OFFICE OF THE STATE COMPTROLLER
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Comptroller's Fiscal Update: Revenue Trends through the Mid-Year of State Fiscal Year 2012-13

October 2012

Summary

Midway through the current fiscal year, tax revenue trends in New York State are running below projections, signaling the need for careful monitoring by State officials and policy makers over the next six months. Over the past five fiscal years, General Fund tax collections have increased an average of 2.1 percent annually.[1] This growth includes revenue generated from a number of tax law changes enacted over the same period, some of which were temporary. According to the Enacted Budget Financial Plan for State Fiscal Year (SFY) 2012-13, year-end General Fund tax collections were projected to grow 3.9 percent from actual year-end collections in SFY 2011-12.[2] This projection was subsequently lowered to 3.7 percent in the First Quarter Update to the Financial Plan released in June 2012.[3]

However, through the first six months of SFY 2012-13, General Fund tax collections have declined $31.2 million from the same period last year. Such collections are $116.4 million below First Quarter Update projections and $315.4 million below initial Enacted Budget Financial Plan expectations. All Funds tax collections totaling $31.6 billion have declined 0.2 percent from the same period last year and are $213 million below projections through September. Based on year-to-date results, All Funds tax collections would have to increase 6.4 percent over the last six months of the fiscal year – more than double the growth expected for SFY 2012-13.

While General Fund tax collections are below projections, total receipts in the General Fund (including transfers to other funds) through September 30, 2012 are $337.1 million higher than projected through the first six months of the year. This is primarily because of unanticipated settlement revenue, including $340 million from Standard Chartered Bank. Such unanticipated resources may help offset any shortfall in tax revenues. However, other risks to the Financial Plan remain. These risks include the potential loss of federal funds because of automatic sequestration under current law enacted by the U.S. Congress in 2011. Other risks include anticipated revenues from health-plan conversions and Native American casinos that together are projected at $379 million and that may not materialize in the current fiscal year. As the Office of the State Comptroller

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[1] General Fund tax collections not including transfers to other funds.
[2] See the Division of the Budget's publication, Enacted Budget Financial Plan for Fiscal Year 2013, http://publications.budget.ny.gov/budgetFP/2012-13EnactedBudget.pdf.
[3] See the Division of the Budget's publication, the First Quarterly Update to the Financial Plan for Fiscal Year 2013, http://publications.budget.ny.gov/budgetFP/FY2013JulyUpdate.pdf.

observed after the end of the first quarter of SFY 2012-13, the continuing softness in the economic recovery suggests the need for caution in the months ahead.

Economic and Revenue Trends

Tax revenue projections are based largely on forecasts of conditions in the economy. In each of the last five years, changing economic conditions dragged actual State tax collections down, below the projections used to develop each initial enacted budget financial plan. In three of those years, mid-year deficit reduction actions were required to achieve budgetary balance by the end of the fiscal year.

Weak economic conditions and forecasts released after the First Quarterly Update to the Enacted Budget Financial Plan help explain why tax revenue growth through the first six months did not meet projections. According to the First Quarter Update, Gross Domestic Product (GDP) is projected to grow 1.9 percent in 2012 and 2.5 percent in 2013. Even these economic projections, which were lowered from those included in the Enacted Budget Financial Plan three months earlier, may prove too ambitious. Since the end of the first quarter, projections from the Blue Chip Economic Indicators have declined and now indicate that national GDP growth in 2013 may be lower than growth in 2012.[4]

General Fund tax collections through the first quarter of SFY 2012-13 were above projections. However, the comparatively positive picture for the quarter was driven primarily by certain estimated Personal Income Tax (PIT) collections from April 2012 (part of what is commonly referred to as the April settlement), which were nearly $400 million higher than expected. In the First Quarter Update to the Financial Plan, the Division of the Budget (DOB) reduced projections for both withholding and current year estimated payments, and increased projections for prior year estimated payments to better reflect actual results through the first quarter.

General Fund Personal Income Tax

Data on the two major components of PIT revenues – withholding and estimated payments – allow an analysis of recent economic activity because withholding taxes are collected on the wages of current workers. Collections of taxes withheld from workers' paychecks represent more than three-quarters of the State's overall PIT revenues, providing a good measure of current trends. Current and prior year estimated payments are primarily made by high-income individuals whose income is largely based on capital gains and thus tends to be comparatively volatile; such revenues can have a disproportionate impact on the overall direction of tax receipts.

