The Revenue Forecast

The Commonwealth's total revenue consists of two types of resources: general and nongeneral funds. About half of state revenues (50.2 percent) are "nongeneral funds," or funds earmarked by law for specific purposes. For example, motor vehicle and gasoline taxes must pay for transportation programs, student tuition and fees must 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. Because 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: corporate income taxes, individual income taxes, sales and use taxes, public service gross receipts and consumption taxes, and insurance premium taxes. Miscellaneous taxes and other revenues also contribute to the general fund.

Growth in general fund revenues exceeds forecast for eighth straight year

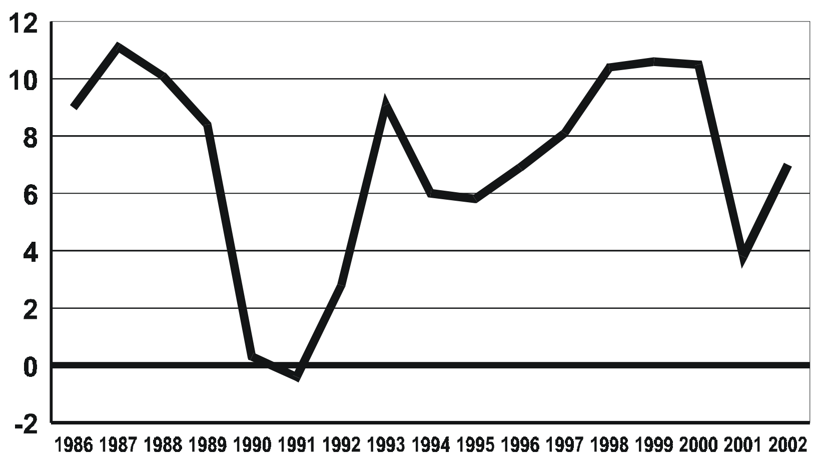
In fiscal year 2000, total general fund tax revenues grew 10.5 percent to $10,721.5 million, exceeding by $5.8 million the official forecast of $10,715.7 million (10.4 percent growth).

A surplus of $84.4 million in corporate income tax collections offset a shortfall of $39.5 million in individual income tax receipts. Collections of sales and use taxes and public service gross receipts taxes also fell short of expectations. Collectively, the five major sources ended the year with a surplus of $25.1 million.

Miscellaneous taxes and other revenues ended the year $19.3 million below the estimate. Most of the shortfall was due to lower than expected collections in estate and gift taxes. Collections of miscellaneous taxes and penalties and other miscellaneous revenues also contributed to the shortfall.

General fund tax revenue growth expected to be 3.8 and 7.0 percent for the 2000-02 biennium

Percent change over previous year



Data for 2001 and 2002 are forecasts. Source: Department of Taxation

The general fund revenue forecast calls for considerably lower growth in fiscal year 2001 than what has been experienced in the past few years. Although the economic forecast is expected to remain solid over the forecast horizon, the outlook for revenue growth is less optimistic because recent data reveal that the fiscal year 2000 base was artificially inflated due to several substantial anomalous revenue events.

Furthermore, the decline in the equity markets, after five years of double-digit growth, is expected to slow revenue growth. Tax revenues are expected to grow by 3.8 percent in fiscal year 2001 and by 7.0 percent in fiscal year 2002.

The general fund forecast for the 2000-02 biennium

	Actual 2000	2000-02 biennium Forecast 2001	Forecast 2002
Major tax sources			
Corporate income	565.9	476.5	514.8
Individual income	6,828.9	7,258.4	7,793.3
Insurance premiums	251.1	259.5	273.3
Public utility	104.2	87.4	95.5
State sales & use	2,201.5	2,297.5	2,448.1
Miscellaneous	769.9	750.6	778.8
Total tax revenues	**10,721.5**	**11,129.9**	**11,903.8**
Tobacco Settlement	66.9	271.4	295.1
Total revenues	**10,788.4**	**11,401.3**	**12,198.9**
Transfers			
ABC profits	30.2	27.4	27.8
Lottery profits	324.3	314.0	314.1
Transfers from the Appropriation Act	83.1	13.6	21.1
Total general fund	**$11,226.0**	**$11,756.3**	**$12,561.9**

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

Five major sources account for most general fund revenue

Here's a look at the forecast for each of the major categories of general fund revenue:

Corporate income taxes

Corporate income taxes increased by 34.6 percent in fiscal year 2000, attributable not only to strong growth but also to several large anomalous payments. Growth in corporate collections should return to a more normal rate in fiscal year 2001, falling by 15.8 percent due mainly to large one-time payments received in fiscal year 2000.

