

THE NELSON A.
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The State of The States

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Lucy Dadayan
Senior Policy Analyst
ldadayan@albany.edu

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Overview

- State fiscal challenges
- Slow economic recovery
- Slower tax revenue recovery
 - Oil & coal states hit hard
 - Growing reliance on sin taxes
- Growing revenue volatility & fiscal challenges
- Fiscal reality & outlook

State fiscal challenges

- Great Recession far worse than past recessions
- Variables that drive revenue hit harder than broader economy, harder than before
- Revenue recovery is very slow
- State inflation-adjusted tax revenue is still below pre-recession in half of the states
- Longer-term spending pressures loom
- Employment and wage recovery is very slow
- Major cuts in government employment
- Growing pension liabilities
- Growing Medicaid costs due to higher recession-related enrollment

Slow economic recovery

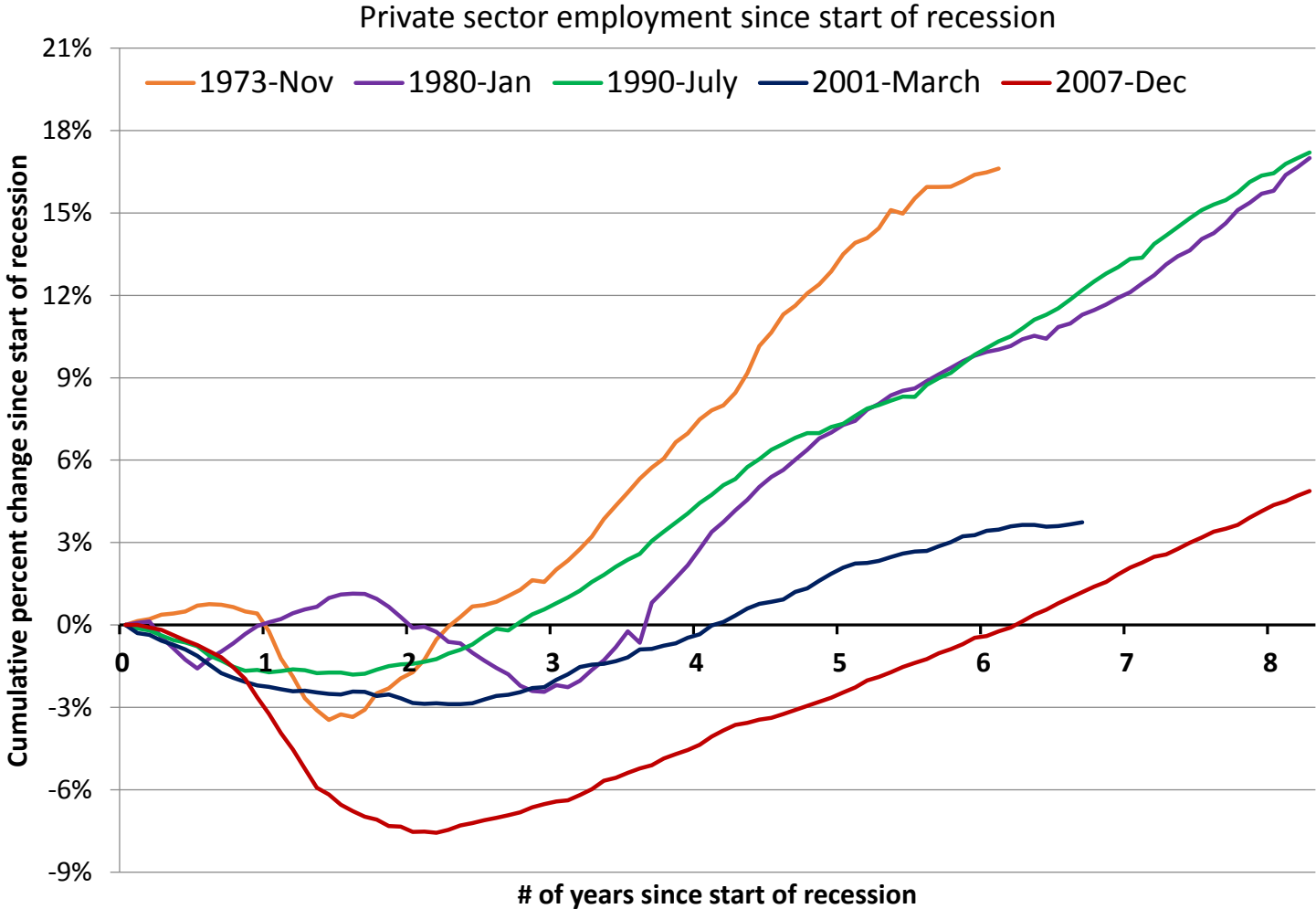
- Employment trends
 - Slow recovery for private sector employment
 - Deep cuts in state-local gov't jobs
- Personal income trends
 - Slower growth in wages & salaries than in prior recoveries
 - Large declines in interest/dividend income
 - Changing nature of personal savings
- Retail sales
 - Weak and slow recovery
- Goods and services
 - Slow recovery in services and non-durable goods
 - High volatility in durable goods

The impact of the Great Recession on employment: dire picture for government emp.

Employment Sector	Employment (thousands)			Recession peak date	Percent change	
	Mar-16	Dec-07	Peak emp		March 2016 vs Dec 2007	March 2016 vs Peak
Total nonfarm	143,774	138,413	138,432	Jan-08	3.9	3.9
Total private	121,692	116,037	116,044	Jan-08	4.9	4.9
State and local government	19,312	19,620	19,824	Aug-08	(1.6)	(2.6)
State government	5,100	5,139	5,214	Aug-08	(0.8)	(2.2)
State gov education	2,432	2,327	2,383	Aug-08	4.5	2.0
State gov, non-education	2,668	2,812	2,830	Aug-08	(5.1)	(5.7)
Local government	14,212	14,481	14,610	Jul-08	(1.9)	(2.7)
Local gov education	7,820	8,055	8,119	Jul-08	(2.9)	(3.7)
Local gov, non-education	6,392	6,426	6,507	Dec-08	(0.5)	(1.8)

Source: U.S. Bureau of Labor Statistics, Current Employment Statistics (seasonally adjusted).

Private sector employment recovery much slower compared to past recoveries

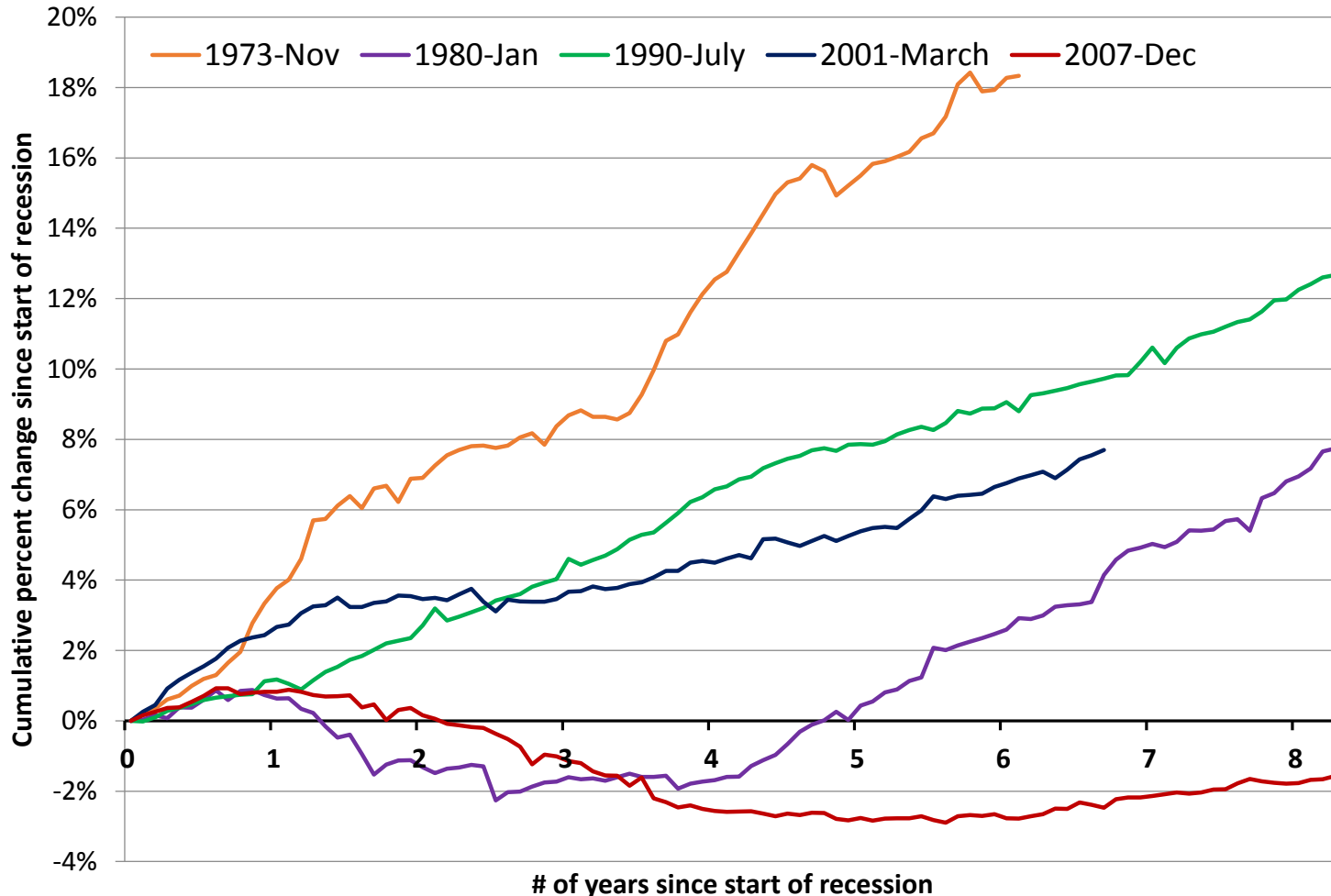


Source: U.S. Bureau of Labor Statistics (CES, seasonally adjusted).

