,435.4)</b>	<b>16,812,584.4</b>	<b>3.6%</b>	<b>586,793.9</b>