Nelson A. Rockefeller Institute of Government

State Revenue Report

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HIGHLIGHTS

- State tax collections for the third quarter of 2008, as reported by the Census Bureau, showed a modest gain but underlying trends were much weaker. After adjusting for inflation, legislative changes, and known anomalies, tax revenue declined in 29 states.
- For the opening months of the final quarter of 2008, a majority of states for which data are available show declines in both sales and personal-income taxes, the two major sources of state tax revenue These early figures show an overall decline of more than 4 percent, a dramatic worsening of fiscal conditions nationwide.
- The first and second quarters of 2009 will likely bring further declines, as weakening conditions in the economy are reflected in major losses for sales and income taxes relative to a year earlier.
- The Southeast was the weakest region in the third quarter, while the Mid-Atlantic region now appears on the cusp of significant declines.
- Local government tax revenue grew by only 0.6 percent over last year, far lower than growth rates witnessed over the preceding five years.

State Tax Revenue Falling Sharply in Fourth Quarter, Early Data Show

Sales Taxes, Income Taxes Both Show Decline; Further Losses Appear Likely in First Half of 2009

Donald J. Boyd and Lucy Dadayan

Introduction

Tax data tend to be noisy and require careful interpretation. This is particularly true of data for the July-September quarter, the focus of most of this report. While we report data from the Census Bureau in Tables 8 and 9, throughout much of the discussion that follows we describe tax revenue growth or declines after reflecting adjustments that we believe are essential for proper interpretation. Because early data from the final quarter of 2008 indicate widespread declines in revenue, we also provide an initial look at currently available reports, which collectively represent more than half of aggregate tax revenue for the October-December quarter.

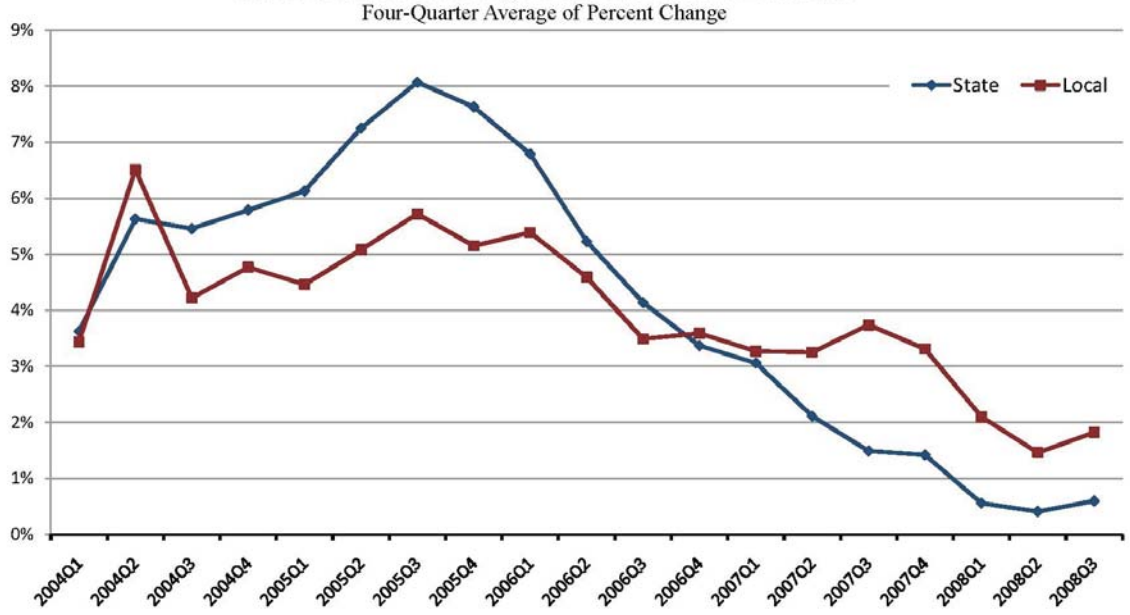
State Taxes and Local Taxes

Overall state tax collections in the July to September quarter of 2008, as reported by the Census Bureau, rose 3.2 percent from the same quarter of the previous year.[1] Local tax collections rose by a surprisingly strong 5.6 percent, driven by 7.3 percent growth in property taxes. Superficially, tax collections appeared to be doing okay. Does that mean the reports of fiscal crisis and budget problems in at least 44 states are overblown? Not at all. Much of the recent strength reflects timing anomalies and other special factors.

The trend in state and local tax collections has been clearly downward from 2005 growth that was unusually high, and 2006 growth rates that were more in line with

IMPORTANT NOTE: We made two significant changes beginning with our April-June Revenue Report: (1) we base our analysis upon quarterly tax data collected by the U.S. Bureau of the Census, which are now more timely than in prior years; and (2) we have changed our method of adjusting for inflation. These changes will allow us to broaden and strengthen our analysis, but they complicate comparisons between these reports and previous reports. We explained our reasons for these changes in appendices in the April-June 2008 Revenue Report available at www.rockinst.org.

Figure 1
State Taxes are Faring Worse Than Local Taxes
But Local Taxes Have Slowed
Year-Over-Year Percent Change in Real State Taxes and Local Taxes
Four-Quarter Average of Percent Change



Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

historical averages. Figure 1 shows the four-quarter moving average of year-over-year growth in state tax collections and local tax collections, after adjusting for inflation. The downward trend in both is evident. Year-over-year growth in state taxes, adjusted for inflation, has averaged 0.6 percent over the last four quarters, down from the 1.5 percent average growth of a year ago and 4.1 percent of two years ago. Year-over-year growth in local taxes has slowed to 1.8 percent over the last four quarters, from 3.7 percent a year ago.

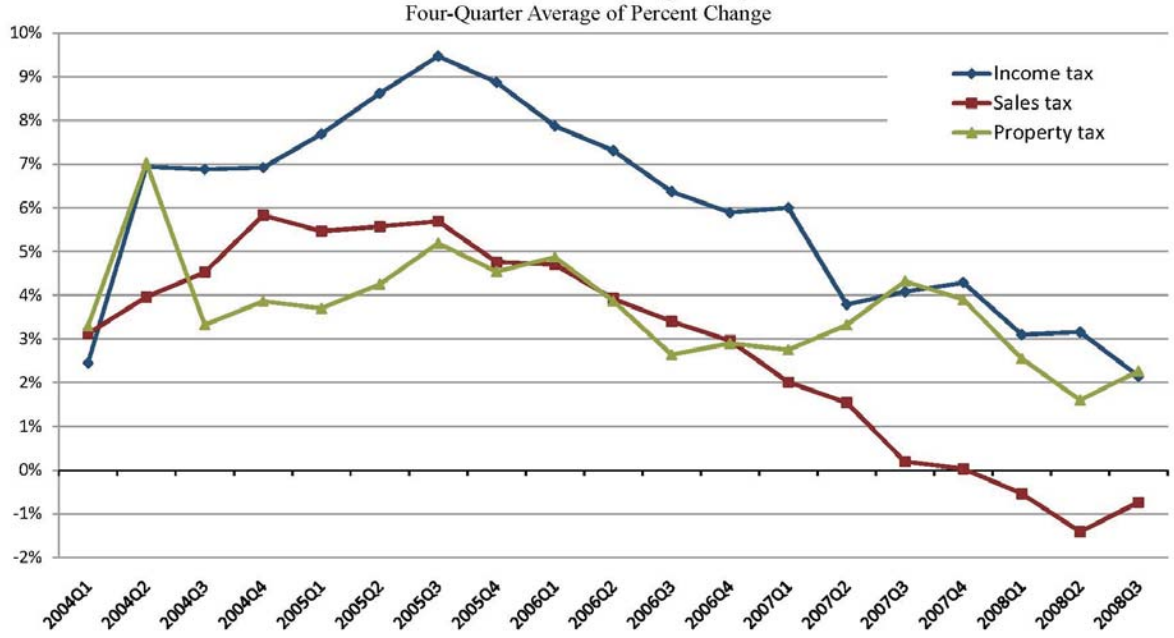
The local tax slowdown has been less pronounced than the state tax slowdown, and local taxes in recent quarters have been growing more quickly than state taxes. Most local governments rely heavily on property taxes, which tend to be relatively stable.

Figure 2 shows the four-quarter average of year-over-year growth in state and local income, sales, and property taxes, adjusted for inflation. Both the income tax and the sales tax have been on a multiyear downward trend. The sales tax has slowed more sharply than the income tax and the average for the most recent four quarters declined, after adjusting for inflation, relative to the same period a year earlier. The relative stability of the property tax is apparent, but nonetheless growth has slowed sharply. Local governments that rely heavily on the property tax are feeling the effects of this slowing growth. It is not yet possible to know what caused the uptick in the property tax in the latest quarter because data by government are not yet available from the Census Bureau — it might reflect rate increases by some local governments attempting to counteract the effects of declines in other sources, or it might be the result of more technical factors. Almost certainly, the growth in local revenue does not come from underlying economic trends.

State Tax Revenue

Total state tax revenue in the third quarter of 2008 increased by 3.2 percent relative to a year ago, before adjustments. The income tax was up 2.1 percent, the sales tax was up 3.0 percent, and the corporate income tax was down by 5.4 percent. See Tables 1 and 2 for growth in tax revenue with and without adjustment for inflation, and for growth by major tax, respectively. Table 1 does not

Figure 2
The Income Tax Has Slowed Sharply, Sales Tax Growth Is Negative And Even the Stable Property Tax Has Slowed
Year-Over-Year Percent Real Change in Major Taxes
Four-Quarter Average of Percent Change



Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

include adjustment for legislative changes. After adjustment for legislated changes, known anomalies, and inflation, state tax revenue was down 0.2 percent in the quarter.

Much of the growth in state taxes was attributable to a quadrupling of tax revenue in a single state, Alaska. See discussion of "Other Taxes" for more on this point.

Personal Income Tax

In the third quarter personal income tax revenue made up at least a third of total tax revenue in 27 states, and it was larger than the sales tax in 31 states.

Personal income tax revenue grew 2.1 percent in the July-September 2008 quarter compared to the same quarter in 2007. This was down sharply from the growth of 7.2 percent in the second quarter, which was temporarily boosted by payments with 2007 tax returns as discussed in the previous two revenue reports.[2] The strongest growth in state personal income tax revenue was in the Great Lakes and Mid-Atlantic regions, where collections grew 4.4 and 4.2 percent, respectively. The income tax declined in nominal terms in the Southwest and Rocky Mountain regions, reflecting continued economic weakness in the former and sharp recent declines in the latter.

Twenty-nine states reported growth, six of which had double-digit increases. North Dakota led the states that have broad-based income taxes, with growth of 14.5 percent.[3] Fourteen states showed a decline in personal income tax collections, the largest being 13 percent for Utah and 12 percent for Louisiana. Utah's economy has been declining for the last seven months and this may reflect that decline; the Louisiana economy has been doing relatively well and the revenue decline may reflect processing or technical factors.

We can get a clearer picture of collections from the personal income tax by breaking this source down into major component parts for which we have data: withholding and quarterly estimated payments. The Census Bureau does not currently collect data on withholding taxes and estimated payments. The data presented here were collected by the Rockefeller Institute.

