STATE REVENUE REPORT

Fiscal Studies Program
The Nelson A. Rockefeller Institute of Government

March 2006
No. 63

A Blip? State Tax Revenue Growth Weakens in the Fourth Quarter

Nicholas W. Jenny

HIGHLIGHTS

- ❖ State tax revenue in the October-December 2005 quarter grew 7.6 percent compared to the same period in 2004.
- ❖ After adjusting for inflation and legislated tax changes, growth was only 0.9 percent, the slowest real adjusted growth since the third quarter of 2003.
- ❖ All three major tax sources showed nominal growth, with the strongest gains recorded in the corporate income tax.
- ❖ Revenue growth was strongest in the Southwest region (15 percent) and weakest in the Great Lakes region (4.2 percent).
- ❖ National employment growth was 1.4 percent this quarter, with the strongest growth in the western and southern regions.
- ❖ State tax revenue growth was reduced by $65 million in net enacted tax cuts. This is the second straight quarter of net tax cuts.

Tax Revenue Change

State tax revenue increased 7.6 percent in the October-December quarter of 2005 compared to the same quarter the year before. This is the second strongest nominal October-December revenue growth since the Rockefeller Institute of Government began to track state revenues in 1991. It is also, however, the slowest year-over-year growth in the last eight quarters. State tax revenue growth remains broad, but is clearly stronger in the south and west. Corporate income tax growth continues to be particularly

Table 1 Year-Over-Year Percent Change in Quarterly State Tax Revenue *Adjusted for Legislated Tax Changes and Inflation*				
	Total Nominal Change	Adjusted Nominal Change	Inflation Rate	Adjusted Real Change
2005				
Oct.-Dec.	7.6 %	7.7 %	6.7 %	0.9 %
July-Sept.	9.3	9.7	5.7	3.8
April-June	13.2	12.9	4.5	8.0
Jan.-Mar.	11.4	9.5	5.1	4.2
2004				
Oct.-Dec.	7.8	7.3	4.9	2.3
July-Sept.	8.6	8.1	3.7	4.2
April-June	11.2	9.0	3.2	5.6
Jan.-Mar.	8.1	7.1	1.5	5.5
2003				
Oct.-Dec.	7.3	4.9	2.3	2.5
July-Sept.	4.5	2.6	2.8	(0.2)
April-June	3.2	0.4	3.0	(2.5)
Jan.-Mar.	1.4	(1.0)	4.2	(5.0)
2002				
Oct.-Dec.	1.9	0.3	3.0	(2.6)
July-Sept.	2.5	0.7	2.5	(1.8)
April-June	(10.6)	(12.1)	2.3	(14.1)
Jan.-Mar.	(7.8)	(8.2)	2.0	(10.0)
2001				
Oct.-Dec.	(2.7)	(2.2)	2.1	(4.2)
July-Sept.	(3.1)	(2.4)	2.6	(4.9)
April-June	2.5	4.2	3.2	1.0
Jan.-Mar.	5.1	6.3	3.4	2.8
2000				
Oct.-Dec.	4.0	5.0	4.2	0.8
July-Sept.	7.1	7.7	4.5	3.1
April-June	11.4	11.8	4.5	7.0
Jan.-Mar.	9.7	10.4	4.8	5.3
1999				
Oct.-Dec.	7.4	8.4	3.7	4.5
July-Sept.	6.1	6.7	3.2	3.4
April-June	5.0	8.0	2.7	5.2
Jan.-Mar.	4.8	6.5	2.0	4.4

Inflation is measured by BEA State and Local Government Consumption Expenditures and Gross Investment Price Index.

strong. Tax revenue changes for the last 28 quarters are shown in Table 1.

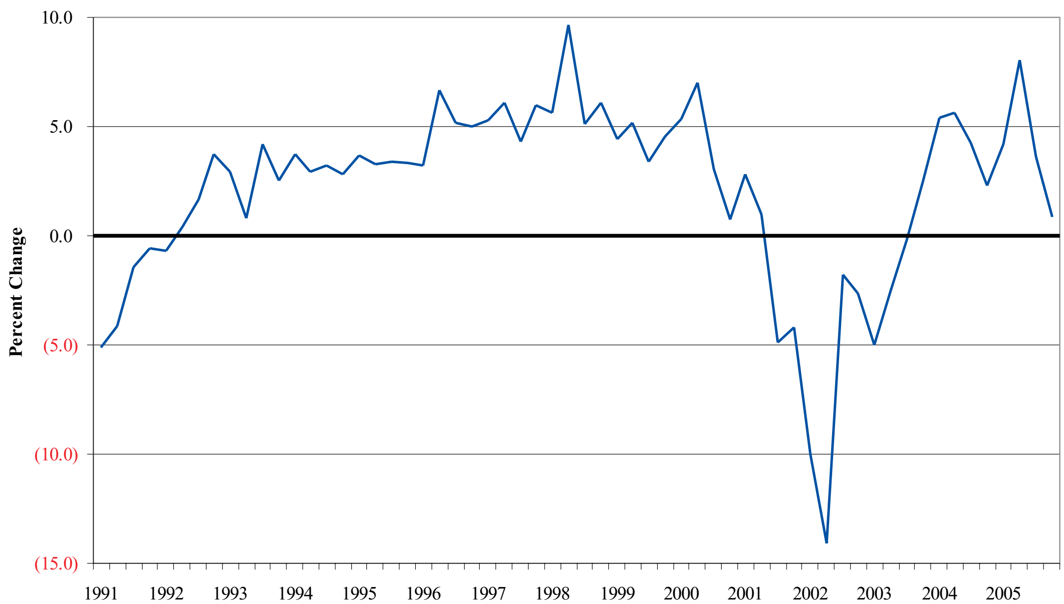
Tax legislation and other processing changes made only a minor net contribution to state tax collections in the October-December quarter, with relatively small legislated cuts in some states nearly balanced by small increases in others. Inflation, however, was quite high this quarter at 6.7 percent.[1] If the effects of net enacted tax cuts and inflation are considered, real adjusted state tax revenue increased only 0.9 percent, as shown also in

