

W E S T V I R G I N I A



DEPARTMENT OF REVENUE

FISCAL FORECAST **2016**

DEPUTY REVENUE SECRETARY MARK B. MUCHOW

West Virginia State Capitol

January 15, 2015

U.S. Economy: IHS Economics Forecast

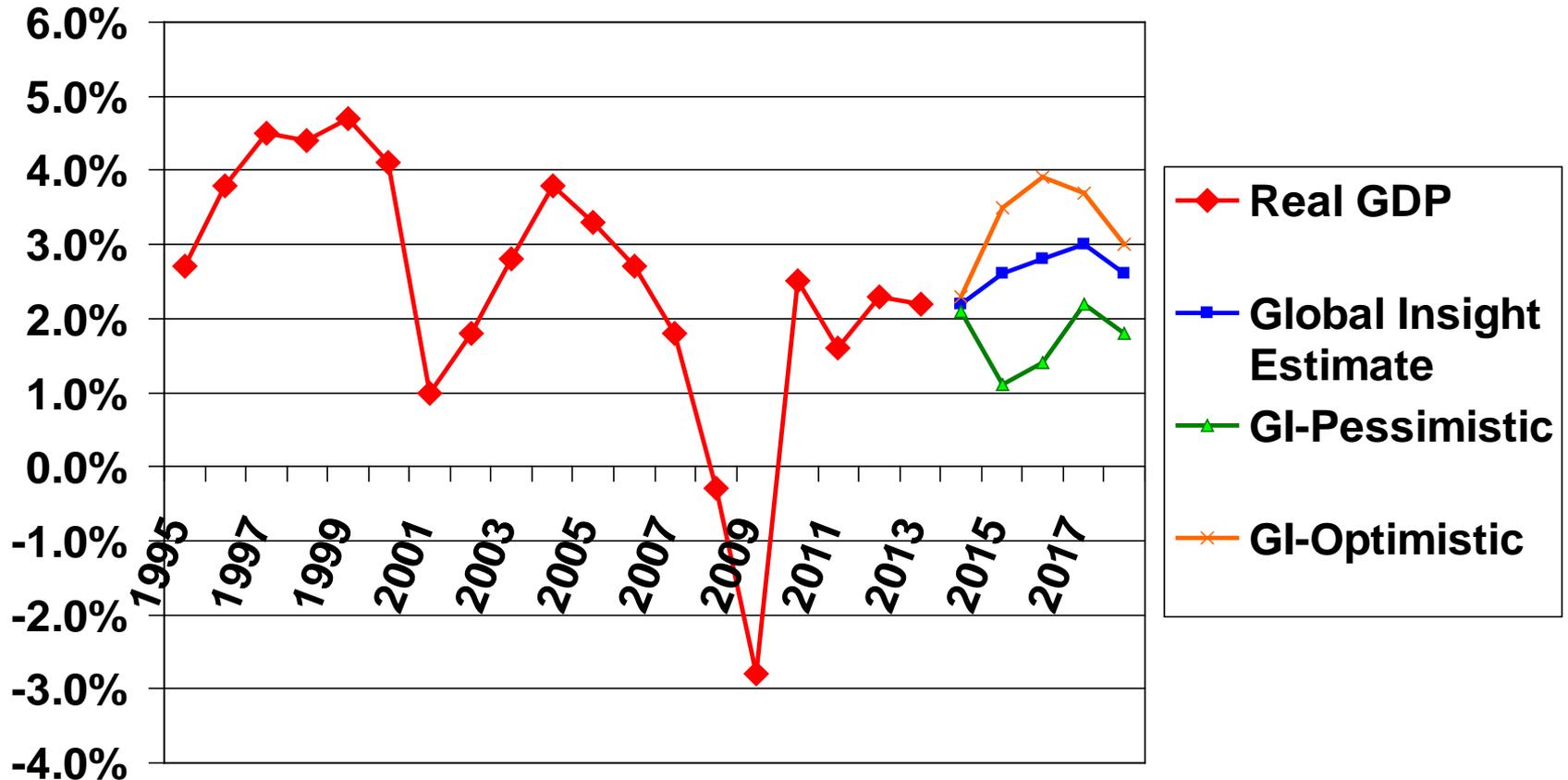
Baseline: November 2014

| <u>Economic Variable</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|----------------------------|-------------|-------------|-------------|
| Real GDP | 2.2% | 2.6% | 2.8% |
| CPI | 1.7% | 1.0% | 1.6% |
| Consumption | 2.3% | 2.8% | 3.0% |
| Industrial Production | 4.0% | 2.6% | 4.0% |
| Payroll Employment | 1.8% | 1.9% | 1.5% |
| Personal Income | 4.2% | 4.3% | 5.0% |
| Real Disposable Income | 2.7% | 2.7% | 3.3% |
| Domestic Corporate Profits | -2.2% | 9.7% | 3.4% |
| 10 Year Treasury Note | 2.57% | 3.13% | 3.64% |

Real Gross Domestic Product Growth in U.S.

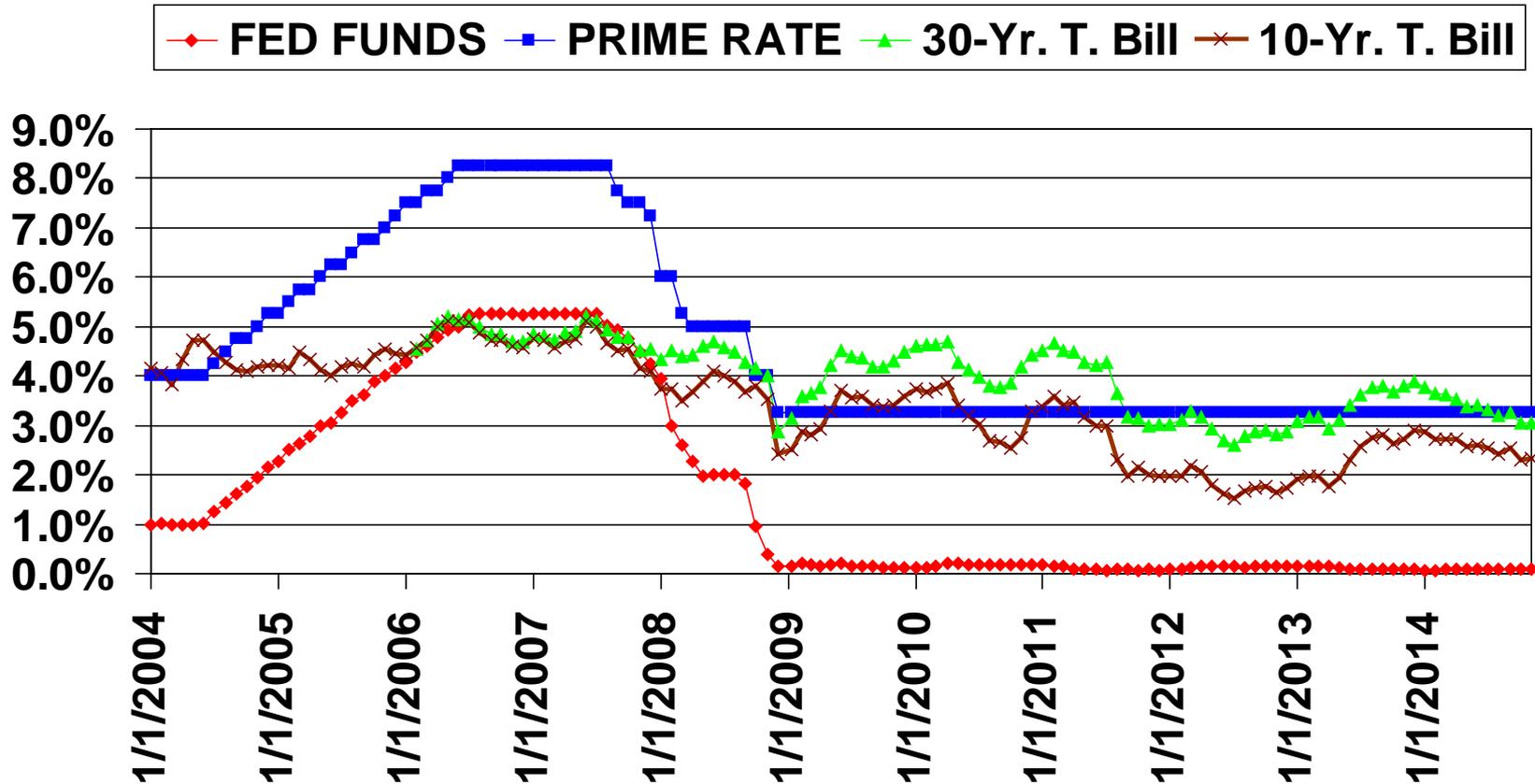
Recovery in 2011-2018

November 2014 Forecast – IHS Economics



Short-Term Rates: FED Easing Almost Over

Long-Term Rates Are Low – Forecast: Rates at Bottom until Mid 2015



Federal Fiscal Belt Tightening To Soften

Source: CBO *Monthly Budget Review*, October-November 2014

Revenues Through November

| <u>Source</u> | <u>\$ Billions</u> <u>Revenue</u> | <u>Percent</u> <u>Change</u> |
|------------------|--------------------------------------|---------------------------------|
| Ind. Income \$ | 192 | 5.6 |
| Corp. Income | 13 | 91.6 |
| Social Insurance | 154 | 3.4 |
| Other | <u>44</u> | <u>0.6</u> |
| Total | <u>403</u> | <u>5.8</u> |

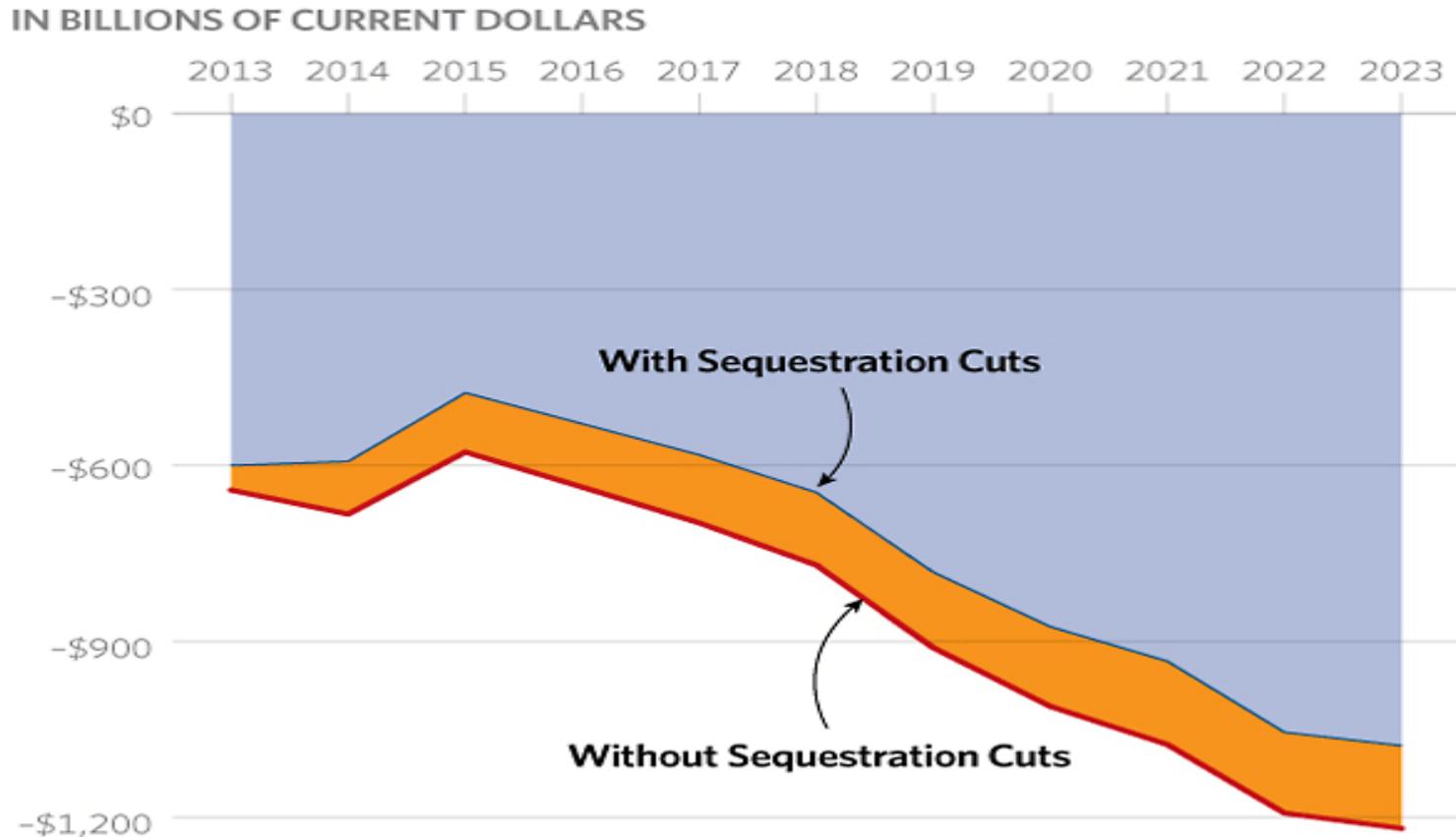
Year-End Federal Budget Deficits

| | |
|---------------------|-------------------|
| FY2007: | \$ 160.7 Billion |
| FY2008: | \$ 458.6 Billion |
| FY2009: | \$1,412.7 Billion |
| FY2010: | \$1,294.4 Billion |
| FY2011: | \$1,299.6 Billion |
| FY2012: | \$1,087.0 Billion |
| FY2013: | \$ 679.5 Billion |
| FY2014 Preliminary: | \$ 483.4 Billion |
| FY2015 Estimate: | \$ 525.2 Billion |

Outlays Through November

| <u>Category</u> | <u>\$ Billions</u> <u>Outlays</u> | <u>Percent</u> <u>Change</u> |
|--------------------|--------------------------------------|---------------------------------|
| Defense \$ | 98 | - 2.0 |
| SS Benefits | 142 | + 4.4 |
| Medicare | 89 | + 16.7 |
| Medicaid | 53 | + 17.2 |
| Exchange Subsidies | 4 | n.m. |
| Other | <u>157</u> | - <u>8.0</u> |
| Subtotal | <u>543</u> | + <u>2.6</u> |
| Debt Interest | 41 | - 2.7 |
| Total | <u>584</u> | + <u>2.3</u> |

Sequestration Reduces the Deficit by Only 13%



Source: Congressional Budget Office, *Updated Budget Projections: Fiscal Years 2013 to 2023, Alternative Fiscal Scenario*, May 2013, <http://www.cbo.gov/publication/44172> (accessed May 15, 2013).

Federal Spending by the Numbers 2013  heritage.org

Economic Diversification

Why is Mining Sector Important to West Virginia?

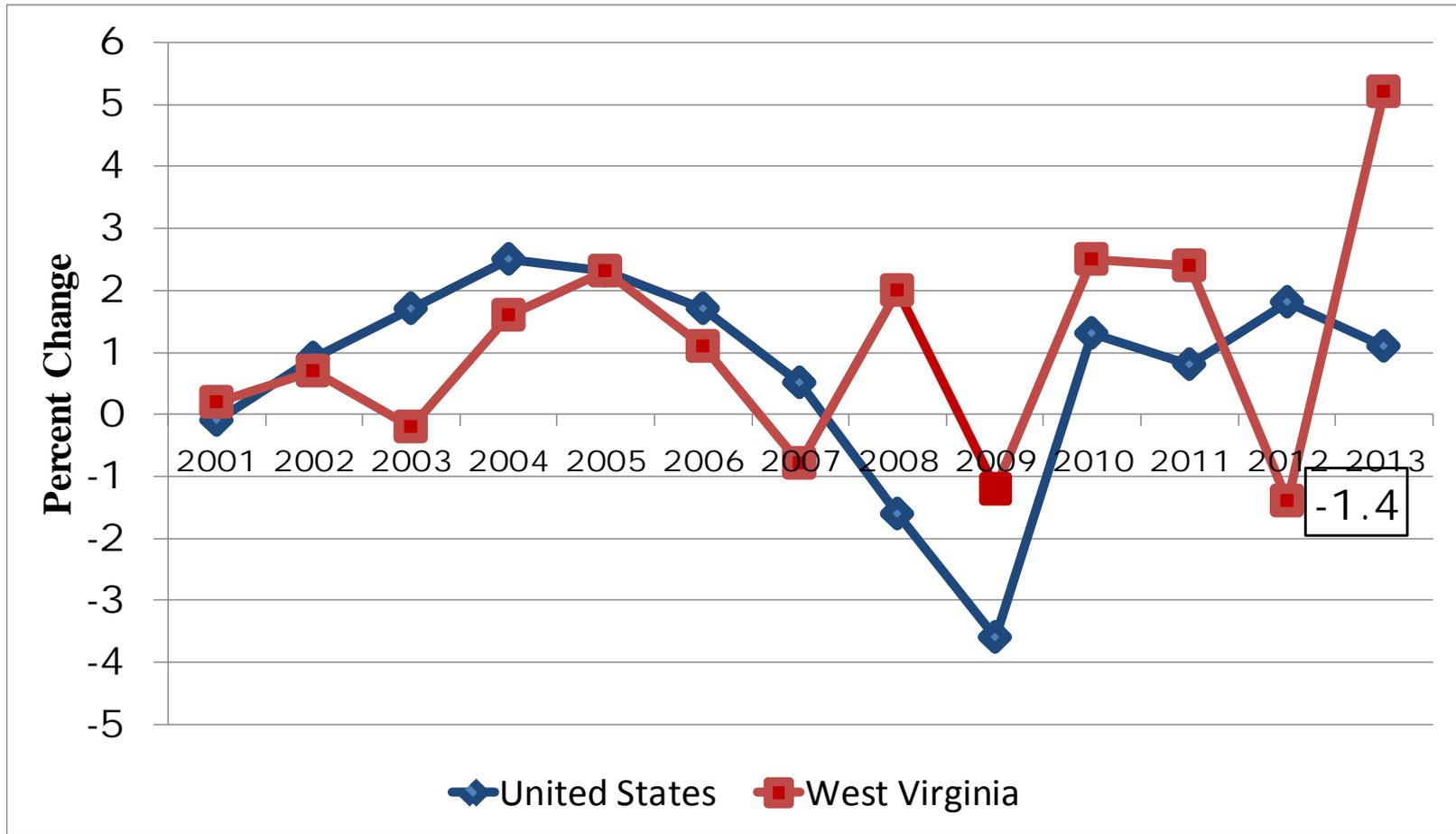
- **Major Growth in WV Population: 1900 – 1950 (109%)**
 - Mining industries shape migration patterns in WV
 - Significant population migration to rural areas in WV
 - Significant population to urban areas in U.S.
- **Fastest Growth Counties 1900-2010?**
 - Raleigh: 6.34 times population of 1900
 - Berkeley: 5.35 times population of 1900
 - Logan: 5.28 times population of 1900
- **Stranded Labor Problem (WV is third most rural at 51%)**
 - Migration is major part of the long-term solution
 - Education enhancement part of solution

