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Revenue Declines Less Severe, But States' Fiscal Crisis Is Far From Over

Recovery Not in Sight; May Be Long and Slow

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HIGHLIGHTS

- State tax revenues continued to deteriorate in the fourth quarter of 2009, marking a record fifth consecutive quarter of year-over-year declines. Overall, revenues showed a drop of 4.2 percent from the same quarter a year earlier and a decline of 8.6 percent from the same period two years earlier, according to Rockefeller Institute research and Census Bureau data.
- Forty-one states reported total tax revenue declines during the quarter, with seven states reporting double-digit declines. Nine states showed improvement in revenues relative to a year earlier.
- Preliminary figures for January and February for 45 early-reporting states show continued weakness, with personal income tax collections dropping 7.1 percent and overall tax collections dropping 2.2 percent from a year earlier. There is a risk that income-tax collections in April and May will fall relative to the already weak levels of a year earlier.
- Local tax revenue increased 4.6 percent in nominal terms and 3.9 percent in real terms, mostly driven by growth in property taxes.
- State fiscal recovery is likely to be long and slow, presenting policy-makers with several years of lingering difficulty in balancing budgets.

Overall State Taxes and Local Taxes

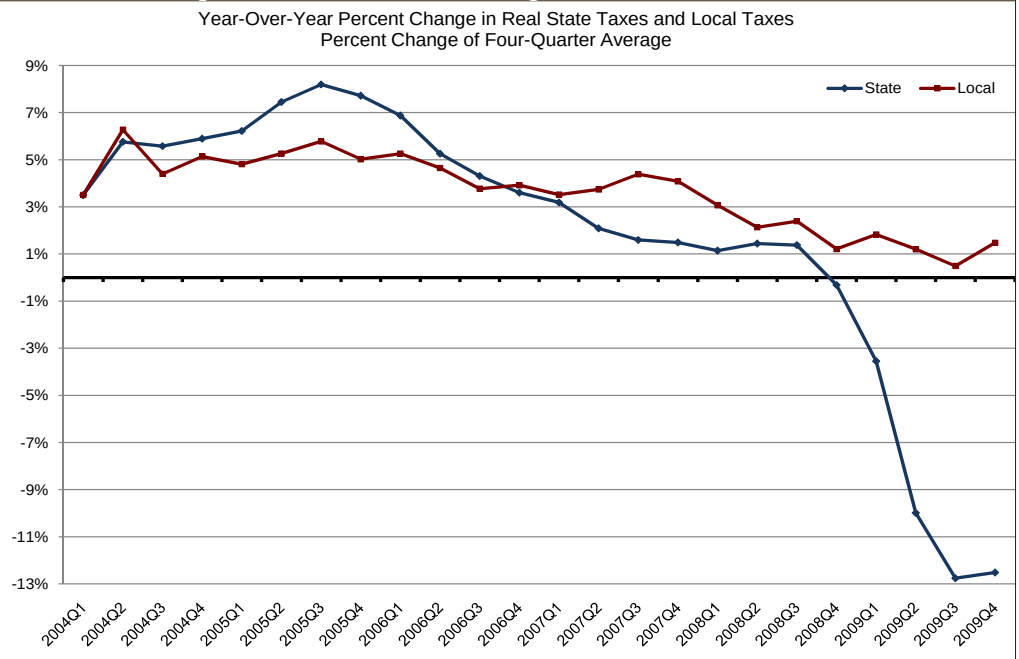
Total state tax collections as well as collections from two major sources — taxes on sales and personal income — all declined for the fifth consecutive quarter. Overall state tax revenues in the October-December quarter of 2009, after reflecting certain adjustments made by the Rockefeller Institute (see "Adjustments to Census Bureau Tax Collection Data" on page 28), declined by 4.2 percent from the same quarter of the previous year.[1] We have compiled historical data from the Census Bureau website going back to 1962. Both nominal and inflation adjusted figures indicate that this is a record fifth consecutive quarter that total tax revenues as well as collections from personal income tax and sales tax declined on a year-over-year basis.

Total revenues were down by 8.6 percent from the same quarter two years earlier. Over the past two decades, before the last national recession, state tax revenues averaged annual, year-over-year increases in the range of 5 to 5.5 percent. In normal times, then, the last two years might have been expected to produce an overall revenue increase of 10 percent or more. Combined with the actual decline mentioned above, states have seen revenue drop by more than 18 percent relative to what might otherwise have been expected.[2]

Another way to assess the current revenue picture is to adjust collections statistics for inflation and to remove seasonality. Using this measure, tax revenues are currently at roughly the same level as they were in both 2000 and 2004 (revenues declined, especially after adjusting for inflation, during and after the 2001 recession.) In other words, state tax revenue, adjusted for inflation, is at about the same level as 10 years ago, although the nation's population has increased by approximately 10 percent during that period. In addition, health care costs, which are a major driver of state expenditures, have grown far faster than general price inflation.

Over the past three years, 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

Figure 1. State Taxes Are Faring Worse Than Local Taxes



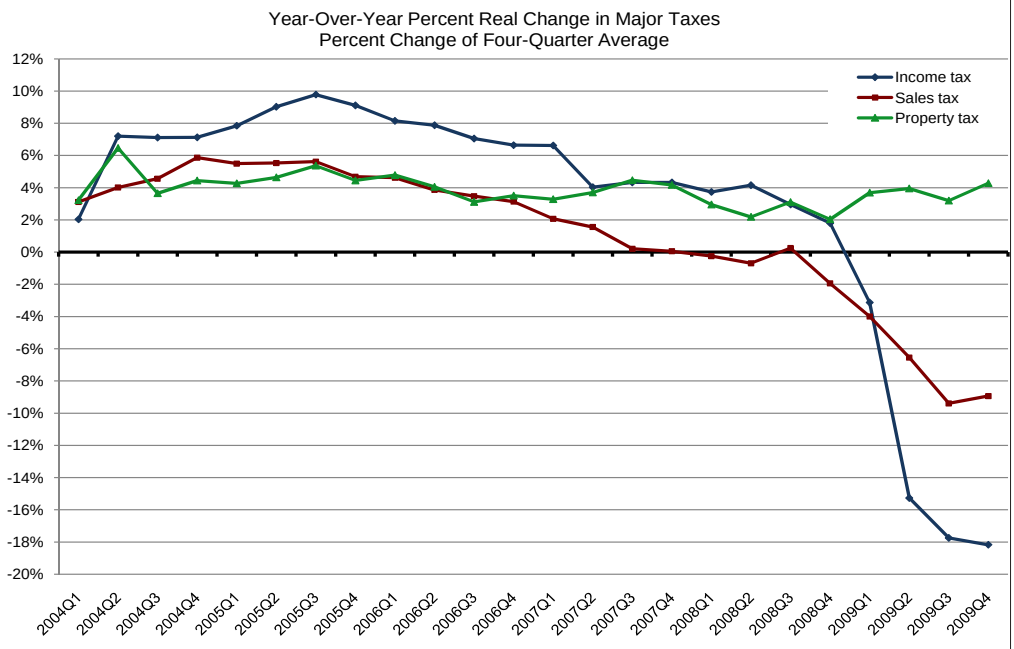
Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.

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 year-over-year change in state taxes, adjusted for inflation, has averaged negative 12.5 percent over the last four quarters, down from the 0.3 percent average decline of a year ago and 1.5 percent average growth of two years ago. Real, year-over-year growth in local taxes was an average of 1.5 percent over the last four quarters, slightly higher compared to 1.2 percent for the preceding year, but much slower compared to 4.1 percent average growth of two years ago. Inflation for the period, as measured by the gross domestic product deflator, was 0.7 percent.

The local tax slowdown is less severe than the state tax slowdown. In the fourth quarter of 2009, local tax collections showed a relatively strong growth of 4.6 percent. Most local governments rely heavily on property taxes, which tend to be relatively stable and rose by 5.6 percent during the quarter. Collections from local individual income tax and sales tax both continued to decline in the fourth quarter of 2009 at 4.7 and 2.5 percent respectively. The decline in local individual income tax and sales tax collections in the fourth quarter of 2009 also represents the fifth consecutive quarter in which local tax revenues from the two sources declined on a year-over-year basis.

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 shown slower growth, and then outright decline, over most of the last four years. While the sales tax underperformed the income tax for most of that period, the dropoff in income-tax collections bypassed the sales tax decline in the second, third and fourth quarters of 2009, relative to the same periods a year earlier. The income tax continued to decline further in the fourth quarter of 2009, while both sales tax and property tax showed some signs of improvement.

Figure 2. Both Income Tax and Sales Tax Declined Sharply



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.

State Tax Revenue

Total state tax revenue in the fourth quarter of 2009 declined by 4.2 percent relative to a year ago, before adjustments for inflation and legislated changes. The income tax was down by 4.6 percent, the sales tax was down by 5.3 percent, and the corporate income tax declined by 3.6 percent. Tables 1 and 2 portray growth in tax revenue with and without adjustment for inflation, and growth by major tax, respectively. Table 1 does not include adjustment for legislative changes. Total tax revenue declined in 41 states in the fourth quarter of 2009, down from 48 states during the third quarter of 2009. Double-digit declines were reported in seven states in the fourth quarter of 2009, compared to 22 states in the third quarter of 2009. Wyoming experienced the largest decline of 46.2 percent in the fourth quarter of 2009 — not surprising as its revenue collections were unusually high in the past few quarters due to high oil prices and strong growth in severance taxes. All regions but New England reported declines in total state tax collections, with the Southwest showing the largest decline at 15.2 percent. The New England states reported total tax revenue growth of 1.7 percent in the fourth quarter of 2009. Revenue gains were reported in nine states. While most of these increases were modest, collections rose 9.9 percent in North Carolina and 5.7 percent in New Hampshire.

Personal Income Tax

In the fourth quarter personal income tax revenue made up at least a third of total tax revenue in 25 states, and was larger than the sales tax in 32 states. Personal income tax revenue declined 4.6 percent in the October-December 2009 quarter compared to the same quarter in 2008. All regions reported declines in personal income tax collections. The largest decline was in the Southwest, where collections dropped by 14.9 percent. Personal income tax collections declined by a single-digit in the rest of the regions, with the Mid-Atlantic region reporting the lowest decline at 0.4 percent. The only state in the Mid-Atlantic region reporting growth in personal income tax collections was

Table 1. Quarterly State Tax Revenue

Adjusted for Inflation
Year-Over-Year Percent Change

Quarter	Total Nominal	Inflation Rate	Adjusted Real Change
2009 Q4	(4.2)	0.7	(4.9)
2009 Q3	(11.4)	0.6	(11.9)
2009 Q2	(16.5)	1.5	(17.7)
2009 Q1	(11.6)	1.9	(13.3)
2008 Q4	(4.6)	1.9	(6.4)
2008 Q3	2.7	2.5	0.2
2008 Q2	5.4	1.9	3.4
2008 Q1	2.6	2.1	0.4
2007 Q4	3.6	2.7	0.8
2007 Q3	3.1	2.6	0.4
2007 Q2	5.5	3.0	2.5
2007 Q1	5.2	3.2	1.9
2006 Q4	4.2	2.9	1.3
2006 Q3	5.9	3.3	2.6
2006 Q2	10.1	3.6	6.3
2006 Q1	7.1	3.3	3.7
2005 Q4	7.9	3.5	4.2
2005 Q3	10.2	3.4	6.6
2005 Q2	15.9	3.1	12.4
2005 Q1	10.6	3.3	7.0
2004 Q4	9.4	3.2	6.0
2004 Q3	6.5	3.0	3.4
2004 Q2	11.2	2.8	8.2
2004 Q1	8.1	2.3	5.7
2003 Q4	7.0	2.1	4.7
2003 Q3	6.3	2.2	4.0
2003 Q2	2.1	2.1	0.1
2003 Q1	1.6	2.2	(0.6)
2002 Q4	3.4	1.8	1.6
2002 Q3	1.6	1.5	0.0
2002 Q2	(9.4)	1.4	(10.7)
2002 Q1	(6.1)	1.7	(7.6)
2001 Q4	(1.1)	2.0	(3.0)
2001 Q3	0.5	2.2	(1.7)
2001 Q2	1.2	2.5	(1.3)
2001 Q1	2.7	2.3	0.4
2000 Q4	4.2	2.4	1.8
2000 Q3	6.8	2.3	4.4
2000 Q2	11.7	2.0	9.5
2000 Q1	12.0	2.0	9.9
1999 Q4	7.3	1.6	5.6
1999 Q3	6.2	1.5	4.7
1999 Q2	3.9	1.5	2.4
1999 Q1	3.8	1.3	2.4

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

Quarter	PIT	CIT	General Sales	Total
2009 Q4	(4.6)	(3.6)	(5.3)	(4.2)
2009 Q3	(11.9)	(22.6)	(10.0)	(11.4)
2009 Q2	(27.0)	0.8	(9.5)	(16.5)
2009 Q1	(17.4)	(20.1)	(8.3)	(11.6)
2008 Q4	(1.2)	(16.8)	(6.4)	(4.6)
2008 Q3	1.2	(12.9)	4.7	2.7
2008 Q2	8.1	(7.0)	1.0	5.4
2008 Q1	4.8	(1.4)	0.7	2.6
2007 Q4	3.8	(14.5)	4.0	3.6
2007 Q3	7.0	(4.3)	(0.7)	3.1
2007 Q2	9.2	1.7	3.5	5.5
2007 Q1	8.5	14.8	3.1	5.2
2006 Q4	4.4	12.6	4.7	4.2
2006 Q3	6.6	17.5	6.7	5.9
2006 Q2	18.8	1.2	5.2	10.1
2006 Q1	9.3	9.6	7.0	7.1
2005 Q4	6.7	33.4	6.4	7.9
2005 Q3	10.2	24.4	8.3	10.2
2005 Q2	19.7	64.1	9.1	15.9
2005 Q1	13.1	29.8	7.3	10.6
2004 Q4	8.8	23.9	10.7	9.4
2004 Q3	5.8	25.2	7.0	6.5
2004 Q2	15.8	3.9	9.5	11.2
2004 Q1	7.9	5.4	9.1	8.1
2003 Q4	7.6	12.5	3.6	7.0
2003 Q3	5.4	12.6	4.7	6.3
2003 Q2	(3.1)	5.1	4.6	2.1
2003 Q1	(3.3)	8.3	2.4	1.6
2002 Q4	0.4	34.7	1.8	3.4
2002 Q3	(3.4)	7.4	2.4	1.6
2002 Q2	(22.3)	(12.3)	0.1	(9.4)
2002 Q1	(14.7)	(15.7)	(1.4)	(6.1)
2001 Q4	(2.5)	(34.0)	1.8	(1.1)
2001 Q3	(0.0)	(27.2)	2.3	0.5
2001 Q2	3.7	(11.0)	(0.8)	1.2
2001 Q1	4.6	(8.4)	1.8	2.7
2000 Q4	6.5	(0.4)	4.4	4.2
2000 Q3	10.0	8.2	4.8	6.8
2000 Q2	21.2	4.2	7.0	11.7
2000 Q1	17.0	11.0	11.9	12.0
1999 Q4	7.3	4.7	7.2	7.3
1999 Q3	6.9	4.3	6.2	6.2
1999 Q2	5.2	5.4	5.0	3.9
1999 Q1	5.8	(5.4)	4.9	3.8

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

New York, where such growth is mostly attributable to legislated changes.