Table 2 Year-Over-Year Percent Change in Quarterly State Tax Revenue *By Major Tax*				
	PIT	CIT	Sales	Total
2005				
Oct.-Dec.	5.7 %	24.8 %	5.5 %	7.6 %
July-Sept.	9.0	25.4	7.8	9.3
April-June	18.2	21.9	7.9	13.2
Jan.-Mar.	11.6	61.6	6.1	11.4
2004				
Oct.-Dec.	8.8	27.0	6.0	7.8
July-Sept.	8.3	23.2	5.8	8.6
April-June	15.6	13.6	7.1	11.2
Jan.-Mar.	8.7	15.2	8.3	8.1
2003				
Oct.-Dec.	6.6	11.1	6.6	7.3
July-Sept.	5.1	9.0	3.7	4.5
April-June	(0.9)	17.9	2.9	3.1
Jan.-Mar.	(3.1)	10.3	1.9	1.4
2002				
Oct.-Dec.	(0.7)	22.4	0.7	1.9
July-Sept.	(1.6)	4.8	3.8	2.5
April-June	(22.3)	(11.7)	1.5	(10.4)
Jan.-Mar.	(14.3)	(16.1)	(1.0)	(7.8)
2001				
Oct.-Dec.	(2.7)	(31.8)	1.0	(2.7)
July-Sept.	(3.7)	(24.0)	0.0	(3.1)
April-June	5.4	(13.1)	0.5	2.5
Jan.-Mar.	8.7	(9.1)	3.4	5.1
2000				
Oct.-Dec.	5.8	(7.7)	4.2	4.0
July-Sept.	11.0	5.7	4.6	7.1
April-June	18.8	4.2	7.3	11.4
Jan.-Mar.	13.6	8.0	8.2	9.7
1999				
Oct.-Dec.	9.1	3.8	7.3	7.4
July-Sept.	7.6	1.4	6.7	6.1
April-June	6.0	(2.1)	7.3	5.0
Jan.-Mar.	6.6	(2.6)	6.1	4.8

Table 1. This is the slowest real adjusted state tax growth since July-September 2003, which marked the end of real adjusted tax decline experienced by the states during and after the 2001 recession. The pattern of growth in state tax revenue, adjusted for inflation and enacted tax increases from 1991 to the present is illustrated in Figure 1.

All three major state taxes showed growth this quarter. The strongest growth was the 24.8 percent increase recorded by the corporate income tax — the ninth straight quarter of double-digit growth. Personal income tax revenue increased 5.7 percent, the weakest growth in nine quarters. Sales tax

Figure 1
Year-Over-Year Change in Real Adjusted Tax Revenue, 1991-2005



growth was 5.5 percent, also the weakest growth in nine quarters. Table 2 shows the last 28 quarters of change in state collections of the major tax sources.

Table 3 shows the growth by state and region for the three major state taxes and total state taxes. The Southwest region had the strongest growth at 15 percent. The Great Lakes region had the slowest growth, at 4.2 percent. Growth of more than ten percent was recorded in 18 states, the best growth being in Alaska, which had a remarkable 74.7 percent increase — driven by strong oil prices. Only two states — Rhode Island and Vermont — had ac-

Figure 2
Percent Change in Tax Revenue by Region, Adjusted for Legislated Changes, October-December, 2004 to 2005

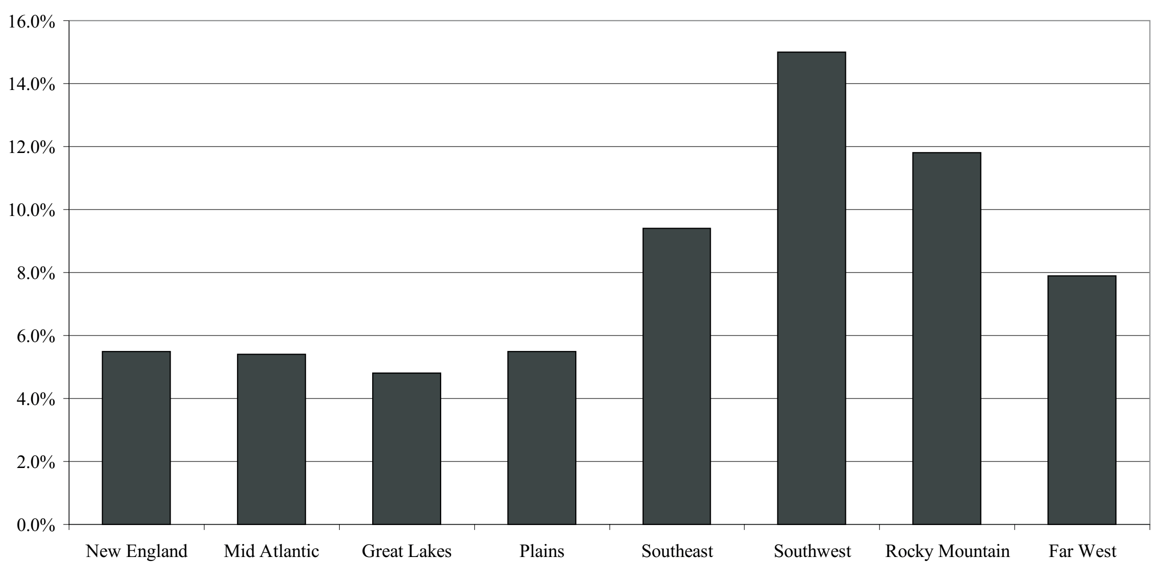


Table 3
Percent Change in Quarterly Tax Revenue by State, October-December, 2004 to 2005

