# Revenue and Budget Update

*A Briefing for the*

*Senate Finance Committee*


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# Topics for Discussion

- National and State Economic Indicators
- General Fund Revenue Collections for May and YTD Fiscal Year 2009
- Next Steps

# National and State Economic Indicators

- The economy remains in a deep recession; however, most national indicators suggest the rate of decline is slowing.
- First-quarter real GDP was revised up from a 6.1 percent decline in the advance estimate to a 5.7 percent annualized decline. Real GDP declined 6.3 percent in the fourth quarter of 2008.
- The labor market continued to contract in May; however, the magnitude of job losses has grown smaller over the last several months. Payroll employment fell by 345,000 jobs in May, following losses of 504,000 in April and 652,000 in March. The job loss in May was about half of the average monthly job loss over the last six months.
- The national unemployment rate rose to 9.4 percent in May from 8.9 percent, the highest rate since August 1983.
- In Virginia, payroll employment fell by 2.8 percent in April, the largest monthly drop since July 1991. Northern Virginia posted a decline of 1.5 percent, Hampton Roads fell 0.8 percent, and employment in the Richmond-Petersburg area fell 3.9 percent in April.
- The unemployment rate in Virginia fell from 6.9 percent to 6.6 percent in April, its second consecutive monthly decline. The unemployment rate was 3.2 percent in April 2008.

# National and State Economic Indicators

- The rate of contraction in the manufacturing sector continues to slow. The Institute of Supply Management index increased by 2.7 points in May, rising from 40.1 to 42.8. Although the index remains at recessionary levels, the gradual improvement over the last several months suggests a marked moderation in the decline in industrial production.

- The Conference Board's index of leading indicators rose 1.0 percent to 99.0 in April, the first increase since June 2008. Seven of the ten components contributed to the increase. The rise in the index suggests the downturn has moderated significantly.

- Consumer confidence continued to improve in May. The Conference Board index of consumer confidence jumped from 40.8 to 54.9 in May. Similar to last month, the expectations component drove the increase, while the current conditions component rose only modestly. Although the index posted the largest two-month gain on record, it is still below its September level, suggesting confidence remains weak.

- The Virginia Leading Index fell 0.3 percent in April, its eighth consecutive decline. Two of the three components – auto registrations and initial unemployment claims – contributed to the decline. Building permits, the third component, increased in April. The leading index declined in eight of the eleven metro areas in the Commonwealth in April. The index remained flat in Richmond and Winchester, and increased modestly in Hampton Roads.

# May Revenue Collections

- May is a significant month for revenue collections. In addition to regular collections of withholding and sales taxes, estimated and final payments for individuals are due May 1, and corporations with a fiscal year ending other than December 31 – primarily retailers – have final payments due in May.

- Total general fund revenues fell 15.6 percent in May compared to May of last year.

  – Most of the decline in May was due to a drop in collections of individual nonwithholding and a continued surge in individual refunds. Individual withholding also contributed to the decline from last May, largely due to one less deposit day than last year.