Only six states reported growth in personal income tax collections. Thirty-seven states showed decline in the fourth quarter of 2009, with ten states reporting double-digit declines. Oklahoma and Montana reported large declines in personal income tax collections at 21.1 and 15.9 percent respectively. In Montana, based on the legislative audit recommendation, the Department of Revenue processed a personal income refund payable adjustment in

the amount of $119 million in October of 2009. Such adjustment was previously done at the end of the fiscal year.

Preliminary figures for 37 of 41 early reporting states with broad-based personal income taxes indicate that personal income tax collections declined still further, by 7.1 percent, in January-February 2010 compared to the same period of 2009.

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.

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 October-December 2009 quarter declined by 1.9 percent for 40 early reporting states that have broad-based income taxes. Thirty-three of 40 states had declines in withholding, with Oklahoma and Louisiana reporting the largest declines at 12.8 and 12.4 percent respectively. Among the seven states reporting growth in withholding for the fourth quarter, Wisconsin and New York had the strongest growth at 7.1 and 4.4 percent respectively. Both states increased their income taxes last year. The Southwest region reported the largest decline in withholding at 9.1 percent, while the Mid-Atlantic and Far West were the only two regions reporting growth at 1.4 and 0.4 percent respectively.

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

The first payment for each tax year is due in April in most states and the second, third and fourth are generally due in June, September, and January. 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 37 states for which we have complete data for all four payments, the median payment was down by 27.4 percent, and by 22.1 percent for the fourth payment (see Table 4). Declines were recorded in 36 of 37 states for all four payments. The only

Table 3. Personal Income Tax Withholding, By State

Last Four Quarters, Percent Change

	2009			
	Jan-March	*April-June*	*July-Sep*	*Oct-Dec*
United States	**(8.0)**	**(5.7)**	**(3.7)**	**(1.9)**
New England	**(5.5)**	**(3.6)**	**(4.3)**	**(1.7)**
Connecticut	(7.7)	(4.5)	(5.0)	1.6
Maine	(3.3)	(2.0)	(0.5)	0.4
Massachusetts	(4.7)	(3.5)	(4.5)	(3.4)
Rhode Island	(5.3)	(4.5)	(3.6)	(2.4)
Vermont	(3.7)	(0.3)	(5.8)	(1.2)
Mid-Atlantic	**(11.4)**	**(8.7)**	**0.5**	**1.4**
Delaware	(3.5)	(2.5)	(3.5)	(5.6)
Maryland	(2.6)	(2.1)	(0.3)	(0.3)
New Jersey	(10.3)	(37.6)	12.8	(0.9)
New York	(16.5)	(1.1)	(1.3)	4.4
Pennsylvania	(1.7)	(2.8)	(4.7)	(3.3)
Great Lakes	**(5.4)**	**(6.3)**	**(7.3)**	**(3.8)**
Illinois	(6.1)	(4.3)	(5.2)	(3.4)
Indiana	(5.1)	ND	ND	ND
Michigan	(6.6)	(8.3)	(8.2)	(7.8)
Ohio	(8.2)	(9.8)	(9.9)	(9.0)
Wisconsin	(0.8)	(3.1)	(5.6)	7.1
Plains	**(2.2)**	**(3.5)**	**(4.8)**	**(5.0)**
Iowa	1.3	1.2	(0.1)	(0.5)
Kansas	(0.5)	(1.9)	(3.6)	(3.0)
Minnesota	(5.0)	(6.4)	(7.6)	(3.6)
Missouri	(2.6)	(5.2)	(4.8)	(11.7)
Nebraska	(1.9)	1.5	(3.6)	0.1
North Dakota	20.4	10.0	0.3	(6.0)
Southeast	**(6.0)**	**(2.6)**	**(2.6)**	**(4.1)**
Alabama	(4.8)	(2.5)	(2.9)	(0.1)
Arkansas	1.8	(0.1)	(2.1)	(2.6)
Georgia	(7.9)	(4.2)	(2.3)	(4.7)
Kentucky	(2.6)	(2.6)	(4.7)	(4.7)
Louisiana	(14.7)	(15.3)	(3.7)	(12.4)
Mississippi	(2.2)	(2.3)	(5.6)	(4.7)
North Carolina	(9.7)	(3.7)	(1.5)	(5.8)
South Carolina	(4.7)	(5.7)	(2.7)	0.7
Virginia	(4.4)	2.6	(2.3)	(2.5)
West Virginia	2.3	0.3	(3.8)	(3.5)
Southwest	**(8.0)**	**(12.5)**	**(4.6)**	**(9.1)**
Arizona	(13.4)	(11.5)	(6.1)	(6.5)
New Mexico	4.0	(21.0)	10.4	(8.1)
Oklahoma	(4.7)	(10.0)	(8.1)	(12.8)
Rocky Mountain	**(5.7)**	**(7.3)**	**(4.7)**	**(4.1)**
Colorado	(3.4)	(4.6)	(4.5)	(4.8)
Idaho	(8.6)	(10.2)	(6.0)	(8.1)
Montana	(4.6)	(32.9)	(3.5)	(2.5)
Utah	(9.1)	(1.5)	(4.7)	(0.7)
Far West	**(10.4)**	**(4.7)**	**(6.8)**	**0.4**
California	(11.1)	(5.5)	(7.1)	1.3
Hawaii	(5.0)	5.2	(3.4)	(10.7)
Oregon	(5.6)	(2.0)	(6.0)	(2.6)

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.
ND - No Data.

Table 4. Estimated Payments/Declarations, By State

Year-Over-Year Percent Change

	April-January (first four payments)	December-January (fourth payment)
Average (Mean)	**(26.5)**	**(21.7)**
Median	**(27.4)**	**(22.1)**
Alabama	(33.1)	(26.6)
Arizona	(36.4)	(23.2)
Arkansas	(25.6)	(13.5)
California	(24.9)	(14.7)
Colorado	(41.9)	(35.0)
Connecticut	(25.7)	(9.6)
Delaware	(29.6)	(25.5)
Georgia	(31.5)	(31.7)
Hawaii	(36.9)	(16.4)
Illinois	(36.7)	(36.9)
Indiana	ND	ND
Iowa	(22.7)	(22.1)
Kansas	(26.7)	(22.5)
Kentucky	(27.1)	(24.6)
Louisiana	(33.6)	(52.4)
Maine	(27.3)	(19.1)
Maryland	(24.1)	(13.2)
Massachusetts	(27.6)	(14.5)
Michigan	(31.7)	(22.0)
Minnesota	(27.4)	(19.3)
Mississippi	(21.4)	(36.7)
Missouri	(31.0)	(32.7)
Montana	(32.2)	(47.9)
Nebraska	(22.2)	(15.7)
New Jersey	(21.1)	(1.0)
New Mexico	ND	ND
New York	(29.2)	4.8
North Carolina	(31.8)	(25.3)
North Dakota	(10.0)	(24.8)
Ohio	(31.3)	(24.2)
Oklahoma	(29.1)	(34.1)
Oregon	(26.1)	(15.2)
Pennsylvania	(27.6)	(22.6)
Rhode Island	(25.2)	(12.4)
South Carolina	(31.1)	(20.0)
Vermont	(26.1)	(17.1)
Virginia	(20.3)	(29.4)
West Virginia	28.2	(1.7)
Wisconsin	(23.8)	(5.5)

Source: Individual state data, analysis by Rockefeller Institute.
Note: ND - No Data

state reporting growth for the all four payments was West Virginia.

The huge and widespread year-over-year declines in the December-January payment is an indication of potential further declines in payments with income tax returns due on April 15. (See "Capital Gains, the Stock Market, and April Tax Returns," page 20, for more on this topic.)

General Sales Tax

State sales tax collections in the October-December 2009 quarter were down 5.3 percent from the same quarter in 2008, and 11.3 percent from the same period two years earlier. This decline is the mildest since the start of the 2007 recession but still far worse than declines in the previous recession. After adjusting for inflation using the gross domestic product price index, state sales tax revenue declined by 5.9 percent in the October-December quarter of 2009.

Sales tax declines were reported in all regions but New England. The Southwest had the largest decline at 15.2 percent, followed by the Rocky Mountain at 3.9 percent. The New England region was the only region reporting growth in sales tax revenue collections in the fourth quarter at 4.8 percent. However, Massachusetts was the only state in the region reporting sales tax growth, mostly attributable to legislated changes. If we exclude Massachusetts from the region, sales tax collections in New England show a 6.2 percent decline.

Forty-one of 45 states with broad-based sales taxes had declines, and ten states had double-digit declines. Massachusetts had the largest increase at 20.8 percent, followed by North Carolina at 17.6 percent. The other two states reporting growth in sales tax revenues were California and Utah at 1.9 and 1.6 percent respectively. Wyoming led the states with the largest decline at 40 percent followed by Georgia at 24.7 percent.

Preliminary figures for the 41 of 45 early reporting states with broad-based sales tax indicate that sales tax collections saw some trivial yet positive growth at 0.1 percent in January-February 2010 compared to the same period of 2009, but nonetheless the sales tax in the median state for these two months was down 4.2 percent. While March data could change the picture,, the sales tax could see small positive growth in the January-March quarter as a result of stabilizing retail sales and consumption as well as legislated changes in several states. (See "State Tax Revenue, While Stabilizing, Is Far Below Its Peak," page 16, for further discussion of retail sales and the sales tax.)

Corporate Income Tax

Corporate income tax revenue is highly variable because of volatility in corporate profits and 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 declined 3.6 percent in the October-December quarter compared to a year earlier, and 19.8 percent from the same period two years earlier. New England, Southeast and Far West regions reported some growth in corporate income tax collections, while the Southwest and Mid-Atlantic region reported the largest declines at 73 and 24 percent, respectively. Among 46 states that have a corporate income tax, 28 showed decreases in such revenue.

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 data collected by the Rockefeller Institute. In Table 5, we show real growth rates for the nation as a whole.

Table 5. Percent Change in Real State Taxes Other Than PIT, CIT, & General Sales Taxes

Year-Over-Year Real Percent Change; Four-Quarter Moving Averages

	Property tax	Motor fuel sales tax	Tobacco product sales tax	Alcoholic beverage sales tax	Motor vehicle & operators license taxes	Other taxes
Collections (millions), latest 12 months	$13,372	$35,582	$16,479	$5,389	$21,934	$97,012
2009Q4	4.9	(4.0)	(2.1)	(0.1)	(0.9)	(15.3)
2009Q3	(1.0)	(4.5)	0.2	(0.3)	(2.5)	(14.4)
2009Q2	(2.3)	(6.3)	1.1	(0.4)	(2.7)	(7.8)
2009Q1	(3.7)	(6.3)	2.4	0.2	(1.9)	3.3
2008Q4	(2.8)	(5.2)	2.9	0.3	(2.2)	7.0
2008Q3	1.7	(3.6)	3.3	(0.3)	(1.3)	9.5
2008Q2	3.2	(1.9)	5.7	0.4	(0.6)	7.5
2008Q1	3.9	(1.4)	6.0	0.4	(1.2)	3.1
2007Q4	3.4	(1.8)	6.0	0.4	(0.6)	2.2
2007Q3	1.4	(0.8)	3.8	1.5	(0.9)	(0.4)
2007Q2	(0.3)	(1.3)	0.4	1.3	(1.0)	(1.4)
2007Q1	1.7	(0.1)	1.5	0.5	0.4	(1.1)
2006Q4	0.1	0.7	2.6	1.0	0.9	(0.4)
2006Q3	(0.3)	(1.1)	5.3	1.1	0.8	1.9
2006Q2	(0.2)	1.4	8.9	1.1	0.7	4.2
2006Q1	0.8	1.5	6.9	2.4	0.1	5.2
2005Q4	1.9	2.1	5.4	1.6	0.3	7.1
2005Q3	3.4	3.6	4.2	(0.2)	1.9	6.3
2005Q2	3.5	0.9	2.1	(0.6)	2.6	4.9
2005Q1	1.7	1.4	2.9	(2.4)	3.5	5.7
2004Q4	(4.9)	1.6	3.5	(1.5)	5.5	6.0
2004Q3	(2.4)	1.5	3.5	(0.0)	6.0	7.5
2004Q2	3.5	2.1	4.8	0.4	6.6	8.9
2004Q1	1.0	0.3	10.5	4.3	5.5	7.5
2003Q4	8.6	(1.0)	17.0	3.9	3.8	5.5
2003Q3	5.5	(1.3)	26.1	2.2	2.8	3.7
2003Q2	(1.1)	(0.4)	35.7	3.1	2.6	2.6
2003Q1	(5.0)	0.7	27.1	0.6	3.6	2.2
2002Q4	(4.8)	1.0	17.2	(0.1)	2.9	2.1
2002Q3	(6.7)	0.7	5.6	2.7	2.5	2.6
2002Q2	(4.4)	1.1	(5.9)	(0.2)	0.6	3.4
2002Q1	5.1	1.7	(5.0)	(0.2)	(1.2)	2.1
2001Q4	2.7	2.5	(1.5)	0.5	(2.9)	2.5
2001Q3	(0.3)	3.5	2.6	(1.4)	(3.3)	1.5
2001Q2	(5.0)	2.5	7.6	1.7	(0.7)	0.9
2001Q1	(12.6)	1.2	8.4	1.4	2.4	3.6
2000Q4	(11.1)	1.2	5.9	1.8	5.9	4.2
2000Q3	(4.1)	1.3	1.7	3.2	6.9	6.5
2000Q2	(2.6)	1.2	(1.3)	2.2	5.9	7.9
2000Q1	2.5	2.3	(4.5)	3.2	3.0	4.7
1999Q4	1.2	2.4	(5.3)	2.7	1.7	3.6
1999Q3	(1.5)	1.6	(2.9)	1.7	1.2	2.9
1999Q2	0.8	2.1	(1.0)	1.4	0.9	1.3
1999Q1	3.9	2.5	1.3	1.5	1.0	2.8

Source: U.S. Census Bureau.