	PIT	CIT	Sales	Total
United States	**5.7 %**	**24.8 %**	**5.5 %**	**7.6 %**
New England	**3.1**	**20.3**	**2.8**	**6.0**
Connecticut	7.5	18.0	3.4	9.9
Maine	(9.0)	77.6 ¶	2.5	5.3 ¶
Massachusetts[1]	3.2	NM	2.6	5.3
New Hampshire	NA	46.3 ¶	NA	15.5 ¶
Rhode Island	(1.8)	(15.0) ¶	0.8	(1.0)
Vermont	2.1	36.9	4.4	(13.8)
Mid-Atlantic	**3.4**	**12.2**	**0.3**	**4.8**
Delaware	5.7	NM	NA	4.6
Maryland	5.8	(37.7) ¶	6.8	3.7
New Jersey	8.5	32.6	2.1	10.2
New York	0.4	16.0	(2.5) *	2.6 *
Pennsylvania	6.8	9.9	0.0	5.1
Great Lakes	**5.4**	**10.5**	**(0.5)**	**4.2**
Illinois	4.1	29.7	4.2	5.2
Indiana	0.6	(22.7)	5.3	2.0
Michigan	0.8	6.1	(2.7)	2.5
Ohio	6.9 *	NM	(8.1) *	5.4 *
Wisconsin	13.5	(25.1)	4.7	6.0
Plains	**6.1**	**30.3**	**3.9**	**5.9**
Iowa	(0.3)	13.3	5.0 *	1.8 *
Kansas	7.6	89.2	4.5	9.6
Minnesota	5.9	7.3	2.3	5.1 ¶
Missouri	9.1	49.4	5.3	5.0
Nebraska	7.3	62.9	0.7	8.2
North Dakota	10.9	85.1	8.4	20.3 ¶
South Dakota	NA	NA	8.6	8.0
Southeast	**7.4**	**44.0**	**9.3**	**9.7**
Alabama	5.0	5.7	13.5	8.8
Arkansas	8.0	37.9	8.5	10.0
Florida	NA	43.6	10.0	11.6
Georgia	7.3	37.0 ¶	10.2	6.9
Kentucky	1.2 *	120.9 ¶	4.0	11.7 ¶
Louisiana	ND	ND	ND	ND
Mississippi	9.2	(2.5)	22.8	13.0
North Carolina	11.2	47.7	10.9	11.5
South Carolina	4.8	(15.4)	9.2	5.5
Tennessee	NA	8.6 ¶	7.2	7.5
Virginia	6.7	105.6	0.4 *	7.7
West Vigínia	13.6	18.4	7.6	14.0
Southwest	**14.8**	**2.3**	**10.4**	**15.0**
Arizona	19.3	(4.7)	17.2	15.2
New Mexico	ND	ND	ND	ND
Oklahoma	9.1	45.2	8.5	11.2
Texas	NA	NA	9.3	15.7
Rocky Mountain	**12.5**	**84.3**	**3.9**	**11.6**
Colorado	8.9	53.4	3.9	8.0 ¶
Idaho	12.9	78.5	(7.5) *	3.6 *
Montana	20.7	156.0	NA	22.9
Utah	16.0	114.9	9.3	15.6
Wyoming	NA	NA	15.3	32.5
Far West	**5.4**	**30.3**	**8.0**	**8.3**
Alaska	NA	54.9	NA	74.7
California	4.6	27.3	6.5	6.1
Hawaii	9.7	(43.4)	13.7 *	11.4
Nevada	NA	NA	11.0	12.1
Oregon	10.2	212.2 ¶	NA	18.7
Washington	NA	NA	10.6	7.8 ¶

See page 9 for notes.

tual revenue declines in this quarter, Vermont's decline being the worst at 13.8 percent.

There were about $65 million in net enacted tax cuts in the October-December quarter. This was the second straight quarter with a net cut, though it was quite small. The Mid-Atlantic and Great Lakes regions had the largest share of the tax cuts. (See Figure 2.) The other regions had relatively small tax increases or cuts that had little effect on tax revenue growth. Table 4 shows the overall effect of legislated tax changes and processing variations. Table 5 shows the percentage change in each state's total tax revenue, adjusted for legislated tax changes and inflation.

Personal Income Tax

Personal income tax revenue grew 5.7 percent in the October-December quarter compared to the same quarter the year before. This was down from the previous quarter's 9.0 percent growth, and the slowest growth since July-September 2003. There is some indication that the slower growth in this quarter may be due to higher-income taxpayers delaying their fourth quarter estimated payments into January. If that is the case, we may see a surge in personal income tax collections in the January-March quarter. The strongest growth was the Southwest region's 14.8 percent. The New England states had the slowest growth at 3.1 percent. Growth was widespread, affecting 36 of the 39 states with broad-based personal income tax for which we have data. Montana led with a very strong 20.7 percent growth in the quarter. Eight other states also had double-digit increases. Maine had a decline of nine percent; Iowa and Rhode Island had smaller declines.

We can get a better idea of what is really happening with the personal in-

Table 4
Change in Quarterly State Tax Revenue Adjusting for Legislated Tax Changes

	PIT	Sales	Total
2005			
Oct.-Dec.	6.0 %	6.4 %	7.7 %
July-Sept.	9.2	8.6	9.7
April-June	17.7	7.8	12.9
Jan.-Mar.	11.2	6.0	9.5
2004			
Oct.-Dec.	8.3	5.7	7.3
July-Sept.	7.3	5.6	8.1
April-June	12.6	6.4	9.0
Jan.-Mar.	7.7	6.8	7.0
2003			
Oct.-Dec.	5.3	4.2	4.9
July-Sept.	3.9	1.9	2.6
April-June	(2.0)	1.3	0.4
Jan.-Mar.	(4.4)	1.0	(1.0)
2002			
Oct.-Dec.	(1.6)	0.7	0.3
July-Sept.	(2.1)	2.7	0.7
April-June	(22.5)	0.1	(11.9)
Jan.-Mar.	(14.5)	(2.4)	(8.4)
2001			
Oct.-Dec.	(2.1)	1.2	(2.3)
July-Sept.	(2.8)	0.4	(2.4)
April-June	7.9	0.6	4.2
Jan.-Mar.	10.1	3.7	6.3
2000			
Oct.-Dec.	6.5	5.0	5.0
July-Sept.	11.6	5.6	7.7
April-June	18.6	7.8	11.8
Jan.-Mar.	13.8	8.8	10.4
1999			
Oct.-Dec.	11.0	7.5	8.4
July-Sept.	8.3	6.9	6.7
April-June	12.4	7.3	8.0
Jan.-Mar.	9.9	6.2	6.5

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.)

come tax by breaking it down into its major component parts: withholding, quarterly estimated payments, and final payments with returns. For this quarter, most collections are from withholding and estimated payments.

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 6 shows that withholding for the October-December 2005 quarter increased 5.5 percent over the same quarter of 2004. This is a decline from the 6.9 percent growth in the previous quarter. Enacted tax law changes reduced withholding by two-tenths of a percent in this quarter.