Based on results through the first half of the fiscal year, collections in both PIT withholding and current year estimated payments must grow at a significantly higher rate in the remaining six months of the fiscal year than they have in the first six months to meet revised projections. Such improved collections may be difficult to achieve unless the economy starts growing at a faster pace in the months ahead. These two

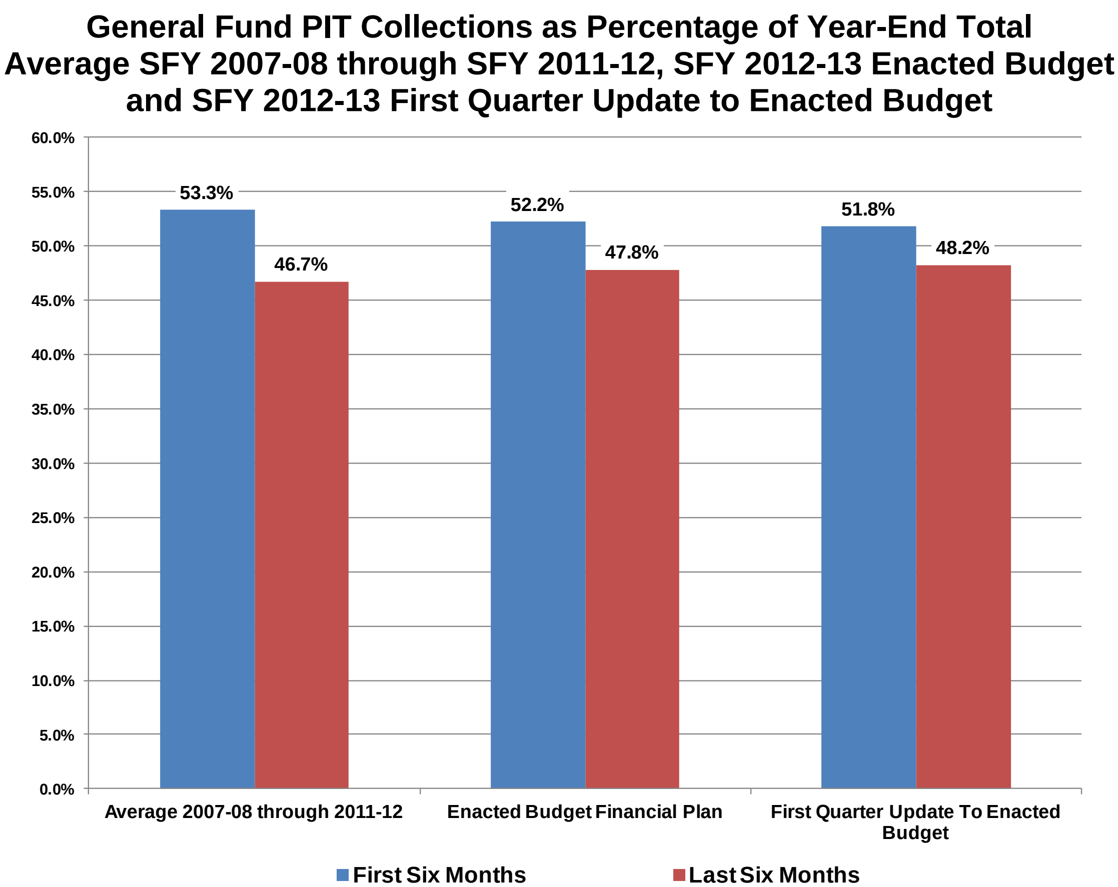
[4] In June 2012, the Blue Chip forecast projected GDP growth of 2.1 percent and 2.4 percent for 2012 and 2013, respectively. In the October forecast, those projections were lowered to 2.1 percent and 2.0 percent, respectively. See Blue Chip Economic Indicators, June and October 2012.

components together make up nearly half of total State Operating Fund revenue, making collections especially important to the State's fiscal balance going forward.

Actual General Fund PIT collections through the first half of SFY 2012-13 totaled $13.9 billion, which is a decline of $64.5 million, or 0.5 percent, compared to last year. This primarily reflects April 2012 collections which, though higher than anticipated, were lower than the unusually high settlement collections from April 2011. However, PIT receipts for the first half of the fiscal year are $6.0 million lower than anticipated in the First Quarter Update to the Financial Plan. The current SFY 2012-13 Financial Plan projects growth of 4.2 percent for PIT receipts through the end of SFY 2012-13 compared to SFY 2011-12.

Figure 1 illustrates actual and projected percentages of the year-end total for the first half and the second half of the year as an average for the last five years, showing initial Enacted Budget Financial Plan projections and revised First Quarter Update projections.[5] As previously mentioned, the April settlement in SFY 2011-12 was significantly higher than anticipated, as was the settlement in SFY 2012-13, albeit lower than the settlement in SFY 2011-12. However, the settlement is typically non-recurring and collections throughout the remainder of the year do not tend to follow suit.

