

**SENATE FISCAL AGENCY
 MEMORANDUM**

DATE: September 15, 2003

TO: Members of the Senate

FROM: Gary S. Olson, Director

RE: Update on State Revenue Collections and State Budget

On September 12, 2003, the Senate Fiscal Agency (SFA) e-mailed to your office a copy of the SFA's Monthly Revenue Report for August 2003. This report provided you with a summary of actual State revenue collections in August and a summary of year-to-date FY 2002-03 revenue collections compared to the expected level of collections based on the consensus estimate agreed to at the May 2003 Consensus Revenue Estimating Conference. Based on the SFA's review of year-to-date State revenue collections, it is very apparent that when actual FY 2003-03 revenue collections are completed, they will total considerably below the amount estimated in the May 2003 consensus estimate and the amount assumed in the enacted State budget. This memorandum provides a brief summary of FY 2002-03 State revenue collections, a discussion of FY 2003-04 State revenue estimates, and the potential impact of any revenue shortfall on the enacted State budget.

FY 2002-03 Revenue Collections

The May 2003 consensus estimate of FY 2002-03 General Fund/General Purpose (GF/GP) and School Aid Fund revenues was built on the primary assumption that improving State economic conditions would translate into improving State revenue collections beginning in June 2003 and continuing throughout the balance of the fiscal year. Based on actual State revenue collections through August 2003, it appears as if this improvement in the State economic condition has yet to occur. The continued weakness in national and State employment levels has resulted in continuing weakness in State revenue collections. The result of these current economic conditions is that when the final level of FY 2002-03 GF/GP and School Aid Fund revenues are tabulated in November 2003, actual collections will fall short of the May 2003 consensus estimate.

The May 2003 consensus revenue estimate assumed that during FY 2002-03, actual collections from the State's 12 major taxes would exceed the level collected in FY 2001-02 by 3.0%. Actual collections for the fiscal year period through August 2003, however, are 1.2% below the level in the same period during FY 2001-02. Part of this revenue shortfall will be made up in the remaining two months of tax collections accrued to FY 2002-03 as the collections from the State Education Property Tax will significantly exceed year-ago levels due to a change in the timing of the payments of this tax. After adjustments are made for the payments expected to be received from the State Education Property Tax, the SFA believes that actual FY 2002-03 GF/GP revenue collections will fall between \$150 million and \$225 million below the May 2003 consensus revenue estimate. Actual FY 2002-03 School Aid Fund revenue collections will fall between \$50 million and \$100 million below the May 2003 consensus revenue estimate. The range in these numbers results from the potential amount of revenues yet to be collected in September and October 2003.

FY 2003-04 Revenue Estimates

The May 2003 consensus estimates of FY 2003-04 GF/GP and School Aid Fund revenues were developed utilizing a base estimate of FY 2002-03 revenue collections and then applying a projected level of revenue growth in FY 2003-04. Due to the fact that the FY 2002-03 base will be below the amount assumed in the May 2003 consensus estimate, it is likely that the FY 2003-04 GF/GP and School Aid Fund consensus revenue estimates also will have to be reduced when they are adjusted at the next consensus revenue estimating conference to be scheduled in January 2004. The combination of the FY 2002-03 base adjustment and any changes in the assumed level of revenue growth in FY 2003-04 will have an impact on the level of changes to the FY 2003-04 GF/GP and School Aid Fund revenue estimates.

If no change is made in the estimated rate at which revenues will grow in FY 2003-04 from the rate built into the May 2003 consensus estimate, the SFA estimates that the FY 2003-04 GF/GP revenues will be between \$150 million and \$225 million below the current consensus estimates and the FY 2003-04 School Aid Fund revenue estimate will be between \$50 million and \$100 million below the current consensus estimate. These ranges could change if there is a change in the economic forecast for FY 2003-04 that would have an impact on the projected level of FY 2003-04 revenue growth.