Table 5
Percent Change in Quarterly Total Tax Revenue by State, Adjusted for Legislation and Inflation
October-December, 2004 to 2005

United States	**0.9 %**
New England	**(1.1)**
Connecticut	2.7
Maine	(3.7)
Massachusetts	(1.3)
New Hampshire	4.9
Rhode Island	(7.4)
Vermont	(19.2)
Mid Atlantic	**(1.2)**
Delaware	(2.0)
Maryland	(3.5)
New Jersey	3.1
New York	(2.5)
Pennsylvania	(1.5)
Great Lakes	**(1.8)**
Illinois	(1.4)
Indiana	(4.4)
Michigan	(3.9)
Ohio	1.6
Wisconsin	(0.7)
Plains	**(1.1)**
Iowa	(3.4)
Kansas	3.0
Minnesota	(2.8)
Missouri	(1.6)
Nebraska	1.5
North Dakota	11.8
South Dakota	1.2
Southeast	**2.5**
Alabama	2.0
Arkansas	2.9
Florida	5.3
Georgia	0.1
Kentucky	1.9
Louisiana	ND
Mississippi	5.8
North Carolina	3.7
South Carolina	(1.1)
Tennessee	0.5
Virginia	0.7
West Virginia	6.8
Southwest	**7.8**
Arizona	8.0
New Mexico	ND
Oklahoma	4.3
Texas	8.4
Rocky Mountain	**4.8**
Colorado	(1.5)
Idaho	3.9
Montana	15.2
Utah	8.3
Wyoming	24.2
Far West	**1.3**
Alaska	63.7
California	(0.6)
Hawaii	4.9
Nevada	5.1
Oregon	11.2
Washington	(0.5)

Inflation is measured by BEA State and Local Government Consumption Expenditures and Gross Investment Price Index.
See page 9 for notes.

Table 6
Change in Personal Income Tax Withholding by State, Last Four Quarters

	2005			
	Jan-Mar.	*Apr.-June*	*July-Sept*	*Oct.-Dec.*
United States	**5.8 %**	**5.8 %**	**6.9 %**	**5.5 %**
New England	**4.3**	**4.4**	**5.4**	**4.2**
Connecticut	4.0	7.4	7.9	1.5
Maine	7.8	0.7	5.5	3.5
Massachusetts[1]	4.1	3.5	5.1	5.6
Rhode Island	3.7 *	4.8 *	(1.5)	ND
Vermont	3.8	5.1	3.4	2.8
Mid-Atlantic	**5.5**	**10.8**	**7.0**	**5.9**
Delaware	8.2	3.4	8.5	5.0
Maryland	(7.4)	37.3	7.8	6.4
New Jersey	10.6 *	11.2	11.1	3.3
New York	8.0	4.7	6.1	6.3
Pennsylvania	8.1 *	4.6 *	4.9	5.8
Great Lakes	**4.1**	**4.0**	**4.4**	**5.1**
Illinois	5.0 *	5.1 *	6.8	3.7
Indiana	5.5	6.0	5.0	6.9
Michigan	(2.0) ¶	2.5 ¶	0.5	(0.7)
Ohio	7.4	2.8	5.0	5.3 *
Wisconsin	4.8	4.5	4.7	12.8
Plains	**6.2**	**4.8**	**5.2**	**5.1**
Iowa	7.3	ND	(0.9)	(1.4)
Kansas	7.7	6.6	9.3	8.6
Minnesota	8.1	2.6	8.0	4.9
Missouri	1.5	6.5	7.0	6.9
Nebraska	7.0	6.7	(5.0)	7.1
North Dakota	19.0	4.6	6.0	12.7
Southeast	**6.3**	**2.8**	**7.4**	**5.6**
Alabama	9.2	5.8	7.8	6.2
Arkansas	9.5	5.8	8.1	7.8
Georgia	2.6	(10.2)	7.0	5.7
Kentucky	7.0	8.9	6.0	3.3 *
Louisiana	5.3	7.2	4.1	ND
Mississippi	6.5	7.0	3.6	8.6
North Carolina	7.5	7.1	8.2	6.7
South Carolina	5.6 ¶	7.1	9.9	3.7
Virginia	7.0	4.4	7.3	4.9
West Virginia	6.7	9.2	8.1	7.2
Southwest	**10.1**	**11.0**	**13.8**	**13.3**
Arizona	16.3	16.0	20.1	16.6
New Mexico	(2.1)	4.9 ¶	9.0	ND
Oklahoma	8.1	8.1	9.2	9.6
Rocky Mountain	**5.7**	**7.1**	**4.9**	**8.4**
Colorado	6.5	5.3	3.7	6.0
Idaho	3.3	11.6	6.2	8.0
Montana	10.6	3.6	(1.7)	13.0
Utah	4.1	9.1	8.5	12.2
Far West	**7.4**	**5.0**	**9.3**	**4.0**
California	7.0	5.0	9.5	3.6
Hawaii	19.8	3.3	6.8	6.7
Oregon	6.9	5.4	8.3	6.4

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.
See page 9 for notes.

Estimated Payments

The highest-income taxpayers generally pay the most estimated tax payments (also known as declarations) on their income not subject to withholding tax. This income often comes from investments, i.e., 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, as do corporate income taxes.

In the 23 states for which we have complete data, the fourth quarterly payment for 2005, paid in December 2005 or January 2006, grew 23.6 percent compared to the year before. (See Table 7.) The median state growth was only 19.0 percent; overall growth was boosted by particularly strong increase in California. For the period April to December, which encompasses all four quarterly payments, growth was 24.2 percent with a median of 17.5 percent. The continued increase indicates that most of those who receive non-wage income are expecting it to be higher this year than last. Since last year saw solid growth in estimated tax payments, this sector of income taxpayers is doing very well indeed. This increase in estimated tax payments should indicate that there will be strong growth in final payments for April 2006.

General Sales Tax

Sales tax revenue in the October-December quarter increased 5.5 percent over the same quarter the year before. This was significantly weaker than the 7.8 percent growth the previous quarter, and the weakest growth since July-September 2003.

Sales tax revenue grew fastest in the Southwest region at 10.4 percent. The Great Lakes region actually had a 0.5 percent decline in sales tax collections. Mississippi had the strongest growth of any state

Table 7
Estimated Payments/Declarations
(Percentage Change Year-Over-Year)

	Apr.-Jan. (All four payments)	Dec.-Jan. (Fourth payment)
Average (Mean)	**24.2 %**	**23.6 %**
Median	**17.5**	**19.0**
Alabama	27.7	30.5
Arkansas	15.2	13.1
California	28.6	31.4
Colorado	23.2	18.8
Connecticut	22.6	22.8
Delaware	21.6	14.1
Hawaii	27.4	14.3
Illinois	14.4	13.2
Kansas	16.2	23.8
Kentucky	(5.6)	(18.3)
Maine	9.2	2.4
Massachusetts	15.7	19.1
Michigan	14.0	21.4
Mississippi	(27.6)	(27.8)
Montana	5.2	8.2
Nebraska	(4.0)	12.5
New York	30.0	18.3
North Carolina	22.5	25.0
North Dakota	19.5	23.0
Oregon	18.3	24.4
Pennsylvania	23.1	26.7
Vermont	19.4	16.8
Virginia	16.6	22.8
West Virginia	14.9	20.6

See page 9 for notes.

