

The State Revenue Outlook

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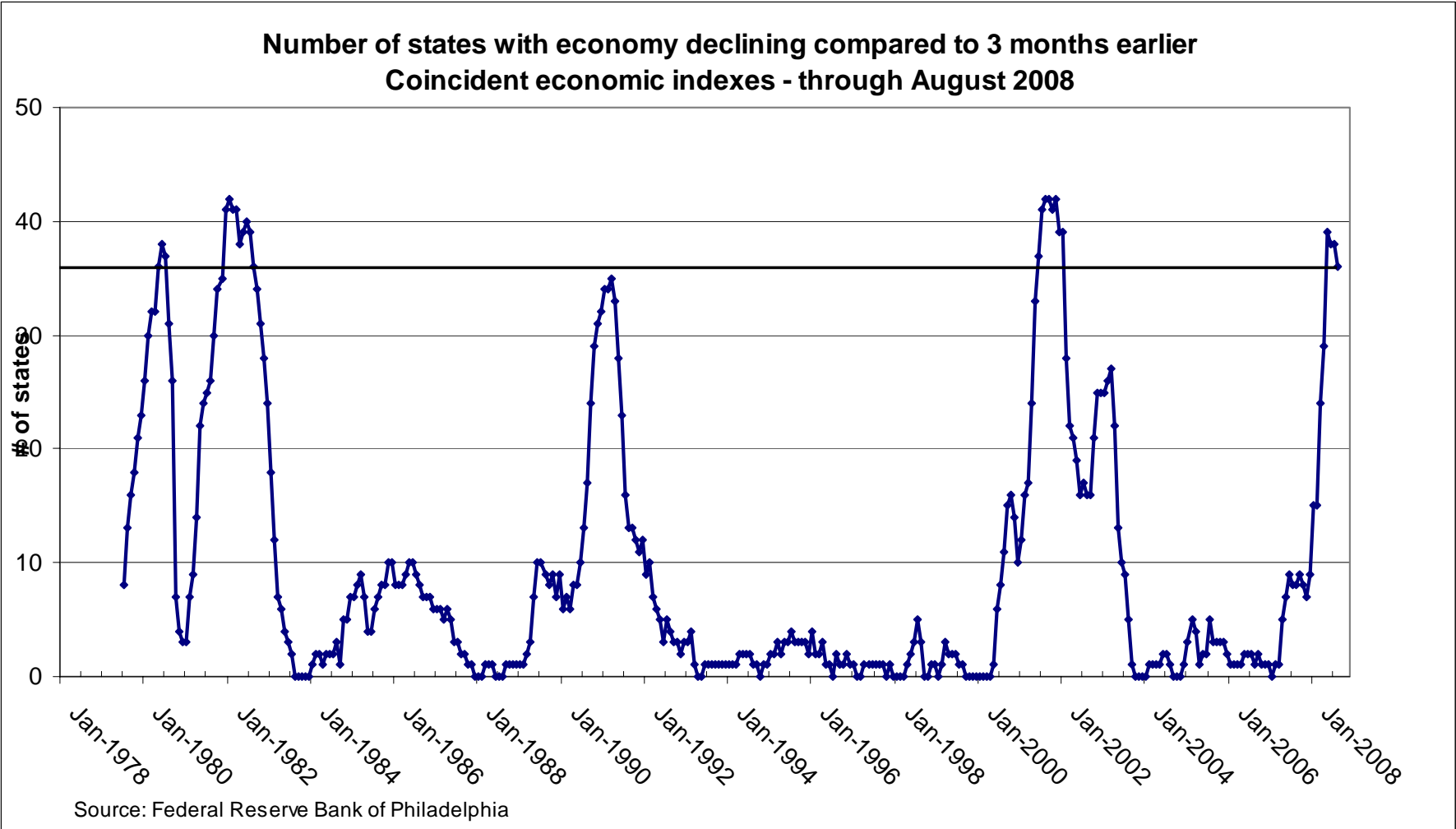


Outline

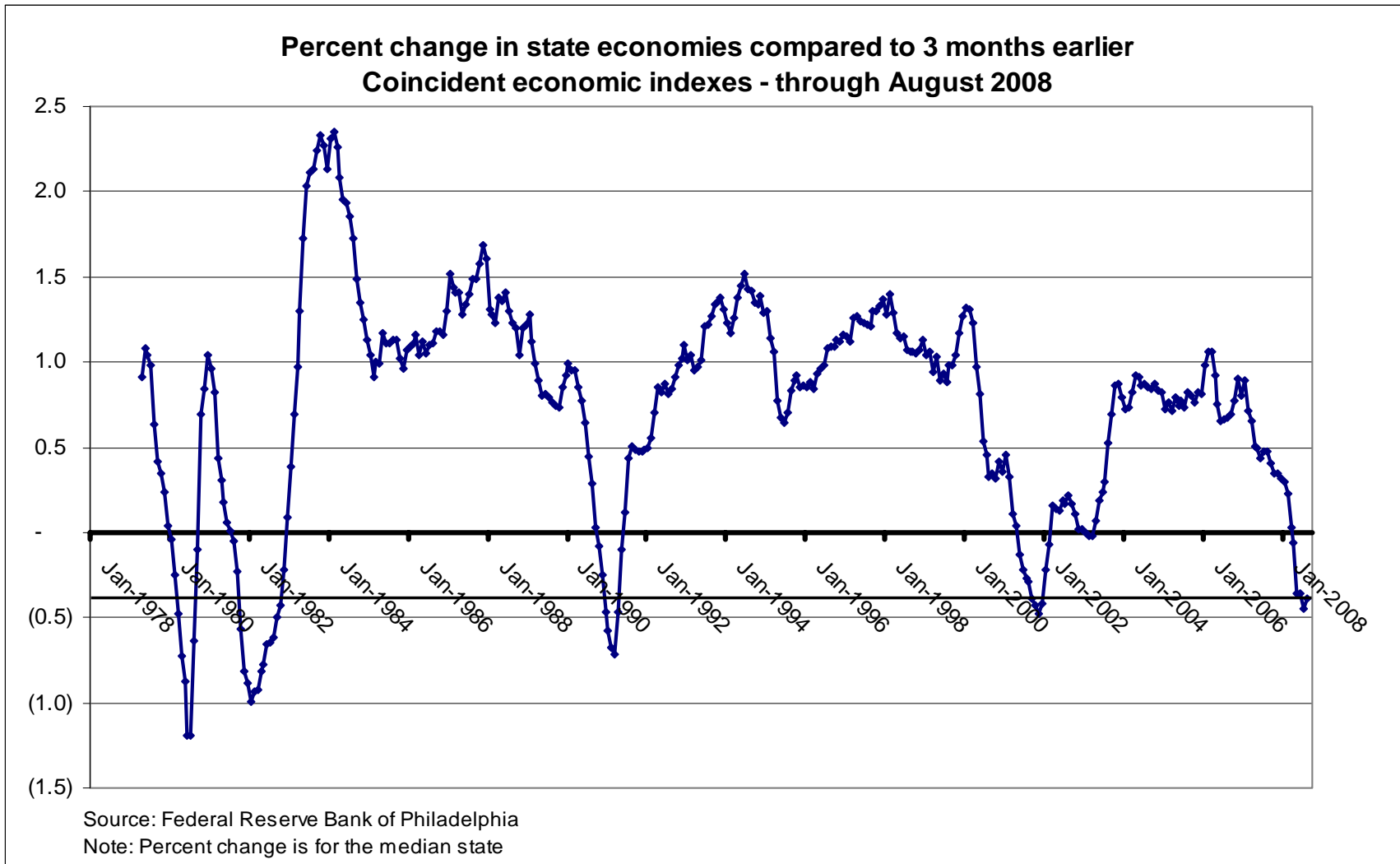
- Where we are
- Insights from where we've been
- Where we're going

Where we are

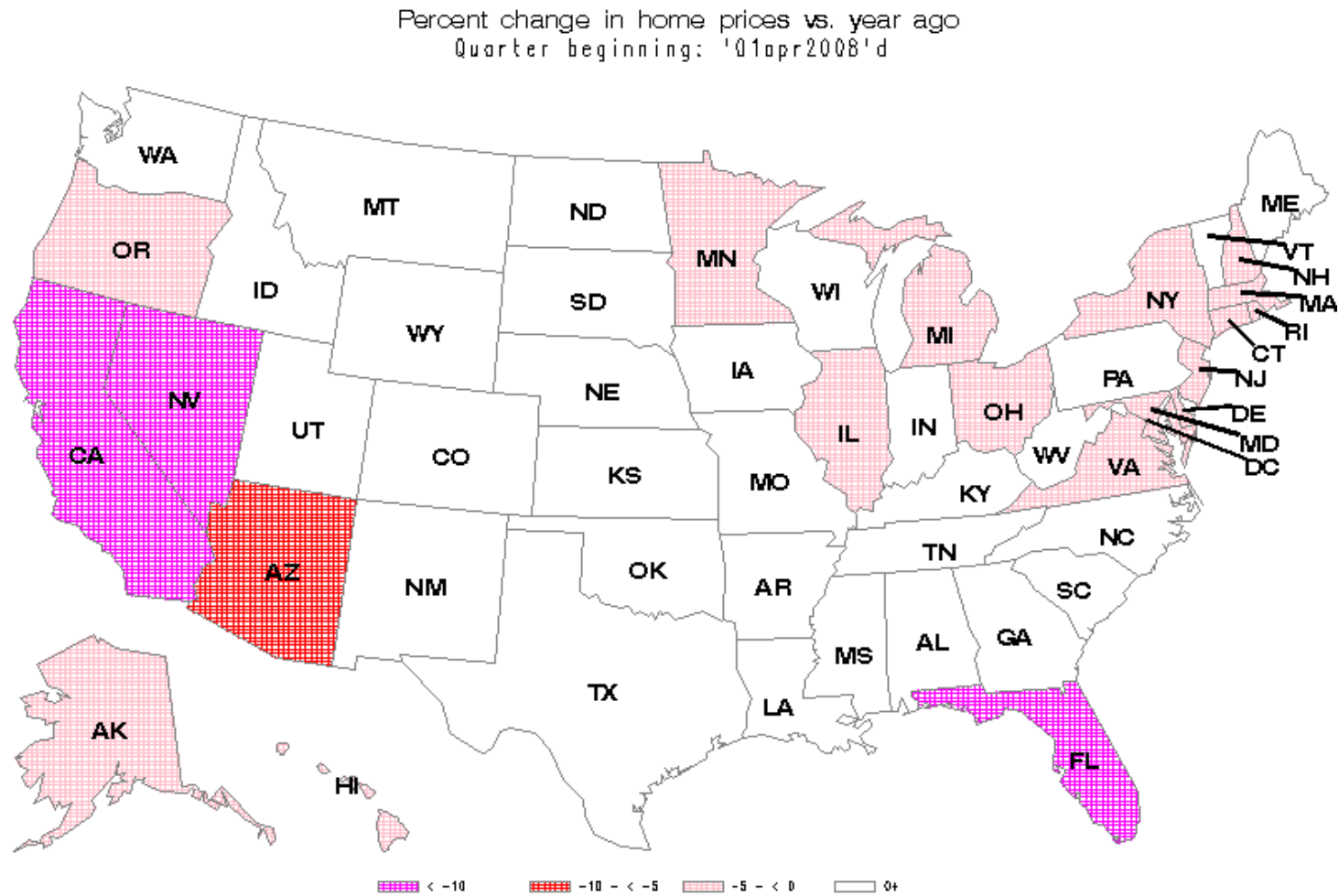
Two-thirds of states have declining economies – not yet as widespread as last recession



