STATE REVENUE REPORT

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Continued Weakness in State Tax Revenue

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HIGHLIGHTS

- ❖ State tax revenue in the July-September 2002 quarter increased by 2.5 percent compared to the same period in 2001. After adjusting for tax law changes and inflation, real underlying state tax revenue declined by 0.9 percent, continuing the adjusted decline for the fifth straight quarter.
- ❖ The decline in state tax revenues was much worse than general economic performance would suggest.
- ❖ There was a net tax increase for the third quarter in a row as legislated tax changes added over $1.8 billion to state tax revenue. Cigarette taxes accounted for over a third of the total increase.
- ❖ Personal income tax revenue declined by 1.6 percent, the fifth straight quarter of decline.
- ❖ The corporate income tax posted its first increase in two years, but the 4.8 percent rise was due largely to legislated tax increases.
- ❖ Sales tax revenue, which increased by 3.8 percent, accounted for most of the overall growth in state tax revenues.

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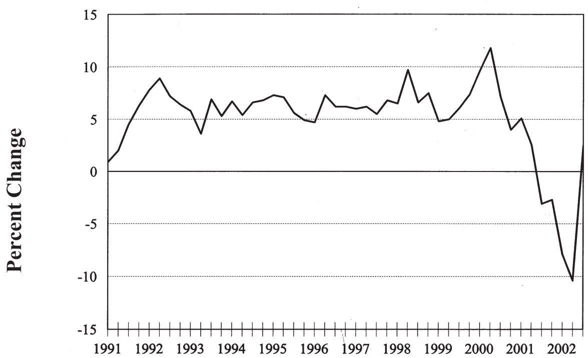


Figure 2. Year-Over-Year Change in Real Adjusted Tax Revenue, 1991-2002

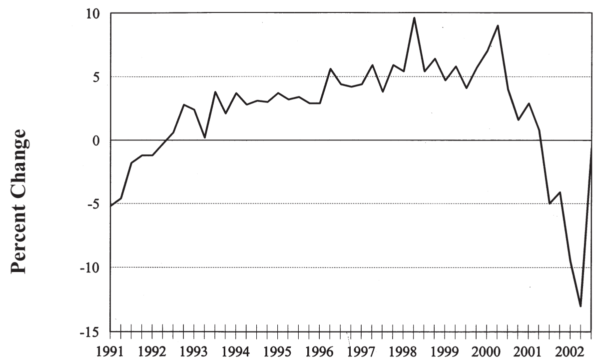


Table 1. Year-Over-Year Change in Quarterly State Tax Revenue, Adjusting for Legislated Tax Changes and Inflation

	Total Nominal Increase	*Adjusted Nominal Increase*	*Inflation Rate*	*Real Increase*
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)
Oct.-Dec.	(2.7)	(2.3)	1.9	(4.1)
2002				
Jan.-Mar.	(7.8)	(8.2)	1.2	(9.3)
April-June	(10.4)	(11.9)	1.3	(13.0)
July-Sept.	2.5	0.7	1.6	(0.9)

Note: Inflation is measured by the Consumer Price Index. Please call Fiscal Studies Program for pre-1996 data.

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

	PIT	*CIT*	*Sales*	*Total*
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)
Oct.-Dec.	(2.7)	(31.8)	1.0	(2.7)
2202				
Jan.-Mar.	(14.3)	(16.1)	(1.0)	(7.8)
April-June	(22.3)	(11.7)	1.5	(10.4)
July-Sept.	(1.6)	4.8	3.8	2.5

Note: Please call Fiscal Studies Program for pre-1996 data.

Introduction

State tax revenue grew by 2.5 percent in the July-September quarter of 2002, reversing a year-long pattern of decline. However, legislation and processing issues caused much of this increase. Without them, the increase would have been only 0.7 percent. (See Table 1.) If we also take the effects of inflation into account, real adjusted state tax revenue actually declined by 0.9 percent — and this is in comparison with a weak quarter last year. In short, states have some way to go before they emerge from their current revenue slumps.

Personal income tax revenue was down by 1.6 percent this quarter, the fifth straight quarter of decline. Sales tax revenue increased by 3.8 percent. Part of this increase was due to legislated increases and processing variations in some states. Corporate income taxes increased by 4.8 percent, finally changing course after seven straight down quarters.

In comparing the July-September 2002 quarter to the same quarter in 2001, we should keep in mind that the terrorist attacks on New York and Washington caused many states to delay 2001 tax collections. Because of these delays, revenue figures from the July-September 2001 quarter were artificially low. This makes the current quarter's growth appear stronger in comparison.

Tax Revenue Change

Table 1 shows tax revenue change for the last 27 quarters before and after adjusting for legislated tax changes and inflation. The nominal 2.5 percent year-over-year increase in the July-September quarter followed four quarters of declining tax collections. Legislated tax changes resulted in a significant net increase in taxes. Without these changes, revenue would have risen by only 0.7 percent. Adjusting for inflation turns this into a 0.9 percent decline. This follows a real decline of 13 percent in the April-June 2002 quarter. While this quarter is quite good by comparison, states are still losing ground in their revenue collections.