Table 1
Quarterly State Tax Revenue
Adjusted for Inflation
Year-Over-Year Percent Change

	Total Nominal Change	Inflation Rate	Adjusted Real Change
Jul-08	3.2	2.6	0.6
Apr-08	4.0	2.0	1.9
Jan-08	1.2	2.3	(1.1)
Oct-07	3.6	2.6	0.9
Jul-07	2.3	2.5	(0.1)
Apr-07	5.4	2.8	2.5
Jan-07	5.4	2.9	2.4
Oct-06	4.0	2.8	1.2
Jul-06	5.6	3.2	2.3
Apr-06	10.1	3.5	6.3
Jan-06	7.1	3.4	3.6
Oct-05	7.9	3.5	4.3
Jul-05	10.2	3.4	6.7
Apr-05	15.9	2.9	12.6
Jan-05	10.6	3.3	7.0
Oct-04	9.4	3.2	6.0
Jul-04	6.5	3.0	3.4
Apr-04	11.2	2.9	8.1
Jan-04	8.1	2.3	5.7
Oct-03	7.0	2.2	4.7
Jul-03	6.3	2.2	4.1
Apr-03	2.1	2.1	0.1
Jan-03	1.6	2.1	(0.5)
Oct-02	3.4	1.7	1.7
Jul-02	1.6	1.6	(0.1)
Apr-02	(9.4)	1.6	(10.9)
Jan-02	(6.1)	2.0	(7.9)
Oct-01	(1.1)	2.4	(3.4)
Jul-01	0.5	2.4	(1.9)
Apr-01	1.2	2.5	(1.3)
Jan-01	2.7	2.2	0.5
Oct-00	4.2	2.2	2.0
Jul-00	6.8	2.3	4.4
Apr-00	11.7	2.1	9.4
Jan-00	12.4	2.1	10.2
Oct-99	7.7	1.6	6.0
Jul-99	6.5	1.5	5.0
Apr-99	4.3	1.5	2.7
Jan-99	3.8	1.2	2.5

Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).

Table 2
Quarterly State Tax Revenue
By Major Tax, Year-Over-Year Percent Change

	PIT	CIT	General Sales	Total
Jul-08	2.1	(5.4)	3.0	3.2
Apr-08	7.2	(7.3)	(1.0)	4.0
Jan-08	3.0	(3.7)	0.1	1.2
Oct-07	4.3	(8.8)	3.5	3.6
Jul-07	6.4	(1.8)	(1.3)	2.3
Apr-07	8.9	1.7	3.4	5.4
Jan-07	8.7	14.8	3.4	5.4
Oct-06	4.0	12.6	4.3	4.0
Jul-06	6.3	16.5	6.2	5.6
Apr-06	18.8	1.2	5.2	10.1
Jan-06	9.3	9.6	7.0	7.1
Oct-05	6.7	33.4	6.4	7.9
Jul-05	10.2	24.5	8.3	10.2
Apr-05	19.7	64.1	9.1	15.9
Jan-05	13.1	29.8	7.3	10.6
Oct-04	8.8	23.9	10.7	9.4
Jul-04	5.8	25.2	7.0	6.5
Apr-04	15.8	3.9	9.5	11.2
Jan-04	7.9	5.4	9.1	8.1
Oct-03	7.6	12.5	3.6	7.0
Jul-03	5.4	12.6	4.7	6.3
Apr-03	(3.1)	5.2	4.6	2.1
Jan-03	(3.3)	8.3	2.4	1.6
Oct-02	0.4	34.7	1.8	3.4
Jul-02	(3.4)	7.4	2.4	1.6
Apr-02	(22.3)	(12.3)	0.1	(9.4)
Jan-02	(14.7)	(15.7)	(1.4)	(6.1)
Oct-01	(2.5)	(34.0)	1.8	(1.1)
Jul-01	(0.0)	(27.2)	2.3	0.5
Apr-01	3.7	(11.0)	(0.8)	1.2
Jan-01	4.7	(8.4)	1.8	2.7
Oct-00	6.5	(0.5)	4.4	4.2
Jul-00	10.0	8.2	4.8	6.8
Apr-00	21.2	4.2	7.0	11.7
Jan-00	17.0	11.0	11.9	12.4
Oct-99	7.3	4.7	7.2	7.7
Jul-99	6.9	4.3	6.2	6.5
Apr-99	5.2	5.4	5.0	4.3
Jan-99	5.8	(5.4)	4.9	3.8

Source: U.S. Census Bureau (tax revenue).

Withholding

Withholding is a good indicator of the current strength of personal income tax revenue because it comes largely from current wages and is much less volatile than estimated payments or final settlements. Table 3 shows that withholding for the July-September 2008 quarter was 3.2 percent higher than the same quarter of 2007. This was faster than growth in the April-June quarter, but slower than in the two previous quarters. Only North Dakota and Wisconsin reported growth of more than 10 percent. Monthly wage data show that real wages grew by less than one-half percent on a year-over-year basis in October and November, and withholding is likely to be very weak in the October-December quarter.

Estimated Payments

The highest-income taxpayers generally make estimated tax payments (also known as declarations) on their income not subject to withholding tax. This income often comes from investments, such as capital gains realized in the stock market. A strong stock market should eventually translate into capital gains and higher estimated tax payments. (For more on this topic, see the box entitled "Capital Gains: An Update.") Strong business

Table 3
Personal Income Tax Withholding, by State
Last Four Quarters, Percent Change

	Jun-05		*Jun-05*	
	Oct.-Dec.	*Jan.-Mar.*	*Apr.-June*	*July-Sep.*
United States	**6.6**	**4.0**	**0.1**	**3.2**
New England	**6.7**	**4.5**	**1.8**	**2.6**
Connecticut	7.9	2.6	0.1	2.5
Maine	4.4	6.3	2.3	3.9
Massachusetts	6.5	5.6	2.6	2.4
Rhode Island	6.1	(0.4)	1.9	1.6
Vermont	7.3	9.5	1.0	6.9
Mid-Atlantic	**5.7**	**3.6**	**(6.5)**	**4.8**
Delaware	5.6	(0.3)	(0.1)	0.6
Maryland	7.8	3.3	1.9	2.8
New Jersey	2.6	3.5	(58.8)	(1.1)
New York	6.0	3.1	4.3	7.6
Pennsylvania	5.5	6.9	0.4	2.0
Great Lakes	**5.5**	**7.5**	**2.9**	**4.1**
Illinois	8.1	7.2	(0.2)	3.6
Indiana	6.0	7.2	4.2	2.0
Michigan	11.0	10.0	10.9	8.1
Ohio	2.5	(1.0)	0.5	(3.0)
Wisconsin	(0.2)	15.9	0.1	13.7
Plains	**7.2**	**6.7**	**3.4**	**4.5**
Iowa	8.3	8.1	4.9	4.5
Kansas	8.9	7.4	1.8	6.0
Minnesota	5.2	6.1	3.5	6.0
Missouri	8.3	7.2	2.9	3.1
Nebraska	8.2	2.9	2.6	(1.5)
North Dakota	9.2	11.2	12.8	19.3
Southeast	**6.9**	**4.4**	**1.9**	**2.5**
Alabama	4.3	5.5	1.8	(0.4)
Arkansas	11.5	10.2	5.6	3.1
Georgia	5.6	1.9	(0.7)	0.1
Kentucky	3.8	7.8	5.7	3.4
Louisiana	15.2	3.5	2.6	(2.1)
Mississippi	8.6	3.8	2.8	2.3
North Carolina	7.4	3.0	2.5	2.8
South Carolina	8.8	2.9	1.4	3.3
Virginia	6.4	5.2	1.0	5.5
West Virginia	1.2	14.7	7.4	5.3
Southwest	**2.9**	**(1.7)**	**1.6**	**(0.3)**
Arizona	1.8	(1.7)	(1.0)	(1.7)
New Mexico	11.8	(3.2)	ND	ND
Oklahoma	0.7	(1.3)	5.2	1.4
Rocky Mountain	**8.7**	**4.1**	**(2.8)**	**(2.0)**
Colorado	8.1	7.5	4.0	4.5
Idaho	9.1	(2.4)	(0.8)	(4.0)
Montana	10.1	4.8	(4.7)	ND
Utah	9.2	1.3	(13.9)	(12.0)
Far West	**8.1**	**1.3**	**2.4**	**2.8**
California	8.9	0.7	2.7	2.5
Hawaii	6.6	20.9	(1.4)	3.8
Oregon	2.4	1.2	2.1	4.2

Source: Individual state data, analysis by Rockefeller Institute.

Note: Nine states — Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming — have no broad-based personal income tax and are therefore not shown in this table.

profits also tend to boost these payments. And when the market declines or profits fall, these payments often decline.

Table 4
Estimated Payments/Declarations, by State
Year-Over-Year (2007-08) Percent Change

	April-September 2008 (first three payments of 2008)	**July-September 2008** (third payment of 2008)
Average (Mean)	**1.1**	**(2.7)**
Median	**3.0**	**0.5**
Alabama	(1.3)	(13.9)
Arkansas	14.3	17.9
California	(1.3)	(3.8)
Colorado	3.3	1.5
Connecticut	1.3	(4.0)
Delaware	3.0	0.5
Georgia	(7.6)	(4.0)
Hawaii	(7.5)	(10.0)
Illinois	4.7	2.5
Indiana	14.0	2.4
Iowa	9.5	11.7
Kansas	2.2	(1.3)
Kentucky	35.3	18.8
Louisiana	(8.6)	(36.9)
Maine	5.2	5.6
Maryland	(31.5)	(83.7)
Massachusetts	6.6	2.1
Michigan	10.3	8.3
Minnesota	10.5	6.2
Missouri	0.1	(3.0)
Nebraska	9.4	3.3
New Jersey	(37.4)	(5.5)
New York	22.9	(7.3)
North Carolina	(1.5)	(4.6)
North Dakota	10.7	21.5
Ohio	(1.4)	(0.7)
Oklahoma	(3.0)	4.7
Oregon	8.5	5.8
Pennsylvania	4.3	2.4
Rhode Island	2.4	(9.7)
South Carolina	(6.2)	(6.3)
Vermont	6.3	3.6
Virginia	3.2	8.8
West Virginia	(42.8)	(21.8)
Wisconsin	1.3	(4.8)

Source: Individual state data, analysis by Rockefeller Institute.

The first payment for each tax year is due in April in most states and the second and third are generally due in June and September. The early payments often are made on the basis of the previous year's tax liability and may offer little insight into income in the current year. It is not safe to extrapolate trends from the first payment, or often even from the first several payments. In the 35 states for which we have complete data for the September payment, the median payment was a minimal 0.5 percent higher than the year earlier (see Table 4). Declines were recorded in 17 of 35 states. Four states — Arkansas, Iowa, Kentucky, and North Dakota — reported double-digit growth. Five states — Alabama, Hawaii, Louisiana, Maryland, and West Virginia — showed double-digit declines.