Notes: Data are shown only until the start of the next recession; 1980 & 1981 recessions treated as single recession.

Deep cuts in state-local gov't jobs; deeper than any other recession in the last 50 years

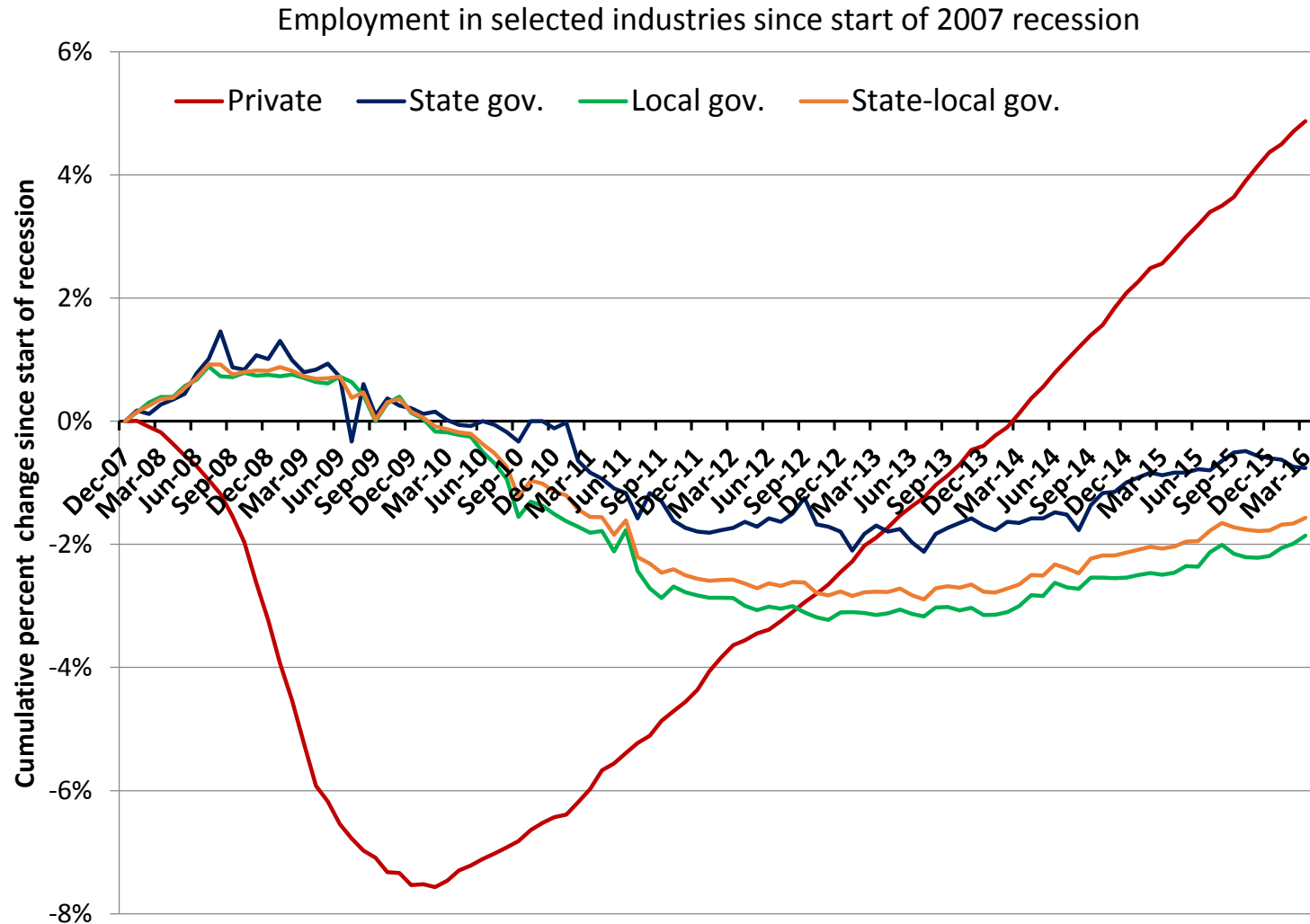
State and local government employment since start of recession



Source: U.S. Bureau of Labor Statistics (CES, seasonally adjusted).

Notes: Data are shown only until the start of the next recession; 1980 & 1981 recessions treated as single recession.

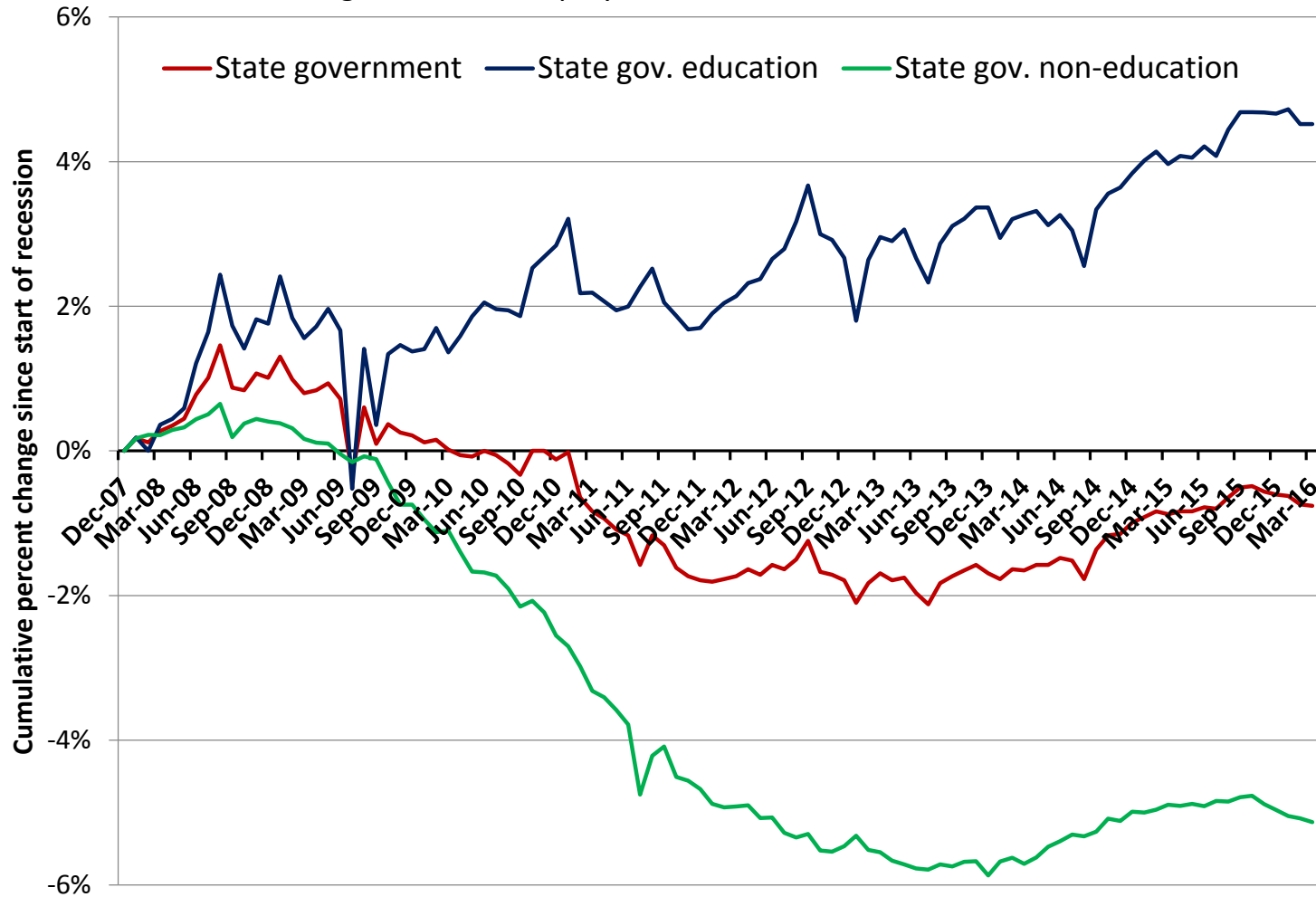
State-local gov't employment still declining, in contrast to the rebound in private employment



Source: U.S. Bureau of Labor Statistics (CES, seasonally adjusted).