The Rocky Mountain states had the worst revenue performance this quarter, with a 1.9 percent decline. (See Table 3.) The Southwest states also had declining revenues. The Mid-Atlantic states had the strongest increase, 4.4 percent. The Great Lakes, Plains, and Southeast states also increased at a faster rate than the national average. When we adjust for tax changes, however, the picture changes somewhat. The increases in the Mid-Atlantic and New England states were largely due to legislated tax increases and processing variations. Legislated tax increases also buoyed growth significantly in the Great Lakes and Plains states. (See Figures 3 and 4.)

Table 2 shows the last 27 quarters of changes in state collections for the major taxes. Personal income taxes declined for the fifth straight quarter, though not as steeply as before. The long decline in corporate income tax collections ended with a modest increase. Growth in the sales tax was stronger than last quarter, though still weaker than it was in previous years.

Table 4 shows the effect of legislated tax changes and processing variations. Without these changes and variations, the decline in the personal income tax would have been greater and the increases in the sales tax and corporate income tax would have been smaller.

Personal Income Tax

The July-September quarter is not a very important one for personal income tax collections. Taxpayers file final returns in April, the fourth and final estimated tax payment is due in January, and businesses pay out most bonuses in December or January. Therefore, underlying employment and economic growth trends — which strongly influence withholding — tend to have the most impact on personal income tax revenues in the July-September quarter. Nevertheless, capital gains, stock options, and other non-wage income still have some impact through estimated payments. Stock options also affect withholding.

Third quarter personal income tax revenue declined for the second year in a row. The rate of decline, however, has slowed. This quarter's 1.6 percent decline pales in comparison to the second quarter's 22.3 percent decline, which resulted from a sharp drop in payments from final returns due to

Figure 3
Percent Change in Tax Revenue by Region, Adjusted for Legislated Changes July-September 2001 to 2002

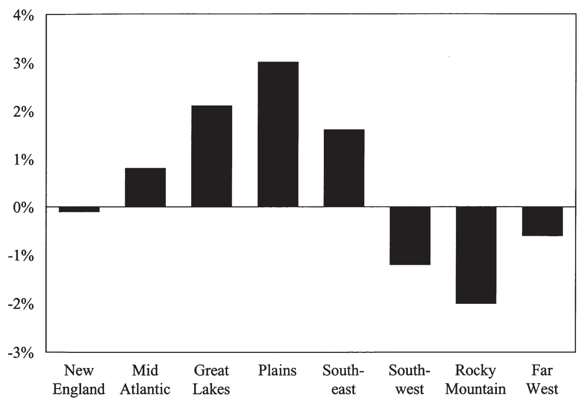


Figure 4
Change in Quarterly Tax Revenue by State, Adjusted for Legislated Changes, July-September 2001 to 2002

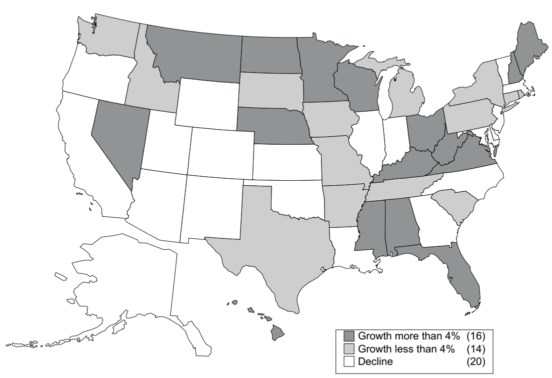


Figure 5
Change in Quarterly Tax Revenue by Tax, Last Four Quarters

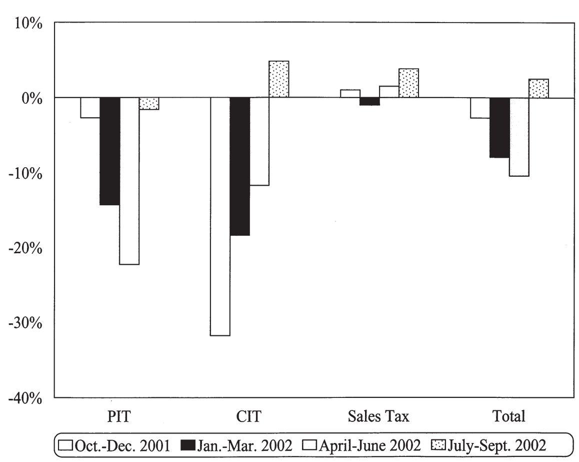


Table 3. Percent Change in Quarterly Tax Revenue by State, July-September 2001 to 2002

