



# COMMONWEALTH of VIRGINIA

Office of the Governor

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June 12, 2002

## MEMORANDUM

**TO:** The Honorable Mark R. Warner  
**THROUGH:** The Honorable William H. Leighty  
**FROM:** John M. Bennett  
**SUBJECT:** May Revenue Data

May revenue collections fell 21.2 percent below collections for May of last year. Almost all of the decline is due to a significant drop in individual income tax payments received with returns which were due May 1.

Income tax collections, which are below forecast, are affecting the vast majority of states in FY 2002. A recent national survey found that 37 of 41 states which levy a broad-based income tax have experienced significant declines in estimated/final payments this spring, including nine of ten states in the southeastern United States. About a third of the 37 states have watched income tax collections fall more than 10 percent below forecast. For some, the drop-off exceeds 25 percent. For Virginia, the gap between the forecast for estimated/final payments and actual collections through May is about six percent.

On a year-to-date basis, total general fund revenue collections (including Tobacco Master Settlement revenues) through May are 5.8 percent below collections for the same period last year. The revenue forecast for FY 2002 (excluding the sales tax acceleration) projected a decline of 3.6 percent.

### National Economic Indicators

Most recent economic indicators suggest the nation is in the midst of a sluggish recovery.

- First quarter growth in real GDP was revised downward to 5.6 percent, from the preliminary estimate of 5.8 percent. The revised data suggest that the first quarter surge in GDP was boosted primarily by businesses replenishing inventory.
- The labor market is showing signs of bottoming out. U.S. payrolls expanded by 41,000 jobs in May, after growth of 6,000 jobs in April. May was the second consecutive month of positive job growth -- the first time this has occurred since before the recession.
- Personal income grew a moderate 0.3 percent in April, in line with expectations and above inflation.
- After six straight months of improvement, the Conference Board's index of leading indicators fell in April, with declines in five of the index's ten components. This suggests the recovery could limp along through the summer.
- The Institute of Supply Management index (formerly the NAPM) rose in May, signaling the fourth consecutive month of expansion in the manufacturing sector.

- Finally, consumer confidence improved slightly in May, rising by 1.3 points to 109.8.

### **The Virginia Economy**

Employment data continue to suggest that Virginia is lagging the national economic recovery. Employment in Virginia declined by 0.9 percent in April, compared to April of last year. Particularly significant are job losses in Northern Virginia, which totaled 1.6 percent in April. Trend data suggests, however, that the employment picture statewide and in Northern Virginia is stabilizing.

The Virginia Leading Index fell in April, largely as the result of a drop in auto registrations and building permits – two areas of the economy that had been resistant to recession-related declines. At least some of the decline in auto registrations is due to delays in renewal notice mailings caused by changes in fees enacted this past legislative session.

### **May Revenue Collections**

May is a key month for general fund revenues because a substantial portion of individual income taxes become due. Total collections for May fell 21.2 percent. Weakness in individual income tax payments accounts for over 80 percent of this decline. Most of the remaining percentage decline is due to one-time Medicaid reimbursements last May, which artificially boosted revenue collections last May.

Overall, revenue collections through May are well below the amount required to meet the annual estimate.

***Individual Income Tax Withholding (58% of general fund revenues)***: Withholding collections dropped 1.1 percent below collections for last May. Although some of the decline is due to timing, year-to-date growth of 2.3 percent is below the official estimate of 3.5 percent. Strong withholding growth in June would be needed in order to reach the withholding forecast for the year.

***Individual Income Tax Refunds***: In May, the Department of Taxation issued 265,000 income tax refunds totaling \$127.4 million. For the year, the average refund is up 15 percent -- about twice the estimated increase on which the refund forecast was based.

Through May, individual income tax refunds have exceeded the FY 2002 forecast total by \$52.1 million. Since the beginning of the filing season in January, the Department has issued over 2.2 million refunds – 385,000 more than last filing season, and considerably more than in any filing season on record.

***Individual Income Tax Nonwithholding (14% of general fund revenues)***: Nonwithholding collections in May, which include both final payments for tax year 2001 and the first estimated payment for tax year 2002, declined by 42.2 percent below last May's collections. Within this overall total, final payments which were due May 1 fell about twice as much as expected. The forecast anticipated a reduction of about 20 percent in final payments. Final payments actually fell 37 percent.

The first estimated payment for tax year 2002, which was also due May 1, was about equal to last year's collections. At this level, estimated payments in fiscal year 2002 are down about 7 percent -- very close to the forecast of -10 percent.

Given the large decline in final payments and the continuing surge in income tax refunds, there is a high degree of uncertainty about whether the second estimated payment for tax year 2002, which is due June 15, will also fall close to the forecast.

***Sales Tax (21% of general fund revenues)***: Sales tax collections for May increased by 2.0 percent. On a year-to-date basis, collections are at 0.1 percent growth – equal to the annual estimate required by the current forecast (excluding the acceleration of sales tax collections expected in June). This is the first time since November, 2000, that there have been three consecutive monthly increases in sales tax collections.

### **Other Revenue Sources**

May 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</u>	<u>Required to Meet Estimate</u>
Corporate (2.7% GF revenues)	-20.5%	-18.7%
Insurance Premiums (2.6% GF revenues)	10.4%	7.4%

ABC Taxes (1.1% GF revenues)	3.5%	2.3%
Interest Income (1.0% GF revenues)	-33.6%	-15.9%
Public Service Corporations (.9% GF revenues)	-14.9%	2.2%

**All Other Revenue.** Revenue from all other sources declined in May by \$37.6 million from last year – a 47.3 percent decline. Medicaid recoveries received last May distort the comparison, however. On a year-to-date basis, collections were 0.9 percent above the same period last year, due primarily to collections of taxes on wills, suits, and deeds, and contract fees. This is slightly above the estimates for this year.

**Lottery Revenues.** In May, lottery net income grew 10.9 percent more than last year. On a year-to-date basis, growth of 13.7 percent is significantly above the amount needed to meet the revised revenue estimate. Growth to date indicates that Lottery collections will exceed the \$329.0 million estimate by a comfortable margin. Sales are up in every lottery product for the year.

### **Summary**

Growth in general fund revenues has now been negative for six consecutive months. Total year-to-date collections, including Tobacco Settlement revenues, are 5.8 percent below collections for the same period last year. Given the decline in individual income tax payments and significant increase in income tax refunds, all signs point to a substantial revenue shortfall at year-end.

Once general fund collections for FY 2002 are final, we will begin the formal process of re-forecasting revenues for FY 2003 and FY 2004.