State government employment: Education (mostly higher ed.) up, all else down

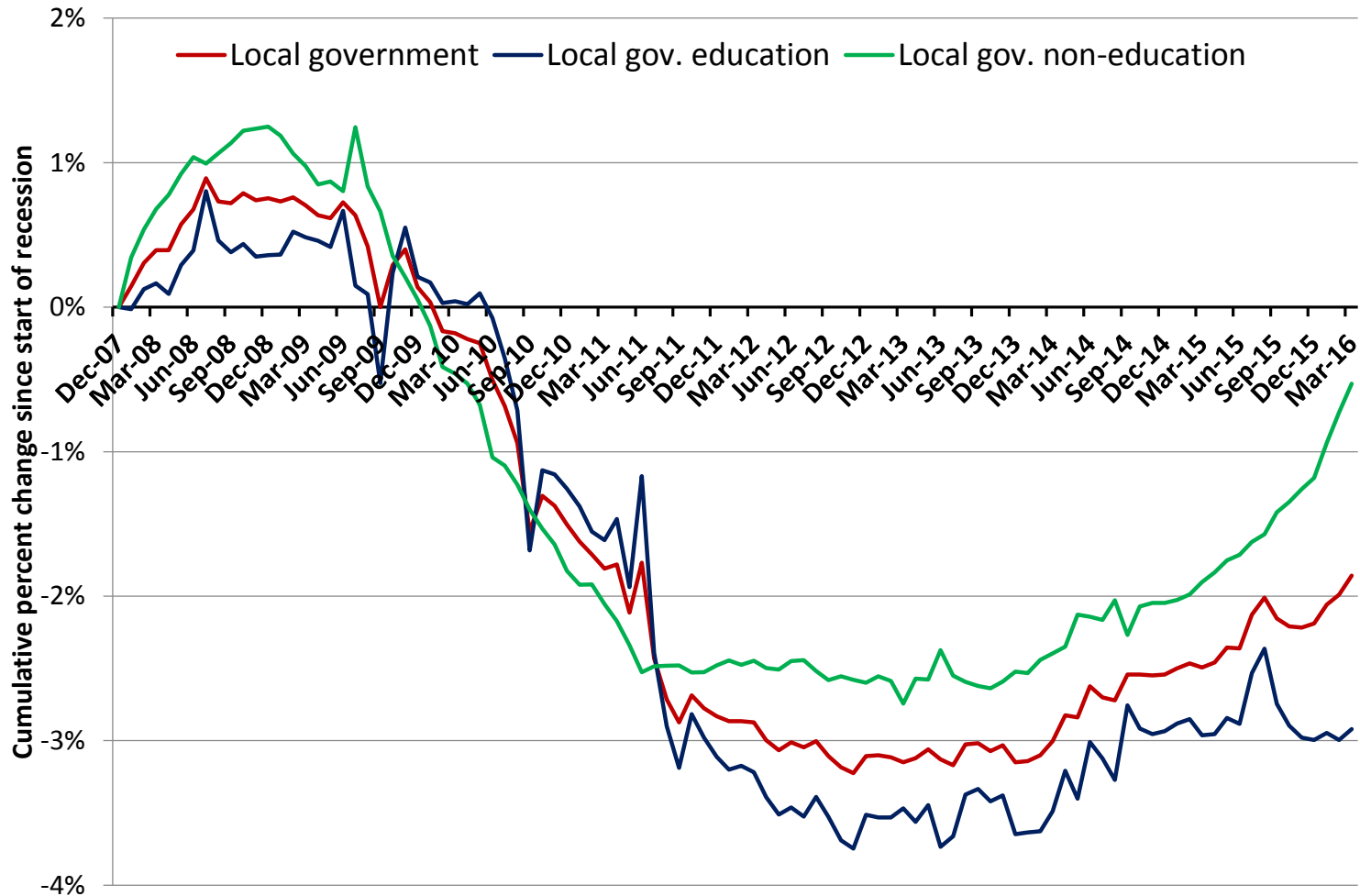
State government employment since start of 2007 recession



Source: U.S. Bureau of Labor Statistics (CES, seasonally adjusted).

Local government employment: Education way down, some improvement in non-education

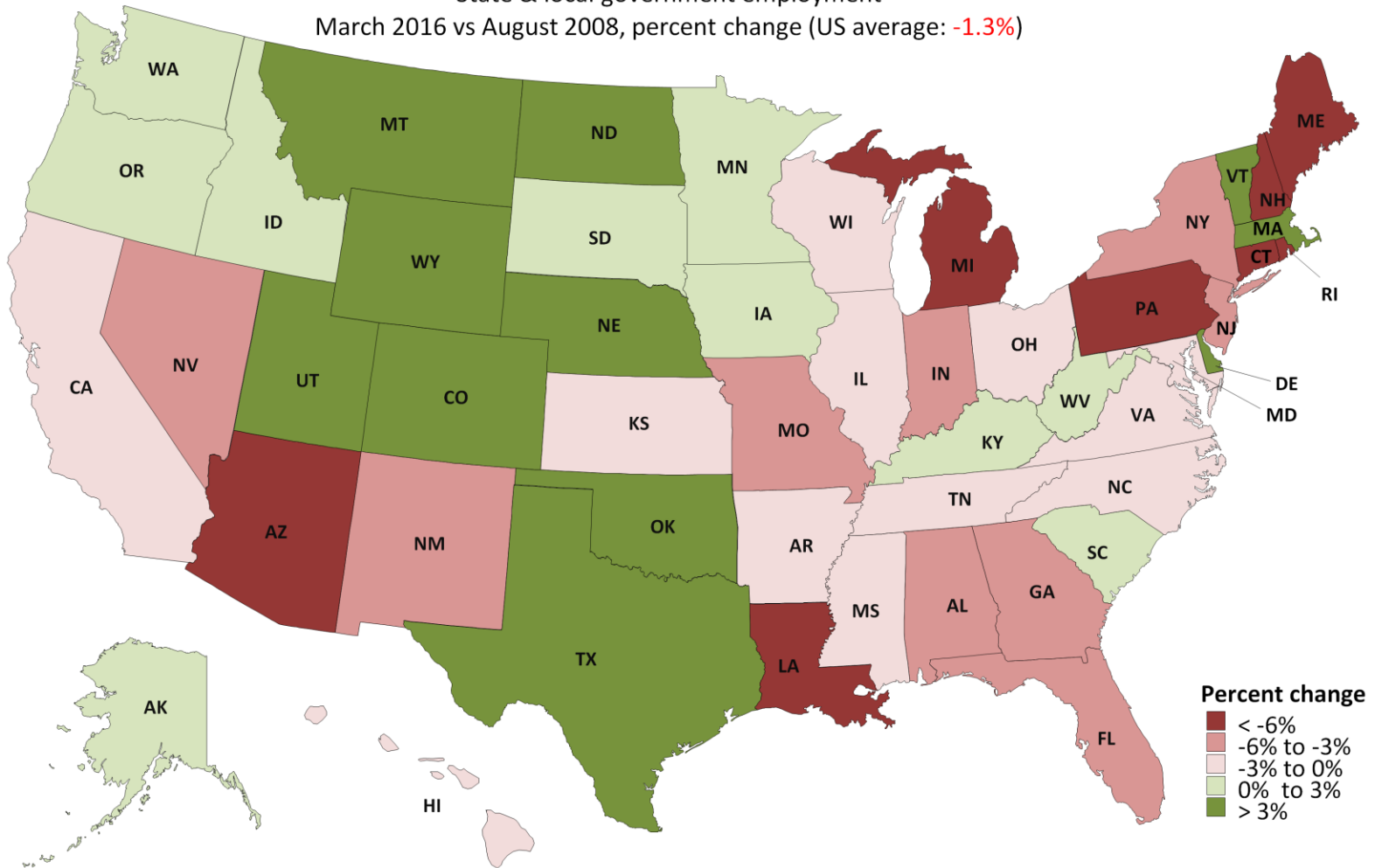
Local government employment since start of 2007 recession



Source: U.S. Bureau of Labor Statistics (CES, seasonally adjusted).

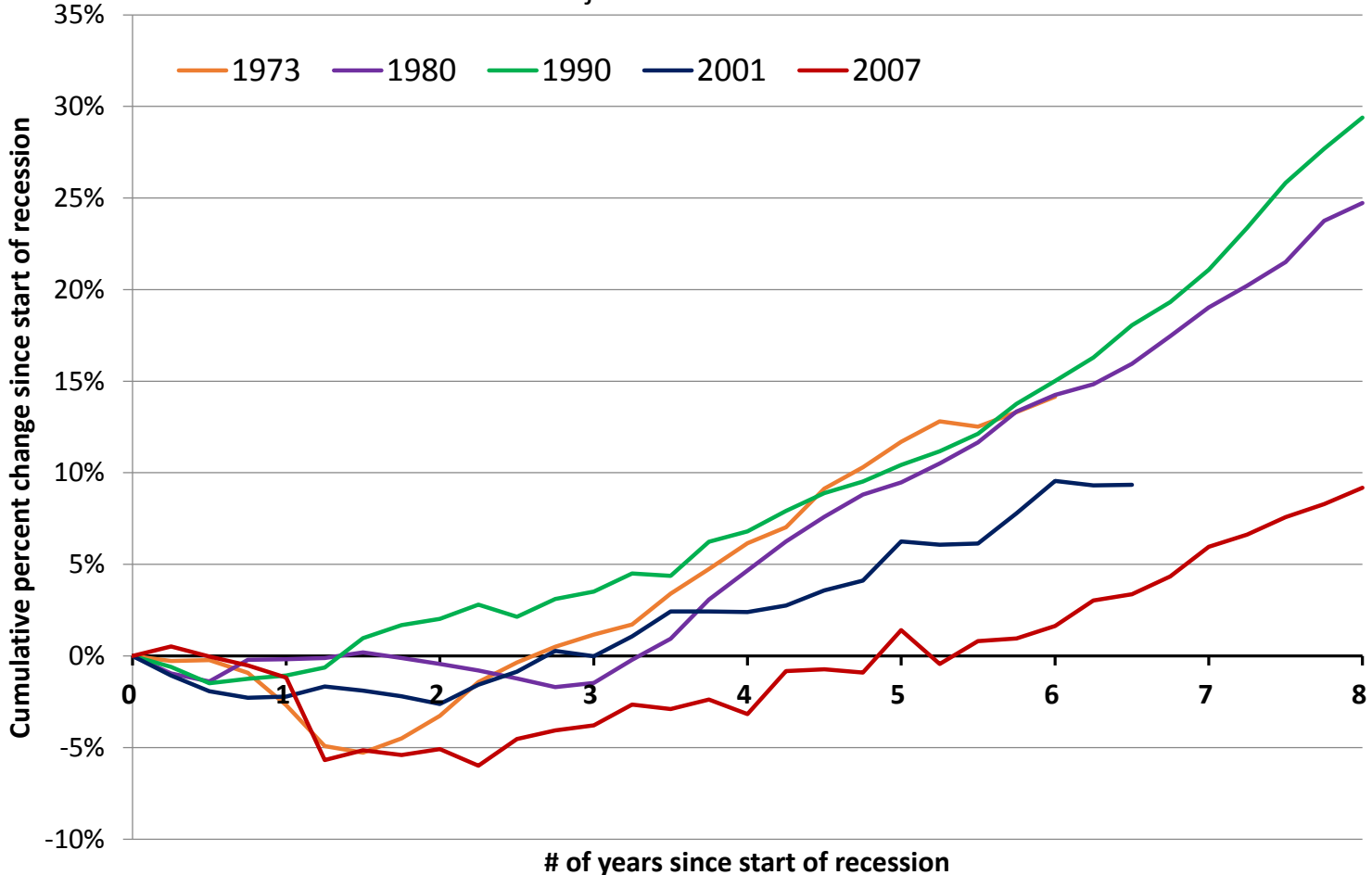
S&L gov't employment down 1/2 million jobs since August 2008; down in 29 states

