The Revenue Forecast

The Commonwealth's total revenue consists of two types of resources: the general fund, and nongeneral funds. About half of state revenues are "nongeneral funds," or funds earmarked by law for specific purposes. For example, motor vehicle and gasoline taxes are earmarked by law for transportation programs, student tuition and fees support higher education, and federal grants are designated for specific activities.

General fund revenues are derived from general taxes paid by citizens and businesses in Virginia. Since general fund revenue is not dedicated to any particular purpose and can be used for a variety of government programs, these are the funds that the Governor and the General Assembly have the most discretion to spend.

General fund revenues are derived primarily from five major revenue sources. The two largest sources are the individual income tax and the sales and use tax. Other major revenue sources are public service gross receipts / consumption taxes**,** corporate income taxes, and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

Fiscal year 2002 collections suffered largest decline since at least 1960

In fiscal year 2002, collections of three of the largest revenue sources – corporate, individual, and public service / consumption taxes – fell short of expectations, while receipts of sales tax and the tax on premiums of insurance companies were slightly above expectations. Collectively, the five major sources ended the year with a shortfall of $256.1 million.

Miscellaneous taxes and other revenues ended the year $19.1 million above the estimate. The bulk of the surplus was due to higher-than-expected collections of miscellaneous taxes and penalties and fees on wills, suits, deeds and contracts.

In total, general fund tax revenues for fiscal year 2002 declined by 3.8 percent to $10.7 billion, falling short of the official target by $237.0 million.

General fund revenue forecast revised downward

Due to the uncertain state of the Virginia economy and slumping general fund revenue collections, an interim revenue forecast was prepared and released by the Governor in August 2002. Total revenues in the interim forecast were substantially lower than those cited in the 2002 Appropriation Act.

As part of the customary fall forecasting process, a November forecast was prepared. The major change from the interim forecast is a significant downward revision in individual income tax collections, which is offset by a slightly better outlook for corporate income, higher interest income, and stronger collections of recordation taxes.

General fund tax revenues are expected to increase marginally in fiscal year 2003, by one percent, and to improve in fiscal year 2004 with 5.2 percent growth.

Forecast for the major general fund revenue sources

For each of the major categories of general fund revenue, the following describes the actual performance in fiscal year 2002 and the forecast for the next two fiscal years:

The general fund forecast for the 2002-2004 biennium

	Actual 2002	2002-2004 biennium *Forecast* 2003	*Forecast* 2004
Major tax sources			
Corporate income	290.2	301.2	315.9
Individual income	6,710.8	6,799.3	7,201.8
Insurance premiums	292.7	308.1	331.7
Public utility	77.2	83.5	83.8
State sales & use	2,429.8	2,342.3	2,458.0
Miscellaneous	878.3	946.4	946.7
Total revenues	**10,679.0**	**10,780.8**	**11,337.9**
Transfers			
ABC Profits	25.4	10.9	7.0
Lottery Profits	367.2	363.7	371.4
Transfers per the Appropriation Act	334.8	654.7	297.8
Total general fund	**$11,406.4**	**$11,810.1**	**$12,014.1**

Dollars in millions. Excludes balances available for appropriation. Figures may not add due to rounding. Source: Department of Taxation

Individual income taxes

Net individual income tax receipts of $6,710.8 million trailed the official estimate by $254.1 million in fiscal year 2002. Individual income tax receipts fell by 7.1 percent over the previous year.

A sluggish economic recovery and malaise on Wall Street are expected to constrain growth in income tax revenue in fiscal year 2003. Growth in withholding collections are forecast to be below three percent in fiscal year 2003. This marks the first time since 1980 (when records on withholding were first kept) that withholding growth would be below three percent for two consecutive years. The continued weakness in payroll withholding illustrates the marginal economic recovery. In addition, the continued slump in the stock market is expected to produce declining nonwithholding payments.

Sales and use taxes

Sales and use tax collections grew by 6.9 percent in fiscal year 2002. However, receipts were inflated due to legislation that required accelerated collections of sales tax. Removing the effects of the accelerated collections, growth in sales tax receipts was an anemic 0.3 percent, slightly ahead of the 0.1 percent forecast. In fiscal year 2003, underlying growth of 2.7 percent growth is expected. Despite sluggish job growth and slipping confidence, consumers have steadfastly supported the current economic recovery.