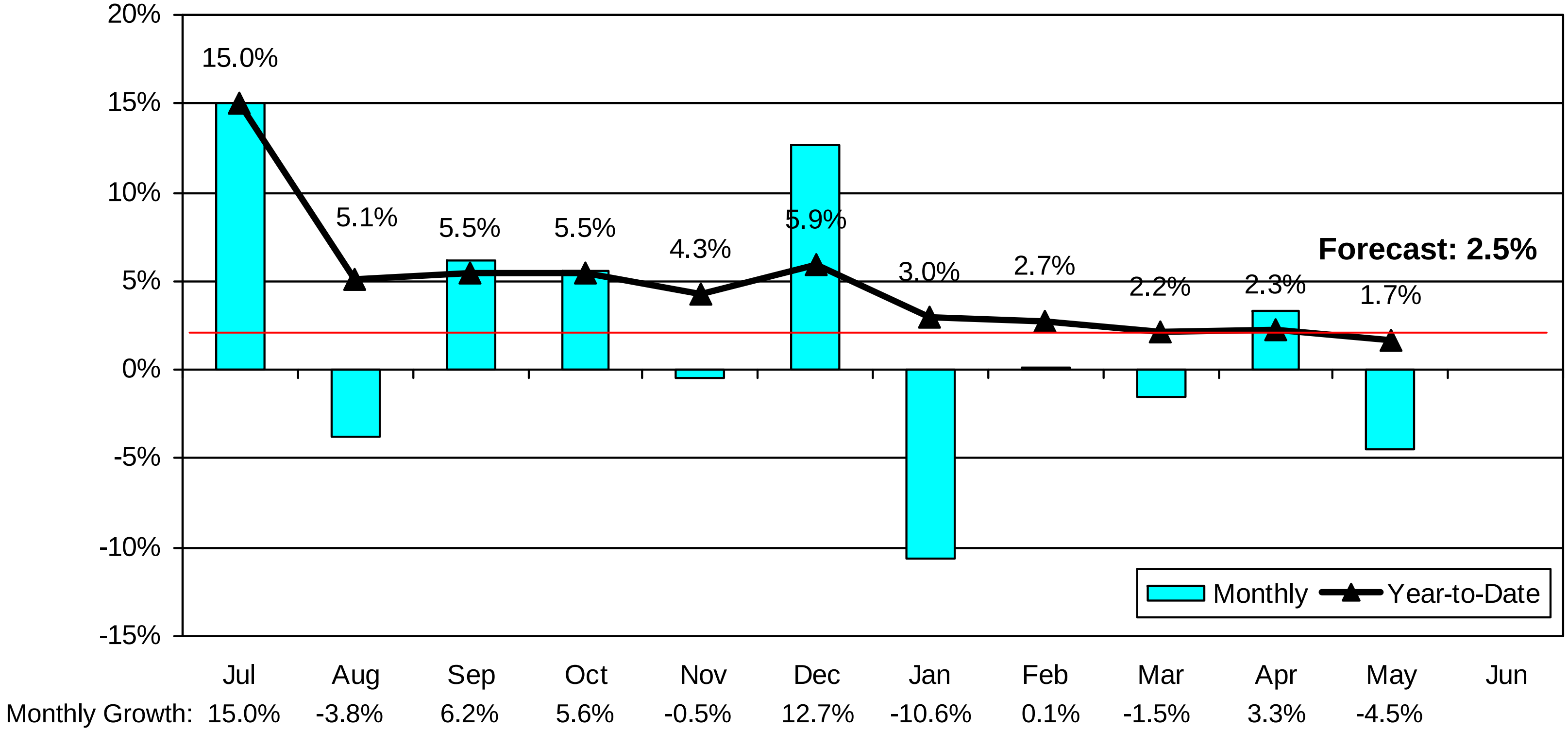
- On a year-to-date basis, total revenues fell 9.3 percent, trailing the revised annual forecast of a 7.3 percent decline.

  – The 9.3 percent decline in revenue collections through May represents the largest drop on record.

  – Adjusted for transfers to the Commonwealth Transportation Fund and the repeal of the estate tax, the year-to-date decline is 7.2 percent, 2.0 percentage points worse that the fiscal year 2002 annual decline (adjusted for accelerated sales tax).

