



REPORT ON KEY ISSUES FROM THE HOUSE APPROPRIATIONS COMMITTEE

BUDGET BRIEFING

DWIGHT EVANS, DEMOCRATIC CHAIRMAN

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First Quarter Revenue 2008/09

Total General Fund Revenue was 4.7% or \$281 million short of the official estimate through the first quarter of the fiscal year. The first quarter shortfall is across all tax types with Corporation, Personal Income and Sales Taxes taking the biggest hit. Corporation Taxes are 8.6% or \$59 million below projections. Sales Tax is 2.7% below projections, or \$61 million. Personal Income Tax collections are down 2.4% or \$58 million.

Compared to collections for the same period last year, total General Fund collections are down by 2.9% or \$170 million.

The table on page 3 shows first quarter collections by tax category. **The next few months will provide a better picture of Pennsylvania's revenue trends as retailers enter the holiday shopping season** and taxpayers (corporate and individual) make their final quarterly estimated payments for the 2008 calendar year.

Discussion of the Economy

According to Moody's *Economy.com*, the probability of a national recession increased to 43 percent in August compared with 35 percent in July. The economy's problems are clearest in financial, housing and job markets, and Moody's believes the odds are high that the Gross Domestic Product (GDP) will post a negative quarter or two through the first half of next year.

The probability of recession in the Middle Atlantic region (including Pennsylvania) rose to 37.7% in August, up from 30.7% in July. This new probability gives the Middle Atlantic region the lowest likelihood of being in a recession in six months; however, all regions' recession probabilities have been steadily increasing. During testimony on October 6 before the Senate Appropriations Committee on state revenues, James Diffley of *Global Insight* (the economic forecasting firm for the Commonwealth) stated that they do not believe Pennsylvania is currently in a recession.

The national unemployment rate was unchanged from August at 6.1%, but September is the ninth consecutive month of employment losses in the United States. The only sectors that continue to expand are education, healthcare and mining, but gains in these sectors are slowing. According to Moody's *Economy.com*, it is likely that conditions will deteriorate further in coming months, and job losses are expected to persist into 2009 with the national unemployment rate expected to rise to 7.3% by the end of 2009. Pennsylvania lost 12,200 jobs in September; however, the state's unemployment rate of 5.7% was below the nation's in September, and has been at or below the national rate for 67 of the past 69 months. Compared to September 2007, the Pennsylvania jobs total is down 6,700. ***Global Insight* projects that Pennsylvania will see no employment growth until 2009.**

In its final report of second quarter GDP, the US Bureau of Economic Analysis reported that corporate profits fell 3.8 percent in the second quarter of 2008 from the first quarter. Corporate profits have now fallen for four straight quarters, the first time this has happened since 1989. Profits were down 8.3 percent in the second quarter of 2008 compared to the second quarter of 2007. Further information on how corporate profits are effecting corporate tax collections in Pennsylvania can be found on page 2 in the section on corporate income tax receipts.

The consumer price index, an indicator of inflation, stayed flat for September 2008 compared to August 2008. The core CPI (everything except food and fuel) increased by 0.1% in September 2008 compared to August 2008, and is up by 2.5% from September 2007, about the same rate of increase from August 2007 to August 2008. The topline CPI (all consumer goods) came in at zero percent from in September 2008 compared to August 2008, and is up by 4.9% from September 2007. Moody's *Economy.com* reports that inflation is retreating in practically every consumer sector except food. It

expects that food price inflation will begin slowing as lower energy prices make themselves felt. The good news is that falling energy prices are driving the deceleration of consumer prices.

Existing home sales in the United States declined in August by 2.2% from July and are down nearly 11 percent from the prior August. The median price of existing houses declined with a drop of 9.5% from September 2007, the largest on record. Moody's *Economy.com* reports that sales of existing homes are stabilizing and monthly fluctuations are small, indicating that the housing market is near the bottom. Pennsylvania's real estate market is cooling, but *Global Insight* reports that home price declines remain rare. Although the bursting of the housing bubble was initially not so severe here, the mortgage mess and the credit crunch will have profound contractionary effects on state home-building and finance. Statewide home prices contracted in the second quarter of 2008 by 0.4 percent when compared with the first quarter of 2008, the first negative in 11 years. However, in a year-over-year comparison with the second quarter of 2007, housing prices have appreciated 1.4%.

