



# Revenue and Budget Update

## *A Briefing for the House Appropriations Committee*

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# Topics for Discussion

- General Fund Revenue Collections, First Quarter of Fiscal Year 2009
- Revised Revenue Forecast (October 9, 2008)
- Governor Kaine's Budget Reduction Actions/Proposals
- Future Activities

# National and State Economic Indicators

- The national labor market contracted for the ninth consecutive month in September with payroll employment falling by 159,000 jobs. The U.S. economy has shed 760,000 jobs since December.
- The national unemployment rate was unchanged at 6.1 percent for September.
- In Virginia, payroll employment grew 0.5 percent in August. Northern Virginia posted job growth of 1.1 percent in August. Jobs grew by 2.2 percent in Hampton Roads and by 0.5 percent in Richmond-Petersburg.
- The Virginia unemployment rate rose slightly from 4.5 percent to 4.6 percent in August.
- Inflation appears to have peaked in July. After increasing 0.8 percent in July, the Consumer Price Index (CPI) fell 0.1 percent in August, for an annual growth of 5.4 percent. Core inflation, excluding food and energy, rose by 0.2 percent in August, with annual growth unchanged at 2.5 percent.

# National and State Economic Indicators

- The manufacturing sector contracted in September. The Institute of Supply Management index fell from 49.9 to 43.5, its lowest level since 2001. Although demand for U.S. exports has so far limited the severity of the downturn in manufacturing, the outlook for global economies is worsening.
- The Conference Board's index of consumer confidence rose modestly in September from 58.5 to 59.8. Because many responses to the survey were received before the recent financial turmoil, it is likely to be revised downward in future reports.
- The Conference Board's index of leading indicators fell 0.5 percent to 100.8 in August, the third decline in the past four months. The weakness in the leading index suggests that the economy will continue to weaken.
- The Virginia leading index grew 0.3 percent in July, only the third increase in the last twelve months.
- To deal with the financial crisis, central banks around the globe have lowered interest rates. The Federal Reserve lowered the federal funds rate by 50 basis points to 1.50 percent on October 8. The latter action was in addition to the federal government's bailout of financial institutions.

## September Revenue Collections

- September completes the first quarter of the fiscal year and is a significant month for revenue collections. Estimated payments from individuals, corporations, and insurance premiums are all due in September, along with regular monthly collections in withholding, sales, and other sources.
- Monthly total general fund revenue collections fell 7.4 percent in September, despite two more deposit days than September of last year. On a year-to-date basis, total revenues declined 4.2 percent in the first quarter of the fiscal year, below the annual forecast of 2.0 percent growth.
- Adjusted for the repeal of the estate tax and transfers to transportation from insurance and recordation tax collections, first quarter collections declined 0.4 percent, only the third time on record (along with fiscal year 1990 and fiscal year 2002) that first quarter collections have declined.

# September Revenue Collections

- ***Net Individual Income Tax (67% of general fund revenues)***: For the first quarter of the fiscal year, net individual income tax increased 3.4 percent from the same period last year, trailing the annual estimate of 6.5 percent.
- ***Sales Tax (20% of general fund revenues)***: Collections of sales and use taxes, reflecting August sales, fell 3.9 percent in September. On a year-to-date basis, collections have fallen 2.0 percent, far behind the annual estimate of 4.9 percent growth. Large payments related to housing continue to decline.
- ***Corporate Income Tax (4% of general fund revenues)***: The first estimated payment for fiscal year 2009 was due in September. Collections in corporate income tax fell 10.9 percent in September. On a year-to-date basis, collections in this source have fallen 12.1 percent from the first quarter of last year, close to expectations. Payments from large corporations in the finance, housing, and investment sectors fell over 50% from the first quarter of last year.
- ***Wills, Suits, Deeds, Contracts (2% of general fund revenues)***: Collections of wills, suits, deeds, and contracts – mainly recordation tax collections – fell 22.4 percent in the month of September, and are down 30.9 percent on a year-to-date basis. Adjusted for the transfer of 3 cents of the 25 cents per \$100 recordation tax to the Commonwealth Transportation Fund, year-to-date collections are down 23.5 percent.
- ***Insurance Premiums (1.8% of general fund revenues)***: Monthly collections of insurance premiums are being transferred to the Transportation Trust Fund per HB 3202 until the required amount of \$132.3 million has been booked.
- ***All Other Revenue (3% of general fund revenues)***: Receipts in All Other Revenue declined mainly due to the repeal of the estate tax. For the fiscal year-to-date, collections of All Other Revenue fell 25.6 percent from the same period in fiscal year 2008, below of the annual estimate of a 22.9 percent decline.

