

STATE REVENUE REPORT

Fiscal Studies Program
The Nelson A. Rockefeller Institute of Government

December 2001
No. 46

Severe Decline in State Tax Revenue

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HIGHLIGHTS

- ❖ State tax revenues in the July-September 2001 quarter declined by 3.1 percent compared to the same period in 2000.
- ❖ After adjusting for tax law changes and inflation, real underlying state tax revenue declined by five percent – the first such decline since the end of the last recession.
- ❖ The recession in the national economy accounted for much of this decline, although the September 11th attacks also dampened revenues.
- ❖ Many states are already taking steps to reduce their budget gaps.
- ❖ Personal income tax revenue declined by 3.4 percent, the worst quarterly performance in over a decade.
- ❖ This was the first quarter in over ten years without sales tax revenue growth.
- ❖ Corporate income tax revenue declined sharply for the fourth straight quarter.
- ❖ Postponed payment deadlines arising from the September 11th attacks magnified the declines in personal and corporate income tax revenues.

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Table 1. Year-Over-Year Change in Quarterly State Tax Revenue, Adjusting for Legislated Tax Changes and Inflation

	Total Nominal Increase	Adjusted Nominal Increase	Inflation Rate	Real Increase
1995				
Jan.-Mar.	7.3%	6.6%	2.8%	3.7%
April-June	7.1	6.4	3.1	3.2
July-Sept.	5.6	6.1	2.6	3.4
Oct.-Dec.	4.9	5.7	2.7	2.9
1996				
Jan.-Mar.	4.7	5.7	2.7	2.9
April-June	7.3	8.6	2.8	5.6
July-Sept.	6.2	7.4	2.9	4.4
Oct.-Dec.	6.2	7.5	3.2	4.2
1997				
Jan.-Mar.	6.0	7.4	2.9	4.4
April-June	6.2	8.3	2.3	5.9
July-Sept.	5.5	6.1	2.2	3.8
Oct.-Dec.	6.8	7.9	1.9	5.9
1998				
Jan.-Mar.	6.5	7.0	1.5	5.4
April-June	9.7	11.4	1.6	9.6
July-Sept.	6.6	7.1	1.6	5.4
Oct.-Dec.	7.5	8.0	1.5	6.4
1999				
Jan.-Mar.	4.8	6.5	1.7	4.7
April-June	5.0	8.0	2.1	5.8
July-Sept.	6.1	6.5	2.3	4.1
Oct.-Dec.	7.4	8.4	2.6	5.7
2000				
Jan.-Mar.	9.7	10.4	3.2	7.0
April-June	11.4	11.8	3.3	8.2
July-Sept.	7.1	7.7	3.5	4.1
Oct.-Dec.	4.0	5.0	3.4	1.5
2001				
Jan-Mar	5.1	6.3	3.4	2.8
April-June	2.6	4.2	3.4	0.8
July-Sept.	(3.1)	(2.4)	2.7	(5.0)

Note: Inflation is measured by the Consumer Price Index. Please call Fiscal Studies Program for pre-1995 data.

Table 2. Year-Over-Year Change in Quarterly State Tax Revenue by Major Tax

	PIT	CIT	Sales	Total
1995				
Jan.-Mar.	6.4%	13.2%	9.0%	7.3%
April-June	8.3	14.3	6.1	7.1
July-Sept.	6.3	8.0	5.2	5.6
Oct.-Dec.	5.6	7.9	4.2	4.9
1996				
Jan.-Mar.	7.1	(4.8)	5.6	4.7
April-June	11.3	0.9	6.8	7.3
July-Sept.	6.9	4.0	5.8	6.2
Oct.-Dec.	9.1	(3.0)	6.1	6.2
1997				
Jan.-Mar.	7.1	9.6	4.7	6.0
April-June	8.8	7.6	4.3	6.2
July-Sept.	8.4	(2.8)	5.8	5.5
Oct.-Dec.	8.3	4.5	5.3	6.8
1998				
Jan.-Mar.	9.3	2.3	5.6	6.5
April-June	19.5	(2.1)	5.3	9.7
July-Sept.	8.9	(0.2)	5.9	6.6
Oct.-Dec.	9.5	5.2	5.5	7.5
1999				
Jan-Mar.	6.6	(2.6)	6.1	4.8
April-June	6.0	(2.1)	7.3	5.0
July-Sept.	7.6	1.4	6.7	6.1
Oct.-Dec.	9.1	3.8	7.3	7.4
2000				
Jan.-Mar.	13.6	8.0	8.2	9.7
April-June	18.8	4.2	7.3	11.4
July-Sept.	11.0	5.7	4.7	7.1
Oct.-Dec.	5.7	(7.7)	4.1	4.0
2001				
Jan-Mar	8.6	(9.1)	3.3	5.1
April-June	5.6	(13.7)	0.5	2.6
July-Sept.	(3.4)	(25.5)	0.0	(3.1)

Note: Please call Fiscal Studies Program for pre-1995 data.

Introduction

After a year of slowing tax revenue growth, state tax revenue fell into a severe and widespread decline in the July-September quarter of 2001. This sharp drop is a bad sign for state budgets, since July-September is the first quarter of fiscal year 2002 in most states. State tax revenue declined by 3.1 percent for the quarter, the first such decline since the end of the last recession. Personal income tax collections declined by 3.4 percent, an abrupt reversal from the substantial — though weakening — growth of the previous three quarters, not to mention the double-digit growth seen before that. Sales tax collections were substantially unchanged from a year ago, while corporate income taxes were down by over 25 percent from last year, the fourth — and by far largest — straight quarter of decline. When adjusted to reflect the effects of legislated changes and inflation, real state tax revenue declined by five percent, which is the sharpest drop since April-June 1991.

The terrorist attacks in September clearly had an effect on the economies of many states. They also caused delays in tax collections. For instance, most states conformed to the federal government's postponement of September corporate income tax collections, which will therefore appear in the next quarter. Some states also allowed delays of estimated personal income tax payments normally due in September. In general, however, the short-term effects of the attacks seem to have simply accentuated a revenue slowdown that had been apparent for several quarters. Economists are now saying that a recession started in March 2001.¹ The weakness in state revenues is consistent with this recession in the national economy.