Typical declines not yet quite as sharp as in recent recessions



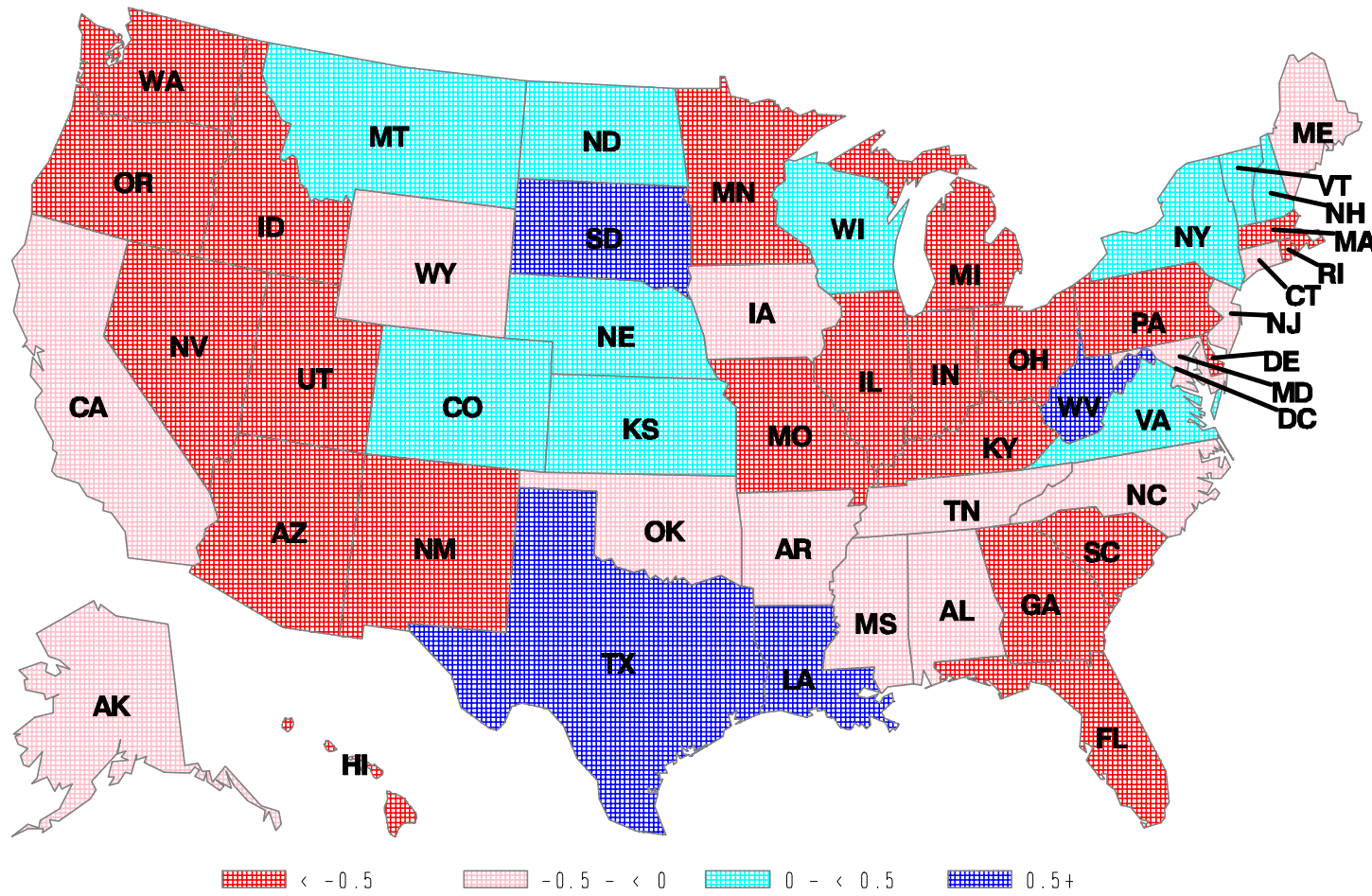
Economic decline (next map) has spread far beyond states with significant housing price declines (this map)



Source: Office of Federal Housing Enterprise Oversight

Growing states are mostly in the nation's middle and northeast. And that seems headed for change.

Percent change in state coincident economic index vs. 3 months earlier
Month beginning: '01aug2008'd



Source: Federal Reserve Bank of Philadelphia

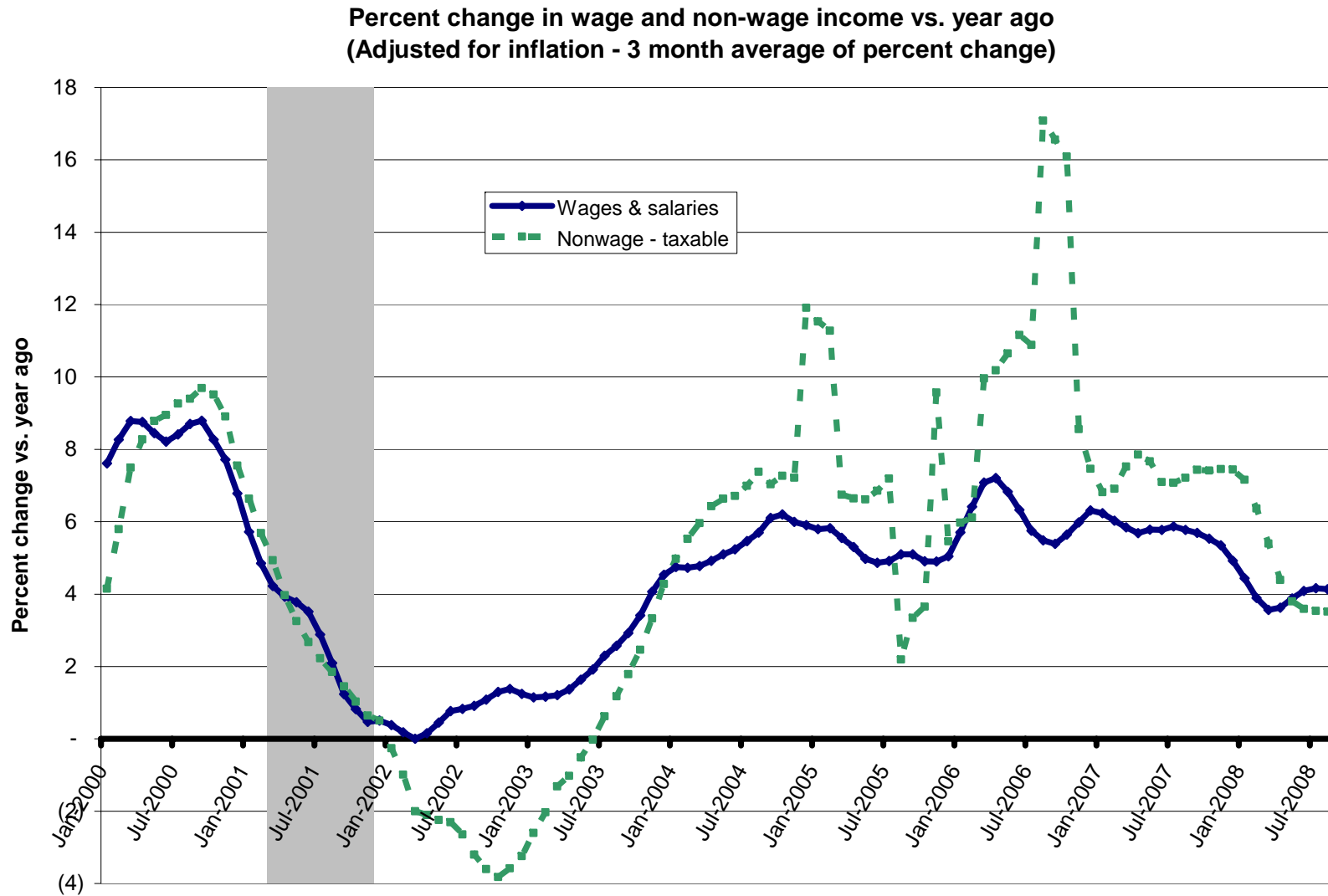
States ranked by 3-month change in economic activity

State indexes of economic activity
States are sorted by % change vs. 3 months ago

	Coincident index August 2008 (Jan 2007=100)	% change vs.			Coincident index August 2008 (Jan 2007=100)	% change vs.	
		1 year ago (August 2007)	3 months ago (May 2008)			1 year ago (August 2007)	3 months ago (May 2008)
West Virginia	102.5	2.6	2.2	Alaska	99.1	(0.7)	(0.4)
Louisiana	103.1	1.4	0.7	Maryland	101.2	0.2	(0.4)
Texas	106.1	3.4	0.6	Maine	99.4	(1.0)	(0.4)
South Dakota	104.8	2.7	0.6	North Carolina	102.4	0.5	(0.5)
North Dakota	102.6	1.4	0.5	Utah	103.0	0.6	(0.5)
New York	103.6	1.9	0.4	Florida	98.3	(1.6)	(0.5)
Colorado	104.2	1.9	0.4	New Mexico	102.1	0.6	(0.5)
New Hampshire	103.7	1.8	0.3	Indiana	100.2	(1.0)	(0.6)
Virginia	102.1	1.0	0.3	South Carolina	100.9	(1.0)	(0.6)
Kansas	101.5	(0.0)	0.2	Rhode Island	95.9	(3.2)	(0.6)
Nebraska	102.7	0.9	0.2	Delaware	98.5	(1.7)	(0.6)
Montana	102.1	(0.3)	0.1	Massachusetts	103.9	1.5	(0.7)
United States average	102.2	0.8	0.0	Hawaii	99.1	(0.8)	(0.8)
Vermont	100.5	(0.1)	0.0	Missouri	98.4	(1.9)	(0.8)
Wisconsin	100.9	0.3	0.0	Ohio	97.9	(2.3)	(0.9)
Tennessee	101.3	0.3	(0.0)	Georgia	100.4	(0.7)	(0.9)
Arkansas	101.7	1.3	(0.1)	Kentucky	100.2	(1.4)	(1.0)
Alabama	100.8	(0.2)	(0.1)	Illinois	100.1	(0.7)	(1.0)
Wyoming	105.1	3.1	(0.1)	Michigan	95.2	(4.0)	(1.0)
Connecticut	102.0	0.3	(0.2)	Washington	99.6	(2.9)	(1.1)
Mississippi	101.2	0.4	(0.2)	Arizona	98.0	(2.3)	(1.1)
California	101.4	0.4	(0.3)	Idaho	99.2	(2.2)	(1.2)
Oklahoma	103.1	1.2	(0.3)	Minnesota	98.9	(1.9)	(1.3)
New Jersey	101.0	0.1	(0.3)	Oregon	99.4	(2.0)	(1.3)
Iowa	101.7	0.5	(0.3)	Pennsylvania	97.7	(3.1)	(1.6)
				Nevada	95.8	(4.2)	(2.1)

