



# COMMONWEALTH of VIRGINIA

Office of the Governor

**John M. Bennett**  
Secretary of Finance

P.O. Box 1475  
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October 15, 2001

## **MEMORANDUM**

**TO:** The Honorable James S. Gilmore, III  
**THROUGH:** The Honorable M. Boyd Marcus, Jr.  
**FROM:** John W. Forbes  
**SUBJECT:** September Revenue Data

In stark contrast to the recent period of unprecedented economic growth, the nation's economy has clearly slowed. Unlike so many other states, Virginia's broad economic base and stable labor market has insulated it from the severity of this economic downturn. However, Virginia is not immune to the effects of a prolonged slowdown and as this one continues it is clearly having a negative effect on the Commonwealth's revenues. Revenues continued to grow, albeit modestly, through July and August. However, September's performance offset the gains made in the previous two months. September's collections were 8.4 percent less than those of last September. For the first quarter (July, August, and September), revenue collections are 2.4 percent less than the first quarter of last year. The Commonwealth's major revenue sources -- payroll withholding, sales tax, and corporate income tax -- continued to show broad-based weakness as the national economy continued to slow.

Nationally, September's economic indicators largely reflect activity before the September 11 terrorist attack. The U.S. economy lost 199,000 jobs in September. This represents the largest one-month decline since February 1991. The nation's unemployment rate remained at 4.9 percent. Consumer confidence, measured prior to the attack, plunged in September. The index of leading economic indicators fell by 0.3 percent in August as seven of the ten components that make up the index declined.

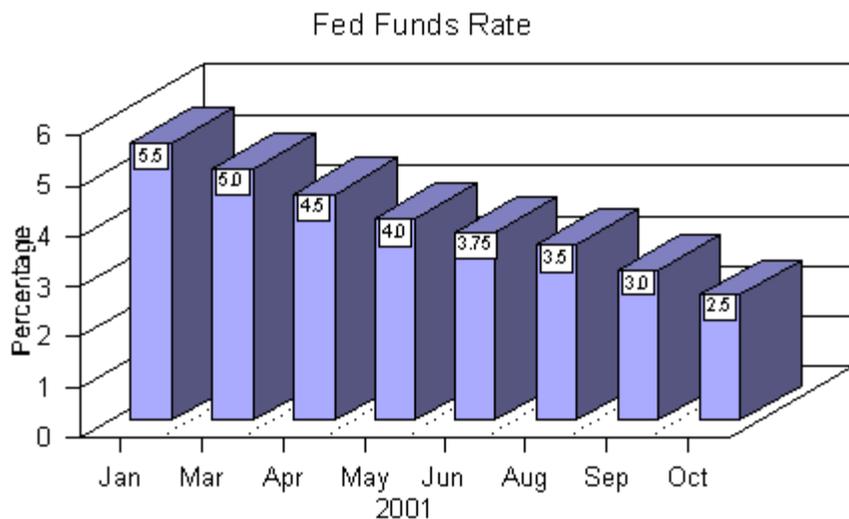
In Virginia, the unemployment rate rose modestly to 3.1 percent in August from 2.9 percent in July. Job growth, in Virginia, continued on a moderate pace, increasing 1.7 percent in August from year-ago levels.

The U.S. economy faces serious problems over the next several months. However, aggressive fiscal and monetary policies executed by the U.S. government and the Federal Reserve should stimulate growth by the spring of calendar year 2002. On October 2, the Federal Open Market Committee lowered its target for the federal funds rate by 50 basis points to 2-1/2 percent. Similarly, the Board of Governors approved a 50 basis point reduction in the discount rate to 2 percent. In announcing this action the Federal Reserve released the following statement:

"The terrorist attacks have significantly heightened uncertainty in an economy that was already weak. Business and household spending as a consequence are being further dampened. Nonetheless, the long-term prospects for productivity growth and the economy remain favorable and should become evident once the unusual forces restraining

demand abate."

The October 2 action marks the ninth time the Federal Reserve Board has cut the federal funds rate target this year. As noted in the chart below, there has been a downward trend in the federal funds rate this year, and the Federal Reserve Board will be expected to use the tools available to them to limit the economic fallout from the September 11 terrorist attacks.



In addition, the President and Congress appear close to agreeing on a fiscal stimulus package of up to \$75 billion intended to jump-start the national economy. Actions by the Federal Reserve, the President, and Congress are designed to address immediate concerns, stimulate the economy, and position the nation for future recovery.

Days after the terrorist attack, Congress passed an emergency \$40 billion defense and recovery package (H.R. 2888). Of that, \$20 billion was earmarked specifically to assist Virginia, New York, and Pennsylvania in their recovery efforts. To fully assess the impact of the attacks in Virginia, you created the Virginia Post-Attack Economic Response Task Force. The initial efforts of this task force have provided the analytical foundation for requesting Virginia's portion of the federal assistance provided for in H.R. 2888. The impact on Virginia of the terrorist attacks differs from that of many states. Not only is Virginia one of three states that had a direct attack within its borders, it also is host to one of the largest military installations in the world. Deployment of multiple naval battle groups and support troops clearly affects consumption in Hampton Roads. On Thursday, October 11, you unveiled a five-point plan designed to soften the financial blow to families whose livelihoods have been impaired. Your October 11 speech outlining this approach is attached.

On Friday, October 12, in a letter to the President, you requested \$3.18 billion in assistance. In addition to \$1.2 billion for direct and indirect costs, this request includes \$380 million for an economic stimulus package and \$1.6 billion for Terrorist Hazard Mitigation projects that will ensure the Commonwealth's preparedness to respond to and deter future terrorist attacks. A copy of your letter is attached.