Tax Revenue Growth

Table 1 shows tax revenue growth for the last 27 quarters before and after adjusting for legislated tax changes and inflation. By either measure, state tax revenue went into a marked decline in the July-September quarter. The unadjusted 3.1 percent decline was the first year-over-year decline since the Rockefeller Institute began to track state revenues in 1990. Adjusting for the effects of legis-

lated tax changes moderates this decline somewhat, bringing it to 2.4 percent. When we consider inflation, however, the decline becomes five percent. Real declines of this magnitude have not been seen since the end of the last recession.

About a year ago, we first observed the slowdown in revenue growth, beginning in the Southeast, Great Lakes, and Plains states. Last quarter the slowdown spread to most of the country. Now, the decline in state revenues is the most severe in the New England, Mid-Atlantic, and Far West states. (See Table 3.) Revenues declined by 8.3 percent in the Far West, caused in part by some large tax cuts and other legislation. In New England and the Mid Atlantic, too, legislation reduced revenues. After adjusting for these changes, however, declines in these three regions were in the four to six percent range. Meanwhile, tax increases in the Southwest and Southeast contributed to the stronger revenue picture in those regions.

Table 2 shows that the decline in state tax collections is occurring in all of the major types of taxes, with the personal income tax and corporate income tax declining very sharply in the last quarter, while the sales tax continues a long and slow decline. Table 4 includes an adjustment for the effects of legislated tax changes, which only slightly increased the apparent decline in revenues.

Personal Income Tax

State revenue estimators usually do not consider the July-September quarter a very important one for personal income tax collections. Final returns are filed in April, and the fourth and final quarterly estimated tax payment is not due until January. In addition, most businesses pay bonuses in December and January. This means that underlying employment and economic growth have the largest effect on third quarter personal income tax revenues, with some possible additions from capital gains and other nonwage income, which affect estimated payments, and stock options, which affect both withholding and estimated payments.

To the extent that this quarter's personal income tax collections do reflect the slowing national economy, the picture is quite bad for most states. Withholding is declining with the decline in em-

Figure 3
Percent Change in Tax Revenue by Region,
Adjusted for Legislated Changes
July-September 2000 to 2001

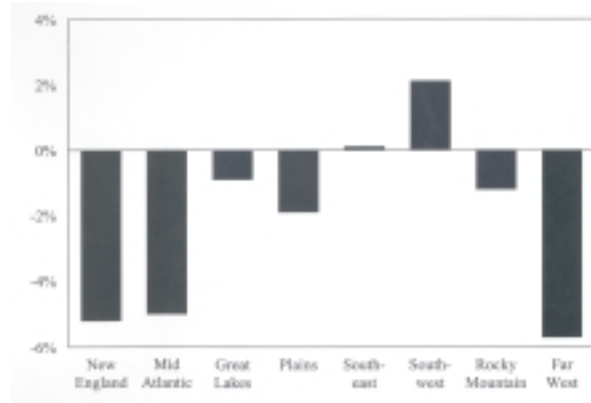


Figure 4
Change in Quarterly Tax Revenue by State, Adjusting for
Legislated Changes, July-September 2000 to 2001

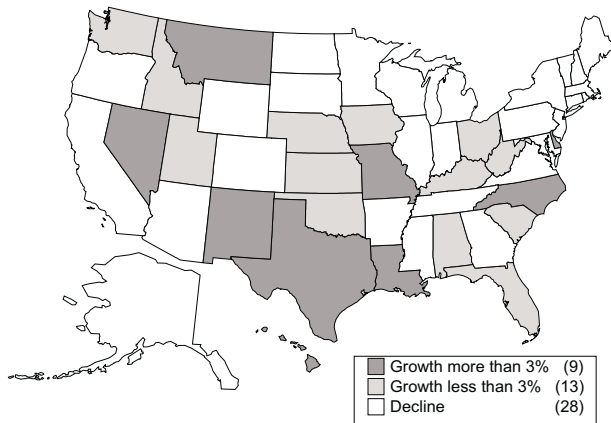
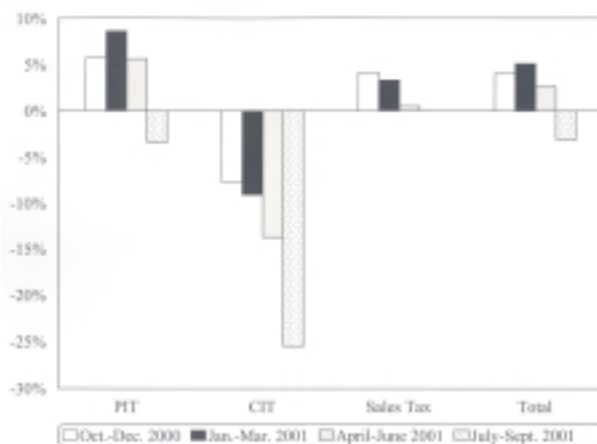


