---

## Forecast of GRF Revenues and Public Assistance Spending
## For the FY 2004-FY 2005 Biennial Budget

## Testimony before the Conference Committee on H.B. 95

*June 11, 2003*


*Testimony of LSC Staff by*
*David Brunson, Division Chief for Education and Taxes*
*With assistance from LSC Tax Staff*


---

Mr. Chairman and Members of the Conference Committee, I will be presenting the Legislative Service Commission's forecast for revenues. GRF revenues for FYs 2003, 2004, and 2005 are now anticipated to be lower than the original January 2003 baseline forecasts by the Office of Budget and Management (OBM) and by the Legislative Service Commission (LSC). The changes from the OBM forecast are estimated to be $+189 million in FY 2003, $-505 million in FY 2004, and $-551million in FY 2005. The LSC revised estimates for conference committee are lower than the OBM revised estimates by $53 million in FY 2003, $70 million in FY 2004, and $20 million in FY 2005. These estimates exclude federal funds. On a percentage basis the differences are 0.3%, 0.4%, and 0.1% lower, respectively.

The forecast for FY 2003 is higher than the original one because of the subsequent changes in H.B. 40 involving the speed up of sales tax payments by larger vendors and other non-tax changes. The speed up added an estimated $288 million to the sales tax over the months of April, May, and June. Adjusting for this change implies that the non-auto sales tax falls below estimate by $42 million for FY 2003.

For FY 2004, significant differences from the original OBM estimates are found in the non-auto sales tax ($-155 million), the personal income tax ($ -276 million), and earnings on investments ($ -35 million). Other changes were in both directions and smaller in size.

For FY 2005, differences from the original OBM estimates are concentrated in the same three sources: non-auto sales ($-148 million), personal income tax ($-324 million), and earnings on investments ($-40 million).

## *Economic Forecast*

State revenues are dependent on the condition of the economy. Forecasts of state revenues have changed because forecasts of the condition of the economy have changed since January. Revenue forecasts have been revised to take into account actual revenue performance since January and changes in economic forecasts. The revisions are in general described by the phrase "slower growth off a lower base."

Global Insight's January forecast assumed that a war with Iraq started in late January and lasted four to six weeks. Gross domestic product (GDP) growth would be moderate in the first quarter, but pick up for the remainder of the year. For 2004, global economic recovery was assumed to push U.S. growth to 4.7%, its highest rate since 1985, before moderating to 3.3% in 2005. The June forecast incorporates the slower than expected growth during the first two quarters of 2003 and assumes that slower than originally forecast growth continues through the first part of 2004.

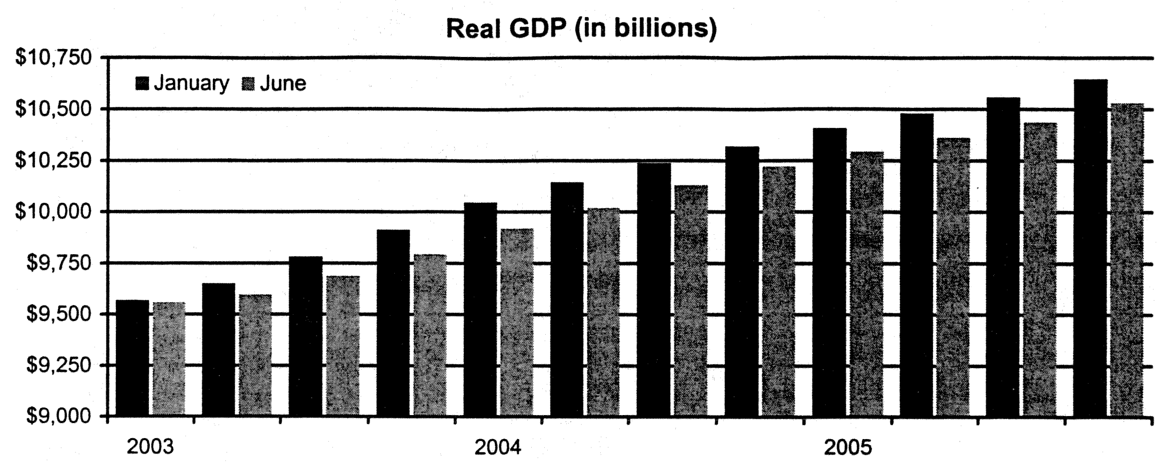
The table below and the accompanying charts present comparisons of the January and June forecasts of three economic indicators: real GDP, U.S. personal income, and U.S. private nonfarm employment. The first set of charts compares the forecasted levels of the three variables. The forecasted levels are lower in the June forecast than in the January forecast. The second set presents the percentage differences between the January and June forecasted levels of the variables. These percentage differences indicate the degree to which the economy is projected to be smaller than originally forecast. The third set of charts compares the forecasted growth rates for the variables. June growth forecasts are generally lower than in the January forecasts.