Economic Data Revision: Impact on Forecasts

- Significant dynamic changes in structure of West Virginia Economy – Harder to measure
- Accurate historic data key to any forecast model
- Significant revisions to key variables result in a shifts in baseline numbers often after release of forecasts

Annual Per Capita Real GDP Growth:

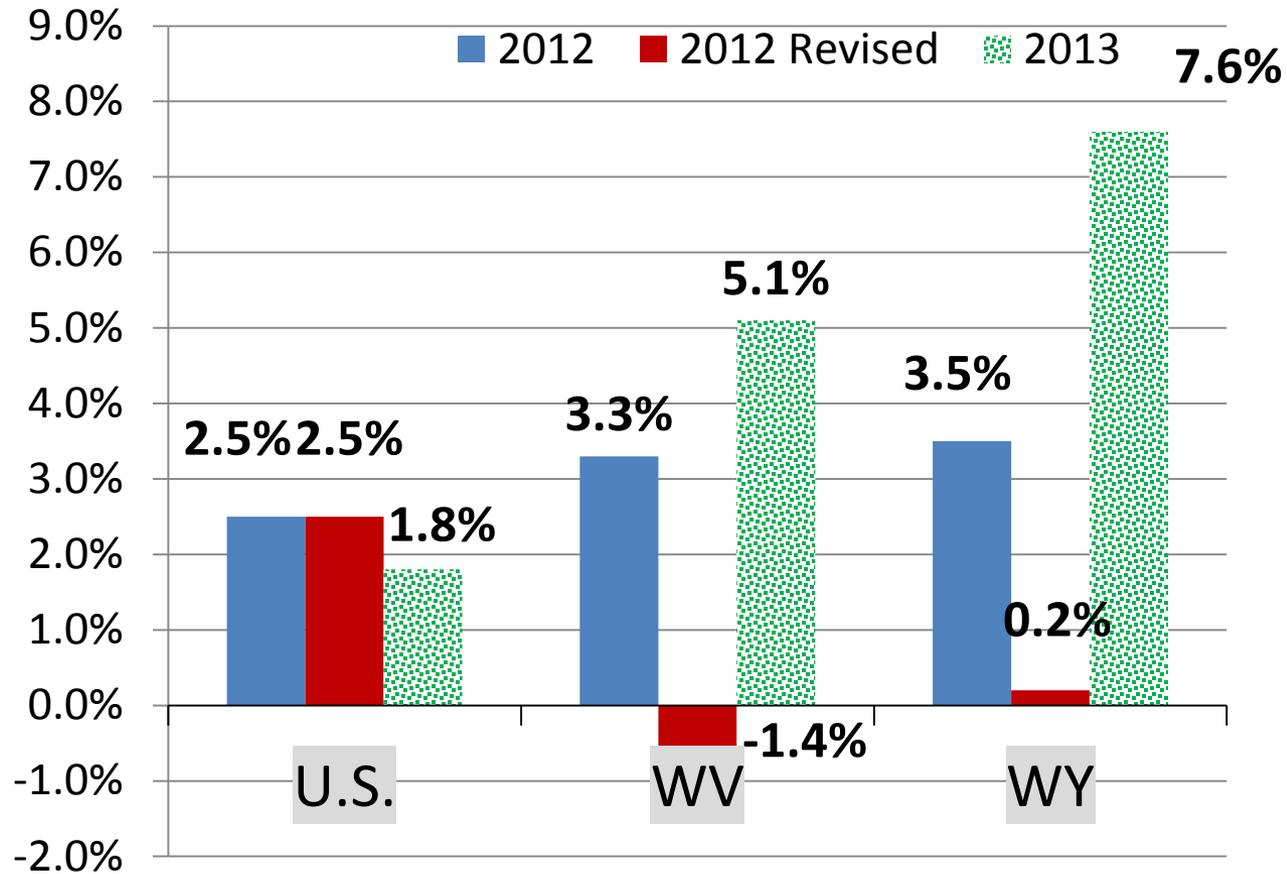
Higher in West Virginia Between 2008 & 2011; However....



Source: U.S. Department of Commerce, Bureau of Economic Analysis

Revisions to Real GDP Growth in 2012

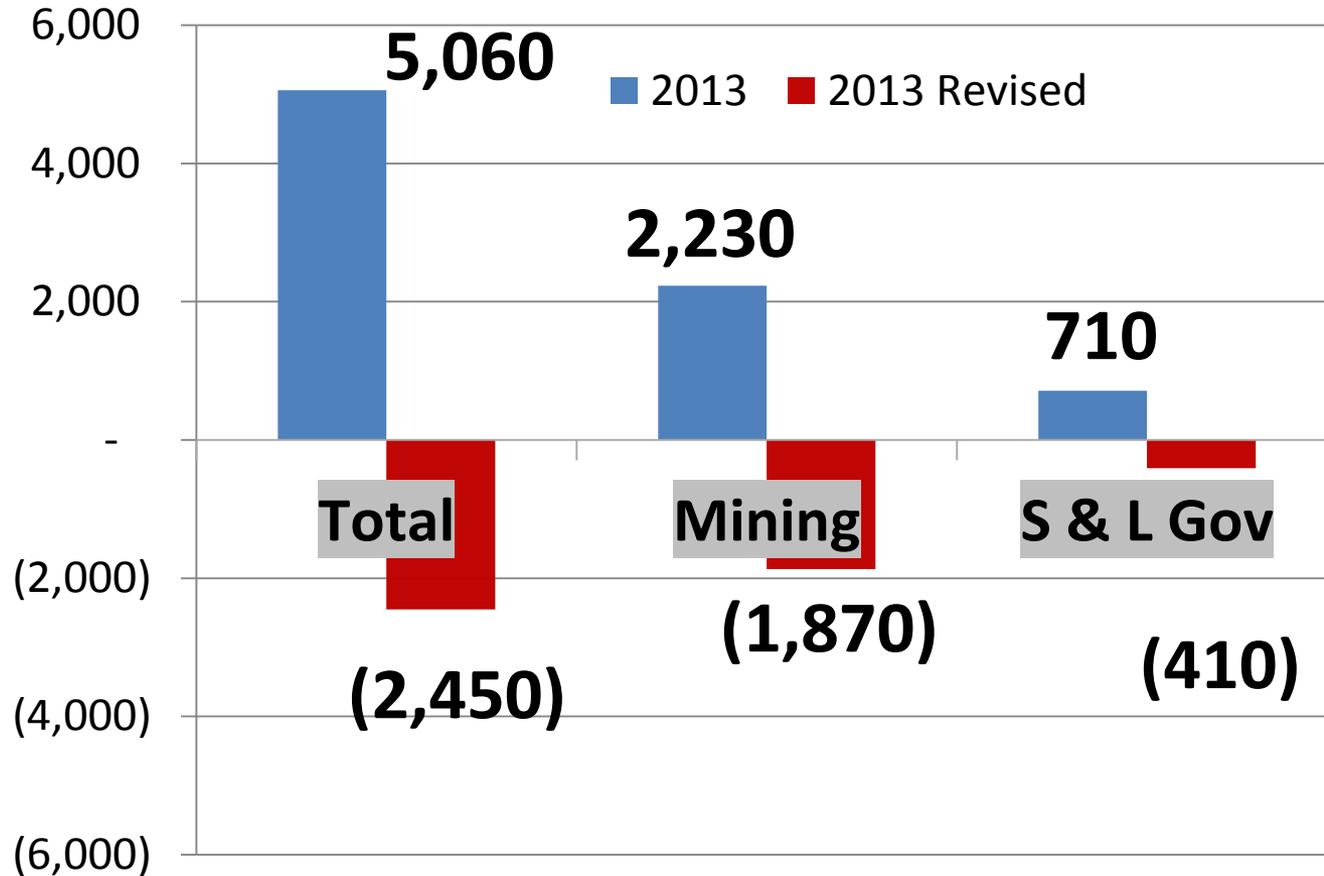
Major Downward Revision in Coal Producing States
Do We Expect a Repeat in 2013 and 2014?



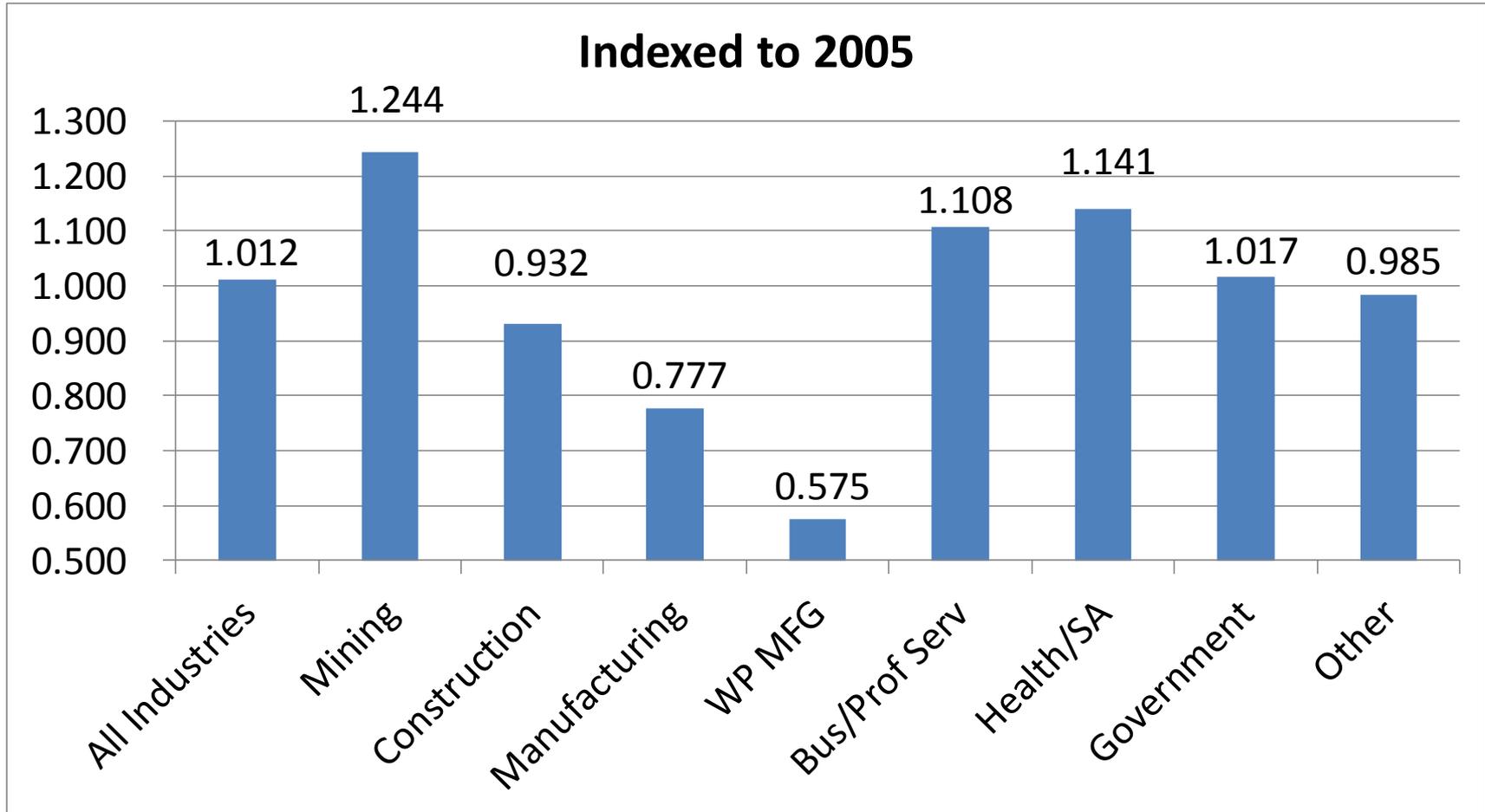
Revisions to WV Employment Data in 2013

Major Downward Revision in Mining Employment

Do We Expect a Repeat in 2014?



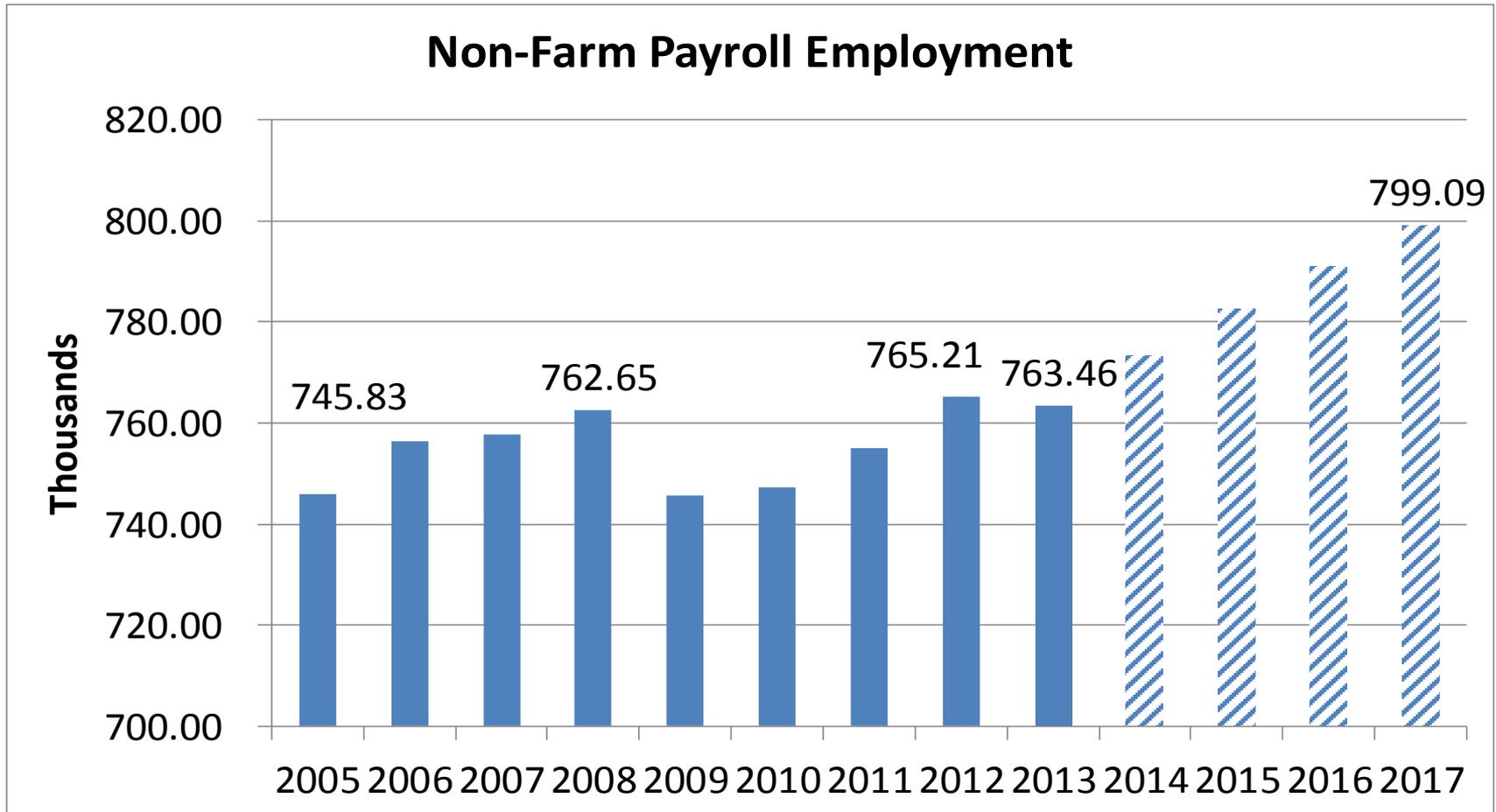
WV Employment Growth 2005-2013: Mining Leads Way