Motor fuel tax revenue continued to decline for the twelfth consecutive quarter with a drop of 4.0 percent. Revenue from motor vehicle and operators' licenses also fell, for the eleventh consecutive quarter, by 0.9 percent. State property taxes increased by 4.9 percent.

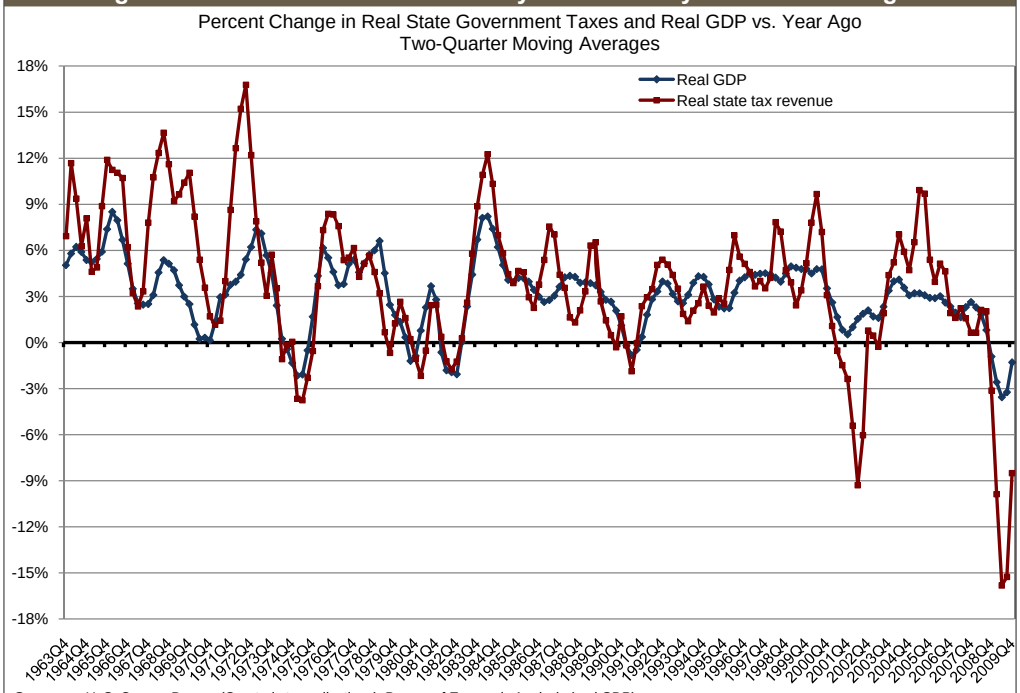
Underlying Reasons for Trends

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 legislated tax changes. The next two sections discuss the economy and recent legislated changes.

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 3 shows year-over-year growth for two-quarter moving averages 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. As shown in Figure 3, the fourth quarter declines in both real state tax revenue and real Gross Domestic Product are less severe — both economic activity and tax revenue

Figure 3. State Tax Revenue Is Heavily Influenced By Economic Changes



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.

are slowly rebounding. The decline in real state tax revenue is still far sharper compared to all previous recessions except for the 2001 recession.

The National Bureau of Economic Research (NBER) has declared that a recession began in December 2007. While many economists argue that the recession is over, the NBER has not yet announced an official end date for the 2007 recession. Real gross domestic product increased at an annual rate of 5.6 percent in October-December 2009, a significant improvement compared to the 2.2 percent increase in the July-September quarter. In general, in the second half of 2009 real gross domestic product improved noticeably after a record four consecutive quarter declines in the second half of 2008 and first half of 2009. The last time we saw large declines in real GDP was during the double-dip recession of the early 1980's, when economic activity fell by 7.9 percent for the second quarter of 1980 and 6.4 percent for the first quarter of 1982.

Among individual sectors during the most recent quarter, investments in structures declined for the sixth quarter at 18 percent. After fourteen straight quarterly declines since 2006, residential investments increased by 18.9 in the third quarter and 3.8 percent in the fourth quarter of 2009. Durable goods consumption, an important element of state sales tax bases, showed a modest increase of 0.4 percent in the fourth quarter of 2009 after significant declines throughout 2008 and a surprising increase of 20.4 percent in the third quarter of 2009.

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. 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. As a result, analysts usually examine these

Table 6. Nonfarm Employment, By State

Last Four Quarters, Year-Over-Year Percent Change

	2009			
	Jan-Mar	Apr-June	July-Sep	Oct-Dec
United States	**(3.7)**	**(4.8)**	**(5.2)**	**(4.5)**
New England	**(2.9)**	**(4.0)**	**(4.4)**	**(3.9)**
Connecticut	(3.2)	(4.7)	(4.8)	(4.1)
Maine	(3.1)	(3.7)	(3.9)	(3.7)
Massachusetts	(2.6)	(3.7)	(4.1)	(3.8)
New Hampshire	(2.6)	(3.4)	(4.4)	(3.2)
Rhode Island	(4.3)	(5.0)	(5.1)	(4.6)
Vermont	(2.7)	(3.7)	(3.9)	(3.2)
Mid-Atlantic	**(2.5)**	**(3.4)**	**(3.5)**	**(3.2)**
Delaware	(4.0)	(4.8)	(5.1)	(4.6)
Maryland	(2.7)	(3.1)	(3.4)	(3.0)
New Jersey	(3.9)	(4.3)	(4.1)	(3.2)
New York	(1.9)	(2.9)	(3.0)	(3.1)
Pennsylvania	(2.3)	(3.5)	(3.9)	(3.5)
Great Lakes	**(4.6)**	**(5.8)**	**(6.2)**	**(5.2)**
Illinois	(3.7)	(5.1)	(5.7)	(5.1)
Indiana	(5.0)	(6.4)	(6.5)	(5.1)
Michigan	(6.8)	(7.5)	(7.5)	(5.6)
Ohio	(4.4)	(5.8)	(6.1)	(5.2)
Wisconsin	(3.0)	(4.5)	(5.4)	(5.1)
Plains	**(2.3)**	**(3.4)**	**(3.9)**	**(3.6)**
Iowa	(2.0)	(3.1)	(3.7)	(3.3)
Kansas	(1.5)	(3.3)	(4.1)	(4.3)
Minnesota	(3.0)	(4.0)	(4.9)	(4.5)
Missouri	(2.9)	(4.0)	(4.1)	(3.5)
Nebraska	(1.3)	(2.1)	(2.3)	(2.8)
North Dakota	0.1	(0.4)	(0.3)	(0.5)
South Dakota	(1.0)	(1.9)	(2.2)	(2.3)
Southeast	**(4.5)**	**(5.2)**	**(5.4)**	**(4.5)**
Alabama	(4.6)	(5.6)	(6.1)	(5.1)
Arkansas	(2.5)	(3.3)	(3.6)	(3.0)
Florida	(6.5)	(6.6)	(6.3)	(5.2)
Georgia	(4.9)	(5.7)	(6.1)	(5.3)
Kentucky	(4.4)	(5.0)	(4.8)	(3.5)
Louisiana	(0.5)	(1.7)	(2.4)	(3.2)
Mississippi	(4.1)	(4.9)	(4.7)	(4.1)
North Carolina	(4.6)	(5.7)	(6.2)	(4.7)
South Carolina	(5.4)	(6.2)	(5.7)	(4.5)
Tennessee	(4.9)	(6.3)	(6.2)	(5.1)
Virginia	(2.5)	(3.4)	(3.9)	(3.6)
West Virginia	(1.2)	(1.7)	(3.0)	(3.4)
Southwest	**(2.2)**	**(3.8)**	**(4.6)**	**(4.1)**
Arizona	(6.5)	(7.9)	(8.1)	(6.6)
New Mexico	(2.9)	(4.3)	(4.7)	(4.3)
Oklahoma	(1.5)	(3.2)	(4.6)	(4.3)
Texas	(1.1)	(2.8)	(3.7)	(3.5)
Rocky Mountain	**(3.4)**	**(5.0)**	**(5.6)**	**(4.8)**
Colorado	(2.8)	(4.7)	(5.5)	(5.0)
Idaho	(5.2)	(6.7)	(7.1)	(4.9)
Montana	(3.6)	(3.8)	(3.8)	(3.6)
Utah	(4.0)	(5.4)	(5.6)	(4.4)
Wyoming	(0.8)	(3.3)	(5.4)	(6.2)
Far West	**(4.7)**	**(6.2)**	**(6.8)**	**(5.9)**
Alaska	0.5	(0.7)	(0.8)	(0.1)
California	(4.8)	(6.3)	(6.9)	(6.1)
Hawaii	(4.2)	(4.7)	(5.1)	(3.9)
Nevada	(7.9)	(10.0)	(10.4)	(8.1)
Oregon	(5.4)	(6.6)	(7.0)	(5.7)
Washington	(3.1)	(4.5)	(5.6)	(4.9)

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

time series on a year-over-year basis, 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.

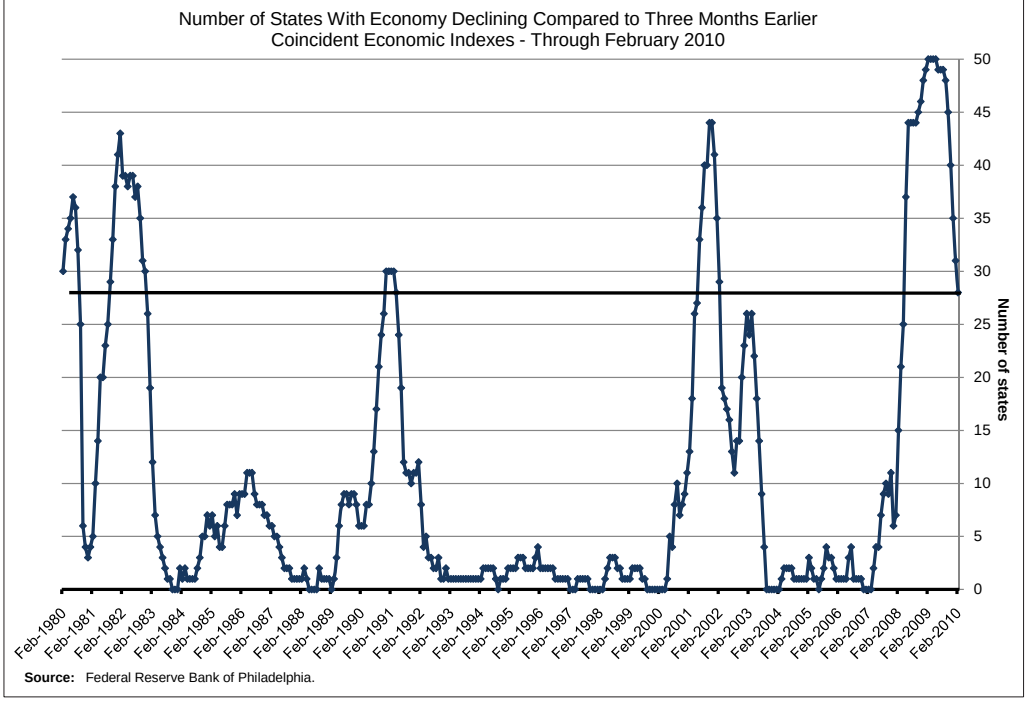
Unfortunately, state-by-state data on income and consumption are not available on a timely basis, and so we cannot easily see variation across the country in these trends. Traditionally, the Rockefeller Institute has relied on employment data from the Bureau of Labor Statistics to examine state-by-state 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, employment declined by 4.5 percent in the October-December quarter. On a year-over-year basis, employment once again declined in all 50 states.

The regional patterns are quite varied: The Far West and Great Lakes regions have suffered a malaise for well over a year and saw large employment declines in the fourth quarter at 5.9 and 5.2 percent respectively. Nevada and Arizona reported the largest declines in employment in the fourth quarter of 2009 compared to the same quarter of 2008 at 8.1 and 6.6 percent respectively.

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. Both sets of data are useful.

Economists at the Philadelphia Federal Reserve Bank developed 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.[3] 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.

Figure 4. Economy Is Declining in 28 States



Source: Federal Reserve Bank of Philadelphia.

These indexes can be used to measure the scope of economic decline.

Figure 4 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 in January of 2008, only seven states suffered declines, but since then economic weakening spread rapidly throughout the country. By February of 2009, all 50 states had declines in economic activity (as measured by the coincident index) compared with three months earlier. That was the first time that all 50 states had declines in economic activity (as measured by this index) since 1979; such widespread weakness continued for four months. By November of 2009, 40 states had declines in economic activity, while by February of 2010 only 28 states showed decreases. The data underlying these indexes are subject to revision, and so tentative conclusions drawn now could change at a later date.

