

GOVERNMENT OF THE DISTRICT OF COLUMBIA  
OFFICE OF THE CHIEF FINANCIAL OFFICER



OFFICE OF RESEARCH AND ANALYSIS

**REVISED REVENUE ESTIMATES FOR FY 2003 – FY 2006**

September 17, 2002

The Office of the Chief Financial Officer has issued revised revenue estimates for the District of Columbia for FY 2003 through FY 2006. The revisions show a drop in expected revenue of \$322.7 million in FY 2003, \$318.0 million in FY 2004, \$349.2 million in FY 2005, and \$350.9 million in FY 2006. The Local Source General Fund estimate for FY 2003 now stands at \$3,499.0 million.

The revised estimates follow just four months after the May 5 adoption of the original estimate for FY 2003, upon which the FY 2003 Congressional budget submission is built. The District experienced an abrupt and dramatic change in revenue collections beginning in April of this year. When fully documented in July, it became clear that individual income tax collections shifted from 14.8% above prior year collections for January through March to 11.7% below prior year collections for January through April. This precipitous drop has continued through the end of August and into September, as shown by the chart on page 4.

The drop in individual income tax revenue results from the end of the capital gains “bubble” that helped sustain revenues in the late 1990s and 2000-2001. After years of rising incomes and tax payments, taxpayers had overpaid expected tax obligations and, suddenly, did not need to pay more with their returns filed on April 15. Indeed, many were due big refunds. As a result, payments for January through April were down 33.4% (after having been up 8.0% for January through March) and refunds paid out by the District were up 13.9% in the same four months.

Importantly, comparatively little of the revenue drop is due to withholding, the part of the income tax associated with resident employment. Over the long run, individual income tax collections are quite closely correlated with the level of resident earnings (the correlation coefficient is 0.97 for FY 1984-2001). The abnormal behavior of the financial markets in the last six years certainly had an abnormal impact on revenues, giving the District a roller coaster ride of revenue growth and decline, and this is an impact we do not expect to be repeated. In the future, revenue is again expected to track with resident earnings. Unfortunately, even withholding is not currently as strong as in 2001. For January through April, withholding was 6.8% ahead of last year. Through August it is down by about 3.2%.

A year after September 11, a sustained recovery in the District’s economy is not evident. Lack of growth in either D.C. sales tax collections or individual income tax withholding appears to confirm the lack of full economic rebound in the District. Employed D.C. residents and the D.C. labor force are below year ago levels and continue to fall mildly.

Like our neighbors, the combined impacts of the recession that seems to linger and the terrorist attacks of a year ago hit the District's revenue stream hard. The change in total tax revenue from July 2001 through Jun 2002 is slightly deeper for the District than for Maryland and Virginia, as shown in the table below.

### CHANGE IN TAX REVENUE

July 2001 – June 2002

	Individual Income Tax	Corporate Income Tax	Sales Tax	Total Tax Revenue
District	- 10.7 %	- 59.4 %	- 4.1 %	- 4.8 %
Maryland	- 6.5 %	- 26.6 %	0.5 %	- 4.6 %
Virginia	- 7.1 %	- 20.2 %	6.9 %	- 3.9 %

Sources: D.C. OCFO and "State Revenue Report," Rockefeller Institute of Government, September 2002.

As to the future, there is no obvious engine for growth, at either the federal or District levels, to give great lift to the District's economy any time soon. Higher debt levels and lagging income gains nationally raise questions as to the ability of consumer spending to continue to drive economic expansion. Business investment is likely to remain slow, and state and local governments throughout the country are cutting spending due to revenue gaps. Should interest rates rise, consumers would be squeezed further, and housing activity would likely slow down. Further declines in the stock market could impart additional weakness to the economy, and the possibilities of conflict in Iraq or further terrorist activity add to the uncertainty.

Key elements of the District economy, based on discussions with local businesses, include the following:

- ❑ District employment was lower in June and July than a year ago. Gains in private sector employment in the spring have largely dissipated.
- ❑ Tourism has rebounded remarkably well from the events of September 11. The full-scale operation of the District's new convention center in 2004 will bring new growth to the industry. Some restaurants have reported gains over last year; however, hotel occupancy and room rates are still below the same period as last year, and profits are not doing well.
- ❑ The market for commercial office space in the District is one of the best in the United States, in terms of vacancy rates and investor interest. However, the vacancy rate is edging up, and construction has slowed. The amount of occupied space in the second quarter of 2002 was virtually unchanged from the preceding quarter.
- ❑ Residential real estate continues to be a strong part of the D.C. economy. Although the volume of sales has leveled off, prices continue to rise. There is considerable demand for moderately priced housing for families with children but little in the way of additional supply of such housing, and it appears most households seeking such housing are attracted to the suburbs. The lack of housing choices in the city is turning D.C. job-holders into commuters.