Source: Work Force West Virginia, *Employment & Wages*

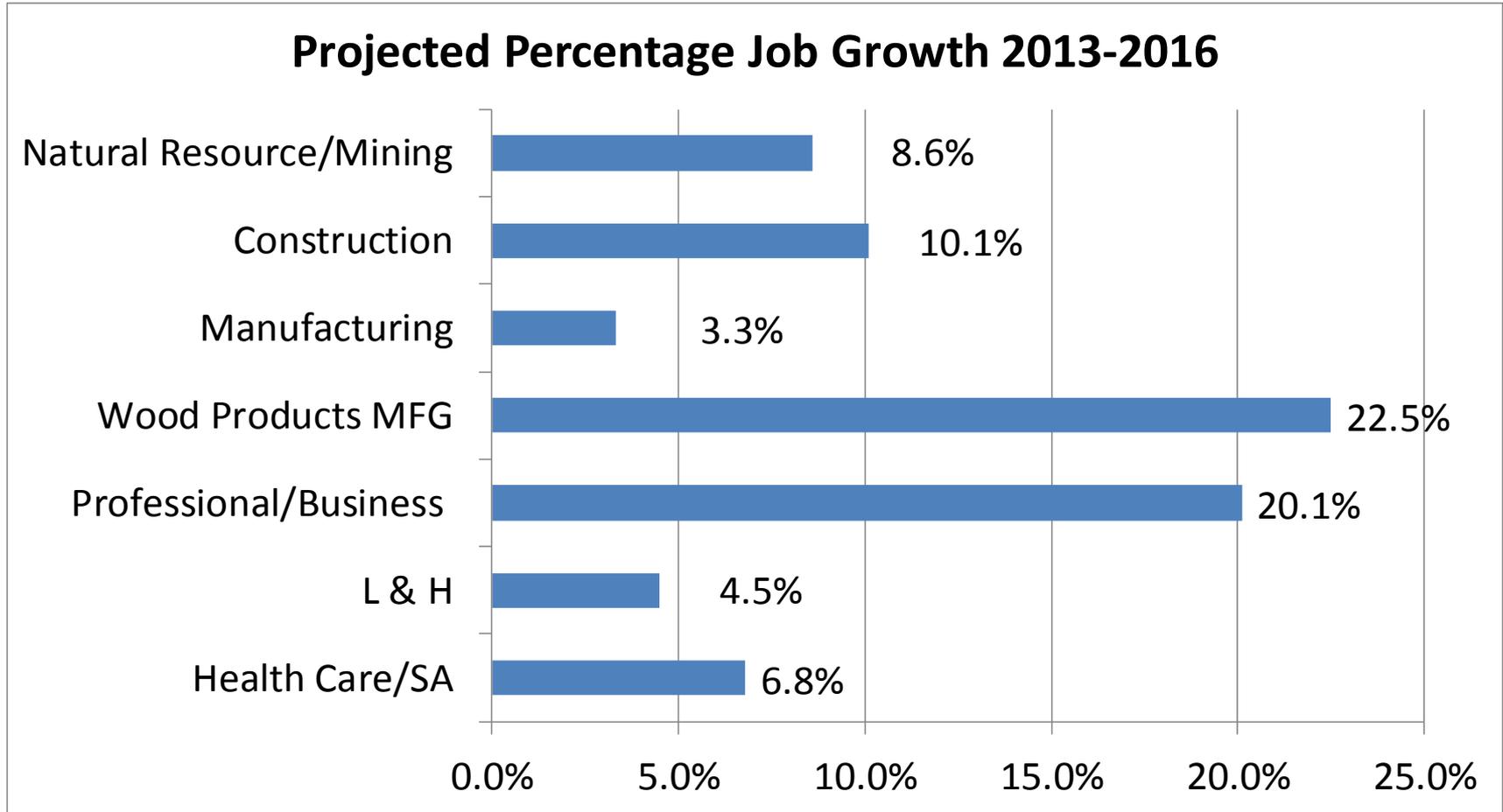
2013-2017: WV Employment Projected to Rise 4.7%

Estimates by IHS Economics U.S. Regional Service November 2014 Long Term



Source of WV Employment Growth 2013-2017: (35,600)

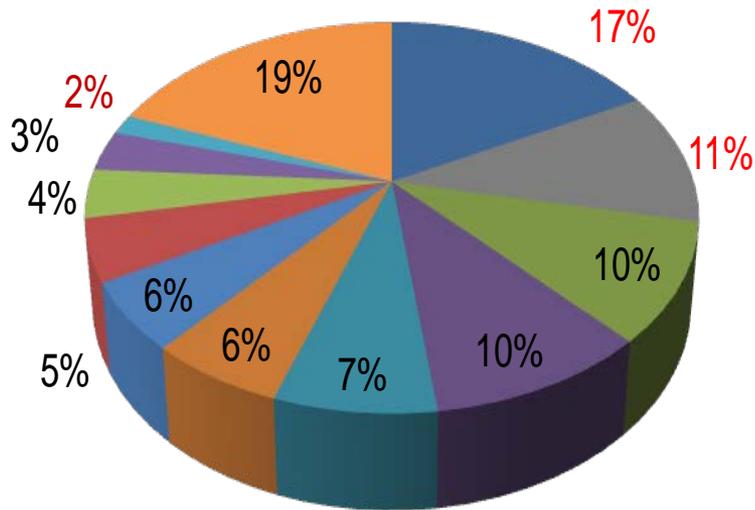
Estimates by IHS Economics, U.S. Regional Service November 2014 Long Term



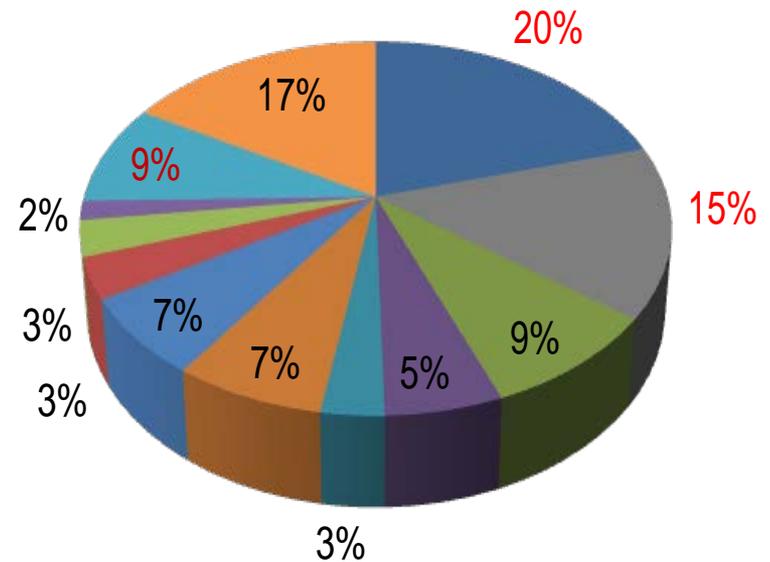
Distribution of Non-Farm Earnings: 2013

Mining, Health Care & Government Play Bigger Role In WV

United States



West Virginia

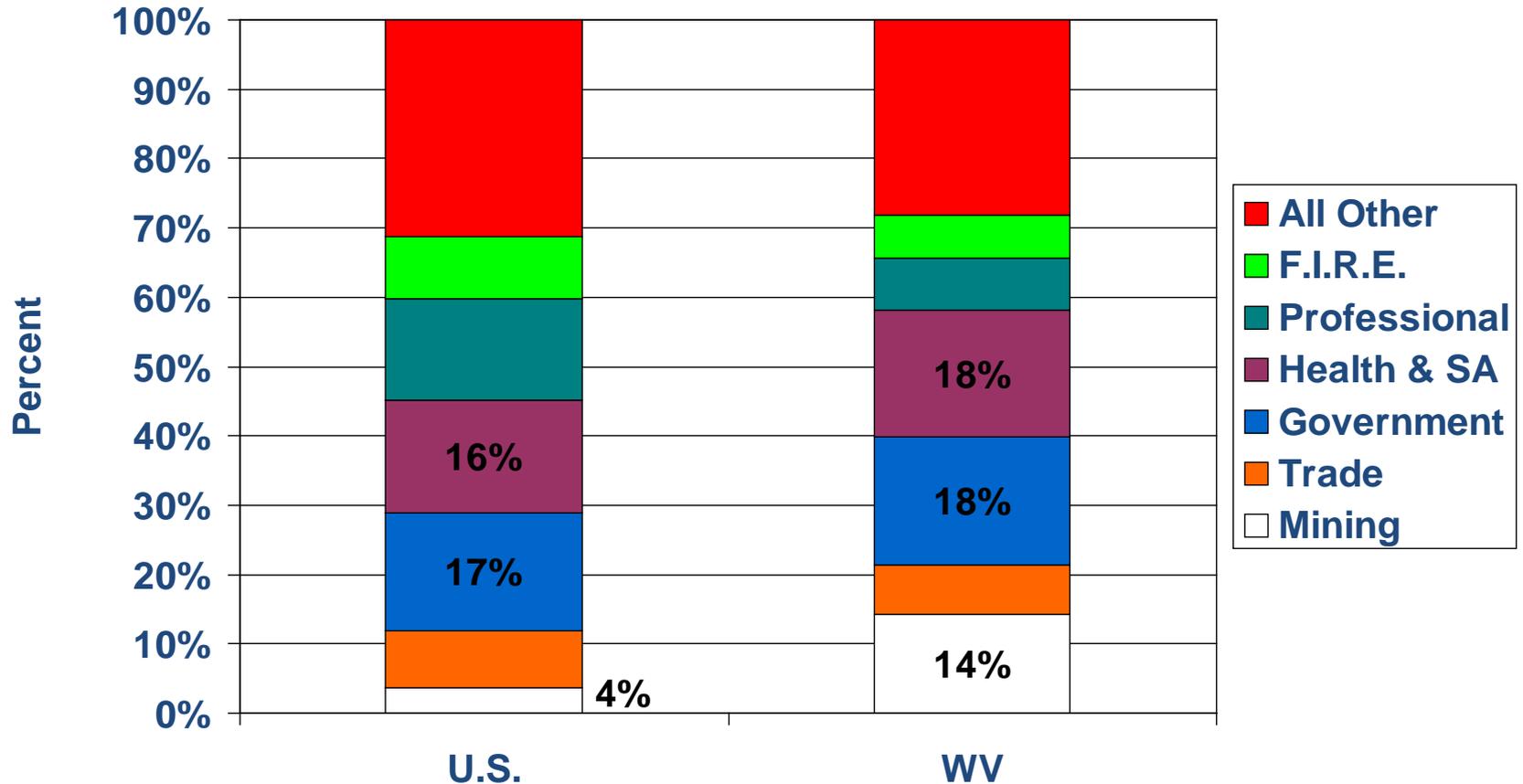


- Government
- Health Care/Social Assistance
- Manufacturing
- Professional/Technical Service
- Finance & Insurance
- Retail Trade
- Construction
- Wholesale Trade
- Administrative & Waste Management
- Information Services
- Mining
- Other

Source: U.S. Department of Commerce, Bureau of Economic Analysis

Contribution to Growth in Non-farm Earnings 2005-2013

Average Annual Growth 3.3% in WV versus 2.9% U.S. [6.1% for WV Mining Sector]

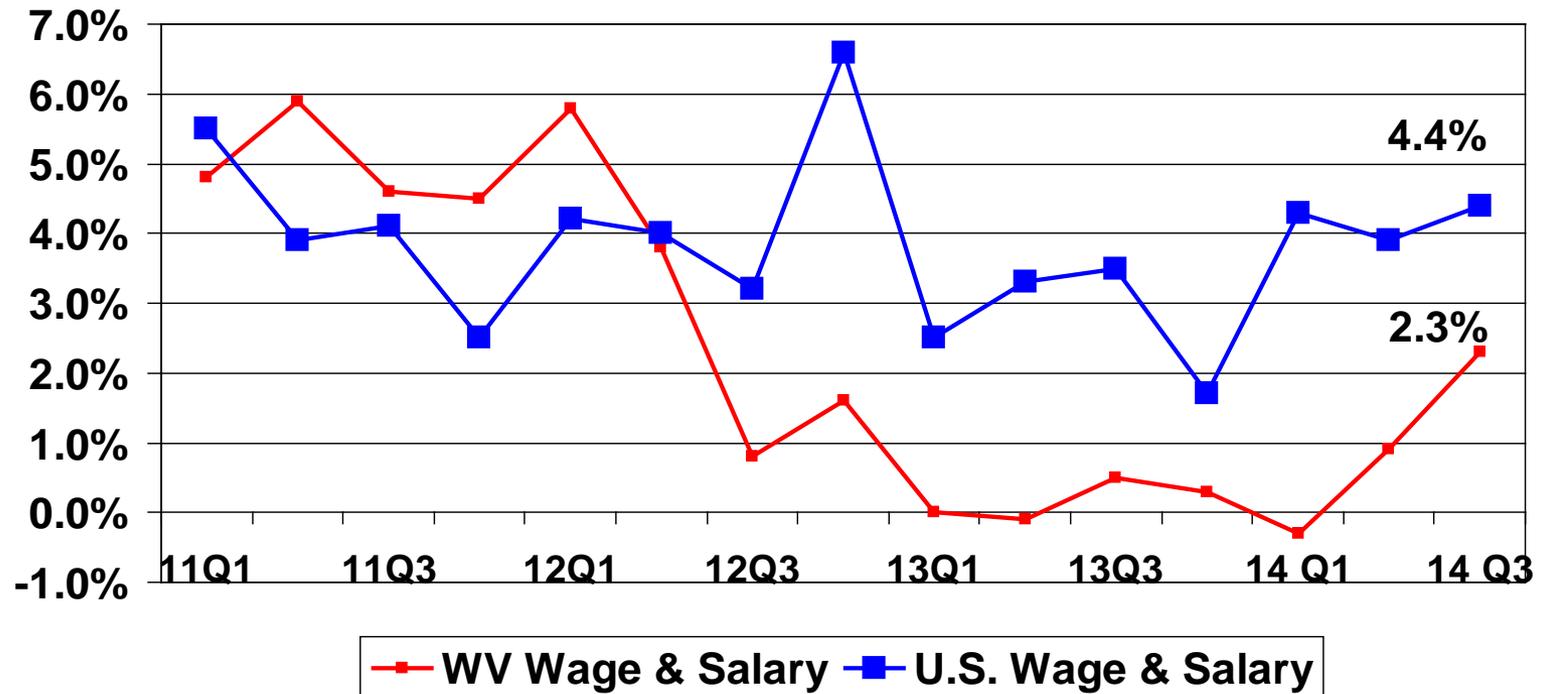


Source: U.S. Bureau of Economic Analysis

Wage Growth Very Sluggish Over Past Two Years

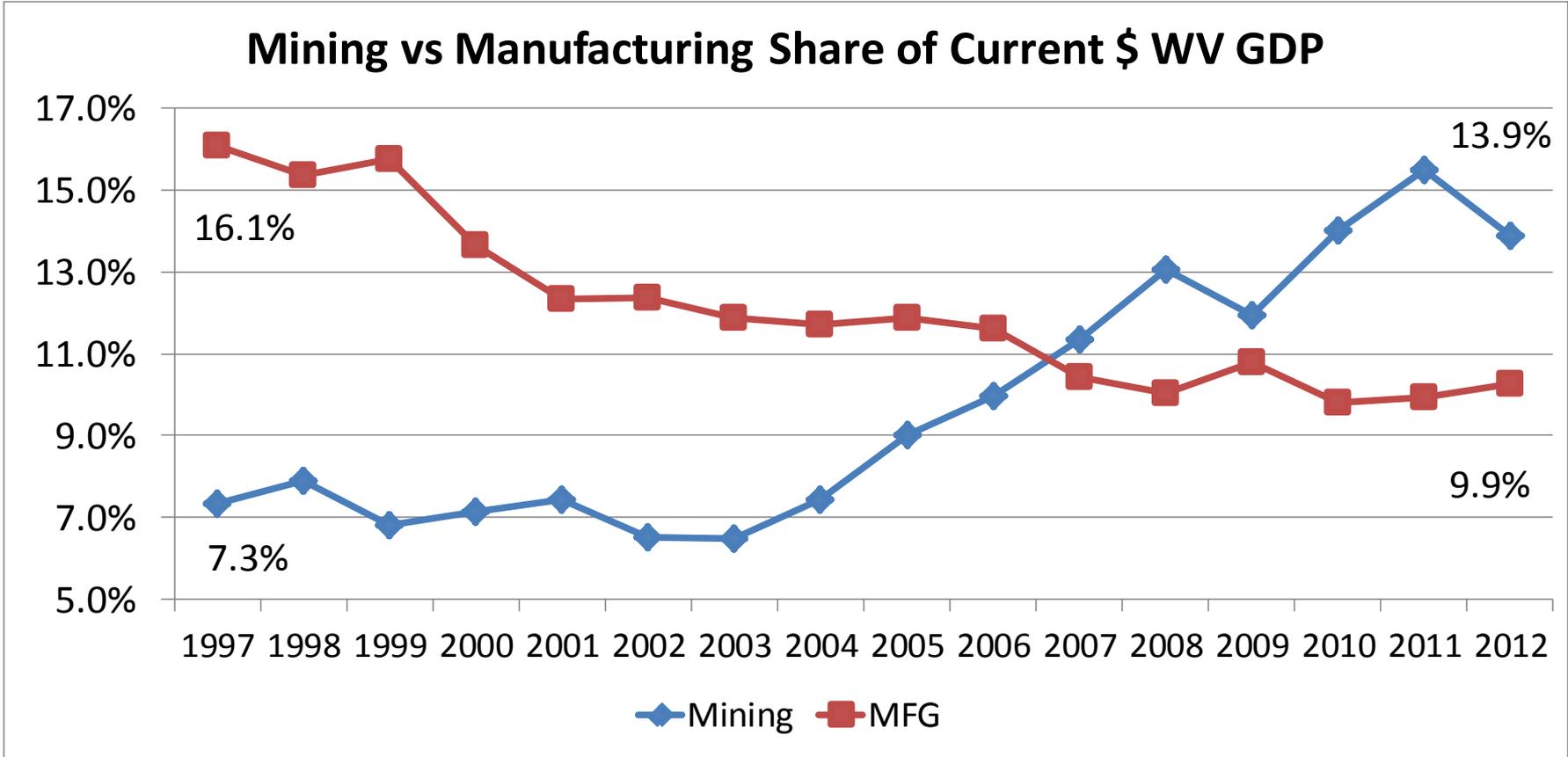
Quarterly Wage & Salary Income Growth Trend -West Virginia

Seasonally Adjusted Annual Rate



Source: U.S. Bureau of Economic Analysis

Mining Industry Share of Economy Grows 1997-2012



Source: U.S. Bureau of Economic Analysis

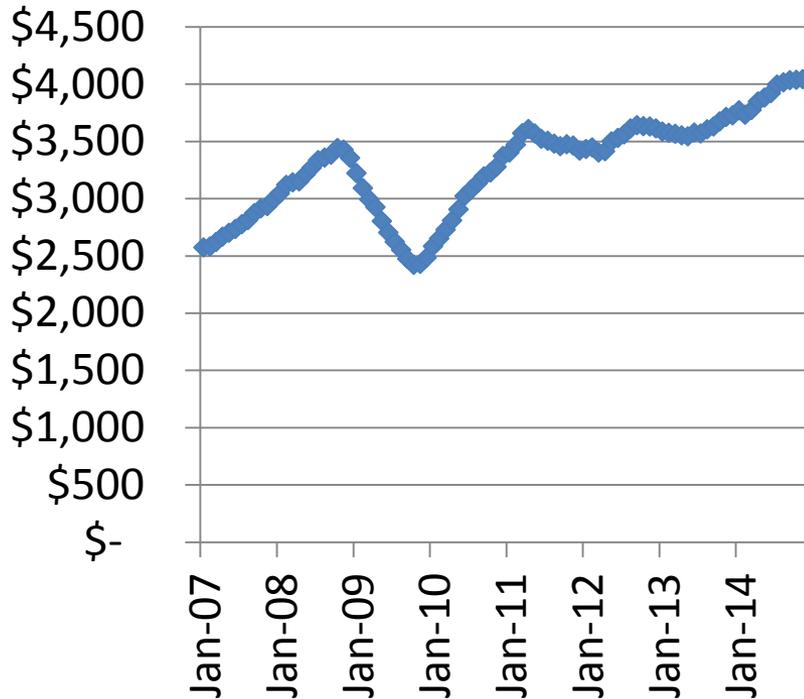
West Virginia Exports Down 33% Since 2012