Figure 5. In February: 28 States Had Declining Economies

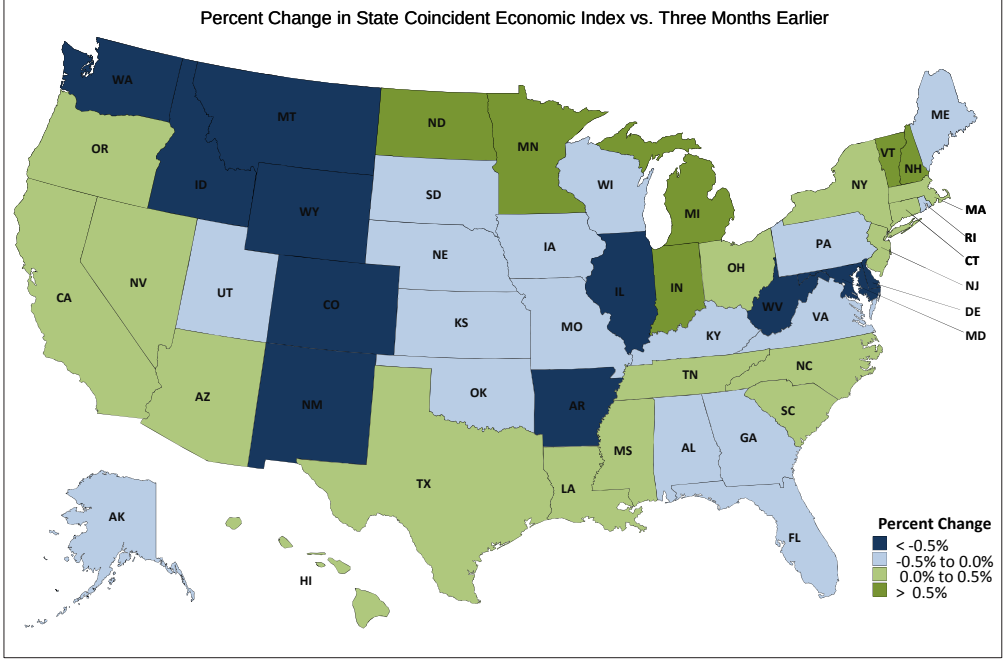


Figure 5 shows state-by-state variation in relative economic activity as of February 2010. Only two states reported declines of more than one percent: West Virginia at 3.1 percent and Maryland at 1.3 percent. Many of the states with weakening economic activity have suffered heavily from large declines in the price of housing and in the financial markets. In general, the majority of states showing continued declines are in the

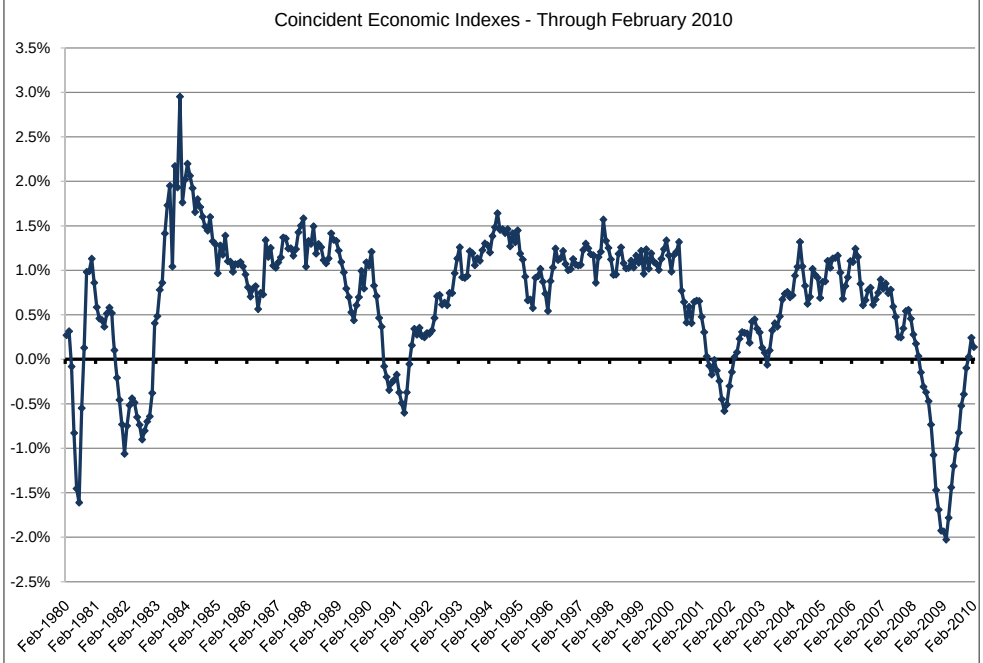
Table 7. State Economic Activity: Declining in 28 States

State Indexes of Economic Activity
States are Sorted by Percent Change vs. 3 Months Ago

State	Coincident index February 2010 (Jul 1992=100)	Percent change vs. 1 year ago (February 2009)	Percent change vs. 3 months ago (November 2009)
Michigan	114.5	(5.3)	1.5
New Hampshire	192.5	(0.8)	1.0
Indiana	136.4	(1.8)	0.9
Minnesota	156.0	(1.6)	0.7
Vermont	154.8	(0.8)	0.7
North Dakota	169.5	1.1	0.6
Oregon	186.4	(1.8)	0.4
New Jersey	152.5	(1.9)	0.3
Ohio	132.5	(4.0)	0.3
Tennessee	152.4	(2.4)	0.3
New York	153.4	(0.8)	0.3
Arizona	206.1	(3.0)	0.3
Nevada	220.9	(3.7)	0.2
Louisiana	125.5	(2.0)	0.2
North Carolina	158.3	(2.6)	0.2
California	158.3	(2.6)	0.2
United States	**156.6**	**(2.2)**	**0.1**
Massachusetts	169.0	(1.6)	0.1
Texas	174.5	(3.4)	0.1
Hawaii	111.2	(3.6)	0.0
South Carolina	147.0	(3.7)	0.0
Mississippi	139.7	(2.3)	0.0
Connecticut	152.1	(2.5)	0.0
Florida	160.2	(3.5)	(0.0)
Kentucky	138.8	(2.7)	(0.0)
Rhode Island	149.0	(5.6)	(0.0)
Wisconsin	138.9	(3.8)	(0.1)
Alabama	133.8	(4.7)	(0.1)
Virginia	156.9	(1.7)	(0.1)
Iowa	148.9	(3.0)	(0.1)
Utah	189.2	(2.7)	(0.1)
Alaska	113.4	(1.7)	(0.2)
Kansas	139.0	(4.5)	(0.2)
Missouri	130.4	(5.5)	(0.3)
Georgia	165.1	(4.1)	(0.3)
Pennsylvania	138.4	(4.2)	(0.3)
South Dakota	165.6	(1.3)	(0.4)
Oklahoma	145.0	(5.1)	(0.4)
Nebraska	155.0	(3.0)	(0.4)
Maine	135.8	(5.5)	(0.5)
Colorado	171.8	(4.8)	(0.6)
Illinois	137.5	(5.2)	(0.6)
Washington	149.4	(4.4)	(0.6)
Arkansas	144.5	(3.2)	(0.6)
Idaho	201.8	(6.3)	(0.7)
Wyoming	158.3	(6.2)	(0.7)
New Mexico	165.6	(4.9)	(0.8)
Delaware	144.6	(5.1)	(0.9)
Montana	164.9	(4.0)	(1.0)
Maryland	147.5	(6.3)	(1.3)
West Virginia	145.4	(13.5)	(3.1)

Source: Federal Reserve Bank of Philadelphia.

Figure 6. Percent Change in State Economies Compared to Three Months Earlier



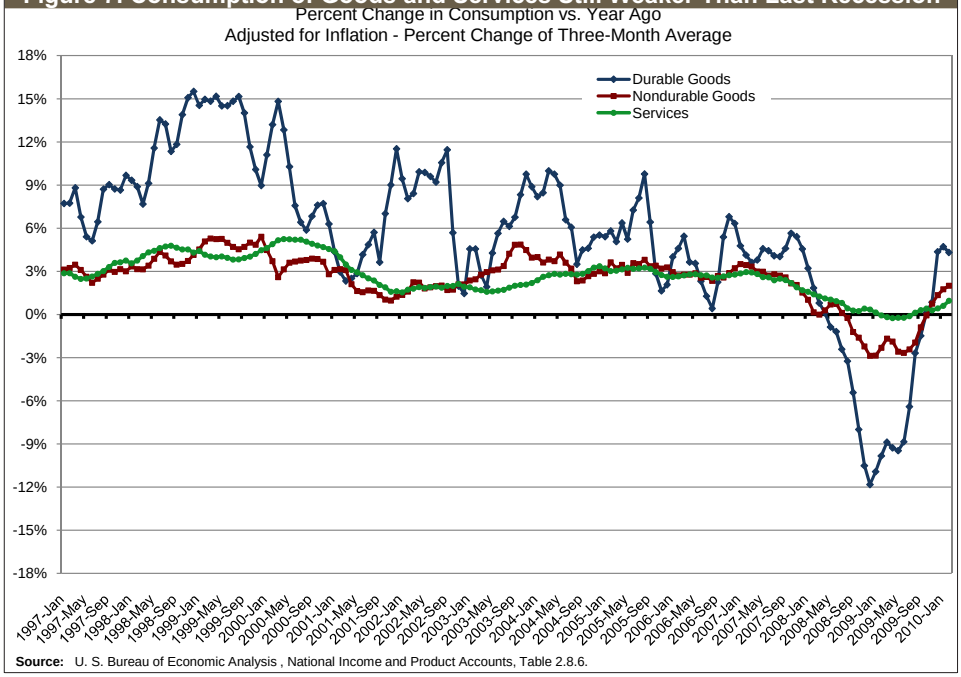
Source: Federal Reserve Bank of Philadelphia.
Note: Percent change is for the median state.

Plains and Rocky Mountain regions. Michigan reported the largest increase at 1.5 percent.

Figures 6 and 7 show the breadth of economic decline but provide little information on the depth of decline. Figure 6 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 reported declines for the current recession in the typical state was worse than those of the 1980-82, 1990-91 and 2001 recessions. However, there is some upward spike in the last few months. The declines as of February 2010 are no longer deep compared to the previous recessions, and almost half of the states have seen some positive growth in the last three months.

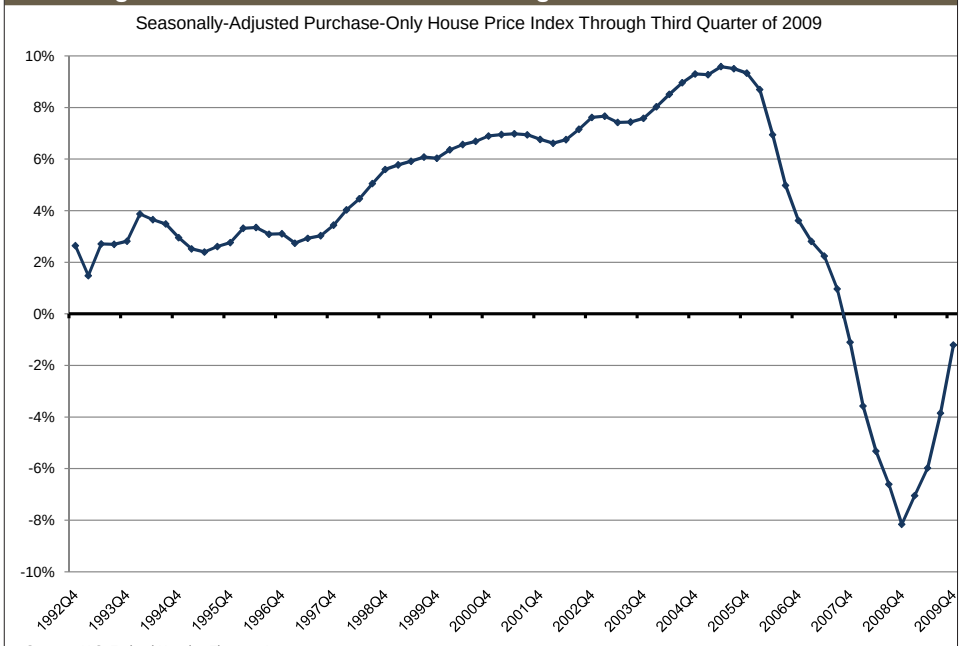
Figure 7. Consumption of Goods and Services Still Weaker Than Last Recession



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

Figure 7 shows consumption of durable goods, nondurable goods, and services. The recent decline in consumption of durable and nondurable goods was much sharper than in the last recession. While consumption of durable and nondurable goods has been slowly recovering, growth levels are still below those of the prerecession period. This indicates that consumers responded to greater economic uncertainty during this recession by eliminating, postponing, and scaling back purchases of items

Figure 8. Year-Over-Year Percent Change in State House Price Index



Source: U.S. Federal Housing Finance Agency.

such as new cars, household appliances, and so on.

Figure 8 shows year-over-year percent change in seasonally-adjusted, purchase-only house price index from 1992 through the fourth quarter of 2009. As Figure 8 shows, the trend in the house price index has been downward since mid-2005, with steeply negative movement from the last quarter of 2004 through the end of 2008. While the house price index started to bounce back in 2009, the rate of change is still negative. The states in the West are still seeing the largest declines in the housing price index.

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.

During the October-December 2009 quarter, enacted tax changes increased state revenue by an estimated net of $4.8 billion compared to the same period in 2008.[4] Personal income tax increases accounted for approximately $2.7 billion and sales tax for approximately $1.6 billion of the change. In a single state, California, legislated changes increased personal income tax and sales tax collections each by an estimated $1.1 billion. Legislated changes in New York were also significant for the personal income tax. Most of the increase in sales tax was due to legislated changes in California, Massachusetts and North Carolina.

The net impact is that the decline in nominal tax revenue would have been even larger, if not for the legislated tax changes.