	PIT	*CIT*	*Sales*	*Total*
United States	**(1.6)%**	**4.8%**	**3.8%**	**2.5%**
New England	**(4.1)**	**12.7**	**3.1**	**1.7**
Connecticut	(4.3)	137.6	1.2	5.7*
Maine	2.6	18.4	5.3	5.3*
Massachusetts	(5.2)	0.4	2.6	(0.8)*
New Hampshire	NA	6.8	NA	4.9
Rhode Island	0.2	(32.1)	7.8	5.0*
Vermont	(2.3)	(28.8)	6.4	0.3*
Mid Atlantic	**(0.5)**	**6.3**	**8.9**	**4.4**
Delaware	(1.5)	(61.5)	NA	(7.6)
Maryland	0.1	33.3	2.3	0.9*
New Jersey	(1.8)	47.7*	2.6	3.9*
New York	(0.6)	(2.5)¶	17.0*	5.4*
Pennsylvania	0.7	(2.0)	5.4	5.2*
Great Lakes	**1.7**	**(7.5)**	**5.0**	**4.3**
Illinois	(1.5)	3.9	1.7	0.1*
Indiana	2.8	(30.3)	2.7	5.7*
Michigan	(1.2)¶	(1.1)¶	3.9	3.3
Ohio	5.3*	NM	9.3*	9.0*
Wisconsin	5.4	(6.7)	10.3	6.7
Plains	**0.1**	**0.2**	**3.5**	**4.2**
Iowa	3.0	8.1	3.0	2.8
Kansas	(4.0)	(47.2)*	4.6*	(0.3)*
Minnesota	0.5	11.7	1.3	4.9
Missouri	(0.1)	1.5	1.6	ND
Nebraska	0.2	(16.2)	8.2	7.7
North Dakota	(2.7)	43.4	26.7	17.1
South Dakota	NA	NA	3.6	1.4
Southeast	**0.0**	**25.1**	**2.8**	**3.5**
Alabama	(3.6)	196.9*	2.9	11.8*
Arkansas	0.8	28.0	2.3	2.3
Florida	NA	(6.6)	2.6	4.6
Georgia	(3.6)	3.4	(9.3)	(5.9)
Kentucky	(1.8)	14.1	10.5	5.8
Louisiana	2.1	(64.7)	(6.4)	(2.8)
Mississippi	(2.0)	51.3	4.2	5.3
North Carolina	(0.7)*	56.1*	21.2*	7.8*
South Carolina	(1.6)	(40.0)	6.4	0.2
Tennessee	NA	50.8	10.8*	10.4*
Virginia	5.8	16.6	(20.4)¶	1.1¶
West Virginia	7.7	5.1	8.6	5.2
Southwest	**(5.6)**	**(27.4)**	**(1.6)**	**(1.2)**
Arizona	(4.9)	(29.2)	1.7	(3.1)
New Mexico	(2.5)	(21.3)	0.6	(5.6)
Oklahoma	(7.6)	(26.7)	(6.6)	(7.7)
Texas	NA	NA	(2.0)	0.8
Rocky Mountain	**(2.2)**	**11.6**	**0.3**	**(1.9)**
Colorado	(2.7)	(0.4)	(3.3)	(4.1)
Idaho	(0.5)	85.6	7.1	2.6
Montana	3.8	(21.2)	NA	5.8
Utah	(4.2)	16.5	0.9	(1.0)
Wyoming	NA	NA	3.0	(23.8)
Far West	**(5.6)**	**3.4**	**6.0**	**0.4**
Alaska	NA	28.2	NA	(6.7)
California	(7.4)	4.0	7.0	(0.7)
Hawaii	(7.9)¶	(62.8)	16.4¶	4.0¶
Nevada	NA	NA	4.4	5.5
Oregon	10.2*	(1.4)	NA	9.6*
Washington	NA	NA	0.6	1.8*

See p. 5 for notes.

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

	PIT	*Sales*	*Total*
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)
Oct.-Dec.	(2.1)	1.2	(2.3)
2002			
Jan.-Mar.	(14.5)	(2.4)	(8.4)
April-June	(22.5)	0.1	(11.9)
July-Sept.	(2.1)	2.7	0.7

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 15.)
For pre-1996 data, call the Fiscal Studies Program.

severe economic conditions in 2001. Both the Far West and Southwest states had declines of 5.6 percent, but if we account for legislated tax changes, the decline in the Far West was even worse. On the other hand, the Great Lakes states showed moderate growth of 1.7 percent. Looking at individual states, we see that of the 41 states with a broad-based personal income tax, 25 had declines. Hawaii recorded the sharpest collections decline at 7.9 percent. However, this was due in part to a tax cut. If we adjust for the effects of tax changes and processing variations, the worst decline was in California. Of the states with increases, Oregon led the way with a 10.2 percent increase resulting from rebates and refunds which the state paid last year but did not repeat this year. Otherwise, the state with the largest increase was West Virginia with 7.7 percent. Only Hawaii and Michigan had significant personal income tax cuts, while only California and Ohio had significant legislated personal income tax increases.

Withholding

Withholding is a good indicator of the current strength of personal income tax revenue because it comes largely from current wages and because it is much less volatile than estimated/declared payments or final settlements. In Table 5, we see that withholding for the July-September 2002 quarter increased by 0.8 percent. Legislated tax changes had relatively little impact on withholding this quarter, increasing collections by only about one-tenth of a percentage point. While the increase is modest, it contrasts with a down quarter a year ago and marks an upward shift after two quarters of decline.