Figure 5
Change in Quarterly Tax Revenue by Tax,
Last Four Quarters



**Table 3. Change in Quarterly Tax Revenue by State,
July-September, 2000 to 2001**

	PIT	CIT	Sales	Total
United States	(3.4)%	(25.5)%	0.0%	(3.1)%
New England	(7.6)	(33.0)	(1.0)	(5.8)
Connecticut	(4.3)	(51.1)¶	(1.6)¶	(5.3)¶
Maine	(2.1)	(15.5)	(7.5)¶	(6.0)
Massachusetts	(10.1)¶	(33.3)	(1.7)	(7.3)¶
New Hampshire	NA	(20.3)*	NA	6.9*
Rhode Island	(2.5)	(35.7)	12.0*	1.7*
Vermont	5.2	(19.8)	(5.7)	(13.6)
Mid-Atlantic	(4.7)	(22.9)	(3.3)	(5.8)
Delaware	1.7	132.2	NA	11.9
Maryland	(3.4)¶	(26.3)	1.1	(3.0)¶
New Jersey	(5.0)	(29.2)¶	3.7	(3.4)
New York	(5.9)	(28.3)¶	(10.5)	(9.5)
Pennsylvania	(1.7)	(12.4)	0.5	(1.7)¶
Great Lakes	(2.3)	(13.3)	1.5	(1.0)
Illinois	(2.8)	(22.8)	1.0*	(3.1)*
Indiana	(5.8)	(7.7)	5.3	(0.1)
Michigan	1.6	(12.2)¶	2.4	(0.7)
Ohio	(3.0)¶	47.2¶	(1.6)	0.7¶
Wisconsin	(3.9)	(4.8)	2.1	(1.5)
Plains	1.1	(28.1)	(0.8)	(1.8)
Iowa	0.9	(16.1)	0.3	0.0
Kansas	3.8	(24.1)	1.9	1.2
Minnesota	(1.3)	(33.2)¶	(3.4)	(6.0)
Missouri ¹	3.4	(20.8)	1.6	4.7
Nebraska	4.3	(29.3)	2.6	1.2
North Dakota	4.6	(24.1)	(10.3)	(8.2)
South Dakota	NA	NA	1.5	(0.5)
Southeast	4.0	(31.8)	0.6	0.3
Alabama	4.3	(32.8)*	1.4	0.8
Arkansas	3.3	(36.3)	1.0*	(0.3)*
Florida	NA	(7.5)	2.8	1.8
Georgia	(2.1)	(58.6)	(6.0)	(6.6)
Kentucky	0.3	(16.8)	2.8*	1.3
Louisiana	21.5	(38.4)	8.1*	7.1
Mississippi	2.0	13.3	(0.5)	(0.4)
North Carolina(p)	15.2	(64.0)	0.6	6.3
South Carolina	1.1	(25.0)	(3.1)	0.2
Tennessee	NA	(28.0)	(1.6)	(1.8)
Virginia	(1.2)	(38.5)	0.2	(2.4)
West Virginia	3.6	(24.8)	0.2	2.1
Southwest	1.4	(15.2)	4.1	2.7
Arizona	(1.0)	(21.9)¶	0.2*	(2.2)*
New Mexico	(0.9)	(14.5)	6.2	3.6
Oklahoma	5.4	10.3	3.7	(0.3)
Texas	NA	NA	4.6	4.3
Rocky Mountain	(4.5)	(30.4)	0.9	(2.4)
Colorado	(8.3)	(30.5)	0.0¶	(5.9)¶
Idaho	(9.2)¶	(40.4)¶	0.4	(1.3)¶
Montana	3.5	(5.5)	NA	7.3
Utah	5.0¶	(34.4)	0.7	0.7
Wyoming	NA	NA	23.3	(2.1)
Far West	(9.5)	(30.0)	(2.3)	(8.3)
Alaska	NA	(36.8)	NA	(6.3)
California	(9.2)	(28.7)	(4.2)¶	(9.3)¶
Hawaii	1.2¶	13.0¶	1.4¶	1.9¶
Nevada	NA	NA	1.2	4.0
Oregon	(15.2)¶	(46.5)	NA	(17.6)¶
Washington	NA	NA	2.3	(3.7)¶

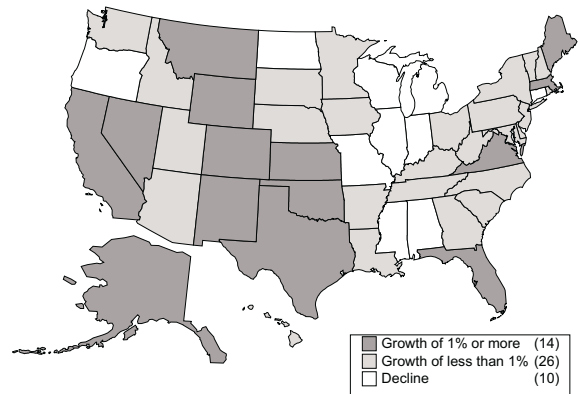
See p. 5 for notes.

Table 4. Change in Quarterly Tax Revenue, Adjusting for Legislated Tax Changes

	PIT	Sales	Total
1995			
Jan.-Mar.	6.1%	7.5%	6.6%
April-June	7.5	5.1	6.4
July-Sept.	7.2	5.4	6.1
Oct.-Dec.	7.1	4.2	5.7
1996			
Jan.-Mar.	8.8	5.7	5.7
April-June	14.1	6.5	8.6
July-Sept.	9.1	5.9	7.4
Oct.-Dec.	11.2	6.4	7.5
1997			
Jan.-Mar.	10.0	5.0	7.4
April-June	12.8	5.0	8.3
July-Sept.	9.5	6.2	6.1
Oct.-Dec.	10.7	5.9	7.9
1998			
Jan.-Mar.	10.0	6.5	7.0
April-June	23.3	5.9	11.4
July-Sept.	9.3	6.4	7.1
Oct.-Dec.	10.2	5.9	6.9
1999			
Jan.-Mar.	9.9	6.2	6.5
April-June	12.4	7.3	8.0
July-Sept.	8.3	6.9	6.5
Oct.-Dec.	11.0	7.5	8.4
2000			
Jan.-Mar.	13.8	8.8	10.4
April-June	18.6	7.8	11.8
July-Sept.	11.6	5.6	7.7
Oct.-Dec.	6.5	5.0	5.0
2001			
Jan.-Mar.	10.1	3.7	6.3
April-June	7.9	0.6	4.2
July-Sept.	(2.8)	0.4	(2.4)

Note: The corporate income tax is not included in this table. The quarterly effect of legislation on this tax's revenue is especially uncertain. (See Technical Notes, page 13.)
For pre-1995 data, call the Fiscal Studies Program.

**Figure 6
Change in Non-Farm Employment
July-September 2000 to 2001**



ployment. Stock options are reportedly in sharp decline, reflecting the weaker stock market, particularly the high-tech sector. Some early signs of recovery in the stock market constitute about the only good news in state revenue at this time.

The decline in personal income tax revenue in the third quarter of calendar 2001 was 3.4 percent. This was the worst quarter in the decade since the *State Revenue Report* began. After adjusting for some tax cuts and rebates, the decline was still 2.8 percent. Both with and without adjustment the worst decline was in the Far West states. The Southeast had the strongest personal income tax revenue growth, boosted by double-digit growth in Louisiana and North Carolina. This rapid growth was something of an anomaly, however. Of the 41 states with a personal income tax, 20 experienced revenue declines. Massachusetts and Oregon suffered double-digit declines. However, legislated tax changes reduced revenues significantly in those two states, as well as in Hawaii, Idaho, Maryland, Ohio, and Utah.

Withholding

Withholding is a good indicator of the current strength of personal income tax revenue because it is based largely on current wages and because it is much less volatile than estimated/declared payments or final settlements. Table 5 shows that year-over-year withholding for the third quarter of calendar 2001 declined by 1.1 percent, shifting the

Key to Interpreting Tables

All percent change tables are based on year-over-year changes.