Trailing 12 Month Trend: November 2014

Manufacturing Exports

Up 12% to \$4.04 Billion

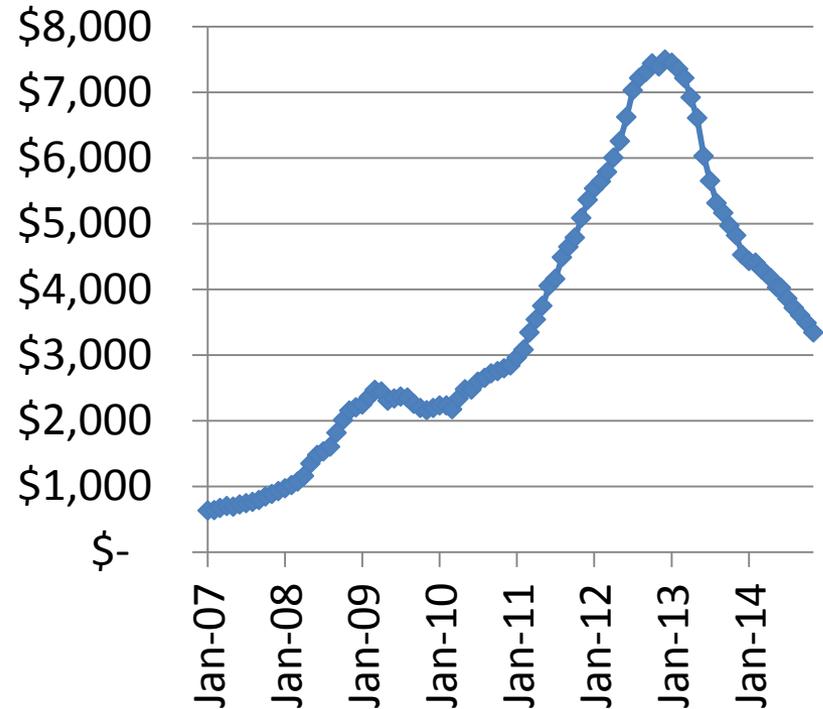
\$ Millions



Non-Manufacturing Exports

Down 55% from \$7.5 Billion to \$3.3 Billion

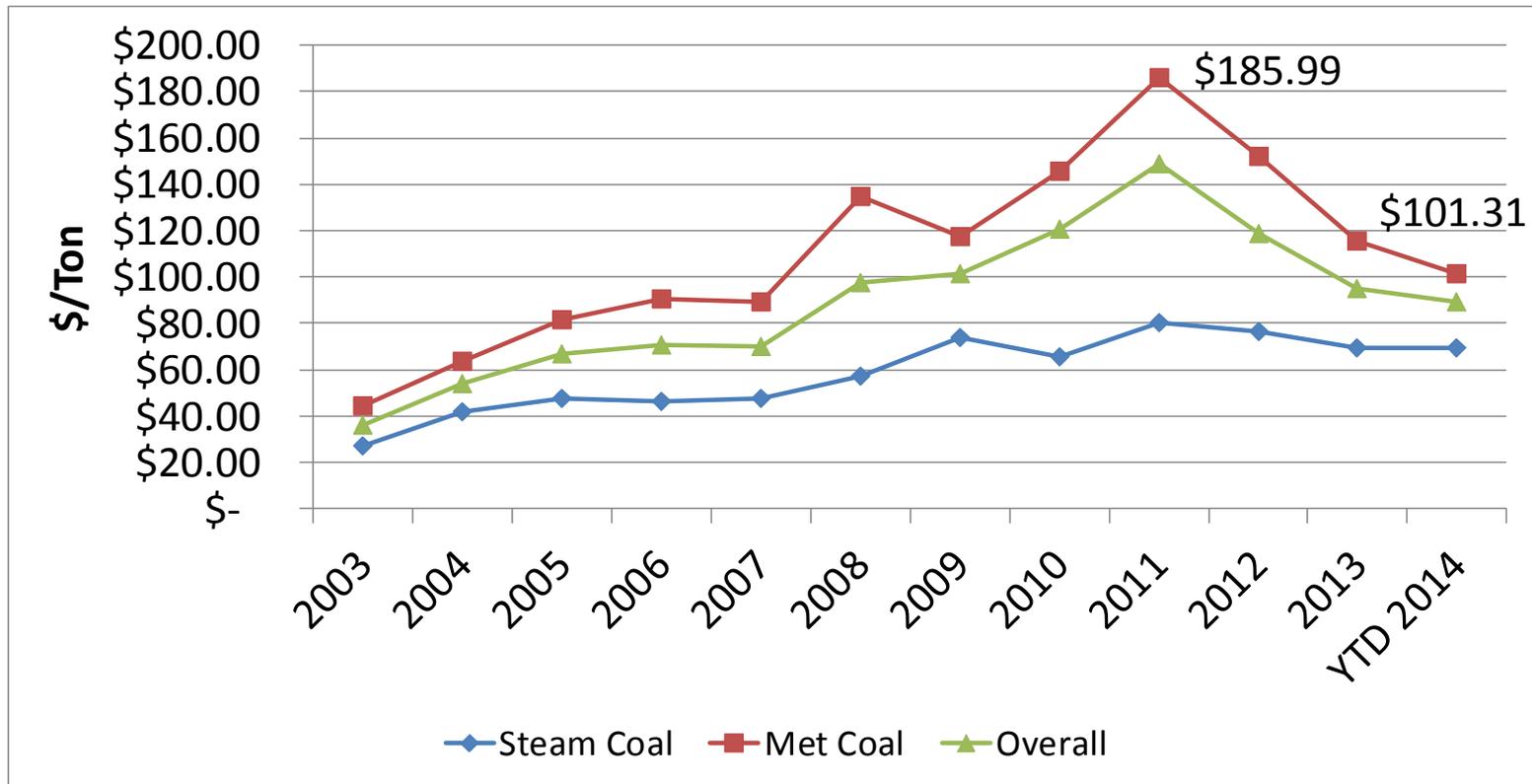
\$ Millions



Source: U.S. Census Bureau

Export Coal Prices Soften in 2012-2015

2014 Prices Reflect Activity Thru June 2014

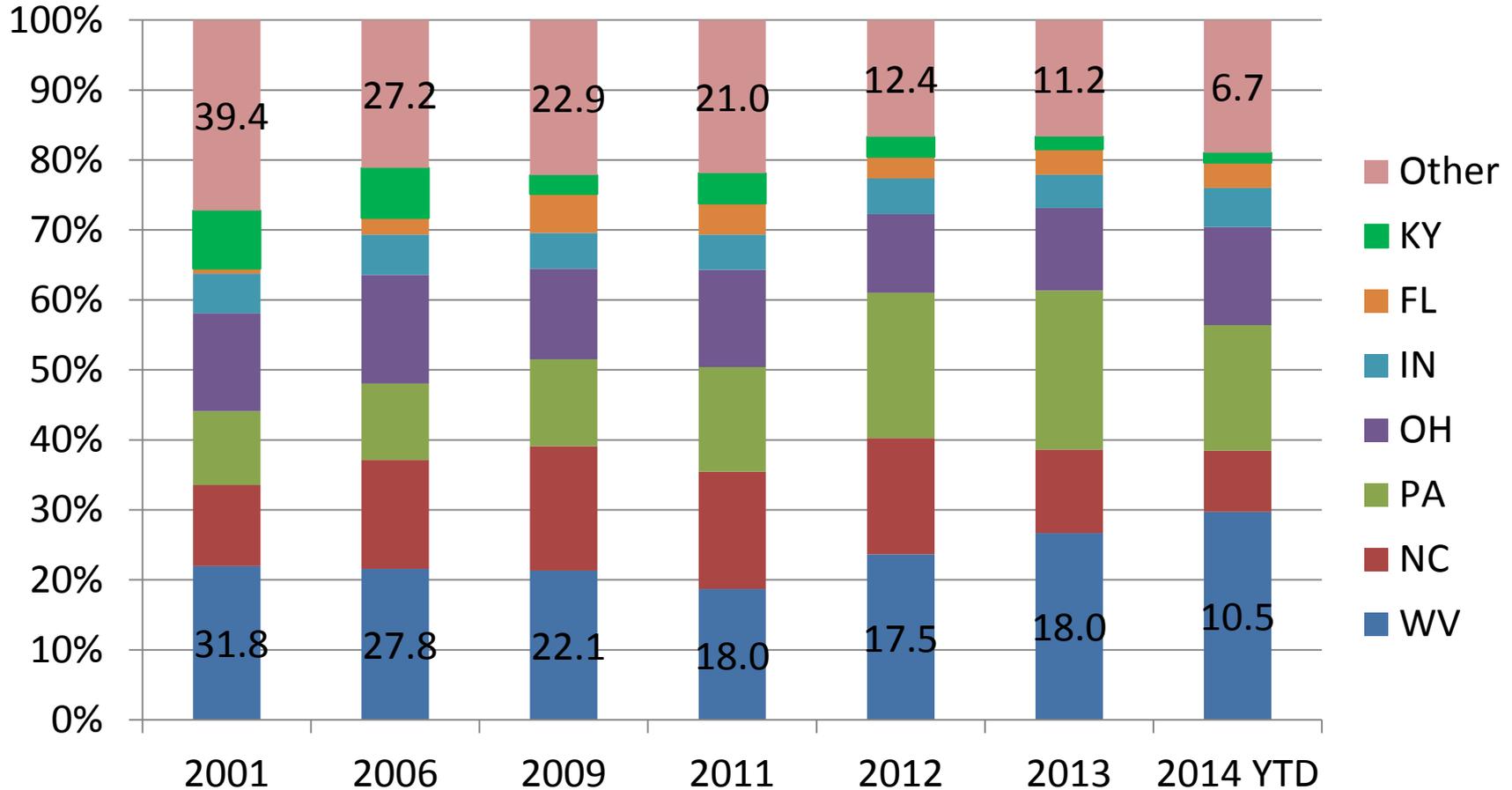


Source: EIA Quarterly Coal Reports

Domestic Distribution of WV Coal

Sales to 34 States and D.C. in 2001; Sales to 24 States and DC in 2014

Domestic Distribution Down 23% in 2012; Down 9% in 2013 and Up 2% YTD in 2014

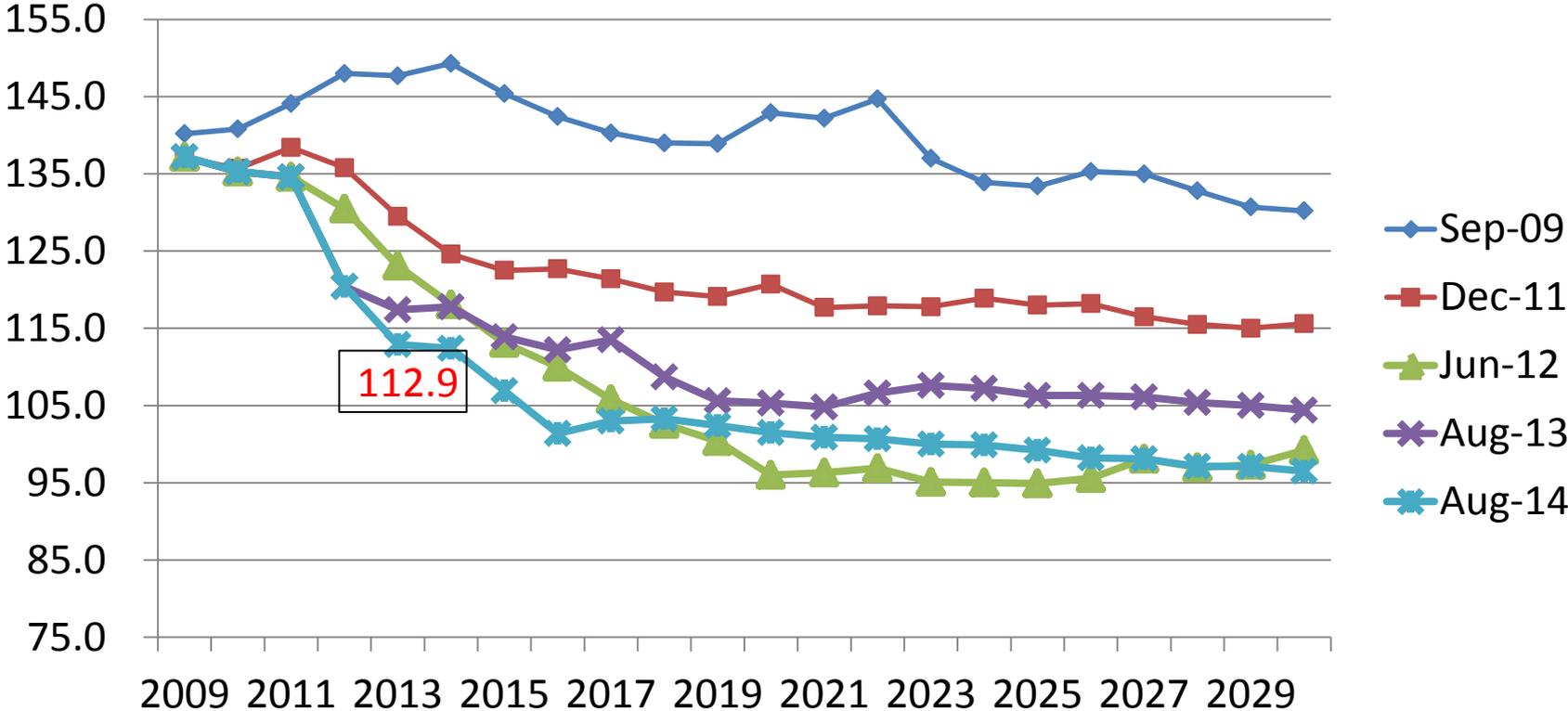


Source: U.S. Energy Information Administration

Consensus Forecast: WV Coal Production

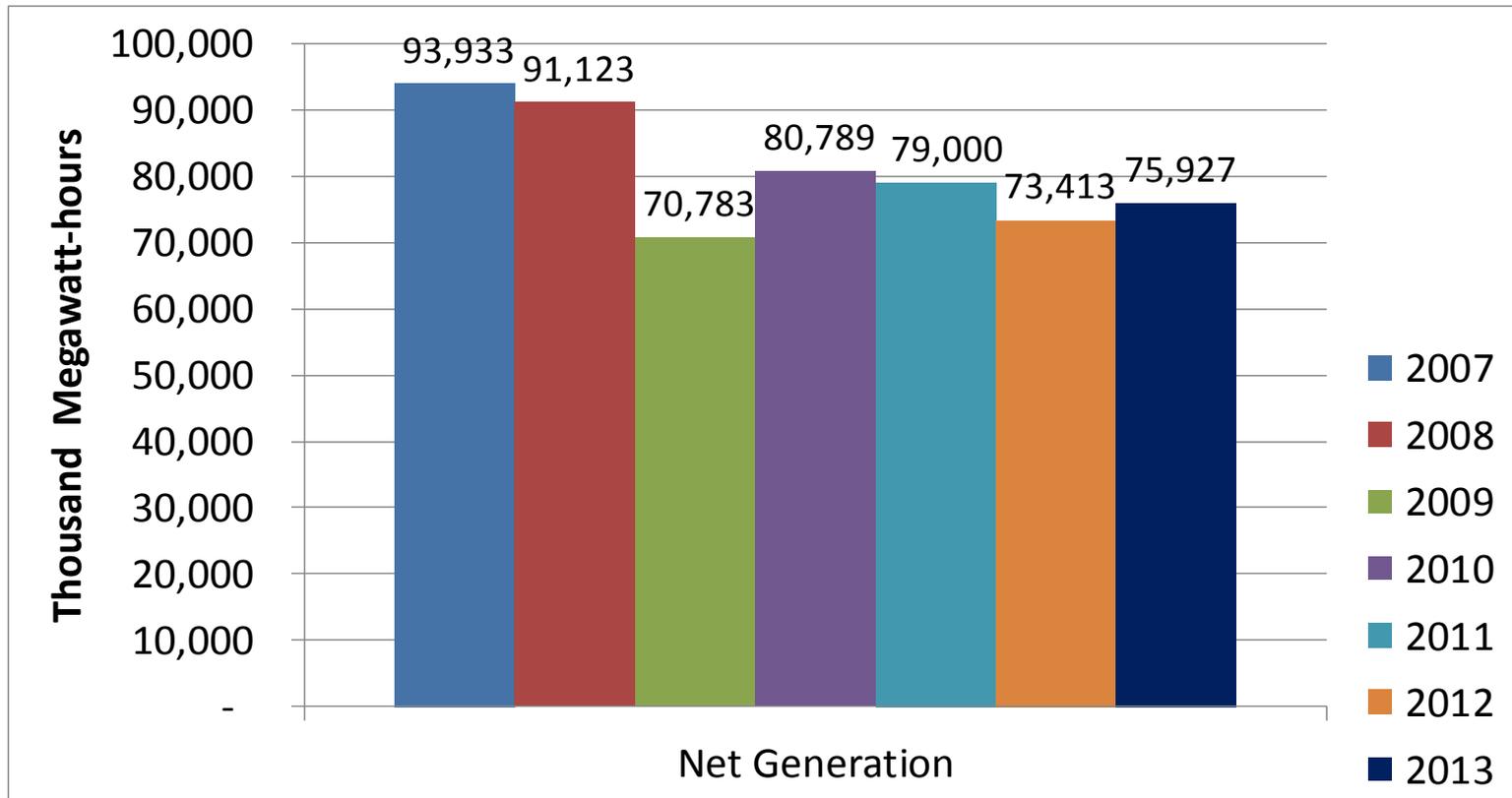
Some Deterioration Over Time-Stability in Long-Run