State & local government employment
March 2016 vs August 2008, percent change (US average: -1.3%)



Growth in salaries & wages slower compared to past recoveries

Salaries & wages for U.S. since start of recession
Adjusted for inflation

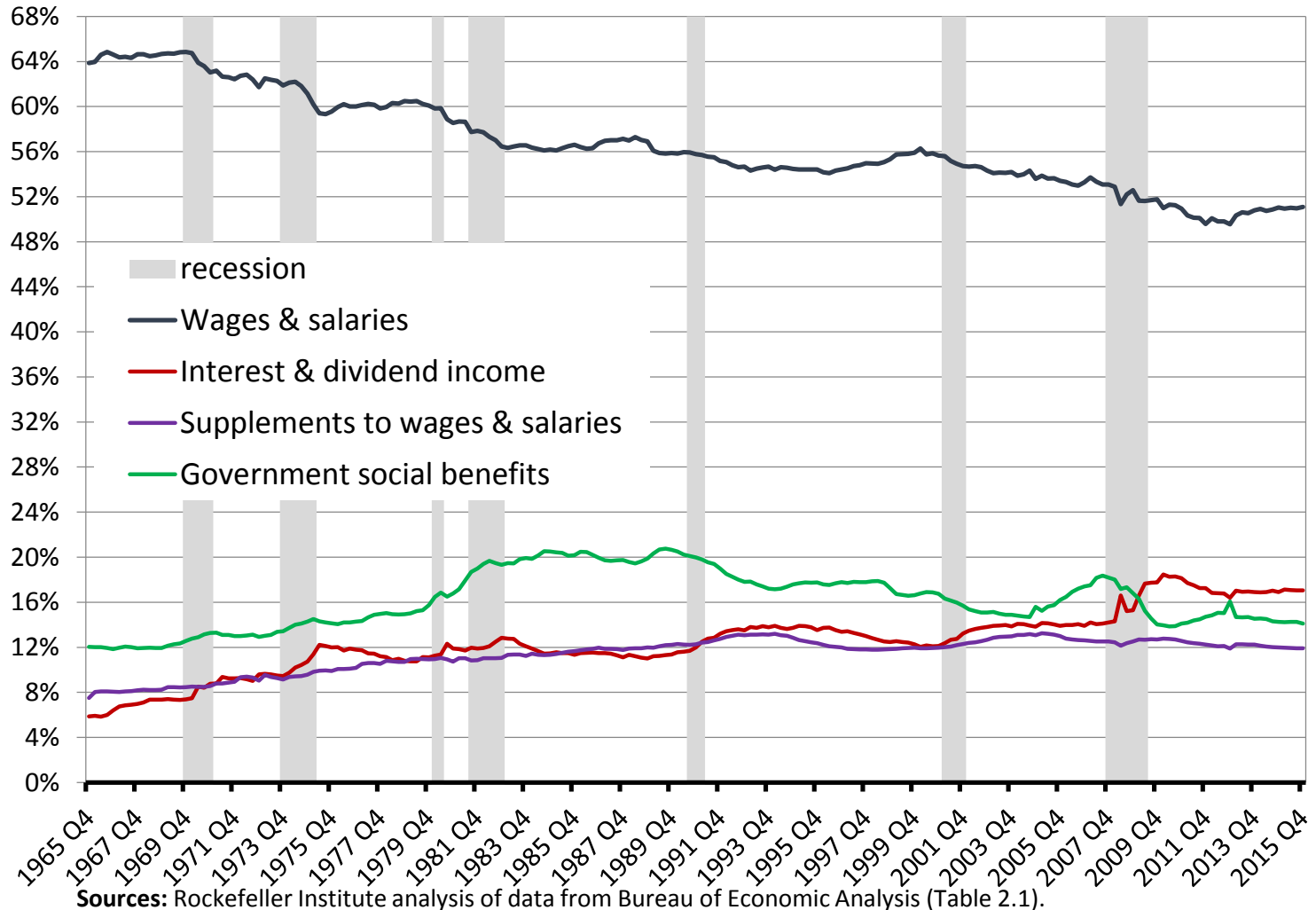


Source: Rockefeller Institute analysis of data from Bureau of Economic Analysis (Table 2.1).

Notes: Data are shown only until the start of the next recession; 1980 & 1981 recessions treated as single recession.

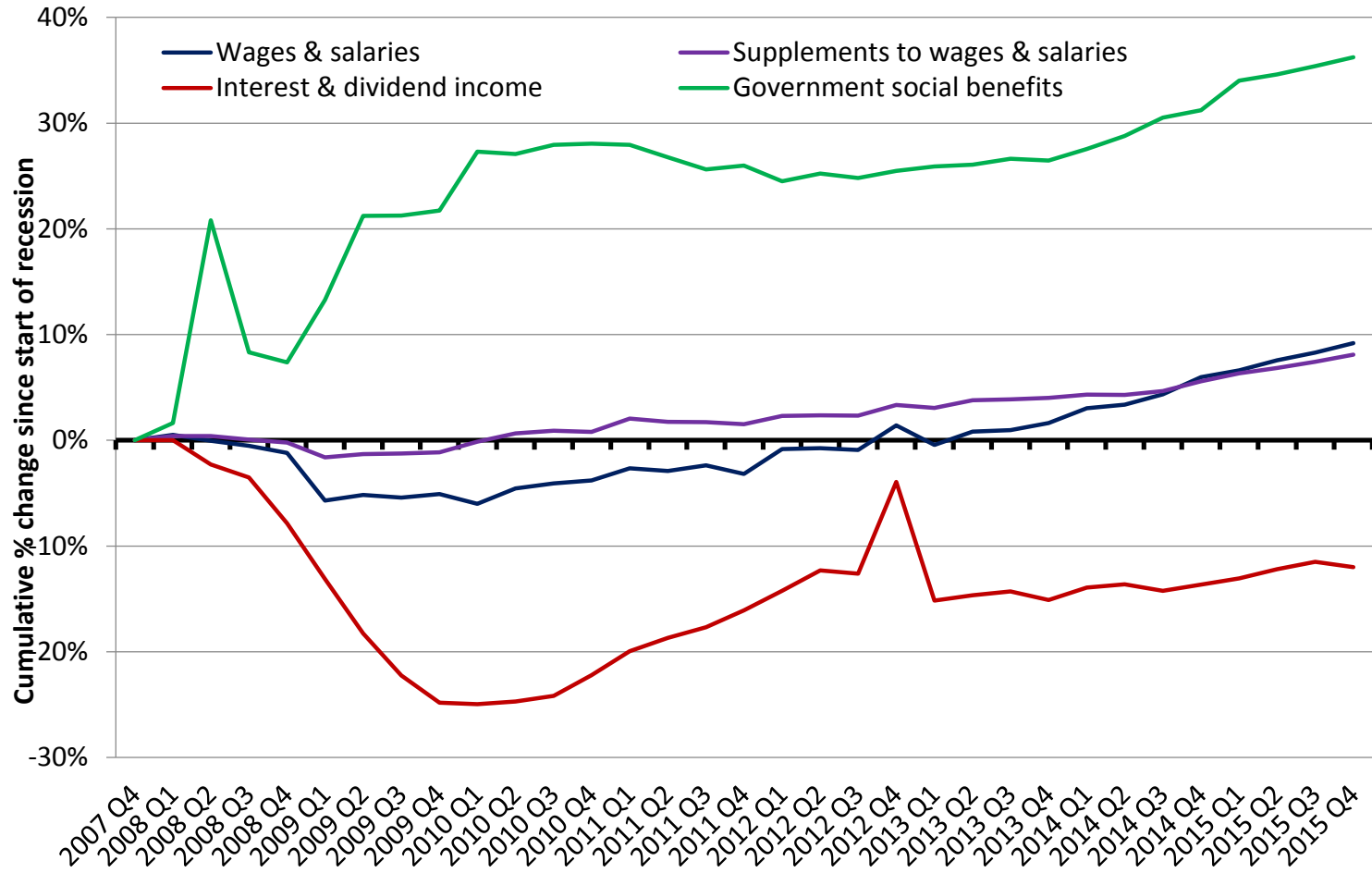
Distribution of personal income sources: Salaries/wages down; growth in interest/dividend

Shares of sources of personal income



Large growth in government social benefits; Large declines in interest/dividend income