¹ September data not available.

* indicates legislation or processing/accounting changes significantly increased tax receipts (by one percentage point or more).

¶ indicates legislation or processing/accounting changes significantly decreased tax receipts.

NA means not applicable.

(p) preliminary data.

Historical Tables (Tables 1, 2 and 4) have been shortened to provide data only back to 1995. For data through 1990, call the Fiscal Studies Program.

Table 5. Change in Personal Income Tax Withholding by State, Last Four Quarters				
	2000		2001	
	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.
United States	6.5%	6.8%	3.3%	(1.1)%
New England	4.4	8.3	2.1	(5.4)
Connecticut	1.2	16.3	2.0	0.2
Maine	8.7	14.3	7.1	2.3
Massachusetts	4.9	4.7	1.3	(8.8)¶
Rhode Island	8.4	11.1	4.9	0.7
Vermont	3.1	2.3	4.1	1.9
Mid-Atlantic	8.9	12.5	4.7	(0.9)
Delaware	(1.7)¶	7.7¶	4.0	7.6
Maryland ¹	5.8¶	5.3	8.7¶	5.3
New Jersey	13.4	5.8	4.7	(5.1)
New York	9.9	18.1	3.1	(1.2)
Pennsylvania	6.4	5.2	4.7	(1.9)
Great Lakes	2.2	(2.1)	1.1	0.0
Illinois	4.6¶	0.9¶	6.2¶	(1.4)
Indiana	4.3	0.0	1.0	(2.4)
Michigan	(2.4)¶	(5.2)¶	0.9¶	2.8
Ohio	4.1	3.1	2.5	0.3
Wisconsin	1.6¶	(9.7)¶	(6.5)¶	(0.9)
Plains	3.7	5.9	3.5	1.6
Iowa	(0.1)	2.3	4.9	0.0
Kansas	7.8	1.4	3.2	2.7
Minnesota	3.5¶	5.4¶	2.6¶	0.4
Missouri	3.9	12.2	3.7	2.7
Nebraska	6.3	3.2	4.1	5.5
North Dakota	3.8	2.5	5.9	3.0
Southeast	5.9	5.4	5.4	2.3
Alabama	6.1	0.7	3.3	4.4
Arkansas	5.2	3.4	6.4	5.5
Georgia	13.9	3.2	10.1	(1.9)
Kentucky	(0.1)	7.0	(0.8)	1.7
Louisiana ¹	5.5	1.2	17.0	20.4
Mississippi	3.8¶	0.6	3.3	3.5
North Carolina	7.3	5.7	2.3	1.7
South Carolina	0.7	5.2	2.2	2.1
Virginia	3.5	9.6	6.9	3.5
West Virginia	(0.9)	12.4	5.5	1.9
Southwest	4.3	5.9	6.1	4.4
Arizona	4.9	0.8	4.7	1.2
New Mexico	5.3	11.1	7.9	5.0
Oklahoma	3.2	10.3	7.0	7.9
Rocky Mountain	10.6	5.5	1.6	(2.0)
Colorado	10.1	7.0¶	0.4	(4.9)
Idaho	14.7	4.2	0.3	(7.6)¶
Montana	10.3	6.7	7.2	4.4
Utah	9.4	3.0	3.2	5.4¶
Far West	9.9	9.4	1.9	(5.8)
California	10.7	10.2	2.2	(6.7)
Hawaii	4.1	5.3	(0.9)	2.7¶
Oregon	5.7	4.2	0.7	(2.3)

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

slowdown seen over the last four quarters into negative territory. Legislated tax cuts depressed withholding by only about two-tenths of a percent in July-September.² The increasing weakness in withholding was nationwide, with every region showing either slowing growth or a decline. This widespread weakness in withholding should be a cause for concern, since it suggests that slowing personal income tax revenues are due primarily to pre-existing problems in the economy, rather than the events of September 11th.

Estimated Payments

The highest-income taxpayers generally pay most estimated tax payments (also known as declarations) on their non-wage income. This income is often from investments, especially from capital gains realized in the stock market. Most state estimators gave much of the credit for strong state revenue growth in the late 1990s to capital gains and stock options. Over the past year or two, however, stock prices, especially those of high-tech stocks, have fallen off their record highs. This fall now appears to be affecting estimated tax payments.

As shown in Table 6, estimated tax payments declined by 12.5 percent in the July-September quarter compared to last year. This includes the third quarterly payment for most states. Some states, however, granted extensions because of the September 11th attacks. State analysts are estimating that several hundred million dollars in estimated payments not collected in September will arrive with the December/January payments. Nevertheless, the overall downward trend in estimated payments is clear when we look at all three payments made so far this year — in April, June and September. Summing the April and June payments results in no growth from last year. Adding the September payment to the total results in an overall decline of 4.4 percent. Overcoming this downward trend would require a very strong December/January payment, which is rather improbable, given the state of the economy. This trend also points to a bad April 2002 for state revenues if final returns go the same way as withholding and estimated payments.

**Table 6. Estimated Payments/Declarations
(change year-over-year)**

<i>State</i>	<i>April-June 2000 to 2001 (First 3 payments)</i>	<i>July-Sept. 2000-2001 (3rd payment only)</i>
Average	(4.4)%	(12.5)%
Alabama	(2.3)	(6.7)
Arizona	2.3	2.3
Arkansas	3.9	(7.2)
California	(11.7)	(17.3)
Colorado	(13.1)	(12.0)
Connecticut	(1.3)	(7.7)
Delaware	(9.0)	(0.2)
Georgia	20.9	(13.8)
Hawaii	4.7	(3.7)
Illinois	(7.5)	(9.1)
Indiana	(3.5)	(18.9)
Iowa	(5.6)	(5.7)
Kansas	2.6	3.0
Kentucky	(4.8)	(3.6)
Maine	(1.0)	(2.2)
Maryland	1.9	(8.9)
Massachusetts	(7.6)	(11.2)
Michigan	(10.8)	(10.6)
Minnesota	(4.4)	(11.8)
Mississippi	5.6	(0.9)
Missouri	(4.4)	(6.4)
Montana	(6.0)	(14.2)
Nebraska	(1.1)	(1.5)
New Jersey	(4.6)	(10.3)
New Mexico	(21.5)	(39.6)
New York	1.7	(24.5)
North Carolina	(2.6)	(3.4)
North Dakota	8.6	5.8
Ohio	(1.1)	(5.3)
Oklahoma	13.0	1.9
Oregon	(2.9)	(7.8)
Pennsylvania	(2.5)	(2.4)
Rhode Island	(5.2)	(11.3)
South Carolina	(1.8)	(4.6)
Vermont	(4.9)	(7.7)
Virginia	0.3	4.7
West Virginia	(1.2)	13.2
Wisconsin	(14.7)	(11.7)

General Sales Tax

Sales tax revenue was unchanged in the July-September quarter, compared to last year, ending the slowing growth seen in the previous five quarters. Adjusting for legislated changes brings growth up to 0.4 percent, the slowest adjusted growth since July-September 1991. This is the second quarter in a row in which the sales tax grew at a slower rate than the consumer price index.

