



The Revenue Forecast

The Commonwealth's total revenue consists of two types of resources: the general fund, and non-general funds. Just over 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 by the federal government.

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 three largest of these are individual income taxes, sales and use taxes, and corporate income taxes. Other major revenue sources are public service gross receipts and consumption taxes, and taxes on insur-

ance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

Growth in general fund revenues fell short of the forecast in fiscal year 2001

In fiscal year 2001, collections of the three largest revenue sources – corporate, individual, and sales taxes – fell short of expectations, while taxes on public service corporations and the premiums of

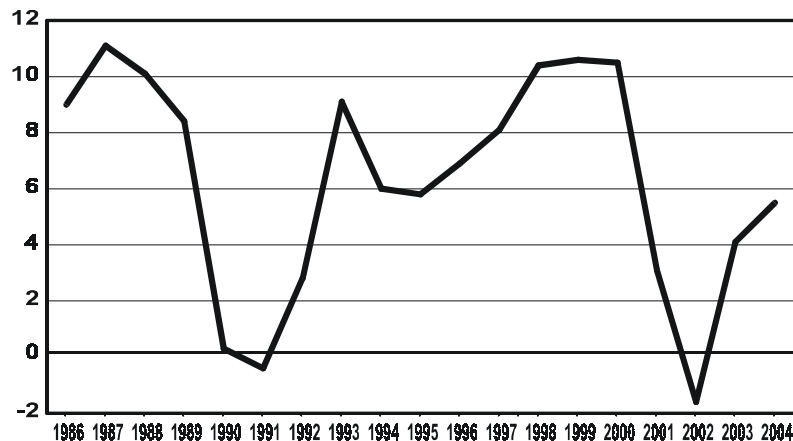
insurance companies were slightly above expectations.

Collectively, the five major sources ended the year \$154.8 million below expectations.

However, miscellaneous taxes and other revenues ended the year \$78.8 million above the estimate. The bulk of the surplus was due to higher-than-expected collections of miscellaneous taxes and penalties and fees from wills, suits, deeds and contracts.

Fiscal year 2002 growth to fall precipitously; Recovery in 2002-2004 biennium to be sluggish

Percent change over previous year



Data for 2002 through 2004 are forecasts. Source: Department of Taxation

In total, general fund tax revenues for fiscal year 2001 grew by 3.1 percent to \$11,054.0 million, falling short of the official target by \$76.0 million.

General fund revenue forecast revised downward

With the nation and the Commonwealth expecting a four-quarter recession in fiscal year 2002, general fund revenues were revised substantially downward over the three-year forecast horizon (fiscal years 2002, 2003, and 2004). In real terms, i.e. adjusted for inflation, the revenue forecast for fiscal year 2002 does not reflect as large a decline in revenues as during the 1990 recession. However, the expected recovery in fiscal years 2003 and 2004 is not forecast to be as robust as the recovery following the 1990 recession.

The cyclical downturn will be felt first and foremost in payroll withholding and sales tax collections. In addition, the decline in the equity markets should have a significant impact on nonwithholding collections. Corporate collections have fallen dramatically for the past five quarters and are expected to remain weak over the next three fiscal years due to the Commonwealth's loss carry-forward provisions.

General fund tax revenues are expected to fall by 1.6 percent in fiscal year 2002, and increase by 4.1 percent and 5.5 percent in fiscal years 2003 and 2004, respectively. When pol-

The general fund revenue forecast for fiscal year 2002 and the 2002-2004 biennium