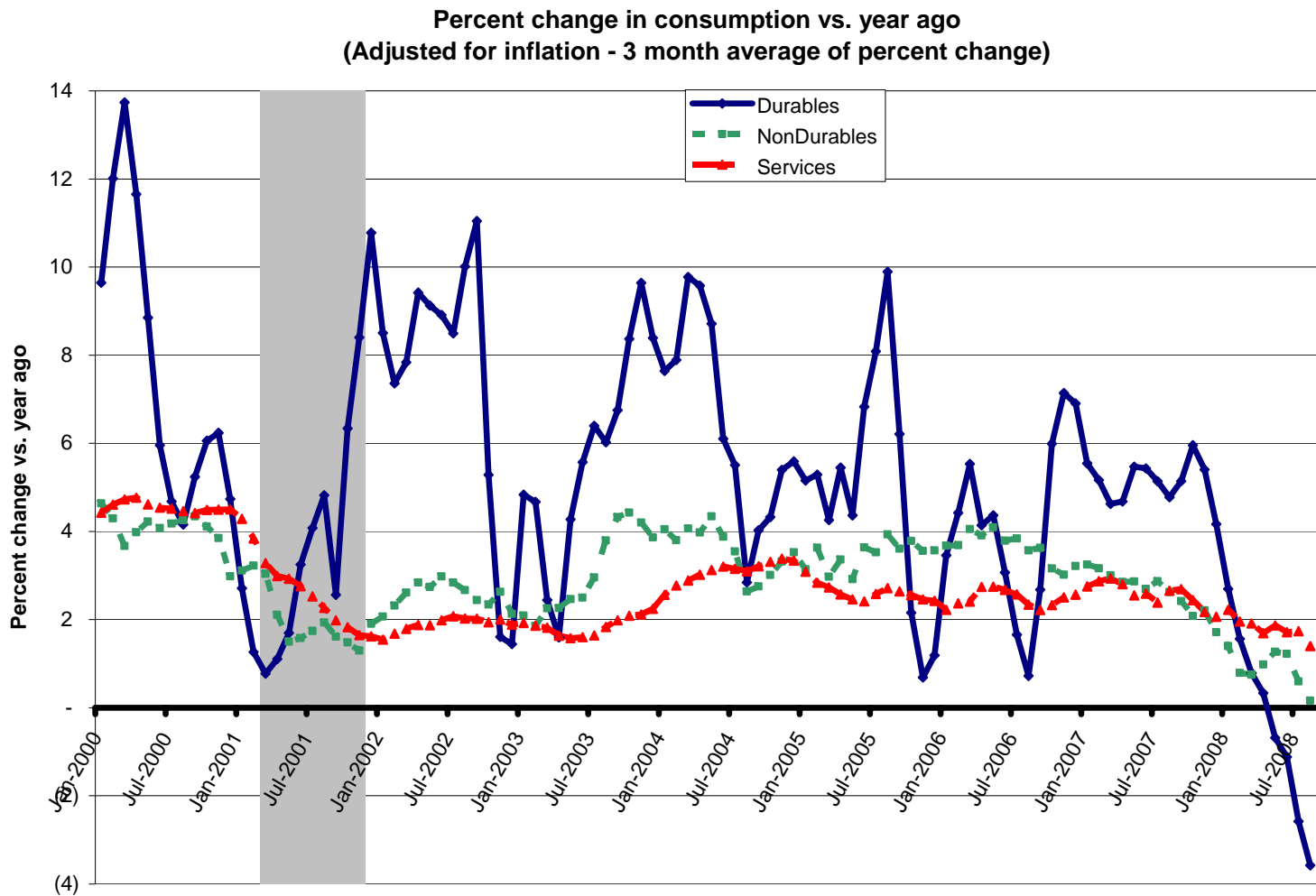
Source: Federal Reserve Bank of Philadelphia

Wages have slowed a little and nonwage income a lot, but they're not yet as weak as in last recession



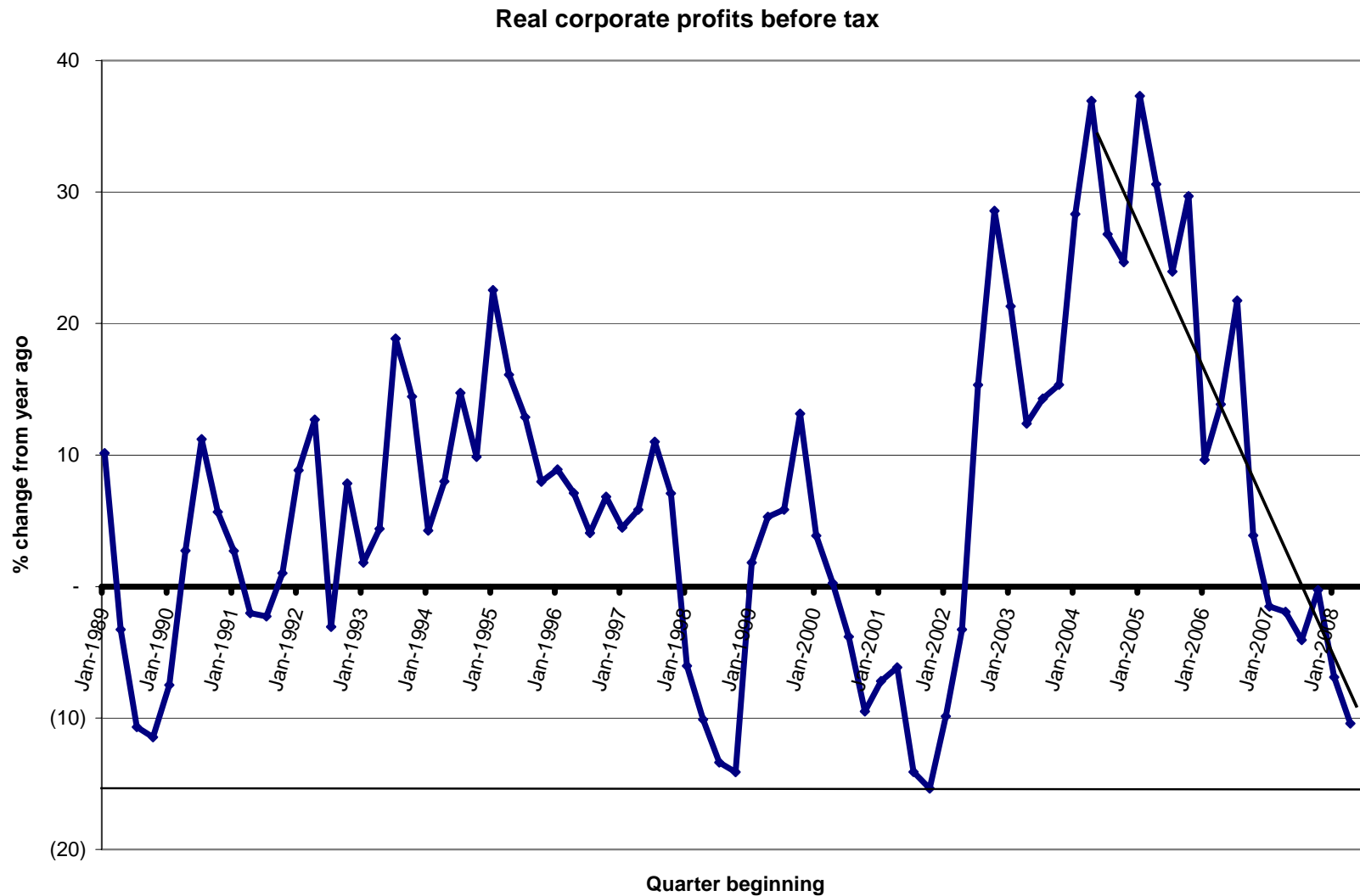
Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Tables 2.6 and 2.8.4

Goods consumption – weaker than last recession



Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Tables 2.6, 2.8.4.

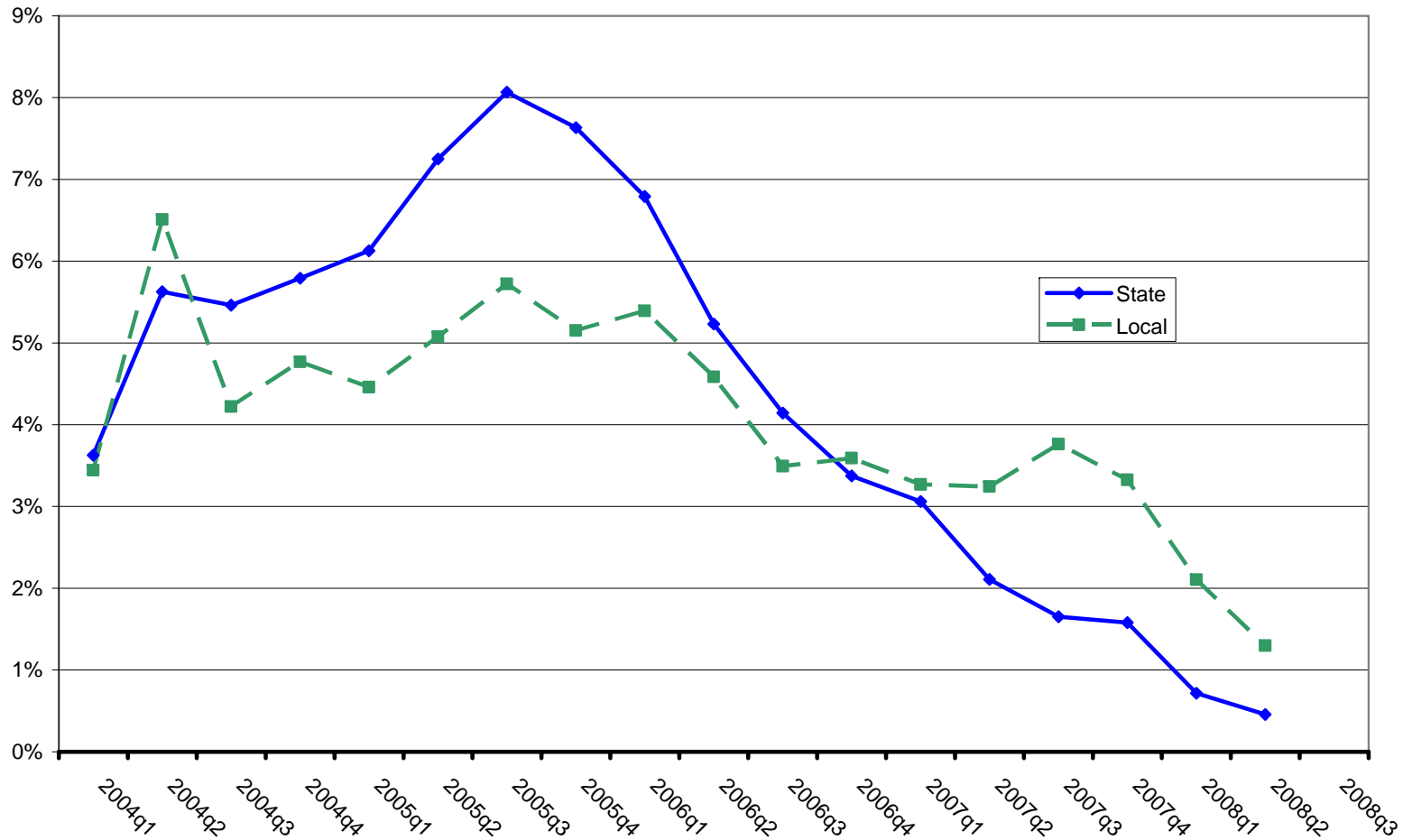
Corporate profits way down from peak growth, declining significantly