Millions of Tons



Sources: CBER, Marshall University and BBER, West Virginia University

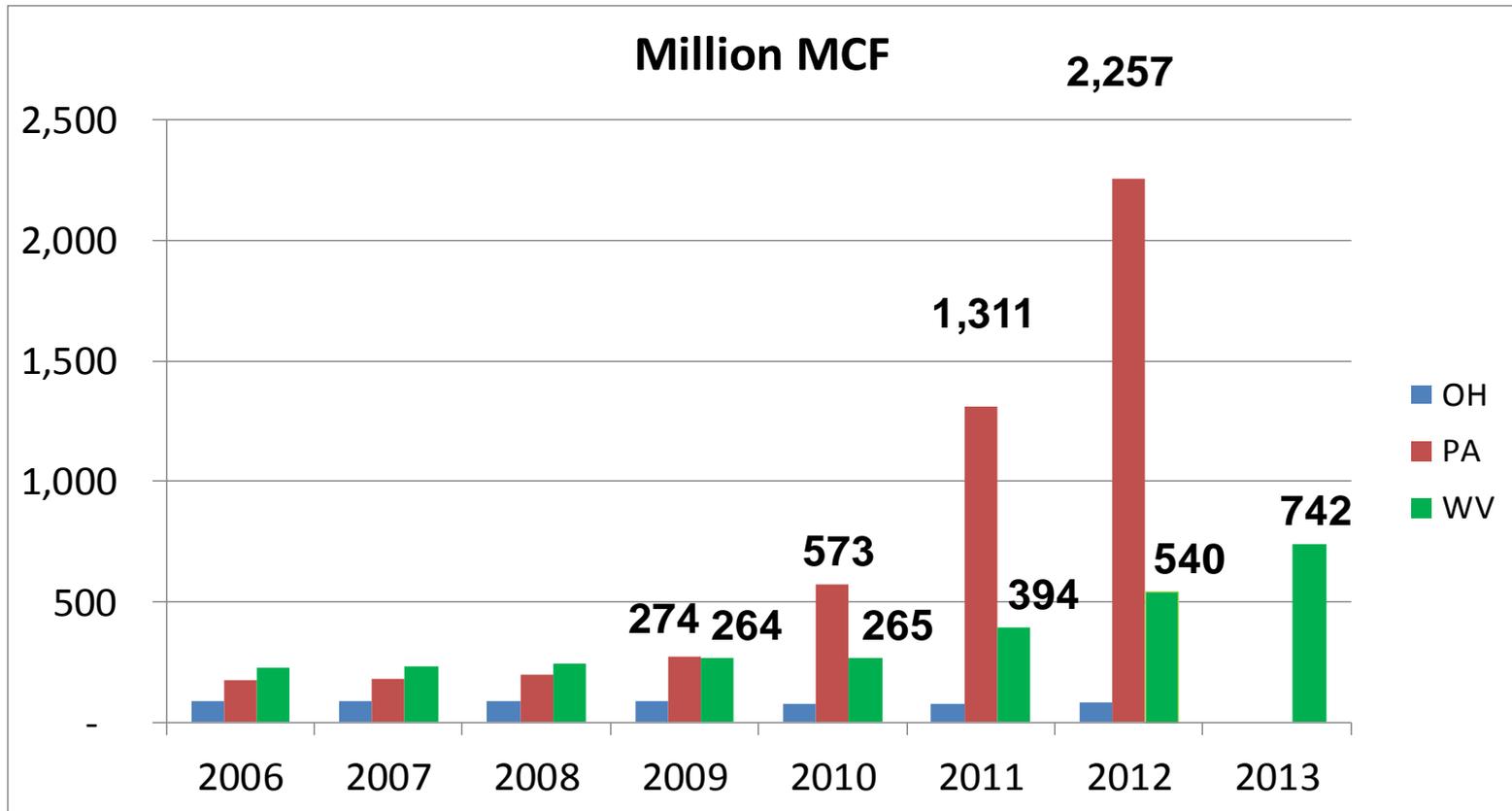
West Virginia Electric Power Generation: Up 7.9% YTD in 2014 & 14.3% Below 2007



Source: U.S. DOE, Energy Information Administration

Natural Gas Production by State 2006-2013

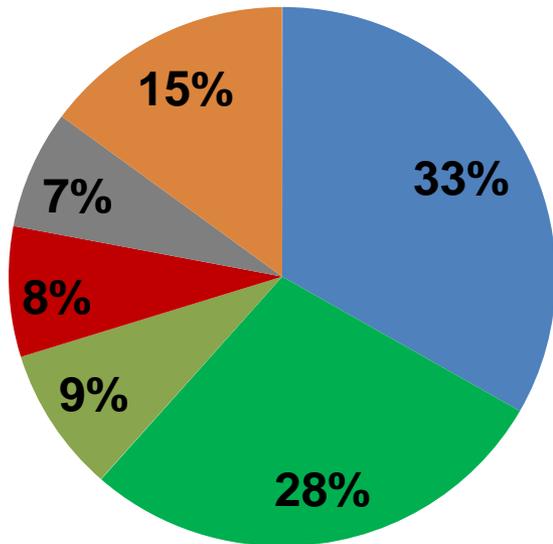
U.S. Production up 5.3% in 2012 and 1.2% in 2013
WV Production Up 37.0% in 2012 and 37.4% in 2013



Source: U.S. Department of Energy & WV DEP

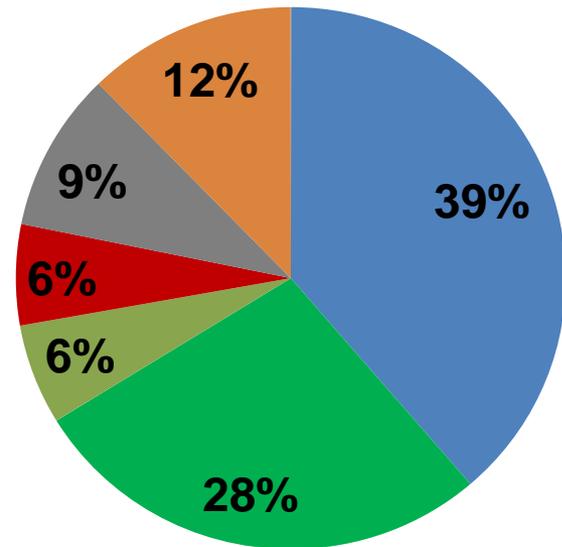
State and Local Government Expenditures 2011

All State Total: \$2.6 Trillion



- Education
- Public Safety
- Transportation
- Social Services/Welfare
- Environment/Housing
- Other

West Virginia: \$14.5 Billion

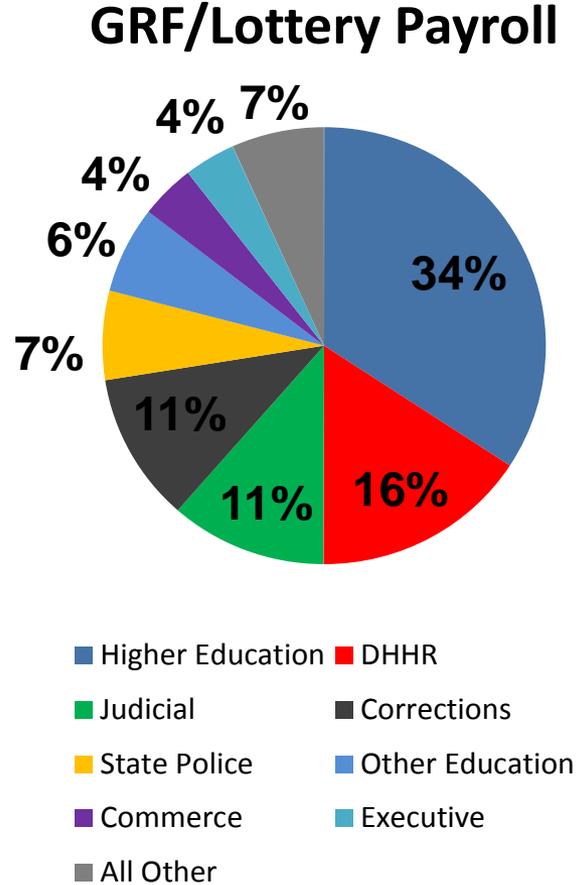
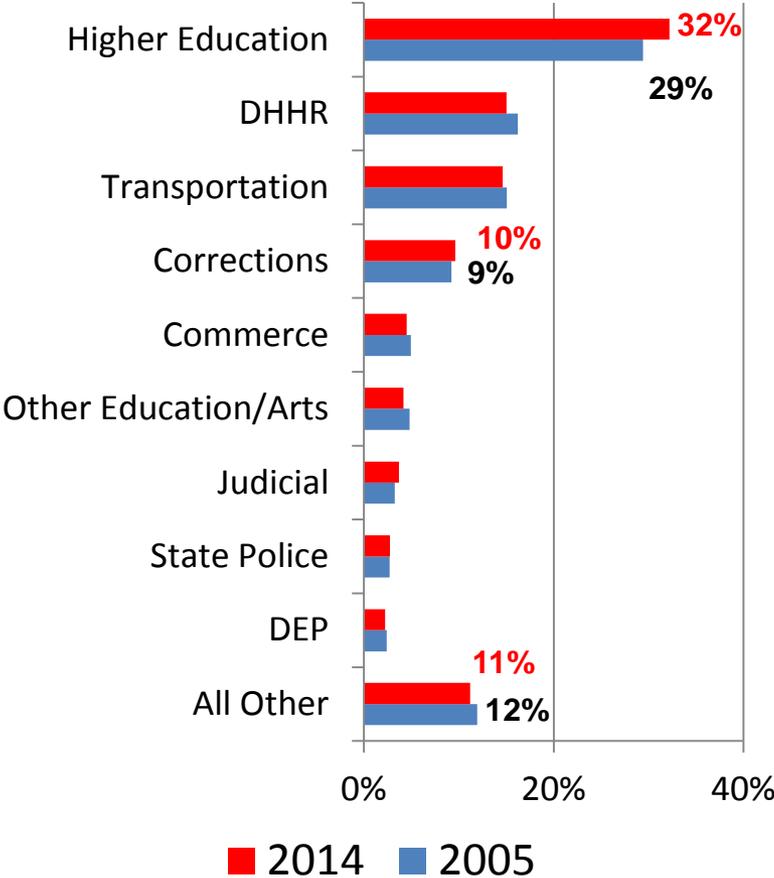


- Education
- Public Safety
- Transportation
- Social Services/Welfare
- Environment/Housing
- Other

Source: U.S. Census Bureau

Share of Full-Time Equivalent Employees by Function

7/31/2005 Versus 7/31/2014 - (37,760 FTE; 15,606 General)



Flat Revenue Trends: Some Easing Begins in FY2015

Revenue Elasticity Declines

- Eight sources of revenue account for over 98% of General Budget

| <u>Revenue Source</u> | <u>Share</u> | <u>Annual Chg FY2007-14</u> | <u>[FY2012-14]</u> |
|---------------------------|--------------|-----------------------------|--------------------|
| Personal Income Tax: | (38%) | +5.5%/year | [-0.4%/year] |
| Consumer Sales & Use Tax: | (26%) | +2.9%/year | [-2.2%/year] |
| Lottery Funds: | (11%) | +10.1%/year | [-5.1%/year] |
| Severance Tax: | (11%) | +6.4%/year | [-0.4%/year] |
| Corporate Income Tax: | (5%) | -1.8%/year | [+2.9%/year] |
| B&O Tax: | (3%) | -2.3%/year since FY1997 | |
| Insurance Premium Tax: | (2%) | +2.9%/year since FY1997 | |
| Tobacco Excise Tax: | (2%) | -0.6%/year since FY2004) | [-3.6%/year] |

General Revenue Fund Forecast

* Assumes \$60.4 million dedicated to Old WC Fund is rededicated to General Revenue Fund

| <u>Source</u> | <u>FY2015</u> \$ Millions | <u>FY2016</u> \$ Millions | <u>FY2017*</u> \$ Millions | <u>FY2018*</u> \$ Millions | <u>FY2019*</u> \$ Millions | <u>FY2020*</u> \$ Millions |
|--------------------|------------------------------|------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| Personal Income | \$1,809.600 | \$1,860.500 | \$2,009.000 | \$2,104.400 | \$2,199.200 | \$2,294.500 |
| Consumer Sales/Use | \$1,253.500 | \$1,281.300 | \$1,325.400 | \$1,388.000 | \$1,448.500 | \$1,514.000 |
| Severance | \$ 474.600 | \$ 471.700 | \$ 524.800 | \$ 580.900 | \$ 606.300 | \$ 631.900 |
| CNIT/BFT | \$ 201.500 | \$ 177.500 | \$ 194.700 | \$ 190.400 | \$ 196.900 | \$ 197.100 |
| B&O | \$ 107.000 | \$ 117.000 | \$ 104.000 | \$ 121.000 | \$ 122.000 | \$ 122.000 |
| Insurance | \$ 117.600 | \$ 120.200 | \$ 122.700 | \$ 123.600 | \$ 127.300 | \$ 128.100 |
| Tobacco | \$ 105.000 | \$ 100.400 | \$ 100.100 | \$ 99.400 | \$ 98.700 | \$ 98.000 |
| Lottery Transfers | \$ 92.600 | \$ 83.355 | \$ 83.355 | \$ 83.355 | \$ 83.355 | \$ 83.355 |
| Other | \$ 92.851 | \$ 109.621 | \$ 135.150 | \$ 136.200 | \$ 137.720 | \$ 139.000 |
| Total | \$4,253.951 | \$4,321.576 | \$4,599.205 | \$4,827.255 | \$5,019.975 | \$5,207.955 |

Personal Income Tax Collections

Average Growth 04-14: + 5.1%

Forecast 2014-20: + 4.7%

- Employment Growth: (IHS Economics)

- 2014: + 1.3%
- 2015: + 1.2%
- 2016: + 1.1%

- Wage Growth:

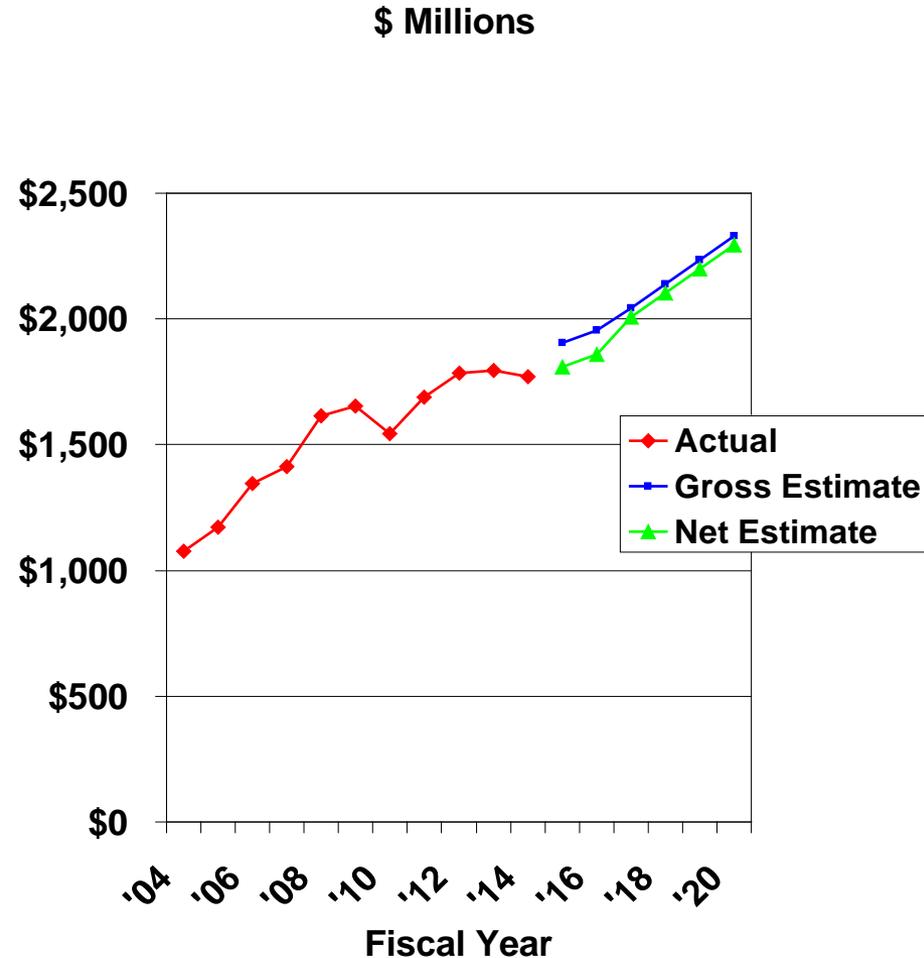
- 2014: + 1.4%
- 2015: + 3.6%
- 2016: + 4.3%