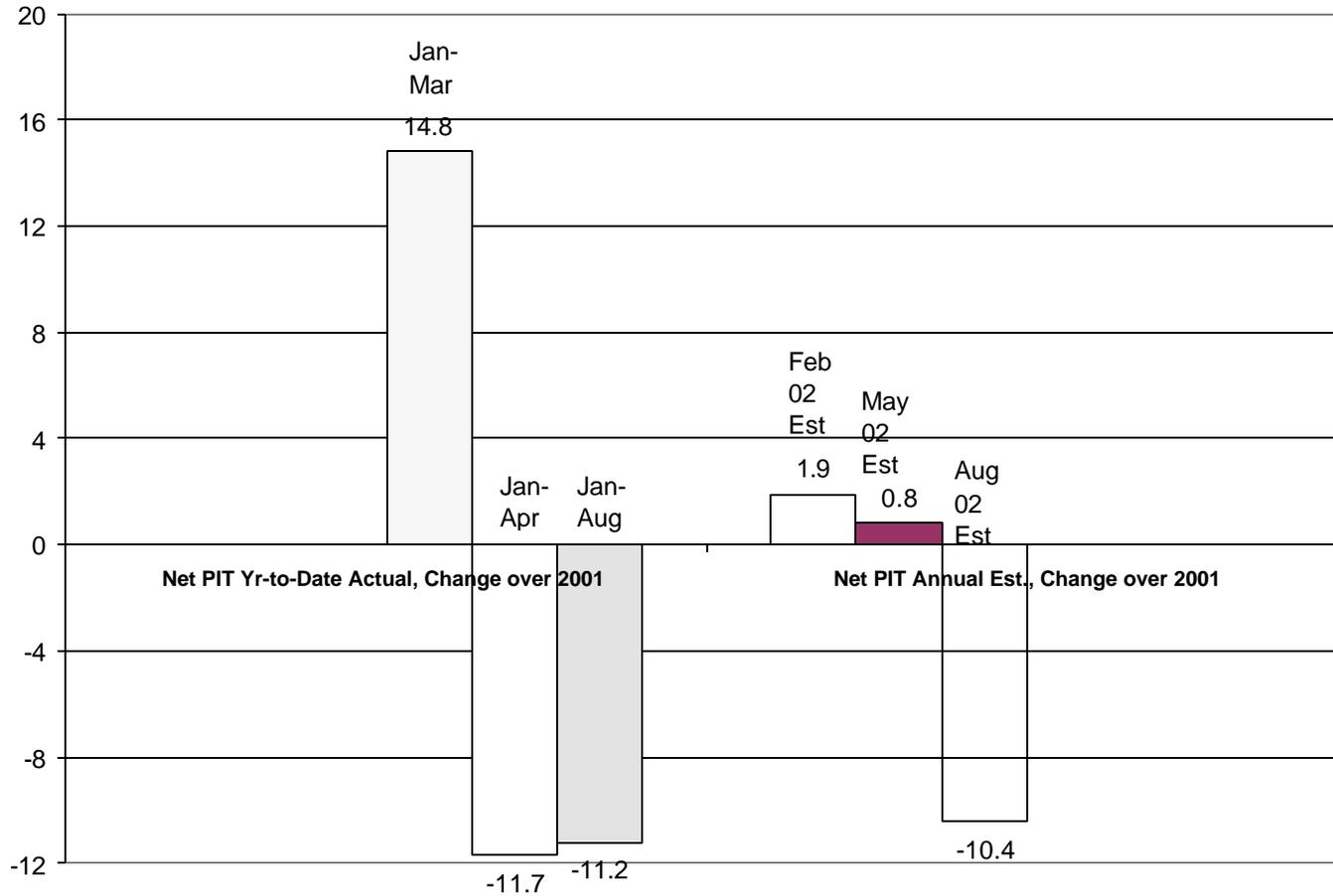
- ❑ Sales in retail such as grocery stores and drug stores have shown some modest growth, but largely in basic items. Downtown retail is reported to be holding on or somewhat better, with little in the way of pull-backs, subleasing, or vacancies.
- ❑ Universities are experiencing an increase in enrollments, as is typical in a period of economic slowdown. Graduates are, however, having a more difficult time finding employment.
- ❑ Although not hit terribly hard by a slower economy, law firms are becoming more cost conscious and are hiring fewer new attorneys, due in part to slower turnover. This will not be a year of big bonuses for most firms. Some firms with extra space in the suburbs may use some of that instead of leasing more in the District.
- ❑ In contrast to past recessions, banks are in relatively sound financial condition and have plenty of money to lend for sound projects. The problem is demand, not supply of capital.
- ❑ Non-profit organizations and universities are adversely affected by declines in the stock market, which reduces resources for private philanthropy. In addition, cut-backs in local government funding also adversely impact this sector.
- ❑ Temporary employment demand is affected by the decline in employee turnover. Employers are also seeking persons who do not need to be trained, making it harder for those with relatively poor skills to get hired.