Source: Bureau of Economic Analysis (A053RC1 adjusted by B191RG3)

State taxes faring worse than local, but local taxes are slowing considerably

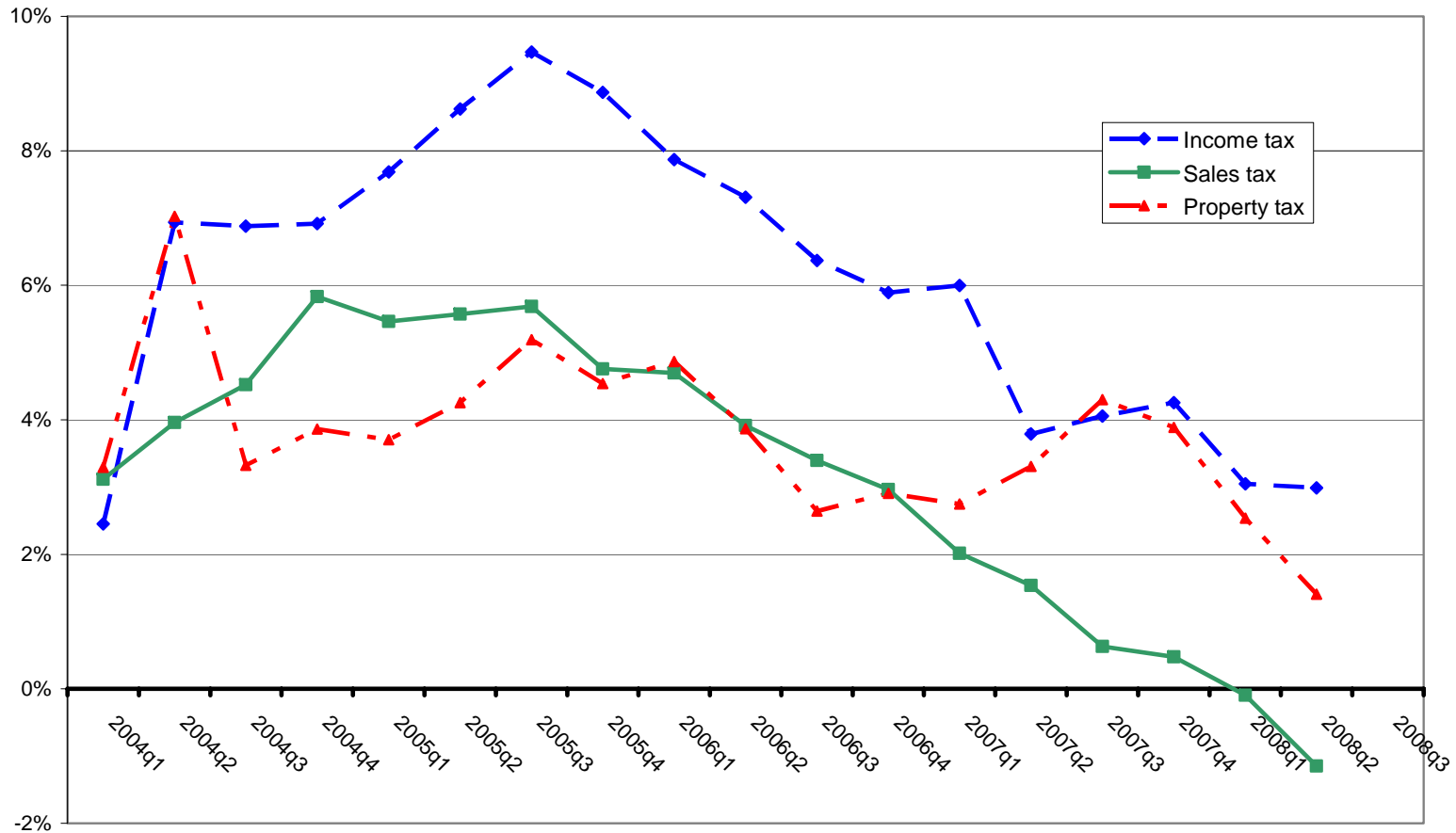
Year-over-year % change in real state taxes and local taxes
4-quarter average of % change



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

Income tax has slowed sharply, sales tax is declining, and even stable property tax is slowing

Year-over-year % change in real state & local taxes
4-quarter average of % change



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

April-June appeared much stronger than it was – strength from 2007 income tax returns

Quarterly Tax Revenue by Major Tax, by State
April-June, 2007 to 2008, Percent Change

	PIT	Corp income	Sales	Total		PIT	Corp income	Sales	Total
United States	6.6	(8.3)	(1.4)	3.6					
New England	7.7	(10.0)	0.7	3.3	Southeast	1.7	(11.9)	(4.7)	(2.6)
Connecticut	10.0	(16.4)	5.2	5.9	Alabama	1.8	(5.9)	(0.7)	1.1
Maine	8.9	(9.7)	2.0	10.8	Arkansas	6.6	(28.8)	(4.3)	0.8
Massachusetts	6.6	(7.5)	(1.9)	3.0	Florida	NA	(10.6)	(6.9)	(8.3)
New Hampshire	7.9	1.2	NA	4.8	Georgia	(3.9)	(26.4)	(8.3)	(6.5)
Rhode Island	7.8	(39.5)	(4.0)	(1.9)	Kentucky	27.6	(64.2)	0.5	2.4
Vermont	2.8	(0.0)	(3.6)	(6.2)	Louisiana	(2.2)	20.5	0.2	2.3
					Mississippi	5.8	(3.7)	(0.1)	1.8
Mid-Atlantic	14.2	(11.7)	1.8	6.7	North Carolina	0.9	(0.8)	(4.9)	(0.5)
Delaware	2.9	30.1	NA	1.5	South Carolina	(4.0)	16.3	(9.3)	(4.8)
Maryland	1.5	8.2	14.3	6.8	Tennessee	19.0	(7.5)	(1.5)	0.2
New Jersey	6.6	(7.5)	(1.9)	1.0	Virginia	(0.5)	5.5	(0.6)	(1.5)
New York	24.6	(28.1)	1.5	13.5	West Virginia	10.5	(27.1)	(7.7)	(0.7)
Pennsylvania	3.5	(10.6)	(0.4)	1.8	Southwest	(6.8)	(14.5)	1.4	12.8
Great Lakes	5.5	(14.1)	1.2	(0.3)	Arizona	(18.7)	(15.6)	(6.0)	(9.8)
Illinois	10.5	5.7	2.8	3.2	New Mexico	6.6	(7.5)	(1.9)	7.9
Indiana	5.9	(3.4)	11.6	3.8	Oklahoma	2.9	(17.9)	0.4	6.7
Michigan	12.7	(59.4)	(6.1)	(6.6)	Texas	NA	NA	3.7	21.5
Ohio	2.1	(30.3)	0.2	(0.0)	Rocky Mountain	0.0	2.9	(4.0)	0.8
Wisconsin	(2.2)	(0.8)	0.5	(2.6)	Colorado	3.2	(7.2)	(1.1)	1.9
Plains	5.6	0.1	(0.6)	4.3	Idaho	1.2	6.4	(6.1)	(0.7)
Iowa	5.8	13.1	5.7	8.1	Montana	(2.5)	7.4	NA	3.8
Kansas	4.0	(20.8)	(3.0)	(0.8)	Utah	(5.5)	13.0	(9.6)	(3.4)
Minnesota	8.2	23.1	0.0	5.4	Wyoming	NA	NA	8.5	5.7
Missouri	3.0	(6.0)	(2.9)	0.8	Far West	6.0	(0.4)	(2.7)	6.4
Nebraska	6.1	3.9	2.7	1.5	Alaska	NA	18.2	NA	136.0
North Dakota	(1.2)	11.0	8.2	38.7	California	5.6	(1.9)	(2.7)	2.0
South Dakota	NA	(28.0)	(16.6)	(10.1)	Hawaii	(6.0)	(2.8)	(3.0)	(4.4)
					Nevada	NA	NA	(4.8)	(4.5)
					Oregon	13.7	(5.7)	NA	8.5
					Washington	NA	NA	(1.9)	(2.0)

Source: Rockefeller Institute analysis of data from the U.S. Census Bureau.