Table 5
Percent Change in State Taxes Other Than PIT, CIT, and General Sales Taxes

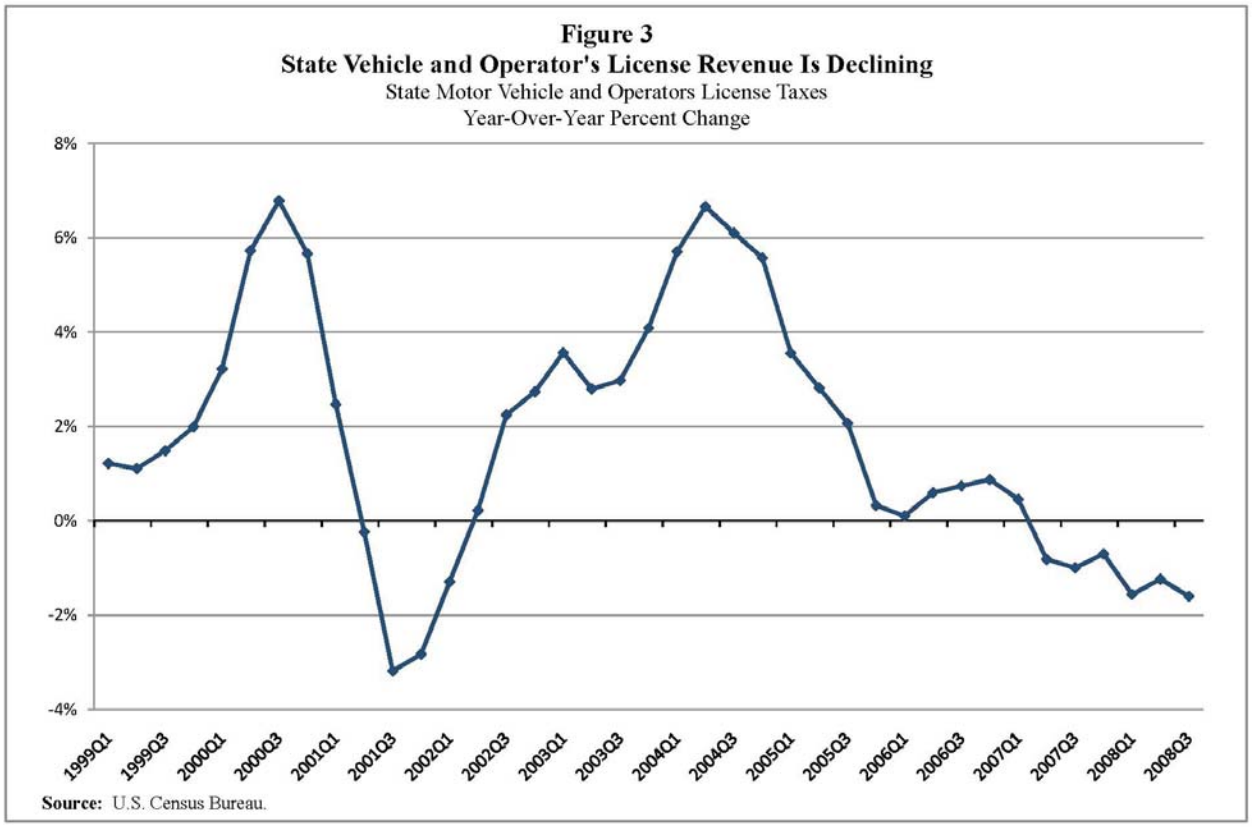
	Property tax	Motor fuel sales tax	Tobacco product sales tax	Alcoholic beverage sales tax	Motor vehicle and operators license taxes	Other taxes
Collections (millions), latest 12 months	$12,593	$37,322	$16,261	$5,280	$21,807	$110,961
2008Q3	0.9	(3.2)	2.7	(0.5)	(1.6)	7.2
2008Q2	(1.3)	(2.0)	5.5	0.3	(1.2)	4.3
2008Q1	0.1	(1.4)	6.0	0.6	(1.6)	1.5
2007Q4	0.7	(1.8)	6.1	0.7	(0.7)	1.4
2007Q3	0.6	(0.5)	4.0	1.6	(1.0)	(0.9)
2007Q2	(0.2)	(1.1)	0.6	1.4	(0.8)	(1.1)
2007Q1	1.7	(0.0)	1.8	0.6	0.5	(1.0)
2006Q4	(0.1)	0.7	3.0	1.1	0.9	(0.5)
2006Q3	(0.5)	(1.1)	5.6	1.3	0.7	2.1
2006Q2	(0.3)	1.4	8.9	1.3	0.6	4.5
2006Q1	1.0	1.6	7.0	2.5	0.1	5.4
2005Q4	2.3	2.3	5.3	1.6	0.3	7.2
2005Q3	3.5	3.7	4.2	(0.2)	2.1	6.3
2005Q2	3.6	0.9	2.2	(0.6)	2.8	4.7
2005Q1	1.5	1.4	2.9	(2.3)	3.6	5.4
2004Q4	(4.4)	1.6	3.5	(1.3)	5.6	5.7
2004Q3	(1.6)	1.5	3.5	0.2	6.1	7.4
2004Q2	5.8	2.1	4.7	0.6	6.7	8.9
2004Q1	3.1	0.4	11.4	4.1	5.7	7.6
2003Q4	9.5	(1.0)	19.1	3.7	4.1	5.8
2003Q3	6.7	(1.2)	28.1	2.2	3.0	3.8
2003Q2	(1.4)	(0.4)	35.8	3.1	2.8	2.5
2003Q1	(4.6)	0.6	27.8	0.8	3.6	2.2
2002Q4	(4.6)	0.9	17.7	(0.1)	2.7	1.9
2002Q3	(6.6)	0.4	5.6	2.5	2.2	2.3
2002Q2	(3.5)	0.9	(6.2)	(0.5)	0.2	3.2
2002Q1	5.3	1.5	(5.2)	(0.5)	(1.3)	2.2
2001Q4	3.4	2.4	(1.1)	0.4	(2.8)	2.7
2001Q3	1.1	3.5	3.1	(1.4)	(3.2)	1.7
2001Q2	(4.8)	2.5	7.7	1.8	(0.2)	1.1
2001Q1	(12.7)	1.3	8.5	1.5	2.5	3.4
2000Q4	(11.4)	1.2	5.8	1.9	5.7	4.0
2000Q3	(4.3)	1.3	1.7	3.2	6.8	6.4
2000Q2	(2.3)	1.2	(1.3)	2.2	5.7	8.0
2000Q1	2.4	2.3	(4.5)	3.1	3.2	5.5
1999Q4	1.4	2.5	(5.2)	2.7	2.0	4.4
1999Q3	(1.5)	1.7	(2.9)	1.7	1.5	3.6
1999Q2	1.2	2.1	(1.0)	1.3	1.1	1.8
1999Q1	4.5	2.5	1.3	1.5	1.2	3.0

Source: U.S. Census Bureau.

States are rightly concerned that the widespread declines in the September payment could be a harbinger of sharp drops in January estimated payments and in final tax returns for 2008 when they are filed in April 2009. With the 2008 tax year over, taxpayers are taking stock of their investment gains and losses, which play major roles in estimated payments. Last year's stock market performance suggests large declines in these coming payments are likely.

General Sales Tax

Reported sales tax collections in the July-September 2008 quarter were up 3.0 percent from the same quarter in 2007 but this apparent growth is misleading. Among other things, it reflected (1) changes in the timing of internal transfers among funds in California that resulted in a reported 9.4 percent increase (although underlying sales tax revenue actually declined), and (2) legislated tax increases



in Indiana (largely offset by local property tax relief) and in Iowa and Maryland.

After adjusting for these and similar changes, nominal sales tax revenue was essentially flat at 0.3 percent. After also adjusting for inflation, the sales tax declined year-over-year in 29 of 45 sales-tax states, with an average among all states of 2.3 percent.

Corporate Income Tax

Corporate income tax revenue is highly variable because of volatility in corporate profits, and volatility in the timing of tax payments. Many states, such as Delaware, Hawaii, Montana, Rhode Island, and Vermont, collect relatively little revenue from corporate taxes, resulting in large fluctuations in percentage terms. As a result, corporate income tax is an unstable revenue source and many states report sizeable changes from quarter to quarter.

Nominal corporate tax revenue decreased 5.4 percent in the July-September quarter compared to a year earlier, the fifth consecutive decline. The Southeast region reported the largest decline at 18.5 percent. Among 46 states for which the Census Bureau reported corporate tax data, 28 showed decreases in corporate tax revenue. Kentucky again had the largest decline, reflecting legislative changes and a high level of refunds. Surging corporate tax refunds have contributed to revenue shortfalls in other states as well.

Other Taxes

Census Bureau quarterly data on state tax collections provide detailed information for some of the smaller taxes not broken out separately in the advance data collected by the Rockefeller Institute. In Table 5 we show growth rates for the nation as a whole.

Last quarter we discussed the pronounced decline in motor fuel tax revenue, a casualty of the then-high oil prices and the economy. Motor vehicle and operators' licenses are affected similarly, particularly by the now-deepening recession, which has caused very large declines in sales of new automobiles, an important source of new motor vehicle license revenue.

Figure 3 shows the year-over-year growth in state government motor vehicle and operators' licenses for the nation as a whole since 1999. Because these data do not incorporate adjustments for legislative changes, swings in license revenue can reflect both changes in license charges and changes in registrations and the numbers of operators' licenses. Nonetheless, most of the slowdown and decline likely is attributable to the recession.

The biggest news in other taxes in the July-September quarter is the 7.2 percent increase in the catchall "other" category. This reflects an increase of 651 percent in Alaska and a 2.5 percent increase in the rest of the country. This was enough to boost the growth rate of all state tax revenue in the entire United States by more than a percentage point. But the Alaska increase will be short-lived.

Until early 2006, Alaska's main oil tax was a severance tax known as ELF (Economic Limit Factor) — essentially a gross receipts tax on production. But Alaska overhauled it dramatically in 2006, instituting the PPT (Production Profits Tax), and in so doing moved from a receipts base to a profit base. The PPT was intended to raise substantial additional revenue. It did raise additional revenue, but much less than intended, because taxable profits were reduced by much higher-than-predicted costs reported by petroleum companies. Amidst investigations in the wake of far-lower-than-expected revenue, the PPT was overhauled in late 2007 and replaced with a new system called ACES that includes a higher profits tax rate and some gross-receipts-tax features.[4] Under ACES the higher oil prices of the July-September and earlier quarters led to a huge spike in revenue.

Unfortunately for Alaska, that gain is disappearing. When Alaska prepared its ACES forecasts in fall 2007, prices for Alaska North Slope West Coast petroleum (ANSWC) were around $95 per barrel. Prices rose to more than $144 per barrel and averaged about $120 in the July-September quarter, contributing to the surge in tax revenue. Since then oil prices have plunged and in early January 2009 the price of ANS WC was $35 to $40 per barrel. The fiscal note on ACES suggested that a $20 price drop from $80 to $60 per barrel could drive ACES revenue down by $1.7 billion on a full-year basis. The revenue loss from the recent price drop of more than $80 will be significant.

Underlying Reasons for Trends

State revenue changes result from three kinds of underlying forces: differences in the national and state economies, the ways in which these differences affect each state's tax system, and recently legislated tax changes. The next two sections discuss the economy and recent legislated changes; there is a separate box on *Tax Structure and Revenue Growth*.