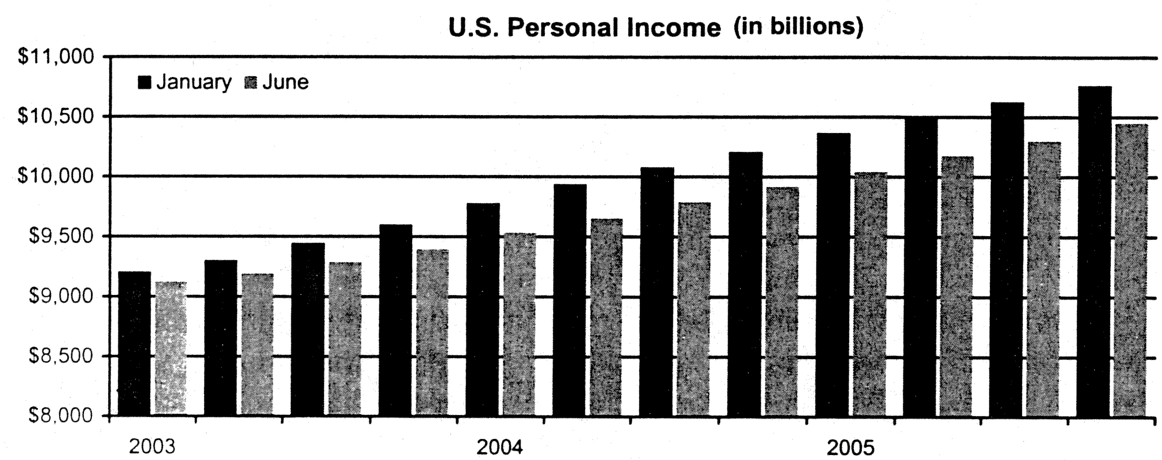
Looking at the second set of graphs shows that lower real GDP estimates build over calendar year 2003 and peak the first quarter of 2004 at a 1.2% reduction compared to the January forecast. Nominal GDP (not shown) has a similar pattern peaking at about 2% lower. Personal income peaks at a 3% reduction with most of that reduction occurring by the second quarter of 2004. The employment gap between the estimates also builds during 2003 and peaks at 2% in the first quarter of 2004. These reductions are reflected in the reduced tax estimates for the sales and personal income taxes.