Preliminary data for July-Sept show further setbacks – bad news in CA, northeast weakening

Preliminary Quarterly Tax Revenue by Major Tax, by State , to extent available as of 10/17/2008
July-September 2007 to 2008, Percent Change

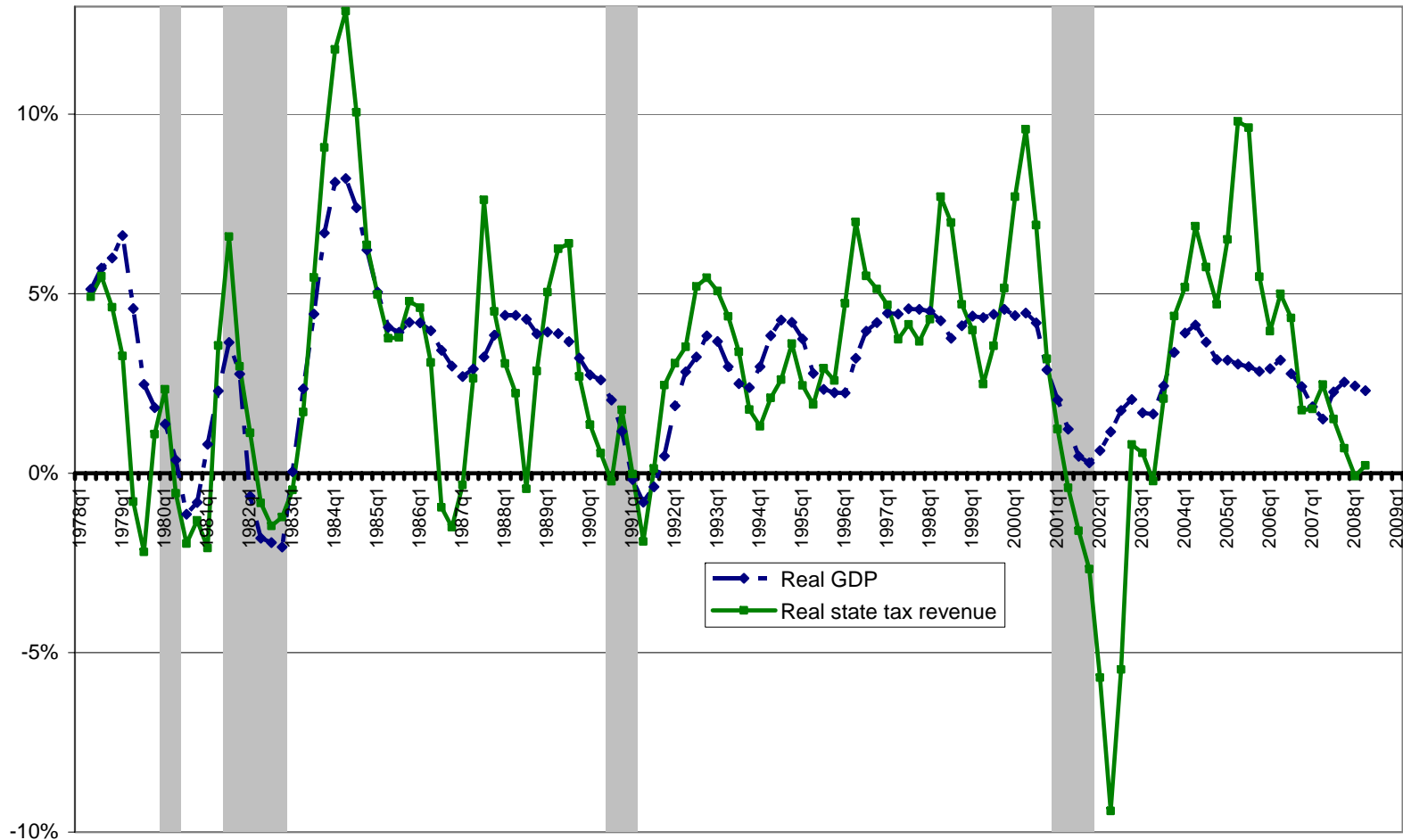
	PIT	Corp income	Sales	Total		PIT	Corp income	Sales	Total
United States	2.0	(19.6)	0.3	0.5					
New England	(6.7)	10.9	13.0	0.2	Southeast	0.6	(21.0)	(1.2)	(0.8)
Connecticut	(7.4)	18.9	21.0	1.6	Alabama	(0.4)	8.0	3.3	2.3
Maine					Arkansas	5.7	(10.7)	3.7	4.8
Massachusetts					Florida				
New Hampshire	NA	2.2	NA	(2.5)	Georgia	(2.4)	(6.8)	(3.1)	(2.6)
Rhode Island	(4.2)	12.6	(2.0)	(2.1)	Kentucky	6.6	(49.8)	1.6	0.4
Vermont					Louisiana				
					Mississippi	(1.9)	(14.6)	2.9	1.2
Mid Atlantic	3.6	(10.6)	1.5	2.2	North Carolina				
Delaware					South Carolina	0.2	(16.7)	(12.5)	(1.2)
Maryland					Tennessee	NA	(25.2)	(2.0)	(4.8)
New Jersey					Virginia				
New York	3.9	(12.0)	2.6	4.1	West Virginia	2.7	(38.4)	(4.5)	(1.5)
Pennsylvania	2.4	(7.8)	0.2	(2.1)	Southwest	(1.8)	8.8	5.2	4.6
					Arizona				
Great Lakes	5.7	(40.7)	1.6	3.2	New Mexico				
Illinois	3.7	1.5	2.5	2.7	Oklahoma	(1.8)	8.8	4.8	8.4
Indiana	(1.9)	(10.5)	2.7	(0.6)	Texas	NA	NA	5.2	4.0
Michigan	7.9	(107.6)	3.0	5.5	Rocky Mountain	(1.5)	5.1	(3.7)	(0.8)
Ohio					Colorado	5.0	(6.2)	(2.9)	1.7
Wisconsin	12.7	(15.7)	(6.0)	4.2	Idaho	(5.1)	(1.2)	(5.2)	(4.3)
					Montana				
Plains	4.1	(14.8)	2.6	1.8	Utah	(12.6)	23.2	(3.4)	(3.8)
Iowa	5.1	(6.1)	15.9	7.7	Wyoming	NA	NA	(5.5)	18.2
Kansas	2.3	(29.4)	1.8	0.8	Far West	0.4	(19.5)	(6.3)	(4.1)
Minnesota	5.7	(14.0)	(4.8)	0.0	Alaska				
Missouri					California	0.0	(19.6)	(6.3)	(4.5)
Nebraska	(1.7)	(8.5)	7.9	1.0	Hawaii				
North Dakota					Nevada				
South Dakota					Oregon	3.9	(18.3)	NA	2.4
					Washington				

Source: Individual state data, analysis by Rockefeller Institute

**History gives insights
about the future**

The last crisis was horrible for states despite the mild recession

Percent change in real state government taxes and real GDP vs. year ago
2-quarter moving averages

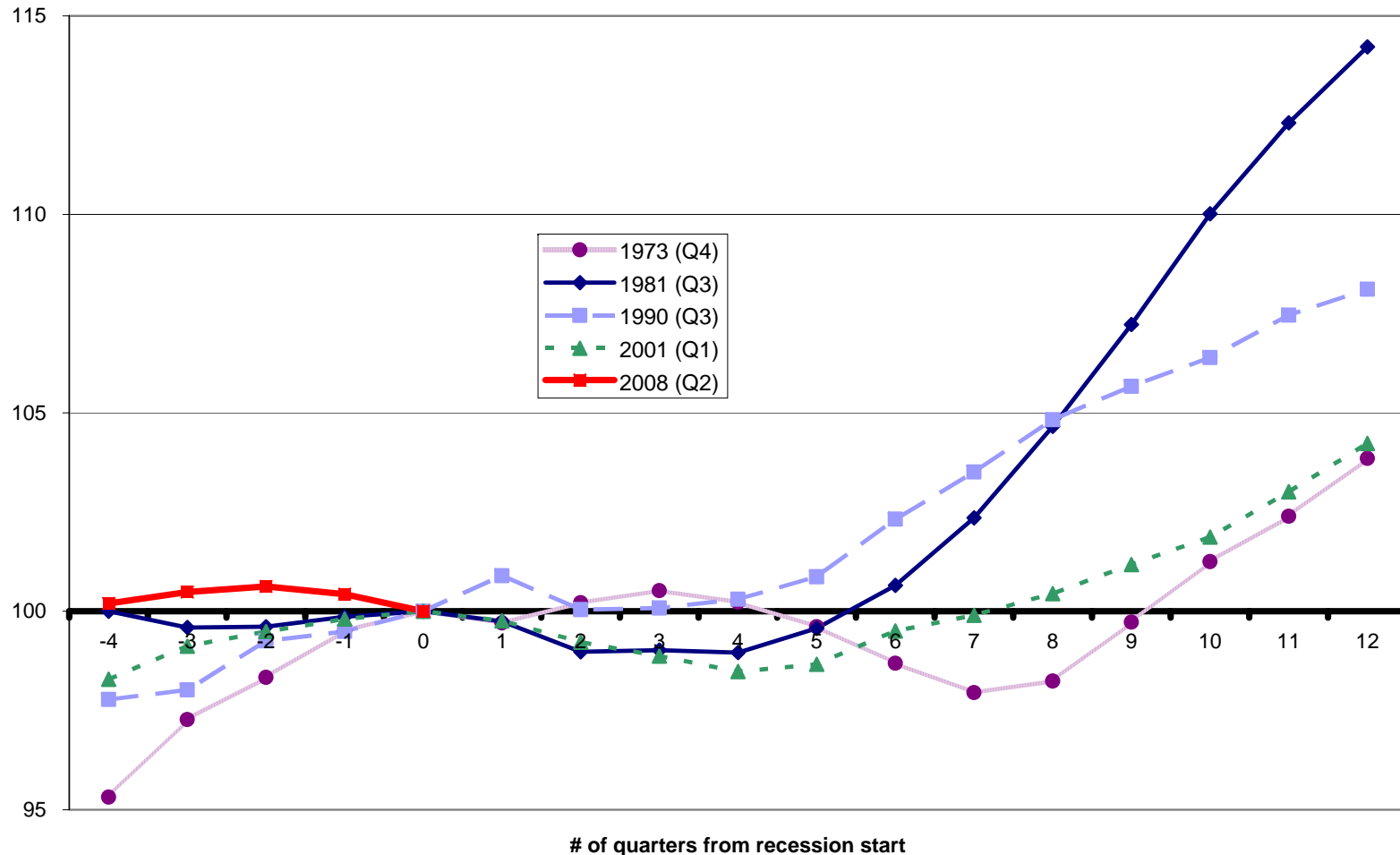


Sources: Census Bureau: Quarterly tax collections; Bureau of Economic Analysis: real GDP

Notes: (1) percentage changes averaged over 2 quarters; (2) No legislative adjustments; (3) Recession