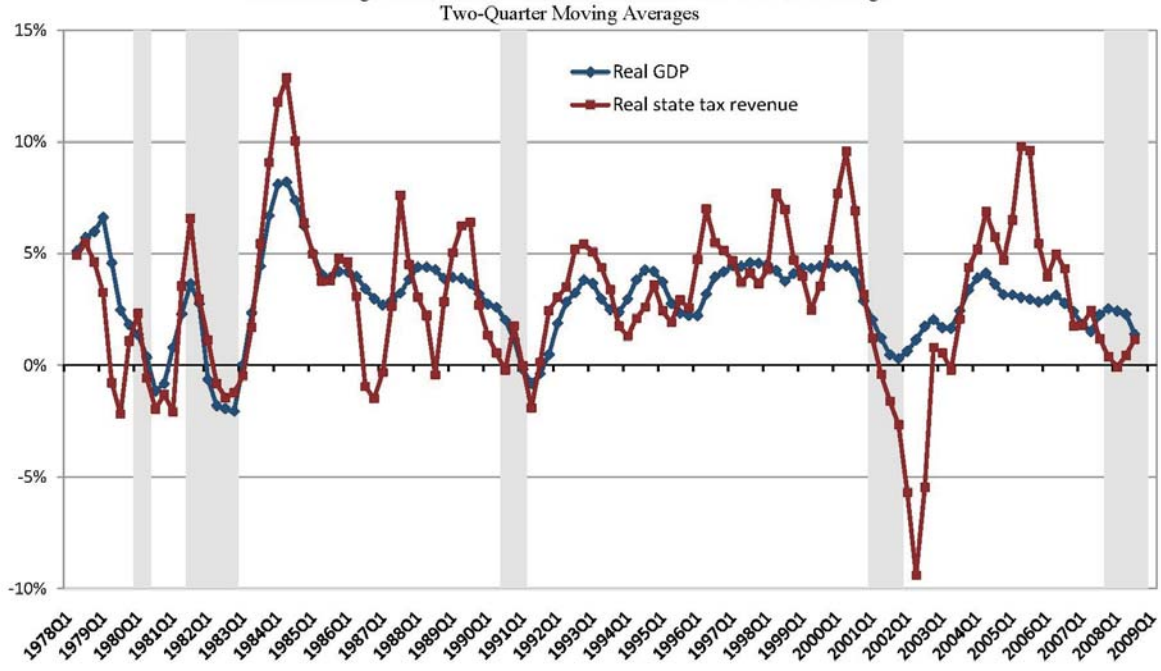
National and State Economies

Most state tax revenue sources are heavily influenced by the economy — the income tax rises when income rises, the sales tax increases when consumers increase their purchases of taxable items, and so on. When the economy booms, tax revenue tends to rise rapidly and when it declines, tax revenue tends to decline. Figure 4 shows year-over-year growth in inflation-adjusted state tax revenue and in real gross domestic product. Tax revenue is highly related to economic growth, but there also is significant volatility in tax revenue that is not explained solely by one broad measure of the economy. While we and forecasters in many state governments expect the current recession and the associated fiscal crisis to be worse than any recession since the Great Depression, that is not yet apparent from the graph.

The National Bureau of Economic Research has declared that a recession began in December 2007. Real gross domestic product declined at an annual rate of 0.5 percent in the July-September quarter after growth of 2.8 percent in April-June. Residential investment declined by 16.0 percent — its tenth straight decline. Durable goods consumption, an important element of state sales tax bases, declined by 14.8 percent after much smaller declines in the two preceding quarters. Preliminary monthly data for October and November show much further weakening.

It is helpful to examine economic measures that are closely related to state tax bases. Most states rely heavily on income taxes and sales taxes, and growth in income and consumption are extremely important to these revenue sources. Figure 5 shows

Figure 4
State Tax Revenue Is Heavily Influenced By Economic Changes
Percent Change in Real State Government Taxes and Real GDP vs. Year Ago
Two-Quarter Moving Averages



Sources: U. S. Census Bureau (Quarterly tax collections); Bureau of Economic Analysis (real GDP).
Notes: (1) Percentage changes averaged over 2 quarters; (2) No legislative adjustments; (3) Recession periods are shaded.

year-over-year growth in two important sources of income: wages and the portion of nonwage income in the National Income and Products Accounts typically subject to income taxes. Most newspaper accounts of economic data show growth from one quarter or month to the next, rather than year over year. That is because most economic time series have been adjusted to remove seasonality so that comparisons from one period to the next are meaningful. Government tax data, by contrast, rarely are adjusted to remove seasonal variations and as a result analysts usually examine these time series on a year-over-year basis, thereby comparing data for this year to the same season or period last year and implicitly removing some of the seasonal effects. To make our analysis of economic data comparable to our analysis of tax data, for most purposes in this report we examine economic data on a year-over-year basis.

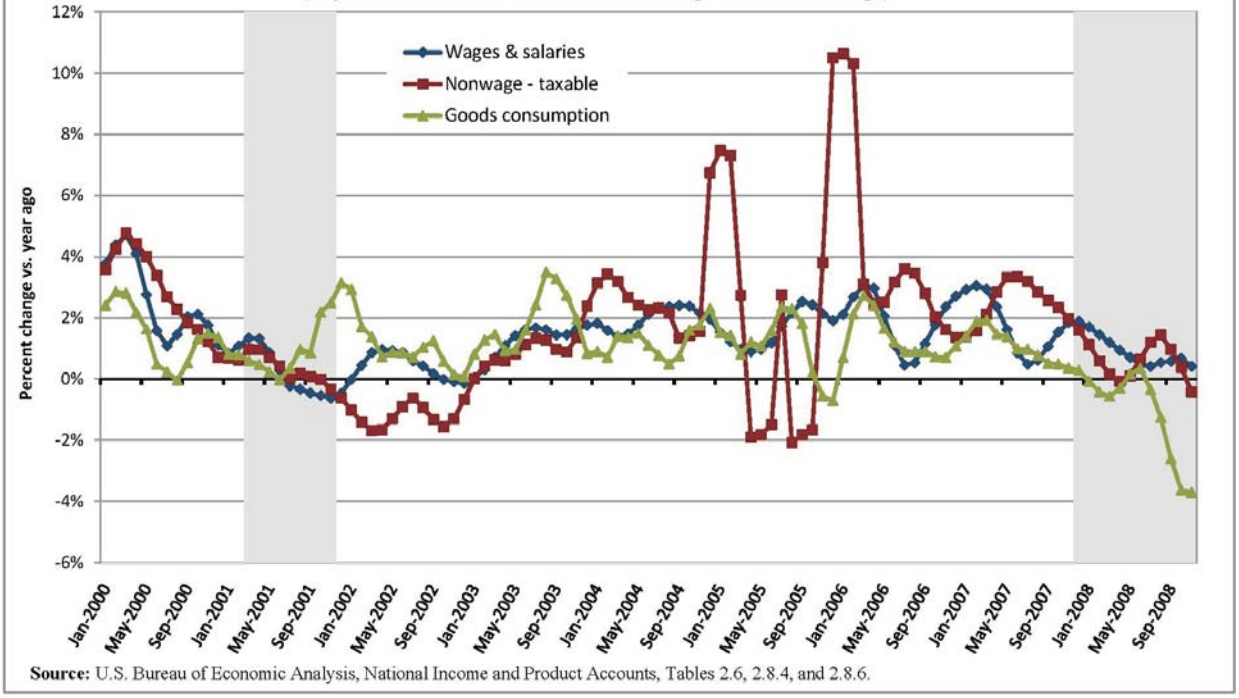
Figure 5 also shows growth in consumption of goods (excluding services because most states exclude a substantial share of services from the sales tax). All the data are adjusted for inflation. The time period covered is January 2000 through November 2008 (two months after the close of the quarter covered in this report). Goods consumption has fallen sharply in October and November and is now faring far worse than in the last recession. Retailer reports for December suggest the situation has since worsened.

Figure 6 shows consumption of durable goods, nondurable goods, and services. The decline in consumption of durable goods is much sharper than the last recession and is the main reason for the overall decline in the consumption of goods.

Several important points are evident:

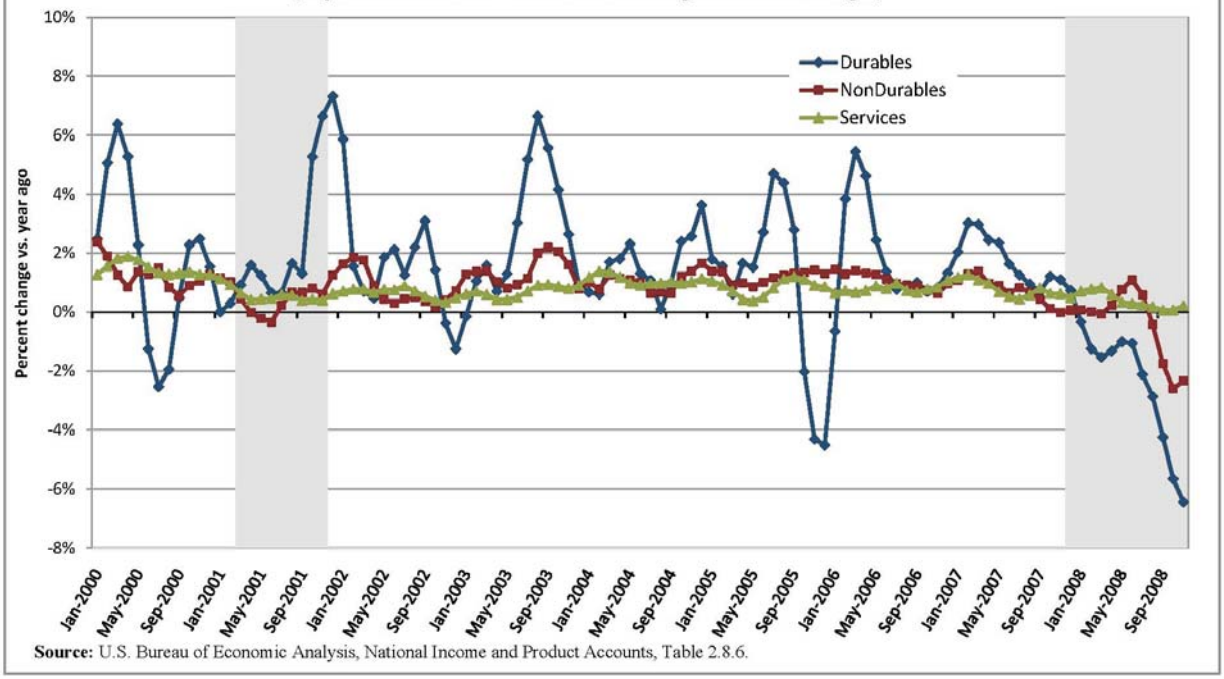
- ✔ While income growth has slowed, the big story so far is that consumption of goods — especially durables — has been declining. This is a classic response of consumers to economic uncertainty and fears of lower income — eliminating, postponing, and scaling back purchases of items that are not necessary or not needed immediately, such as new cars, washing machines, and so on.
- ✔ Consumption continued to weaken in October and November (after the period covered by this report), suggesting that sales tax col-

Figure 5
Consumption Has Fallen Sharply
Percent Change in Income and Consumption vs. Year Ago
(Adjusted for Inflation - Three Month Average of Percent Change)



Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Tables 2.6, 2.8.4, and 2.8.6.

Figure 6
Consumption of Durables, A Mainstay of Sales Taxes, Has Plummetted
Percent Change in Consumption vs. Year Ago
(Adjusted for Inflation - Three Month Average of Percent Changes)



Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 2.8.6.