Table 8
Year-Over-Year Percentage Change In Non-Farm Employment by State, Last Four Quarters

	2005			
	Jan.-Mar.	*Apr.-June*	*July-Sept.*	*Oct.-Dec.*
United States	**1.6**	**1.5**	**1.6**	**1.4**
Sum of States	**1.6**	**1.4**	**1.3**	**1.2**
New England	**1.2**	**1.0**	**1.0**	**0.7**
Connecticut	1.4	1.3	1.1	0.7
Maine	0.9	0.6	0.5	0.4
Massachusetts	1.0	0.7	0.6	0.4
New Hampshire	2.0	1.8	2.2	1.5
Rhode Island	1.4	1.0	1.1	1.0
Vermont	1.7	1.4	1.5	1.2
Mid Atlantic	**1.3**	**1.2**	**1.3**	**1.0**
Delaware	2.3	2.2	1.6	1.5
Maryland	1.9	2.2	2.1	1.6
New Jersey	1.6	1.3	1.2	1.0
New York	1.0	0.9	1.0	0.7
Pennsylvania	1.1	1.1	1.2	1.1
Great Lakes	**0.8**	**0.4**	**0.3**	**0.4**
Illinois	0.6	0.6	0.8	1.1
Indiana	2.2	1.2	0.7	0.4
Michigan	(0.1)	(0.6)	(0.9)	(0.8)
Ohio	0.7	0.3	0.2	0.1
Wisconsin	1.2	0.8	0.7	1.0
Plains	**1.5**	**1.1**	**1.2**	1.3
Iowa	1.0	1.1	1.2	1.6
Kansas	1.9	1.2	1.2	1.7
Minnesota	1.8	1.1	1.4	1.3
Missouri	1.1	0.8	1.0	0.8
Nebraska	1.8	1.1	0.9	1.3
North Dakota	1.9	1.5	1.3	1.7
South Dakota	1.8	1.5	1.5	1.7
Southeast	**1.9**	**1.4**	**1.3**	**0.8**
Alabama	2.1	1.6	1.2	1.0
Arkansas	1.2	1.1	1.0	1.1
Florida	3.4	2.9	3.5	3.4
Georgia	0.8	0.5	0.9	1.5
Kentucky	1.1	1.0	1.2	1.2
Louisiana	0.6	0.3	(3.5)	(10.8)
Mississippi	1.2	1.0	(0.5)	(2.4)
North Carolina	1.6	1.4	1.2	1.4
South Carolina	1.0	0.1	0.1	0.6
Tennessee	1.2	0.8	0.9	0.6
Virginia	2.5	1.5	1.2	1.2
West Virginia	1.3	0.9	0.7	0.9
Southwest	**1.9**	**1.8**	**1.9**	**2.0**
Arizona	4.1	3.9	4.2	4.2
New Mexico	1.9	2.1	2.0	2.0
Oklahoma	1.8	1.8	1.8	1.7
Texas	1.4	1.2	1.3	1.5
Rocky Mountain	**2.9**	**2.5**	**2.6**	**2.8**
Colorado	2.5	2.1	2.0	1.8
Idaho	3.0	3.3	3.7	4.1
Montana	2.4	1.4	1.8	1.8
Utah	3.7	3.3	3.5	4.1
Wyoming	2.2	2.1	2.8	2.5
Far West	**2.3**	**2.1**	**2.1**	**2.0**
Alaska	1.5	1.4	1.5	1.6
California	1.7	1.7	1.6	1.4
Hawaii	2.8	2.8	2.8	2.6
Nevada	6.7	6.5	6.2	5.9
Oregon	4.0	3.1	3.2	3.1
Washington	2.3	2.0	2.4	2.9

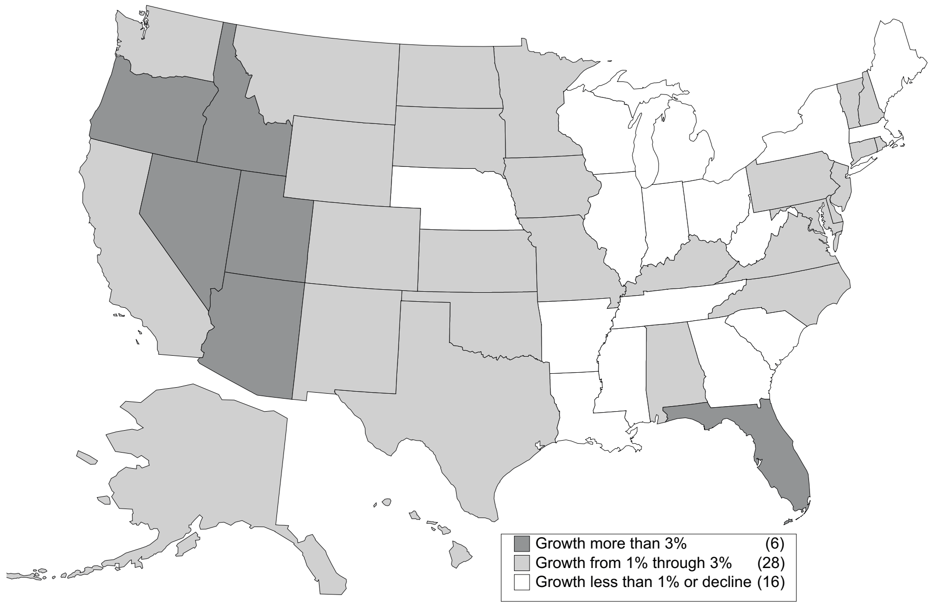
Source: Bureau of Labor Statistics.

at 22.8 percent, perhaps reflecting post-hurricane reconstruction. Nine other states also had double-digit growth. Ohio had the weakest performance, with an 8.1 percent decline driven by a tax cut. The declines in Idaho and New York were also the results of tax cuts, while Michigan had no such excuse.

Corporate Income Tax

Corporate income tax revenue grew 24.8 percent in the October-December quarter, slightly less than the previous quarter's 25.4 percent. This quarter represented a continuation of the strong growth in the corporate income tax that the states have enjoyed for the previous thirteen quarters. The corporate income tax is a volatile tax source, growing and declining rapidly. Of late, however, this tax

Figure 3
Change in Non-Farm Employment, October-December, 2004 to 2005



source has continued to move in one consistent direction — up — and very rapidly.