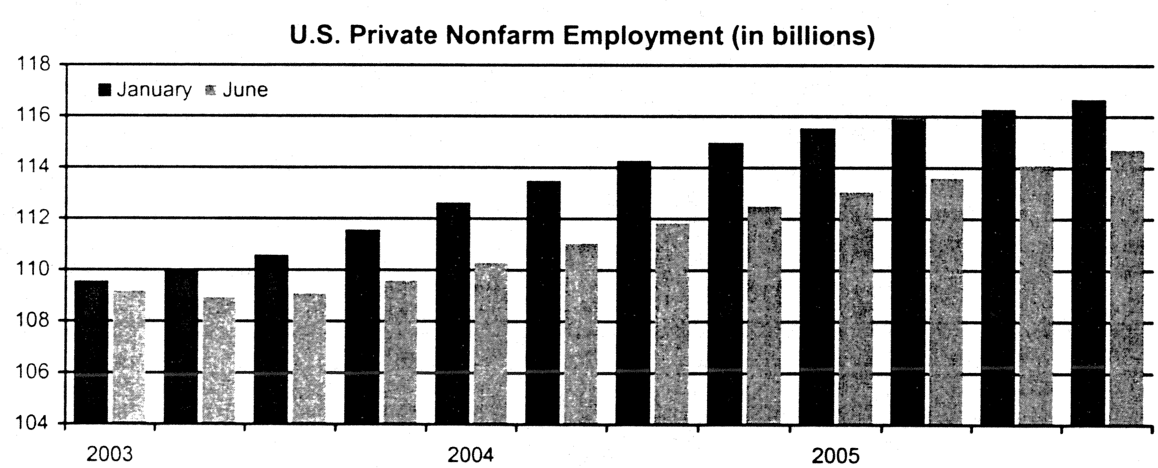
**Global Insight January 2003 and June 2003 Forecasts**

| | 2003 | | | | 2004 | | | | 2005 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 |
| ***Real GDP Growth*** | | | | | | | | | | | | |
| January Forecast | 2.6% | 3.5% | 5.5% | 5.5% | 5.5% | 4.0% | 3.7% | 3.2% | 3.4% | 2.9% | 3.0% | 3.4% |
| June Forecast | 1.9% | 1.5% | 3.8% | 4.5% | 5.2% | 4.1% | 4.5% | 3.6% | 2.9% | 2.7% | 2.9% | 3.7% |
| ***U.S. Personal Income Growth*** | | | | | | | | | | | | |
| January Forecast | 5.9% | 4.3% | 6.3% | 6.7% | 7.6% | 6.7% | 5.9% | 5.3% | 6.2% | 5.4% | 4.8% | 5.3% |
| June Forecast | 3.9% | 3.2% | 4.1% | 4.9% | 5.8% | 5.2% | 5.7% | 5.4% | 5.2% | 5.3% | 5.1% | 5.7% |
| ***U.S. Private Nonfarm Employment*** (in millions) | | | | | | | | | | | | |
| January Forecast | 109.6 | 110.0 | 110.6 | 111.6 | 112.6 | 113.5 | 114.3 | 115.0 | 115.6 | 115.9 | 116.3 | 116.7 |
| June Forecast | 109.2 | 109.0 | 109.1 | 109.6 | 110.3 | 111.1 | 111.9 | 112.5 | 113.1 | 113.6 | 114.1 | 114.7 |

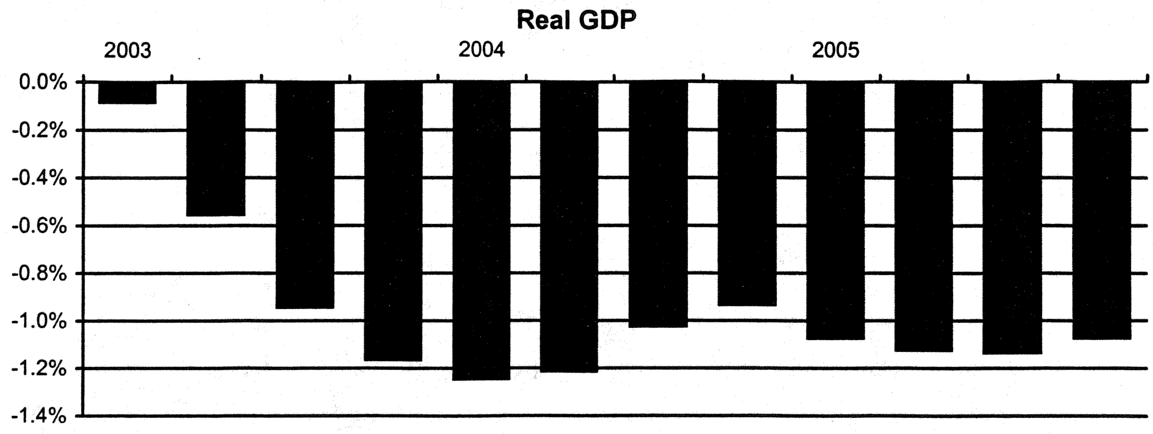
### *Comparison of Global Insight January 2003 and June 2003 Forecasts - Levels*