Corporate income taxes

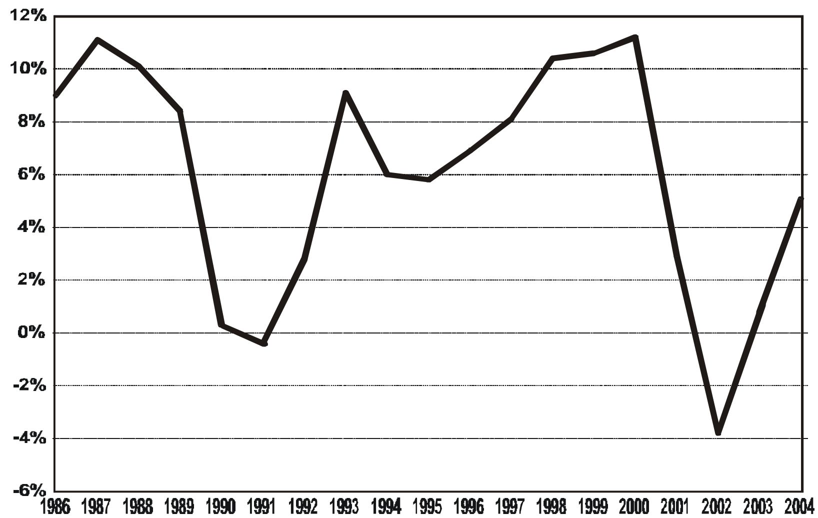
The corporate income tax is the most volatile of Virginia's revenue sources and tends to be even more sensitive to the business cycle than personal income taxes.

Corporate income tax collections have been notoriously difficult to forecast due to: (1) the tenuous link between profits and tax liability, (2) Virginia's profit/loss carry-forward, carry-back provisions, and (3) the varying time lag between the booking of profits and the payment of taxes. In addition, large fluctuations are often caused by payments of, or refunds to, a few large corporations.

Corporate income taxes fell by 20.2 percent in fiscal year 2002 to $290.2 million. This marks the lowest level of corporate income tax receipts since fiscal year 1993 and was the second consecutive yearly decline of over 20 percent. With the slowing economy and slump in corporate profits, gross payments fell 7.8 percent while refunds surged 22.2 percent, more than doubling

General fund revenues show slight rebound

Percent change over previous year



Data for 2003 and 2004 are forecasts. Source: Department of Taxation

the level reached just four years ago. Corporate payments are expected to increase by 3.8 percent in fiscal year 2003.

Public service gross receipts / consumption taxes

With a mild winter and the economic slowdown, revenues from the consumption tax finished the year $18.3 million below the estimate. Fiscal year 2002 marked the first full fiscal year that the gross receipts tax on natural gas and electric utilities was completely replaced by the consumption tax. Legislation signed into law in 1999 and 2000 began the process of deregulation of the electric and natural gas public utilities. As part of the deregulation process, a consumption tax on users of natural gas and electricity was enacted.

Collections from this source are expected to grow by 8.2 percent in fiscal year 2003 and 0.4 percent in fiscal year 2004.

Insurance company premiums taxes

Tax collections on insurance company premiums exceeded the forecast by $4.7 million in fiscal year 2002. Over the forecast horizon, collections of insurance premiums taxes are anticipated to continue a path of steady growth.

Miscellaneous taxes and other revenue

Miscellaneous taxes and other revenues exceeded projections by $19.1 million in fiscal year 2002. Most of the surplus was the result of higher-than-anticipated collections of other miscellaneous revenues and fees on wills, suits, deeds and contracts (mainly the recordation fee charged on home financing activities.) Collections of miscellaneous taxes and other revenues are expected to increase by 7.8 percent in fiscal year 2003, mainly due to the continuing refinancing boom and the strength in the housing market.

Nearly half of state revenue is nongeneral fund revenue

Although most public attention is focused on general fund revenue, more than one-half of all revenue in the state budget is nongeneral funds that are earmarked by law for specific purposes.

Nongeneral fund revenue is expected to increase by 0.5 percent in 2003 and by five percent in 2004. Nongeneral funds will comprise about 53.4 percent of the total state budget during the 2002-2004 biennium.

Federal grants

Federal grants are the largest source of nongeneral fund revenue (more than one-third of the total).

Frequently these grants do not come to the state as simple cash transfers. The federal government mandates many program requirements as conditions of the grants and often states must provide matching funds. The Medicaid program for indigent health care is an example of a federal entitlement program which requires a state contribution.

In 2002, federal grants and contracts totaled $5.3 billion. This source is projected to increase by 3.8 percent to $5.5 billion in 2003, and increase by 5.4 percent to $5.8 billion in 2004.

