

THE NELSON A.
ROCKEFELLER
INSTITUTE
OF GOVERNMENT

The Fiscal Environment & State Tax Reform

**The New Normal: Government
Working More Efficiently**

Session:

***Tough Times: Case Studies of
States Doing More With Less***

**A Conference of the Pew
Center on the States**

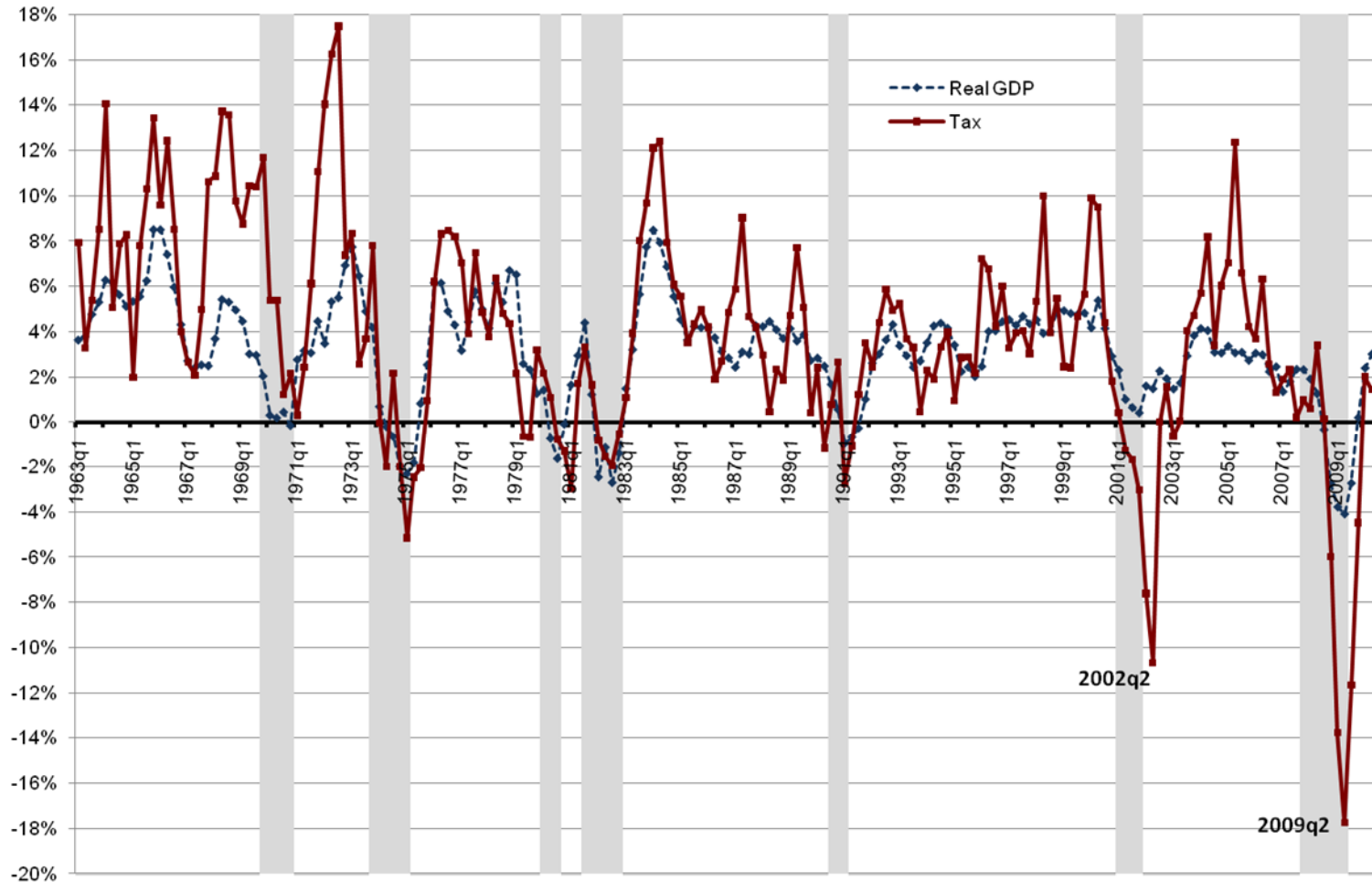
*Omni Austin Hotel Downtown, Austin, TX
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Worst state government tax declines in 5+ decades

