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State Tax Revenue Showing Signs of Slowdown

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Highlights

- State tax revenue totaled $140.6 billion in the July-September 2006 quarter, up 4.6 percent from the same period in 2005.
- After adjusting for inflation and legislated tax changes, growth was 1.1 percent, the second slowest real adjusted growth since the fourth quarter of 2003.
- Nominal revenue growth among the regions generally followed a familiar pattern: strongest in the Rocky Mountain states (9.1 percent) and Southwest (7.6 percent), and weakest in the Great Lakes (1.5 percent).
- National employment growth was 1.3 percent this quarter versus one year ago, with the strongest growth continuing in the western regions and the weakest in the Great Lakes and New England states.
- State tax revenue growth was reduced by more than $1.1 billion in net enacted tax cuts.

Tax Revenue Change

State tax revenue increased 4.6 percent in the July-September quarter of 2006 compared to the same quarter the year before. This nominal growth rate was nearly half of the previous quarter's 9.9 percent, and was the weakest since the July-September quarter of 2003. Tax revenue changes for the last 30 quarters are shown in Table 1.

Inflation remained relatively high at 4.4 percent this quarter, as measured by the state and local government consumption expenditure index. Although this measure of inflation was slower than the previous nine quarters, it is comparable to state tax revenue changes. However, tax legislation and other processing changes had a significant net impact on state tax collections this quarter, with a relatively large net legislated reduction overall. When the effects of enacted tax cuts and inflation are considered, real adjusted state tax revenue increased only 1.1 percent, as shown also in Table 1. This continues the recent pattern whereby state tax collections weaken in the July-September quarter — when only late income tax and estimated payments are typically received. 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 weaker growth than the previous quarter with sales and corporate income tax growth rates at their lowest point since mid-2003:

- ✔ Personal income tax revenue increased 6.6 percent, significantly slower growth than in the previous two quarters.
- ✔ Sales tax collections grew 4 percent.
- ✔ The corporate income tax showed a gain of 10.9 percent.

Table 2 shows the last 30 quarters of change in collections of the major state tax sources.

State tax revenue growth slowed this quarter, and all regions showed only single-digit increases. The Great Lakes region had the slowest overall growth at 1.5 percent, followed by the Plains states at 2.1 percent, and New England at 2.8 percent. The strongest growth, at 9.1 percent, was seen in the Rocky Mountain states, followed by the Southwest at 7.6 percent. However, both the Rocky Mountain and Southwest regions recorded much stronger growth in the previous quarter at 21.9 and 16.1 percent respectively — again, reflecting the weaker growth trend in the July-September period. Growth of 10 percent or more was recorded in only seven states, compared with 22 states the previous quarter. And seven states had actual

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

	Total Nominal Change	Adjusted Nominal Change	Inflation Rate	Adjusted Real Change
2006				
July-Sept.	4.6 %	5.5 %	4.4 %	1.1 %
April-June	9.9	9.9	5.6	4.1
Jan.-Mar.	6.8	6.8	5.8	0.9
2005				
Oct.-Dec.	7.6	7.7	6.3	1.3
July-Sept.	9.3	9.7	6.4	3.1
April-June	13.2	12.9	6.0	6.5
Jan.-Mar.	11.4	9.5	5.9	3.4
2004				
Oct.-Dec.	7.8	7.3	5.7	1.5
July-Sept.	8.6	8.1	4.6	3.3
April-June	11.2	9.0	3.9	4.9
Jan.-Mar.	8.1	7.1	2.9	4.1
2003				
Oct.-Dec.	7.3	4.9	3.8	1.1
July-Sept.	4.5	2.6	3.9	(1.3)
April-June	3.1	0.4	3.9	(3.4)
Jan.-Mar.	1.4	(1.0)	4.7	(5.4)
2002				
Oct.-Dec.	1.9	0.3	3.3	(2.9)
July-Sept.	2.5	0.7	2.7	(1.9)
April-June	(10.6)	(12.1)	2.2	(14.0)
Jan.-Mar.	(7.8)	(8.2)	1.7	(9.7)
2001				
Oct.-Dec.	(2.7)	(2.2)	2.0	(4.1)
July-Sept.	(3.1)	(2.4)	2.6	(4.9)
April-June	2.5	4.2	3.3	0.9
Jan.-Mar.	5.1	6.3	3.6	2.6
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

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

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

	PIT	CIT	Sales	Total
2006				
July-Sept.	6.6 %	10.9 %	4.0 %	4.6 %
April-June	15.1	14.7	5.7	9.9
Jan.-Mar.	10.6	(13.8)	6.6	6.8
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