Table 8. State Tax Revenue, October-December, 2008 and 2009 ($ in millions)

	2008				2009			
	PIT	CIT	Sales	Total	PIT	CIT	Sales	Total
United States	**58,836**	**8,394**	**57,282**	**170,441**	**56,108**	**8,093**	**54,245**	**163,264**
New England	**4,553**	**489**	**2,362**	**9,812**	**4,438**	**693**	**2,476**	**9,976**
Connecticut	1,336	29	855	2,980	1,382	100	798	2,965
Maine	313	30	260	835	339	35	242	862
Massachusetts	2,513	300	964	4,618	2,351	420	1,165	4,766
New Hampshire	10	109	NA	379	10	105	NA	401
Rhode Island	244	11	201	566	231	15	193	555
Vermont	137	11	82	434	126	17	77	428
Mid-Atlantic	**13,838**	**2,333**	**7,791**	**30,389**	**13,786**	**1,776**	**7,455**	**29,349**
Delaware	232	43	NA	602	209	26	NA	572
Maryland	1,882	134	971	3,924	1,799	179	920	3,757
New Jersey	2,469	586	2,018	6,257	2,428	449	1,836	5,812
New York	7,074	1,209	2,688	13,128	7,275	800	2,681	12,892
Pennsylvania	2,181	361	2,114	6,478	2,076	321	2,018	6,315
Great Lakes	**8,531**	**1,518**	**8,363**	**25,552**	**8,132**	**1,325**	**7,943**	**24,461**
Illinois	1,969	439	1,982	6,360	1,904	426	1,750	5,958
Indiana	938	196	1,530	3,519	864	136	1,429	3,198
Michigan	1,888	669	1,920	6,103	1,711	554	1,912	5,709
Ohio	2,184	66	1,891	6,241	1,982	47	1,881	6,156
Wisconsin	1,552	148	1,040	3,328	1,672	161	971	3,441
Plains	**4,677**	**354**	**3,660**	**12,090**	**4,325**	**314**	**3,533**	**11,581**
Iowa	677	12	531	1,655	684	29	531	1,665
Kansas	623	113	550	1,631	577	106	548	1,535
Minnesota	1,699	118	1,096	4,291	1,594	110	1,084	4,223
Missouri	1,227	24	749	2,554	1,048	30	701	2,323
Nebraska	385	44	374	962	364	21	326	890
North Dakota	66	31	164	630	58	12	154	606
South Dakota	NA	11	196	367	NA	7	188	339
Southeast	**11,732**	**1,517**	**13,964**	**37,841**	**11,099**	**1,975**	**13,176**	**36,840**
Alabama	656	95	522	2,086	685	118	509	2,101
Arkansas	546	89	694	2,033	521	133	632	2,109
Florida	NA	479	4,451	7,829	NA	406	4,186	7,542
Georgia	2,217	168	1,379	4,370	2,028	101	1,039	3,781
Kentucky	860	112	716	2,556	788	92	691	2,331
Louisiana	724	180	773	2,495	653	287	663	2,359
Mississippi	369	58	755	1,588	359	55	697	1,490
North Carolina	2,597	83	1,282	5,236	2,471	464	1,509	5,756
South Carolina	944	25	672	2,054	937	-23	645	1,902
Tennessee	8	66	1,574	2,300	5	81	1,493	2,267
Virginia	2,488	69	859	4,197	2,341	171	843	4,135
West Virginia	322	92	287	1,096	310	89	270	1,067
Southwest	**1,735**	**280**	**7,686**	**15,674**	**1,477**	**76**	**6,647**	**13,290**
Arizona	802	130	958	2,646	720	4	827	2,302
New Mexico	207	81	514	1,267	184	22	429	1,136
Oklahoma	725	69	580	2,146	572	49	491	1,699
Texas	NA	NA	5,634	9,614	NA	NA	4,900	8,153
Rocky Mountain	**2,183**	**181**	**1,523**	**5,803**	**1,994**	**153**	**1,368**	**4,998**
Colorado	1,102	67	533	2,159	1,012	42	502	1,951
Idaho	301	31	300	786	271	22	274	722
Montana	198	47	NA	596	167	15	NA	503
Utah	582	36	428	1,336	545	74	435	1,324
Wyoming	NA	NA	263	926	NA	NA	158	498
Far West	**11,589**	**1,722**	**11,933**	**33,281**	**10,856**	**1,780**	**11,647**	**32,769**
Alaska	NA	107	NA	1,215	NA	107	NA	1,209
California	9,926	1,549	7,949	23,716	9,314	1,628	8,101	23,749
Hawaii	386	5	607	1,174	341	-5	549	1,100
Nevada	NA	NA	744	1,470	NA	NA	625	1,413
Oregon	1,277	62	NA	1,786	1,202	51	NA	1,671
Washington	NA	NA	2,633	3,919	NA	NA	2,371	3,627

Source: U.S. Census Bureau.

Table 9. Quarterly Tax Revenue By Major Tax
October-December, 2008 to 2009, Percent Change

	PIT	CIT	Sales	Total
United States	**(4.6)**	**(3.6)**	**(5.3)**	**(4.2)**
New England	**(2.5)**	**41.8**	**4.8**	**1.7**
Connecticut	3.4	251.0	(6.6)	(0.5)
Maine	8.1	16.6	(6.8)	3.3
Massachusetts	(6.5)	40.4	20.8	3.2
New Hampshire	(1.4)	(3.1)	NA	5.7
Rhode Island	(5.0)	28.4	(3.9)	(2.1)
Vermont	(8.3)	63.4	(5.7)	(1.4)
Mid-Atlantic	**(0.4)**	**(23.9)**	**(4.3)**	**(3.4)**
Delaware	(10.0)	(40.3)	NA	(4.9)
Maryland	(4.4)	33.7	(5.3)	(4.3)
New Jersey	(1.7)	(23.3)	(9.0)	(7.1)
New York	2.8	(33.8)	(0.3)	(1.8)
Pennsylvania	(4.8)	(11.1)	(4.5)	(2.5)
Great Lakes	**(4.7)**	**(12.7)**	**(5.0)**	**(4.3)**
Illinois	(3.3)	(3.0)	(11.7)	(6.3)
Indiana	(7.9)	(30.7)	(6.6)	(9.1)
Michigan	(9.4)	(17.1)	(0.4)	(6.5)
Ohio	(9.3)	(28.5)	(0.5)	(1.4)
Wisconsin	7.7	8.7	(6.6)	3.4
Plains	**(7.5)**	**(11.1)**	**(3.5)**	**(4.2)**
Iowa	1.0	135.7	(0.0)	0.6
Kansas	(7.4)	(6.4)	(0.4)	(5.9)
Minnesota	(6.2)	(7.2)	(1.1)	(1.6)
Missouri	(14.6)	23.1	(6.4)	(9.0)
Nebraska	(5.3)	(52.2)	(12.7)	(7.5)
North Dakota	(12.3)	(59.5)	(6.0)	(3.7)
South Dakota	NA	(40.8)	(4.2)	(7.8)
Southeast	**(5.4)**	**30.2**	**(5.6)**	**(2.6)**
Alabama	4.4	24.3	(2.5)	0.7
Arkansas	(4.6)	49.7	(8.9)	3.7
Florida	NA	(15.2)	(6.0)	(3.7)
Georgia	(8.5)	(40.1)	(24.7)	(13.5)
Kentucky	(8.3)	(18.6)	(3.5)	(8.8)
Louisiana	(9.8)	59.7	(14.3)	(5.5)
Mississippi	(2.7)	(4.6)	(7.8)	(6.2)
North Carolina	(4.9)	458.7	17.6	9.9
South Carolina	(0.7)	(192.8)	(4.0)	(7.4)
Tennessee	(35.3)	22.1	(5.1)	(1.4)
Virginia	(5.9)	147.1	(1.8)	(1.5)
West Virginia	(3.8)	(3.2)	(5.8)	(2.6)
Southwest	**(14.9)**	**(73.0)**	**(13.5)**	**(15.2)**
Arizona	(10.3)	(96.6)	(13.7)	(13.0)
New Mexico	(11.0)	(72.6)	(16.5)	(10.3)
Oklahoma	(21.1)	(28.7)	(15.3)	(20.8)
Texas	NA	NA	(13.0)	(15.2)
Rocky Mountain	**(8.6)**	**(15.2)**	**(10.2)**	**(13.9)**
Colorado	(8.2)	(37.0)	(5.7)	(9.6)
Idaho	(10.0)	(29.4)	(8.9)	(8.1)
Montana	(15.9)	(67.2)	NA	(15.7)
Utah	(6.3)	105.1	1.6	(0.9)
Wyoming	NA	NA	(40.0)	(46.2)
Far West	**(6.3)**	**3.4**	**(2.4)**	**(1.5)**
Alaska	NA	0.0	NA	(0.5)
California	(6.2)	5.1	1.9	0.1
Hawaii	(11.8)	(207.6)	(9.6)	(6.3)
Nevada	NA	NA	(16.0)	(3.9)
Oregon	(5.9)	(18.6)	NA	(6.5)
Washington	NA	NA	(9.9)	(7.5)

Source: U.S. Census Bureau.

State Tax Revenue, While Stabilizing, Is Far Below Its Peak

Recent data show an unmistakable improvement in the economy and a very slight firming in state tax revenue collections. Employment has stabilized and is bouncing along the bottom with an increase in the most recent month and retail sales are now increasing on a month-to-month basis; these are among the most important determinants of trends in state tax revenue. The pace of year-over-year declines in state tax revenue has slackened, and it is now rare for state governments to report new unanticipated shortfalls. In fact, several states recently have reported monthly tax revenue coming in above projections, albeit often below year-ago levels — for example, California's controller reported that March tax collections were nearly 6 percent above the amount projected for March.[5] In addition, many states are forecasting modest tax revenue growth in 2010-11.[6] And, combined state and local government tax revenue rose in the October-December quarter, but that was driven by rising local government property tax collections — state government tax revenue declined.[7]

What does this mean? Are states out of the woods?

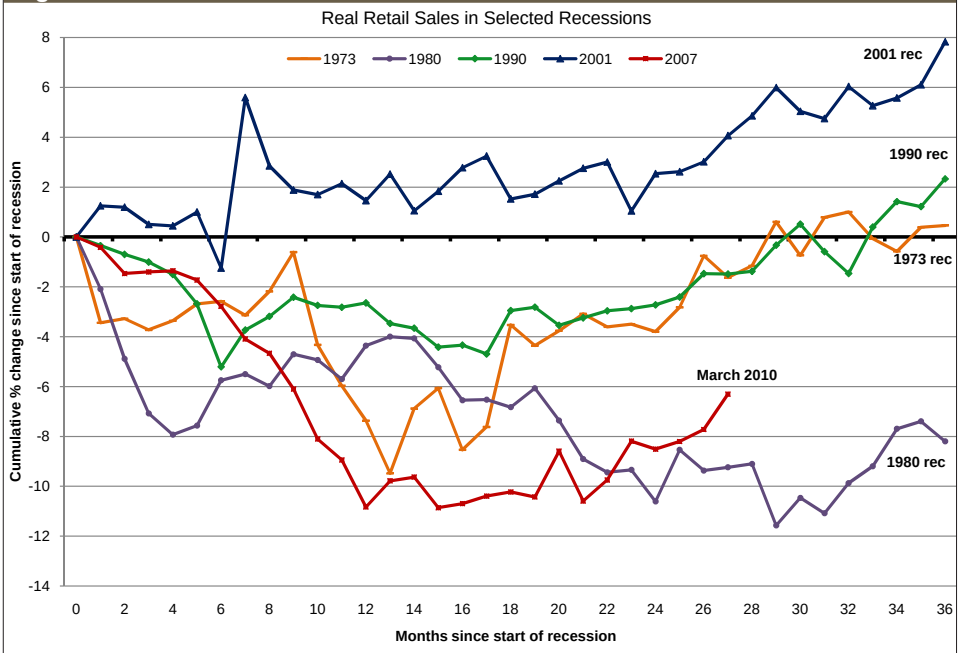
Let's begin by putting some of the numbers into a longer-term perspective.

States rely on the sales tax for about 31 percent of their tax revenue, and it has been hit far harder in this recession than in previous recessions. Retail sales and consumption are major drivers of sales taxes.

Figure 9 shows the cumulative percentage change in inflation-adjusted retail sales in the 36 months following the start of each recession from 1973 forward.[8] Several points are noteworthy. First, real retail sales in the current recession (the solid red line) plummeted after December 2007, falling sharply and almost continuously until December 2008, by which point they were more than 10 percent below the prerecession peak. This was deeper than in most recessions, although the declines in the 1973 and 1980 recessions also were quite bad. Any state that based its expectations for this recession on what happened in the 2001 recession (the orange line) would have been sadly disappointed: in stark contrast to this recession, in the 2001 recession consumers kept right on spending and the impact on retail sales and state sales taxes was barely noticeable.

Second, while real retail sales have been rising from their lows for about the last year, they are still more than six percent below their prerecession peak. So even if sales taxes mirrored retail sales, they would be well below their recession peak. In fact, though, many state sales taxes

Figure 9. Real Retail Sales Have Stabilized But Are Still More Than 6% Below Peak



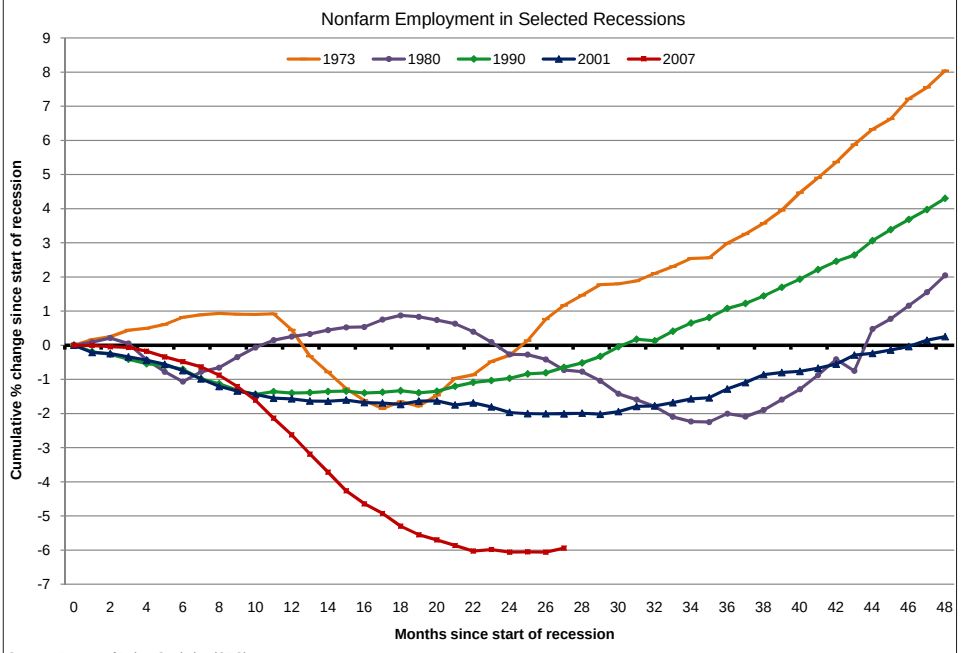
Sources: Cleveland Federal Reserve Bank (pre-1990 retail sales), Census Bureau (1990+), and Bureau of Labor Statistics (CPI).

exempt food and other necessities, and exempt or exclude many services, relying more heavily on non-necessities. Many of these taxable goods and services — such as cars, other durable goods and restaurant meals — are far easier to do without or postpone than are necessities and they tend to be more volatile and suffer greater declines in business downturns. We estimate that inflation-adjusted sales taxes currently are more than 11 percent below their prerecession peak.

States on average count on the income tax for about 36 percent of their tax revenue. Employment and associated wage payments are major drivers of income taxes.

Figure 10 shows the cumulative percentage change in nonfarm employment for the nation as a whole in the 36 months following the start of each recession from 1973 forward.[9] The last point for the 2007 recession is March 2010, month 27. As the graph shows, the 6.1 percent employment drop in this recession is about three times as bad as the declines in the previous recessions, which averaged about 2 percent. Even after the increase of 160,000 jobs recorded in March, employment remains about 6 percent below the December 2007 start of the recession.