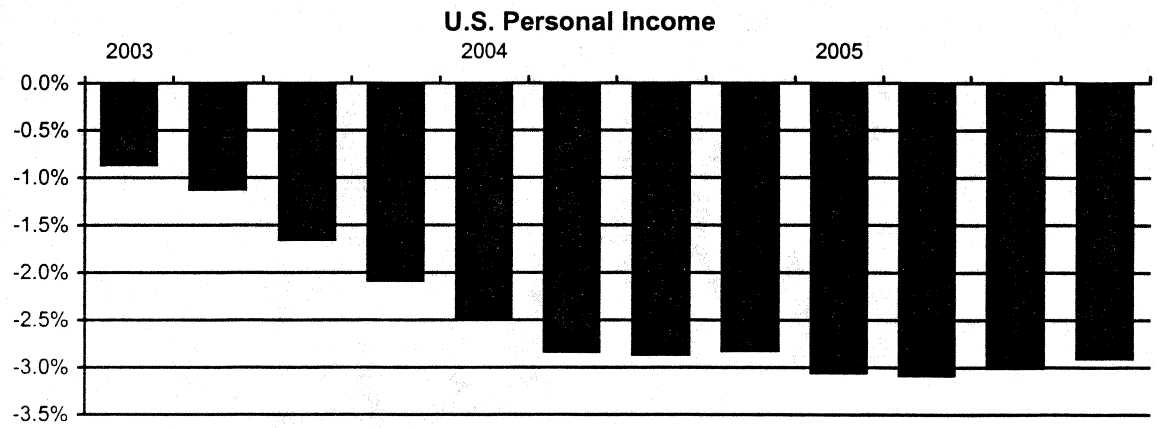


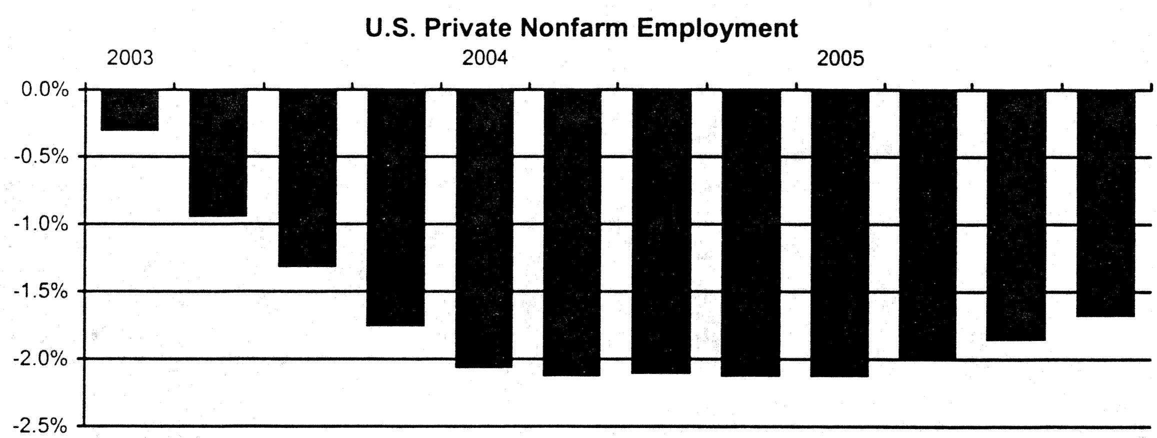



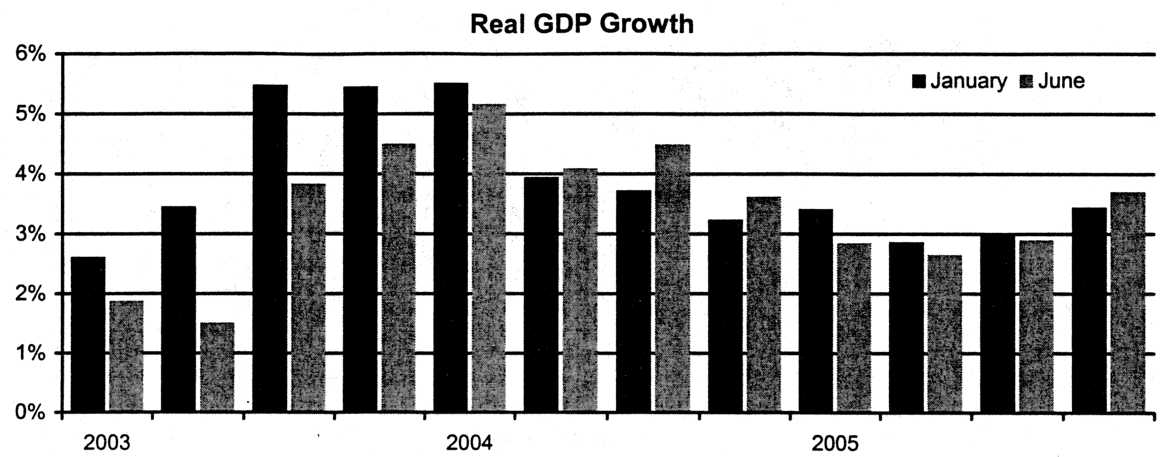
***Percentage Difference Between January 2003 and June 2003 Forecast - Levels***