Table 6
Nonfarm Employment, by State
Last Four Quarters, Year-Over-Year Percent Change

	Jun-05		*Jun-05*	
	Oct.-Dec.	*Jan.-Mar.*	*Apr.-June*	*July-Sep.*
United States	**0.8**	**0.6**	**0.3**	**0.0**
New England	**0.7**	**0.5**	**0.4**	**0.1**
Connecticut	1.0	0.7	0.4	0.2
Maine	0.5	0.2	0.1	(0.3)
Massachusetts	0.8	0.6	0.5	0.4
New Hampshire	1.5	1.3	1.7	0.9
Rhode Island	(1.1)	(1.7)	(2.2)	(2.6)
Vermont	(0.1)	0.1	0.1	(0.2)
Mid-Atlantic	**0.8**	**0.6**	**0.3**	**0.2**
Delaware	0.4	0.2	(0.1)	0.1
Maryland	0.8	1.0	1.1	1.0
New Jersey	0.0	0.1	(0.1)	(0.2)
New York	1.3	0.9	0.5	0.3
Pennsylvania	0.5	0.4	0.1	(0.0)
Great Lakes	**(0.1)**	**(0.2)**	**(0.4)**	**(0.6)**
Illinois	0.5	0.5	0.2	(0.1)
Indiana	0.6	0.3	(0.0)	(0.7)
Michigan	(1.6)	(1.4)	(1.5)	(1.5)
Ohio	(0.2)	(0.1)	(0.3)	(0.3)
Wisconsin	0.3	(0.4)	(0.5)	(0.5)
Plains	**0.9**	**0.7**	**0.3**	**0.1**
Iowa	0.6	0.7	0.5	0.4
Kansas	1.5	1.1	0.4	0.5
Minnesota	0.6	0.5	0.2	(0.3)
Missouri	0.7	0.3	(0.2)	(0.6)
Nebraska	1.9	1.5	1.2	1.1
North Dakota	1.3	1.8	1.3	1.3
South Dakota	1.7	1.7	1.0	1.6
Southeast	**0.9**	**0.6**	**0.2**	**(0.3)**
Alabama	1.5	0.7	0.4	0.3
Arkansas	0.4	0.4	0.3	0.1
Florida	(0.2)	(0.4)	(1.0)	(1.3)
Georgia	0.9	1.0	0.4	(0.8)
Kentucky	1.3	1.1	0.5	0.3
Louisiana	2.8	1.9	1.7	1.0
Mississippi	0.4	0.6	0.5	(0.3)
North Carolina	2.0	1.6	0.9	0.2
South Carolina	1.7	1.0	0.7	(0.3)
Tennessee	0.6	0.2	(0.3)	(0.7)
Virginia	0.7	0.4	0.5	0.5
West Virginia	(0.1)	0.3	0.4	0.2
Southwest	**2.0**	**1.8**	**1.7**	**1.4**
Arizona	0.2	(0.1)	(0.7)	(1.9)
New Mexico	1.0	0.9	1.1	0.3
Oklahoma	1.7	1.5	1.2	1.0
Texas	2.6	2.4	2.4	2.4
Rocky Mountain	**2.4**	**1.9**	**1.4**	**0.7**
Colorado	2.2	2.0	1.5	1.2
Idaho	1.9	0.5	(0.1)	(0.8)
Montana	1.8	1.8	1.6	0.7
Utah	3.0	2.4	1.5	0.1
Wyoming	3.4	3.1	2.9	2.8
Far West	**0.6**	**0.3**	**0.1**	**(0.3)**
Alaska	0.5	0.5	1.0	0.7
California	0.3	(0.0)	(0.1)	(0.5)
Hawaii	0.4	0.8	0.4	0.1
Nevada	0.2	(0.1)	(0.5)	(0.5)
Oregon	1.2	0.8	0.3	(0.2)
Washington	2.4	2.0	1.3	0.8

Source: Bureau of Labor Statistics, analysis by Rockefeller Institute.

lections are likely to have deteriorated further in the October-December quarter.

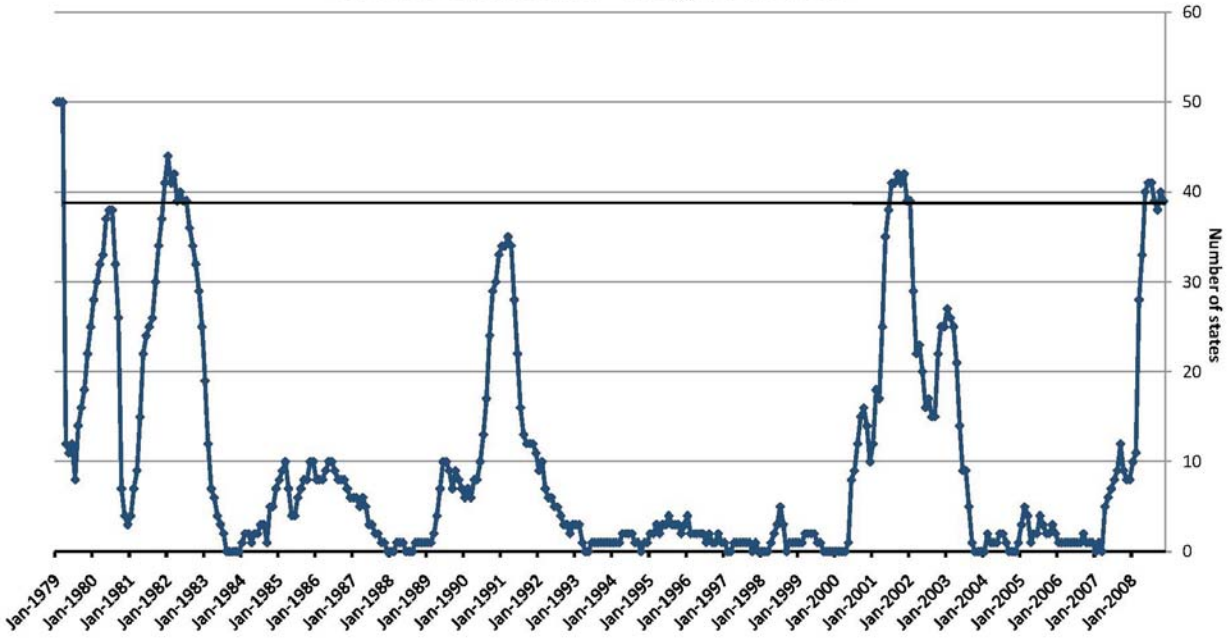
- ✔ Nonwage income historically has been more volatile than either wages or consumption. This income fell extremely sharply in the 2002-2003 period and the recent slowdown in this income — so far — still pales in comparison to that period. That may change in coming months.

Unfortunately, state-by-state data on income and consumption are not available on a timely basis, and so we cannot easily see variation across the country in these trends. Traditionally, the Rockefeller Institute has relied on employment data from the Bureau of Labor Statistics to examine state-by-state economic conditions. These data are relatively timely and are of high quality. Table 6 shows year-over-year employment growth for the last four quarters. For the nation as a whole, this growth came to a halt in the July-September quarter, continuing the slowing seen in earlier quarters. On a year-over-year basis, employment declined in 22 states. Measured relative to the previous quarter (rather than a year ago), employment declined in a majority of states.

The regional patterns are quite varied: The Great Lakes region has suffered a malaise for more than a year. The previously strong Rocky Mountain region slowed very sharply by this measure, and other data examining the region on a quarter to quarter basis show rapid deterioration in many of these states although it was still the nation's second-fastest growing region. There are few bright spots, but Nebraska, North Dakota, South Dakota, Texas, and Wyoming continue to stand out.

The employment data are compared to the same period a year ago rather than to preceding months. If employment begins to decline relative to earlier months it can still be higher than its value a year ago. What we are likely to see in the employment data in such a case is a slowing rate of year-over-year growth when the economy begins to decline relative to recent months. The coincident indexes presented below can be compared more easily to recent months and thus can provide a more-intuitive picture of a declining economy, but both sets of data are useful.

Figure 7
Economy Is Declining in 39 States
Number of States With Economy Declining Compared to Three Months Earlier
Coincident Economic Indexes - Through November 2008

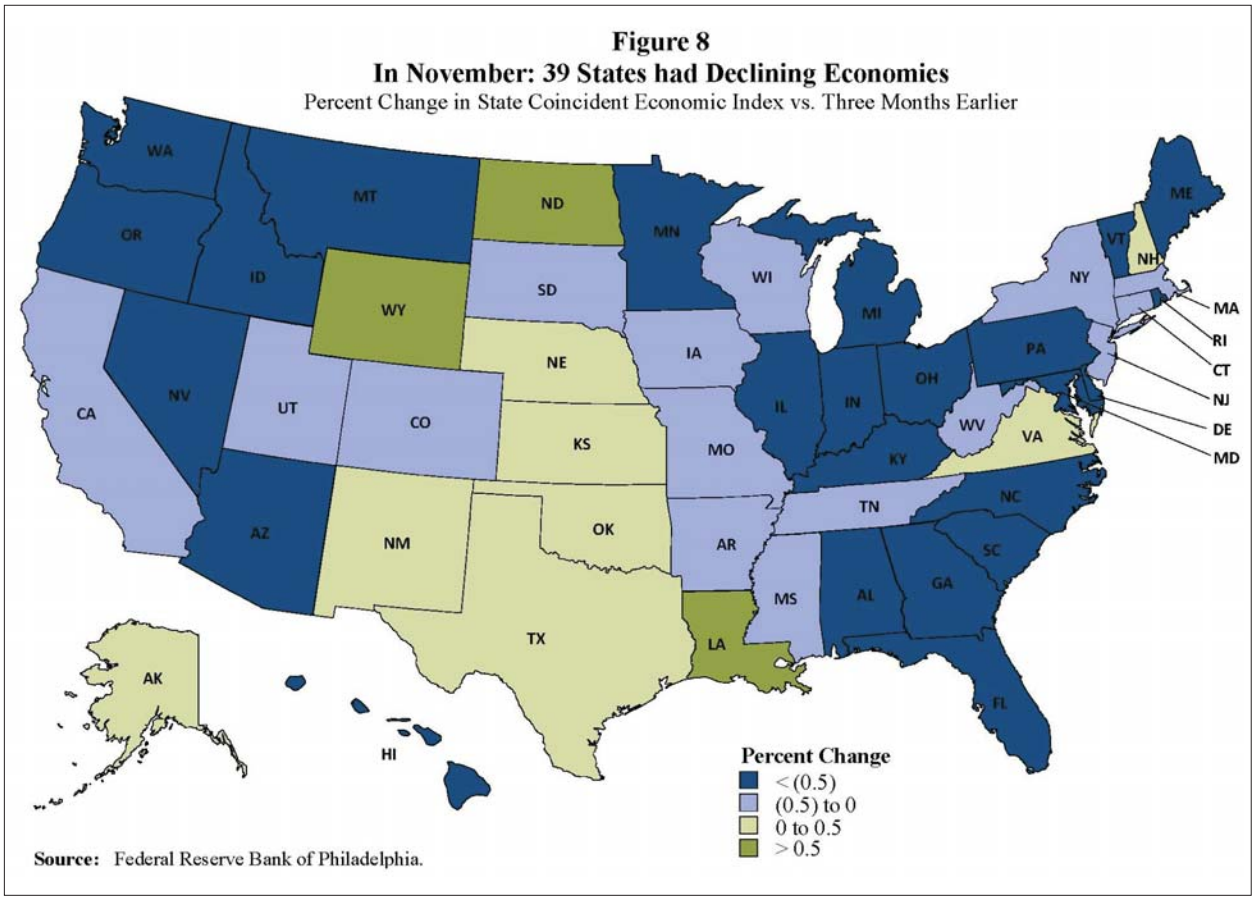


Source: Federal Reserve Bank of Philadelphia.

Thanks to work by economists at the Philadelphia Federal Reserve Bank, we can supplement employment data with broader and highly timely measures known as "coincident economic indexes" intended to provide information about current economic activity in individual states. Unlike leading indexes, these measures are not designed to predict where the economy is headed; rather, they are intended to tell us where we are now.[5] They are modeled on a similar measure for the nation as a whole, but due to limited availability of state-level data they are focused on labor market conditions, incorporating information from nonfarm payroll employment, average hours worked in manufacturing, the unemployment rate, and real wage and salary disbursements. These indexes can be used to measure the scope of economic decline.

Figure 7 shows, by month over the last three decades, the number of states that had declining economic activity relative to three months earlier. As recently as January, only 15 states suffered declines, but since then economic weakening has spread rapidly throughout the country. By May, fully 40 states had declines in economic activity (as measured by the coincident index) compared with three months earlier and the index has hovered near then since, with 39 states declining in November relative to three months earlier. The horizontal line drawn to the left of the November 2008 point on the graph shows that declines now appear to be more widespread than in the 1990-91 recession, but slightly less so than in the 2001 and 1980-82 recessions. The data underlying these indexes are subject to revision, and so tentative conclusions drawn now could change at a later date.