## Growth in Withholding Tax Collections

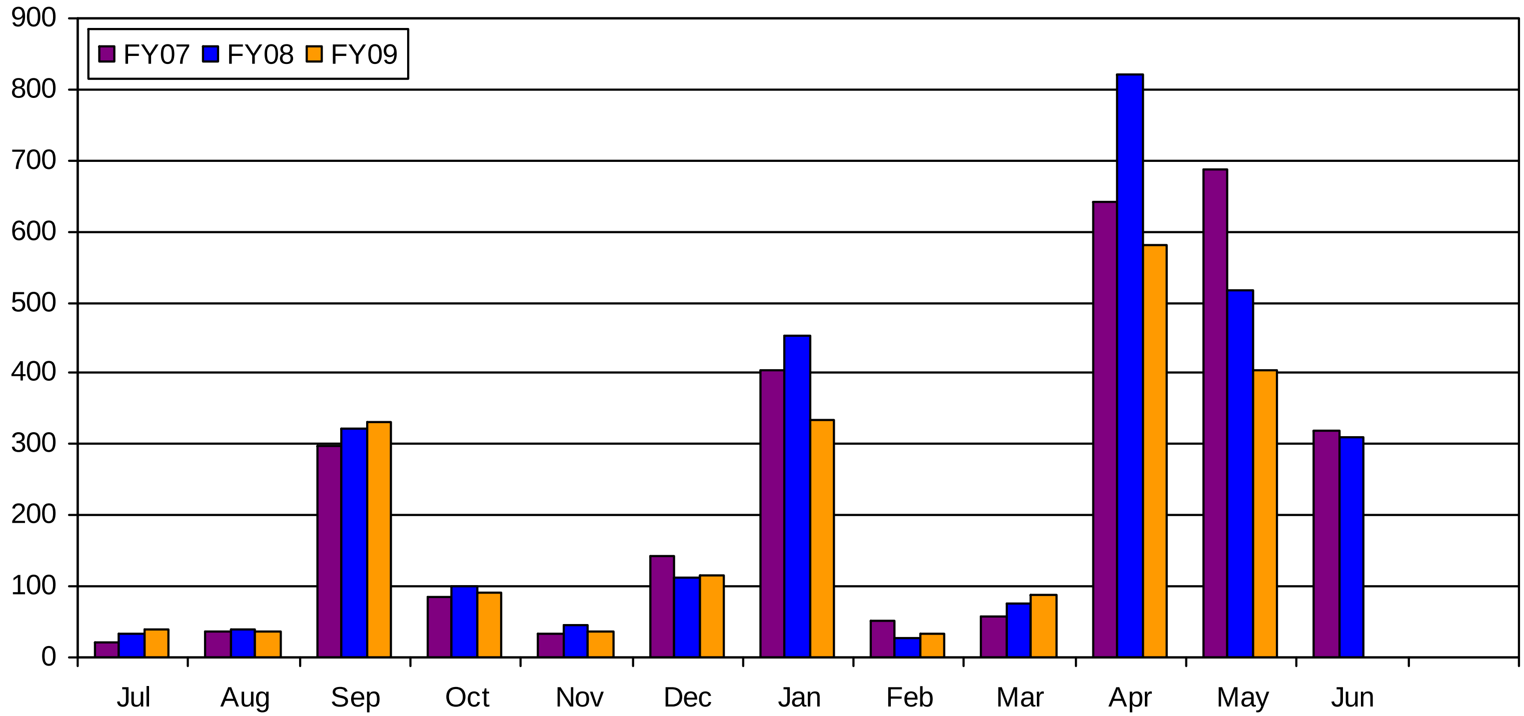
FY09 Monthly and Year-to-Date




- Collections of payroll withholding taxes fell 4.5 percent in May, partially due to one less deposit day than May of last year.
- Year-to-date withholding growth is 1.7 percent, trailing the projected annual growth rate of 2.5 percent.
- June will have an additional deposit day as compared with last June, evening out the number of deposit days in the year.

# Nonwithholding Tax Collections

FY07-FY09 Monthly




- Since a large portion of final payments due May 1 are received in April, one must consider April and May collections together to accurately assess growth in this source. Taken together, nonwithholding collections in April and May were down 26.5 percent.
- Through May, about 89 percent of the nonwithholding forecast has been collected. The final estimated payment for this fiscal year is due June 15.
- Year-to-date collections are 17.9 percent below the same period last year, matching the revised annual estimate.

