GENERAL FUND REVENUES REMAIN ON TRACK POST-KATRINA

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Mississippians well understand that Hurricane Katrina left tremendous damage in the state. Estimates of the total property damage in Mississippi are between $20 and $50 billion. Apart from the initial damage, we know that some establishments located in the coastal counties are trying to operate, but employees are unable to get to work. Many have no place to live and have not returned to the area. These businesses are operating at less than full capacity. Other businesses have been forced to close their doors. Katrina was the most devastating natural disaster in the nation's history. The negative effects to the state, while difficult to quantify, are not difficult to see.

Less understood, however, are the economic consequences of this damage and in particular the effects on the state budget. These consequences include the negative effects just mentioned, but there are positive effects. The state has seen an inflow of evacuees, emergency personnel and construction workers, all of whom are generating economic activity. Some Louisiana businesses have relocated all or part of their operations to Mississippi. Furthermore, re-building efforts are already underway and this generates economic activity. As the rebuilding efforts expand, the influx of reinvestment dollars will be tremendous. In fact, the historical pattern for an area recovering from a natural disaster is to experience an initial downturn in economic activity followed by an economic boom as the rebuilding phase gets underway.

With regard to the state's budget, there are two sides to be considered: revenues and expenditures. At this stage, very little is known about the expenditure side. We do not know what portion of the recovery expenditures will be picked up by the federal government. We do not know what aid, if any, the state will give the local governments. Nor do we know the level of uninsured loss and what, if any, aid the state will provide the uninsured. The estimates vary widely.

The revenue picture is a bit more foreseeable. Tax revenues generally follow the level of economic activity. This is particularly true for states such as Mississippi that are highly dependent upon sales and income taxes. In Mississippi, these two revenue sources account for 72% of the General Fund. In a natural disaster such as Katrina, tax revenues, like economic activity in general, are expected to experience an initial decline immediately following the disaster, followed by a rebound driven by the rebuilding activity. What is not known is how long and how deep the dip will be or how large will be the rebound.

Two months after the storm, it is becoming increasingly evident that the dip in revenues will be small and short-lived. While many retail businesses located nearest the coast remain closed, those in operation are experiencing a high level of sales. This is true throughout much of the state. Unlike New Orleans, the clean-up and rebuilding was able to begin almost immediately following the storm. The influx of construction workers has already begun and hotels and restaurants located in southern counties are unseasonably busy. Significant damage occurred throughout the southern counties and, unlike the coastal areas, there is no dispute over insurance coverage so rebuilding has begun in earnest. Additionally, the limited supply of goods in coastal counties is sending residents inland to replace items that were destroyed. This increased activity has resulted in strong retail sales in Mississippi since the storm. Also experiencing strong growth has been the use tax which is essentially a sales tax on out-of-state purchases. The use tax is strongly affected by construction activity.

Additionally, the purchase and lease of casino equipment boosts retail sales.

In addition to sales tax collections, individual income tax collections have grown at a rapid pace. The state was on the upswing when the storm hit. Increased demand has led to more jobs and overtime pay in utilities, sales, accommodations and services related to debris removal. Additionally, some businesses

chose to continue to pay their employees even though operations were halted. The result, income taxes have continued to increase.

Transfers to the General Fund during the first four months of FY2006 are $19.4 million above the estimate. This includes a $20.1 million overage for sales tax, $7.3 million overage for individual income tax and an $8.8 million overage for use tax. It also includes a $14.3 million underage or shortage for the gaming tax. The overage was due largely to strong collections in the month of October. Through September, the General Fund was $3.0 million below the estimate. While one month does not make a trend, the strong collections in October suggest that Katrina will not significantly reduce tax collections.

Looking forward, we expect retail sales in particular to remain strong throughout FY2006 and into FY2007. Individual income growth in FY2006 is expected to exceed that observed in FY2005. We expect the growth to be even stronger in FY2007. Use tax growth will likely strengthen through the FY2006 and FY2007 year as rebuilding efforts increase and casinos in particular begin to refurnish their facilities. Gaming taxes, however, will remain below the year ago level throughout the remainder of the fiscal year. We expect at least two casinos to open on the coast by the end of 2005 or early 2006. More casinos will open in FY2007.

With these underlying assumptions, the revenue estimating committee recommended and the Joint Legislative Budget Committee adopted a FY2006 estimate of $3,980.1 million or 3.6% over actual FY2005 and a FY 2007 estimate of $4,253.5 million or 6.9% above the expected FY2006 estimate.

Tax revenues are only one side of the budget question. While we are optimistic regarding tax revenues, little is known about the expenditure side. However, caution dictates that we anticipate increased expenditures and therefore tight budgets.