Which states have declined? Figure 8, for November, shows that most states still growing are rich in oil and minerals and many are near the center of the country. Table 7 shows the states sorted by the change in the coincident economic index versus three months ago. Many of the states with the largest declines, toward the bottom of the list, have suffered heavily from large declines in the price of housing, including Michigan, Nevada, and several southeastern states. However, they have been joined in recent months by Idaho, Oregon,



and Washington, which have declined significantly in recent months.

Figures 7 and 8 show the breadth of economic decline but provide little information on the depth of decline. Figure 9 shows the median percentage change compared to three months earlier — in a sense, how the typical state has been faring. The median state change generally will not be the same as the national change because it gives every state equal importance — in this measure, California is no more important than Wyoming.

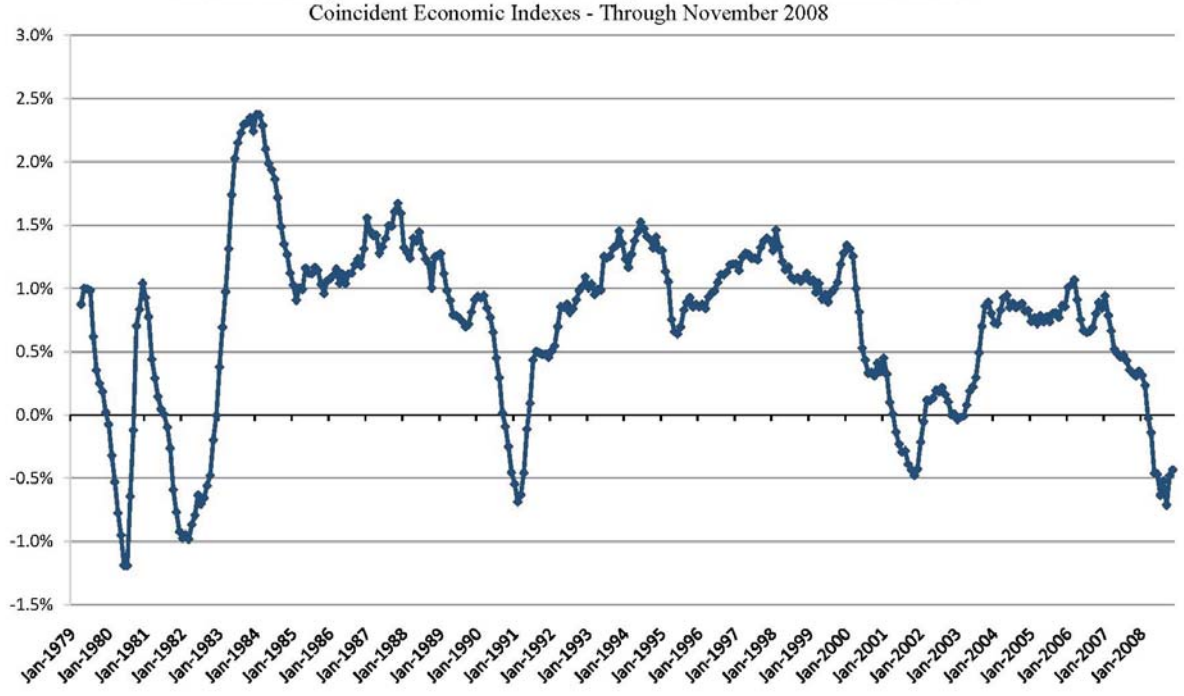
Here we can see that the most-recently reported decline in the typical state is about as bad as it was during the 2001 recession but not yet as bad as in the 1990-91 or 1980-82 recessions. For reasons discussed elsewhere, tax revenue has not yet suffered as much as it did in the last recession.[6] However, we expect tax revenue to be even worse in this recession than in the last one.

The continued weakening in October and November suggests that state tax collections in the just-completed October-December quarter will have been worse than in July-September, and that tax collections will weaken further. We expect to issue a "flash report" on the October-December quarter as soon as we have enough data to report.

Tax Law Changes Affecting This Quarter

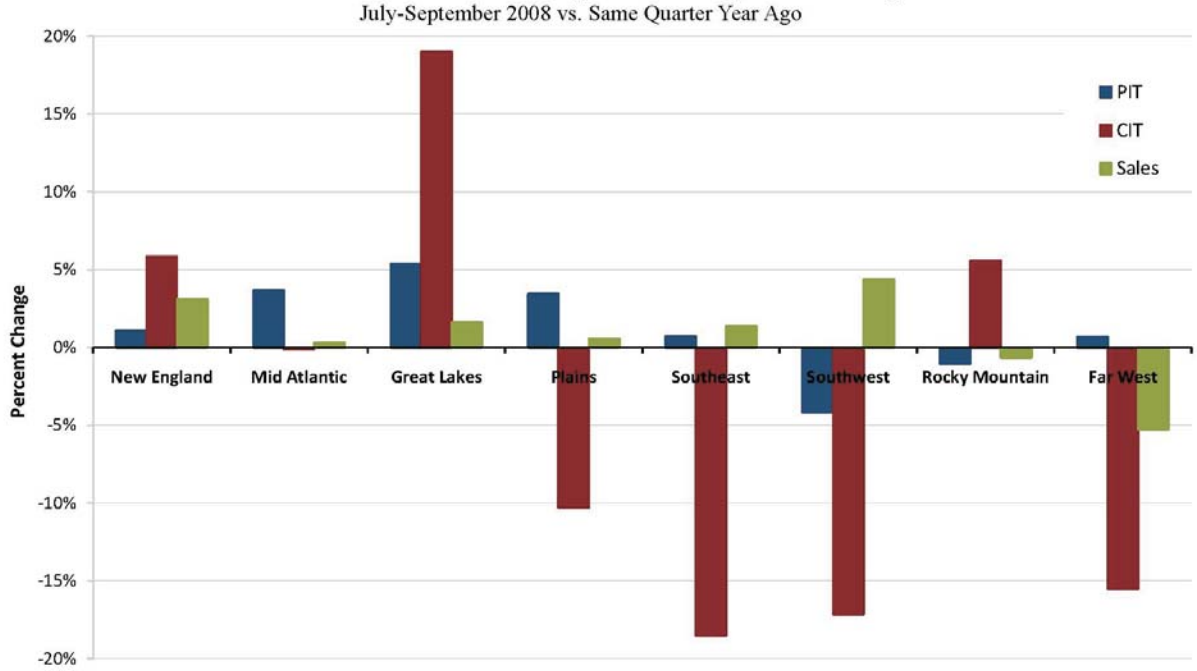
Another important element affecting trends in tax revenue growth is changes in states' tax laws. When states boost or depress their revenue growth with tax increases or cuts, it can be difficult to draw any conclusions about their current fiscal condition from nominal collections data. That is why this report attempts to note where such changes have significantly affected each state's revenue growth. We also occasionally note when tax-processing changes have had a major impact on revenue growth, even though these are not due to enacted legislation, as it helps the reader to understand that the apparent growth or decline is not necessarily indicative of underlying trends.

Figure 9
Percent Change in State Economies Compared to Three Months Earlier
Coincident Economic Indexes - Through November 2008



Source: Federal Reserve Bank of Philadelphia.
Note: Percent change is for the median state.

Figure 10
State Tax Revenue Growth Adjusted For Legislative Changes
July-September 2008 vs. Same Quarter Year Ago



Sources: Rockefeller Institute Analysis of (1) data from U.S. Bureau of the Census (tax revenue, most states), (2) data from National Association of State Budget Officers (legislative enactments, most states), and (3) data from selected individual states (supplemental data on tax revenue and legislative enactments).

Tax Structure and Revenue Growth

Even if economic growth affected all regions and states to exactly the same degree and at exactly the same time, the impact on state revenue would vary because the tax systems used by the states react differently to similar economic situations. States that rely heavily on the personal income tax will tend to see stronger growth in good times, since they benefit from growth in income earned by the highest income individuals. This is most evident in states with more progressive income tax structures, since higher incomes are taxed at the highest rates. The sales tax is also very responsive to economic conditions, but is historically less elastic than the personal income tax, dropping more slowly in bad times and increasing more slowly in good times. States that rely heavily on corporate income or severance taxes often see wild swings in revenue that are not necessarily related to general economic conditions. (Severance taxes are levied on the removal of natural resources, such as oil and natural gas.)

Because high-end incomes are based more heavily upon volatile sources such as stock options and capital gains, growth in personal income tax revenue is far more subject to dramatic fluctuations than it would be if it were based entirely on wages and salaries. Over the last few years, we have seen growth in the stock market and relatively strong growth in corporate profits and other business-related income. In the last recession, we saw the downside of this volatility. Declines in the stock market and other investments pushed personal and corporate income tax collections down much faster than the economy and created large holes in almost every state's budget. As was the case before the 2001 recession, capital gains now constitute a large share of adjusted gross income, and thus contribute a large share of state tax revenues.* Such an environment creates relatively high levels of risk for states that depend heavily on personal income tax revenues. Corporate profits and corporate income tax revenue both showed weak numbers in the last two quarters of 2007 and in 2008.

Sales tax revenue generally fluctuates less rapidly than corporate income taxes and can be more or less volatile than the personal income tax depending on the nature of the business cycle. It does not capture spending on services well, which tends to be less volatile than spending on goods taxed under the sales tax. Over the past decade or so, some state tax analysts have expressed concern that as states have removed more stable elements of consumption such as groceries and clothing from their bases, their sales taxes were more subject to plunge as consumers became nervous about spending on optional and big-ticket items. The sales tax generally maintained slow growth in the latest economic downturn, but grew rapidly and remained steady as general economic conditions improved. Sales tax revenue has been weak in each of the last six quarters.

* Donald J. Boyd, *What Will Happen to State Government Finances in a Recession?,* The Nelson A. Rockefeller Institute of Government, January 30, 2008.

Table 7
State Economic Activity: Declining in 39 States
State Indexes of Economic Activity
States are Sorted by Percent Change vs. 3 Months Ago

State	Coincident index November 2008 (Jan 2007=100)	Percent change vs. 1 year ago (November 2007)	Percent change vs. 3 months ago (August 2008)
Wyoming	107.6	4.0	1.6
North Dakota	103.7	1.8	1.0
Louisiana	104.0	1.0	0.8
New Mexico	101.2	(1.5)	0.5
Texas	106.4	2.8	0.3
Virginia	102.3	0.9	0.2
Oklahoma	103.8	1.3	0.2
Nebraska	102.8	0.6	0.2
Kansas	101.4	(0.4)	0.1
New Hampshire	103.5	0.9	0.1
Alaska	99.4	(0.4)	0.1
Tennessee	100.9	(0.5)	(0.0)
Arkansas	101.4	0.2	(0.1)
New York	103.0	0.7	(0.2)
Iowa	100.9	(0.8)	(0.2)
California	101.1	(0.2)	(0.2)
Colorado	103.6	0.8	(0.3)
South Dakota	103.5	0.5	(0.3)
Massachusetts	103.7	0.3	(0.3)
West Virginia	101.3	0.7	(0.3)
New Jersey	100.2	(0.9)	(0.4)
Utah	102.7	(0.4)	(0.4)
Mississippi	100.6	(0.8)	(0.4)
Connecticut	100.9	(0.9)	(0.4)
Missouri	98.1	(2.2)	(0.4)
Wisconsin	100.1	(0.5)	(0.4)
Illinois	99.3	(1.9)	(0.6)
United States	**101.4**	**(0.4)**	**(0.6)**
Kentucky	99.5	(2.7)	(0.7)
Hawaii	97.8	(2.2)	(0.9)
Vermont	99.0	(1.8)	(0.9)
Ohio	96.6	(3.1)	(1.1)
Florida	96.8	(3.0)	(1.1)
Rhode Island	93.3	(5.6)	(1.2)
Indiana	98.5	(2.7)	(1.2)
Maine	97.6	(2.9)	(1.2)
Maryland	99.0	(2.0)	(1.3)
Arizona	96.1	(4.0)	(1.4)
Montana	99.7	(3.2)	(1.4)
Delaware	95.8	(3.8)	(1.4)
Minnesota	97.5	(3.3)	(1.5)
Alabama	98.8	(2.6)	(1.6)
Pennsylvania	95.4	(5.4)	(1.8)
Georgia	98.3	(3.1)	(1.8)
North Carolina	100.1	(2.4)	(2.0)
Michigan	93.2	(5.0)	(2.1)
Nevada	93.0	(6.5)	(2.2)
Idaho	96.3	(5.2)	(2.2)
South Carolina	97.0	(4.9)	(2.8)
Washington	96.7	(6.1)	(3.0)
Oregon	92.6	(8.9)	(5.2)

Source: Federal Reserve Bank of Philadelphia.