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 economy continues to grow, but the growth slowed in the fourth quarter of 2005. The Bureau of Economic Analysis' (BEA's) preliminary estimate for the real Gross Domestic Product (GDP) showed growth of only 1.6 percent for the fourth quarter of 2005, down from the previous quarter's 4.1 percent.[2] The national unemployment rate was 5.0 percent for the fourth quarter, unchanged from the previous quarter, but down from the 5.4 percent for the same quarter the year before.[3]

The difficulty 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), are the only broad-based, timely, high-quality state-level economic indicators available. Yet, these data are far from ideal indicators of revenue growth. Most taxes are based on 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.

Table 8 shows year-over-year employment growth for the nation and for each state for the four quarters of 2005 using BLS data. Figure 3 maps the change in fourth quarter 2005 employment compared to the same period in 2004. By this measure, employment in the October-December 2005 quarter grew 1.4 percent compared to the year before. Employment growth was strongest in the Rocky Mountain region at 2.8 percent; the weakest growth — 0.4 percent — was in the Great Lakes region. We see the effects of the hurricanes with the employment declines in Louisiana and Mississippi; Michigan continues to lose employment slowly, but steadily. Every other state had employment growth. Thirty-seven states had employment growth of one percent or more, up from 35 the previous quarter. Nevada continues to lead the country with robust 5.9 percent growth. Five other states — Arizona, Florida, Idaho, Oregon, and Utah — continued to have strong growth of over three percent.

Overall, the employment picture has shown solid growth for the previous several quarters, and this has continued into the fourth quarter of 2005. The states with the strongest growth are concentrated in the southern and western sections of the country, the pattern seen before the recent recession, and consistent with the overall pattern of population growth.

Nature of the Tax System

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

Because high-end incomes are based more heavily upon volatile sources such as stock options and capital gains, growth in personal income tax revenue is far more subject to dramatic fluctuations than it would be if it were based entirely on wages and salaries. Over the last couple of years, we have seen growth in the stock market and strong growth in corporate profits and other business-related income. This is leading to the personal and corporate income taxes growing faster than the general economy. In the recent recession, we saw the downside of this volatility. As the stock market and other investments declined, it pushed personal and corporate income tax collections down much faster than the economy, and created large holes in almost every state's budget.

States also have learned more about how sales tax revenue responds to an economic slowdown. There has been some fear that as states have removed more stable elements of consumption such as groceries and clothing from their bases, their sales taxes were more subject to plunges as consumers became nervous about spending on optional and big-ticket items. Most state sales taxes also do not capture spending on services well. In the latest economic downturn, however, the sales tax generally maintained slow growth. It is now growing more rapidly as general economic conditions improve, though less rapidly than the personal income or corporate income taxes.

Oil has been a 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 through their severance taxes, and through increases in collections in other state taxes resulting from the generally stronger state economies. Conversely, when the price falls, these states' revenue tends to follow suit. This dynamic often operates largely independently of the general economy. Now that we are seeing a relatively high price of oil, it is likely that this will constitute a drag on most states' economies, as well as a significant increase in state expenses.

Key to Interpreting Tables

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

1 indicates data through November only.

2 indicates data through September only.

* 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 indicates not applicable.

ND indicates no data.

Historical Tables (Tables 1, 2 and 4) have been shortened to provide data only back to 1999. For data through 1991 call the Fiscal Studies Program.

Table 9
Percent Change in Quarterly Tax Revenue by State, July-December, 2004 to 2005

	PIT	CIT	Sales	Total
United States	**7.1 %**	**25.9 %**	**6.2 %**	**8.2 %**
New England	**4.8**	**19.4**	**3.7**	**6.5**
Connecticut	7.4	11.7	3.4	7.7
Maine	(3.8)	49.6	3.2	6.2
Massachusetts[1]	5.6	12.7	4.3	7.0
New Hampshire	NA	40.6	NA	13.3
Rhode Island	(1.1)	20.1	2.6	1.0
Vermont	4.8	23.9	4.3	(2.6)
Mid-Atlantic	**5.8**	**20.4**	**(1.3)**	**5.8**
Delaware	8.4	139.3	NA	9.0
Maryland	8.8	(20.2)	6.6	5.7
New Jersey	12.1	29.7	2.5	11.2
New York	3.4	31.4	(7.5)	3.8
Pennsylvania	7.3	13.4	2.8	6.0
Great Lakes	**5.3**	**10.5**	**1.2**	**4.4**
Illinois	5.9	24.4	6.2	5.8
Indiana	(0.1)	1.0	5.0	3.3
Michigan	2.3	0.6	0.5	3.1
Ohio	7.0	(553.0)	(5.8)	5.0
Wisconsin	10.0	(1.6)	4.5	4.6
Plains	**6.9**	**35.3**	**4.6**	**7.9**
Iowa	0.1	13.8	4.4	3.2
Kansas	9.7	58.5	5.7	9.5
Minnesota	7.6	20.5	4.4	9.6
Missouri	8.4	66.6	4.6	5.5
Nebraska	7.4	52.2	2.8	10.9
North Dakota	9.6	60.8	3.8	16.7
South Dakota	NA	NA	7.2	6.8
Southeast	**8.1**	**39.9**	**9.7**	**9.9**
Alabama	9.0	25.2	10.3	9.5
Arkansas	8.1	36.8	8.0	9.6
Florida	NA	48.0	12.5	12.8
Georgia	7.4	42.2	10.3	8.1
Kentucky	2.3	90.0	5.3	11.9
Louisiana[2]	(0.6)	(9.9)	12.0	4.7
Mississippi	6.9	(6.2)	14.4	7.5
North Carolina	10.7	19.7	7.7	9.8
South Carolina	7.4	12.6	7.5	6.9
Tennessee	NA	31.4	7.7	8.8
Virginia	9.1	91.0	4.6	10.9
West Viginia	10.9	18.3	7.3	8.6
Southwest	**15.4**	**27.3**	**10.8**	**13.0**
Arizona	22.2	16.4	17.1	18.1
New Mexico[2]	7.2	58.1	6.4	13.6
Oklahoma	9.5	56.6	6.9	10.2
Texas	NA	NA	10.2	12.2
Rocky Mountain	**9.7**	**53.9**	**4.9**	**9.5**
Colorado	7.6	37.6	4.8	7.3
Idaho	10.8	48.1	(3.7)	4.1
Montana	10.6	91.8	NA	13.5
Utah	13.0	72.5	8.9	13.0
Wyoming			18.0	26.2
Far West	**8.1**	**25.9**	**9.7**	**10.1**
Alaska	NA	67.8	NA	58.0
California	7.7	22.9	9.0	9.0
Hawaii	10.4	178.4	12.6	13.9
Nevada	NA	NA	11.4	11.4
Oregon	11.0	75.8	NA	14.2
Washington	NA	NA	10.7	8.0

See page 9 for notes.