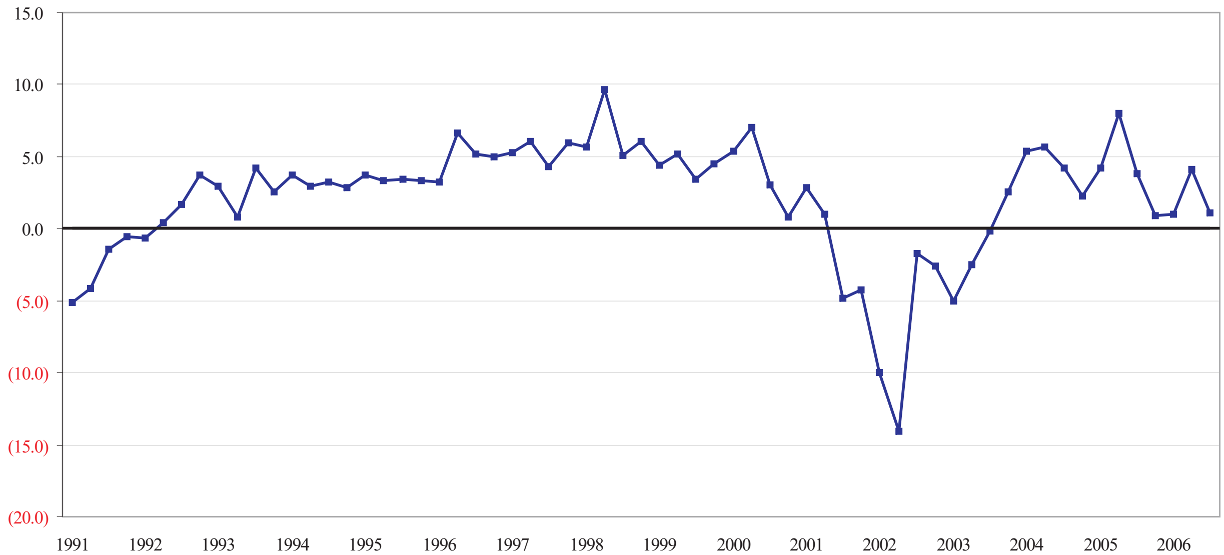
revenue declines, compared with only 3 states the quarter before. Table 3 shows the growth by state and region for the three major state taxes and total state taxes.

This was the fifth consecutive quarter with a net tax cut, and it was much larger than the previous quarter's, with more than $1.1 billion in net enacted tax reductions. The Mid-Atlantic region had the largest net tax cuts, driven by New York's School Tax Relief program, while only the Far West region showed a net increase. (See Figure 2.) 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.

Collections Versus Projections

Given the sharp slowdown in tax collections compared to this same quarter last year, we might expect that collections were close to state projections for the quarter. This was indeed the case. Nineteen states that have a July-June fiscal year

Figure 1
Real Adjusted Tax Revenue, 1991-2006
Year-Over-Year Percent Change



also report comparisons of year-to-date collections to projected cash flows. For these 19 states, total actual tax collections exceeded projections by 1.8 percent. Five states reported positive variances in collections of 3 percent or more, while three showed negative variances. It should be stressed that these results by themselves do not indicate that states will report budget surpluses since, for the most part, state reports do not compare actual spending to projections.

Personal Income Tax

Tax revenue grew 6.6 percent in the July-September 2006 quarter compared to the same quarter in 2005, and less than half the previous quarter's growth. By way of comparison, federal personal income tax collections grew 8.5 percent over the same period. The strongest growth was in the Rocky Mountain region, where collections grew 11.5 percent, followed closely by the Far West states, at 9.4 percent. Collections in the Southwest region increased 4.5 percent — a respectable number, but lower than all other regions, including the Great Lakes. Growth was reported by 32 of the 37 states with a broad-based personal income tax and for which July-September quarterly information is available. Only six states had double-digit increases, compared with 37 of 41 in the previous quarter. Mississippi led the states with 17.7 percent growth. Five states showed collections' declines, with West Virginia having the sharpest drop at 4.8 percent.

We can get a clearer picture of collections from the personal income tax by breaking this source down into major component parts for which we have data: withholding and quarterly estimated payments.