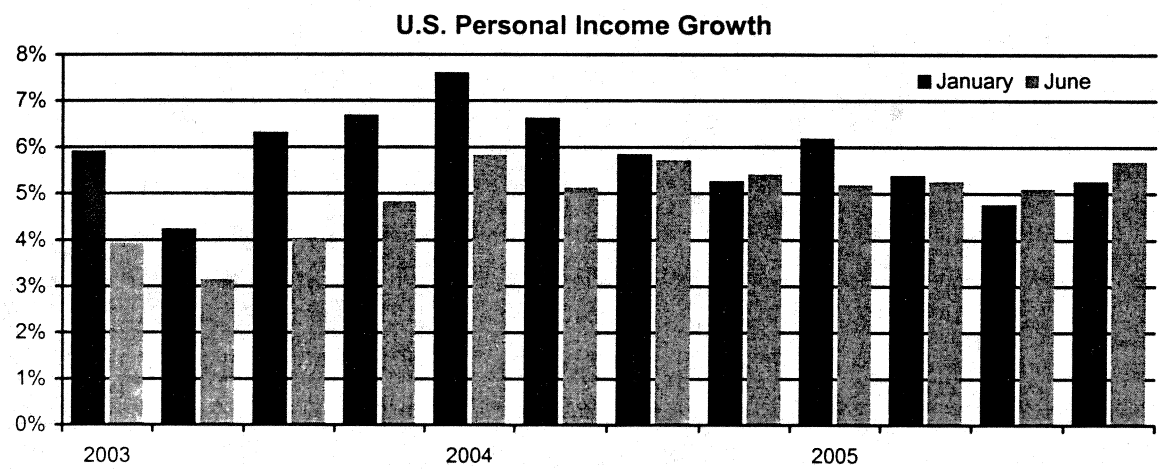


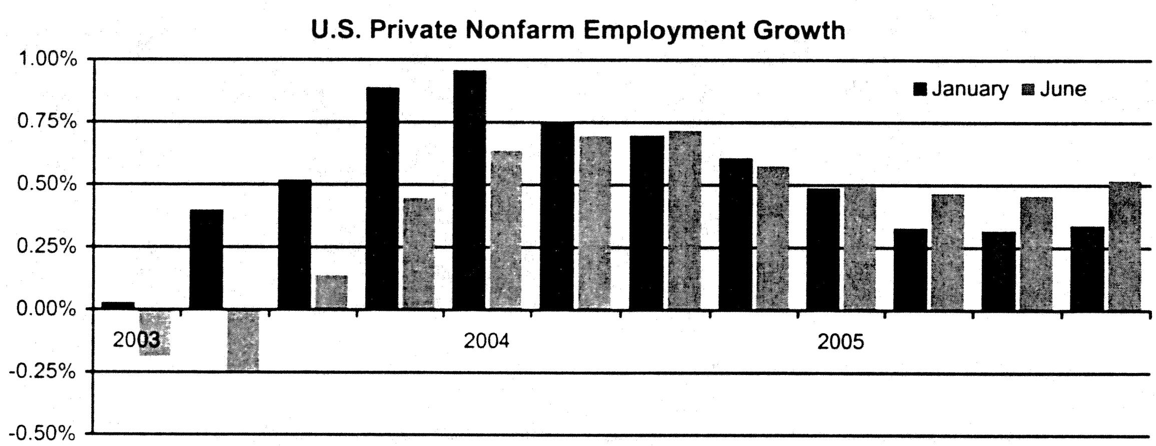



***Comparison of Global Insight January 2003 and June 2003 Forecasts - Growth Rates***



## *Revenue Forecast*

After adjusting for tax changes, it appears that both the non-auto sales tax and the personal income tax could end FY 2003 slightly below the level of FY 2002. The new tax on trusts and the local government fund true up affect income for the personal income tax in FY 2003. For the non-auto sales tax, the new vendor payment schedule affects FY 2003 and the auto leasing change affect the tax for both FY 2002 and FY 2003. This lack of growth in the two largest sources of state revenue highlights the rough spot we find ourselves in. Together the non-auto sales tax and the personal income tax account for 73% of state GRF revenue.

The forecast for the auto sales tax is expected to be relatively flat over the next two years. Sales are being controlled by manufacturer incentives. How big the incentives will be is unknown. Sales could increase if the high level of incentives remains, but sales could also fall if the high level of incentives is withdrawn. We have seen sales fall in months where incentives were scaled back.

The non-auto sales tax is expected to grow slowly during FY 2004 and pick up in FY 2005. Consumers may be cautious after this extended slow economy. The federal tax cuts will help, but sustained job growth and greater consumer confidence are also needed to stimulate demand. Increases in housing purchases are often part of the post recession pick up in demand. With high levels of housing purchases through the last several years, this pick up in demand is unlikely for this expansion. (Housing purchases stimulate purchases of household durable goods that are taxable under the sales tax.)