Like most states, Virginia has been experiencing slow growth in revenues for several months. Prior to the terrorist attacks, the national economy was very weak in most sectors. Most economists agree that the attacks have sharply increased the economic risks that we face over the next few quarters. The following comments provide an overview of September revenue collections by major sources.

### Individual Income Taxes

Net individual income tax receipts fell by 6.8 percent from last September. The year-to-date decline from last year was 1.2 percent.

**Withholding:** Withholding receipts fell in September when compared to last September, declining by 2.1 percent for the month. On a year-to-date basis, withholding receipts have grown 3.5 percent over last year. Although September's receipts were affected by one less deposit day, withholding collections have been on a trend of declining growth for the past two quarters, slowing as economic activity has softened.

**Nonwithholding:** September normally provides the first meaningful opportunity in the current fiscal year to evaluate nonwithholding receipts. However, due to the terrorist attack and disruptions in mail delivery, several thousand September payments were received in the first few days of October. For the month of September, nonwithholding fell 8.3 percent from last year and is down 6.8 percent on a year-to-date basis.

**Refunds:** September is typically a slow month for issuing refunds. Refunds of \$37.3 million were issued this September compared to \$20.5 million last September. Year-to-date \$175 million in refunds have been issued compared to \$124 million during the first quarter last year.

## **Sales**

Sales tax receipts remained sluggish in September, increasing by 1.5 percent. Year-to-date, this revenue source has grown 0.3 percent. Sales tax receipts over the past eight months have been fairly flat. The deterioration in consumer confidence creates a great deal of uncertainty for the upcoming holiday shopping season.

## **Corporate Income Tax**

September is the first significant month of corporate income tax receipts for the fiscal year as estimated payments fell due on the fifteenth of the month. Corporate collections fell by 31 percent in September when compared to last September, continuing a decline that began in fiscal year 2001. Year-to-date collections are 38.1 percent less than the first quarter of last year, well behind the official estimate of 41.5 percent growth.

## **Public Service Corporations**

Collections from public service companies were \$2.8 million this month compared to \$25.6 million last September as Virginia continues to move towards deregulation of the electric and natural gas public utilities. Under this reporting change, monthly consumption taxes replace quarterly gross receipts taxes.

## **Insurance Premiums**

Taxes on the gross receipts of insurance companies were up 7.8 percent in September. Year-to-date growth of 3.2 percent is tracking close to the estimate required to meet the current annual forecast.

## **Interest**

Interest collections in September were \$16.4 million compared with \$20.2 million in September of last year. The year-to-date decline of 8.4 percent is trailing the annual 4.6 percent growth needed to attain the current estimate.

## **ABC Taxes**

Collections of ABC taxes (beer only) were \$4.0 million in September compared with \$3.9 million in September of last year. The year-to-date decline of 1.9 percent trails the current annual estimate of 1.6 percent growth.

## **All Other Revenue**

Revenue from all other sources was up 14.0 percent for the month, bringing year-to-date growth to 18.3 percent. Collections in this source are being driven by the continuing surge in collections of wills, suits, deeds, and contract fees (mainly recordation taxes) as low interest rates buoy the housing market and spur home mortgage refinancing activity.

## **Lottery**

Lottery net income for the month declined 4.7 percent as prize payouts were higher than average. For example, Pick 3 had one payout of more than \$3.4 million when the number 769 was drawn in September. On a year-to-date basis, the

decline in lottery net income of 1.5 percent is well ahead of the expected annual decline of 5.7 percent.

## Summary

It is widely acknowledged that the national economy has been slowing for over a year. Likewise, this prolonged period of slow national economic growth has now started to dampen Virginia's economy. Corporate profits began slowing several quarters ago. Sales tax receipts have continued to grow this year, but at a markedly slow pace. Now in the first quarter of fiscal year 2002 individual tax receipts are showing signs of weakness. This economic scenario, while unpleasant and admittedly painful to many families, is typical of what one should expect following 10 years of unprecedented economic growth. It is a part of the business cycle that is well documented in history, although its continued existence is frequently questioned during extended periods of prosperity.

The most recently experienced period of extraordinary economic growth was particularly unique in that it was marked by exceptionally high growth accompanied by low rates of inflation. Likewise, the economic contraction that follows promises to be equally unique. Seldom in history has so much monetary and fiscal stimulus been available to fuel a cooling economy. Economists across the nation generally agree that the United States economy is postured to rebound in the spring or summer of 2002.

This recovery, like so many things, will be shaped by the terrorist attacks of September 11 and the corresponding response by consumers to the threat of future attacks. Two-thirds of national GDP comes from the consumer and consequently consumer confidence will be a determinate factor in the speed with which economic recovery occurs.

Both you and leaders in Washington D.C. are attempting to address these concerns and accelerate economic recovery. Congress passed an emergency \$40 billion defense and recovery package. You requested \$3.18 billion in federal assistance. Also, you announced a series of initiatives designed to stimulate Virginia's economy. The President and Congress appear close to agreeing on a fiscal stimulus package. The collective impact of these initiatives should be a surge in economic activity.

On October 29, 2001, I convene your Advisory Board of Economists. As you are aware, this board is comprised of the state's leading economists from the Federal Reserve, universities, and major corporations. Also in attendance will be legislative staff and economists from state agencies that have a role in the revenue forecasting process. With the goal of forming a consensus on what economic assumptions are appropriate for forecasting purposes, the outlook for the U.S. and Virginia economies will be thoroughly explored in this meeting. On November 19, 2001, your Advisory Council on Revenue Estimates meets to consider the economic outlook and accompanying revenue estimates for the current fiscal year and next biennium. As you are aware, this Council is comprised of senior legislators, key executives from Virginia's largest companies, and the president of the Richmond Federal Reserve Bank. This forecast will serve as the basis for the revised revenue forecast to be released on December 19, 2001.