Why was 2001 so bad? Not the sales tax - real decline was only about 1.5%

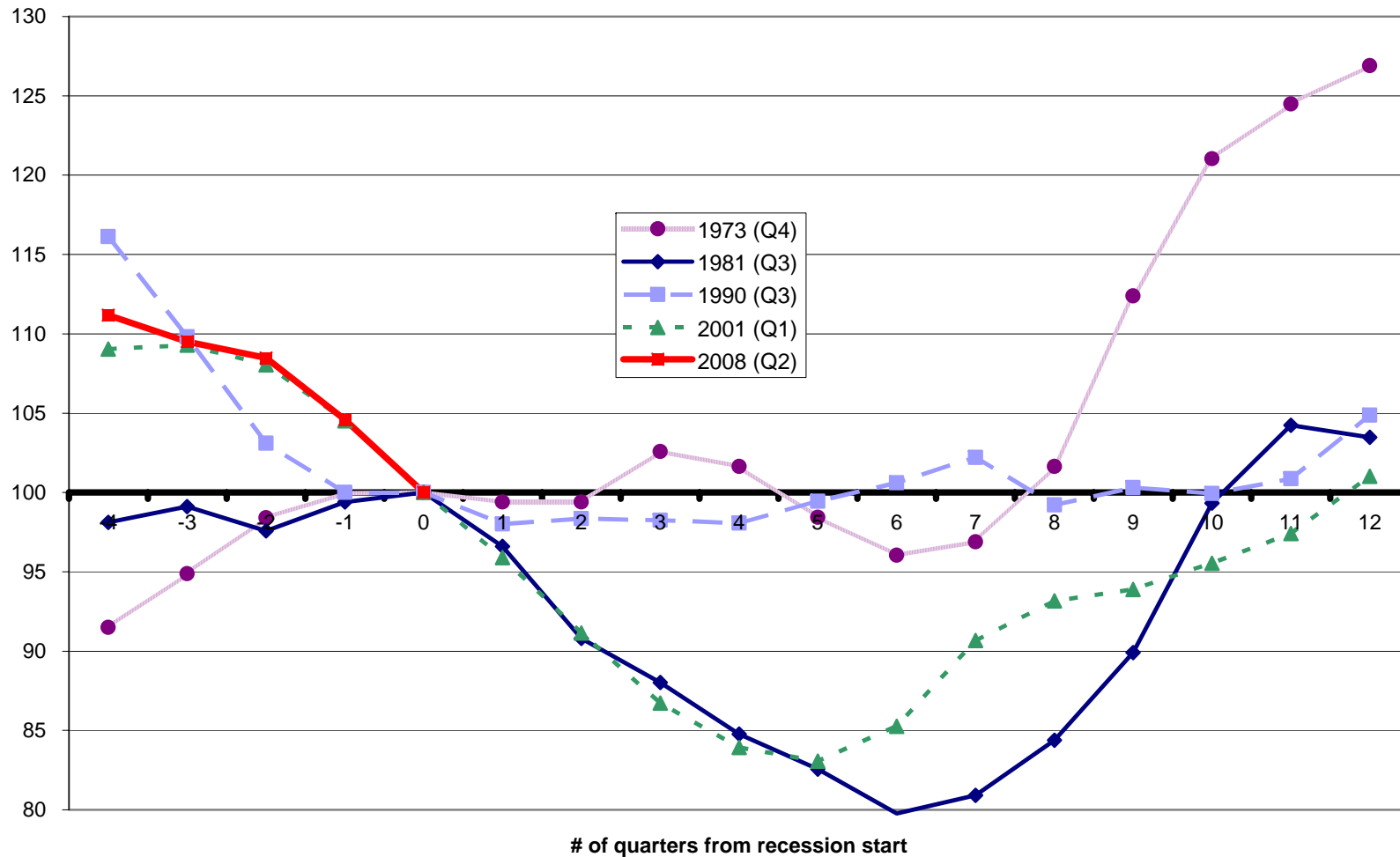
Real sales tax revenue indexed to start of recession (start=100)
4-quarter moving average



Sources: U.S. Bureau of Economic Analysis for real GDP, and tax revenue (NIPA Table 3.3). Tax revenue adjusted for inflation using GDP price index. Recession dates from NBER.

Not the corp tax – it declined sharply, but is only 6.5% of state tax revenue

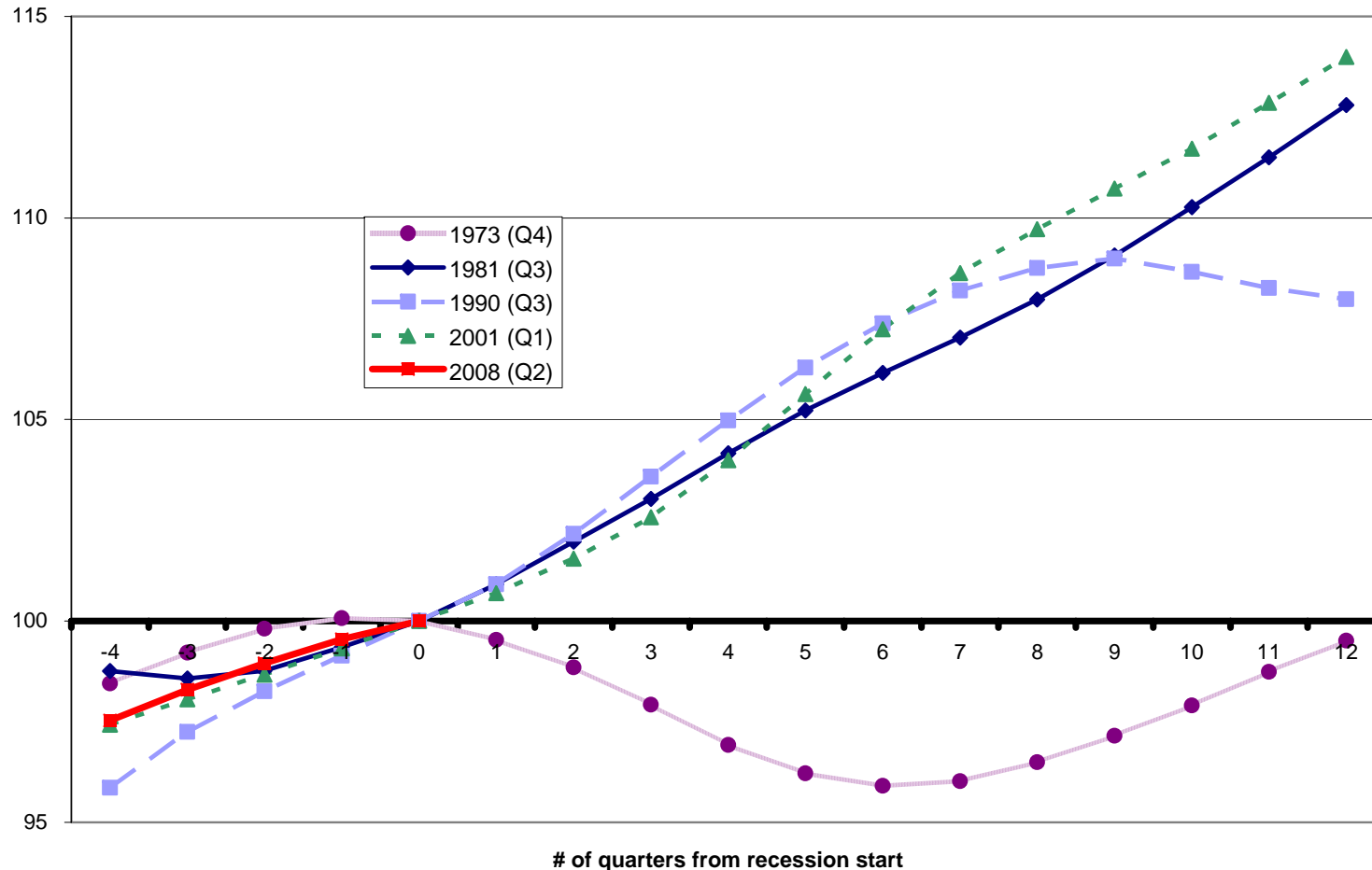
Real corporate income tax revenue indexed to start of recession (start=100)
4-quarter moving average



Sources: U.S. Bureau of Economic Analysis for real GDP, and tax revenue (NIPA Table 3.3). Tax revenue adjusted for inflation using GDP price index. Recession dates from NBER.

Not the property tax – it rarely declines and is tiny for states (but is of local interest)

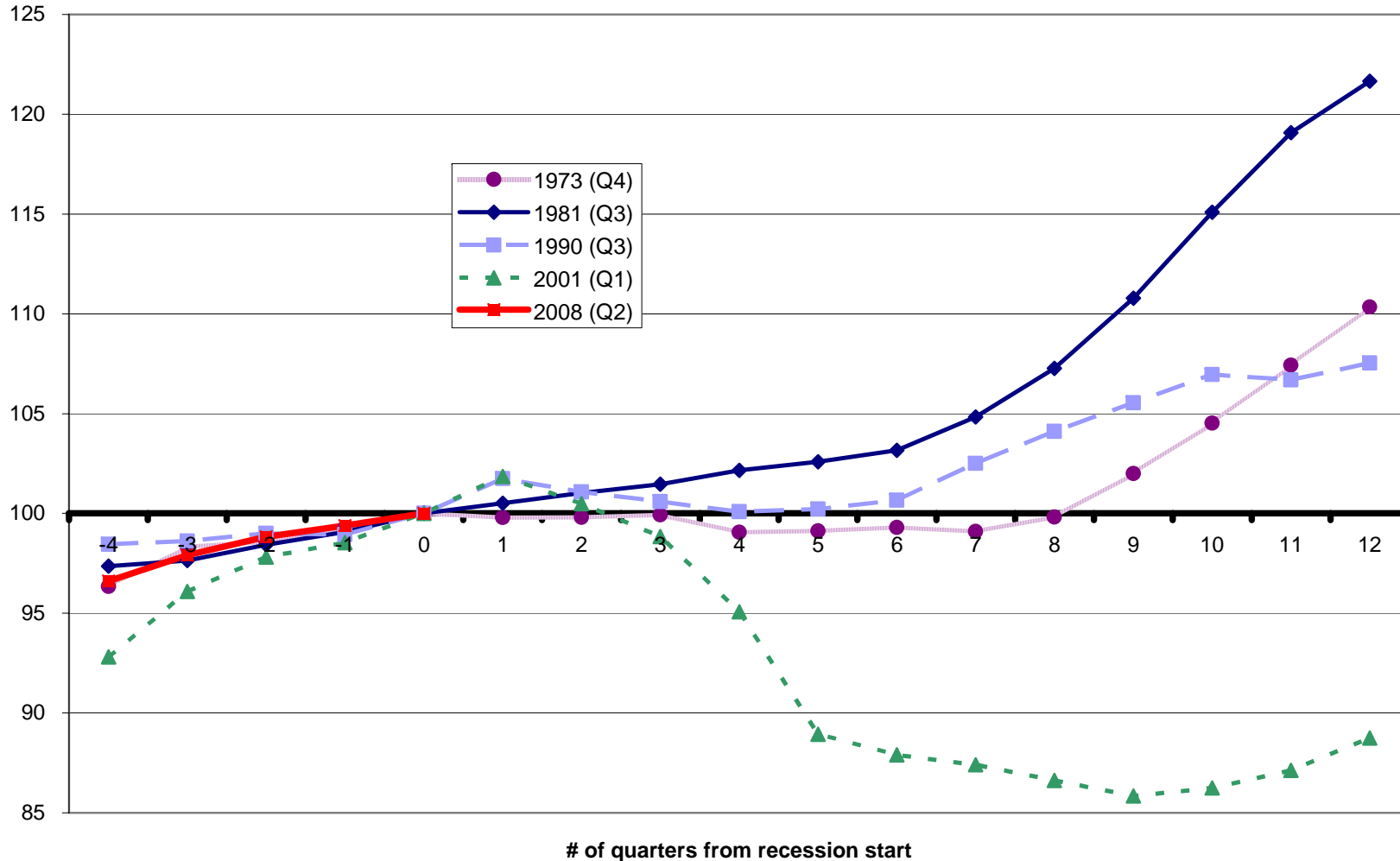
Real property tax revenue indexed to start of recession (start=100)
4-quarter moving average



Sources: U.S. Bureau of Economic Analysis for real GDP, and tax revenue (NIPA Table 3.3). Tax revenue adjusted for inflation using GDP price index. Recession dates from NBER.