The only region where sales tax growth outpaced inflation was the Southwest. In the New England, Mid-Atlantic, Plains, and Far West states, sales tax revenues declined. In all, thirteen states reported declines in their sales tax collections. In three of these states, however, tax cuts caused all or part of the decline.³ New York and North Dakota experienced double-digit declines in sales tax revenue, with the terrorist attack certainly contributing to the New York decline. Two states had double-digit sales tax increases; in one — Rhode Island — this was due to legislated tax changes. Only Wyoming experienced true underlying double-digit sales tax growth.

The overall downward trend in sales tax revenues is probably largely the result of the general slowing of the economy. Consumer confidence has dropped significantly over the last year, and a negative “wealth effect” may be causing people with declining investment portfolios to defer large purchases. Moreover, consumption had been unsustainably high for some time, with extremely low — even negative — savings rates and very high debt.⁴ Whatever its cause, this end to growth in sales tax revenues should arouse deep concern in the majority of states, since the 45 states that have a sales tax count on it for over 36 percent of their general fund tax revenues. In the six states that have a sales tax but no personal income tax — Florida, Nevada, South Dakota, Tennessee, Texas, and Washington — the sales tax accounts for between 58 and 76 percent of state tax revenues.

Corporate Income Tax

This is the fourth straight quarter of accelerating declines in corporate income tax revenue. Revenue in the April-June 2001 quarter fell by 25.6 percent compared to the year before. Year-over-year revenue fell by 7.7 percent in the fourth quarter of 2000, 9.1 percent in the first quarter of 2001, and 13.7 percent in the second quarter. These four quarters have seen the sharpest drops in corporate tax revenue since the beginning of the *State Revenue Report* ten years ago. Of the 45 states that have corporate income taxes, 39 experienced declines.

The magnitude of the decline in corporate income tax revenue for the July-September 2001 quar-

ter is due in part to postponement of payment deadlines. In the wake of the September terrorist attacks, the federal government postponed its September deadline for corporate income tax payments until October 1st. Many states followed suit. As a result, this quarter's figures are especially difficult to interpret. It does appear, however, that four consecutive quarters of strong declines have begun to take their toll on overall state tax revenue growth.

Underlying Reasons for Trends

These revenue changes result from three kinds of underlying forces: differences in state economies, how these differences affect each state's tax system, and recently legislated tax changes.

State Economies

The National Bureau of Economic Research announced in November that the economy had been in recession since March 2001.⁵ Meanwhile, the real Gross Domestic Product declined by 1.1 percent in the third quarter, and unemployment has been increasing.⁶ It is clear that the national economy is in bad shape, but the severity and timing of the downturn is not likely to be the same in every state.

One problem with assessing state economies in a report such as this is a general lack of timely state-by-state indicators. Data on non-farm employment, tracked by the Bureau of Labor Statistics, is the only broad-based, timely, high-quality state-level economic indicator available. Yet these data are a far from ideal indicator of revenue growth. For one thing, most taxes are based upon nominal measures such as income, wages, and profits, rather than employment. Unfortunately, however, state-level data on these nominal measures — when they are available at all — usually are reported too late to be of much use analyzing recent revenue collections. In addition, employment data can be subject to large retroactive revisions. In the past several years, these revisions have generally been upward, but they could go the other way during an economic slowdown.

Table 7 shows year-over-year employment growth for the nation and for each state during the last four quarters. Figure 6 maps the first quarter 2001 employment growth in the states over the same period last year. According to the Bureau of Labor Statistics' national data, employment in the July-September quarter grew only 0.3 percent over the year before. Employment growth has been slowing for several quarters. These numbers are subject to revision, which is why the sums of state and national numbers differ, although both show the same downward trend.

Employment growth has been more rapid in the western states than elsewhere for several years, and this is still true. However, the downward trend in employment growth is present in every region of the country. In fact, employment growth rates have fallen fastest in the Rocky Mountain and Far West states. Employment is flat in the Plains states and in absolute decline in the Great Lakes states.

Two states — Florida and Nevada — continue to enjoy employment growth of over three percent, although even in those states, employment growth is declining. Thirty-six states had employment growth of less than one percent in the July-September quarter, up from 27 the quarter before. Ten states reported employment declines, up from six the previous quarter. In five states, employment shrank by more than one percent. The sharpest decline was in Mississippi, where employment has been declining for over a year.

Nature of the Tax System

Even if the economy were growing at an even pace across all regions and sectors, revenues would vary because states' tax systems do not all react to similar economic situations in the same way. States that rely heavily on the personal income tax tend to have larger revenue increases during periods of economic growth, and larger revenue decreases or slowdowns during periods of recession. The more progressive the tax structure is, the faster tax revenue grows relative to income in good times, especially if the state's tax brackets are not indexed to offset the effects of inflation. States that rely mostly on sales taxes generally have less elastic revenue growth, even though sales taxes are still