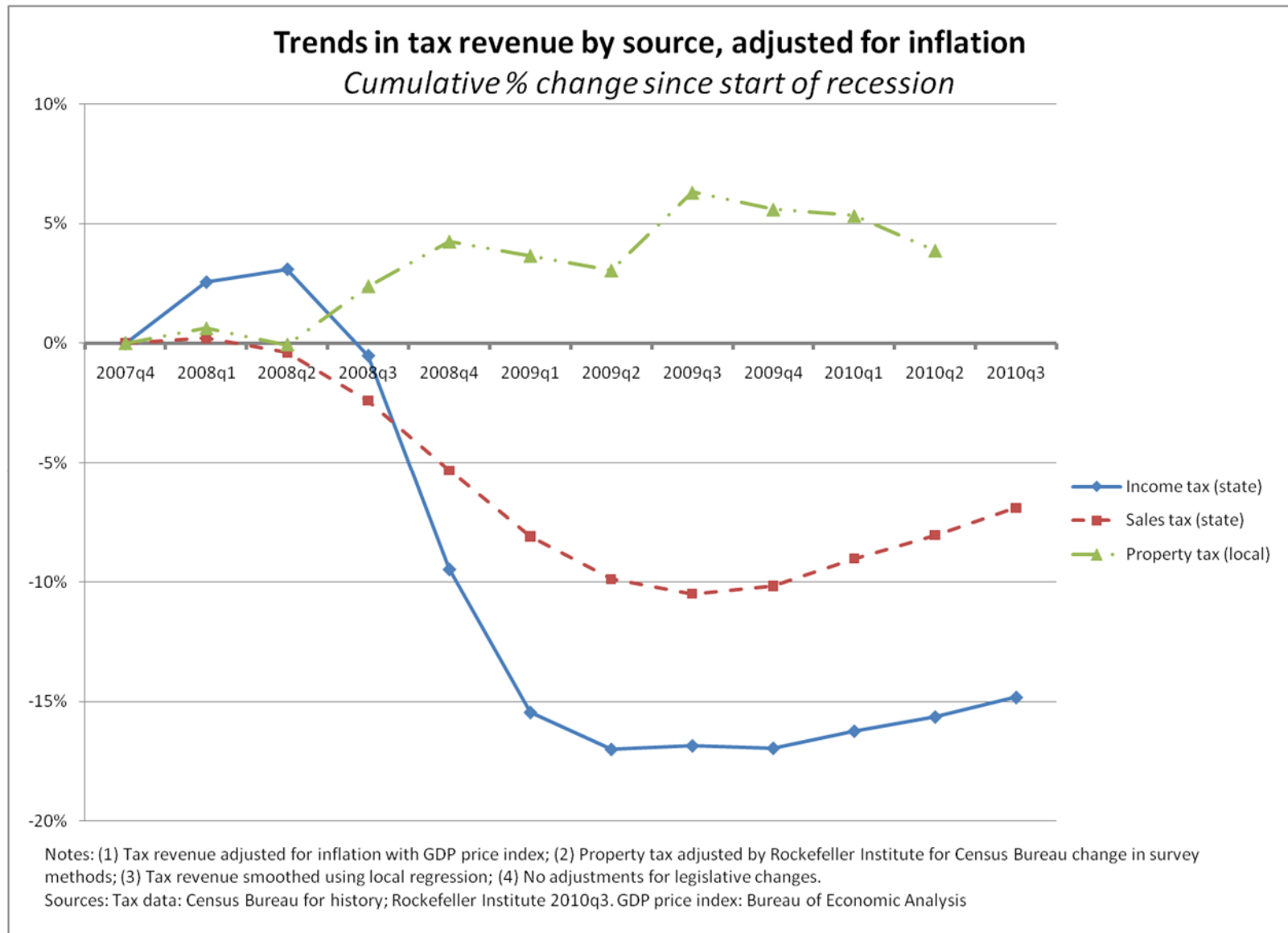
- worse than 2001 recession, worse than economy suggests -

Real state government taxes and real GDP
- % change vs. year ago -



Sources: Taxes: Census Bureau with Rockefeller Institute adjustment for 2010q2. Real GDP, and GDP price index: Bureau of Economic Analysis
Notes: (1) Tax revenue adjusted for inflation using GDP price index; (2) No legislative adjustments; (3) Recession periods are shaded.