Impact on State Budget

During July 2003, the Legislature completed final action on the initial FY 2003-04 appropriation bills and also adjusted the enacted FY 2002-03 appropriation bills. All of the appropriation bills approved and signed into law by the Governor were based on the May 2003 consensus revenue estimates. On August 21, 2003, the SFA sent to your offices a memorandum that outlined the projected year-end balances in both the FY 2002-03 and FY 2003-04 GF/GP and School Aid Fund budgets. Any change in the revenue estimates will have an impact on these projected year-end balance estimates.

The current SFA estimate of the FY 2003-04 GF/GP year-end balance is \$146.2 million. Based on provisions in the enacted budget, this projected year-end balance is to be distributed equally to the Budget Stabilization Fund and the newly created School Aid Stabilization Fund. This distribution to the two reserve funds will occur only if the final FY 2002-03 GF/GP year-end balance exceeds \$350 million. As previously mentioned, the SFA now believes that the balance carried forward from FY 2002-03 will fall between \$135 million and \$210 million short of the \$360 million built into the FY 2003-04 GF/GP budget. This shortfall, coupled with an anticipated downward revision in the FY 2003-04 GF/GP revenue estimate resulting from a base adjustment to FY 2002-03 GF/GP revenues, will result in a projected FY 2003-04 GF/GP budget deficit of between \$154 million and \$304 million.

This projected FY 2003-04 GF/GP budget deficit could also be affected by expenditure pressures that might result in the need for supplemental appropriations to be enacted. Two expenditure issues being monitored by the SFA are the State Medicaid program and State classified employee concessions built into the enacted budget. Actual Medicaid expenditures appear to be exceeding the rate upon which the FY 2002-03 and FY 2003-04 Department of Community Health budget was based. The SFA is meeting with the House Fiscal Agency and the Office of the State Budget to discuss this potential spending issue. The enacted FY 2003-04 GF/GP budget includes \$140 million of expenditure reductions resulting from State classified

employee concessions. As of today, the State's labor unions have not agreed to any employee concessions. Failure to reach employee concessions may result in the need to supplement certain existing departmental appropriations in order to continue the delivery of essential State services. It is too early to place a potential cost on either of these expenditure issues.

The current SFA estimate of the FY 2002-03 School Aid Fund year-end balance is \$1.3 million. If actual FY 2002-03 School Aid Fund revenue collections are between \$50 million and \$100 million under the May 2003 consensus estimate, the FY 2002-03 School Aid Fund budget is potentially in deficit by between \$50 million and \$100 million. Due to the fact that almost all FY 2002-03 School Aid Fund appropriations have been released to the State's K-12 school districts, this potential deficit will be dealt with in one of two ways. The first would be to transfer surplus FY 2002-03 GF/GP revenues to the School Aid Fund, and the second would be to carry forward any FY 2002-03 deficit into the FY 2003-04 School Aid Fund budget.

The current SFA estimate of the FY 2003-04 School Aid Fund year-end balance is a deficit of \$16.4 million. If one assumes a \$50 million to \$100 million downward revision in both FY 2002-03 and FY 2003-04 School Aid Fund revenue estimates, the State will likely be dealing with a projected FY 2003-04 School Aid Fund deficit of between \$116 million and \$216 million. This estimate assumes that any FY 2002-03 School Aid Fund budget deficit is carried forward into FY 2003-04.

The SFA is currently in discussions with the House Fiscal Agency, the Department of Treasury, and the State Budget Office reviewing actual State revenue collections and the potential impact on the enacted State budget. Discussions are also under way concerning the scheduling of a special meeting of the Consensus Revenue Estimating Conference before the statutory required meeting to be held in January 2004. An earlier meeting of the Consensus Revenue Estimating Conference would provide the Governor and the Legislature more time to discuss and enact changes to the FY 2003-04 State budget in order to eliminate any potential deficits in the GF/GP and School Aid Fund budgets.

If you have any questions on this memorandum, please call my office at 373-5300.

/kjh

c: Chris Hackbarth, Senate Majority Policy Office
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