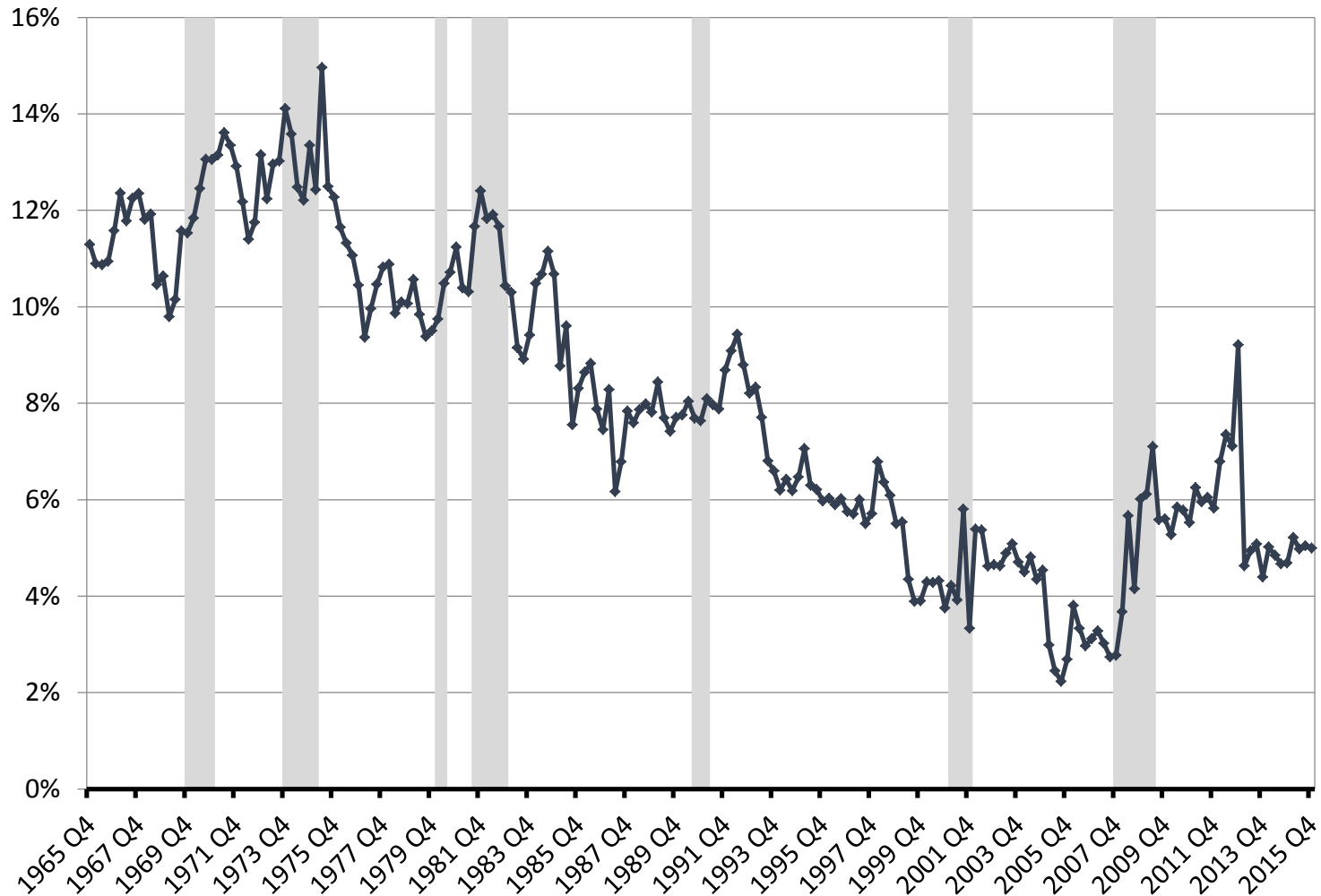
Sources of personal income for U.S. since start of 2007 recession
Adjusted for inflation



Sources: Rockefeller Institute analysis of data from Bureau of Economic Analysis (Table 2.1).

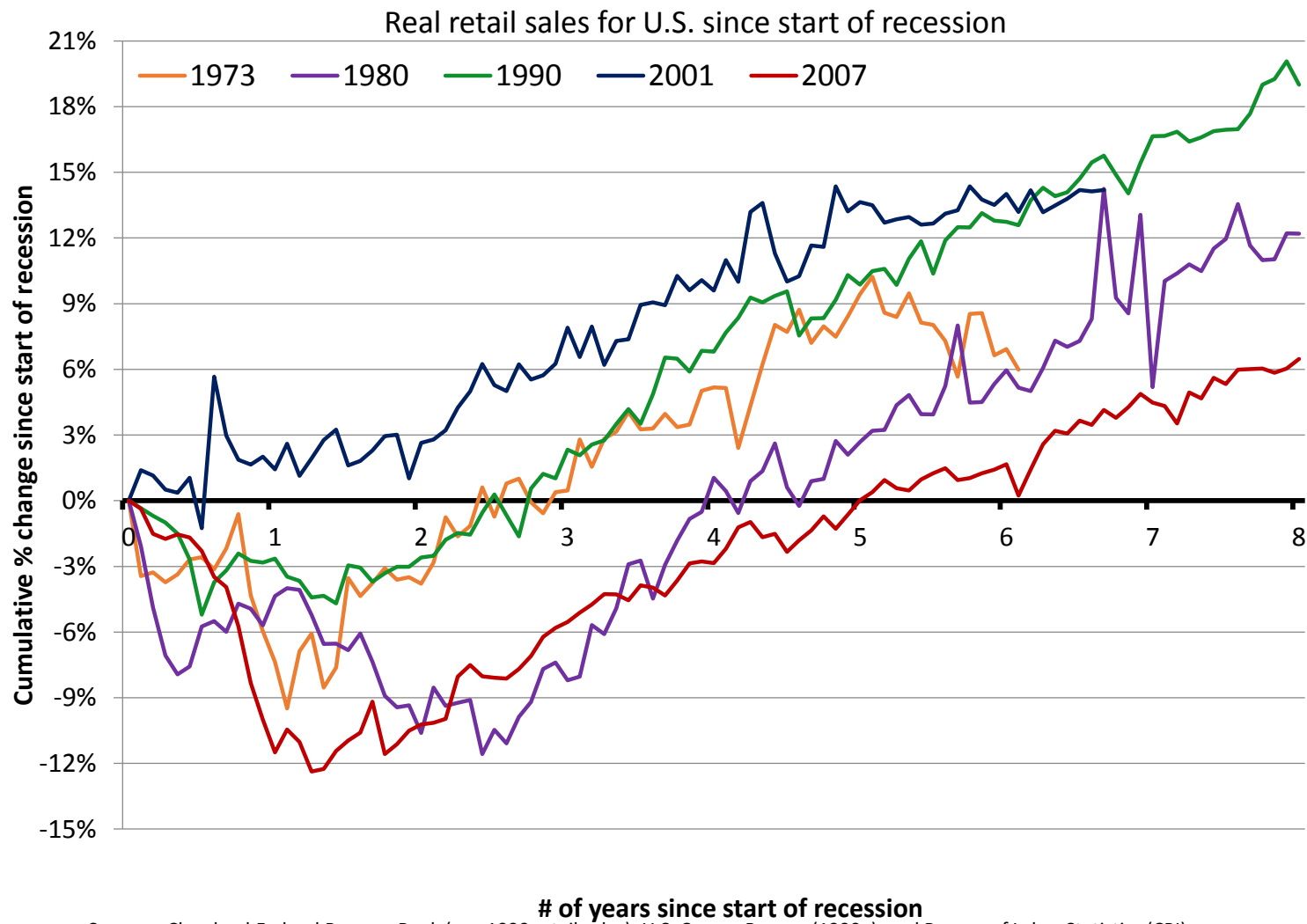
Personal savings as share of disposable personal income

Personal savings as share of disposable personal income



Sources: Rockefeller Institute analysis of data from Bureau of Economic Analysis (Table 2.1).

Real retail sales are weak compared to historical levels

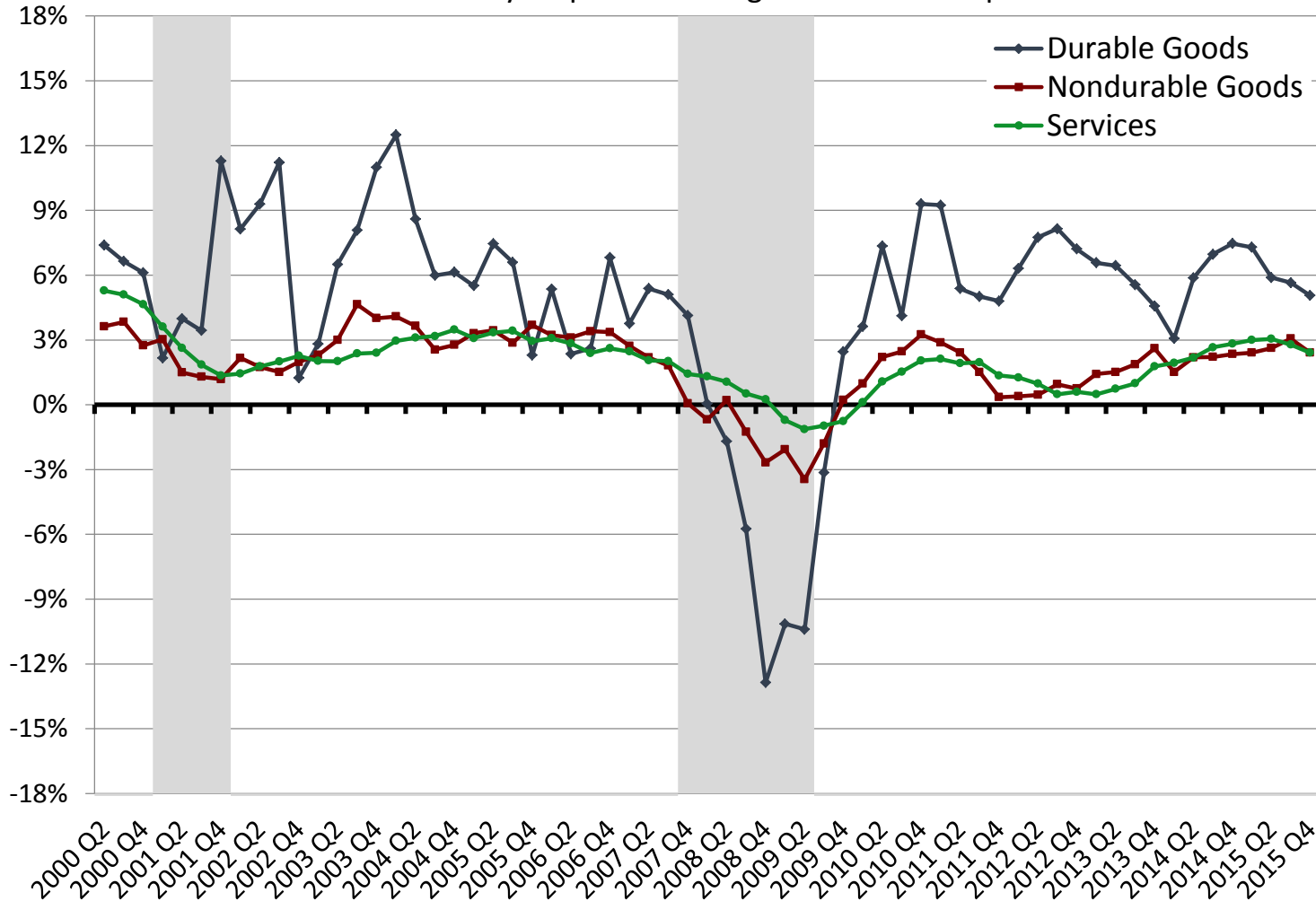


Sources: Cleveland Federal Reserve Bank (pre-1990 retail sales), U.S. Census Bureau (1990+), and Bureau of Labor Statistics (CPI).