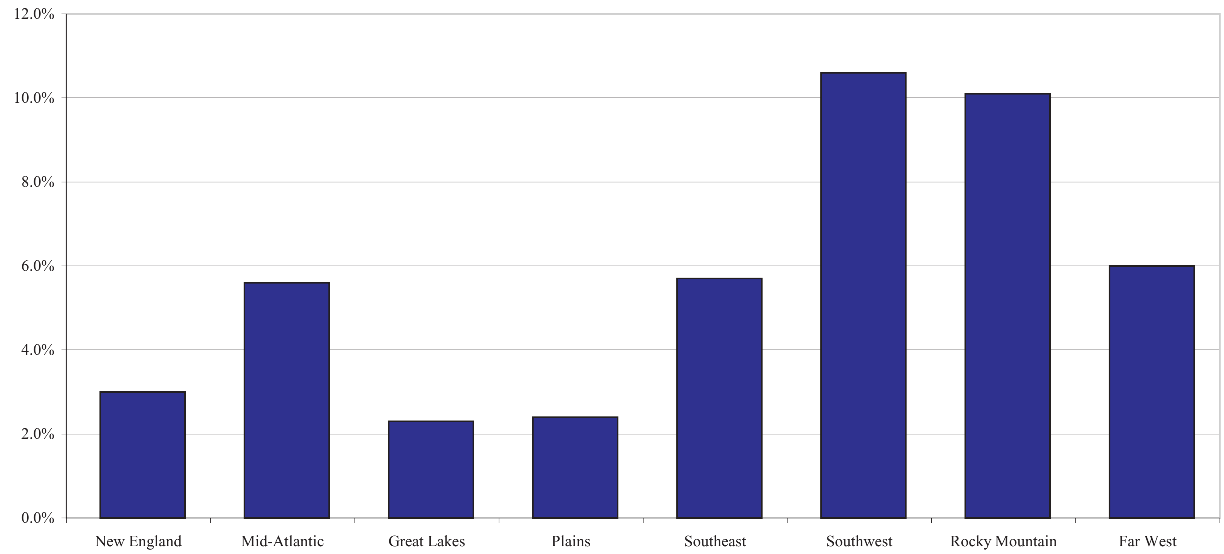
Withholding

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 withholding for the July-September 2006 quarter increased 2.4 percent over the same quarter of 2005 and about one-third the rate of growth recorded in the previous quarter.

Estimated Payments

The highest-income taxpayers generally make estimated tax payments (also known as declarations) on their income that is not subject to

Figure 2
Tax Revenue, Adjusted for Legislated Changes,
July-September, 2005 to 2006
Percent Change



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 33 states for which we have complete data, growth in estimated tax payments in September, the third quarter payment, was 14 percent compared to the year before. (See Table 7.)

Increases were recorded in 28 states with 15 reporting double-digit growth; five states had increases of more than 20 percent. Delaware, Hawaii, Kentucky, New Mexico, and West Virginia showed year-over-year declines. The continued increase indicates that most of those who receive nonwage income are expecting it to be higher this year than last, a theory generally supported by recent stock market gains. And if the strong growth in final payments for last year's income is any indication, many taxpayers in this sector will need to pay more just to match their total payments for last year, as required to avoid penalties. If estimated tax payments remain strong for the rest of the year, it also points to continued strong growth in final payments for April 2007.

General Sales Tax

Collections in the July-September 2006 quarter were 4 percent above the same quarter in 2005. This is a slight decline from the previous quarter's 5.7 percent growth and the lowest growth rate since July-September 2003.

All regions showed net gains except New England and the Great Lakes. Sales tax revenue again grew fastest in the Southwest region at 11.7 percent. The New England region recorded the largest decline at 4 percent, with Connecticut having a decline of 16 percent. The Great Lakes declined 1.6 percent, again reflecting reductions in Ohio, but this will be Ohio's only sales tax adjustment for fiscal year 2007.

Corporate Income Tax

Nominal tax revenue increased 10.9 percent in the July-September quarter. This growth was weaker than the previous quarter, although some states, such as Ohio, recorded atypically large settlement payments. The July-September increase,

Table 3
Quarterly Tax Revenue by Major Tax, by State
July-September, 2005 to 2006, Percent Change

	PIT	CIT	Sales	Total
United States	**6.6 %**	**10.9 %**	**4.0 %**	**4.6 %**
New England	**6.0**	**25.3**	**(4.0)**	**2.8**
Connecticut	6.3 ¶	43.1 ¶	(16.0)	0.3 ¶
Maine	0.5	21.8	3.4	3.9
Massachusetts	6.1	17.9	(0.8)	3.9
New Hampshire	NA	59.3	NA	1.9
Rhode Island	9.1	31.0 ¶	(0.3)	4.5
Vermont	7.4	(31.9)	3.5	(2.4) *
Mid-Atlantic	**5.5**	**9.3**	**1.0**	**3.5**
Delaware	8.3	(9.6) ¶	NA	(1.2)
Maryland	0.0	(9.2)	2.3	2.0
New Jersey	(1.6)	8.8 *	12.2 *	1.7 *
New York	7.2 ¶	14.9 ¶	(4.7) ¶	3.9 ¶
Pennsylvania	8.2	10.8 ¶	1.9	4.9
Great Lakes	**4.6**	**13.2**	**(1.6)**	**1.5**
Illinois	8.0	24.5	2.6	6.3
Indiana	7.5	10.1	3.5	5.4
Michigan	3.4	(4.3)	(6.6)	(3.3)
Ohio	0.7 ¶	5,540.0	(5.3) ¶	(1.8) ¶
Wisconsin	4.4	9.0	3.2	3.4
Plains	**6.3**	**15.3**	**4.5**	**2.1**
Iowa	3.8	50.6	2.8	5.9
Kansas	10.5	50.6	3.8	9.7
Minnesota	4.2 ¶	6.7	0.3	(1.9)
Missouri	7.2	(0.2)	1.7	2.1
Nebraska	10.7	15.2	27.8 ¶	0.2 ¶
North Dakota	ND	ND	ND	ND
South Dakota	NA	NA	5.1	6.1
Southeast	**6.0**	**14.1**	**6.7**	**5.6**
Alabama	8.7	30.2	9.1	10.5
Arkansas	8.9	10.3	6.4	7.1
Florida	NA	7.6	4.1	0.5
Georgia	8.9	(18.0)	3.9 ¶	5.4
Kentucky	(3.8)	43.8	1.2	2.6
Louisiana	ND	ND	ND	ND
Mississippi	17.7	37.4	21.4	18.1
North Carolina	8.9	15.7	6.0	9.7
South Carolina	8.8	22.5	13.7	7.4 *
Tennessee	NA	3.3	5.0	3.9
Virginia	1.6	20.5 ¶	23.6	6.3
West Viginia	(4.8)	20.1	(3.6)	(1.7)
Southwest	**4.5**	**19.0**	**11.7**	**7.6**
Arizona	7.6 ¶	14.4 ¶	9.6	8.2 ¶
New Mexico	(4.7)	7.9	34.1	19.5
Oklahoma	4.9	51.5	8.9	8.8
Texas	NA	NA	10.6	5.9 ¶
Rocky Mountain	**11.5**	**18.0**	**7.6**	**9.1**
Colorado	9.9	1.9	5.3	7.4
Idaho	12.5	16.1	3.2	6.7
Montana	ND	ND	ND	ND
Utah	14.4 ¶	42.7	6.5 ¶	11.5 ¶
Wyoming	NA	NA	15.8 ¶	11.6 ¶
Far West	**9.4**	**3.4**	**2.7**	**6.1**
Alaska	NA	34.2	NA	23.9
California	10.2	4.7	0.8	5.5
Hawaii	(0.1)	(66.0)	4.5	(2.1)
Nevada	NA	NA	3.0	3.2
Oregon	5.5	7.5	NA	8.2
Washington	NA	NA	8.7	10.7 *