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.

Individual income taxes

Net individual income tax receipts of $6,828.9 million trailed the official estimate by $39.5 million in fiscal year 2000. Actual growth over the previous year was 12.2 percent. For 2001, these receipts are forecast to be $7,258.4 million, a moderate 6.3 percent increase over 2000. The deceleration of growth in this source is attributable, either directly or indirectly, to the recent slump in the stock market. Solid growth of 7.4 percent is expected in fiscal year 2002.

Sales and use taxes

Sales and use tax collections grew by 6.6 percent in fiscal year 2000, $4.1 million behind the official forecast. In fiscal year 2001, despite solid consumer fundamentals, sales tax collections are expected to increase only modestly by 4.4 percent due to higher energy prices, reduced wealth effects, higher interest rates, and a full year's impact of the reduced sales tax on food. Collections in fiscal year 2002 are expected to grow by 6.6 percent.

Public service gross receipts / consumption taxes

Revenues from public utility companies fell short of the 2000 forecast, finishing the year $17.2 million below the estimate. Legislation signed into law in 2000 will begin the process of deregulation of the electric utilities on January 1, 2001. Therefore, collections from this source will decline beginning in fiscal year 2001 as corporate income tax payments from the electric companies will begin in that same year.

As part of the deregulation legislation, a per kilowatt hour consumption tax on consumers of electricity was enacted. Revenues from this tax are included here. Collections in this source are expected to decline by 16.1 percent in fiscal year 2001 and then grow by 9.3 percent in fiscal year 2002.

Insurance company premiums taxes

Tax collections on insurance company premiums exceeded the forecast by $1.5 million in 2000. Over the biennium, collections of insurance premiums taxes are anticipated to continue a path of slow, steady growth. Fiscal years 2001 and 2002 collections are expected to grow at 3.4 and 5.3 percent, respectively.

Miscellaneous taxes and other revenue

Miscellaneous taxes and other revenues fell short of projections by $19.3 million in 2000. Most of the shortfall was caused by lower-than-expected collections of estate taxes. Collections of miscellaneous taxes and other revenues are expected to decline by 2.5 percent in 2001 and increase by 3.8 percent in 2002.

Tobacco settlement funds

The Governor proposes to sell Virginia's Master Settlement Agreement allocation for future years. This initiative will add another $460 million to general fund revenue during the 2000-02 biennium ($223.0 million for 2001 and $237.0 million for 2002).

When these amounts are taken into account, total general fund revenue collections, excluding transfers, are expected to grow by 5.7 percent in 2001 and 7.0 percent for 2002. *(See detailed discussion of "Tobacco Master Settlement Agreement funds" at the end of this chapter.)*

Nearly half of state revenue is nongeneral fund revenue

Although most public attention is focused on general fund revenue, about 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 10.4 percent in 2001 and by 8.1 percent in 2002. Nongeneral funds will comprise about 50.2 percent of total state revenue during the 2000-02 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 2000, federal grants and contracts totaled $3.9 billion. This source is projected to increase by 19.0 percent to $4.7 billion in 2001, and then level off for 2002.

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 2000, institutional revenue collections were $2.5 billion, nearly one-fourth of all nongeneral fund revenue. Institutional revenues are projected to grow modestly by 2.4 percent to $2.6 billion in 2001 and by 1.0 percent in 2002. These growth rates are affected by two offsetting trends: the continuation of the freeze on tuition increases at institutions of higher education, and the collection of additional revenues at correctional institutions for 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 $1.88 billion in 2000, an increase of $111.5 million over the prior year. Total collections ended at $67.0 million, or 3.7 percent above the forecast. This variance was primarily due to a strong economy, greater-than-expected vehicle purchases, increased travel, growth in motor fuel sales, and higher interest earnings. For 2001 and 2002, total fund revenues from state sources are expected to grow to $1.90 billion and $1.97 billion, respectively. These amounts are equal to annual growth of 0.9 percent and 3.5 percent, respectively.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be lower each year of the biennium, reflecting higher wage and employment growth and the increase 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 2000, actual unemployment tax collections were $149.1 million. For 2001 and 2002, revenues are anticipated to decrease to $132.6 million