During the July-September 2008 quarter, enacted tax changes increased state revenue by an estimated net of $426 million compared to the same period in 2007. Sales tax increases accounted for approximately $380 million of the change, and the "other" tax category accounted for an $86 million increase, reflecting tobacco tax increases. Corporate tax changes accounted for most of the remainder.[7] In addition, we included an adjustment to the California sales tax for changes in the timing of sales tax transfers in California that drove the reported growth up to 9.4 percent compared with an adjusted decline of 6.2 percent.

The net impact is that total tax revenue grew 0.8 percent more than it would have in absence of these changes — unadjusted growth would have been 2.4 percent rather than the 3.2 percent reported growth. Figure 10 shows adjusted growth by region.

Conclusions

State tax collections slowed in the July-September quarter from the temporarily boosted growth of the April-June quarter, and underlying data were far weaker than the official data suggest. After adjusting for inflation, legislated changes, and known anomalies, revenue declined in 29 states with a median change of minus 1.2 percent.

The economy has declined significantly since the July-September quarter ended, and state tax collections will worsen. Consumption data, retail sales data, and early tax reports from states all point to dramatic reductions in sales taxes in the October-December quarter. Real consumption of goods

Table 8
State Tax Revenue, July-September, 2007 and 2008 ($ in millions)

	2007				2008			
	Personal Income	Corporate Income	Sales	Total	Personal Income	Corporate Income	Sales	Total
United States	**60,291**	**11,836**	**56,670**	**174,528**	**61,564**	**11,195**	**58,371**	**180,193**
New England	**4,557**	**717**	**2,049**	**9,340**	**4,607**	**760**	**2,113**	**9,451**
Connecticut	951	71	439	1,993	890	84	532	2,014
Maine	301	44	219	766	319	39	225	776
Massachusetts	2,887	449	1,070	5,108	2,979	487	1,045	5,195
New Hampshire	18	119	NA	403	22	111	NA	410
Rhode Island	256	14	234	682	245	16	229	670
Vermont	144	22	86	388	151	23	82	386
Mid-Atlantic	**14,046**	**2,345**	**7,913**	**31,711**	**14,641**	**2,377**	**8,045**	**32,735**
Delaware	232	67	NA	688	236	92	NA	724
Maryland	1,567	155	580	3,558	1,758	225	684	4,124
New Jersey	2,129	500	2,174	6,075	2,175	516	2,117	6,087
New York	7,873	1,173	2,875	14,143	8,181	1,155	2,949	14,715
Pennsylvania	2,245	450	2,285	7,248	2,290	390	2,295	7,085
Great Lakes	**8,704**	**2,018**	**8,621**	**26,788**	**9,089**	**2,325**	**8,987**	**28,063**
Illinois	2,072	538	1,984	6,858	2,150	520	2,023	6,956
Indiana	1,122	255	1,416	3,555	1,101	228	1,695	3,878
Michigan	2,194	706	2,527	8,041	2,367	1,099	2,603	8,755
Ohio	2,030	326	1,906	5,551	2,008	326	1,918	5,550
Wisconsin	1,287	194	789	2,784	1,464	153	748	2,924
Plains	**4,595**	**621**	**3,569**	**11,517**	**4,752**	**563**	**3,653**	**11,892**
Iowa	487	29	358	1,231	521	41	445	1,360
Kansas	643	127	571	1,630	660	88	582	1,646
Minnesota	1,753	274	1,055	4,096	1,854	237	1,032	4,173
Missouri	1,213	92	841	2,669	1,215	89	811	2,639
Nebraska	433	62	415	1,083	426	57	398	1,036
North Dakota	66	26	122	465	76	37	167	677
South Dakota	NA	11	208	343	NA	13	217	361
Southeast	**11,284**	**2,276**	**14,233**	**38,262**	**11,360**	**1,855**	**14,409**	**37,876**
Alabama	725	112	563	2,158	755	103	586	2,236
Arkansas	560	103	717	1,781	595	90	744	1,838
Florida	NA	458	4,431	8,158	NA	474	4,686	8,033
Georgia	2,179	205	1,408	4,303	2,083	191	1,398	4,258
Kentucky	823	164	728	2,408	877	82	751	2,439
Louisiana	770	168	819	2,572	677	108	825	2,595
Mississippi	371	85	680	1,491	364	73	697	1,511
North Carolina	2,556	319	1,344	5,367	2,572	229	1,299	5,190
South Carolina	606	28	558	1,574	583	18	505	1,529
Tennessee	4	252	1,759	2,800	5	189	1,724	2,682
Virginia	2,322	224	919	4,350	2,470	187	904	4,276
West Virginia	369	158	305	1,301	379	111	291	1,289
Southwest	**1,537**	**338**	**7,297**	**16,060**	**1,469**	**280**	**7,614**	**16,990**
Arizona	727	240	1,360	2,976	670	175	1,262	2,749
New Mexico	91	4	186	613	93	4	193	735
Oklahoma	719	93	551	2,115	706	102	577	2,362
Texas	NA	NA	5,200	10,355	NA	NA	5,582	11,144
Rocky Mountain	**2,178**	**289**	**1,663**	**5,343**	**2,155**	**305**	**1,653**	**5,436**
Colorado	1,118	124	615	2,273	1,176	116	597	2,338
Idaho	291	40	374	866	277	39	355	830
Montana	210	41	NA	497	217	46	NA	558
Utah	558	84	481	1,423	486	103	488	1,387
Wyoming	NA	NA	195	283	NA	NA	213	322
Far West	**13,389**	**3,232**	**11,325**	**35,507**	**13,491**	**2,730**	**11,898**	**37,750**
Alaska	NA	322	NA	659	NA	358	NA	2,891
California	11,658	2,760	7,503	26,492	11,611	2,239	8,209	26,438
Hawaii	379	32	646	1,256	383	37	669	1,289
Nevada	NA	NA	244	522	NA	NA	241	521
Oregon	1,352	117	NA	1,867	1,497	96	NA	2,006
Washington	NA	NA	2,931	4,710	NA	NA	2,779	4,605

Source: U.S. Census Bureau.

Table 9
Quarterly Tax Revenue by Major Tax, by State
July-September, 2007 to 2008, Percent Change

	PIT	CIT	Sales	Total
United States	**2.1**	**(5.4)**	**3.0**	**3.2**
New England	**1.1**	**5.9**	**3.1**	**1.2**
Connecticut	(6.4)	18.7	21.1	1.0
Maine	5.8	(12.1)	2.8	1.3
Massachusetts	3.2	8.6	(2.3)	1.7
New Hampshire	22.0	(6.1)	NA	1.8
Rhode Island	(4.2)	12.8	(2.4)	(1.8)
Vermont	4.9	6.4	(5.2)	(0.5)
Mid-Atlantic	**4.2**	**1.4**	**1.7**	**3.2**
Delaware	1.4	36.1	NA	5.1
Maryland	12.2	44.8	18.0	15.9
New Jersey	2.2	3.3	(2.6)	0.2
New York	3.9	(1.5)	2.6	4.0
Pennsylvania	2.0	(13.2)	0.5	(2.2)
Great Lakes	**4.4**	**15.2**	**4.2**	**4.8**
Illinois	3.8	(3.4)	1.9	1.4
Indiana	(1.9)	(10.5)	19.7	9.1
Michigan	7.9	55.7	3.0	8.9
Ohio	(1.1)	0.0	0.7	(0.0)
Wisconsin	13.7	(21.0)	(5.1)	5.1
Plains	**3.4**	**(9.4)**	**2.4**	**3.3**
Iowa	6.9	40.7	24.4	10.5
Kansas	2.6	(30.6)	1.8	0.9
Minnesota	5.7	(13.5)	(2.1)	1.9
Missouri	0.2	(3.0)	(3.5)	(1.1)
Nebraska	(1.7)	(8.5)	(4.0)	(4.4)
North Dakota	14.5	41.9	37.3	45.7
South Dakota	NA	24.2	4.6	5.3
Southeast	**0.7**	**(18.5)**	**1.2**	**(1.0)**
Alabama	4.1	(8.5)	4.1	3.6
Arkansas	6.2	(12.4)	3.7	3.2
Florida	NA	3.6	5.8	(1.5)
Georgia	(4.4)	(6.8)	(0.7)	(1.0)
Kentucky	6.6	(49.8)	3.2	1.3
Louisiana	(12.0)	(35.7)	0.7	0.9
Mississippi	(1.8)	(14.6)	2.5	1.4
North Carolina	0.6	(28.3)	(3.4)	(3.3)
South Carolina	(3.7)	(35.9)	(9.6)	(2.8)
Tennessee	39.9	(25.2)	(2.0)	(4.2)
Virginia	6.4	(16.6)	(1.7)	(1.7)
West Virginia	2.7	(29.4)	(4.7)	(0.9)
Southwest	**(4.4)**	**(17.2)**	**4.3**	**5.8**
Arizona	(7.8)	(27.4)	(7.2)	(7.6)
New Mexico	1.9	(9.7)	3.6	19.9
Oklahoma	(1.8)	9.0	4.7	11.6
Texas	NA	NA	7.3	7.6
Rocky Mountain	**(1.1)**	**5.6**	**(0.7)**	**1.7**
Colorado	5.1	(6.2)	(2.9)	2.9
Idaho	(5.0)	(1.2)	(5.1)	(4.2)
Montana	3.2	12.3	NA	12.3
Utah	(12.9)	22.7	1.6	(2.6)
Wyoming	NA	NA	9.3	13.7
Far West	**0.8**	**(15.5)**	**5.1**	**6.3**
Alaska	NA	11.2	NA	338.6
California	(0.4)	(18.9)	9.4	(0.2)
Hawaii	1.0	16.7	3.5	2.6
Nevada	NA	NA	(1.1)	(0.2)
Oregon	10.7	(18.3)	NA	7.4
Washington	NA	NA	(5.2)	(2.2)

Source: U.S. Census Bureau.

declined by 5.0 percent in October versus the year earlier, and by 2.2 percent in November.

Sales tax revenue for the 35 states that have reported collections for October and November (and December in a few cases) was down 6.5 percent versus the year earlier, with declines in 29 states. The sales tax decline will be especially damaging to states that rely heavily on these taxes, particularly in the Southeast and Southwest where the sales tax plays a larger role than elsewhere.

The income tax, too, is being clobbered with declines in 18 out of 33 states reporting so far. The national total may not look quite as bad as the experience of most states because our data are skewed by a single state, Oregon, where the preliminary data show a quadrupling of revenue compared with the previous year. This is because Oregon's "kicker rebate" law required about $1.1 billion of surplus revenue to be rebated to taxpayers in the October-December quarter of 2007, but there were no surplus revenues to be rebated this year. Including Oregon, the national total for the states we have so far is up 0.1 percent; excluding Oregon, it is down 2.6 percent. In addition, the corporate income tax is showing a double-digit decline.