See page 9 for notes.

though nominally strong, was less than half that of the same quarter of 2005, and aside from California's recent tax amnesty collections' adjustment, the weakest growth rate since July-September 2003. It could be that the spectacular performance from this source is finally beginning to wane.

Underlying Reasons for Trends

State 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

National economic growth slowed again this quarter. Preliminary estimates from the Bureau of Economic Analysis (BEA) for the real Gross Domestic Product (GDP) indicated the economy grew at an annual rate of 2.2 percent in the third calendar quarter, compared to 2.6 percent last quarter and 5.6 percent in the January-March period. This continued slowdown is attributed to downturns in private investments, as well as Federal government spending. The national unemployment rate was 4.7 percent for the third quarter, unchanged from the previous two quarters.

The general lack of timely state-level indicators presents a challenge to an assessment of state economies. Data on nonfarm 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.

On a national basis, nonfarm employment continued to exhibit solid growth. By this measure, employment in the July-

Table 4
Quarterly State Tax Revenue
Adjusted for Legislated Tax Changes
Year-Over-Year Percent Change

	PIT	Sales	Total
2006			
July-Sept.	8.1 %	4.2 %	5.5 %
April-June	15.4	6.5	9.9
Jan.-Mar.	10.9	7.4	6.8
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.)

September 2006 quarter grew 1.3 percent compared to the year before, and has remained in the 1.3-1.5 percent range over the last four quarters. But the disparity in employment growth among the regions remains pronounced. Table 8 shows year-over-year employment growth for the nation and for each state for the first three quarters of 2006 and the last quarter of 2005. Figure 3 maps the change in third quarter 2006 employment compared to the same period in 2005.

Job growth continues to be concentrated in the western states. The Rocky Mountain and Southwest regions have vied for the lead in creating jobs

Table 5
Quarterly Total Tax Revenue, by State
Adjusted for Legislation and Inflation
July-September, 2005 to 2006, Percent Change

United States	**1.1 %**
New England	**(1.3)**
Connecticut	(3.0)
Maine	(0.4)
Massachusetts	(0.5)
New Hampshire	(2.4)
Rhode Island	0.4
Vermont	(7.6)
Mid-Atlantic	**1.1**
Delaware	(5.1)
Maryland	(2.0)
New Jersey	(10.9)
New York	5.9
Pennsylvania	0.8
Great Lakes	**(2.0)**
Illinois	1.6
Indiana	0.3
Michigan	(7.4)
Ohio	(1.6)
Wisconsin	(1.0)
Plains	**(1.9)**
Iowa	1.4
Kansas	5.5
Minnesota	(5.6)
Missouri	(2.2)
Nebraska	(3.1)
North Dakota	ND
South Dakota	1.6
Southeast	**1.2**
Alabama	5.9
Arkansas	2.6
Florida	(3.1)
Georgia	1.5
Kentucky	(1.9)
Louisiana	ND
Mississippi	13.1
North Carolina	5.1
South Carolina	(0.7)
Tennessee	(0.6)
Virginia	2.0
West Virginia	(5.8)
Southwest	**5.9**
Arizona	8.0
New Mexico	ND
Oklahoma	4.2
Texas	4.8
Rocky Mountain	**5.5**
Colorado	3.1
Idaho	2.2
Montana	ND
Utah	9.5
Wyoming	7.9
Far West	**1.5**
Alaska	18.7
California	1.1
Hawaii	(6.2)
Nevada	(1.1)
Oregon	3.6
Washington	4.9

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

See page 9 for notes.