Tax Law Changes Affecting This Quarter

The final 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 2005 quarter, enacted tax changes and processing variations decreased state revenue by an estimated net of only about $65 million compared to the same period in 2004. This is the second straight quarter of net enacted tax cuts.

Sales tax collections declined by a net of just over $400 million. Ohio's sales tax collections declined by almost $200 million due to a rate cut. New York also had a sale tax rate cut that cost the state $150 million.

Enacted tax changes decreased personal income tax collections by a net of over $100 million, the largest cut being a rate-reduction in Ohio. Ohio also had increases in cigarette and gas taxes, and changes in various business taxes. There were also many other smaller tax cuts and increases in other states.

Conclusions

Some weakening was seen in state tax revenue growth in the fourth quarter of 2005. This weakening is in line with the slower economic growth for that quarter. There is certainly some impact from the hurricanes on the Gulf of Mexico's coasts, though the slowdown was not limited to the directly affected states. Also, the slowdown in revenue growth may have been in part due to the delay of some personal income tax payments, though the sales tax also showed slower growth. Whatever the causes of the slowdown, it may very well turn out to be short-term — just a blip in an overall strong economy and in state tax revenue growth.

As governors and state legislatures propose and begin to work on the state budgets for the next fiscal year, there is little concern about any prolonged slowdown in tax revenue growth. On the contrary, most states are reporting surpluses in their current fiscal years, and most proposals call for spending increases and tax cuts in the coming fiscal year.

Endnotes

1 We use the Bureau of Economic Analysis' State and Local Government Consumption Expenditures and Gross Investment Price Index as an inflation measure, since it reflects the pressures of inflation on state governments better than the Consumer Price Index.

2 United States Department of Commerce, Bureau of Economic Analysis News Release, February 28, 2006.

3 United States Department of Labor, Bureau of Labor Statistics, *Labor Force Statistics From the Current Population Survey*, www.bls.gov.

Table 10
State Tax Revenue, October-December, 2004 and 2005 ($ in millions)

	2004				2005			
	Personal Income	Corporate Income	Sales	Total	Personal Income	Corporate Income	Sales	Total
United States	**49,315**	**7,110**	**48,665**	**126,559**	**52,141**	**8,874**	**51,359**	**136,207**
New England	**3,075**	**248**	**1,979**	**6,662**	**3,172**	**299**	**2,034**	**7,064**
Connecticut	1,110	170	814	2,521	1,194	201	842	2,769
Maine	302	28	239	711	275	50	246	748
Massachusetts[1]	1,305	-15	639	2,218	1,347	-36	655	2,335
New Hampshire	NA	40	NA	337	NA	58	NA	390
Rhode Island	237	17	208	517	233	15	209	512
Vermont	121	8	79	359	124	12	82	310
Mid Atlantic	**11,587**	**1,878**	**7,030**	**24,139**	**11,986**	**2,108**	**7,049**	**25,307**
Delaware	211	0	NA	453	223	16	NA	474
Maryland	1,145	278	766	2,317	1,212	173	818	2,402
New Jersey	1,980	542	1,585	4,892	2,149	719	1,618	5,392
New York	6,457	594	2,683	11,151	6,485	689	2,616	11,444
Pennsylvania	1,794	465	1,996	5,326	1,917	511	1,997	5,596
Great Lakes	**7,694**	**1,133**	**7,878**	**20,183**	**8,108**	**1,251**	**7,842**	**21,025**
Illinois	1,846	276	1,667	4,569	1,922	358	1,737	4,805
Indiana	904	250	1,202	2,700	909	193	1,265	2,754
Michigan	1,667	460	2,019	5,613	1,681	488	1,964	5,753
Ohio	1,892	-36	1,997	4,235	2,023	75	1,836	4,464
Wisconsin	1,385	183	993	3,065	1,573	137	1,040	3,249
Plains	**3,882**	**455**	**3,209**	**9,081**	**4,119**	**594**	**3,333**	**9,614**
Iowa	623	69	440	1,192	621	78	462	1,214
Kansas	460	38	469	1,073	495	72	490	1,177
Minnesota	1,430	212	1,124	3,461	1,514	228	1,150	3,636
Missouri	1,003	77	647	2,240	1,095	115	681	2,353
Nebraska	317	40	299	694	340	66	301	751
North Dakota	49	19	98	239	54	35	106	287
South Dakota	NA	NA	132	182	NA	NA	144	197
Southeast	**9,172**	**1,384**	**12,159**	**27,910**	**9,854**	**1,994**	**13,286**	**30,616**
Alabama	623	104	490	1,747	654	110	556	1,901
Arkansas	445	71	482	1,067	481	98	522	1,173
Florida	NA	366	4,171	5,651	NA	526	4,588	6,307
Georgia	1,916	135	1,253	3,711	2,056	184	1,382	3,968
Kentucky	739	96	735	2,111	748	213	764	2,358
Louisiana								
Mississippi	278	64	624	1,299	303	63	767	1,467
North Carolina	2,066	230	1,144	4,220	2,297	340	1,268	4,704
South Carolina	833	46	534	1,568	873	39	583	1,654
Tennessee	NA	94	1,465	2,103	NA	102	1,571	2,261
Virginia	2,034	125	990	3,688	2,171	257	994	3,973
West Virginia	238	53	270	746	270	62	290	850
Southwest	**1,293**	**207**	**6,011**	**10,142**	**1,484**	**212**	**6,638**	**11,666**
Arizona	719	178	871	1,829	857	170	1,021	2,106
New Mexico								
Oklahoma	575	29	402	1,246	627	42	436	1,386
Texas	NA	NA	4,739	7,067	NA	NA	5,181	8,174
Rocky Mountain	**1,815**	**123**	**1,233**	**3,640**	**2,041**	**227**	**1,281**	**4,063**
Colorado	886	57	482	1,460	966	87	501	1,576
Idaho	246	24	275	657	278	42	254	680
Montana	129	14	NA	279	156	36	NA	343
Utah	553	29	386	1,099	642	62	422	1,270
Wyoming	NA	NA	91	147	NA	NA	105	194
Far West	**10,797**	**1,680**	**9,167**	**24,801**	**11,376**	**2,189**	**9,896**	**26,852**
Alaska	NA	17	NA	314	NA	27	NA	549
California	9,352	1,622	6,316	18,099	9,786	2,064	6,726	19,210
Hawaii	312	11	483	886	343	6	550	987
Nevada	NA	NA	725	939	NA	NA	805	1,053
Oregon	1,132	30	NA	1,246	1,248	92	NA	1,478
Washington	NA	NA	1,642	3,317	NA	NA	1,816	3,576

See page 9 for notes.