## Summary of Fiscal Year 2009 Revenue Collections

July through September

<u>Major Source</u>	As a % of Total <u>Revenues</u>	Percent Growth over Prior Year		
		<u>YTD Actual</u>	<u>C. 879 Estimate</u>	<u>Variance</u>
Withholding	59.1 %	5.5 %	6.4 %	(0.9) %
Nonwithholding	19.0	3.1	6.9	(3.8)
Refunds	(11.1)	52.0	6.4	45.6
Net Individual	67.0	3.4	6.5	(3.1)
Sales	20.0	(2.0)	4.9	(6.9)
Corporate	4.4	(12.1)	(12.6)	0.5
Wills (Recordation)	2.4	(30.9)	(16.6)	(14.3)
Insurance	1.8	(100.0)	(25.7)	(74.3)
All Other Revenue	4.4	(25.6)	(22.9)	(2.7)
<b>Total</b>	<b>100.0 %</b>	<b>(4.2) %</b>	<b>2.0 %</b>	<b>(6.2) %</b>

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 0.4 percent compared with the forecast of 4.2 percent growth.

## **The Governor Accelerated the Fall Forecasting Process**

- The October revenue forecast is the outcome of a major consensus process that included industry experts, academic economists, business leaders, and members of the General Assembly:
  - A meeting of housing industry experts – August 21
  - A meeting of consumer spending/auto industry experts – September 5
  - Governor’s Advisory Board of Economists (GABE) – September 10
  - Governor’s Advisory Council on Revenue Estimates (GACRE) – September 23

## **The Economic Outlook Underlying the October Revenue Forecast Is Substantially Weaker Than the Official Economic Forecast**

- The standard and alternative economic outlooks presented to the GABE and GACRE were based on the Global Insight August 2008 standard and alternative U.S. forecasts.
  - In the standard scenario, real GDP is projected to decline in the fourth quarter of 2008 and first quarter of 2009, meeting the oft-cited definition of a recession.
  - In the alternative scenario, real GDP is projected to fall earlier and deeper, declining in the third quarter of 2008 through the first quarter of 2009.
- These forecasts differ from the official forecast used in the budget which anticipated a mild downturn in fiscal year 2009 (no recession) followed by a sluggish rebound in fiscal year 2010.

## **Virginia's Outlook Was Revised Downward From the Standard Forecast**

- The GABE unanimously approved the standard outlook for fiscal year 2009 and the majority approved fiscal year 2010.
- The September standard and alternative economic and revenue forecasts were presented to the GACRE.
  - Business members were split on the forecasts, with four supporting the September standard forecast, four supporting the alternative lower growth scenario, and one choosing “standard minus”.

## **October Revenue Forecast Reflects a Combination of the Standard and Alternative Low Growth Scenarios and First Quarter Revenue Collections for FY2009**

- The resulting October revenue forecast reduces total general fund revenues and transfers for the 2008-2010 biennium by \$2.5 billion (7.4 percent) from the official forecast.
- Revenues are now expected to decline 4.0 percent in FY2009<sup>(Note)</sup>.
  - The projected decline for FY2009 represents the second worst performance on record (outside of FY2002) and a major revision from the +2.0 percent growth projected in the official forecast.
- Total general fund revenues are projected to increase a sluggish 3.6 percent in FY2010. However, the dollar amount of the projected revenue collections for FY2010 will remain below actual revenue collections for FY2008.

(Note): Adjusted for the Estate Tax repeal and HB 3202 (Transportation Plan), base revenues are expected to decline 2.0%.