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

	2005	2006		
	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.
United States	**5.4 %**	**8.6 %**	**6.6 %**	**2.4 %**
New England	**4.1**	**8.6**	**6.7**	**5.8**
Connecticut	1.5	15.3	7.7	6.1 ¶
Maine	3.5	2.5	5.6 ¶	4.0
Massachusetts	5.6	6.4	6.4	5.5
Rhode Island	3.2	4.1	6.8	10.5
Vermont	2.8	12.4	5.6	5.4
Mid-Atlantic	**5.9**	**7.8**	**4.4**	**(4.9)**
Delaware	5.0	23.4	13.0	11.8
Maryland	6.4	8.9	5.8	(11.2)
New Jersey	3.3	13.5	16.1 *	(36.7)
New York	6.3	6.4	6.4 *	3.0
Pennsylvania	5.8	4.2	(11.8)	7.9 ¶
Great Lakes	**5.1**	**4.0**	**4.4**	**3.7**
Illinois	3.7	6.5	7.1	8.1
Indiana	6.9	5.1	5.6	4.7
Michigan	(0.7)	2.7	(0.5)	1.9
Ohio	5.3 *	2.1	3.3 ¶	0.7 ¶
Wisconsin	12.8	3.7	7.2	3.8
Plains	**5.1**	**5.8**	**7.0**	**5.2**
Iowa	(1.4)	(1.8) *	4.4 ¶	5.1
Kansas	8.6	10.3	10.0	8.8
Minnesota	4.9	5.1 ¶	6.1	2.7 ¶
Missouri	6.9	8.1	6.2	6.3
Nebraska	7.1	10.2	13.8	7.5
North Dakota	12.7	2.1	10.3 ¶	ND
Southeast	**5.3**	**8.9**	**7.6**	**5.0**
Alabama	6.2	6.9	7.9	9.7
Arkansas	7.8	8.3 *	9.9 ¶	8.9
Georgia	5.7	9.6	6.3	ND
Kentucky	3.3 *	2.7	0.3 ¶	0.1
Louisiana	(1.9)	30.6	10.2	ND
Mississippi	8.6	9.0	9.5	ND
North Carolina	6.7	9.7	7.5	6.1
South Carolina	3.7	6.7	7.9	4.9
Virginia	4.9	7.1	10.0 ¶	4.0
West Virginia	7.2	9.6	6.2	0.0
Southwest	**12.0**	**11.7**	**8.5**	**3.2**
Arizona	16.6	13.0	9.9	5.9 ¶
New Mexico	5.0	7.6	0.5 ¶	(2.8)
Oklahoma	9.6	6.1	8.5 ¶	4.5
Rocky Mountain	**8.4**	**10.6**	**8.9**	**10.1**
Colorado	6.0	7.7	8.2	7.4
Idaho	8.0	10.6	11.1	11.2
Montana	13.0	12.2	8.9	ND
Utah	12.2	15.7	9.1	14.4 ¶
Far West	**4.0**	**14.2**	**9.6**	**4.7**
California	3.6	15.7	10.3	4.6
Hawaii	6.7	(9.8)	5.5	5.5
Oregon	6.4	10.5	5.7	5.1

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.

in recent quarters — the Rocky Mountain states again came out on top in the July-September period, at 3.2 percent to the Southwest's 2.7 percent growth rate. The Far West was just behind its neighboring regions at 1.9 percent. Thirteen of the 15 states in these three regions grew faster than the nation, with Alaska and California keeping pace with national growth. These regions accounted for nearly 50 percent of the nation's job growth in the third quarter compared to the same period one year ago, while having about 30 percent of the total jobs. Nevada led the nation with strong 5.2 percent growth, just ahead of Arizona and Utah, which recorded 4.8 percent growth each. These three states plus nine others — Florida, Idaho, Minnesota, Montana, New Mexico, South Carolina, Oregon, Washington, and Wyoming — recorded growth of more than double the national rate. In contrast, job growth remains sluggish in the New England, Mid-Atlantic, and Great Lakes regions, with each expanding jobs at rates of less than 1 percent. This slow job growth rate was broad-based, with only Delaware among the 16 states in these three regions exceeding the national average. The Great Lakes and New England regions had the slowest job growth — 0.5 and 0.6 percent, respectively. Only Michigan and Louisiana lost jobs in the July-September quarter, with the latter still struggling from the effects of the hurricanes, but recovering from a 9.2 percent job loss last quarter to a 5.1 percent decline this quarter.

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

Table 7
Estimated Payments/Declarations, by State
Year-Over-Year Percent Change

	April-September	September
Average (Mean)	**16.5 %**	**14.0 %**
Median	**12.9**	**9.4**
Alabama	10.2	1.8
Arkansas	11.1	16.7
California	23.5	22.8
Colorado	34.3	30.4
Connecticut	8.4	0.7
Delaware	8.0	(0.3)
Hawaii	20.8	(13.5)
Illinois	16.8	13.8
Indiana	11.7	9.4
Iowa	9.9	2.7
Kansas	24.8	26.8
Kentucky	(12.8)	(12.2)
Maine	7.3	3.1
Maryland	14.4	9.7
Massachusetts	12.9	10.5
Michigan	8.8	8.2
Minnesota	16.0	10.0
Missouri	16.6	14.3
Nebraska	11.6	8.7
New Jersey	7.4	8.8
New Mexico	55.2	(40.4)
New York	15.6	17.9
North Carolina	19.4	17.9
Ohio	3.7	2.5
Oklahoma	23.8	22.6
Oregon	12.9	21.9
Pennsylvania	16.5	13.0
Rhode Island	8.8	14.5
South Carolina	22.3	19.2
Vermont	13.1	8.8
Virginia	14.7	7.2
West Virginia	1.9	(31.2)
Wisconsin	11.3	9.1

See page 9 for notes.