Notes: Data are shown only until the start of the next recession; 1980 and 1982 recessions are treated as single recession.

Consumption of durable & non-durable goods was hit hard

Year-over-year percent change in real consumption



Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 2.3.6.

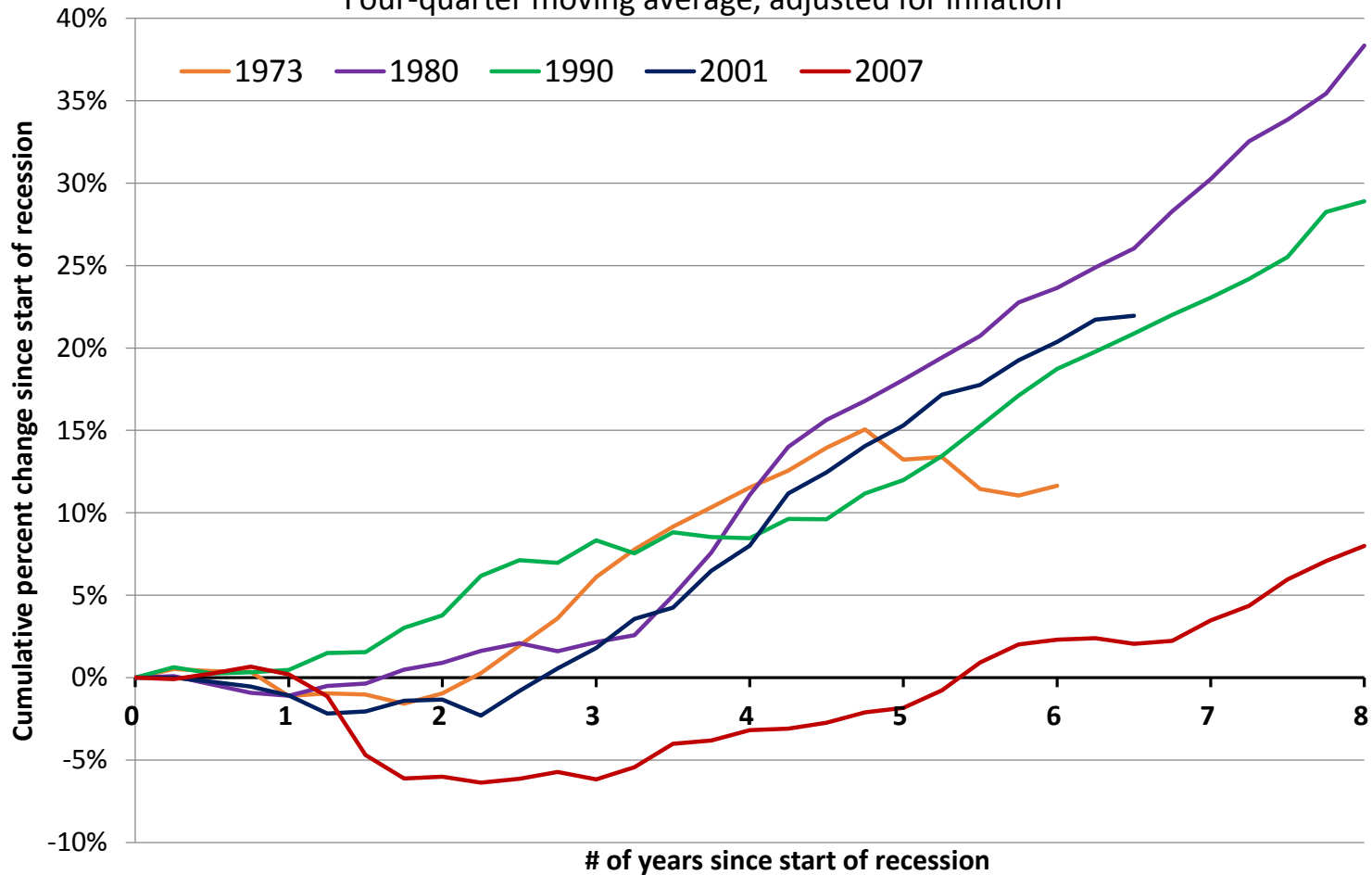


Slower tax revenue recovery

- 8 years after recession start, state-local taxes only 5+ % above prior peak
- State gov't tax recovery is weak & slow
- Sales taxes: still below pre-recession level
- PIT: now above pre-recession level
- CIT: no recovery
- Local property taxes: continued but soft growth
- Oil & coal states hit hard
 - Declines in taxes & employment
- Growing reliance on sin taxes
 - Gambling expansion
 - Gambling revenues: declines & cannibalization

State & local government tax revenues: Only 8+0% above prior peak

State and local government major tax revenue since start of recession
Four-quarter moving average, adjusted for inflation

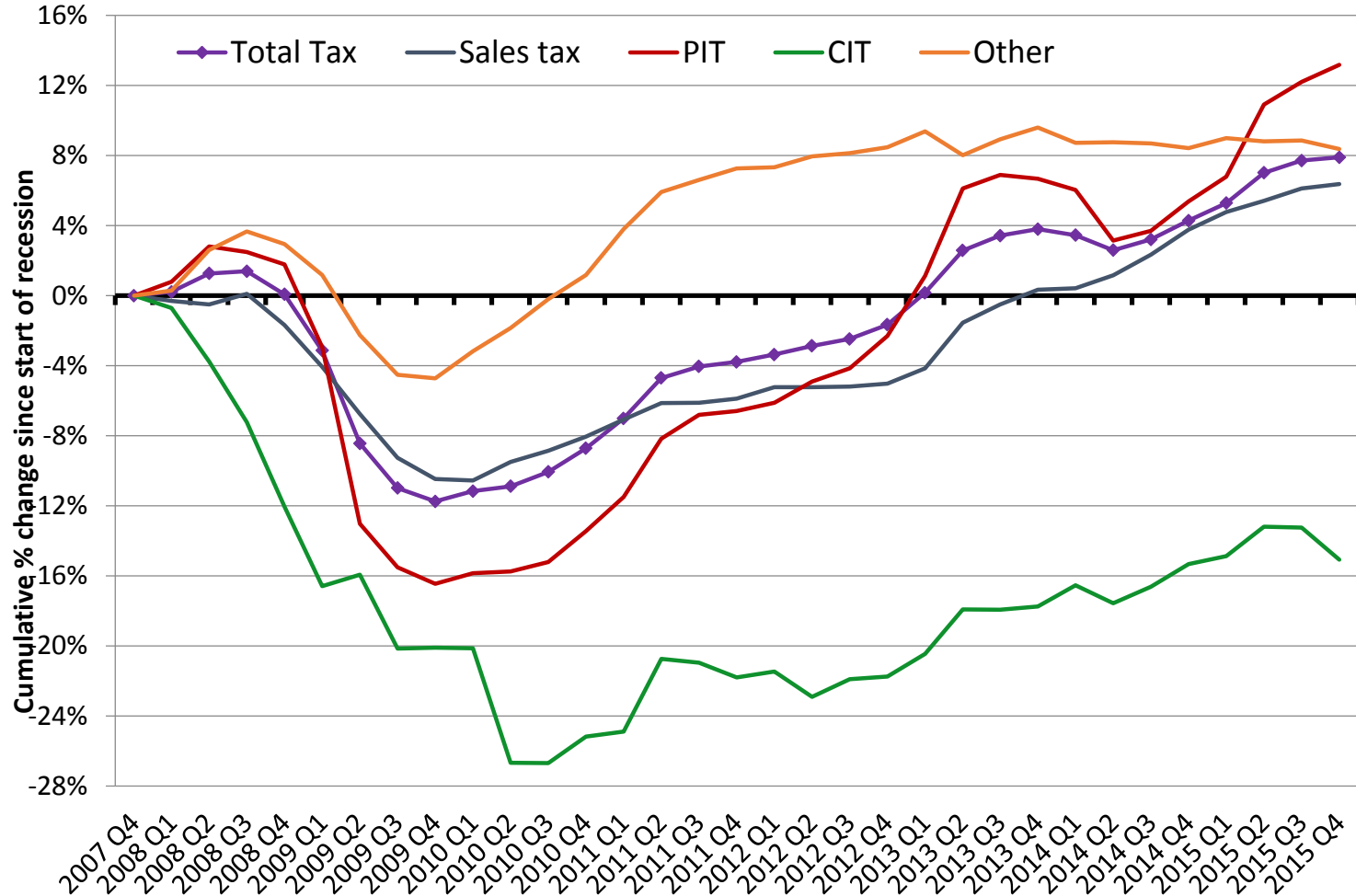


Source: Rockefeller Institute analysis of data from U.S. Census Bureau.

Notes: Data are shown only until the start of the next recession; 1980 & 1981 recessions treated as single recession.