Figure 10. Employment Decline Was Nearly 3x That Of Previous Recessions. Recovery Will Take A Long Time



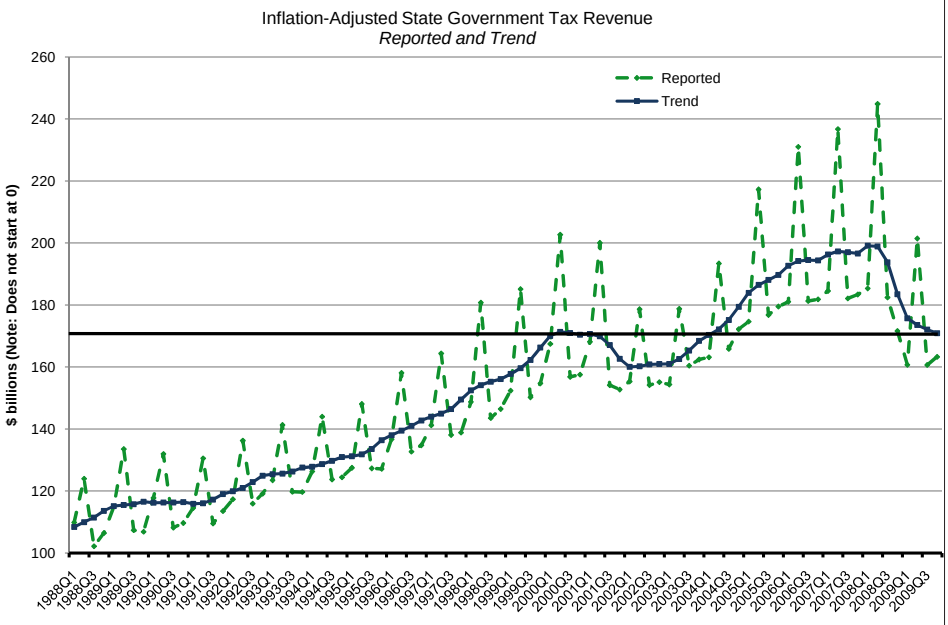
Source: Bureau of Labor Statistics (CES).

Economists generally expect this recovery in employment to be slower than recoveries from prior recessions, reflecting efforts by consumers to rebuild balance sheets after declines in housing and financial asset values, and caution after shocks to the financial

system and to consumer and business confidence. It is likely to be several years before employment reattains its prerecession peak, as inspection of Figure 10 suggests.

We are beginning to see some reflection of the stabilizing economy in state tax revenue. The dashed line in Figure 11, which is quite bouncy, shows total tax revenue adjusted for inflation using the GDP price index. The solid dark line that moves through the dashed line is an adjusted version of the same data smoothed to remove seasonality and irregularities so that it shows the underlying trend.[10] (The solid horizontal line shows the value of trend tax revenue in the fourth quarter of 2009 so that we can easily compare it to earlier periods.) The trend, while showing some evidence of stabilizing, is approximately 14 percent below its peak and in fact is at the same level as in the first quarter of 2004 and also in the middle of 2000. Put differently, state tax revenue, adjusted for inflation, is at about the same level as 10 years ago, although the nation's population has grown by approximately 10 percent since then and health care costs, which are a major driver of state expenditures, have grown far faster than general price inflation.

Figure 11. State Tax Revenue Is Beginning To Stabilize But At Levels Last Seen in 2004 & 2000

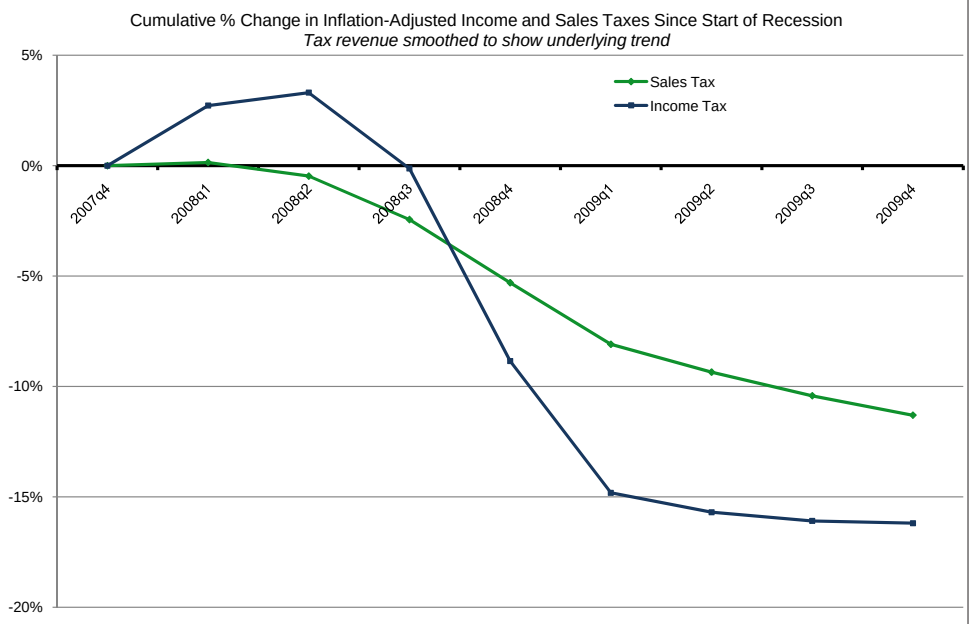


Sources: "Reported": Census tax data with Rockefeller Institute adjustments described in text, adjusted for inflation using GDP price index; no adjustments for legislative changes. (2) "Trend": Reported, adjusted for seasonality in R using Loess regression (STL).

Figure 12 shows the underlying trend for income and sales taxes separately since the recession's start in the fourth quarter of 2007. As we have noted elsewhere, the sales tax decline started sooner than the income tax decline and is far deeper than in past recessions. Nonetheless, when the income tax began to fall it fell more steeply and is now more than 16 percent below its level at the start of the recession and about 19 percent below its peak. The sharp decline in the income tax reflects, among other things, the falloff in capital gains discussed in the separate section on that topic and, in some states, an extraordinarily sharp decline in wages related to the financial sector collapse, a topic that we may address in a future report. The difference in when and how income taxes and sales taxes have been affected by this recession help to explain differences across the country in overall tax revenue.

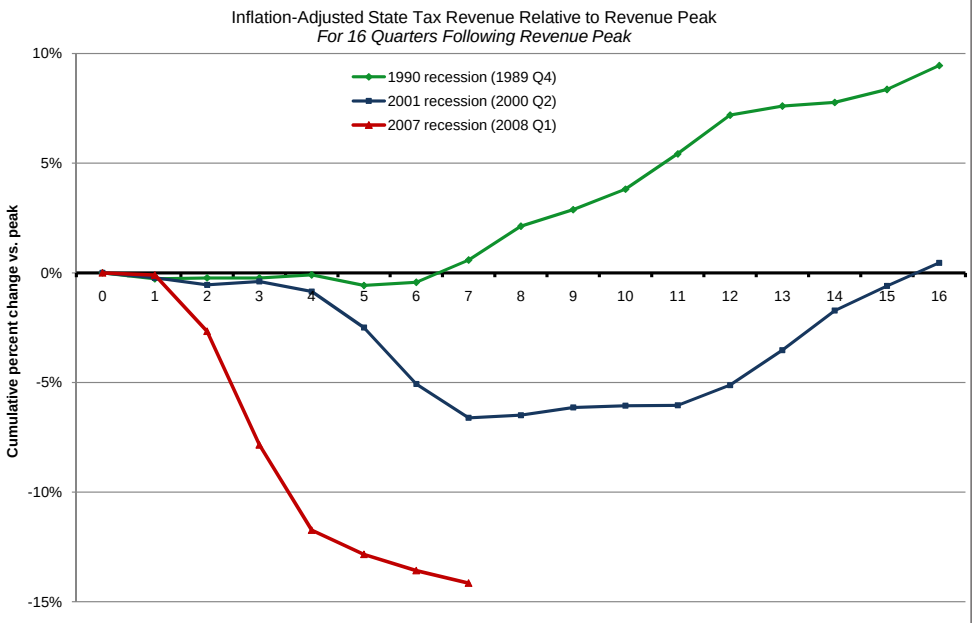
Figure 13 shows the trend in total state tax revenue in the current recession and each of the two previous recessions. The

Figure 12. Tax Revenue Is Stabilizing But Remains Far Below Peak Levels



Sources: Census tax data with Rockefeller Institute adjustments described in text, adjusted for inflation using GDP price index; no adjustments for legislative changes; adjusted for seasonality in R using Loess regression (STL).

Figure 13. Tax Revenue Decline In This Recession Is Far Deeper Than In Past Recessions



Sources: Census tax data with Rockefeller Institute adjustments described in text, adjusted for inflation using GDP price index; no adjustments for legislative changes; adjusted for seasonality in R using Loess regression (STL).

decline is more than twice as deep in this recession as in the previous recession, which itself was the worst tax revenue decline for states in 50 years. These data are not adjusted for legislative changes and so they must be interpreted carefully. (It is very difficult to create a long time series of data adjusted for legislative changes, and is beyond our capacity for purposes of this report.) Some of the revenue recovery in past recessions is the result of tax increases adopted in those periods. The tax increases were quite small in the 2001 recession relative to overall tax revenue, but were considerably larger in the 1990 recession.

Even if the economic recovery is as rapid as those from prior recessions, it would likely take state tax revenue several years to recover to its previous peak, but with the expected slow recovery from this recession it is likely to take longer. Furthermore, preliminary data on tax collections in January and February in 45 states show that year-over-year increases are few and far between. Tax revenue is continuing to decline in the median state, and at this point it appears as if the January-March quarter will have declines in the median state. Finally, as the section on capital gains notes, states are at risk of another significant decline in state tax revenue in the April-June quarter of 2010, although revenue should begin to improve after that.

Capital Gains, the Stock Market, and April Tax Returns

Shortly after this report goes to print, the most important tax-collection period of the year in most states will begin — the filing period for income tax returns due on April 15. This is when taxpayers "settle up" with the government for any under or over payments of tax for the prior tax year, in this case the 2009 calendar year.

Taxpayers pay income tax throughout the tax year and shortly afterward mainly through regular withholding on wages. In addition, taxpayers with substantial nonwage income may make payments of estimated tax, usually in April, June, September, and December/January. Taxpayers who have paid more through these methods than they owe will receive a refund when they file their return in April, and those who have underpaid will make an additional payment with their return.[11] Wages are fairly easy to determine and withholding can be a quite accurate estimate of taxes owed on wages, but nonwage income can be hard for taxpayers to determine during the year and estimated payments are a less-accurate reflection of taxes associated with nonwage income. As a result, the April "settling up" tends to be highly related to nonwage income, and quite variable.

In almost all years, the April-June quarter is the largest quarter for state government income tax revenue, and as a consequence it usually is the largest for total tax revenue as well. Furthermore, revenue in this quarter is volatile. In April-June of 2009 income tax payments declined 27 percent on a year-over-year basis, but in April-June 2008 they were up 8.1 percent year over year — and in April-June 2006 they were up 18.8 percent.

Much of this volatility is related to nonwage income — particularly stock market gains — for several reasons. First, the underlying forces determining the potential magnitude of taxable income are quite volatile: the stock market can go up and down significantly, creating opportunity for taxpayers to take capital gains and losses. Interest income also can be volatile — for someone with a variable-rate asset, a fall in the interest rate from 4 percent to 3 percent represents a decline of 25 percent in interest income. (Most portfolio income does not respond as suddenly or fully to interest rate changes, but it certainly does happen.) The broader economy, too, can have a big influence on potential capital gains and losses and on other forms of nonwage income.

Second, in the case of capital gains, the decision to realize gains — whether to sell assets with accrued gains — is a discretionary one that reflects not just asset values, but also current and expected future tax rates, transaction costs, expected earnings on alternative investments, and a host of personal planning considerations. Gains realized for tax purposes therefore are more volatile than accrued gains.

Third, the timing of associated tax payments is volatile and variable. Taxpayers generally must make estimated payments related to expected taxable income — typically on April 15, June 15,

September 15, and January 15 — but safe harbors, estimating uncertainties, behavioral stickiness, and considerations related to deductibility of state taxes against federal taxes all influence the timing and variability of estimated payments.

Because nonwage income is hard to estimate during the year and because estimated payments may be only loosely related to taxes owed on that income, payments with April 15 tax returns are volatile. Making matters worse, the magnitude of this volatility is large relative to state budgets.

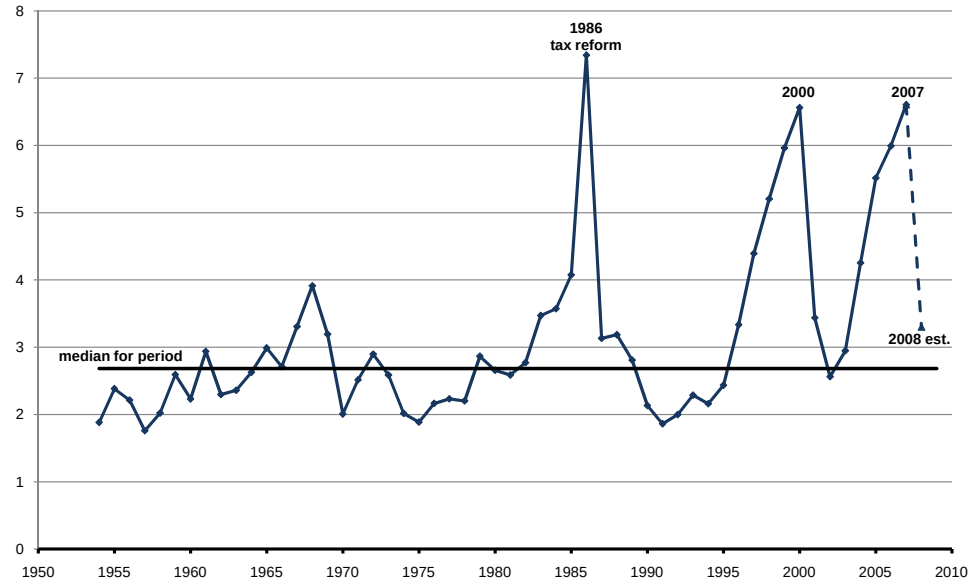
Furthermore, this heightened uncertainty comes right in the midst of peak budget negotiations. While we do not have daily tax collection data for state governments, we do have daily data for the federal government, which has similar tax payment dates. We can get a rough idea of what happened to tax returns in past years by looking at federal "not withheld" payments of income taxes, which appear to consist primarily of estimated payments and payments with tax returns. The tax-return filing season is largely in April and May. In 2009 (the year in which April-June state income tax collections fell by 27 percent), fully 87 percent of the federal government's April/May "not withheld" taxes were deposited between April 14 and April 28.[12] Our experience with state governments suggests that the timing for most states is similar.