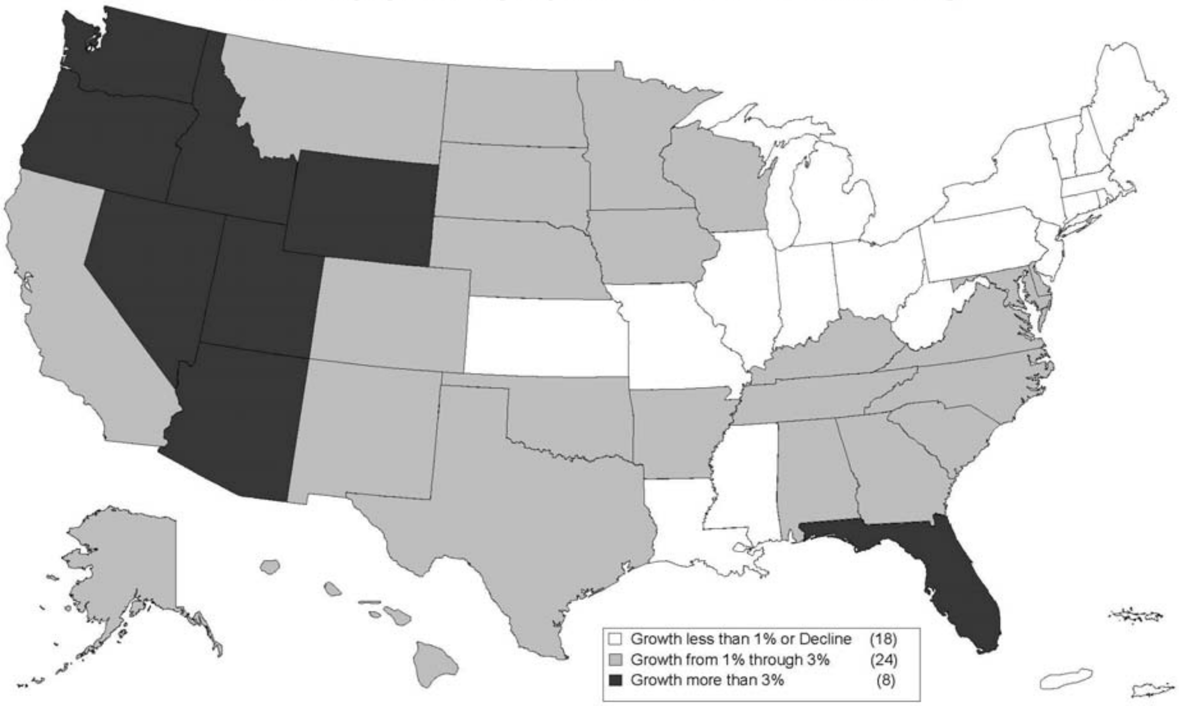
more progressive income tax structures, since higher incomes are taxed at the highest rates. The sales tax is also very responsive to economic conditions, but is historically less elastic than the personal income tax, dropping more slowly in bad times and increasing more slowly in good times. States that rely heavily on corporate income or severance taxes often see wild swings in revenue that are not necessarily related to general economic conditions. (Severance taxes are levied on the removal of natural resources, such as oil and natural gas.)

Table 8
Nonfarm Employment, by State
Last Four Quarters, Year-Over-Year Percent Change