Income & sales taxes are recovering; “other” taxes stagnant; corporate 15% below prior peak

State government tax revenue for U.S. since start of 2007 recession
 Four-quarter moving average, adjusted for inflation

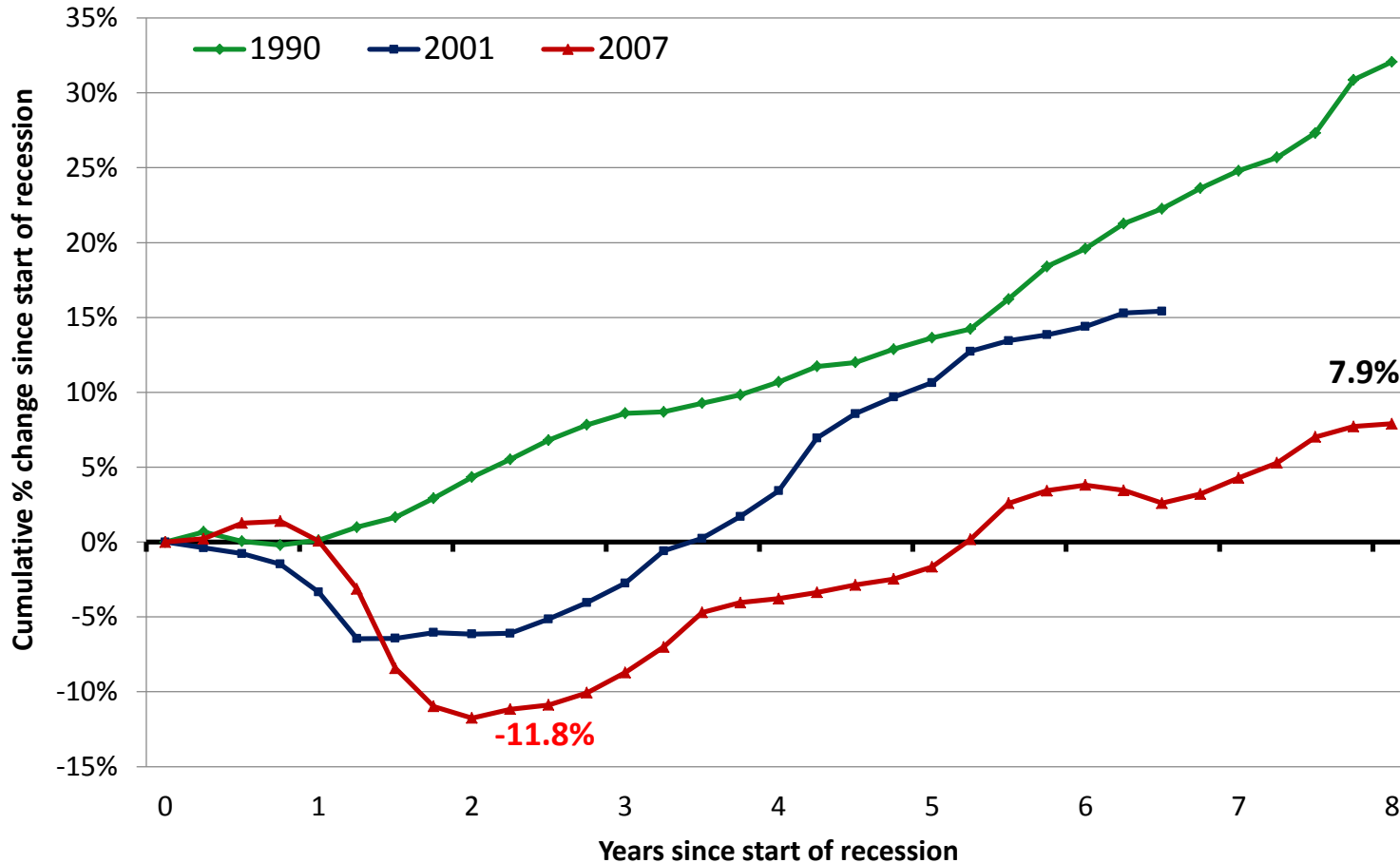


Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).

Notes: (1) 4-quarter average of inflation-adjusted tax revenue; (2) No adjustments for legislative changes.

State government tax revenues: Recovery is weak and slow

State government tax revenue since start of recession
Four-quarter moving average, adjusted for inflation

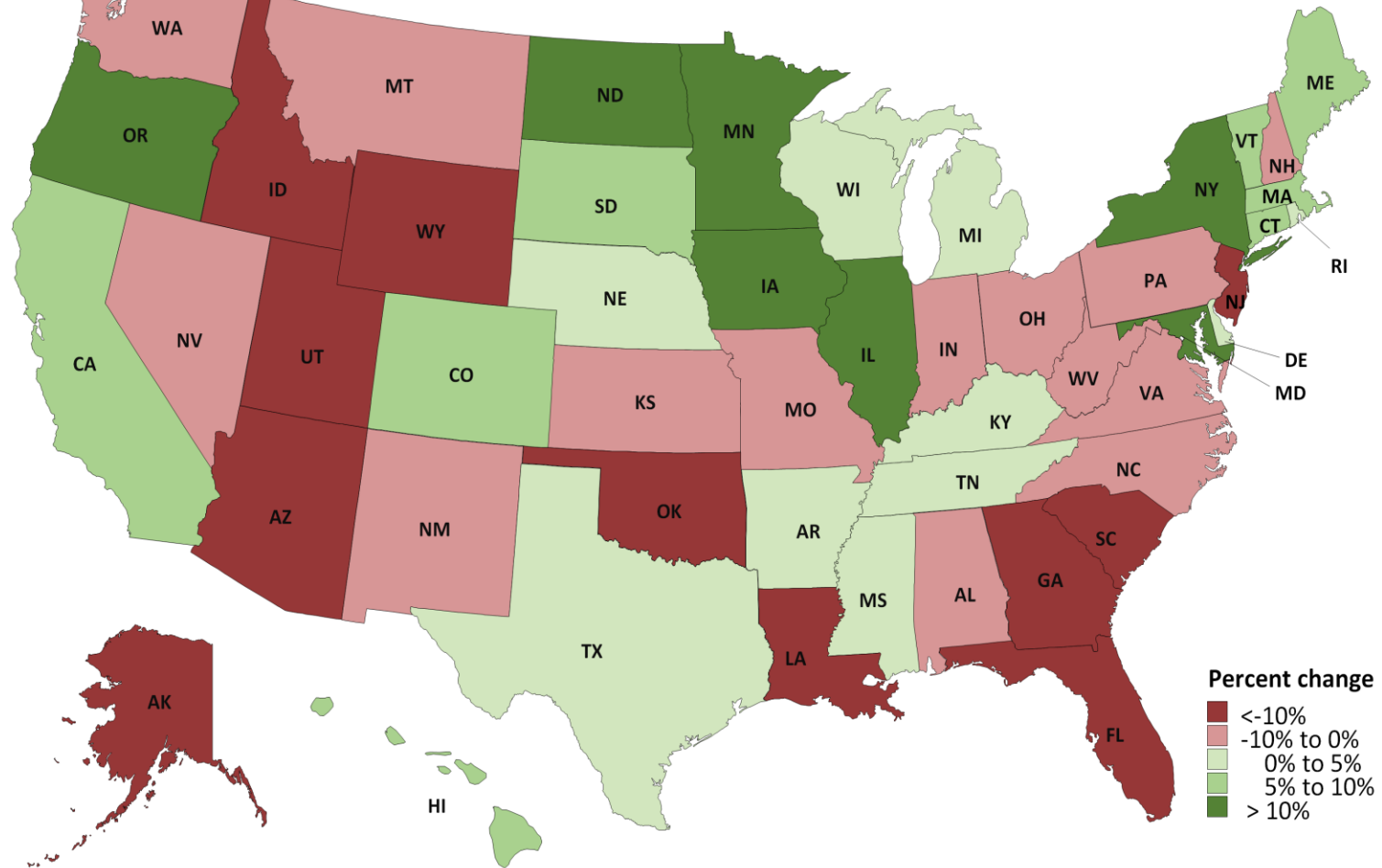


Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).

Notes: 4-quarter average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.

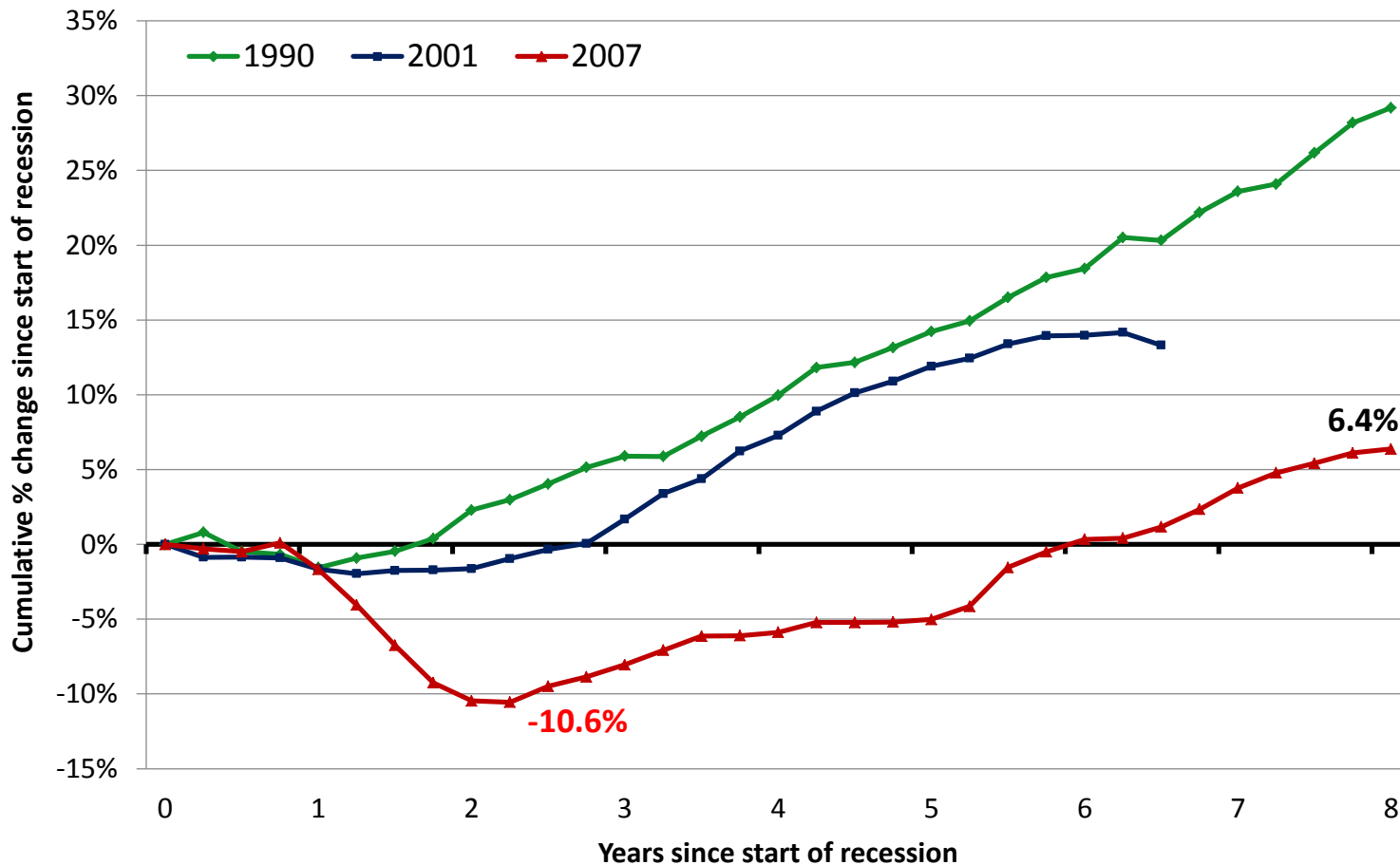
State taxes, adjusted for inflation & population growth, still below pre-recession in 25 states