	2000-2002 biennium		2002-2004 biennium	
	Actual 2001	Forecast 2002	Forecast 2003	Forecast 2004
Major tax sources				
Corporate income	363.8	357.5	361.6	397.5
Individual income	7,226.3	7,215.3	7,480.1	7,873.9
Insurance premiums	268.1	288.0	298.0	319.9
Public utility	93.4	95.5	98.5	101.8
State sales & use	2,273.0	2,445.0	2,372.7	2,526.4
Miscellaneous	829.5	728.5	759.9	777.5
Total tax revenues	11,054.0	11,129.8	11,370.8	11,997.0
Tobacco Settlement	51.3	59.31	59.1	52.0
Total revenues	11,105.3	11,189.1	11,429.9	12,049.0
Transfers				
ABC Profits	28.1	24.9	13.6	12.6
Lottery Profits	329.4	323.0	320.0	320.0
Transfers per the Appropriation Act	25.1	285.3	393.9	367.5
Total general fund	\$11,487.9	\$11,822.3	\$12,157.4	\$12,749.1

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

icy changes to accelerate withholding and sales tax collections are taken into consideration, general fund tax revenues should grow by 0.7 percent in 2002, by 2.2 percent in 2003, and by 5.5 percent in 2004.

Forecast for the major general fund revenue sources

For each of the major categories of general fund revenue, here's a look at actual performance in fiscal year 2001 and the forecast for the next three fiscal years:

Individual income taxes

Net individual income tax receipts of \$7,226.3 million trailed the official estimate by \$32.1 million in fiscal year 2001. Actual growth over the previous year was 5.8 percent.

In terms of absolute dollar magnitude, the economic scenario of a four-quarter recession has the most impact on individual income tax collections. Growth in the withholding and nonwithholding components is expected to weaken considerably. Refunds, the third component of individual income taxes, are expected to experience a considerable surge in fiscal year 2002.

For 2002, net individual income tax receipts are forecast to be \$7,215.3 million, actually falling below the prior year's level for the first time since fiscal year 1990. The anticipated decline in this source is attributable to slowing job growth, general business malaise, and the sluggish stock market.

Sales and use taxes

Sales and use tax collections grew by 3.2 percent in fiscal year 2001, \$24.5 million behind the official forecast. In fiscal year 2002, practically no growth in sales tax collections is anticipated due to rapidly weakening consumer fundamentals (growing unemployment, slowing personal income growth, plunging consumer confidence, and the diminishing wealth effect). However, legislation is anticipated to accelerate sales tax collections from dealers in June, thereby boosting the growth in this source in 2002 to 7.6 percent. Growth is then expected to be sluggish in fiscal year 2003, with a healthy recovery in this source not arriving until fiscal year 2004.

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 35.7 percent in fiscal year 2001. The drop in collections follows unusually strong growth in fiscal year 2000, when broad-based growth and several large anomalous payments boosted growth in this source to 34.6 percent. As the national economy soured, gross payments fell 9.2 percent in fiscal year 2001, while refunds on taxable year 1999 payments jumped 34.6 percent. Fiscal year 2002 collections are expected to fall by 1.7 percent and grow only nominally in fiscal year 2003.

Corporate income tax receipts have been falling rapidly for the past five quarters, but are expected to hit bottom this fiscal year. First Call, a national financial research firm, estimates that national corporate profitability through the second quarter of calendar year 2002 will be dismal and points to sizeable declines in corporate profits.

Public service gross receipts and consumption taxes

Revenues from public utility companies exceeded the fiscal year 2001 forecast, finishing the year \$6.0 million above the estimate. Legislation deregulating utilities became effective in January 2001. As part of the deregulation legis-

lation, a per kilowatt hour consumption tax on consumers of natural gas and electricity was enacted.

The first collections of the tax levied on the consumption of natural gas and electricity were received in March 2001. Fiscal year 2002 will mark the first full fiscal year that the gross receipts tax on natural gas and electric utilities will be completely replaced by the consumption tax.

Collections in this source are expected to grow by 2.2 percent in fiscal year 2002, 3.1 percent in fiscal year 2003, and 3.4 percent in fiscal year 2004.

Insurance company premiums taxes

Tax collections on insurance company premiums exceeded the forecast by \$8.6 million in fiscal year 2001. Over the forecast horizon, collections of taxes on insurance premiums are anticipated to continue a path of slow, steady growth.