Estimated Payments

The highest-income taxpayers generally pay most estimated tax payments (also known as declarations) on their non-wage income. This income often comes from investments, especially capital gains realized in the stock market. Over the past two years falling stock prices appear to have depressed capital gains, which have in turn reduced estimated tax payments.

Key to Interpreting Tables

All percent change tables are based on year-over-year changes.
* 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.
1 Data through August only.
NA means not applicable.
NM means not meaningful.
ND means no data.
Historical Tables (Tables 1, 2 and 4) have been shortened to provide data only back to 1995. For data through 1991 call the Fiscal Studies Program.

Table 5. Change in Personal Income Tax Withholding by State, Last Four Quarters

	2001	2002		
	Oct.-Dec.	Jan-Mar	Apr-June	July-Sept
United States	**0.1%**	**(4.9)%**	**(0.6)%**	**0.8%**
New England	**(0.6)**	**(9.8)**	**(4.8)**	**(0.5)**
Connecticut	3.7	(5.7)	(3.0)	1.8
Maine	1.0	(6.5)	(0.4)	9.7
Massachusetts	(2.6)¶	(12.7)¶	(6.7)¶	(3.2)
Rhode Island	(0.5)	(5.1)¶	1.9¶	4.9
Vermont	4.9	1.1	(0.9)	5.3
Mid Atlantic	**0.3**	**(6.4)**	**(0.3)**	**1.8**
Delaware	2.9	2.1	5.4	(1.0)
Maryland[1]	7.2	(0.3)¶	0.4¶	4.6
New Jersey	(7.6)	(1.2)	2.9	1.0
New York	(0.3)	(10.8)	(1.4)	1.0
Pennsylvania	1.9	0.1	(1.2)	3.2
Great Lakes	**2.4**	**(3.9)**	**0.1**	**2.5**
Illinois	1.3	(1.7)	(2.6)	0.8
Indiana	2.3	(2.7)	4.0	1.2
Michigan	0.1	(8.7)¶	(3.3)¶	(0.3)¶
Ohio	3.3	(1.5)	2.8	4.3*
Wisconsin	5.8	(4.5)	1.4	10.5
Plains	**2.5**	**1.2**	**2.4**	**2.6**
Iowa	1.1	4.8	3.5	5.0
Kansas	2.7	2.8	2.2	0.9
Minnesota	(1.0)	(2.6)	2.3	1.8
Missouri	8.1	4.2	1.0	2.9
Nebraska	3.7	0.3	5.6	3.2
North Dakota	6.2	3.7	(1.2)	1.2
Southeast	**1.6**	**1.8**	**2.2**	**0.8**
Alabama	(3.9)	3.8	4.0	(2.9)
Arkansas	2.0	2.4	2.8	1.8
Georgia	(0.1)	2.5	1.5	(1.9)
Kentucky	ND	1.0	0.8	0.0
Louisiana[1]	8.5	(1.2)	(0.6)	(4.8)
Mississippi	1.8	(0.2)	1.1	ND
North Carolina	0.4	3.4*	2.0	2.1
South Carolina	2.0	(1.7)	3.7	1.1
Virginia	2.7	2.0	2.6	2.8
West Virginia	16.3	(2.0)	(1.4)	13.4
Southwest	**3.4**	**(7.1)**	**2.1**	**0.5**
Arizona	1.4	(5.9)	(5.4)	(3.3)
New Mexico	5.9	(2.2)	12.9	1.3
Oklahoma	4.8	(10.5)	6.9¶	4.3
Rocky Mountain	**(2.0)**	**(4.7)**	**(0.7)**	**(0.6)**
Colorado	(4.1)	(7.5)	(1.0)	0.2
Idaho	(10.2)¶	(0.1)¶	(7.5)¶	(1.2)
Montana	3.4	2.6	(1.0)	7.1
Utah	6.0¶	(3.4)	3.4	(3.9)
Far West	**(4.2)**	**(9.6)**	**(4.6)**	**(2.1)**
California	(5.1)	(10.4)	(5.3)	(2.5)
Hawaii	(1.7)¶	(2.3)¶	3.1¶	(2.9)¶
Oregon	1.2	(5.4)	(2.2)	0.6

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.

This quarter, in the 36 states for which we have full data, estimated tax payments declined by 8.7 percent compared to the year before. (See Table 6.) This figure includes the third quarterly payment. Last year, however, several states granted extensions for this third payment because of the terrorist attacks. This means that comparing this quarter to the same quarter last year is somewhat misleading, as last year's numbers were artificially low. It also makes the drop this year even more striking. Moreover, the 17.7 percent decline for the first three payments of the year shows the persistent weakness of this revenue source. Since estimated payments often mirror the strength of payments with final returns, this trend may foreshadow a bad April 2003 for many states. We will have an even better sense of the way things are going when we see the final quarterly payment, due in December or January.