#### ATTACHMENTS:

Personal Income Tax Collections  
Key Variables for the D.C. Economy

# Personal Income Tax Collections

CY2002 Collections, January thru March, April & August, 2002 as % of same period 2001  
 FY2002 Estimates of February, May, & August 2002 as % of actual total FY2001



- FY02 Est (Feb 02) compared to FY01 Actual
- FY02 Est (May 02) compared to FY01 Actual
- FY02 Est (Aug02) compared to FY01 Actual
- DC: Actual, Jan thru March
- DC: Actual, Jan thru April
- DC: Actual, Jan thru Aug

### Estimated Key Variables for the D.C. Economy for the Forecast Period FY 1997 through FY 2006: (Preliminary)

Fiscal Years	1997 act	1998 act	1999 act	2000 act	2001 est	2002 est	2003 est	2004 est	2005 est	2006 est
Gross State Product (\$ billion)	49.92 2.8%	51.70 3.6%	54.39 5.2%	58.42 7.4%	61.17 4.7%	63.11 3.2%	65.55 3.9%	68.28 4.2%	71.56 4.8%	75.35 5.3%
Real Gross State Product (billions of \$96)	49.18 0.6%	50.23 2.1%	52.17 3.9%	54.93 5.3%	56.05 2.1%	56.95 1.6%	58.23 2.3%	59.53 2.2%	61.11 2.6%	62.89 2.9%
Personal Income (\$ billion)	19.00 3.4%	19.94 4.9%	20.55 3.0%	21.74 5.8%	23.01 5.9%	23.73 3.1%	24.53 3.4%	25.51 4.0%	26.73 4.8%	28.07 5.0%
Real Personal Income (billions of \$96)	18.71 1.2%	19.41 3.7%	19.72 1.6%	20.35 3.2%	21.11 3.7%	21.47 1.7%	21.79 1.5%	22.12 1.5%	22.61 2.2%	23.19 2.6%
Per Capita Income	33,446 4.2%	35,260 5.4%	36,095 2.4%	38,076 5.5%	40,251 5.7%	41,460 3.0%	42,739 3.1%	44,261 3.6%	46,187 4.3%	48,316 4.6%
Real Per Capita Income (\$96)	32,935 2.0%	34,315 4.2%	34,642 1.0%	35,640 2.9%	36,915 3.6%	37,509 1.6%	37,959 1.2%	38,387 1.1%	39,076 1.8%	39,921 2.2%
Earnings of D.C. Residents (\$ billion)	12.76 2.3%	13.15 3.1%	13.70 4.2%	14.61 6.6%	15.53 6.2%	16.07 3.5%	16.61 3.4%	17.29 4.1%	18.14 4.9%	19.07 5.1%
Population ('000)	568.2 -0.8%	565.6 -0.5%	569.3 0.7%	571.0 0.3%	571.8 0.1%	572.5 0.1%	574.0 0.3%	576.3 0.4%	578.6 0.4%	580.9 0.4%
Households ('000)	241.9 -0.5%	241.5 -0.2%	246.5 2.1%	248.4 0.8%	248.7 0.1%	250.0 0.5%	251.4 0.6%	252.6 0.4%	253.6 0.4%	254.6 0.4%
Civilian Labor Force ('000)	259.8 -5.0%	265.2 2.1%	277.8 4.8%	279.4 0.6%	278.8 -0.2%	275.0 -1.4%	275.3 0.1%	277.1 0.6%	278.4 0.5%	279.8 0.5%
At-Place Employment ('000)	619.1 -1.4%	614.6 -0.7%	620.5 1.0%	645.3 4.0%	653.1 1.2%	647.9 -0.8%	653.4 0.9%	658.9 0.8%	666.9 1.2%	675.6 1.3%
Resident Employment ('000)	239.6 -4.0%	241.3 0.7%	258.8 7.2%	263.6 1.9%	261.0 -1.0%	256.9 -1.6%	257.6 0.3%	260.4 1.1%	262.0 0.6%	263.7 0.6%
Unemployment Rate	7.8	9.0	6.9	5.7	6.0	6.6	6.3	5.8	5.8	5.6
Housing Starts	0	185	644	1,373	1,572	2,478	2,780	2,491	2,395	2,395
Housing Stock ('000)	273.1 -0.1%	273.2 0.1%	273.6 0.1%	274.6 0.3%	275.5 0.3%	276.3 0.3%	277.6 0.5%	278.5 0.3%	279.5 0.3%	280.3 0.3%
Change in S & P 500 Index of Common Stock	27.9%	27.5%	21.3%	13.1%	-12.2%	-15.9%	-3.5%	11.0%	11.5%	9.5%
Interest rate on 10-year Treasury notes	6.5	5.6	5.3	6.2	5.2	4.8	5.3	6.4	6.8	6.5
Washington Area Consumer Prices: % change from prior year	2.5	1.0	1.9	3.1	2.7	1.6	2.4	2.4	2.5	2.5

*Note: Estimated by the D.C. Office of Research and Analysis based on forecasts of the D.C. and national economies prepared in June 2002 by DRI-WEFA and Economy.com; on forecasts of the national economy prepared by the Congressional Budget Office (August 2002) and Blue Chip Economic Indicators (September 2002); on BLS labor market information from July 2002; on the 2000 Census and Census Bureau estimates of the 2001 D.C. population (April 2002); on Bureau of Economic Analysis estimate of D.C. Personal Income (July 2002); and on D.C. Office of Planning information on housing construction activity (March 2002).*