	2005	*2006*		
	Oct.-Dec.	*Jan.-Mar.*	*Apr.-Jun.*	*Jul.-Sep.*
United States	**1.4**	**1.5**	**1.4**	**1.3**
New England	**0.5**	**0.9**	**0.6**	**0.6**
Connecticut	0.7	0.8	0.5	0.6
Maine	(0.0)	0.1	0.2	0.4
Massachusetts	0.5	1.0	0.7	0.7
New Hampshire	0.7	1.4	1.1	0.8
Rhode Island	0.6	0.9	0.5	0.3
Vermont	0.7	0.6	0.6	1.0
Mid-Atlantic	**0.9**	**1.2**	**0.9**	**0.9**
Delaware	1.4	1.8	1.6	1.6
Maryland	1.4	1.6	1.4	1.3
New Jersey	1.1	1.3	0.9	0.7
New York	0.6	1.0	0.8	0.9
Pennsylvania	1.0	1.2	0.9	0.9
Great Lakes	**0.6**	**0.8**	**0.6**	**0.5**
Illinois	1.0	1.1	1.0	1.1
Indiana	1.0	1.2	0.7	0.5
Michigan	(0.4)	(0.3)	(0.4)	(0.4)
Ohio	0.5	0.7	0.6	0.4
Wisconsin	1.1	1.4	1.1	0.9
Plains	**1.1**	**1.6**	**1.4**	**1.6**
Iowa	1.8	1.9	1.7	1.8
Kansas	0.2	0.7	0.1	0.5
Minnesota	1.0	1.8	1.9	2.6
Missouri	1.0	1.4	1.0	0.8
Nebraska	1.7	2.1	1.7	1.6
North Dakota	2.0	2.5	1.5	1.6
South Dakota	1.8	2.5	2.4	2.4
Southeast	**1.6**	**1.7**	**1.4**	**1.6**
Alabama	2.2	2.5	1.8	1.5
Arkansas	1.7	1.4	1.2	1.3
Florida	4.0	3.8	3.2	3.1
Georgia	2.4	2.4	1.9	1.9
Kentucky	1.5	1.6	1.2	1.0
Louisiana	(9.9)	(8.6)	(9.2)	(5.1)
Mississippi	(0.2)	0.2	0.0	1.2
North Carolina	1.8	1.7	2.1	1.9
South Carolina	1.4	2.2	2.6	2.6
Tennessee	1.3	1.4	1.2	1.2
Virginia	2.2	2.2	1.8	1.5
West Virginia	1.4	1.4	0.9	1.1
Southwest	**3.2**	**3.4**	**2.9**	**2.7**
Arizona	5.3	5.6	4.8	4.8
New Mexico	2.6	2.8	2.6	3.1
Oklahoma	2.5	2.9	2.0	1.5
Texas	2.9	2.9	2.6	2.3
Rocky Mountain	**3.2**	**3.2**	**3.2**	**3.2**
Colorado	2.2	2.3	2.1	2.0
Idaho	4.9	5.0	5.1	4.2
Montana	2.3	2.2	2.1	3.0
Utah	4.6	4.4	4.6	4.8
Wyoming	3.2	3.6	3.6	4.1
Far West	**2.4**	**2.6**	**2.1**	**1.9**
Alaska	1.6	1.7	1.5	1.3
California	1.8	2.0	1.5	1.3
Hawaii	3.0	3.5	2.7	2.5
Nevada	6.0	6.3	5.1	5.2
Oregon	3.2	3.9	3.6	3.1
Washington	3.2	3.4	3.2	3.2

Source: Bureau of Labor Statistics.

Figure 3
Nonfarm Employment, July-September, 2005 to 2006, Percent Change



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 helps explain why personal and corporate income taxes are growing faster than the general economy. In the most 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.

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.
NA indicates not applicable.
ND indicates no data.
NM indicates not meaningful.
Historical Tables (Tables 1, 2, and 4) have been shortened to provide data only back to 1999. Data through 1991 are available at http://rfs.rockinst.org/data/revenue.

States also have learned more about how sales tax revenue responds to an economic slowdown. There has been some fear that as states remove more stable elements of consumption such as groceries and clothing from their tax bases, their sales taxes are more subject to plunge as consumers become 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 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' revenues tends to follow suit. This dynamic often operates largely independently of the general economy. Most states, and especially the nonproducing ones, face more complex revenue impacts from rising gasoline prices, as consumer spending on other taxable products may be squeezed. A relatively high price of oil will likely constitute a drag on most states' economies, as well as create a significant increase in state expenses with potentially some positive impact in states that impose general sales taxes on gasoline.

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 July-September 2006 quarter, enacted tax changes and processing variations decreased state revenue by an estimated net $1.1 billion compared to the same period in 2005, as reported by 45 states. This is the fifth straight quarter of net enacted tax cuts and the largest since this same quarter last year.

Nearly three-quarters of the net reduction was in the personal income tax, where enacted tax changes decreased collections by a net of $772 million. The largest such cut was New York's School Tax Relief program (STAR), which was estimated to have more than a $500 million impact for this quarter. Ohio had the second largest income tax reduction, with a net decline of $85 million. Sales tax reductions totaled a net $99 million. In the 45 states that reported tax changes for FY 2007, New Jersey recorded the largest sales tax increase at $251 million, while New York had the largest reduction, at $202 million.

Conclusions

Revenue growth slowed rather decidedly this quarter. All three major taxes showed significantly weaker growth than the previous quarter.

State tax collections were consistent with a slowing national economy, as the GDP has exhibited a slower expansion for two consecutive quarters. Notwithstanding more restrained national indicators, strong economic performance continues to characterize the three western regions, where employment growth again substantially exceeded the 1.3 percent national rate. Not surprisingly, tax collections in these three regions also significantly outpaced national trends.

As many states acted to reduce taxes during the 2006 legislative session, they were encouraged by an extremely robust tax collection performance. After adjusting for these tax reductions, state tax collections slowed sharply in the July-September period. Early indications are that tax collections are about as expected in the states, but more pronounced slowdowns could suggest some budget stress ahead.