Thus, if states are going to have a significant overage or shortfall in the April 15 tax returns, they are likely to discover it at the end of April or early May, after sufficient returns are processed and after they have a chance to analyze the data. That is why so many states announced income tax shortfalls in May of last year. Needless to say, a significant shortfall or overage announced in May when budget negotiations are down to their last few weeks and the time to develop and negotiate proposals is short further complicates already complex political dynamics — and can make it difficult to close any new budget gaps that arise.

What will happen this April and May, and beyond?

As we have noted in previous reports and presentations, capital gains play an important role. Figure 14 shows capital gains as a share of gross domestic product from 1954 through 2007 and provides an estimate for 2008 assuming an approximately 50 percent decline (reflecting our assessment of estimates from states and the decline in last year's income tax in April and May). Several points are noteworthy. First, the large spike in gains in 1986 reflected a behavioral response by taxpayers to the 1986 federal tax reform that increased effective tax rates on most capital gains in 1987 (and presumably beyond) by approximately 40 percent, creating a dramatic incentive for taxpayers to accelerate gains into 1986. The near-doubling of gains in 1986 followed by a 55 percent decline in 2007 illustrate how sensitive taxable gains are to taxpayer choices, and how the choice to realize gains can be affected by actual and expected tax rates.

Figure 14. Volatile Capital Gains Fell Sharply in 2008. Gains in 2009 Are a Large Risk for States



Source: (1) Capital gains: 1954-1998: Table capgain1-2001.pdf from IRS Statistics of Income web site (www.irs.gov/taxstats); 1999-2007 07in14ar.xls and similar SOI files; (2) Gross domestic product from U.S. Bureau of Economic Analysis.

Second, during the dot-com stock market boom of the 1990s capital gains surged, nearly reattaining their 1986 peak in 2000. (Note that many factors beside the stock market influence the pool of potential capital gains, including bond values, real estate values, and the economy in general. But gains from corporate stock appear to account for more than half of all capital gains and the stock market plays an extraordinarily important role.[13])

Third, although 2000 was the first of three successive years of stock market declines, capital gains actually increased by 16.6 percent, perhaps because much of the selling during the initial decline was by investors selling stocks that still had gains (albeit vanishing rapidly) or because much of the selling and decline occurred late in the year and did not outweigh gains realized earlier in the year — a point we'll return to in a minute.

Fourth, capital gains declined for two successive years, falling 46 percent in 2001 and a further 22 percent in 2002 before increasing by 240 percent over five successive years to the 2007 peak, while the stock market climbed by 67 percent. Then market, financial system, and confidence collapses appear to have led to a capital gains decline of approximately 50 percent in 2008.

So were capital gains in 2009 — which will influence tax payments this April and May — up or down? Capital gains forecasting models usually take into account factors such as stock market values, stock market volumes, real estate values, the general state of the economy, and current and expected tax rates.[14] But the forecasts produced by these models can vary significantly depending on how these variables are specified. Although there is relatively little recent data on when capital gains are realized and how long the assets generating gains were held, it is clear that gains are realized fairly regularly throughout the year, and that many assets generating gains are held for several years.[15]

Some models incorporate stock market values by using year-end measures of change, which is the way we often think of the market. For example, most people think of 2009 as a year in which the stock market increased dramatically, and by year-end

Table 10. Will 2009 Capital Gains Reflect the Calendar Year Average Decline in the 2009 Stock Market?

Capital Gains and the S&P 500, Selected Years

	Percent change in S&P 500 from prior:		Percent change in capital gains
	Year-end	Calendar-year average	
2000	-10.1%	7.5%	16.6%
2001	-13.0%	-16.3%	-46.0%
2002	-23.4%	-16.8%	-23.0%
2003	26.4%	-2.9%	20.4%
2008	-38.5%	-17.4%	-50% estimate
2009	23.5%	-22.3%	??
2010 YTD	7.1%	19.1%	??

Sources: S&P 500 index is based on daily close adjusted for splits and dividends from Yahoo (http://finance.yahoo.com/q/hp?s=^GSPC), through April 9, 2010; Capital gains are assembled and estimated from various documents from the U.S. Treasury and from the IRS Statistics of Income website (www.irs.gov/taxstats).

measures this is true: the S&P 500 index on December 31, 2009, was up 23.5 percent from its value on December 31, 2008.[16] But because taxpayers realize gains throughout the year, the average value of the S&P 500 may be more relevant, and in fact that was actually down 22 percent in 2009, as Table 10 shows (and in fact it was well below the levels of 2007, 2006, and 2005 as well, suggesting a negative influence on assets held for multiple years). Table 10 also shows that although the stock market declined in 2000 on a year-end basis, the calendar year average was up 7.5 percent. This may help to explain why capital gains increased in 2000, as noted earlier. While this hardly proves that capital gains declined in 2009, it is one piece of evidence in favor. Forecasting models that use year-end stock market values rather than calendar-year averages and that do not include several years of lagged market values may, by contrast, forecast an increase in capital gains in 2009.

Other factors that enter into capital gains forecasting models also suggest a decline in 2009. Real estate values were declining in much of the nation, real estate investment activity was weak, and the overall economy declined.

Two states that publish their capital gains forecasts expect capital gains to have declined in 2009, on top of the large decline in 2008: New York forecasted a 35.1 percent decline in 2009 in its executive budget, and California forecasted a 15 percent decline. The Congressional Budget Office projects a 15.7 percent decline.[17]

States face further substantial uncertainty about capital gains in 2010 and 2011 due to potential changes in federal tax rates. The federal tax rate on long-term capital gains affecting most taxpayers, which was 15 percent from 2008 through 2010, is scheduled to rise to 20 percent in 2011. This creates an incentive for taxpayers to accelerate capital gains into 2010, which could be a temporary benefit to state budgets in the 2010-11 fiscal year (assuming taxpayers believe the scheduled rate increase will go into effect), followed by a decline in capital gains in 2011 with a negative impact on 2011-12.[18] (The pattern could be similar to the 1986 surge and 1987 falloff described earlier, although the magnitude is likely to be much smaller.) California and New York, at least, are already counting on this. California expects a 40 percent increase in capital gains in 2010, and New York expects a 59 percent increase. New York expects this to be followed by a 47 percent decline in 2011; California does not appear to have published a similar forecast for 2011. The Congressional

Budget Office projects a 29 percent increase in 2010 followed by a 17 percent decline in 2011.

Estimated payments of income tax during the course of the tax year can be a useful, albeit noisy, predictor of what will happen when tax returns are filed in April. Estimated payments in the median state fell by approximately 25 to 30 percent for each of the payments due in April, June, and September of 2009. By itself this need not indicate that nonwage income declined in 2009 — it could reflect a timing correction on the part of taxpayers if they had overpaid in the same period a year earlier and indeed payments in 2008 had not yet been depressed by the weakening economy, and were actually up 3 percent from April-September of 2007. But the estimated payment declines in April-September of 2009 were followed by a 22 percent drop in estimated payments in December 2009 and January 2010, and this is less likely to be a timing-related correction: in the wake of the fall 2008 financial sector collapse estimated payments in the December 2008 and January 2009 period were down 16.8 percent in the median state. The 22 percent decline in December 2009 and January 2010 suggests that nonwage income and associated tax liability may in fact have declined substantially in 2009, potentially boding ill for final returns in April.

Unfortunately, it is too early to glean insights from daily federal data on nonwithheld taxes. Payments this early reflect only a small share of the total payments with tax returns and need not be representative or indicative of what will happen. We will monitor these data but do not expect them to yield useful insights until late April or early May.

Which states could be most-affected by a decline in capital gains? Table 11 shows, for each of the 41 states with a broad-based income tax, (1) capital gains as a share of adjusted gross income in 2007 (the latest year available) based on federal Statistics of Income data, (2) the state's top tax rate on capital gains from corporate equities as reported by the American Council for Capital Formation for tax year 2008 (the latest available year),[19] and (3) the state's reliance on the income tax as a share of total taxes for fiscal year 2009, from the Census Bureau. The table also ranks states by an indicator of capital gains importance, which was constructed by indexing each state's capital gains share and its top capital gains tax rate to the nation, and then multiplying the two resulting indexes and ranking the result.[20] States at the top of the list have relatively high reliance on capital gains while those low on the list do not. The measure should be taken as a broad indicator of capital gains reliance, and small differences between states should not be considered meaningful.

It is clear that states face the risk of a substantial decline in income tax payments on 2009 income this April and May, despite the large decline that already occurred in April and May of 2009 and despite the clear signs that the current economy is stabilizing and beginning to recover. Such a decline would be bad news at

Table 11. Income-Tax States Ranked by a Measure of Capital Gains Dependence

State	Capital gains as share of AGI (2007)	Top Capital Gains Tax Rate on Corporate Equities (2008)	PIT as share of taxes (2009)	Rank (1=highest), considering capital gains share and top rate together
US average or median	***9.6%***	***5.7%***	***34.4%***	
California	10.7	10.3	43.9	1
New York	13.5	6.9	56.7	2
Idaho	10.3	7.8	37.1	3
Oregon	8.9	9.0	73.2	4
New Jersey	7.9	9.0	39.2	5
Maine	7.9	8.5	39.3	6
Connecticut	13.3	5.0	49.3	7
Massachusetts	11.7	5.3	54.4	8
Vermont	10.8	5.7	21.3	9
Nebraska	8.8	6.8	40.0	10
Hawaii	8.1	7.3	28.4	11
Minnesota	7.4	7.9	40.5	12
North Carolina	7.3	7.8	46.6	13
Iowa	6.0	9.0	38.7	14
Colorado	11.4	4.6	50.7	15
Montana	10.4	4.9	34.4	16
Oklahoma	8.7	5.5	31.2	17
Utah	9.5	5.0	42.8	18
Delaware	8.0	6.0	32.5	19
Georgia	7.8	6.0	48.5	20
Kansas	7.1	6.5	40.8	21
Virginia	7.9	5.8	55.1	22
Maryland	8.0	5.5	42.8	23
Arizona	9.6	4.5	17.4	24
Missouri	6.9	6.0	46.1	25
Kentucky	6.1	6.0	34.0	26
Ohio	5.7	6.2	34.7	27
Alabama	7.0	5.0	32.1	28
Louisiana	5.5	6.0	29.4	29
South Carolina	7.9	3.9	32.9	30
Arkansas	6.3	4.9	30.0	31
West Virginia	4.6	6.5	32.5	32
Illinois	9.9	3.0	31.4	33
Mississippi	5.1	5.0	22.8	34
Michigan	5.8	4.4	25.6	35
North Dakota	6.4	3.9	15.3	36
Pennsylvania	7.6	3.1	31.8	37
New Mexico	7.9	2.7	19.2	38
Indiana	6.0	3.4	29.0	39
Wisconsin	7.0	2.7	42.9	40
Rhode Island	8.4	1.7	37.2	41

Sources: (1) Capital gains as share of AGI: calculated by Rockefeller Institute from IRS Statistics of Income File 07in54cm.xls, (2) top capital gains tax rate: State Individual Capital Gains Tax Rates, American Council for Capital Formation, October 2008; rate for United States is median of rates shown, (3) PIT as share of taxes calculated by Rockefeller Institute from Census Bureau state tax data; (4) Rank calculated by Rockefeller Institute by first indexing each state's capital gains share and top rate to the nation, multiplying the two resulting indexes, and ranking them.

the worst time for any states that did not incorporate declines in nonwage income into their forecasts.

The Outlook

Calendar 2009 brought the worst ever drop in overall tax collections, at a decline of 11 percent. The worst decline in both personal income tax and sales tax in half a century represents historic weakness in the two major tax sources for states. The Great Recession hit virtually every single source of tax revenue and pushed a number of states to revise revenue forecasts numerous times throughout fiscal years 2009 and 2010.

Preliminary data for the January-March quarter of 2010 suggest that fiscal conditions continue to be weak, though there is evidence of further slowing in the rate of decline. With preliminary data for January and February now available for 45 states, tax revenue for the two months combined has declined further by 2.2 percent versus the same period last year. About 84 percent of states reporting personal income tax data had a year-over-year decline, with a median decline

of 7.1 percent, while 80 percent of states reporting sales-tax data had a year-over-year decline.

While March data could change this troubling picture, there is little reason to expect reported revenues for that month to be strong enough to make the quarter positive. Continued weakness in revenues, along with continued if more moderate growth in expenditures, will force the states to take unwelcome actions to close budget gaps. Most states have already taken a variety of measures to balance their budgets, including across-the-board budget cuts, tax increases, tapping rainy day funds, employee furloughs and/or reductions, and agency consolidations. About 39 forecasters surveyed by the Federal Reserve Bank of Philadelphia predicted modest economic growth but delayed labor market recovery over the next two years. The forecasters predicted a high unemployment rate throughout 2010, falling slightly lower to 9.9 percent in December 2010.[21] While the recession may be over for the national economy, the state fiscal crisis is far from over. Most states are uncertain as to when to expect a return to prerecession revenue levels.

Endnotes

1 We made adjustments to Census Bureau data for six states — Arizona, Maryland, Michigan, New Mexico, Oregon, and Wisconsin — based upon data and information provided to us directly by these states. These revisions together account for some noticeable differences between the Census Bureau figures and the Rockefeller Institute estimates.

2 Revenue growth in normal times would vary depending on differences in inflation and other factors, but this is a good indicator of what might be expected assuming inflation was similar to average inflation over the period.

3 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): 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): 351-94. The data and several papers are available at www.philadelphiafed.org/econ/indexes/coincident.

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

5 See www.sco.ca.gov/Files-EO/04-10summary.pdf.

6 See Dunstan McNichol, "Tax Receipts Rebound as 15 Biggest States See Gain," *Business Week*, March 30, 2010, (www.businessweek.com/news/2010-03-30/california-revenue-shows-state-cash-collapse-ending-update1-.html).

7 See Conor Dougherty, "Property, Corporate Taxes Finally Lift State Revenue," *The Wall Street Journal*, April 2, 2010. The headline refers to state and local taxes combined, not state government tax revenue. (online.wsj.com/article/SB10001424052702303395904575158164085893090.html?mod=googlenews_wsj#articleTabs%3Darticle).

8 This treats the 1980-82 "double-dip" recession as a single long recession.

9 Ibid.

10 The trend was calculated using the seasonal-trend-Loess (STL) local regression approach in the software package R.

11 This is a simplified description of the process, and there are other possibilities as well. For example, taxpayers can adjust withholding upward or downward as a partial alternative to making estimated payments, and they may credit overpayments forward to the next tax year rather than claim a refund.