But real income tax declined by about 15%!

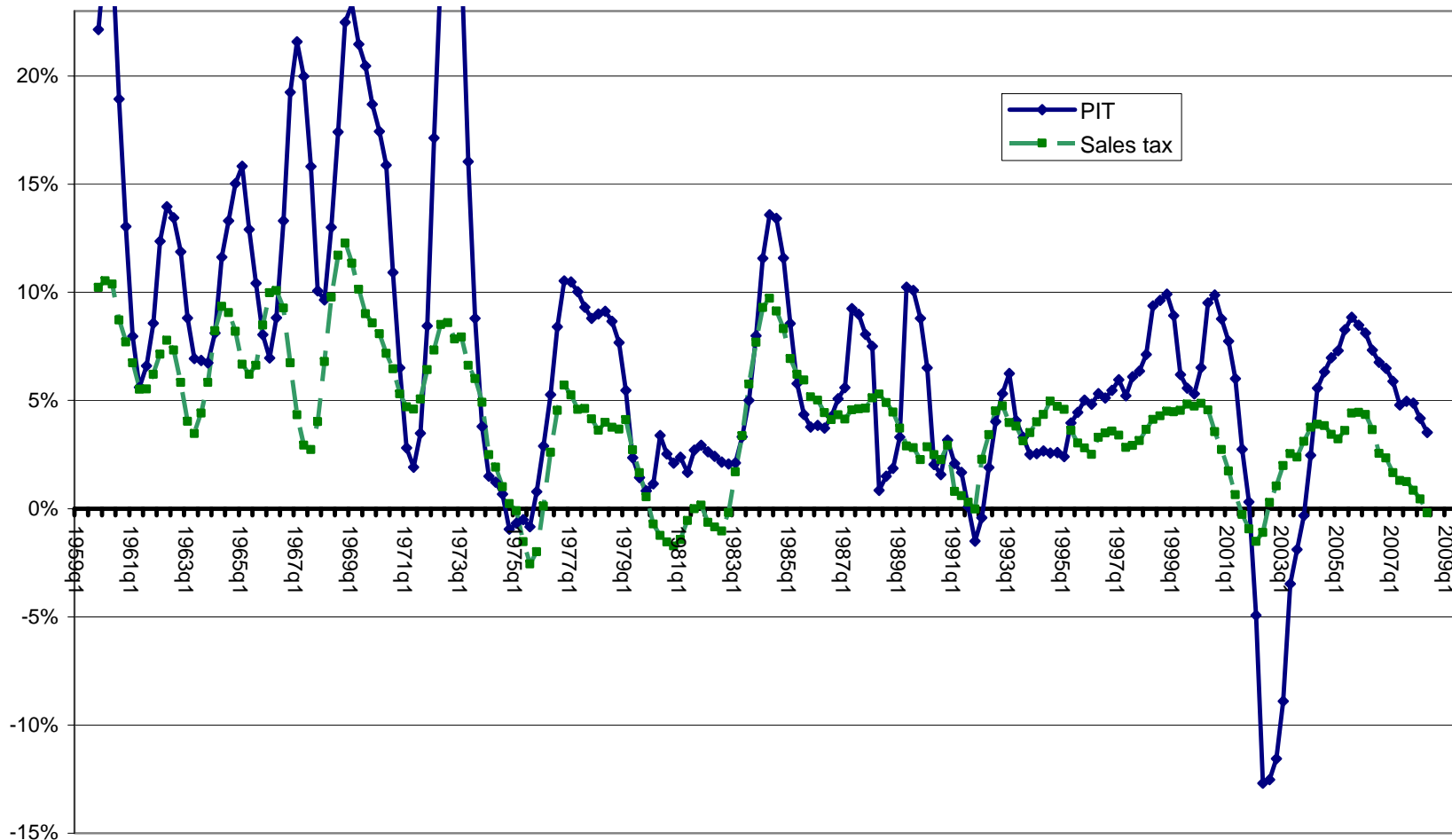
Real income tax revenue indexed to start of recession (start=100)
4-quarter moving average



Sources: U.S. Bureau of Economic Analysis for real GDP, and tax revenue (NIPA Table 3.3). Tax revenue adjusted for inflation using GDP price index. Recession dates from NBER.

Another perspective – worst by far in 50 years

50 years of inflation-adjusted income and sales tax growth
% change vs. prior year of 4-quarter moving average



Sources: U.S. Bureau of Economic Analysis for real GDP, and tax revenue (NIPA Table 3.3). Tax revenue adjusted for inflation using GDP price index.
NOTE: Some points are above the top of the vertical scale.

Why did the income tax
decline like this?

Astonishing 2-year declines in AGI: Capital gains declined; Even wages declined

Growth in components of federal adjusted gross income (AGI), taxable years

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Salaries & wages	7.0%	7.4%	6.5%	7.8%	2.4%	-0.1%	2.0%	5.8%	4.7%	6.1%
Net capital gains and distributions	41.4%	25.3%	21.7%	16.2%	-48.2%	-26.9%	23.3%	60.9%	41.0%	16.7%
All other AGI, net	10.2%	9.0%	8.3%	8.3%	0.0%	-3.4%	2.2%	10.3%	14.8%	11.4%
Adjusted gross income	9.6%	9.0%	8.1%	8.7%	-3.1%	-2.2%	2.9%	9.4%	9.3%	8.2%
% change in calendar-year-average										
S&P500 index	29.8%	24.2%	22.3%	6.7%	-16.5%	-16.6%	-2.1%	17.2%	6.5%	9.2%

Sources: (1) AGI components: IRS Statistics of Income Division (www.irs.gov/taxstats/indtaxstats), various data files;
(2) S&P500: average of monthly adjusted closes over the calendar year. Symbol ^GSPC from finance.yahoo.com

Wage declines were concentrated among top-bracket taxpayers – bonuses, stock options – driving people into lower brackets

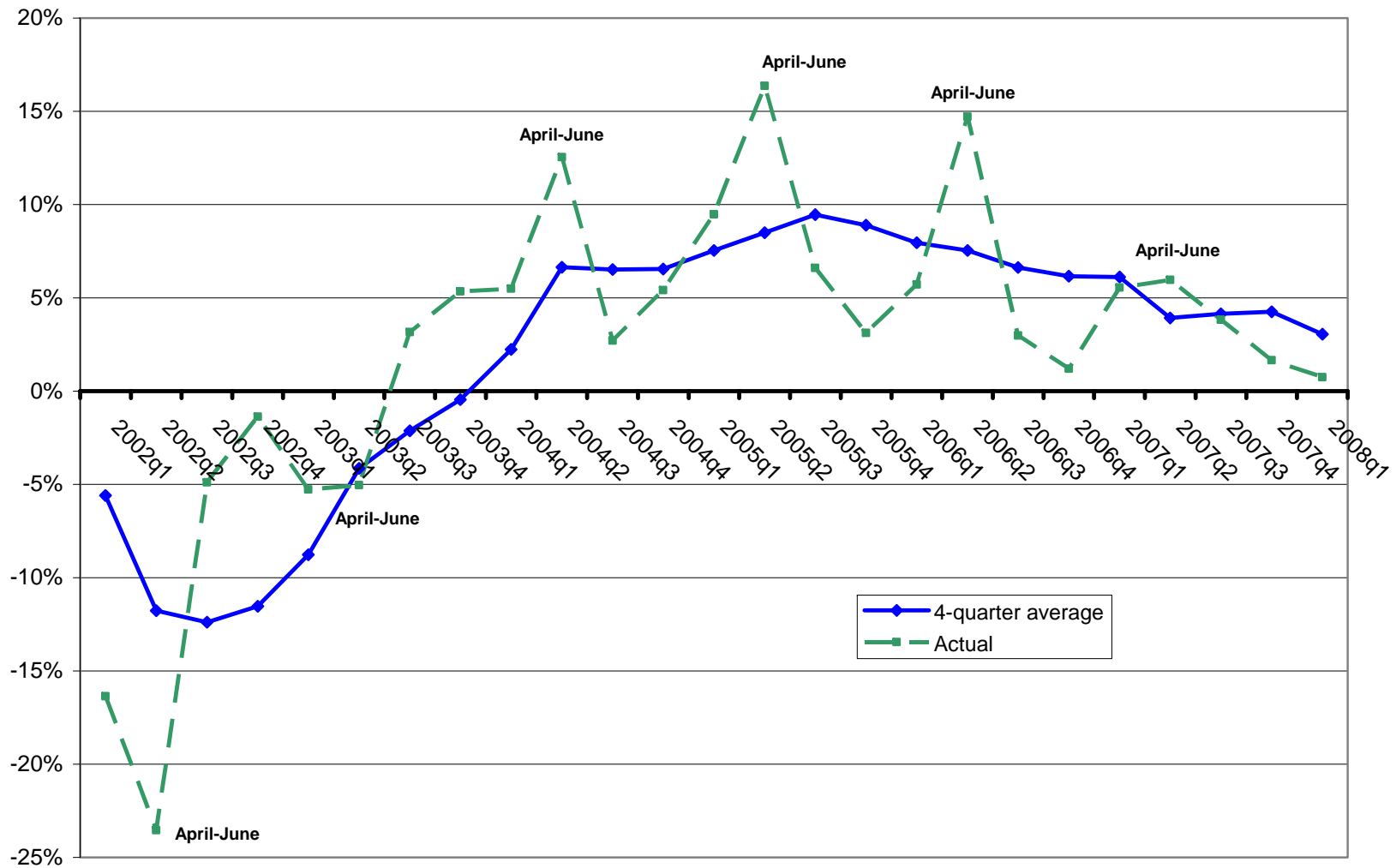
Wage income on federal tax returns before and during the last recession Year-over-year percent change

	2000	2001	2002
Total wages on tax returns:			
All returns with wage income	7.8%	2.4%	-0.1%
Returns with AGI below \$200k	5.5%	4.5%	1.4%
Returns with AGI of \$200k or more	20.5%	-7.7%	-8.7%
Returns with AGI of \$500k or more	26.1%	-17.1%	-13.7%
Number of tax returns reporting wage income:			
All returns with wage income	1.8%	1.0%	-0.3%
Returns with AGI below \$200k	1.6%	1.1%	-0.1%
Returns with AGI of \$200k or more	14.1%	-5.3%	-5.9%
Returns with AGI of \$500k or more	14.3%	-12.5%	-7.5%