Retail sales in the United States fell 1.2% in September 2008, the largest decline in over three years, following a decline in August 2008 of 0.4%. Sales excluding automobiles fell 0.6%, indicating that auto sales were a major driver of this decline. Excluding auto dealers, declines were largest at furniture, apparel, electronics and appliance, and department stores. Sales were below last year's level and year-ago growth has been negative only two other times since 1991 – October 2002 and September 2001. The only segments to post growth occurred in drug stores and gasoline stations, which posted small gains. The weakness in consumer spending in recent months is not surprising, as the economy is losing jobs and stock prices are tumbling. Information on the effect of consumer spending on taxes in Pennsylvania can be found in the section below on sales tax receipts.

Corporate Taxes

The \$59 million first quarter shortfall was driven by September collections. Based on preliminary data, the current shortfall in Corporate Taxes is largely due to estimated payments for Corporate Net Income and Capital Stock and Franchise Taxes. **September is always a significant deposit month for Corporate Taxes because many corporations make their 2008 third quarter estimated payments** for the Corporate Net Income Tax and the Capital Stock/Franchise Tax. These estimated payments tend to be indicators for December's

estimated payments and April's final payments. We will continue to monitor deposits in the upcoming months to determine if any trends are developing.

Sales Tax

First quarter Sales Tax receipts are behind estimate for the year due to shortfalls in both non-motor vehicle sales and motor vehicle sales. **Non-motor vehicle sales fell short nearly \$39 million** (or 5.1%) while **motor vehicle sales are short \$22 million** (or 7.6%) for the year. When comparing the first quarter sales tax receipts against the first quarter of fiscal year 2007/08, we find that they grew by only \$4 million or 0.2%. Non-motor vehicle sales tax receipts are nearly \$36 million above first quarter last year; however, motor vehicle sales tax receipts are nearly \$32 million below the same period last year. According to *TNS Retail Forward*, nearly four out of every 10 shoppers (37 percent) plan to spend less on the holiday than they did last year. Given the way consumers are responding to the current economic environment, it remains to be seen how Sales Tax collections will perform in the critical holiday months ahead.

Personal Income Tax

First quarter Personal Income Tax (PIT) collections were below estimate by 2.4% or \$58 million. Withholding, which reflects wages and salaries, is \$30 million or 3.8% below estimate through the first quarter. Non-withholding (on investment earnings and proprietors' income) has a first quarter shortfall of \$28 million or 7.1%. PIT collections, when compared with the first quarter of 2006/07, have grown 2.4% or \$56 million. Withholding is \$37 million (or two percent) higher than last year while non-withholding is up \$19 million (or 4.3%). Three months of collections are not sufficient to discern any trends and we will carefully monitor deposits in the coming months.



Preliminary General Fund Revenue Report	Official Estimate	Actual	Change from Estimate		Annual Growth
			Amount	Percent	
(\$ in millions)	Year-Through-September				
GENERAL FUND TOTAL	\$6,040.2	\$5,758.8	(\$281.39)	-4.7%	-2.9%
I. TAX REVENUE	\$5,968.3	\$5,745.7	(\$222.62)	-3.7%	-1.2%
A. CORPORATION TAXES	\$691.4	\$631.9	(\$59.47)	-8.6%	-11.5%
B. CONSUMPTION TAXES	\$2,527.6	\$2,451.4	(\$76.16)	-3.0%	0.0%
1. Sales	\$2,254.8	\$2,193.7	(\$61.15)	-2.7%	0.2%
a. Non-Motor Vehicle	\$1,958.5	\$1,919.8	(\$38.73)	-2.0%	1.9%
b. Motor Vehicle	\$296.3	\$273.9	(\$22.4)	-7.6%	-10.3%
2. Cigarette	\$206.8	\$194.8	(\$12.01)	-5.8%	-2.7%
3. Malt Beverage	\$7.3	\$7.3	(\$0.05)	-0.7%	-4.2%
4. Liquor	\$58.7	\$55.8	(\$2.95)	-5.0%	4.6%
C. OTHER TAXES-TOTAL	\$2,749.3	\$2,662.3	(\$87.00)	-3.2%	0.4%
1. Personal Income	\$2,412.2	\$2,354.0	(\$58.2)	-2.4%	2.4%
a. Withholding	\$1,930.6	\$1,900.8	(\$29.8)	-1.5%	2.0%
b. Non-Withholding	\$481.6	\$453.2	(\$28.40)	-5.9%	4.3%
2. Realty Transfer	\$119.1	\$103.7	(\$15.45)	-13.0%	-27.3%
3. Inheritance	\$217.1	\$203.6	(\$13.55)	-6.2%	-3.3%
4. Minor & Repealed	\$0.9	\$1.1	\$0.151	16.7%	136.7%
II. NON-TAX REVENUE	\$71.9	\$13.1	(\$58.8)	-81.7%	-88.3%

Corporate and Non-tax number will differ some from Department to Revenue final numbers due to the preliminary nature of the data.

QUESTIONS AND COMMENTS

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