



COMMONWEALTH of VIRGINIA
Office of the Governor

John M. Bennett
Secretary of Finance

March 14 , 2002

MEMORANDUM

TO: The Honorable Mark R. Warner
FROM: John M. Bennett
SUBJECT: February Revenue Data

This month's revenue letter includes the mid-session forecast that you communicated to the General Assembly on February 11, 2002. The mid-session forecast revision, which reduced the December forecast by \$616 million over the next 28 months, was incorporated into the budget agreed to by the General Assembly conferees. Total general fund revenues are now projected to decline by 2.5 percent this fiscal year.

February collections fell 11.0 percent below collections for last February, largely due to weakness in individual withholding and sales tax collections, as well as record refunds of individual income taxes. We will closely monitor individual withholding and sales tax collections during the next few months because they are our best indicators of current economic activity. Our revised forecast anticipates improvements in these sources during the final four months of this fiscal year.

National Economic Indicators

February produced a number of signs of positive economic news. The consensus among most economists is that the brief recession is drawing to a close.

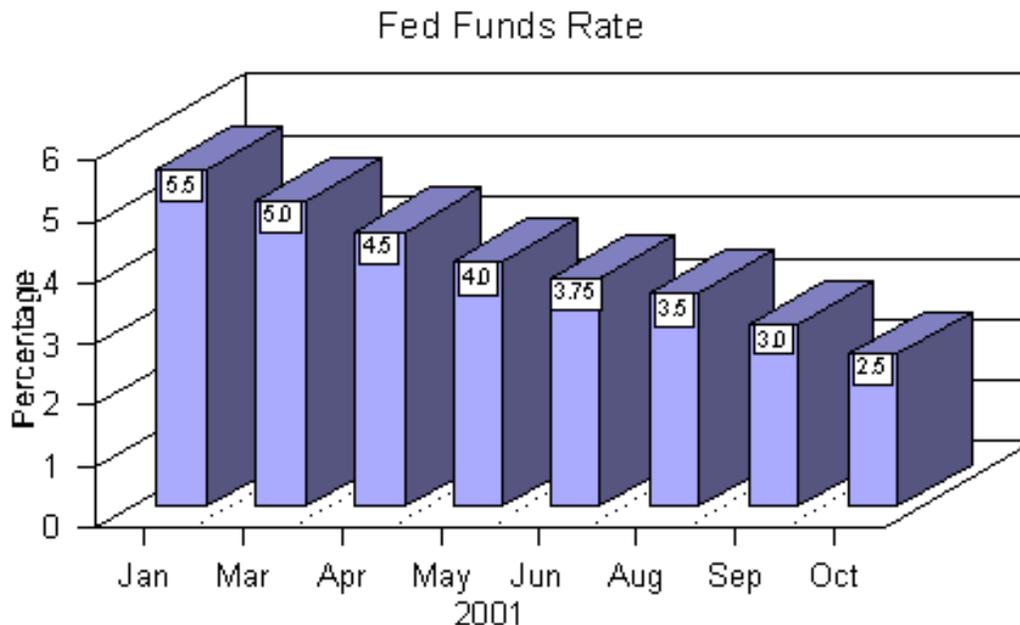
- Fourth quarter real GDP growth was revised sharply upward to 1.4 percent, driven primarily by a large increase in consumption;
- U.S. payrolls in February expanded by 66,000 jobs, ending six consecutive months of declines;
- The index of leading economic indicators rose 0.6 percent in January, the fourth consecutive month of improvement in the index;
- The Institute of Supply Management index (formerly the NAPM) climbed above the critical 50 percent level, indicating that the manufacturing sector is now expanding after eighteen consecutive months of decline; and
- Federal Reserve Chairman Alan Greenspan said on March 7, 2002 that recovery from the recession "is already well under way."

The principal negative sign was consumer confidence, which declined in February.

The Virginia Economy

The federal Bureau of Labor Statistics has re-estimated Virginia's employment growth for the past 12 months, based on more precise data. The re-benchmarked employment data show that the Commonwealth's labor market actually started to deteriorate in April 2001. Employment growth for calendar year 2001 was an anemic 0.3 percent. In January, 2002, employment actually declined by 1.2 percent.

The graph below compares revised Virginia employment estimates with the old data series. It seems clear now that deterioration in employment growth coincided almost exactly with the beginning of the recession. This mirrors the collection trend for payroll withholding, which also began deteriorating in Spring of 2001.



February Revenue Collections

February's weak revenue collections can be attributed to a record amount of individual refunds along with the expected sluggishness in withholding and sales tax collections.

Individual Income Tax Withholding (58% of general fund revenues): Withholding collections in February were essentially flat, falling by 0.2 percent compared to last year. Year-to-date growth of 2.9 percent is slightly behind the official estimate of 3.2 percent. Monthly withholding growth has been negative in two of the last three months.

Individual Income Tax Refunds: Refunds in February totaled \$205.2 million - about \$73.8 million above last February's total. The average refund is up 13 percent, considerably ahead of the expected increase of around 7 percent.

In February, the Department of Taxation has issued over 704,000 refunds, compared to last year's 532,000. Error rates on returns filed through February are currently running about 5 percent, significantly below last year's 13 percent rate for the same period. And, the number of returns filed electronically is up considerably.

Individual Income Tax Nonwithholding (14% of general fund revenues): February is not a significant month for nonwithholding receipts. Through February, nonwithholding receipts are down 10.9 percent, slightly ahead of the 14.0 percent decline included in the mid-session re-forecast.

Sales Tax (21% of general fund revenues): collections for February fell by 0.4 percent. On a year-to-date basis, collections are down 0.4 percent -- slightly behind the annual estimate of 0.1 percent growth required by the mid-session re-forecast (after adjusting for the June acceleration of sales tax collections).

Other Revenue Sources

February was not a significant month for a number of other revenue sources, such as corporate income tax and insurance

premiums. The following list provides data on other key taxes:

	<u>Year to Date Meet Estimate</u>	
Corporate Income (2.7% GF revenues)	-33.5	-19.1
Insurance Premiums (2.6% GF revenues)	13.7	7.4
ABC Taxes (1.1% GF revenues)	3.5	2.3

All Other Revenue. Revenue from all other sources fell in February, declining by 7.3 percent over last year, mainly due to abnormal activity in the other taxes and excess fees revenue categories. Collections of wills, suits, deeds and contract fees continued to surge, growing by 29.7 percent.

Lottery Revenues. Lottery net income increased 13.0 percent above February of last year. Sales increased 8.8 percent, mainly due to higher prize payouts in the Pick 3 game and an increase in the number of retailers selling online products. On a year-to-date basis, Lottery net income is up 7.9 percent, well above the revised estimate of -0.1 percent.

Summary

General fund revenues have now declined for three consecutive months, and total collections, including Tobacco Settlement revenues, for the year are 2.7 percent below collections for the same period last year.

Collections declined in February due in part to the significant increase in the volume of individual income tax refunds issued. Even discounting refunds, however, February revenue collections remained sluggish, with continuing weakness in withholding and sales taxes - two barometers of current economic activity.

The mid-session reforecast projected slight improvement in withholding and sales tax receipts over the next few months, as the national recovery gains momentum. That improvement is central to meeting the FY 2002 forecast target of -2.5 percent.