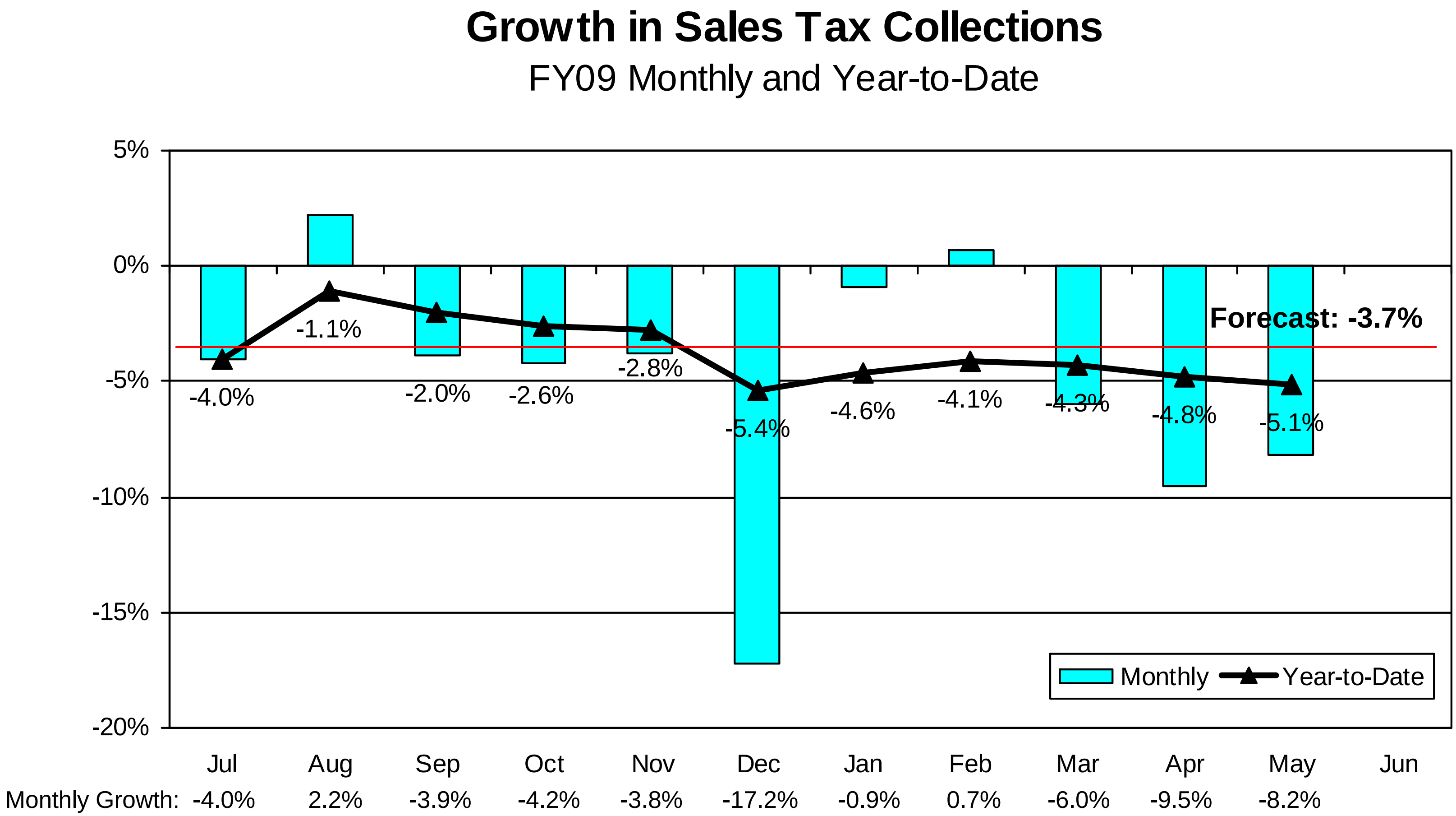
## Individual Income Tax Refunds

- Through May, $1.8 billion in individual refunds have been issued, compared with $1.6 billion in the same period last year.
  - The amount of refunds issued now exceeds the annual forecast by $38.2 million.

- Year to date, refunds are 13.7 percent ahead of the same period last year, ahead of the annual forecast of a 7.4 percent increase.

## Net Individual Income Tax

- Net individual income tax declined 5.9 percent through May, behind the annual forecast of a 4.1 percent decline.




- Collections of sales and use taxes, reflecting April sales, fell 8.2 percent in May.
- On a year-to-date basis, collections have fallen 5.1 percent, lagging the annual estimate of a 3.7 percent decline.

# Corporate Income Tax Collections

- Year-to-date collections are down 20.2 percent from the same period last year, trailing the annual estimate of a 15.2 percent decline.

- The second estimated payment for tax year 2009 is due June 15. About $175 million is needed to meet the annual forecast in this source. Last year, about $168 million was collected in June.

# Recordation Tax Collections

- Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – fell 22.4 percent in May, and are down 32.6 percent on a year-to-date basis, near the forecast of a 34.7 percent decline.