General Sales Tax

Sales tax revenue in the July-September 2002 quarter increased by 3.8 percent. This continues an upward trend in sales tax revenues, which began last quarter. Removing the effects of legislated changes reduces the increase to less than three percent.

Sales tax revenue grew the fastest in the Mid-Atlantic states, increasing by 8.9 percent compared to the year before. The only region with a decline was the Southwest, where sales tax revenues were off by 1.6 percent. Seven states had double-digit increases in sales tax revenue.[1] Meanwhile, seven other states had declines.[2] Processing delays as a result of last year's terrorist attacks made New York's growth seem larger than it really was. Ohio also had a processing delay last year. Kansas and Tennessee had significant legislated sales tax increases, while Hawaii made a significant tax cut. Virginia accelerated some sales tax revenue into the April-June quarter, depressing this quarter's collections.

The sales tax is showing some real, albeit moderate growth. Lackluster as it is, this revenue source has been the strongest feature of a generally bad state revenue situation for over a year now.

Corporate Income Tax

The July-September 2002 quarter's 4.8 increase in corporate income tax revenue was the first increase in two years. We should note, however, that much of this increase came from legislated tax changes, including tax hikes in New Jersey and North Carolina. Furthermore, we are measuring the increase with respect to a heavily eroded base. For although the corporate income tax accounted for about 10 percent of state tax revenues a decade ago, it now accounts for only about 6 percent.

Table 6. Estimated Payments/Declarations (change year-over-year)		
	April-Sept. 2001 to 2002 (First three payments)	*July-Sept. 2001 to 2002 (Third payment only)*
Average State	**(17.7)%**	**(8.7)%**
Alabama	(9.7)	(22.7)
Arkansas	(16.8)	(5.9)
California	(20.4)	(14.5)
Colorado	(19.5)	(8.8)
Connecticut	(16.0)	(9.8)
Delaware	(10.9)	(13.1)
Georgia	(14.4)	(12.2)
Hawaii	(18.7)	(9.0)
Illinois	(19.4)	(15.7)
Indiana	(7.9)	(9.2)
Iowa	(14.4)	(9.5)
Kansas	(19.0)	(16.9)
Kentucky	(15.5)	(22.3)
Maine	(14.0)	(8.7)
Maryland	(19.3)	(7.3)
Massachusetts	(18.1)	12.1
Michigan	(19.1)	(14.7)
Minnesota	(18.5)	(11.4)
Missouri	(15.3)	(12.9)
Montana	(9.6)	(2.3)
Nebraska	(10.0)	(10.7)
New Jersey	(13.0)	(4.4)
New Mexico	6.8	45.3
New York	(23.8)	2.1
North Carolina	(15.7)	(11.9)
North Dakota	(13.5)	(11.0)
Ohio	(5.1)	(4.9)
Oklahoma	(18.1)	(16.5)
Oregon	(19.3)	(16.3)
Pennsylvania	(13.8)	(11.6)
Rhode Island	(10.0)	(3.2)
South Carolina	(18.1)	(15.9)
Vermont	(15.2)	(9.1)
Virginia	(5.1)	(5.4)
West Virginia	(5.2)	(14.9)
Wisconsin	(7.8)	(7.6)

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

When we look at the national economy, we get a confused picture. The Bureau of Economic Affairs estimated that the Gross Domestic Product (GDP) grew by four percent in the third quarter of 2002.[3] This relatively strong growth is encouraging; if it continues it should eventually help the states' revenue situation. On the other hand, the unemployment rate was 6.0 percent in November, a slight increase from previous months.[4] These mixed signals remind us of the complexity of the U.S. economy and the extent to which the timing and impact of any recovery may vary from state to state. In order to gauge the full impact of the economic slowdown on state revenue we need to look at the economy on the state level.

One problem with assessing state economies in a report such as this is a general lack of timely state indicators. Data on non-farm employment, tracked by the Bureau of Labor Statistics (BLS), 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, state-level data on these nominal measures — when they are available at all — usually are reported too late to be of much use in analyzing recent revenue collections. In addition, employment data can be subject to large retroactive revisions. In times of growth, these revisions are usually upwards, but recently there have been significant downward revisions as the indicators have lagged the recent economic downturn.