The personal income tax is expected to follow a similar pattern to the non-auto sales tax: slow growth in FY 2004 followed by higher growth in FY 2005. Withholding has been growing at 2.4% through May of this year compared to the same period last year. Withholding growth should gradually rise during the next two years as the economy accelerates. Quarterly estimated tax payments and refunds have been a drag on withholding gains during FY 2003 and may cause the overall tax to decline for the year. Through May, quarterly estimated payments are $1,023 million. This is $285 million or 21.8% below last year's corresponding amount of $1,308 million. Refunds are up 10.0% over last year. To attain an overall growth rate for the tax of 2.7% for FY 2004, the quarterly estimated payments and refunds must at least stabilize next year. Growth is expected for quarterly payments in FY 2005 as overall growth reaches an estimated 5.0%.

The corporate franchise tax is expected to grow slowly in FY 2004. Taxes are based on calendar year 2003 profits. Fiscal year 2005 is expected to see brisk growth of 10.0%.

Many of the other taxes are expected to see modest growth. The insurance taxes are an exception. High premium growth leads to 6.6% and 4.0% increases for the foreign insurance tax and 7.3% and 4.5% increases for the domestic insurance tax.

Earnings on investments have shrunk this fiscal year along with state balances and interest rates. Some recovery is expected the next two years assuming the GRF stabilizes. Slightly higher interest rates in FY 2004 and again in FY 2005 will help earnings increase.