Our preliminary total for all taxes is down about 4.4 percent based on the states we have so far (5.5 percent if we exclude Oregon). While the numbers will change as we receive data for December and for states that have not yet reported, this portends an extremely bad October-December quarter. States are reflecting expectations of large declines in the budgets currently being proposed by governors. Whether they are reducing their forecasts enough to keep up with declines of these magnitudes is an open question.

In the January-March quarter, significant sales tax declines are likely to continue, reflecting collections from holiday sales remitted in that quarter. In addition, states with income taxes are likely to be hit by declines in the estimated payment of income tax due in that quarter and by withholding on wages in the quarter. In those states reliant on bonuses from workers in the financial sector and from executives, withholding is likely to be very weak.

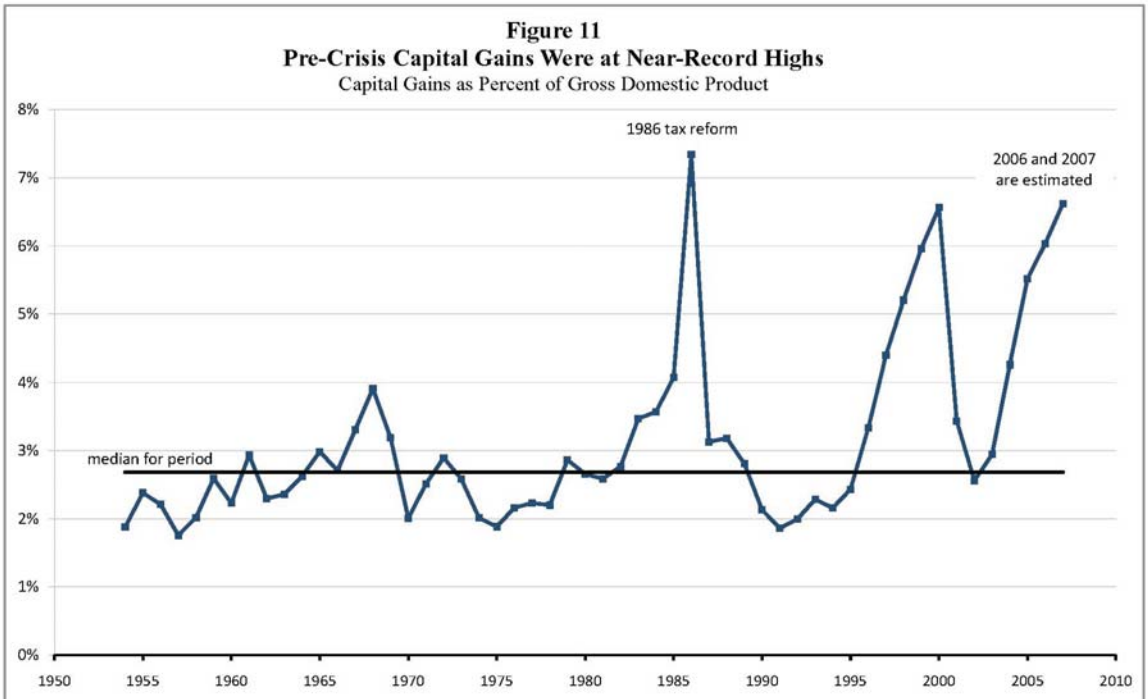
The most worrisome quarter will be April-June, when income tax returns for 2008 are due. Most information points to a large decline in this quarter.

Capital Gains: An Update

In recent reports we have made several points about capital gains:

- ✔ Huge declines in capital gains in 2001 and 2002 from unprecedented heights were the most important reason that the post-2001 state fiscal crisis was the worst in more than 50 years.
- ✔ Capital gains recovered and are now an even larger share of the economy than they were right before the 2001 fall, as Figure 11 shows.
- ✔ The seeds are sown for declines now that could be even worse than the 48 and 27 percent declines in 2001 and 2002.

Figure 11
Pre-Crisis Capital Gains Were at Near-Record Highs
Capital Gains as Percent of Gross Domestic Product



Sources: (1) Capital gains: 1954-1998: Table capgain1-2001.pdf from IRS Statistics of Income web site (www.irs.gov/taxstats); 1999-2005 various SOI files; 2006 based on preliminary data; 2007 based on estimates from individual states; (2) Gross domestic product from U.S. Bureau of Economic Analysis

Conversations with experts in capital gains forecasting suggest that many are expecting declines of 30-50 percent in tax year 2008 (much of which will be felt when tax returns are filed this April) followed by a decline of perhaps 20-40 percent in the 2009 tax year. For example, the Legislative Analyst's Office in California expects a decline of about 48 percent in 2008 and a 37 percent decline in 2009. The longer-term outlook is for a bumpy ride that will inject even more uncertainty into forecasts that are just one step above conjecture*: the federal tax rate on most long-term capital gains is scheduled to increase from 15 percent to 20 percent in 2011, creating an incentive for taxpayers to accelerate gains into 2010 and creating a hollow in 2011.

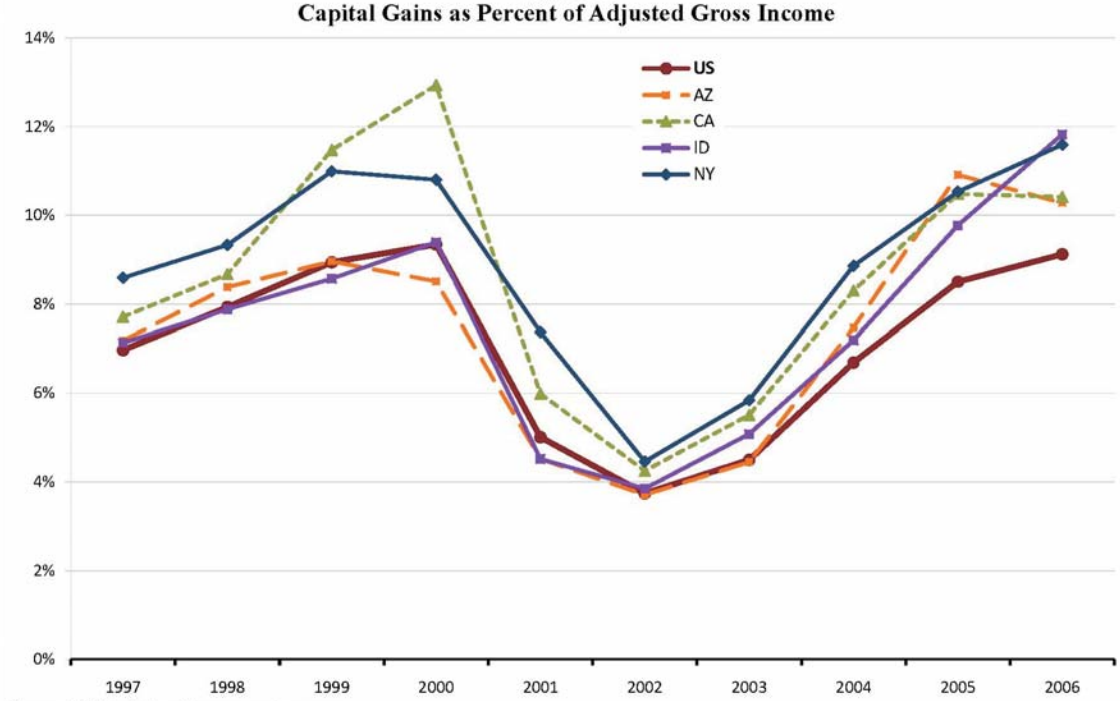
* We mean no disrespect to capital gains forecasters by this. They know as well as anyone that (a) it is important to use formal models to guide their forecasts, and that (b) the best formal models have huge forecasting errors nonetheless.

One particularly large uncertainty for the near term is created by the fact that the worst of the stock market decline occurred very late in 2008. It is possible that capital gains realizations prior to the sharp drop in the last quarter were reasonably strong, and that 2009 will have even worse declines than 2008. The little available data on the intra-year distribution of capital gains realizations certainly allow for this. The last time around capital gains declines did not begin until 2001 although the stock market decline began in 2000. Issues such as this make the forecaster's job very difficult. Thus, even if tax returns filed in April 2009 are less devastating than states expect, they will still need to worry that gains on 2009 tax returns may be far worse.

The general pattern of a huge increase in capital gains prior to 2001 followed by declines and then growth occurred in most states, but in some it was more pronounced than others. Figure 12 below shows the pattern measured by capital gains as a share of adjusted gross income, for the United States as a whole and for four states with income taxes where gains are now especially high as a share of income: Arizona, California, Idaho, and New York. These states appear to be particularly at risk if gains fall considerably.

Income-tax states are in for a rough ride.

Figure 12
Capital Gains as Percent of Adjusted Gross Income



Source: IRS Statistics of Income, various years.

Endnotes

1 Census Bureau data with no adjustments show 3.0 percent growth. However, Census data do not include complete information for Massachusetts, Michigan, New Mexico, and Washington. We incorporated estimates for Massachusetts, Michigan and Washington based upon data provided to us directly by these states, and this accounts for the small difference. We were unable to obtain better data for New Mexico than that reported by the Census Bureau and so we made no adjustments to New Mexico.

2 Income tax growth for the April-June quarter has been revised upward slightly by the Census Bureau from earlier-reported growth.

3 Tennessee and New Hampshire had larger increases, but they have narrow-based taxes on nonwage income and are not normally thought of as income-tax states.

4 ACES stands for Alaska's Clear and Equitable Share.

5 For a technical discussion of these indexes and their national counterpart, see Theodore M. Crone and Alan Clayton-Matthews. "Consistent Economic Indexes for the 50 States," *Review of Economics and Statistics,* 87 (2005), pp. 593-603; Theodore M. Crone, "What a New Set of Indexes Tells Us About State and National Business Cycles," *Business Review*, Federal Reserve Bank of Philadelphia (First Quarter 2006); and James H. Stock and Mark W. Watson. "New Indexes of Coincident and Leading Economic Indicators," *NBER Macroeconomics Annual* (1989), pp. 351-94. The data and several papers are available at www.philadelphiafed.org/econ/indexes/coincident.

6 See Donald J. Boyd, "What Will Happen to State Government Finances in a Recession?," The Nelson A. Rockefeller Institute of Government, January 30, 2008.

7 Rockefeller Institute analysis of data from the National Association of State Budget Officers and from reports in several individual states.

About The Nelson A. Rockefeller Institute of Government's Fiscal Studies Program

The Nelson A. Rockefeller Institute of Government, the public policy research arm of the State University of New York, was established in 1982 to bring the resources of the 64-campus SUNY system to bear on public policy issues. The Institute is active nationally in research and special projects on the role of state governments in American federalism and the management and finances of both state and local governments in major areas of domestic public affairs.

The Institute's Fiscal Studies Program, originally called the Center for the Study of the States, was established in May 1990 in response to the growing importance of state governments in the American federal system. Despite the ever-growing role of the states, there is a dearth of high-quality, practical, independent research about state and local programs and finances.

The mission of the Fiscal Studies Program is to help fill this important gap. The Program conducts research on trends affecting all 50 states and serves as a national resource for public officials, the media, public affairs experts, researchers, and others.

This report was researched and written by Donald Boyd, senior fellow, and Lucy Dadayan, senior policy analyst. Robert B. Ward, deputy director of the Institute, directs the Fiscal Studies Program. Michael Cooper, the Rockefeller Institute's Director of Publications, did the layout and design of this report, with assistance from Michele Charbonneau.

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