Severe Decline in State Tax Revenue

Table 7. Year-Over Change In Non-Farm Employment by State, Last Four Quarters

	2000		2001	
	Oct.- Dec	Jan.- Mar.	Apr.- June	July- Sept.
United States	1.6%	1.2%	0.5%	0.3%
Sum of States	2.2	2.0	1.2	0.6
New England	2.2	1.9	1.0	0.6
Connecticut	1.4	0.9	0.4	(0.2)
Maine	2.5	2.3	1.3	1.3
Massachusetts	2.7	2.4	1.5	1.0
New Hampshire	2.1	2.0	0.8	0.2
Rhode Island	1.4	1.4	0.4	0.5
Vermont	1.7	1.3	0.6	0.3
Mid Atlantic	2.0	1.7	0.9	0.5
Delaware	1.8	1.6	1.4	0.4
Maryland	2.2	2.3	1.0	0.8
New Jersey	2.2	1.7	0.8	0.3
New York	1.9	1.7	1.2	0.7
Pennsylvania	2.0	1.5	0.6	0.2
Great Lakes	0.9	0.7	0.0	(0.3)
Illinois	0.4	0.9	0.2	(0.3)
Indiana	0.6	0.0	(0.8)	(1.1)
Michigan	1.8	0.9	0.0	(0.4)
Ohio	0.9	0.6	0.2	0.0
Wisconsin	1.3	1.1	0.3	(0.1)
Plains	1.0	1.1	0.4	(0.0)
Iowa	0.6	0.8	0.5	0.6
Kansas	1.2	1.8	1.1	1.6
Minnesota	1.5	1.2	0.8	0.2
Missouri	0.7	0.7	(0.3)	(1.3)
Nebraska	1.3	1.3	0.2	0.0
North Dakota	0.3	1.1	0.0	(0.3)
South Dakota	0.7	1.3	0.1	0.0
Southeast	2.2	2.1	1.3	0.9
Alabama	0.6	0.6	(0.6)	(1.1)
Arkansas	1.4	1.0	0.4	0.2
Florida	3.7	3.5	3.2	3.1
Georgia	2.4	2.1	1.6	0.1
Kentucky	1.1	1.0	1.0	0.5
Louisiana	2.0	2.0	0.7	0.4
Mississippi	(0.2)	(0.6)	(1.4)	(1.6)
North Carolina	2.0	2.1	0.7	0.3
South Carolina	2.2	1.8	0.9	0.0
Tennessee	1.6	1.2	0.8	0.4
Virginia	2.4	2.5	1.7	1.5
West Virginia	1.2	1.1	(0.2)	0.2
Southwest	3.0	2.7	2.0	1.5
Arizona	3.4	2.8	1.4	0.2
New Mexico	1.9	1.7	1.6	1.5
Oklahoma	1.4	1.6	1.0	1.0
Texas	3.2	2.9	2.3	2.0
Rocky Mountain	3.6	3.2	2.1	1.2
Colorado	4.3	4.0	2.4	1.2
Idaho	3.8	2.7	1.4	0.9
Montana	2.4	2.1	1.5	1.4
Utah	2.8	2.4	1.8	0.9
Wyoming	2.4	2.4	2.3	2.3
Far West	3.4	3.1	2.0	1.1
Alaska	2.4	2.0	1.2	1.7
California	3.8	3.4	2.3	1.3
Hawaii	3.0	2.9	1.6	0.6
Nevada	4.6	5.0	4.4	3.3
Oregon	1.3	1.2	(0.3)	(1.4)
Washington	2.3	2.0	1.1	0.6

very responsive to economic conditions. Those few states that rely almost exclusively on corporate income or severance taxes often see wild swings in revenue. (Severance taxes are taxes on the removal of natural resources, such as oil and lumber.)

These patterns have played out particularly strongly over the course of the past few years. Most states with personal income taxes have had extremely strong growth, partly because the incomes of upper-income (and thus upper-bracket) taxpayers have been growing at a much more rapid pace than those of middle-income taxpayers. Because their incomes are based more heavily upon volatile sources such as stock options and capital gains, growth in personal income tax revenues has also been far more subject to wild swings than it would otherwise be. A market downturn that affects relatively few wage earners could turn gains into losses for investors, thus sharply contracting a hitherto rich source of revenue almost overnight; this may be exactly what is happening now.

States are also learning about how sales tax revenues respond to an economic slowdown. States that have removed more stable elements of consumption, such as groceries and clothing, from their bases, as well as those that do not capture spending on services well in their bases, are more subject to plunges in sales tax revenues as state residents become nervous about spending on optional and big-ticket items. Thus far, however, the sales tax seems to be reacting to the latest economic downturn more moderately than the personal income or corporate income taxes.

Finally, the recent high oil prices have been a revenue boon for many oil-producing states, such as Alaska, New Mexico, Oklahoma, and Texas. On the other hand, the higher costs of energy and transportation have been a drag on the economies of other states, and have led to extra expenses for state governments. Now that oil prices are in decline, the situation may very well reverse, bad for the oil producing states, good for other states.

Tax Law Changes Affecting This Quarter

The final element that affects trends in tax revenue growth is legislated tax changes. When states boost or depress their revenue growth with tax increases or cuts, it is difficult to draw any conclusions about their current fiscal condition. That is why this report attempts to note where such changes have significantly affected each state's revenue growth. We also occasionally note when changes in the manner of processing receipts have had a major impact on revenue growth, even though these are not due to legislation, as it helps the reader to know that the number is not necessarily indicative of underlying trends.

In the July-September 2001 quarter there were relatively few tax cuts affecting revenue collections compared to the last several years. In many cases states were still phasing in tax cuts enacted before 2001. On the other hand, a few of the states that experienced the revenue decline early increased taxes. The net effect of all of the legislated tax changes in the quarter was to reduce revenues by about \$700 million. Without the changes, tax revenues would have declined by 2.4 percent instead of 3.1 percent.

California made the largest single cut for this quarter by reducing its sales tax rate by a quarter-point in 2001. This cut revenues by about \$300M. Oregon paid out over \$100M in refunds for personal income taxes that it had collected on federal pensions. Connecticut, Hawaii, and Idaho also had significant tax cuts affecting this quarter. Among the states with significant tax increases were New Hampshire, which increased its business taxes, and Arizona and Arkansas, which increased their sales tax rates.

Ongoing Problems with State Revenues and Budgets

Table 8 shows estimated revenue shortfalls and/or actions taken to close existing revenue gaps in 41 states. Some of these gaps are quite large — enough to use up much or all of the reserves and rainy day funds that states have built up over the last several years. In the coming months, many of

these states will have to make up these shortfalls before they can even begin to consider new budgets for fiscal 2003. Since the slowdown in the economy will probably continue to depress state revenues well into next year, the 2002 budget season will present some unpleasant choices for state budget makers trying to balance revenues and expenditures. It seems likely that we will see more budget cutting and possibly more tax increases.