The employment numbers are much less encouraging indicators of national and state economic activity than the GDP data or even the

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

State	2001 Oct-Dec	2002 Jan-Mar	2002 Apr-June	2002 July-Sept.
United States	**(0.8)%**	**(1.2)%**	**(1.1)%**	**(0.8)%**
Sum of States	**(0.8)**	**(0.9)**	**(0.8)**	**(0.7)**
New England	**(1.1)**	**(1.0)**	**(0.8)**	**(0.7)**
Connecticut	(1.3)	(0.9)	(0.6)	(0.4)
Maine	0.3	0.0	0.2	0.1
Massachusetts	(1.5)	(1.6)	(1.4)	(1.5)
New Hampshire	(0.6)	(0.4)	(0.4)	0.1
Rhode Island	(0.3)	0.4	0.6	0.6
Vermont	(1.1)	(1.5)	(1.0)	(0.2)
Mid Atlantic	**(0.8)**	**(1.0)**	**(1.0)**	**(0.9)**
Delaware	(0.9)	(0.8)	(1.0)	(0.5)
Maryland	(0.1)	(0.2)	(0.8)	(1.1)
New Jersey	0.2	(0.2)	(0.6)	(0.4)
New York	(1.4)	(1.6)	(1.1)	(0.9)
Pennsylvania	(0.8)	(1.1)	(1.1)	(1.1)
Great Lakes	**(1.7)**	**(1.2)**	**(1.0)**	**(0.9)**
Illinois	(1.6)	(1.4)	(1.5)	(1.3)
Indiana	(2.1)	(1.3)	(1.6)	(1.3)
Michigan	(2.3)	(1.3)	(0.8)	(0.8)
Ohio	(1.4)	(1.1)	(0.9)	(0.9)
Wisconsin	(0.7)	(0.6)	(0.0)	0.5
Plains	**(0.9)**	**(0.8)**	**(0.8)**	**(0.8)**
Iowa	(1.1)	(0.7)	(0.7)	(0.3)
Kansas	0.7	0.7	0.7	0.3
Minnesota	(1.5)	(1.3)	(0.8)	(0.8)
Missouri	(1.5)	(1.8)	(2.1)	(1.9)
Nebraska	0.1	0.6	0.1	(0.5)
North Dakota	0.6	1.0	(0.2)	(0.1)
South Dakota	0.2	(0.3)	0.1	(0.4)
Southeast	**(0.7)**	**(0.7)**	**(0.6)**	**(0.4)**
Alabama	(1.2)	(0.8)	(1.0)	(1.0)
Arkansas	(0.6)	(0.5)	(0.6)	(0.4)
Florida	0.3	(0.1)	(0.1)	0.3
Georgia	(1.5)	(2.6)	(2.3)	(2.2)
Kentucky	(0.7)	0.1	0.6	1.0
Louisiana	1.0	0.7	(0.3)	(0.4)
Mississippi	(1.3)	(0.5)	(0.3)	(0.3)
North Carolina	(1.1)	(1.2)	(0.5)	(0.1)
South Carolina	(1.3)	(0.5)	(0.4)	(0.2)
Tennessee	(0.8)	(0.3)	(0.2)	(0.2)
Virginia	(1.4)	(1.3)	(1.0)	(0.8)
West Virginia	(0.4)	(0.1)	(0.8)	(1.1)
Southwest	**(0.4)**	**(0.7)**	**(0.8)**	**(0.6)**
Arizona	(0.7)	(1.2)	(1.1)	(1.0)
New Mexico	0.9	0.9	0.6	0.5
Oklahoma	0.7	0.8	0.7	0.6
Texas	(0.7)	(1.0)	(1.0)	(0.8)
Rocky Mountain	**(0.5)**	**(0.9)**	**(1.3)**	**(1.5)**
Colorado	(1.3)	(1.8)	(2.0)	(2.2)
Idaho	0.9	0.4	(0.4)	(1.3)
Montana	1.0	0.7	0.6	0.8
Utah	(0.8)	(0.7)	(1.4)	(1.7)
Wyoming	2.6	1.9	1.2	0.4
Far West	**(0.4)**	**(0.6)**	**(0.6)**	**(0.5)**
Alaska	2.4	1.6	0.8	0.8
California	0.0	(0.2)	(0.3)	(0.4)
Hawaii	(2.0)	(1.2)	(1.0)	(1.2)
Nevada	0.5	0.7	1.1	1.3
Oregon	(2.2)	(1.9)	(1.4)	(0.6)
Washington	(2.1)	(2.4)	(2.2)	(1.9)

unemployment rate. Table 7 shows year-over-year employment growth for the nation and for each state during the last four quarters using BLS data. Figure 6 maps the change in third quarter 2002 employment compared to the same period last year. Overall, employment in the July-September quarter declined by 0.8 percent compared to the year before. This is the fourth straight quarter of decline in the national employment numbers.

Employment declined in every region of the country during the July-September quarter, measured on a year-over-year basis. The largest drop, 1.5 percent, occurred in the Rocky Mountain states, which also experienced the sharpest decline in the previous quarter. The smallest decline, 0.4 percent, occurred in the Southeast states. Thirty- seven states had employment declines. This was the same number as in the April-June quarter, although some of the names have changed. Fourteen states had declines of one percentage point or more. Two states — Colorado and Georgia — had declines of over two percentage points. Only Kentucky and Nevada managed to post employment growth of one percent or more.