Table 9
State Tax Revenue, July-September, 2005 and 2006 ($ in millions)

	2005				2006			
	Personal Income	Corporate Income	Sales	Total	Personal Income	Corporate Income	Sales	Total
United States	**52,010**	**9,624**	**50,769**	**134,436**	**55,429**	**10,668**	**52,820**	**140,641**
New England	**3,742**	**503**	**2,081**	**7,889**	**3,966**	**631**	**1,999**	**8,112**
Connecticut	794	86	521	1,670	844	123	438	1,675
Maine	248	41	192	592	250	50	198	615
Massachusetts	2,342	291	1,052	4,335	2,484	343	1,044	4,505
New Hampshire	NA	46	NA	397	NA	74	NA	405
Rhode Island	233	23	236	557	254	30	236	582
Vermont	126	16	81	339	135	11	83	331
Mid Atlantic	**11,710**	**1,903**	**6,515**	**24,101**	**12,354**	**2,079**	**6,578**	**24,947**
Delaware	215	32	NA	510	233	29	NA	504
Maryland	1,182	219	528	2,082	1,182	199	540	2,123
New Jersey	1,542	460	1,133	3,741	1,518	500	1,270	3,803
New York	6,727	754	2,715	11,931	7,209	866	2,586	12,391
Pennsylvania	2,044	438	2,140	5,837	2,212	485	2,181	6,126
Great Lakes	**7,854**	**1,204**	**7,912**	**19,764**	**8,213**	**1,364**	**7,785**	**20,053**
Illinois	2,014	335	1,821	4,959	2,176	417	1,869	5,269
Indiana	974	218	1,307	2,797	1,047	240	1,352	2,948
Michigan	1,649	439	2,120	5,199	1,706	420	1,979	5,025
Ohio	2,043	1	1,946	4,408	2,058	56	1,842	4,327
Wisconsin	1,174	211	719	2,402	1,226	230	742	2,484
Plains	**4,196**	**611**	**3,207**	**9,350**	**4,460**	**704**	**3,353**	**9,542**
Iowa	617	57	485	1,264	640	85	498	1,338
Kansas	524	72	509	1,207	580	109	529	1,324
Minnesota	1,581	290	1,037	3,393	1,648	309	1,041	3,328
Missouri	1,114	132	698	2,436	1,194	131	709	2,487
Nebraska	360	61	324	845	398	70	414	847
North Dakota	ND	ND	ND	ND	ND	ND	ND	ND
South Dakota	NA	NA	154	205	NA	NA	162	218
Southeast	**9,559**	**1,968**	**12,718**	**29,204**	**10,135**	**2,245**	**13,571**	**30,840**
Alabama	669	98	514	1,766	727	128	561	1,950
Arkansas	499	88	532	1,197	544	97	566	1,281
Florida	NA	506	4,567	6,076	NA	545	4,753	6,109
Georgia	1,871	180	1,406	3,840	2,038	148	1,462	4,049
Kentucky	767	194	803	2,204	738	280	813	2,261
Louisiana	ND	ND	ND	ND	ND	ND	ND	ND
Mississippi	286	68	576	1,246	337	93	700	1,471
North Carolina	2,145	271	1,167	4,330	2,335	313	1,237	4,748
South Carolina	843	61	396	1,425	917	75	451	1,530
Tennessee	NA	215	1,622	2,483	NA	223	1,703	2,580
Virginia	2,196	215	855	3,786	2,230	259	1,057	4,024
West Virginia	283	72	280	851	269	86	269	837
Southwest	**1,739**	**384**	**6,931**	**13,288**	**1,818**	**458**	**7,742**	**14,297**
Arizona	811	229	1,026	2,200	872	262	1,124	2,380
New Mexico	294	91	396	989	280	99	531	1,182
Oklahoma	635	64	425	1,388	666	97	463	1,511
Texas	NA	NA	5,084	8,711	NA	NA	5,624	9,225
Rocky Mountain	**1,622**	**228**	**1,647**	**4,053**	**1,809**	**269**	**1,772**	**4,422**
Colorado	937	111	543	1,621	1,030	113	572	1,741
Idaho	231	41	297	671	260	48	307	716
Montana	ND	ND	ND	ND	ND	ND	ND	ND
Utah	454	75	443	1,128	520	108	472	1,259
Wyoming	NA	NA	364	633	NA	NA	421	706
Far West	**11,586**	**2,822**	**9,757**	**26,788**	**12,674**	**2,919**	**10,022**	**28,429**
Alaska	NA	27	NA	499	NA	36	NA	618
California	9,976	2,610	6,540	19,903	10,996	2,733	6,595	20,993
Hawaii	362	67	580	1,100	362	23	606	1,077
Nevada	NA	NA	781	1,009	NA	NA	805	1,041
Oregon	1,248	118	NA	1,429	1,317	127	NA	1,545
Washington	NA	NA	1,856	2,848	NA	NA	2,017	3,154

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: Nongeneral 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 noneconomic 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.

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

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

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

This report was written by Brian T. Stenson, Deputy Director of the Institute. Nai-Ling Kuo collected the data and prepared tables and figures. Michael Cooper, the Rockefeller Institute's Director of Publications, did the layout and design of this report, with assistance from Michele Charbonneau. Barbara Stubblebine edited the report.

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