Figure 1



Source: Office of the State Comptroller; Division of the Budget.

[5] Note that the second half of SFY 2009-10 and the first half of SFY 2010-11 were adjusted to reflect the delay of $500 million in PIT refunds from the last quarter of SFY 2009-10 to the first quarter of SFY 2010-11.

Figure 1 shows that the current Financial Plan requires greater growth in PIT collections in the second half of the fiscal year than has been typical over the last five years. Over the preceding years, second-half collections averaged 46.7 percent of the annual total; current projections reflect an expectation that receipts from October 2012 through March 2013 will represent 48.2 percent. While the percentage difference between the five-year average and current projections appears relatively small, it translates into approximately $400 million. General Fund PIT collections are currently $6.0 million below Plan. To meet year-end projections, collections must increase 9.6 percent over the second half of the year – more than double the growth currently projected for the entire year.

DOB publicly reports monthly projections for overall General Fund PIT collections at the start of the fiscal year, but not for subcategories such as withholding and estimated payments. Therefore, for these subcategories, comparisons can only be made to projected annual totals. Figure 2 illustrates how much PIT withholding and estimated payments, which represent the two largest components of PIT collections, would have to grow to meet year-end projections.

Figure 2

PIT Withholding and Current Year Estimated Taxes
Growth Needed to Meet Year-End Projections
(in millions of dollars)

Personal Income Tax	**Year End Actual/ Projected**	**Through 6 Months**	**Collections Needed in Remaining 6 Months to Meet Projections**
Withholding			
2011-12	31,199	13,644	17,555
2012-13	32,173	13,613	18,560
Growth	*3.1%*	*-0.2%*	***5.7%***
Current Year Estimated			
2011-12	8,096	4,272	3,824
2012-13	8,559	4,470	4,089
Growth	*5.7%*	*4.6%*	***6.9%***
Total Withholding and Current Year Estimated			
2011-12	39,295	17,916	21,379
2012-13	40,732	18,083	22,649
Growth	*3.7%*	*0.9%*	***5.9%***

Source: Office of the State Comptroller; Division of the Budget.

Withholding collections are received directly from paychecks and are not as volatile as estimated payments. The most significant timing issue is related to the number of pay days in each month. Nonetheless, withholding collections represent New York State's single largest State source of revenue. In the All Funds budget, only federal receipts exceed withholding collections. As such, any fluctuation in revenue from withholding taxes is very influential, and overly optimistic projections can be damaging. The last time actual year-end withholding collections met the initial enacted budget Financial Plan projections was in SFY 2006-07.

As shown in Figure 2, the First Quarter Update to the Financial Plan projects withholding collections will grow 3.1 percent in SFY 2012-13 from SFY 2011-12 (reduced from 5.0 percent in the Enacted Budget Financial Plan). However, through September 30, 2012, withholding collections have totaled just under $13.6 billion, representing a slight decline from last year for the same period. To meet year-end projections, withholding receipts will have to grow by 5.7 percent for the remaining six months of the year.

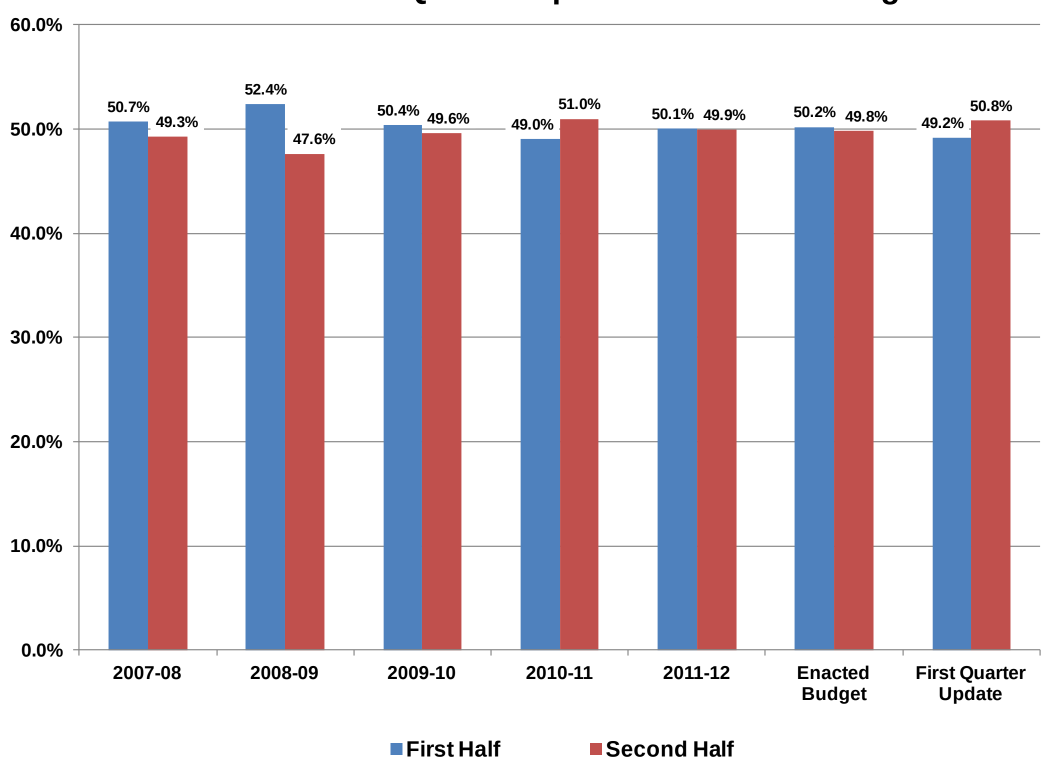
Through September 30, 2012, current year estimated payments have increased 4.6 percent, below the 5.7 percent growth projected by year-end (which was reduced from 9.7 percent growth initially anticipated in the Enacted Budget Financial Plan). Current year estimated collections in the second half of the year will have to increase 6.9 percent over collections from the same period last year to meet the downwardly revised forecast.