Institutional revenue

The second largest class of nongeneral fund revenue is institutional revenue. The principle sources of this revenue are patient fees at teaching hospitals and mental health institutions as well as tuition and fees paid by students at institutions of higher education. In 2002, institutional revenue collections were $2.8 billion, nearly one-fourth of all nongeneral fund revenue. Institutional revenues are projected to grow by 7.6 percent to $3.0 billion in 2003 and by 7.3 percent in 2004. These growth rates are affected by two opposing trends: an increase in tuition charges at institutions of higher education, and a decline in revenue at correctional institutions for housing out-of-state prisoners.

Transportation Fund

State transportation revenue comes from several sources including the motor vehicle fuels tax, the motor vehicle sales and use tax, road taxes, vehicle license fees, state sales tax, interest earnings, and other miscellaneous taxes and fees. Money in this fund is used to support highway construction and maintenance and operating costs. Federal, local, and toll revenues are also used to finance transportation programs.

Commonwealth transportation revenues from state taxes and fees amounted to $2.0 billion in 2002, an increase of $44.7 million over the prior year. Total collections ended at $59.8 million, or 3.1 percent above the forecast. This variance was primarily due to much stronger than anticipated motor vehicle sales tax collections. For 2003 and 2004, total fund revenues before transfers from state sources are expected to grow to $2.06 billion or 4.1 percent and $2.07 billion or 0.7 percent, respectively. However, $317 million in sales tax receipts will be transferred to the general fund in 2003 so that net revenues will temporarily decline.

The nongeneral fund forecast for the 2002-2004 biennium

	Actual 2002	2002-2004 biennium *Forecast* 2003	*Forecast* 2004
Motor vehicle fuel tax	$855.6	$877.2	$900.2
Unemployment compensation payroll tax	143.8	216.6	407.0
Special highway tax from sales tax	388.1	402.5	398.0
Motor vehicle sales and use tax	526.1	550.1	539.6
Other taxes	107.2	110.4	92.5
Rights and privileges	570.5	653.1	663.2
Sales of property and commodities	381.1	381.7	403.3
Institutional revenue	2,780.2	2,992.1	3,210.0
Interest dividends and rents	153.5	104.6	85.9
Federal grants and contracts	5,341.2	5,544.9	5,842.9
Master Tobacco Settlement Agreement Funds	89.8	90.8	79.5
Other Revenue	1,933.3	1,417.9	1,381.9
Total	**$13,270.5**	**$13,341.8**	**$14,004.1**

Dollars in millions. Figures may not add due to rounding.
Total excludes balances and bond proceeds available for appropriation, as well as Lottery, Literary, and internal service funds.

Source: Department of Planning and Budget, based on data submitted by agencies.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be much higher in each year of the biennium, reflecting higher payments from employers as a result of a decrease in wage and employment growth and a decline in the fund balance factor (solvency level) which governs the tax schedules or formula used to make collections for the Unemployment Insurance Trust Fund. For 2002, actual unemployment tax collections were $143.8 million. For 2003 and 2004, revenues are anticipated to increase to $216.6 million and $407.0 million.

Master Tobacco Settlement Agreement Funds

The Master Settlement Agreement (MSA) was signed between the major participating cigarette manufacturers and 46 states, the District of Columbia, and five United States' territories on November 23, 1998. The settlement agreement releases participating manufacturers from past, present, and future smoking-related claims of the states in return for an annual cash payment to the states in perpetuity. These payments are to be adjusted over time for several factors, including inflation and changes in volume of domestic cigarette shipments.

The Commonwealth's plan for the use of MSA funds has three elements. First, legislation passed by the 1999 General Assembly (Chapter 880, 1990 Acts of Assembly) earmarked 60 percent of the allocation in two separate trust funds. The Tobacco Indemnification and Community Revitalization Fund receives 50 percent of the MSA allocation. This share is used to compensate tobacco growers and tobacco quota holders for the economic loss resulting from quota loss or elimination and to promote economic growth and development in tobacco-dependent communities in the Southside and Southwest regions of the state.

The Virginia Tobacco Settlement Fund receives the next 10 percent of the MSA allocation for the purposes of discouraging, eliminating, or preventing the use of tobacco products by minors and for health care. Programs targeted at minors include but are not limited to educational and awareness programs on the health effects of tobacco and on laws restricting the distribution of tobacco products to minors.

For fiscal year 2002, the Tobacco Indemnification and Community Revitalization Fund received $74.8 million, and it is anticipated that it will receive $75.7 million, and $66.3 million in 2003 and 2004. The Virginia Tobacco Settlement Fund took in $15.0 million in 2002, and will take in $15.1 million, and $13.3 million in 2003 and 2004

The remaining 40 percent share of the MSA funds is deposited to the general fund.