# Summary of Fiscal Year 2009 Revenue Collections

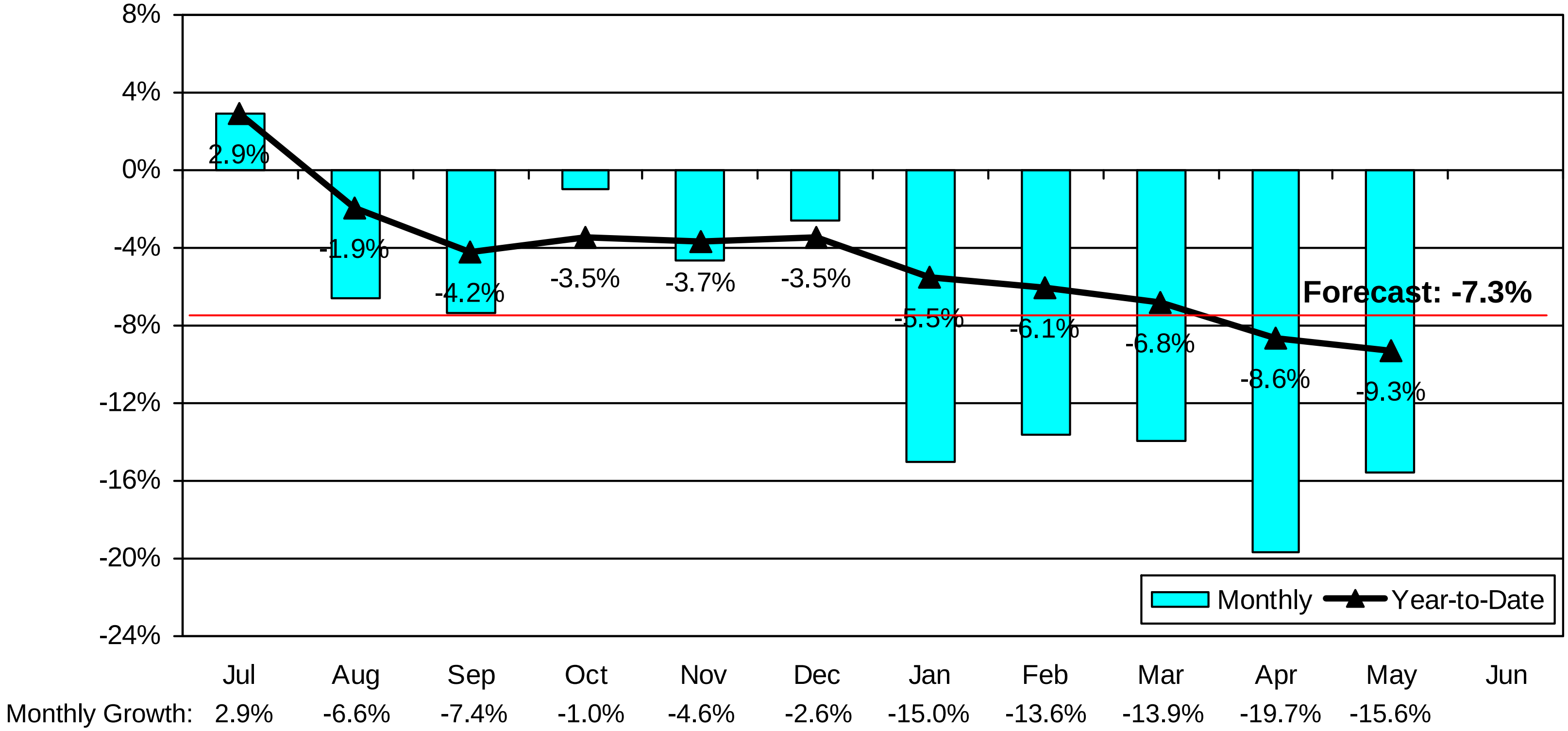
July through May

| Major Source | As a % of Total Revenues | Percent Growth over Prior Year: YTD Actual | Official Estimate | Variance |
|---|---|---|---|---|
| Withholding | 62.6 % | 1.7 % | 2.5 % | (0.8) % |
| Nonwithholding | 16.1 | (17.9) | (17.9) | 0.0 |
| Refunds | (12.4) | 13.7 | 7.4 | 6.3 |
| Net Individual | 66.4 | (5.9) | (4.1) | (1.8) |
| | | | | |
| Sales | 20.3 | (5.1) | (3.7) | (1.4) |
| Corporate | 4.7 | (20.2) | (15.2) | (5.0) |
| Wills (Recordation) | 2.0 | (32.6) | (34.7) | 2.1 |
| Insurance | 1.8 | (47.5) | (35.1) | (12.4) |
| All Other Revenue | 4.9 | (27.7) | (21.9) | (5.8) |
| | | | | |
| **Total** | **100.0 %** | **(9.3) %** | **(7.3) %** | **(2.0) %** |

Note: Adjusted for the repeal of the estate tax and transfers to transportation from insurance and recordation per HB 3202, year-to-date collections have declined 7.2 percent compared with the forecast of a 5.3 percent decline.

## Growth in Total General Fund Revenue Collections

FY09 Monthly and Year-to-Date




- Through May, total general fund revenues have declined 9.3 percent, below the projected annual decline of 7.3 percent.
- Total revenues must increase 10.2 percent in June in order to attain the annual estimate.

# Next Steps

- June is an important month for revenue collections and completes the fiscal year.
  - The second estimated payment for individuals, corporations, and insurance companies are due.

- Revenue and Budget Items
  - Governor has ordered a reforecast of revenues to be presented on August 19th.
  - Department of Planning and Budget is working on budget reductions instructions that will be released to agencies later this month.

# Looking Ahead to the Next Biennium
# Slower Growth

- How have general fund revenues grown?

| | Average Annual Growth |
|---|---|
| Last 5 years (FY03 to FY08) | +7.6% |
| Last 10 years (FY98 to FY08) | +6.0% |
| Last 15 years (FY93 to FY08) | +6.5% |
| Last 20 years (FY88 to FY08) | +5.9% |
| Last 25 years (FY83 to FY08) | +6.9% |
| Last 30 years (FY78 to FY08) | +7.3% |
| Last 35 years (FY73 to FY08) | +8.0% |
| Last 40 years (FY68 to FY08) | +7.8% |

- There is no revised general fund revenue forecast for the 2010-12 biennium at this point.