General Fund Consumption and Use Taxes

The SFY 2012-13 Enacted Budget Financial Plan projected General Fund consumption and use tax collections would increase 2.4 percent, or $216 million, from SFY 2011-12 levels. Projected year-over-year growth was lowered in the First Quarter Update to the Financial Plan to 1.6 percent. With both Plans, the entire increase was expected from sales tax collections, which represent approximately 92 percent of total consumption and use taxes. In the First Quarter Update, DOB reduced projected growth in General Fund sales tax collections from 2.6 percent to 1.7 percent, for a reduction of $104 million.

Figure 3

General Fund Consumption and Use Taxes as Percentage of Year-End Total SFY 2007-08 through SFY 2011-12, SFY 2012-13 Enacted Budget and SFY 2012-13 First Quarter Update to Enacted Budget



Source: Office of the State Comptroller; Division of the Budget.

Through September 30, 2012, consumption and use tax collections in the General Fund totaled $4.5 billion, representing an increase of $14.3 million, or 0.3 percent, from the previous year. This was $24.8 million higher than projections from the First Quarter Update. In particular, sales tax collections have increased $26.0 million, or 0.6 percent. However, to meet year-end projected growth of 1.6 percent, total consumption and use tax collections will have to increase 2.8 percent over the next six months and sales tax collections will have to increase 2.7 percent.

Consumption and use tax collections can be relatively volatile, so an average of the last five years is not used. Instead, Figure 3 illustrates actual first and second half proportions from the last five years, as well as projections from the Enacted Budget Financial Plan and the First Quarter Update. While second half collections have exceeded first half collections only once in the last five years, the latest Financial Plan Update expects this to occur in SFY 2012-13, with $150 million more expected to be collected in the second half of the year, relative to the first.

General Fund Business Taxes

The SFY 2012-13 First Quarter Update to the Financial Plan projects year-end General Fund business tax collections will increase 4.8 percent, or $275 million, from SFY 2011-12 collections, which is only slightly reduced from initial projections. However, the First Quarter Update shifted its projection of where the growth would occur from the Corporate Franchise Tax to Bank taxes. The Corporate Franchise Tax was initially expected to increase 6.6 percent, or $181 million. It is currently expected to increase only $13.0 million, or 0.5 percent. Bank taxes were initially expected to decline $2.0 million, or 0.2 percent, but are currently expected to increase $131 million, or 11.3 percent.

Through the first half of the fiscal year, year-to-year General Fund business tax collections have increased $67.4 million, or 2.8 percent, from last year's levels, primarily in Bank tax collections (up $121.6 million, or 27.4 percent). Through September 30, General Fund business tax collections are $106.7 million lower than updated projections, indicating that higher growth is expected in the next six months. Growth over the second half of the fiscal year must total 6.2 percent to meet year-end projections.

All Funds Non-Tax Revenue

Miscellaneous Receipts

Miscellaneous receipts include fees, fines, reimbursements from public authorities, municipalities and other sources, recoveries, Lottery proceeds, tuition revenue, interest earnings, and other non-tax and non-federal revenue (there are miscellaneous receipts that are disbursed from federal special revenue funds). The State's share of Lottery proceeds, both traditional and from Video Lottery Terminals (VLTs), are counted as miscellaneous receipts and are primarily used to finance education, with a small portion used for administration of the various lottery programs.