Sales & PIT recovering but way below pre-recession peak Property tax appears to be weakening



Nominal state tax revenue in 48 states is lower than two years earlier– much lower, in most states

Percent change in state government tax revenue			
<i>Year ending June 2010 vs. two years earlier</i>			
	Sum of states	-10.8%	
Alaska	-41.4%	Maryland	-9.7%
Louisiana	-20.9%	Massachusetts	-9.7%
New Mexico	-19.4%	California	-9.4%
Georgia	-19.4%	Tennessee	-9.2%
Idaho	-19.2%	Indiana	-8.8%
Arizona	-18.8%	New York	-8.6%
South Carolina	-18.2%	Mississippi	-7.1%
Utah	-16.6%	Kansas	-7.1%
Ohio	-16.5%	Rhode Island	-6.9%
Oklahoma	-16.4%	Minnesota	-6.1%
Colorado	-16.0%	Kentucky	-5.9%
Connecticut	-15.7%	North Carolina	-5.7%
Illinois	-14.6%	Hawaii	-5.4%
New Jersey	-14.0%	New Hampshire	-5.2%
Texas	-13.8%	Maine	-5.2%
Wyoming	-13.8%	Pennsylvania	-5.0%
Montana	-12.8%	West Virginia	-4.6%
Nebraska	-11.3%	Arkansas	-3.8%
Virginia	-11.3%	Iowa	-2.8%
Missouri	-11.2%	Vermont	-2.3%
Alabama	-10.8%	Wisconsin	-2.2%
Michigan	-10.7%	Oregon	-1.2%
Florida	-10.6%	South Dakota	-0.7%
Washington	-10.6%	Nevada	0.7%
Delaware	-10.2%	North Dakota	14.4%
Source: U.S. Bureau of the Census and Rockefeller Institute of Government			

Note: Although Nevada's 2010 tax revenue was above 2008, it was below 2007 and barely above 2006.

Outlook

- State *revenue* crisis is ending, but *fiscal* crisis continues.
- Slow economic recovery means revenue growth likely to be modest.
- Lagged spending pressure from Medicaid and pensions
- “Cliff”: Temporary federal aid to decline by \$66b in FY 2012.
- Most state budgets far from balanced on recurring basis. Many larded up with gimmicks. CA \$19b plan was 2/3 temporary. IL delaying bill payments.
- Many local gov'ts hurting, more pain to come as property taxes weaken and state aid is cut.
- A good environment for tax reform?

Commonly accepted principles of taxation and tax reform

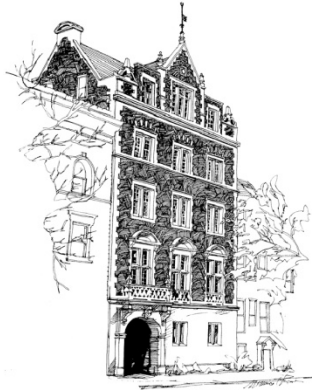
- *Adequacy* – sufficiency, stability
- *Equity* – horizontal, vertical
- *Economic impact* – minimize distortion
- *Costs* - easy to comply with & administer
- *A system* - Must consider whole system – state-local, all major sources
- Economists' mantra - Repeat:
Broad base, low rates, broad base, low rates,
broad base, low rates, broad base, low rates,
broad base, low rates, BBLR, BBLR, ...

Unfortunately, principles often conflict with each other!

- Steeply progressive income tax may meet some policymakers' equity goals, but it is volatile and high marginal rates are distortionary
- Sales tax on food and services may be stable and less-distortionary, but will violate some policymakers' equity goals
- Crucial to think about system as a whole. Problematic individual options can work together as part of a larger package – e.g., sales tax on food plus low-income credit?

Practical considerations

- Are packages that create winners and losers harder to enact than those that create just winners or just losers?
- Having your ducks in a row
 - Good rationale – *why* we are doing this
 - Good analysis – who is affected and how
 - Public information campaign
 - No policy surprises – tax reform is complex
- Small steps or throw all balls up in the air?
Fiscal strategy vs. political strategy
- Persistence – tax reform often takes many years, multiple false starts



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