Conclusions

After three quarters of weakening growth in state tax revenues, we have now seen a quarter of decline, due in part to effects of the September 11th attack, but also reflecting a national economy that has gone into recession. Personal income tax revenue had been the only major state revenue source that was growing strongly; now it is in significant decline. Corporate income tax collections are down, and sales tax revenues are flat. The weak employment picture in many states points to a continuation of weak — and even declining — state tax revenues. In short, as many states begin formulating their fiscal 2003 budgets, they are finding no good news from the revenue side of the equation.

Endnotes

- 1 Business Cycle Dating Committee, National Bureau of Economic Research, "The Business-Cycle Peak of March 2001," November 26, 2001.
- 2 States that had significant personal income tax cuts affecting withholding were: Hawaii, Idaho, and Massachusetts.
- 3 States where sales tax cuts caused or significantly increased declines were: California, Connecticut, and Maine.
- 4 See Donald J. Boyd, "Fiscal Issues and Risks at the Start of a New Century," Nelson A. Rockefeller Institute of Government: www.rockinst.org.
- 5 National Bureau of Economic Research, "The Business-Cycle Peak of March 2001."
- 6 United States Department of Commerce, Bureau of Economic Analysis News Release, November 30, 2001. Unemployment data from United States Department of Labor, Bureau of Labor Statistics, *The Employment Situation*, various months.

Severe Decline in State Tax Revenue

Table 8
Continuing Fiscal Trouble in the States

<i>State</i>	<i>FY 2002 Projected Shortfall (millions)</i>	<i>Percent of FY 2000 GF Expenditures</i>	<i>Action</i>
Alabama	\$160	3.1%	Special session Dec. 4 on Gov. Siegelman's (D) plan to raise corporate taxes \$160M to prevent cuts to education spending.
Alaska	\$640	28.3%	
Arizona	\$675	11.2%	Gov. Hull (R) proposed budget cuts of 4%; Special session ongoing
Arkansas	\$20	0.6%	
California	\$4,500	6.8%	Gov. Davis (D) ordered state hiring freezes and agency cuts of \$150M
Colorado	\$385	6.4%	Lawmakers passed measure to cut \$392M in capital projects; Gov. Owens (R) ordered an across-the-board cut of 1%; exempting K-12 education and Medicaid
Connecticut	\$96	0.9%	Legislature passed bill to reduce spending by about \$200M
Florida	\$1,300	7.0%	Second special session ongoing; Legislature passed 18 month delay of intangible tax cut
Georgia	\$600	4.4%	Gov. Barnes (D) ordered spending cuts of 2.5%
Hawaii			Gov. Cayetano (D) declared an economic emergency in the state
Idaho	\$36	2.1%	Gov. Kempthorne (R) ordered across-the-board spending cuts of 3%
Illinois	\$500	2.2%	Gov. Ryan (R) ordered \$485M in budget cuts and a hiring freeze
Indiana	\$450-600	5.0-6.7%	Gov. O'Bannon (D) ordered a 7% cut in state spending and a pay freeze for executive staff
Iowa	\$158	3.3%	Gov. Vilsack (D) ordered across-the-board spending cuts of 4.3%
Kansas			State revenue forecasters cut FY 2002 estimate by \$113.4M
Kentucky	\$533	8.1%	Gov. Patton (D) proposed spending cuts of \$498M
Maine	\$30	1.3%	Gov. King (I) proposed cuts totaling about \$15M and a hiring freeze
Maryland	\$124	1.4%	Gov. Glendening (D) ordered \$205M in cost cutting including: a 1.5% agency spending cut, a hiring freeze, and deferments of capital project funding
Massachusetts	\$1,400	6.7%	Enacted FY 2002 budget was cut by \$605M, state reserves were tapped for \$700M
Michigan	\$830	8.5%	Gov. Engler (R) proposed \$319M in spending cuts, revenue transfers, layoffs, and use of Rainy Day and Tobacco settlement funds
Minnesota	\$1,953	17.0%	
Mississippi	\$80	2.3%	Gov. Musgrove (D) ordered \$55M in spending cuts
Missouri	\$324	4.4%	Gov. Holden (D) ordered \$156M in spending cuts
Nebraska	\$220*	9.4%	Legislature enacted \$171M in budget cuts
Nevada			Gov. Guinn (R) instituted a hiring freeze; Some agencies are freezing one-time expenditures
New Jersey	\$1,900	9.8%	Acting Gov. Donald DiFrancesco (R) ordered \$32M in spending cuts, a partial hiring freeze, and 5% across-the-board cuts
New Mexico	\$12	0.4%	
New York	\$3,000	8.1%	Gov. Pataki (R) ordered a hiring freeze; Legislature enacted an expansion of casino gambling
North Carolina			Gov. Mike Easley (D) ordered 4% agency cuts; Legislature enacted \$650M in tax increases in FY 2002 budget
Ohio	\$1,500*	3.9%	Gov. Taft (R) ordered a hiring freeze; Legislature passed balanced-budget measure, containing \$308M tax increase
Oregon	\$720*	6.9%	
Pennsylvania	\$622		Gov. Ridge (R) ordered a \$200M spending freeze before leaving office
Rhode Island	\$80-100	3.6-4.5%	Gov. Almond (D) called on state departments and agencies to limit expenditures
South Carolina	\$500	9.7%	State financial board ordered 4% across-the-board spending cut; Rainy Day fund was tapped for \$100M
South Dakota	\$12	1.6%	
Tennessee	\$300	4.6%	
Utah	\$200	5.9%	Gov. Leavitt (R) ordered \$73M in spending cuts
Vermont	\$35-50	4.1-5.8%	Gov. Dean (D) ordered \$17M in cuts
Virginia	\$1,200	10.6%	Gov. Gilmore (R) ordered an across-the-board reduction of 2%
Washington	\$200-1,000	2.0-9.8%	
Wisconsin	\$300-1,300	2.7-11.5%	Gov. McCallum (R) ordered a hiring freeze

FY 2000 actual expenditures from National Governors Association and National Association of State Budget Officers, *The Fiscal Survey of the States*, June 2001.

* Indicates biennium total.