- YTD Withholding: + 3.8%

- YTD Estimated: + 25.7%

- YTD Refunds: - 16.6%

- Total: + 6.3%

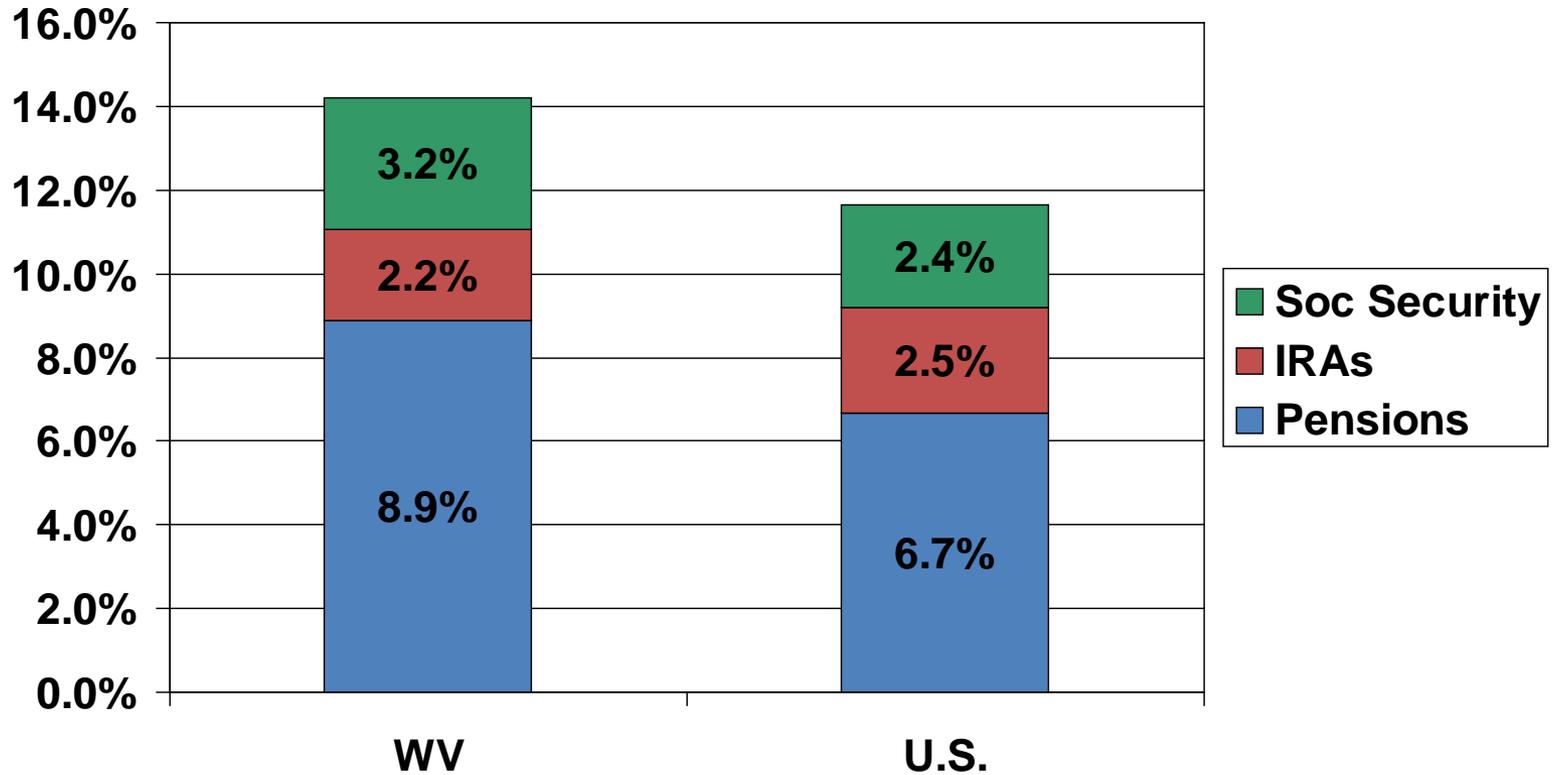


Personal Income Tax Slump

Partially Due to Temporary Factors

- 1997-2012: Average Growth 5.5%/year
- 2012-2014: -0.4%/year
- Reasons for Stagnation:
 - Temporary Alternative Fuel Vehicle Credit
 - Lack of employment or wage growth in CY2012-13
 - Federal Fiscal Cliff Uncertainty at end of CY2012
- Gradual turnaround due to improved employment outlook and some stability from Washington

Percentage of Adjusted Gross Income Attributable to Retirement Income in 2012

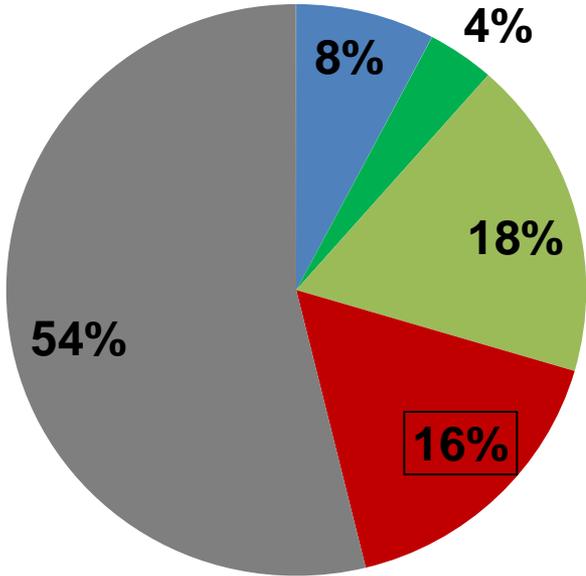


Source: IRS Statistics of Income

Per Capita Personal Consumption Expenditures 2012

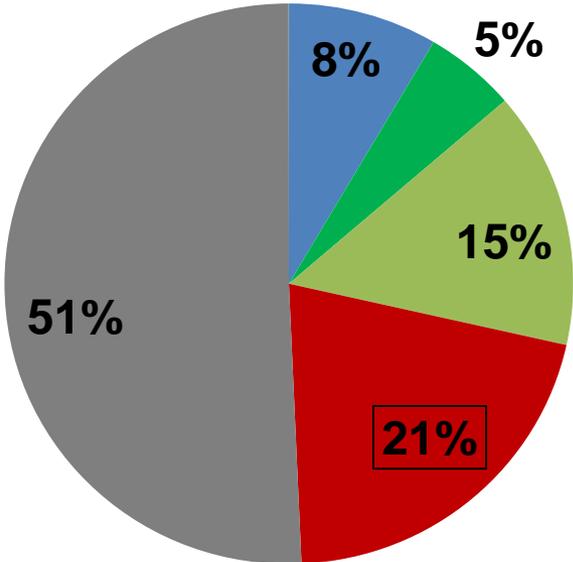
Average Citizen's Consumption of Health Care 8% Higher in WV

United States: \$35,498



■ Food ■ Energy ■ Housing
■ Health Care ■ Other

West Virginia: \$30,642



■ Food ■ Energy ■ Housing
■ Health Care ■ Other

Source: U.S. Bureau of Economic Analysis

Consumer Sales and Use Tax Collections

Average Growth 04-14: 2.0%

Forecast 2014-20: 4.9%

➤ No Action –Remote Sales - Congress

➤ Consumer Inflation:

– +1.7% in 2014

– +1.0% in 2015

– +1.6% in 2016

➤ Consumer Confidence Improving

– + 3.0%/year consumption average

– + 2.9% in 2014-15

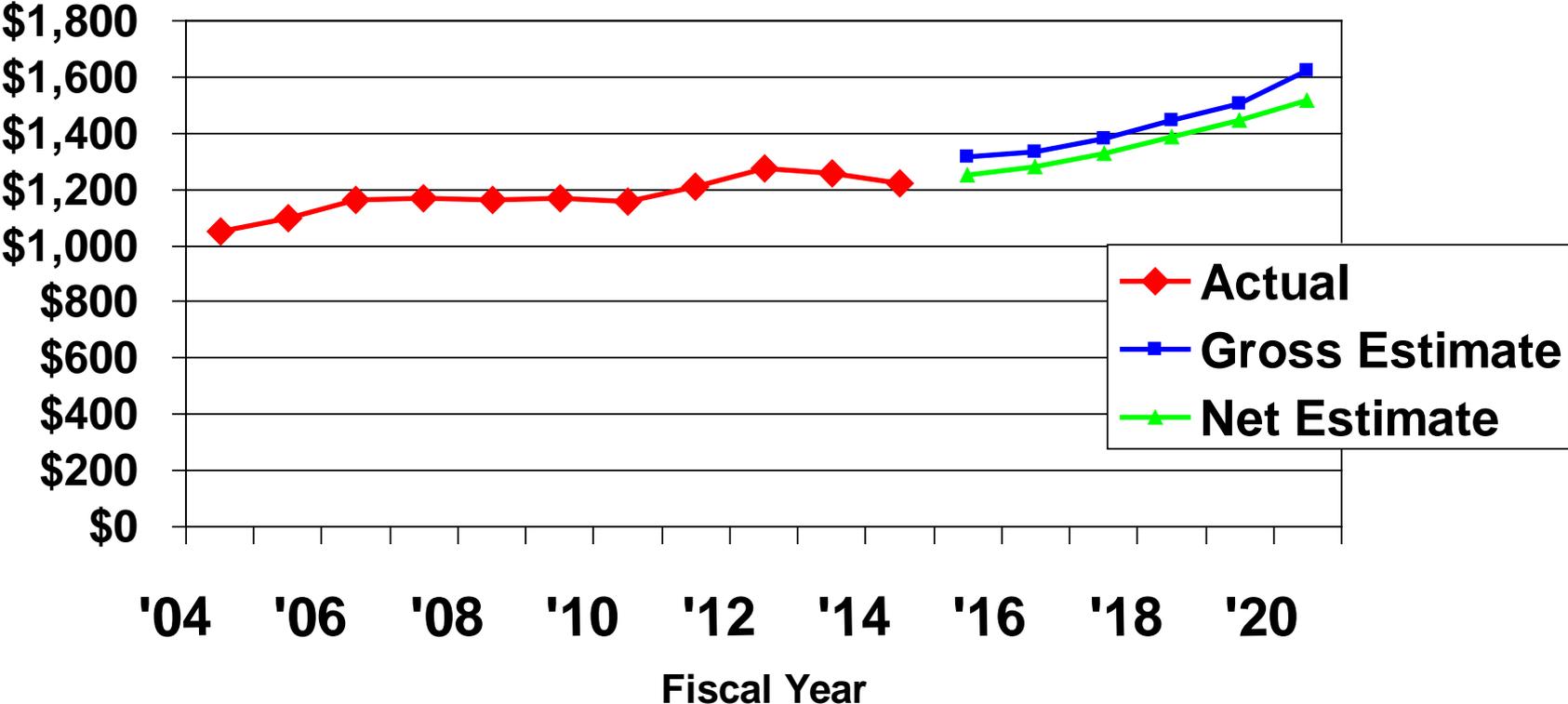
➤ Food Tax Reduction: -\$160M+

➤ Drug Exemption: -\$ 15 M+

YTD Sales Tax: + 4.3%

Consumer Sales and Use Tax Collections

\$ Millions



Severance Tax Collections

Average Growth 04-14: + 9.4%
Forecast 2014-20: + 4.2%

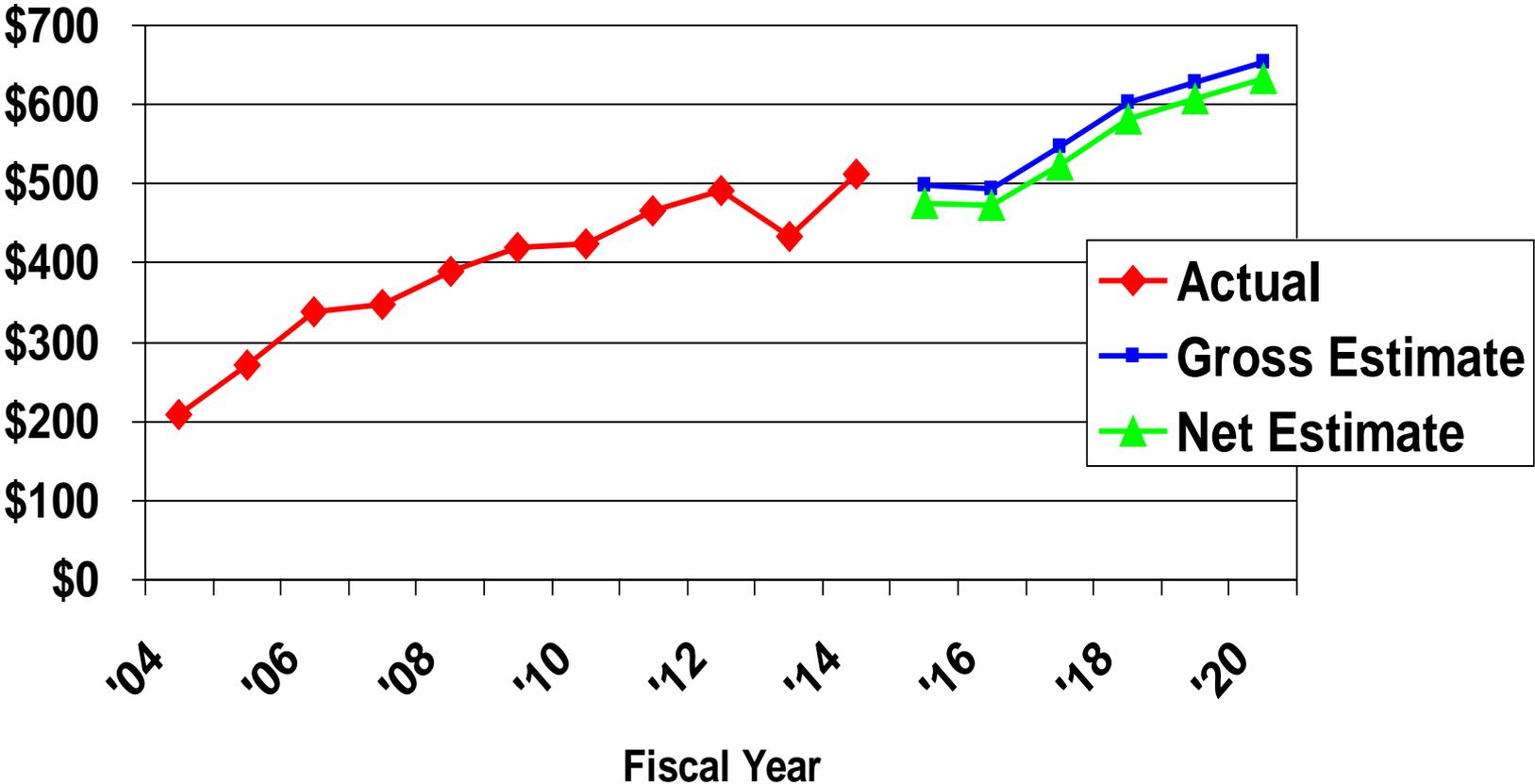
- Natural Gas Prices: Falling
2015-20: Some rebound
- Gas Production: Increasing
2015-20: Increasing more slowly
- Coal Prices: Falling
2015-20: Some stabilization
- Coal Production: Stable
2014-16: Additional decline
- Coal Exports: Falling
2015-20: Some stabilization

- New Revenue Plateau
- Some Price Volatility Expected

YTD Severance Tax: + 1.8%

Severance Tax Collections

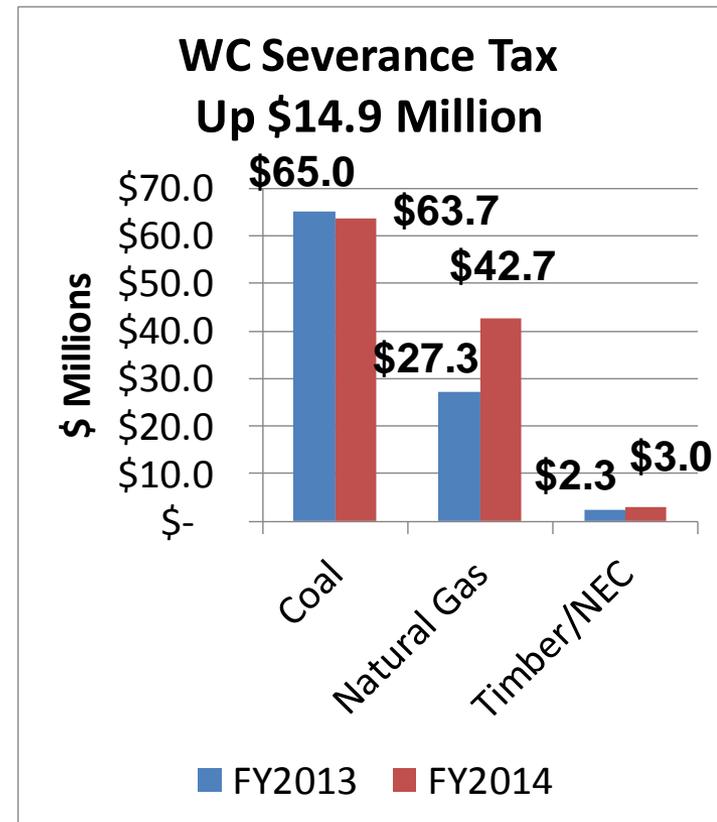
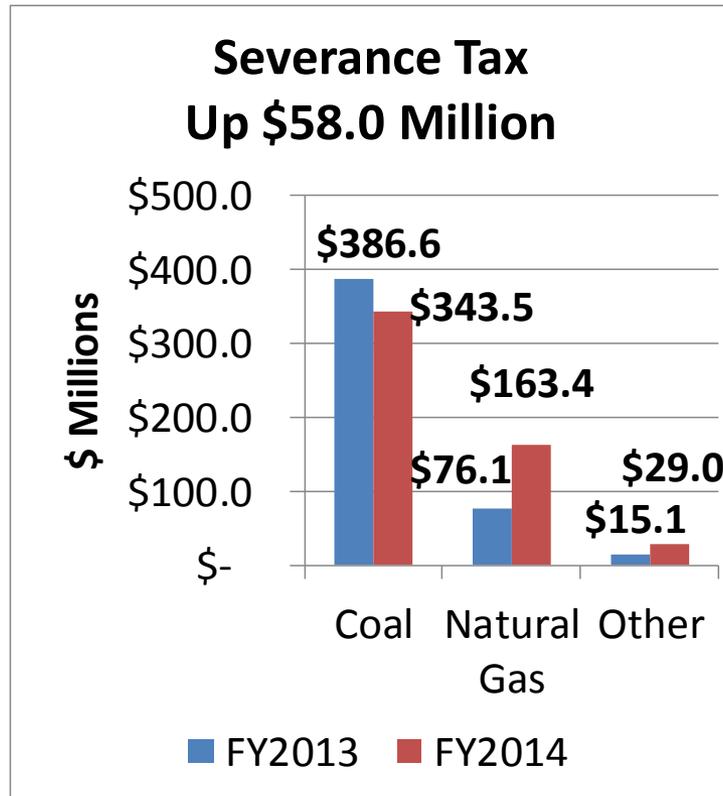
\$ Millions