## **The October Revenue Forecast Reflects a Combination of the Standard and Alternative Low Growth Scenarios and First Quarter Revenue Collections for FY2009**

- Withholding -- Data for the first quarter of FY2009 confirmed the September standard forecast for withholding.
- Nonwithholding -- The September estimated payment was slightly stronger than anticipated, however, comments from the GACRE supported a more cautious approach to the forecast for estimated and final payments.
  - Final payments in FY2009 are expected to be lower than the alternative low growth and FY2010 expectations are based on the alternative low growth.
- Individual Refunds -- Adjusted to reflect the revised alternative low growth nonwithholding forecast and outlook for higher base refund activity.
- Sales Tax -- Updated to include first quarter collections (slightly stronger than anticipated) and based on GACRE advice, the alternative low growth economic outlook for FY2009 and FY2010.
- Corporate -- Updated to include first quarter collections (nearly identical to projection) and the alternative low growth economic outlook for fiscal year 2010.

## Summary of the October General Fund Revenue Forecast (\$ in millions)

Major Source	As a % of Total Revenues	Fiscal Year 2009			Fiscal Year 2010		
		Official	October	\$ Change	Official	October	\$ Change
Withholding	59.1 %	\$ 9,506.5	\$ 9,231.9	\$ (274.6)	\$ 10,105.4	\$ 9,647.1	\$ (458.3)
Nonwithholding	19.0	3,057.2	2,635.1	(422.1)	3,315.6	2,661.8	(653.8)
Refunds	(11.1)	1,786.8	1,794.9	8.1	1,827.5	1,868.7	41.2
Net Individual	67.0 %	\$ 10,776.9	\$ 10,072.1	\$ (704.8)	\$ 11,593.5	\$ 10,440.2	\$ (1,153.3)
Sales	20.0 %	\$ 3,225.7	\$ 3,075.5	\$ (150.2)	\$ 3,391.2	\$ 3,153.9	\$ (237.3)
Corporate	4.4	706.0	684.9	(21.1)	728.2	716.7	(11.5)
Wills (Recordation)	2.4	380.8	347.3	(33.5)	415.1	347.3	(67.8)
Insurance	1.8	294.8	257.5	(37.3)	317.3	283.1	(34.2)
All Other Revenue	4.4	705.7	696.2	(9.5)	744.8	733.9	(10.9)
<b>Total GF Revenues</b>	<b>100.0 %</b>	<b>\$ 16,089.9</b>	<b>\$ 15,133.5</b>	<b>\$ (956.4)</b>	<b>\$ 17,190.1</b>	<b>\$ 15,675.1</b>	<b>\$ (1,515.0)</b>
<b>Total Transfers</b>		<b>\$ 384.8</b>	<b>\$ 367.6</b>	<b>\$ (17.2)</b>	<b>\$ 387.5</b>	<b>\$ 362.4</b>	<b>\$ (25.1)</b>
<b>TOTAL GENERAL FUND</b>		<b>\$ 16,474.7</b>	<b>\$ 15,501.1</b>	<b>\$ (973.6)</b>	<b>\$ 17,577.6</b>	<b>\$ 16,037.5</b>	<b>\$ (1,540.1)</b>

# **Governor Addressed the Projected Shortfall for FY 2009 Through a Variety Of Savings Actions and Reduction Strategies**

## Savings Actions

- Capturing savings of over \$24 million resulting from Governor's directives for agencies to reduce discretionary spending beginning in FY2008;
- Recovering over \$40 million in agency operating balances at the end of FY2008;
- Reducing agency spending by over \$323 million, based primarily on the recommendations made by state agencies in their 5, 10, and 15 percent reduction strategies, including the delay of the planned 2% employee salary increase;
- Adjusting revenue sharing programs (K-12 sales tax/HB599 payments) down by \$28.4 million to reflect lower revenue collections;
- Using \$51.3 in Literary Fund balances and \$6.2 million from the Tuition Moderation Fund;
- Bonding nearly \$250 million in capital outlay; and
- Withdrawing around \$400 million from the Revenue Stabilization Fund, which currently has over \$1 billion.
  - Use of the Revenue Stabilization Fund in fiscal year 2009 enables the state to protect certain critical services from 2009 cuts, most prominently, K-12 education.