The nongeneral fund forecast for the 2000-02 biennium

	1998-00 biennium	2000-02 biennium	
	Actual **2000**	*Forecast* **2001**	*Forecast* **2002**
Motor vehicle fuel tax	$822.3	$872.8	$883.1
Unemployment compensation payroll tax	149.1	132.6	141.1
Special highway tax from sales tax	372.5	390.2	415.6
Motor vehicle sales and use tax	491.6	479.4	501.7
Other taxes	105.0	103.5	111.6
Rights and privileges	539.5	564.3	577.1
Sales of property and commodities	321.0	334.3	349.5
Institutional revenue	2,516.2	2,577.0	2,602.6
Interest dividends and rents	123.9	109.4	132.8
Federal grants and contracts	3,912.0	4,656.4	4,689.2
Tobacco Master Settlement Agreement Funds	100.4[1]	72.6	788.2
Other Revenue	912.9	1,154.7	1,185.6
Total[2]	**$10,366.4**	**$11,447.2**	**$12,378.1**

Dollars in millions. Figures may not add due to rounding.
[1]Not in Appropriation Act for fiscal year 2000. Appropriated by stand-alone legislation (Chapter 880, 1999 Acts of Assembly).
[2]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.

and $141.1 million, respectively.

Tobacco Master 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 participating manufacturers are currently making these payments to the MSA Escrow Agent. Disbursement of the funds to individual settling states started in December 1999 when: (1) each state settled its pending or potential litigation with a consent decree and the time for all appeals against the consent decree had expired (i.e. State-Specific Finality), and (2) at least 80 percent of the settling states, in terms of number and dollar volume of entitlement to MSA payments, reached State-Specific Finality (i.e., Final Approval).

The Commonwealth's plan for the use of MSA funds has four 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 years 2001, and 2002, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund will receive $60.5 million and $72.6 million, respectively, while the Virginia Tobacco Settlement Fund will take in $12.1 million, and $14.5 million over the same period.

The remaining 40 percent of the MSA allocation will be deposited to the general fund through fiscal year 2002. In fiscal year 2001, the general fund deposit is estimated to be $48.4 million, and in fiscal year 2002 it is projected to be $58.1 million.

Finally, the Governor proposes that the MSA allocation for future years be sold to a special-purpose legislatively created entity that will sell bonds to investors to finance the purchase of the allocation. The sale will be made in a series of transactions in 2001 and 2002 and will involve the MSA allocation for 2003 and beyond. The Commonwealth will receive a lump sum payment, rather than continuing to receive multi-year payments during the period for which the allocation is sold.

This financing option provides an up-front payment to the Commonwealth with smaller residual payments over the life of the bonds. The financing is secured solely by the asset of the cash flows generated by the annual income stream of the MSA allocation.

The Governor recommends that the lump sum payments, anticipated to total approximately $1.2 billion when all payments are complete, be deposited as follows: to the Tobacco Indemnification and Community Revitalization Endowment (50 percent of the allocation), the Virginia Tobacco Settlement Endowment (10 percent) and the Higher Education and Economic Development Trust Fund (40 percent).

The earnings and a portion of the corpus of each of the endowments and the trust fund shall be applied as follows: (1) in the case of the Tobacco Indemnification and Community Revitalization Endowment, to the Tobacco Indemnification and Community Revitalization Commission, for the purposes set forth in current statutes; (2) in the case of the Virginia Tobacco Settlement Endowment to the Virginia Tobacco Settlement Foundation, for the purpose of discouraging, eliminating, or preventing the use of tobacco products by minors as set forth in current statutes and for health care; (3) in the case of the Higher Education and Economic Development Trust Fund, to support the debt service on obligations to be issued by the Virginia Public Building Authority and the Virginia College Building Authority for higher education and economic development projects.