FY2014 Severance Tax Collections

Regular Severance: Coal Down 11%; Natural Gas Up 115%; Other Up 92%

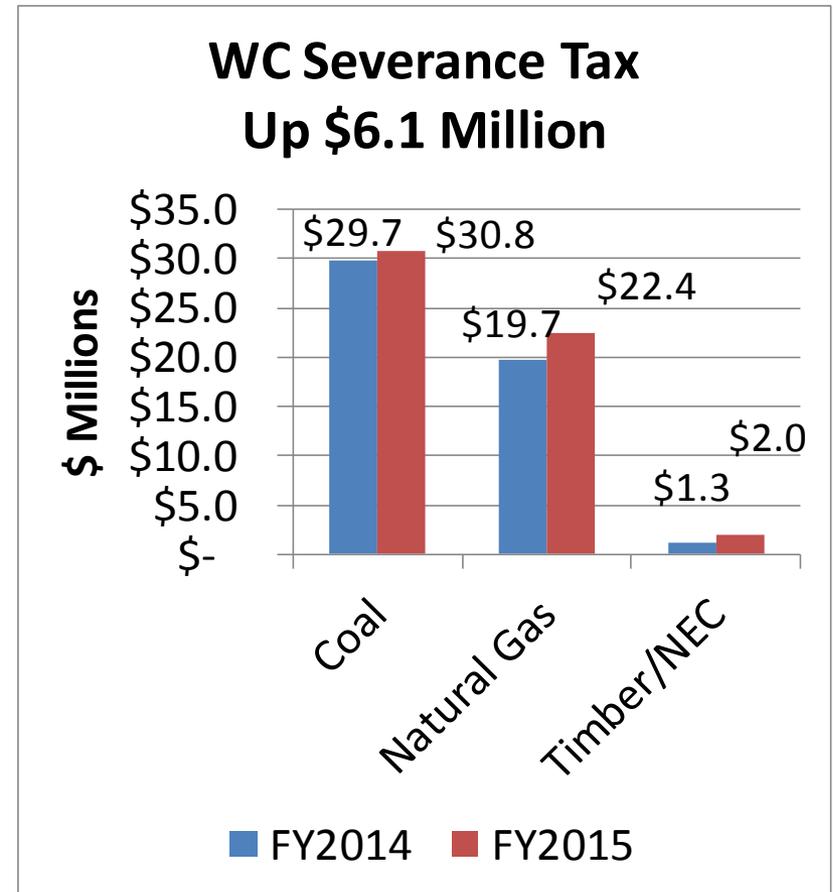
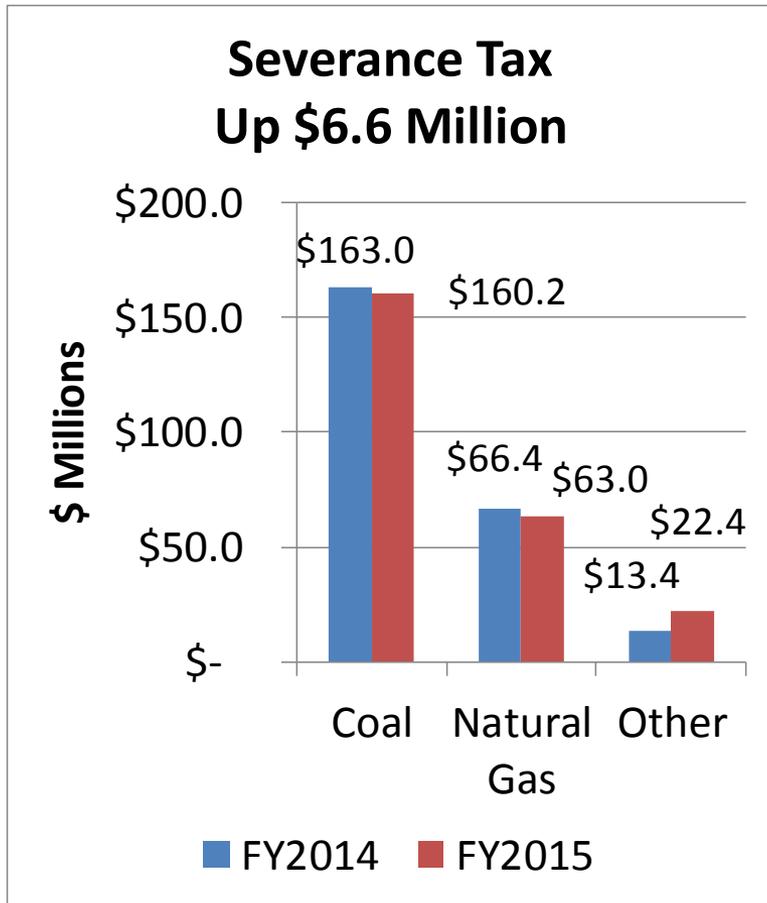
WC Severance: Coal Down 2%; Natural Gas Up 57%; Timber Up 33%



FY2015 Severance Tax Collections Thru December

Regular Severance: Coal Down 2%; Natural Gas Down 5%; Other Up 67%

WC Severance: Coal Up 4%; Natural Gas Up 14%; Timber Up 60%



Regular Education Levy Property Tax Revenue Trends 2008-2014

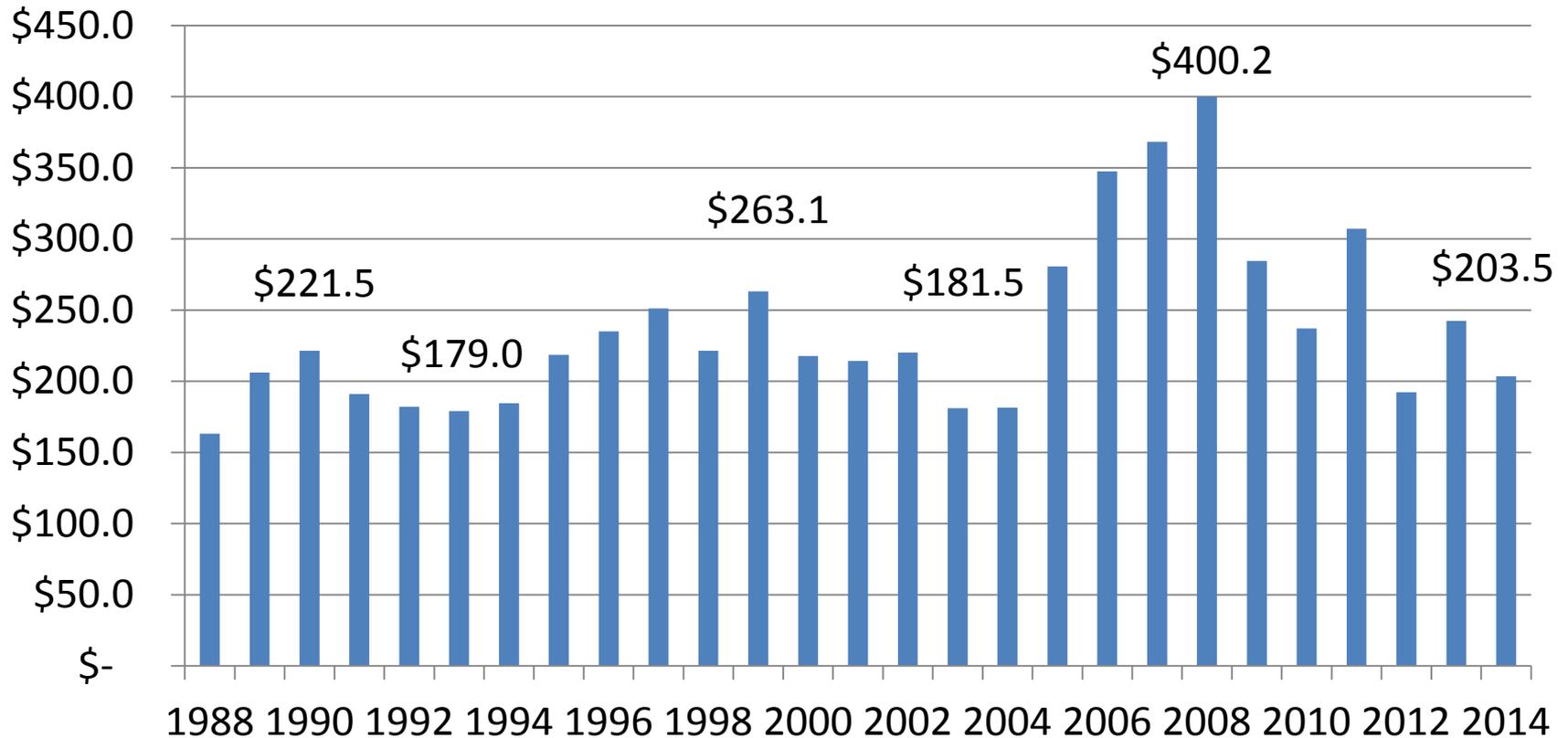
Comparative Data on Changes in Tax Assessments

| <u>County</u> | <u>2008 Taxes</u> | <u>2014 Taxes</u> | <u>Change in Tax</u> | <u>Average Annual Growth</u> |
|------------------|----------------------|----------------------|----------------------|------------------------------|
| WETZEL | \$ 3,856,517 | \$ 10,348,553 | 168.3% | 17.9% |
| DODDRIDGE | \$ 2,576,611 | \$ 5,407,453 | 109.9% | 13.2% |
| MARSHALL | \$ 10,025,878 | \$ 20,830,697 | 107.8% | 13.0% |
| TAYLOR | \$ 2,883,357 | \$ 4,734,850 | 64.2% | 8.6% |
| MONONGALIA | \$ 23,275,224 | \$ 33,019,530 | 41.9% | 6.0% |
| JEFFERSON | \$ 21,121,135 | \$ 16,841,245 | -20.3% | -3.7% |
| BERKELEY | \$ 28,041,690 | \$ 25,437,760 | -9.3% | -1.6% |
| BOONE | \$ 10,705,404 | \$ 10,583,510 | -1.1% | -0.2% |
| MCDOWELL | \$ 6,191,216 | \$ 6,786,861 | 9.6% | 1.5% |
| LOGAN | \$ 9,195,689 | \$ 10,624,679 | 15.5% | 2.4% |

WV Corporate Tax Collection History

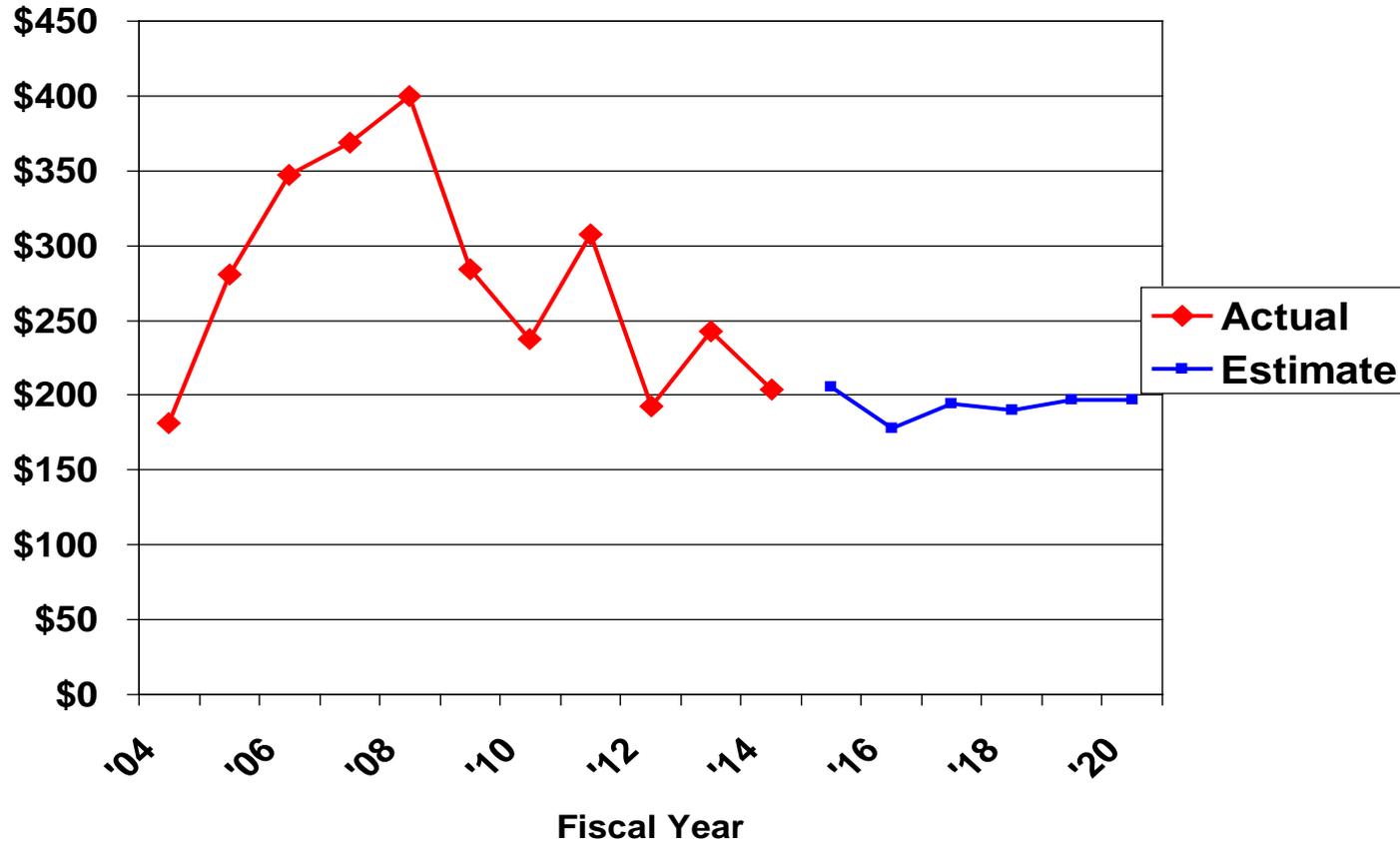
From 1987 Tax Reform to Phase-In 2009 Tax Reforms

\$ Millions



Corporation Net Income/ Business Franchise Tax Collections

\$ Millions



Corporation Net Income/ Business Franchise Tax Collections

Average Growth 04-14: + 1.2%
Forecast 2014-20: - 0.5%

- Very Volatile Source
- 2006-09: Profits Down by 27%
- 2009-2013: Profits gradually rebound
- 2014: Profits up 17% since 2006
- 2013-2018: Profit growth 2%/year
- Combined Reporting-2009
 - 100% BFT rate cut 2008-15
 - 24% CNIT rate cut 2012-14
- Bonus Depreciation 2010-2014

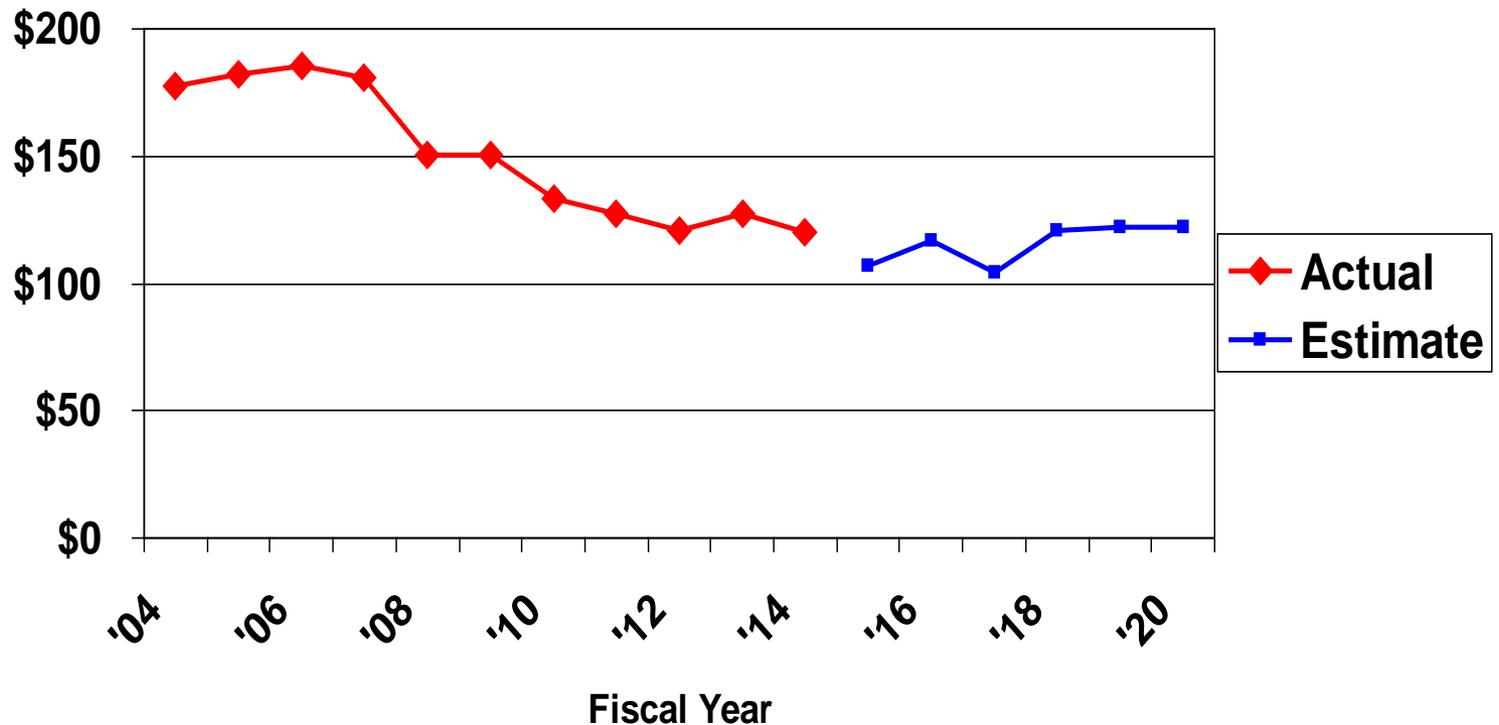
2008-2015

- 100% Rate Reduction in BFT
- 26% Rate Reduction in CNIT

YTD CNIT/BFT: + 0.9%

Business and Occupation Tax Collections

\$ Millions



Business and Occupation Tax Collections

Average Growth 04-14: - 3.8%
Forecast 2014-20: + 0.3%

- Capacity Tax – 75% of base
- Pollution Abatement Costs
 - 9% Scrubber Rate Reduction
 - Tax Credits on Investment Rise
 - Plant Closures: 2014-2016
 - 2014-20: Investment Tax Credit Decrease