Nature of the Tax System

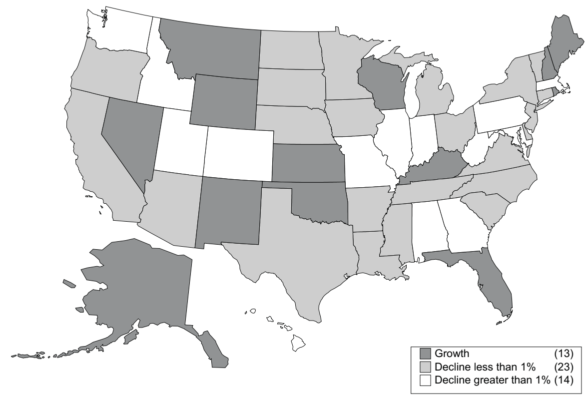
Even if the recession and recovery affected all regions and states to exactly the same degree and at exactly the same time, the impact on state revenue would still vary because states' tax systems react differently to similar economic situations. States that rely heavily on the personal income tax have taken a harder hit from this economic downturn, since it has reduced income generated at the high end of the income scale, the income that is taxed most heavily. This is even more evident in the case of states with more progressive income tax structures. The sales tax is also very responsive to economic conditions, but is historically less elastic than the personal income tax — dropping more slowly in bad times and increasing more slowly in good times. The states that rely heavily on corporate income taxes or severance taxes often see wild swings in revenue that are not necessarily related to general economic conditions. (Severance taxes are taxes on the removal of natural resources, such as oil and lumber.)

The upside of these patterns played out particularly strongly in the late 1990s and into 2000. Most states with personal income taxes had extremely strong revenue growth, partly because the incomes of upper-income (and thus upper-bracket) taxpayers grew at a much more rapid pace than those of middle-income taxpayers. Because these high-end incomes were based more heavily upon volatile sources such as stock options and capital gains, growth in personal income tax revenue was far more subject to dramatic fluctuations than it would have been if it were based entirely on wages and salaries. In this economic downturn, we see the downside of this volatility. While initially the market downturn affected relatively few wage earners, it turned gains into losses for investors, thus sharply contracting a hitherto rich source of revenue almost overnight. Meanwhile stock options became both less common and less lucrative. As the downturn drags on the loss of investment capital is beginning to manifest itself in weak employment numbers, which in turn depress withholding.

States are also learning about how sales tax revenue responds 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, are more subject to plunges in sales tax revenue as state residents become nervous about spending on optional and big-ticket items. Thus far, however, the sales tax is reacting to the latest economic downturn more moderately than the personal income or corporate income taxes — even increasing slightly this quarter.

Oil has been the wild card in state tax revenue in recent years. When the price of oil increases, oil-producing states such as Alaska, Oklahoma and Wyoming benefit. Conversely, when the price falls, these states' revenues tend to follow suit. This dynamic can operate largely independently of the general economy.

Figure 6
Change in Non-Farm Employment
July-September 2001 to 2002



Tax Law Changes Affecting This Quarter

The final element affecting trends in tax revenue growth is legislated tax changes. 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. 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.

During the July-September 2002 quarter, legislated tax changes and processing variations increased state revenue by over $1.8 billion compared to the same period in 2001. This was the third quarter in a row of net tax increases, after nearly seven years of tax cuts.

Net tax changes resulted in a nearly $500 million increase in the sales tax, and an increase of over $200 million in the personal income tax. North Carolina had a total of nearly $400 million increases involving several taxes, including the sales, personal income, and corporate income taxes. New Jersey closed loopholes in the corporate income tax, bringing in almost $100 million more this quarter. Tennessee increased its sales tax rate, raising over $100 million more this quarter than it would have otherwise.

Some major processing variations also affected this quarter. In New York, about $250 million of last year's September sales tax receipts were not filed until October, which made growth this September seem just that much stronger and will make October growth seem weaker. Virginia accelerated over $100 million in sales tax revenue into the previous quarter, and out of this quarter. Oregon paid $100 million in refunds to comply with a court ruling finding that federal pensions should not have been subject to the state's personal income tax.

The big increase in taxes this quarter came in cigarette and tobacco taxes, which brought states over $700 million in additional revenue. Seventeen states had legislated increases in their tobacco taxes affecting this quarter.[5] Pennsylvania brought in the most revenue in this fashion, raising nearly $150 million extra this quarter by increasing its cigarette tax by over 300 percent.

Conclusions

This quarter represents the first quarter of net increase in state tax collections in over a year. When adjusted for legislation, processing, and inflation, however, this increase becomes a decline. While the general economy shows signs of recovering, employment is still declining. Personal income tax collections are still down, and the outlook for next April is uncertain. There is also some evidence that retail sales was weaker in the early part of the fourth quarter, a bad sign for sales tax revenue. Therefore, while states may have some reason to feel relieved that the situation is not worse, they are not yet out of the woods. It is likely that over the next few months, as states begin to consider their fiscal 2004 budgets, they will need to contend with persistently weak revenue collections.

Endnotes

1 Hawaii, Kentucky, New York, North Carolina, North Dakota, Tennessee, and Wisconsin.

2 Colorado, Georgia, Louisiana, Oklahoma, Texas, Virginia, and Washington.

3 United States Department of Commerce, Bureau of Economic Analysis News Release, November 26, 2002.

4 United States Department of Labor, Bureau of Labor Statistics, *The Employment Situation, November 2002,* December 9, 2002.