Miscellaneous taxes and other revenue

Miscellaneous taxes and other revenues exceeded projections by \$78.8 million in fiscal year 2001. Most of the surplus was the result of higher-than-anticipated collections of other miscellaneous revenues and fees from wills, suits, deeds and contracts (mainly the recordation fee charged on home financing activities).

Collections of miscellaneous taxes and other revenues are expected to decline by 12.2 percent in fiscal year 2002, and

grow by 4.3 percent in fiscal year 2003, and by 2.3 percent in fiscal year 2004. The dismal outlook is due mostly to the sizeable decline expected in interest earnings over the forecast horizon.

Nearly half of state revenue is nongeneral fund revenue

Although most public attention is focused on general fund revenue, over 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 8.2 percent in 2002 and by 0.7 percent in 2003 and by 4.4 percent in 2004. Nongeneral funds will comprise about 52.9 percent of total state revenue 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 that requires a state contribution.

In 2001, federal grants and contracts totaled \$4.4 billion.

This source is projected to increase by 21.0 percent to \$5.3 billion in 2002, then decline by 3.9 percent in 2003 to \$5.1 billion before increasing again in 2004 by 4.5 percent. This pattern is caused by some large one-time payments related to Medicaid services in 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 2001, institutional revenue collections were \$2.8 billion, about one-fourth of all nongeneral fund revenue. Institutional revenues are projected to grow modestly by 2.3 percent to \$2.8 billion in 2002 and by 4.0 percent in both 2003 and 2004. These growth rates are affected by two offsetting

The nongeneral fund forecast for the 2002-04 biennium

	2000-2002 biennium		2002-2004 biennium	
	Actual 2001	Forecast 2002	Forecast 2003	Forecast 2004
Motor vehicle fuel tax	\$860.3	\$855.2	\$883.7	\$912.6
Unemployment compensation payroll tax	162.7	143.7	188.6	242.7
Special highway tax from sales tax	387.6	415.7	403.8	429.8
Motor vehicle sales and use tax	496.6	490.7	516.2	541.5
Other taxes	120.8	113.0	117.3	122.0
Rights and privileges	608.7	585.8	599.7	608.0
Sales of property and commodities	361.0	376.9	394.5	412.2
Institutional revenue	2,759.7	2,822.8	2,936.8	3,054.5
Interest dividends and rents	156.2	92.5	91.6	90.2
Federal grants and contracts	4,352.9	5,265.4	5,059.3	5,285.3
Master Tobacco Settlement Agreement Funds	76.9	88.9	88.6	78.0
Other Revenue	1,134.7	1,166.3	1,228.5	1,278.4
Total¹	\$11,478.1	\$12,416.9	\$12,508.6	\$13,055.2

Dollars in millions. Figures may not add due to rounding.

¹Total 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.

trends. An increase in tuition is assumed for institutions of higher education for the next biennium, but the collection of additional revenues at correctional institutions for out-of-state prisoners is expected to decline in the out years.

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 \$1.9 billion in 2001, an increase of \$50.9 million over the prior year. Total collections ended at \$33.5 million, or 1.7 percent above the original forecast. This variance was primarily due to greater-than-expected vehicle purchases fueled by attractive interest rates and the increased demand for gasoline and diesel fuel as gasoline prices moderated during the summer driving season.

For 2002 and 2003, total fund revenues from state sources are expected to be about \$2.0 billion. For 2004, they will grow to \$2.1 billion. These amounts are equal to annual growth of 2.2 percent, 2.3 percent, and 4.0 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) that governs the tax schedules or formula used to make collections for the Unemployment Insurance Trust Fund. For 2002, unemployment tax collections are expected to decrease to \$143.7 million from actual collections of \$162.7 million in 2001. For 2003 and 2004, revenues are anticipated to increase to \$188.6 million and \$242.7 million, respectively.

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 Gen-

eral 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 2002, 2003, and 2004, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund will receive \$74.1 million, \$73.8 million, and \$65.0 million, respectively. The Virginia Tobacco Settlement Fund will take in \$14.8 million, \$14.8 million, and \$13.0 million over the same period.

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