12 See data at www.fms.treas.gov/dts/index.html and https://fms.treas.gov/fmsweb/DTSFilesArchiveAction.do.

13 See G. Thomas Woodward, "Capital Gains Taxes and Federal Revenues," *Revenue and Tax Policy Brief* No. 1, Congressional Budget Office, October 2002.

14 See, for example, Preston Miller and Larry Ozanne, "Forecasting Capital Gains Realizations," *Technical Paper 2000-5*, Congressional Budget Office, August 2000; G. Thomas Woodward, "Revenue Projections and the Stock Market," *Revenue and Tax Policy Brief* No. 3, Congressional Budget Office, December 2002; and Congressional Budget Office, "Estimating and Forecasting Capital Gains with Quarterly Models," *Technical Paper 2004-14*, September 2004.

15 See Janette Wilson, *Sales of Capital Assets Reported on Individual Income Tax Returns, 1999*, from the Statistics of Income Web site (www.irs.gov/taxstats/indtaxstats/article/0,,id=96649,00.html), for what appears to be the most recent IRS analysis of data on when capital gains are realized and on asset holding periods, particularly Table 3 for month of transaction and Table 4 for holding periods.

16 Source: daily values from http://finance.yahoo.com/q/hp?s=^GSPC.

17 Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, Table 4-3.

18 This would be the timing for states with a July 1 fiscal year rather than for New York, which has an April 1 fiscal year and thus has income tax returns filed in its subsequent fiscal year.

19 It would be preferable to use capital gains tax rates for 2009 but we do not have them from a well-researched source. Our analysis of tax changes in 2009 indicates that top tax rates on gains increased significantly in Delaware, Maryland, New Jersey, New York, and Oregon, and by lesser amounts in several other states. Our preliminary analysis suggests that these changes would be large enough to increase New York's ranking from number 2 to number 1, but most states' ranking would change little or not at all.

20 For example, Idaho's capital gains share of 10.3 percent was 7 percent (not 7 percentage points) above the national average of 9.6 percent, giving it a capital-gains-share index of 107. Its top rate on gains of 7.8 percent was 37 percent above the national median, giving it a tax-rate index of 137. Multiplying the two and dividing by 100 gives a combined index of 147, which places it third highest in the nation.

21 For detailed information see Philadelphia Federal Reserve Bank's Livingston Survey available at http://www.philadelphiafed.org/research-and-data/real-time-center/livingston-survey/.

Adjustments to Census Bureau Tax Collection Data

The numbers in this report differ somewhat from those released by the Bureau of the Census at the end of March. For reasons we describe below, we have adjusted Census tax collections in selected states to arrive at numbers that we believe are best-suited for our purpose of examining underlying economic and fiscal conditions. As a result of these adjustments, we report a year-over-year decline in tax collections of 4.2 percent, compared with the 4.1 percent decline that can be computed from data on the Census Bureau's website (www.census.gov/govs/www/qtax.html). In this section we explain how and why we have adjusted Census Bureau data, and the consequences of these adjustments.

The Census Bureau and the Rockefeller Institute engage in two related efforts to gather data on state tax collections, and we communicate frequently in the course of this work. The Census Bureau has a highly rigorous and detailed data collection process that entails a survey of state tax collection officials, coupled with web and telephone follow-up. It is designed to produce, after the close of each quarter, comprehensive tax collection data that, in their final form after revisions, are highly comparable from state to state. These data abstract from the fund structures of individual states (e.g., taxes will be counted regardless of whether they are deposited to the general fund or to a fund dedicated for other purposes such as education, transportation, or the environment).

The Census Bureau's data collection procedure is of high quality but is labor-intensive and time-consuming. States that do not report in time, or do not report fully, or that have unresolved questions may be included in the Census Bureau data on an estimated basis, in some cases with data imputed by the Census Bureau. These imputations can involve methods such as assuming that collections for a missing state in the current quarter are the same as those for the same state in a previous quarter, or assuming that collections for a tax not yet reported in a given state will have followed the national pattern for that tax. In addition, state accounting and reporting for taxes can change from one quarter to another, complicating the task of reporting taxes on a consistent basis. For these reasons, some of the initial Census Bureau data for a quarter may reflect estimated amounts or amounts with unresolved questions, and will be revised in subsequent quarters when more data are available. As a result, the historical data from the Census Bureau are comprehensive and quite comparable across states, but on occasion amounts reported for the most recent quarter may not reflect all important data for that quarter.

The Rockefeller Institute also collects data on tax revenue but in a different way and for different reasons. Because historical Census Bureau data are comprehensive and quite comparable, we rely almost exclusively on Census data for our historical analysis. Furthermore, in recent years Census Bureau data have become far more timely and where practical we use them for the most recent quarter as well, although we supplement Census data for certain purposes. We collect our own data on a monthly basis so that we can get a more-current read on the economy and state finances. For example, as this report goes to print we have data on tax collections in January and February in 45 states — not enough to use as the basis for a comprehensive report, but useful in understanding what is happening to state finances. Although some states have seen significant year-over-year increases in one or more taxes, these increases are few and far between. Tax revenue is continuing to decline in the median state, and at this point it appears as if the January-March quarter will have declines in the median state.

In addition, we collect information on withholding tax collections and payments of estimated income tax, both of which are important to understanding income tax collections but are not available in the Census data.

Our main uses for the data we collect are to report more frequently and currently on state fiscal conditions, and to report on the income tax in more detail.

Ordinarily there are not major differences between our data for a quarter and the Census data, so when we do a full quarterly report we use the Census data without adjustment. But in the October-December quarter there were enough large differences for few states that we decided to adjust

the Census data. Table 10 shows the year over year percent change by state in major taxes as reported by the Census Bureau and as adjusted by the Rockefeller Institute. The adjusted numbers are what we describe in this report. The states with differences are Arizona, Maryland, Michigan, New Mexico, Oregon, and Wisconsin. Some differences reflect more-recent information obtained by the Institute. For example, the Census Bureau had not received a response for Wisconsin in time for its publication and so used imputed data that will be revised in later reports, whereas the Institute obtained data from Wisconsin that is less comprehensive than would be used by the Census Bureau but provides a better picture of fiscal conditions than imputed data.

We expect that in most quarterly Institute reports on state tax revenues we will not adjust the officially reported data, but when we do we will note the differences.

Table 12. Census Bureau Tax Data Compared With Data as Adjusted by Rockefeller Institute

October-December, 2008 to 2009, Percent Change

	As Reported By Census Bureau				As adjusted by RIG			
	PIT	CIT	Sales	Total	PIT	CIT	Sales	Total
United States	**(4.7)**	**(0.7)**	**(4.9)**	**(4.1)**	**(4.6)**	**(3.6)**	**(5.3)**	**(4.2)**
New England	**(2.5)**	**41.8**	**4.8**	**1.7**	**(2.5)**	**41.8**	**4.8**	**1.7**
Connecticut	3.4	251.0	(6.6)	(0.5)	3.4	251.0	(6.6)	(0.5)
Maine	8.1	16.6	(6.8)	3.3	8.1	16.6	(6.8)	3.3
Massachusetts	(6.5)	40.4	20.8	3.2	(6.5)	40.4	20.8	3.2
New Hampshire	(1.4)	(3.1)	NA	5.7	(1.4)	(3.1)	NA	5.7
Rhode Island	(5.0)	28.4	(3.9)	(2.1)	(5.0)	28.4	(3.9)	(2.1)
Vermont	(8.3)	63.4	(5.7)	(1.4)	(8.3)	63.4	(5.7)	(1.4)
Mid-Atlantic	**(0.4)**	**(17.2)**	**(4.3)**	**(2.9)**	**(0.4)**	**(23.9)**	**(4.3)**	**(3.4)**
Delaware	(10.0)	(40.3)	NA	(4.9)	(10.0)	(40.3)	NA	(4.9)
Maryland	(4.4)	182.2	(5.3)	(0.2)	(4.4)	33.7	(5.3)	(4.3)
New Jersey	(1.7)	(23.3)	(9.0)	(7.1)	(1.7)	(23.3)	(9.0)	(7.1)
New York	2.8	(33.8)	(0.3)	(1.8)	2.8	(33.8)	(0.3)	(1.8)
Pennsylvania	(4.8)	(11.1)	(4.5)	(2.5)	(4.8)	(11.1)	(4.5)	(2.5)
Great Lakes	**(5.6)**	**(10.2)**	**(4.7)**	**(4.6)**	**(4.7)**	**(12.7)**	**(5.0)**	**(4.3)**
Illinois	(3.3)	(3.0)	(11.7)	(6.3)	(3.3)	(3.0)	(11.7)	(6.3)
Indiana	(7.9)	(30.7)	(6.6)	(9.1)	(7.9)	(30.7)	(6.6)	(9.1)
Michigan	(3.2)	(6.5)	(1.3)	(4.7)	(9.4)	(17.1)	(0.4)	(6.5)
Ohio	(9.3)	(28.5)	(0.5)	(1.4)	(9.3)	(28.5)	(0.5)	(1.4)
Wisconsin	(4.6)	(0.7)	(2.9)	(2.9)	7.7	8.7	(6.6)	3.4
Plains	**(7.5)**	**(11.1)**	**(3.5)**	**(4.2)**	**(7.5)**	**(11.1)**	**(3.5)**	**(4.2)**
Iowa	1.0	135.7	(0.0)	0.6	1.0	135.7	(0.0)	0.6
Kansas	(7.4)	(6.4)	(0.4)	(5.9)	(7.4)	(6.4)	(0.4)	(5.9)
Minnesota	(6.2)	(7.2)	(1.1)	(1.6)	(6.2)	(7.2)	(1.1)	(1.6)
Missouri	(14.6)	23.1	(6.4)	(9.0)	(14.6)	23.1	(6.4)	(9.0)
Nebraska	(5.3)	(52.2)	(12.7)	(7.5)	(5.3)	(52.2)	(12.7)	(7.5)
North Dakota	(12.3)	(59.5)	(6.0)	(3.7)	(12.3)	(59.5)	(6.0)	(3.7)
South Dakota	NA	(40.8)	(4.2)	(7.8)	NA	(40.8)	(4.2)	(7.8)
Southeast	**(5.4)**	**30.2**	**(5.6)**	**(2.6)**	**(5.4)**	**30.2**	**(5.6)**	**(2.6)**
Alabama	4.4	24.3	(2.5)	0.7	4.4	24.3	(2.5)	0.7
Arkansas	(4.6)	49.7	(8.9)	3.7	(4.6)	49.7	(8.9)	3.7
Florida	NA	(15.2)	(6.0)	(3.7)	NA	(15.2)	(6.0)	(3.7)
Georgia	(8.5)	(40.1)	(24.7)	(13.5)	(8.5)	(40.1)	(24.7)	(13.5)
Kentucky	(8.3)	(18.6)	(3.5)	(8.8)	(8.3)	(18.6)	(3.5)	(8.8)
Louisiana	(9.8)	59.7	(14.3)	(5.5)	(9.8)	59.7	(14.3)	(5.5)
Mississippi	(2.7)	(4.6)	(7.8)	(6.2)	(2.7)	(4.6)	(7.8)	(6.2)
North Carolina	(4.9)	458.7	17.6	9.9	(4.9)	458.7	17.6	9.9
South Carolina	(0.7)	(192.8)	(4.0)	(7.4)	(0.7)	(192.8)	(4.0)	(7.4)
Tennessee	(35.3)	22.1	(5.1)	(1.4)	(35.3)	22.1	(5.1)	(1.4)
Virginia	(5.9)	147.1	(1.8)	(1.5)	(5.9)	147.1	(1.8)	(1.5)
West Virginia	(3.8)	(3.2)	(5.8)	(2.6)	(3.8)	(3.2)	(5.8)	(2.6)
Southwest	**(1.4)**	**(73.0)**	**(10.4)**	**(12.6)**	**(14.9)**	**(73.0)**	**(13.5)**	**(15.2)**
Arizona	15.9	(96.6)	4.8	1.2	(10.3)	(96.6)	(13.7)	(13.0)
New Mexico	14.7	(72.6)	(16.5)	(10.3)	(11.0)	(72.6)	(16.5)	(10.3)
Oklahoma	(21.1)	(28.7)	(15.3)	(20.8)	(21.1)	(28.7)	(15.3)	(20.8)
Texas	NA	NA	(13.0)	(15.2)	NA	NA	(13.0)	(15.2)
Rocky Mountain	**(8.6)**	**(15.2)**	**(10.2)**	**(13.9)**	**(8.6)**	**(15.2)**	**(10.2)**	**(13.9)**
Colorado	(8.2)	(37.0)	(5.7)	(9.6)	(8.2)	(37.0)	(5.7)	(9.6)
Idaho	(10.0)	(29.4)	(8.9)	(8.1)	(10.0)	(29.4)	(8.9)	(8.1)
Montana	(15.9)	(67.2)	NA	(15.7)	(15.9)	(67.2)	NA	(15.7)
Utah	(6.3)	105.1	1.6	(0.9)	(6.3)	105.1	1.6	(0.9)
Wyoming	NA	NA	(40.0)	(46.2)	NA	NA	(40.0)	(46.2)
Far West	**(7.8)**	**3.4**	**(2.4)**	**(2.1)**	**(6.3)**	**3.4**	**(2.4)**	**(1.5)**
Alaska	NA	0.0	NA	(0.5)	NA	0.0	NA	(0.5)
California	(6.2)	5.1	1.9	0.1	(6.2)	5.1	1.9	0.1
Hawaii	(11.8)	(207.6)	(9.6)	(6.3)	(11.8)	(207.6)	(9.6)	(6.3)
Nevada	NA	NA	(16.0)	(3.9)	NA	NA	(16.0)	(3.9)
Oregon	(17.5)	(18.6)	NA	(15.0)	(5.9)	(18.6)	NA	(6.5)
Washington	NA	NA	(9.9)	(7.5)	NA	NA	(9.9)	(7.5)

Source: U.S. Census Bureau and Rockefeller Institute analysis of individual state data.
Notes: States and revenue sources revised are shaded in grey.
Data for New Mexico were adjusted to reflect important differences for the income tax. The Institute did not have sufficient information to make adjustments to total tax revenue for New Mexico and so those data have not been adjusted in this report but could be when more comprehensive and revised data become available. Adjustments to the total for New Mexico would not have a meaningful impact on the national total.

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