Source: IRS Statistics of Income Division (www.irs.gov/taxstats/indtaxstats), various data files

April-June – Important for income taxes

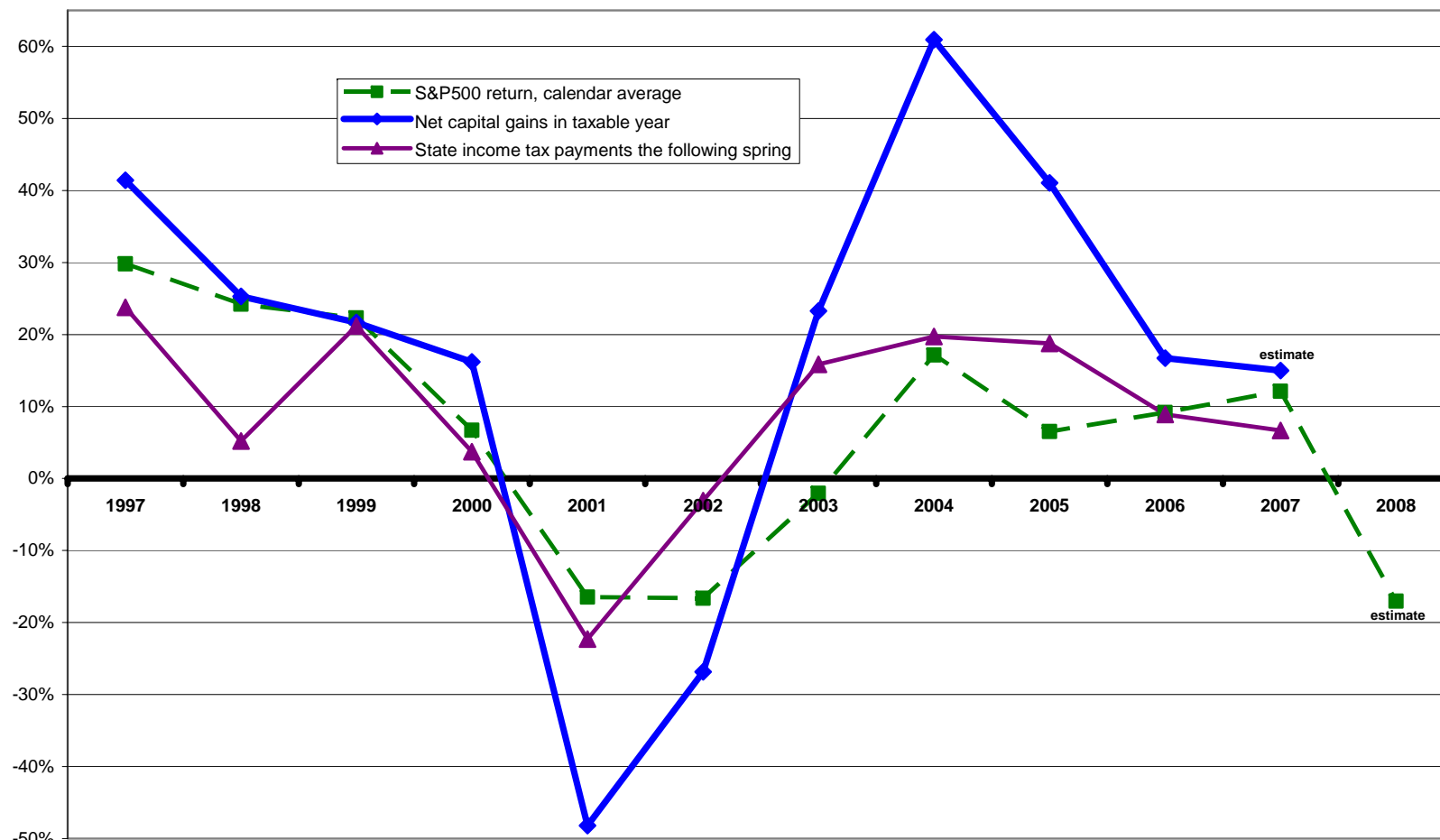
Year-over-year % change in real state income taxes



Source: Census Bureau: Quarterly tax collections; Bureau of Economic Analysis: GDP price index

Stock market decline led to gains declines, and huge (atypically large) drop in income tax the following spring

S&P500 returns, Capital gains reported on federal tax returns, and State income tax payments
Year-over-year percent change

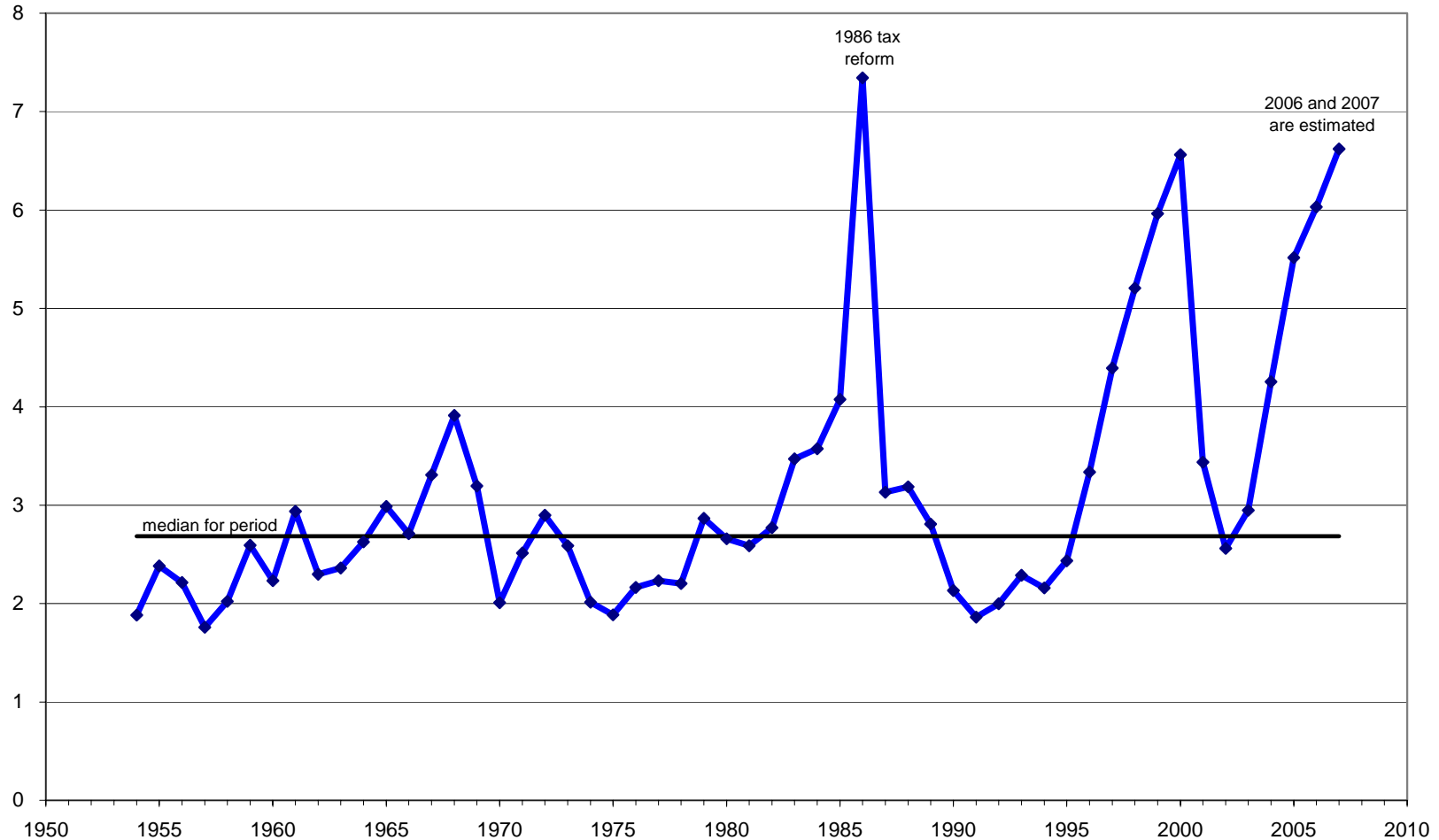


Sources: (1) S&P500: average of monthly adjusted closes over the calendar year. Symbol ^GSPC from finance.yahoo.com. Estimate for 2008 assumes September 30 value for rest of year;
 (2) Capital gains: IRS Statistics of Income Division (www.irs.gov/taxstats/indtaxstats), various data files. Estimate for 2007 assumes 15% growth;
 (3) State income tax revenue from U.S. Bureau of the Census

**Could the 2001 bust
happen again?**

Capital gains again are at a dizzying height from which to fall

Capital gains as % of gross domestic product



Sources: (1) Capital gains: 1954-1998: Table capgain1-2001.pdf from IRS Statistics of Income web site (www.irs.gov/taxstats); 1999-2005 various SOI files; 2006 based on preliminary data; 2007 based on estimates from individual states; (2) Gross domestic product from U.S. Bureau of Economic Analysis

State concentration in finance and insurance

Share of gross domestic product in the finance and insurance industry in 2007

	<i>United States total</i>	<i>8.1</i>		
Delaware	32.5		Missouri	5.9
South Dakota	19.6		Colorado	5.9
New York	17.9		Vermont	5.9
Connecticut	16.5		Tennessee	5.8
North Carolina	12.7		Maryland	5.7
Rhode Island	12.1		North Dakota	5.7
Iowa	10.7		Texas	5.7
Massachusetts	10.6		Kansas	5.6
Illinois	9.5		Washington	5.4
Utah	9.4		Alabama	5.4
Minnesota	9.4		Indiana	5.4
Nebraska	8.4		Oregon	5.2
Arizona	8.4		South Carolina	5.0
New Jersey	8.3		Montana	4.9
Ohio	8.1		Idaho	4.7
New Hampshire	8.1		Kentucky	4.7
Pennsylvania	7.5		Oklahoma	4.2
Nevada	7.3		Mississippi	4.2
Florida	7.1		Hawaii	4.0
Wisconsin	6.9		Arkansas	4.0
California	6.6		West Virginia	4.0
Maine	6.6		New Mexico	3.2
Georgia	6.5		Louisiana	3.1
Virginia	6.5		Alaska	2.8
Michigan	6.1		Wyoming	2.4

Source: Bureau of Economic Analysis, Gross Domestic Product By State

Preconditions for a big bust – possibly worse than 2001 – appear to exist

- Two-year outlook for capital gains is dismal:
 - Capital gains again at an all-time high
 - Stock market decline may be as bad or worse as last time, so large capital gains decline in 2008 seems likely
 - Gains likely to decline again in 2009: even if stock market recovers 10% by January, calendar-year average S&P500 in 2009 would be nearly 20% below 2008 average!
- Loss of wages in highly paid financial sector appears likely to be large – top end of wage distribution could fall again
- Forecasters expect real economy to be worse than last time – and consumption and sales taxes already doing worse