The SFY 2012-13 First Quarter Update to the Enacted Budget Financial Plan projects miscellaneous receipts will increase 2.8 percent, or $666 million, in SFY 2012-13. This represents an increase from the Enacted Budget Financial Plan, which projected growth of 1.8 percent, or $432 million. The First Quarter Update increase was attributed to the timing of various settlements (not including Standard Chartered Bank), better-than-anticipated VLT receipts through the First Quarter, as well as other smaller positive adjustments. Lottery receipts for education are currently projected to increase $205 million, or 7.2 percent, primarily because SFY 2012-13 represents the first full year of VLT gambling at the Aqueduct Racetrack.

In June 2012, the State received $150.3 million from ING Bank as the State's share of the federal settlement reached by the U.S. Department of Justice and the New York City District Attorney. In September 2012, the State received $340 million from Standard Chartered Bank from a settlement reached as a result of legal action taken against the Bank by the New York State Department of Financial Services. The entire amount was credited to the General Fund. These funds are non-recurring, but do provide a one-time boost to receipts.

Through September 30, 2012, All Funds miscellaneous receipts totaled $11.7 billion, which was 7.7 percent or $837.7 million higher than collections for the same period in SFY 2011-12. Miscellaneous receipt collections were $508.1 million above updated Plan projections through September 30.

Federal Receipts

Federal receipts are projected to decline nearly $2.0 billion, or 4.4 percent, from SFY 2011-12, primarily reflecting the end of stimulus funding from the American Recovery and Reinvestment Act of 2009. Federal receipts are typically reimbursements for spending that has already occurred, and finance approximately 20 percent of the State's annual capital spending. The largest non-capital program utilizing federal funding is Medicaid, which is expected to make up approximately 70 percent of federally funded non-capital spending in SFY 2012-13.

Federally funded capital spending is projected to increase 1.5 percent, or $27 million. Non-capital spending financed with federal funds is projected to decline nearly $2.0 billion or 5.2 percent, primarily because federal stimulus funding largely ended in SFY 2011-12.

Year-to-date, federal receipts are down $3.3 billion, or 14.8 percent, compared to last year, which is $43.7 million above Financial Plan projections through September 30.

Risks for the Second Half of the Fiscal Year

Given the continued lag in actual tax collections relative to Financial Plan expectations, the State's fiscal picture must be closely monitored during the second half of SFY 2012-13. Since the SFY 2012-13 Enacted Budget Financial Plan was released in April 2012, various economic indicators, as well as projections, have declined. Projected economic growth for 2013 is now lower than the growth projected for 2012. The Office of the State Comptroller recently reported that the securities industry earned $10.5 billion in the first half of 2012 (fifth best on record) and such profits could reach $15 billion for the year. In 2011, the securities industry reported strong profits through the first half of 2011, but faced significant losses through the second half of the calendar year, largely due to the deepening European debt crisis.

While the State recently received a previously unanticipated settlement totaling $340 million, which will assist in maintaining balance in the General Fund, a number of risks remain in the Financial Plan. As this report demonstrates, growth in tax collections must increase significantly to meet year-end projections. Volatile economic conditions and uncertainty in the financial sector threaten those projections.

The Financial Plan also anticipates other revenues that may not materialize, thus requiring either additional spending reductions or the identification of other revenue sources to preserve budget balance. Health care spending is dependent on $250 million in proceeds from the privatization of two not-for-profit health insurance plans. At this point, that process has not moved along significantly. Another $129 million is anticipated from Native American casinos. The State has not received a full payment from Native American casinos since SFY 2009-10.

In addition, the Financial Plan warns of risks associated with the loss of federal funds, including potential reductions associated with the Federal Budget Control Act of 2011. DOB estimates that New York State and local governments could lose approximately $5.0 billion over nine years under sequestration. While the magnitude of any reduction has yet to be determined, the Act calls for automatic sequestration of federal funds beginning in January 2013 if additional measures to reduce the federal deficit are not enacted.

The unanticipated settlement revenue will help offset some of the risks described above. However, for the sixth consecutive year, the State is unlikely to reach the tax collection projections that were used as the basis for the Enacted Budget Financial Plan. Structural budgetary balance is now a primary goal for the State, unlike in the past when budgets were often built on temporary or non-recurring actions that deferred the fiscal challenges to future years. Nonetheless, if recurring revenues continue to trail expectations as they have for the last five years, attaining New York State’s goal of long-term structural balance may remain elusive.