5 Connecticut, Illinois, Indiana, Kansas, Louisiana, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, and Washington.

Table 8
State Tax Revenue, July-September, 2001 and 2002 (In Millions of Dollars)

	2001				*2002*			
	PIT	*CIT*	*Sales*	*Total*	*PIT*	*CIT*	*Sales*	*Total*
United States	**$43,150**	**$5,481**	**$41,547**	**$103,668**	**$42,473**	**$5,742**	**$43,143**	**$106,236**
New England	**3,152**	**246**	**1,813**	**6,331**	**3,023**	**277**	**1,870**	**6,437**
Connecticut	613	23	478	1,320	586	54	483	1,395
Maine	207	17	159	440	213	21	168	463
Massachusetts	2,033	156	932	3,644	1,927	157	956	3,616
New Hampshire	NA	31	NA	278	NA	33	NA	292
Rhode Island	193	11	193	443	193	8	208	465
Vermont	107	7	52	205	104	5	55	206
Mid Atlantic	**8,886**	**1,256**	**5,207**	**18,051**	**8,845**	**1,335**	**5,672**	**18,851**
Delaware	176	42	NA	417	174	16	NA	385
Maryland	777	75	432	1,444	778	100	442	1,456
New Jersey	1,113	213	996	2,813	1,092	314	1,021	2,924
New York	5,226	600	1,933	8,988	5,196	585	2,262	9,471
Pennsylvania	1,594	326	1,847	4,390	1,605	320	1,947	4,616
Great Lakes	**6,994**	**993**	**6,584**	**16,679**	**7,112**	**918**	**6,914**	**17,396**
Illinois	1,818	206	1,543	4,242	1,791	214	1,570	4,246
Indiana	860	190	953	2,178	885	132	979	2,302
Michigan	1,717	475	2,007	5,134	1,697	470	2,085	5,303
Ohio	1,660	(8)	1,484	3,369	1,748	(19)	1,623	3,672
Wisconsin	940	130	596	1,756	991	121	657	1,874
Plains	**3,684**	**371**	**2,858**	**5,744**	**3,687**	**372**	**2,957**	**5,985**
Iowa	538	49	431	1,083	554	53	444	1,114
Kansas	459	49	433	1,010	440	26	453	1,007
Minnesota	1,363	151	938	2,696	1,370	169	951	2,828
Missouri	975	81	621	ND	973	83	631	ND
Nebraska	302	28	233	602	302	23	252	649
North Dakota	48	13	78	186	47	19	99	217
South Dakota	NA	NA	124	167	NA	NA	128	170
Southeast	**8,374**	**902**	**10,479**	**23,161**	**8,373**	**1,128**	**10,775**	**23,969**
Alabama	584	39	430	1,371	563	116	443	1,533
Arkansas	412	44	436	953	415	57	446	975
Florida	NA	198	3,408	4,244	NA	185	3,498	4,439
Georgia	1,621	76	1,156	3,108	1,562	79	1,048	2,924
Kentucky	683	73	680	1,603	671	83	751	1,697
Louisiana	414	31	608	1,398	423	11	569	1,358
Mississippi	279	53	585	1,231	274	80	609	1,297
North Carolina	1,855	149	873	3,083	1,842	233	1,058	3,322
South Carolina	724	41	327	1,215	713	25	347	1,218
Tennessee	NA	96	1,170	1,821	NA	144	1,296	2,010
Virginia	1,562	77	575	2,485	1,653	90	458	2,513
West Virginia	239	26	231	650	258	27	251	683
Southwest	**1,378**	**227**	**6,054**	**10,800**	**1,301**	**165**	**5,954**	**10,672**
Arizona	609	140	848	1,688	579	99	862	1,636
New Mexico	230	37	337	753	224	29	339	711
Oklahoma	539	51	383	1,168	498	37	358	1,078
Texas	NA	NA	4,487	7,191	NA	NA	4,396	7,247
Rocky Mountain	**1,525**	**120**	**1,111**	**3,153**	**1,491**	**134**	**1,114**	**3,094**
Colorado	818	57	500	1,433	796	57	483	1,375
Idaho	193	15	209	519	192	27	224	532
Montana	126	17	NA	207	131	13	NA	220
Utah	389	32	370	924	373	37	373	915
Wyoming	NA	NA	33	69	NA	NA	34	53
Far West	**9,157**	**1,367**	**7,441**	**19,749**	**8,641**	**1,413**	**7,887**	**19,832**
Alaska	NA	11	NA	262	NA	14	NA	244
California	7,956	1,286	4,984	14,893	7,370	1,337	5,332	14,792
Hawaii	289	11	407	789	266	4	473	820
Nevada	NA	NA	511	605	NA	NA	534	638
Oregon	912	59	NA	1,003	1,004	58	NA	1,100
Washington	NA	NA	1,539	2,198	NA	NA	1,548	2,238

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