Table 11
State Tax Revenue, July-December, FY 2005 and 2006 ($ in millions)

	FY 2005				FY 2006			
	Personal Income	Corporate Income	Sales	Total	Personal Income	Corporate Income	Sales	Total
United States	**99,213**	**15,037**	**96,605**	**253,279**	**106,248**	**18,927**	**102,604**	**274,149**
New England	**6,597**	**672**	**3,968**	**14,035**	**6,914**	**802**	**4,114**	**14,953**
Connecticut	1,851	257	1,318	4,121	1,987	287	1,362	4,440
Maine	544	61	424	1,261	523	91	437	1,340
Massachusetts[1]	3,494	226	1636	6,235	3,688	255	1,706	6,670
New Hampshire	NA	74	NA	695	NA	104	NA	787
Rhode Island	471	31	434	1,058	466	38	446	1,069
Vermont	238	22	156	665	249	28	163	648
Mid Atlantic	**23,673**	**3,612**	**13,818**	**48,528**	**25,051**	**4,348**	**13,644**	**51,349**
Delaware	404	20	NA	902	438	48	NA	984
Maryland	2,201	492	1,262	4,244	2,394	392	1,345	4,484
New Jersey	3,293	909	2,685	8,215	3,691	1,179	2,751	9,133
New York	14,081	1,355	5,847	24,381	14,567	1,780	5,410	25,316
Pennsylvania	3,693	836	4,024	10,786	3,961	948	4,137	11,433
Great Lakes	**15,152**	**2,223**	**15,562**	**39,082**	**15,962**	**2,455**	**15,754**	**40,798**
Illinois	3,715	557	3,350	9,230	3,936	693	3,558	9,764
Indiana	1,885	407	2,450	5,372	1,884	411	2,572	5,552
Michigan	3,255	922	4,065	10,628	3,331	928	4,084	10,960
Ohio	3,801	-17	4,014	8,451	4,066	76	3,782	8,872
Wisconsin	2,497	354	1,683	5,401	2,746	348	1,759	5,650
Plains	**7,834**	**901**	**6,353**	**17,810**	**8,373**	**1220**	**6,646**	**19,224**
Iowa	1,237	119	906	2,402	1,238	135	946	2,478
Kansas	929	91	945	2,176	1,019	144	999	2,384
Minnesota	2,878	429	2,094	6,410	3,096	517	2,187	7,029
Missouri	2,038	148	1318	4,538	2,209	247	1378	4,789
Nebraska	652	83	608	1,439	700	127	625	1,596
North Dakota	102	31	204	470	111	51	212	548
South Dakota	NA	NA	278	376	NA	NA	298	402
Southeast	**18,447**	**2,872**	**24,259**	**55,858**	**19,939**	**4,018**	**26,618**	**61,408**
Alabama	1,214	166	971	3,349	1,323	208	1,071	3,667
Arkansas	906	136	976	2,163	980	187	1,054	2,370
Florida	NA	698	8,139	10,978	NA	1,032	9,154	12,384
Georgia	3,656	256	2,533	7,225	3,928	365	2,792	7,813
Kentucky	1,481	214	1,489	4,077	1,515	407	1,568	4,562
Louisiana[2]	528	62	544	1513	525	56	609	1583
Mississippi	551	139	1,174	2,523	590	130	1,343	2,713
North Carolina	4,012	511	2,261	8,226	4,443	611	2,436	9,034
South Carolina	1,598	89	911	2,880	1,716	100	980	3,078
Tennessee	NA	242	2,963	4,358	NA	317	3,193	4,743
Virginia	4,001	247	1,767	6,999	4,367	472	1,849	7,759
West Virginia	499	113	531	1,566	553	134	570	1,702
Southwest	**2,792**	**468**	**12,244**	**22,083**	**3,224**	**596**	**13,569**	**24,954**
Arizona	1,366	343	1,748	3,646	1,668	399	2,046	4,306
New Mexico[2]	274	58	372	870	294	91	396	989
Oklahoma	1,152	68	805	2,517	1,262	106	861	2,774
Texas	NA	NA	9,319	15,050	NA	NA	10,265	16,884
Rocky Mountain	**3,484**	**309**	**2,494**	**7,169**	**3,823**	**476**	**2,615**	**7,848**
Colorado	1,769	144	996	2,980	1,903	198	1,044	3,197
Idaho	459	56	572	1,299	509	83	551	1,351
Montana	286	33	NA	546	316	63	NA	619
Utah	970	76	794	2,117	1,096	131	865	2,392
Wyoming	NA	NA	132	229	NA	NA	156	288
Far West	**21,235**	**3,980**	**17,907**	**48,714**	**22,962**	**5,011**	**19,645**	**53,615**
Alaska	NA	32	NA	663	NA	54	NA	1,048
California	18,348	3,802	12,171	35,897	19,762	4,674	13,266	39,113
Hawaii	638	26	1,003	1,832	705	74	1,129	2,087
Nevada	NA	NA	1,424	1,828	NA	NA	1,586	2,037
Oregon	2,249	120	NA	2,545	2,496	210	NA	2,907
Washington	NA	NA	3,310	5,949	NA	NA	3,664	6,424

See page 9 for notes.

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 many 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 corporate 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.

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. Nai-Ling Kuo assisted with data collection. Barbara Stubblebine edited the report.

You can contact the Fiscal Studies Program at The Nelson A. Rockefeller Institute of Government, 411 State Street, Albany, NY 12203-1003, (518) 443-5285 (phone), (518) 443-5274 (fax), fiscal@rockinst.org (e-mail).

Fiscal Studies Program
The Nelson A. Rockefeller Institute of Government
State University of New York
411 State Street
Albany, New York 12203-1003

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