Table 9
State Tax Revenue, July to September 2000 and 2001 (In Millions of Dollars)

	2000				2001			
	<i>Personal Income</i>	<i>Corporate Income</i>	<i>Sales</i>	<i>Total</i>	<i>Personal Income</i>	<i>Corporate Income</i>	<i>Sales</i>	<i>Total</i>
United States	\$44,273	\$7,224	\$41,200	\$108,565	\$42,752	\$5,380	\$41,214	\$105,226
New England	3,414	368	1,835	6,697	3,154	247	1,816	6,306
Connecticut	640	46	486	1,393	613	23	478	1,320
Maine	212	21	172	468	207	17	159	440
Massachusetts	2,261	234	948	3,932	2,033	156	932	3,644
New Hampshire	NA	39	NA	260	NA	31	NA	278
Rhode Island	200	19	174	441	195	12	195	448
Vermont	101	9	55	204	106	7	52	176
Mid Atlantic	9,325	1,629	5,384	19,156	8,886	1,256	5,207	18,042
Delaware	173	18	NA	373	176	42	NA	417
Maryland	804	102	427	1,479	777	75	432	1,435
New Jersey	1,171	300	960	2,913	1,113	213	996	2,813
New York	5,554	837	2,161	9,927	5,226	600	1,933	8,988
Pennsylvania	1,622	373	1,837	4,465	1,594	326	1,847	4,390
Great Lakes	7,161	1,145	6,485	17,383	6,994	993	6,584	17,202
Illinois	1,870	267	1,528	4,379	1,818	206	1,543	4,243
Indiana	913	206	905	2,703	860	190	954	2,700
Michigan	1,690	541	1,959	5,171	1,717	475	2,007	5,134
Ohio	1,711	-5	1,508	3,346	1,660	-8	1,484	3,369
Wisconsin	978	136	584	1,784	940	130	596	1,756
Plains	3,246	430	2,586	6,871	3,283	310	2,567	6,746
Iowa	533	59	430	1,083	538	49	431	1,083
Kansas	442	65	425	998	459	49	433	1,010
Minnesota	1,380	226	971	2,868	1,363	151	938	2,696
Missouri ¹	555	25	325	957	574	20	330	1,002
Nebraska	290	39	227	595	302	28	233	602
North Dakota	46	17	87	202	48	13	78	186
South Dakota	NA	NA	122	168	NA	NA	124	167
Southeast	8,049	1,155	10,480	23,199	8,375	788	10,542	23,268
Alabama	560	58	425	1,432	584	39	431	1,443
Arkansas	399	69	432	955	412	44	436	953
Florida	NA	214	3,316	4,265	NA	198	3,408	4,341
Georgia	1,656	185	1,290	3,375	1,621	76	1,212	3,154
Kentucky	681	87	662	1,582	683	73	680	1,603
Louisiana	341	50	563	1,306	414	31	608	1,398
Mississippi	274	47	588	1,241	279	53	585	1,236
North Carolina(p)	1,611	99	875	2,795	1,855	36	880	2,970
South Carolina	716	54	337	1,213	724	41	327	1,215
Tennessee	NA	133	1,189	1,854	NA	96	1,170	1,821
Virginia	1,580	125	574	2,546	1,562	77	575	2,485
West Virginia	231	34	231	636	239	26	231	650
Southwest	1,359	268	5,713	10,412	1,378	227	5,947	10,693
Arizona	615	179	739	1,616	609	140	740	1,580
New Mexico	232	43	317	727	230	37	337	753
Oklahoma	512	46	369	1,172	539	51	383	1,169
Texas	NA	NA	4,288	6,897	NA	NA	4,487	7,191
Rocky Mountain	1,597	176	1,102	3,233	1,526	123	1,111	3,155
Colorado	893	83	499	1,526	819	58	500	1,436
Idaho	212	25	208	525	193	15	209	519
Montana	122	18	NA	193	126	17	NA	207
Utah	371	51	368	919	389	33	370	926
Wyoming	NA	NA	27	70	NA	NA	33	68
Far West	10,122	2,052	7,616	21,615	9,157	1,437	7,441	19,814
Alaska	NA	129	NA	277	NA	81	NA	259
California	8,760	1,804	5,205	16,418	7,956	1,286	4,984	14,893
Hawaii	286	10	401	774	289	11	407	789
Nevada	NA	NA	505	646	NA	NA	511	671
Oregon	1,076	109	NA	1,218	912	59	NA	1,003
Washington	NA	NA	1,505	2,283	NA	NA	1,539	2,198

Technical Notes

This report is based on information collected from state officials, most often in state revenue departments, but in some cases from state budget offices and legislative staff. This is the latest in a series of such reports published by the Rockefeller Institute's Fiscal Studies Program (formerly the Center for the Study of the States).

In most states, revenue reported is for the general fund only, but in several states a broader measure of revenue is used. The most important category of excluded revenues in most states is motor fuel taxes. Taxes on health-care providers to fund Medicaid programs are excluded as well.

California: Non-general fund revenue from a sales tax increase dedicated to local governments is included.

Michigan: The Single Business Tax, a type of value-added tax, is treated here as a corporation income tax.

Several caveats are important. First, tax collections during a period as brief as three months are subject to influences that may make their interpretation difficult. For example, a single payment from a large corporation can have a significant effect on corporate tax revenues.

Second, estimates of tax adjustments are imprecise. Typically the adjustments reflect tax legislation, however they occasionally reflect other atypical changes in revenue. Unfortunately, we cannot speak with every state in every quarter. We discuss tax legislation carefully with the states that have the largest changes, but for states with smaller changes we rely upon our analysis of published sources and upon our earlier conversations with estimators.

Third, revenue estimators cannot predict the quarter-by-quarter impact of certain legislated changes with any confidence. This is true of almost all corporate tax changes, which generally are reflected in highly volatile quarterly estimated tax payments; to a lesser extent it is true of personal income tax changes that are not implemented through withholding.

Finally, many other non-economic factors affect year-over-year tax revenue growth: changes in payment patterns, large refunds or audits, and administrative changes frequently have significant impacts on tax revenue. It is not possible for us to adjust for all of these factors.

This report contains first calendar quarter revenue data for 50 states, although Missouri only had data for its three major taxes, so no totals are included.

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. Donald J. Boyd, who has spent two decades analyzing state and local fiscal issues, is director of Fiscal Studies.

This report was written by Nicholas W. Jenny, a senior policy analyst with the Program. Michael Cooper, the Rockefeller Institute's Director of Publications, did the layout and design of this report, with assistance from Michele Charbonneau. Allison White and Kabutey Ocansey assisted with the collection of data for this report.

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