# Summary of Governor's Proposed Budget Actions/Proposals

	<u>FY2009</u>	<u>FY2010</u>
<b>General Fund Revenue Shortfall (incl. transfers)</b>	\$ (973.6)	\$ (1,540.1)
 <b>Agency-based Actions</b>		
Balance from Governor's Aug. Savings Plan	\$ 24.4	
Unspent FY 2008 Operating Balances	\$ 40.7	
Defer December 2008 Salary Increase	\$ 44.7	
Institutions of Higher Education Reductions	\$ 86.1	
Agency Reductions	\$ 192.9	
<b>Subtotal</b>	<b>\$ 388.8</b>	
 <b>Revenue Sharing Adjustments</b>		
HB 599 Payments	\$ 7.7	
K-12 Sales Tax	\$ 20.7	
<b>Subtotal</b>	<b>\$ 28.4</b>	
 <b>Other Actions</b>		
Revert Excess Tuition Moderation Fund	\$ 6.2	
Literary Fund Balances -		
Unspent Revenue - Interest Rate Sub. Sale	\$ 23.3	
Excess Revenue From FY 2008	\$ 18.5	
Other balances	\$ 9.5	
Bond Capital Outlay - max	\$ 250.0	
RSF Withdrawal	\$ 400.0	
<b>Subtotal</b>	<b>\$ 707.5</b>	
<b>Total of All Actions</b>	<b>\$ 1,124.7</b>	
 <b>Amount Over/(Under) Shortfall</b>	 <b>\$ 151.1</b>	

# **Almost One-Third of the \$323 Million In Agency Spending Reductions are From Efficiency Actions**

## Reduction Strategies

- Nearly \$100 million in improved business practices and efficiencies
- Approximately \$44.7 million from deferring the pay increase until July 2009
- Nearly \$32 million in the reduction or elimination of current services
- Over \$27 million in reduced personnel costs
- Over \$13 million in reduced discretionary expenses

# Selected Agency Budget Reduction Strategies of Significance

- Education
  - None to K-12 Direct Aid (will use additional Literary Fund balances)
  - 5% or 7% on Institutions of Higher Education (depending on whether they had either: 1) more than 50% of their student body applying for financial aid or 2) base adequacy funding of 93% or less) - \$86.1 million
  - Varying percentage reductions to museums for vacancy/turnover and efficiencies. Days of operation adjusted at Science Museum and Museum of Natural History
- Natural Resources
  - Reorganize Department of Environmental Quality - \$704,000 and 35 layoffs

# Selected Agency Budget Reduction Strategies of Significance

- Health and Human Resources
  - MH/MR facilities will substitute NGF (previously Medicaid) for general fund to capture savings - \$20.1 million
  - Administrative cuts for Community Service Boards - \$12.4 million
  - A number of pass-thru grants in the departments of Aging and Health
  - Suspend payments into Indigent Care Trust Fund (focus on Certificate of Public Need requirements) - \$4.3 million
  - Reduce Department of Social Services central operations – 80 wage, contractual and classified positions including 9 layoffs for \$1.0 million
  - Cost recoveries provided for the administration of TANF programs - \$15.2 million

## Selected Agency Budget Reduction Strategies of Significance

- Public Safety
  - Close 2 correctional facilities, 2 field units, 1 detention center, and 1 diversion center - \$5.6 million and 253 layoffs
  - Eliminate day reports program (11 sites) and increase electronic surveillance - \$495,000 and 27 layoffs
  - Reduce funding for 3 public inebriate centers - \$68,000
  - Postpone 115<sup>th</sup> Basic Trooper School (State Police) - \$1.2 million
  - Hold civilian position vacancies (State Police) - \$1.6 million
  - Close 3 juvenile justice community programs (Chesapeake Community Placement Program, Camp New Hope, and Virginia Wilderness Institute) - \$1.3 million

# Future Activities

- Revenue Forecast
  - Evaluate against actual collections
  - Monitor national economic outlook
  - Convene GACRE meeting (if warranted)
- 2008-2010 Budget Process
  - Incorporate any revenue revisions
  - Spending adjustments
- Mid-Session Forecast
  - Evaluate against revenue collections (including holiday retail results)
  - Review national economic update