STATE OF INDIANA

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STATE BUDGET AGENCY
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Christopher A. Ruhl
Director

MEMORANDUM

To: State Revenue Forecasting Technical Committee:
David Dukes
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John Grew
Bob Lain
Prof. John Mikesell
Dan Novreske
Susan Preble
William Sheldrake

From: Christopher A. Ruhl, State Budget Director CL

Date: October 9, 2009

Re: First Quarter Revenues

This morning the State Budget Agency released state revenue collections for the quarter ending September 30, 2009. For the first quarter of the fiscal year, revenue collections missed your May 2009 forecast by $254 million or 8%. The quarter included $34 million in collections for motor vehicle, commercial excise and financial institutions taxes that were not expected to be received until later in the fiscal year. Therefore, the normalized miss for the quarter is $288 million, nearly 10% worse than you projected.

Your May 2009 forecast projected that first quarter FY 2010 revenues would be 6.5% below the first quarter of FY 2009. The remaining nine months were projected to be 4.5% higher than the same period last year. Given the 14% actual decline in the first quarter versus the same period last year—missing by more than double the forecast—we are seeking your input and guidance on what to expect for the remaining nine months. This is critical as major decisions will be necessary with respect to spending reductions, the amount and composition of the state's rainy day funds and the size and scope of state government operations.

For example, if revenues for the rest of the fiscal year were flat compared to prior year, instead of 4.5% growth, an additional miss of $430 million would occur, bringing the total miss for the year to over $715 million. And that would assume an immediate and dramatic rebound. If the 14% year over year decline from the first quarter continued for the entire fiscal year, the miss would amount to over $2 billion.

If we were still using the December 2008 forecast, the size of the first quarter miss would have been $455 million. Compared to the April 2009 forecast, the first quarter miss would have been $374 million. Therefore, it was very fortunate that the Governor demanded yet another forecast in May; but the magnitude of the first quarter miss relative to your May 2009 forecast is nonetheless alarming.

Given the first quarter results, to achieve the fiscal year 2010 target predicted by your May 2009 forecast, tax collections would have to exceed prior year by over 7% for the remainder of the fiscal year. At this point, we find that scenario to be extremely unlikely.

As part of the May 2009 forecast you modified certain equations and formulas to reflect changing economic circumstances. This was a helpful beginning. However, it seems clear that the implications of a failed national economy and certain new economic realities are still not completely incorporated or reflected in your current forecast. The following are questions that we request the committee consider as it integrates the new economic realities into the current forecast:

- Do eleven straight months of declines in sales tax collections indicate a permanent reset in consumption? What impact does the significant increase in personal savings rate mean for your sales tax projections?
- What impact does a 10% drop in income tax withholdings for this calendar year to date mean for next April's income tax collections?
- How many years until the $300 million decline in estimated income tax payments that have occurred over the last twelve months is reversed?
- Is the 42% decline in corporate tax collections for the first quarter indicative of future results?

One forum for discussion of these issues is an upcoming meeting of the state budget committee. An alternative would be a presentation addressing these questions at the time of the December revenue forecast update. I will consult with members of the budget committee on which option is preferable.

If you have any questions, please let me know.