- However, the last official long-term forecast of general fund revenues (released December 2008) called for much slower growth in the future.

| | Average Annual Growth |
|---|---|
| FY2011 | +4.7% |
| FY2012 | +4.7% |
| FY2013 | +4.8% |
| FY2014 | +4.6% |

# Looking Ahead to the Next Biennium
# Available New Money

- Let’s assume growth averages +4.5% per year during the next biennium (well below long-term trend of +6-8%).

- General fund revenues would then total about $32.0 billion for the 2010-12 biennium (coming off a reduced base because of current trends in revenue collections).

- Normal transfers to the general fund would be about $360 million per year bringing total general fund resources for the biennium to $32.7 billion.

- This amount would yield about $1.0 billion for new spending after covering the FY2010 operating expense base ($31.7 billion).

# Looking Ahead to the Next Biennium
# Spending Demands

- While $1.0 billion in new money is a large figure, it will not cover expected spending trends.

- For example, a relatively modest 8 percent growth rate in Medicaid utilization and inflation would require an additional $1.5 billion (or more than all of the new money) after accounting for the end of the enhanced federal Medicaid match rate in January 2011 associated with the ARRA stimulus package.

- This would exclude other needs such as routine SOQ rebasing at the start of the biennium, and to higher education increased debt services costs, other health and human resource needs, public safety requirements, or employee compensation adjustments.

- Depending on one's assumptions about funding needs in these other areas, a calculated budget gap in the billions of dollars is certainly possible.

# Looking Ahead to the Next Biennium
# Conclusion

- The fact is that:
  - Slower revenue growth in the future
  - Growing spending needs as the result of recessionary pressures, rising costs, and unmet needs, as well as
  - The end of enhanced federal aid as the stimulus package begins to terminate in the future
- Means that:
  - Significant budget pressures will continue in the next biennium, and
  - Budget reductions to current spending levels in many areas will be needed to maintain fiscal balance.