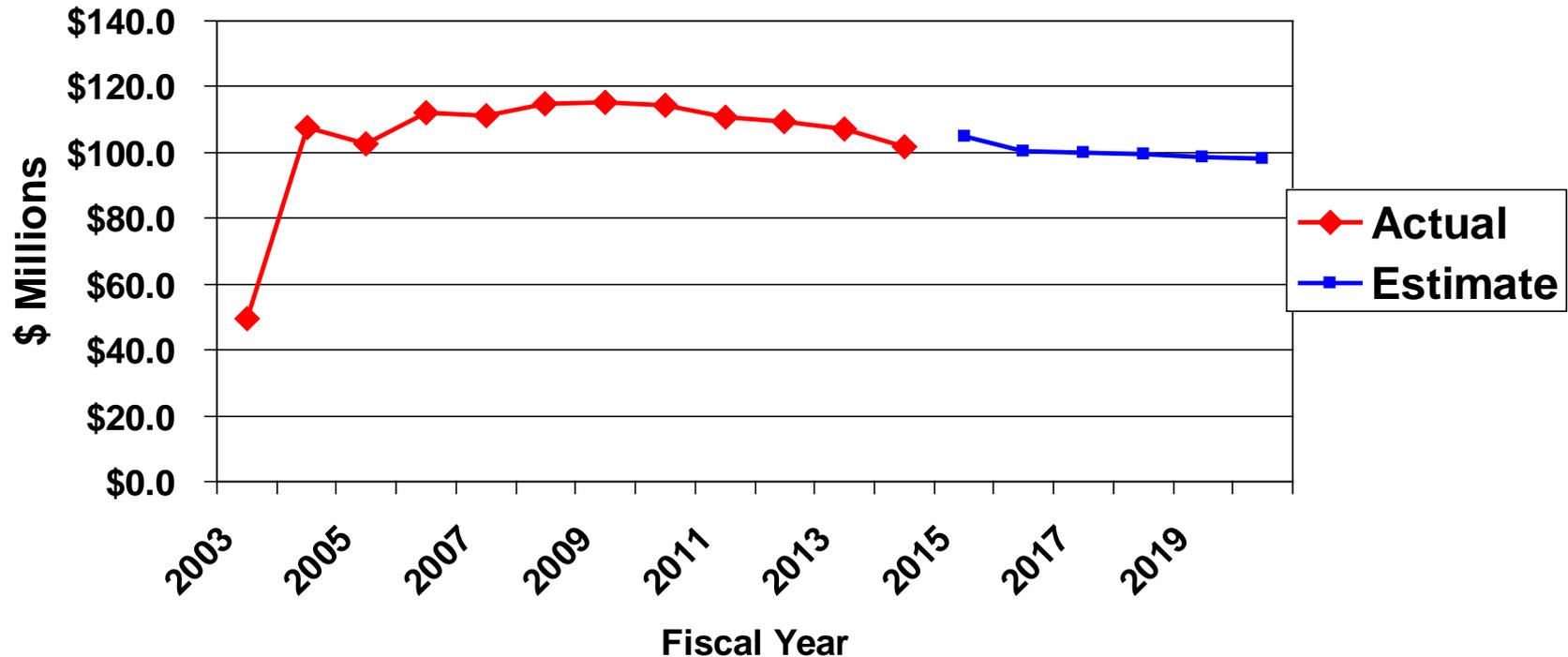
- Utility Gross Receipts – 18%
- Gas Storage Tax – 7%

YTD B&O Tax: + 7.9%

Tax Increase Provides Most Gain

Mini-Gains from: OH - \$1.25 on 7/1/2005, MD - \$2.00 on 1/1/2008,
KY - \$0.60 on 4/1/2009 & PA -\$1.60 on 11/1/2009

Tobacco Tax Collections



FY2016 Forecast Versus Official FY2015 Estimates

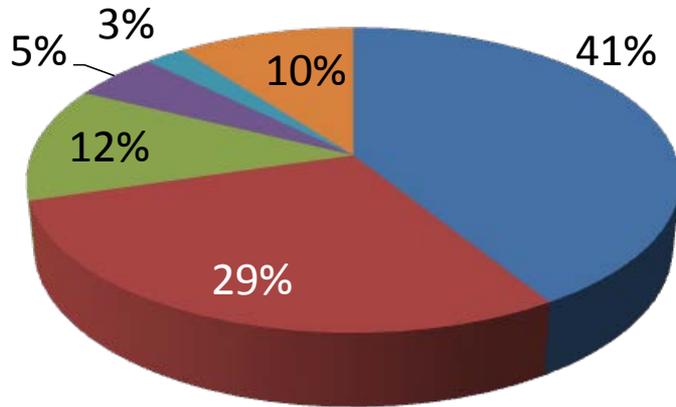
\$ Millions

| <u>Tax Source</u> | <u>FY2015</u> | <u>FY2016</u> | <u>Change</u> |
|-----------------------------|---------------------------|---------------------------|-------------------------|
| Personal Income: | \$1,809.600 | 1,860.500 | \$ 50.900 |
| Sales & Use: | 1,253.500 | 1,281.300 | 27.800 |
| Severance: | 474.600 | 471.700 | (2.900) |
| Corp Income: | 201.500 | 177.500 | (24.000) |
| B&O: | 107.000 | 117.000 | 10.000 |
| Tobacco Excise: | 105.000 | 100.400 | (4.600) |
| Insurance Premium: | 117.600 | 120.200 | 2.600 |
| Lottery-GRF: | 92.600 | 83.355 | (9.245) |
| All Other: | 92.551 | 109.621 | 17.070 |
| <i>Total General</i> | <i>\$4,253.951</i> | <i>\$4,321.576</i> | <i>\$ 67.625</i> |

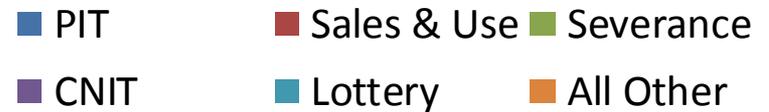
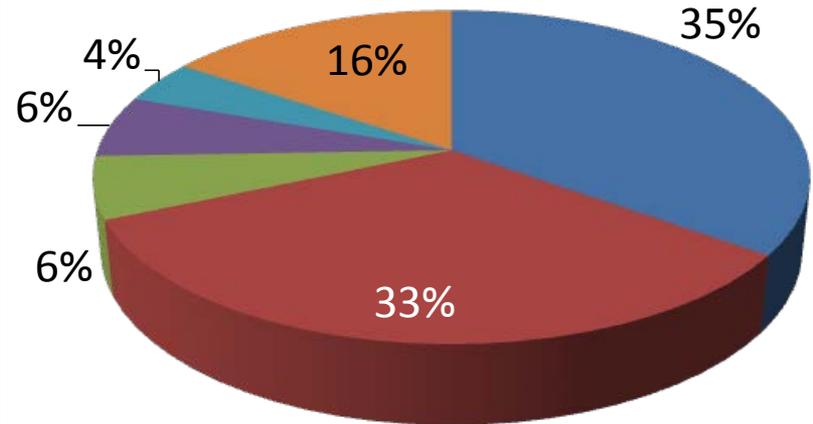
General Revenue Fund: Sources of Revenue

More Reliance on Severance Tax and Income Tax Revenues

General Revenue 2014



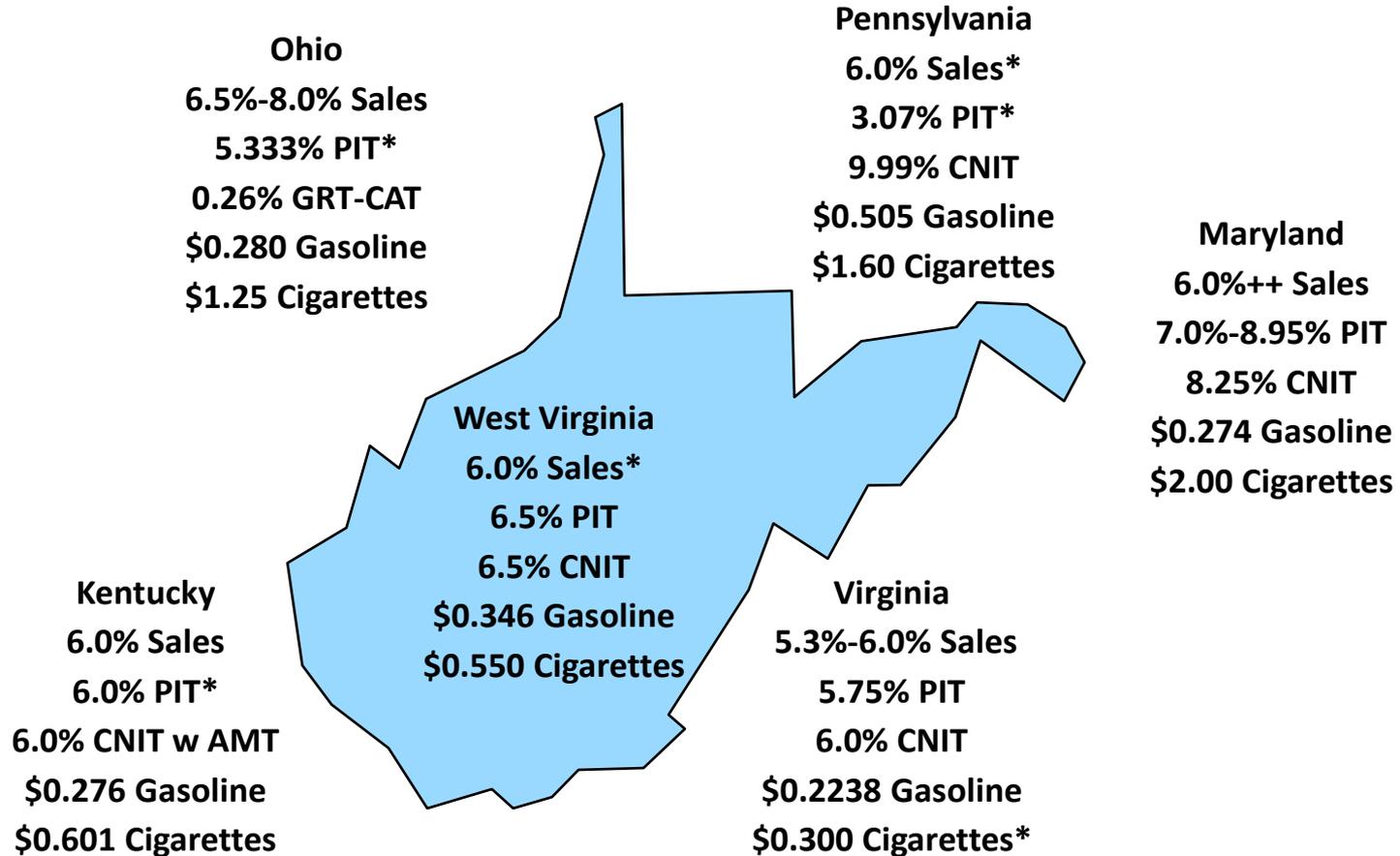
General Revenue 2004



COMPARATIVE TAX RATES

As of January 1, 2015

* Additional local taxes may apply



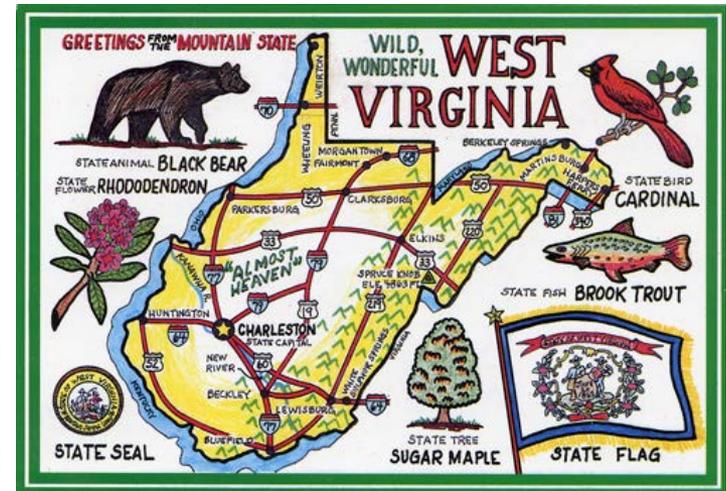
West Virginia Tax Structure Overview

25% of taxes imposed by local governments [31st in per capita tax burden]

| <u>Tax Type</u> | <u>Share</u> | <u>Per Capita</u> | <u>Average Tax (\$130K Household)</u> |
|-----------------|--------------|-------------------|---------------------------------------|
| Property | 20% | \$ 774 (45) | \$1,560 (50) [1.2% income] |
| Income: | 25% | \$ 946 (26) | \$7,472 (11) [5.8% income] |
| CNIT-Franchise: | 3% | \$ 104 (34) | |
| Sales: | 18% | \$ 689 (44) | |
| Other Sales/GR | 20% | \$ 755 (6) | |
| Other: | 14% | \$ 536 (8) | |

Other Tax Information

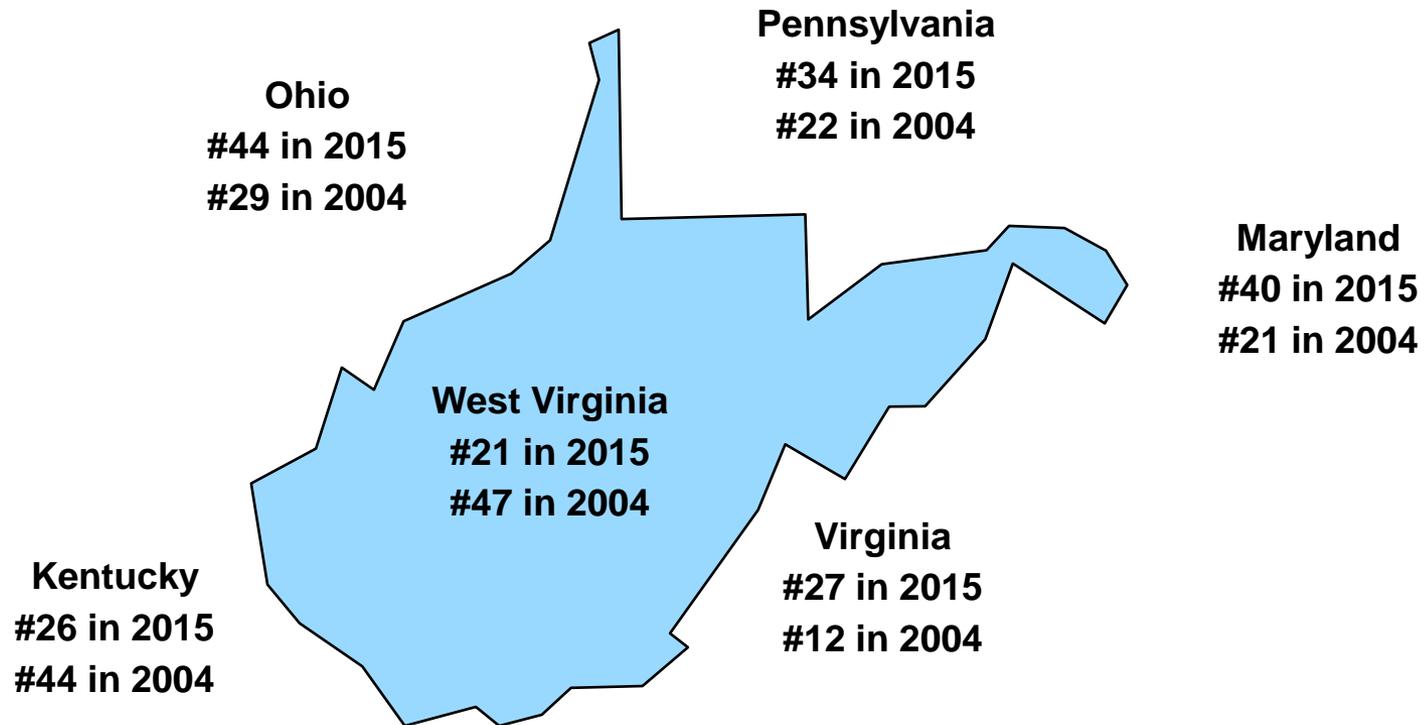
| | |
|--|-----------------|
| Average Sales Tax Rate: | 6.05% (35) |
| Number of services taxed (FTA): | 105 (6) |
| Motor Fuel Tax (API): | \$0.346 (9) |
| Centralization (State tax share @75%): | 6 th |



Sources: U.S. Census Bureau (FY2011-2012), Tax Foundation, Internal Revenue Service, FTA, API

STATE BUSINESS TAX CLIMATE INDEX, FY2015

#1 = Best to #50 = Worst



Source: Tax Foundation, *2015 State Business Tax Climate Index (2014)*
Tax Foundation, Background Paper, October 2004, Number 45

Outlook: Gradual Improvement in Economic Growth Revenues Growing, But Face Energy-Price Headwinds

- **Major Economic Transformation**
 - Shift from Coal to Natural Gas
 - Geographic Shift to Northern West Virginia
 - Additional decline in coal production for next couple years before stabilization
 - Natural gas production growth & price limited by infrastructure & markets
- **Sluggish National Economic Recovery: 2009-Present**
 - Accelerated growth forecast in 2015-16
 - Higher short-term interest rate by mid-2015
- **Broader West Virginia economy improvement**
 - Energy headwinds limit growth to less than historical average
 - International economic rebound a key for growth in West Virginia
 - Payoff of Workers Compensation Debt by end of CY2016 key to budget stabilization and additional tax relief for mining sector and others

W E S T V I R G I N I A



DEPARTMENT OF REVENUE

Questions?