Percent change in 4-quarter moving average of state tax revenues, 2015q4 vs 2007q4
Adjusted for inflation & population change (U.S. average = 1.1%, U.S. median = 0.3%)



State government sales taxes: Still below pre-recession level

State government sales tax revenue since start of recession
Four-quarter moving average, adjusted for inflation

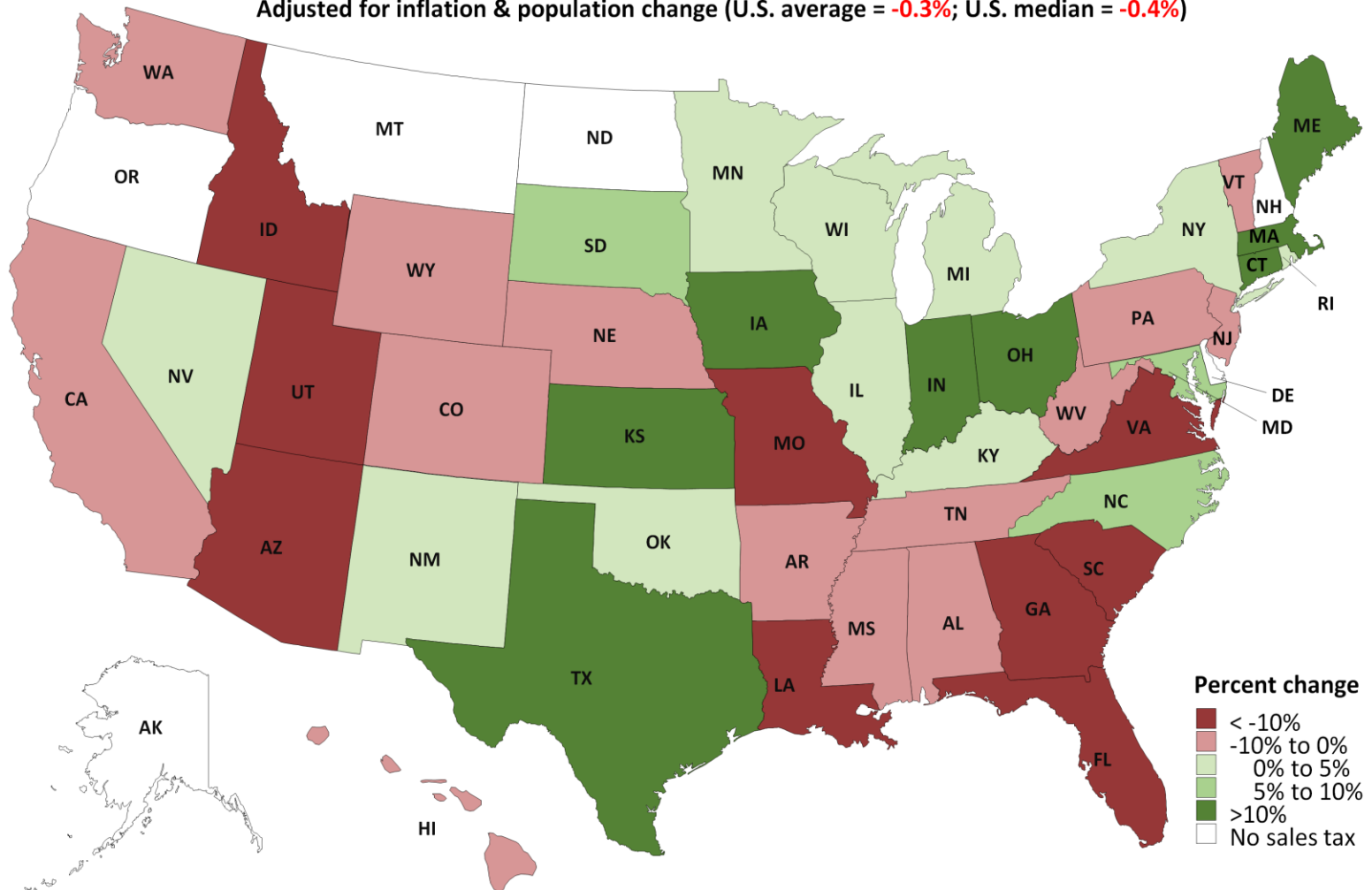


Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).

Notes: 4-quarter average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.

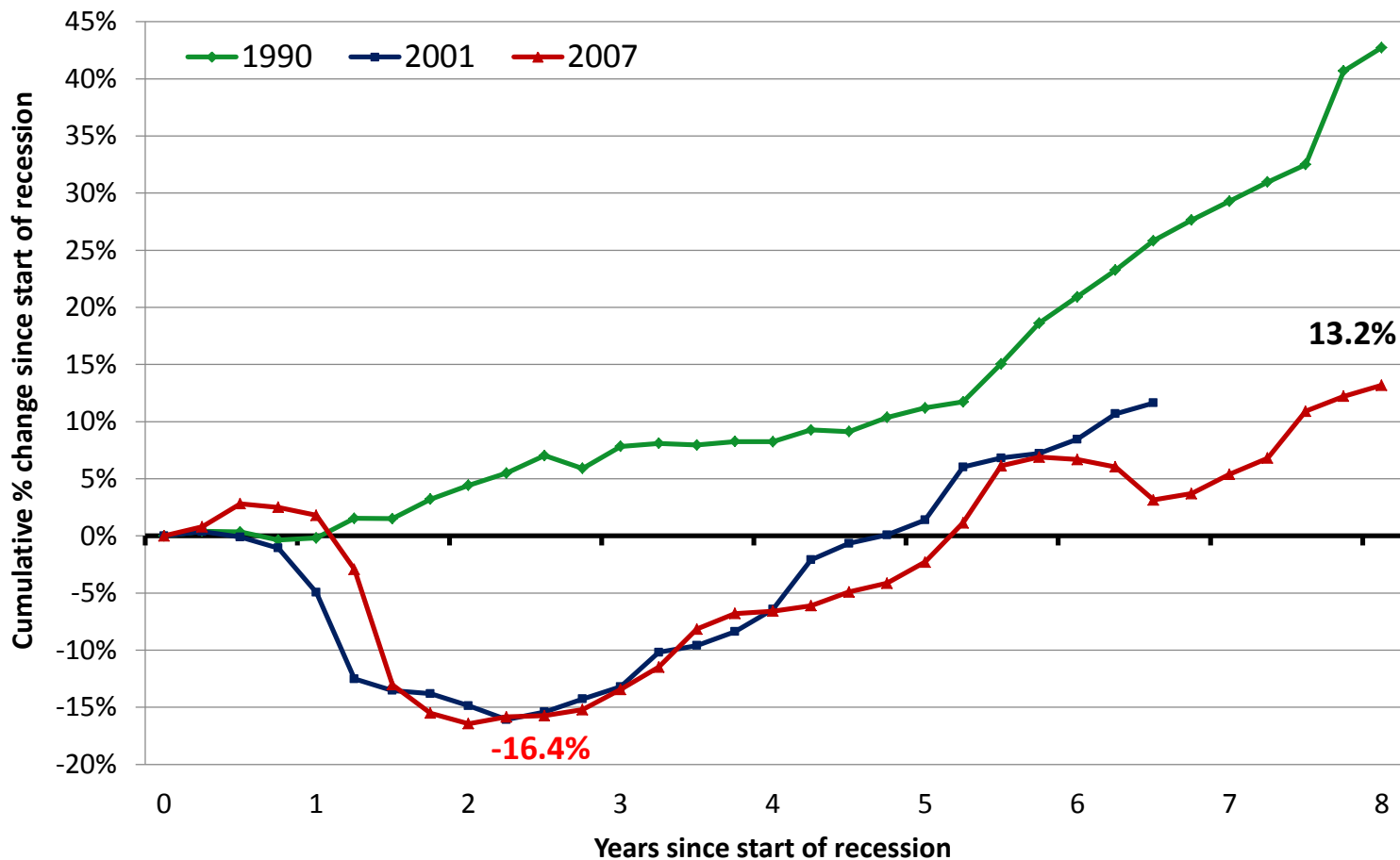
Sales tax, adjusted for inflation & population growth, still below pre-recession in **23** states

Percent change in 4-quarter moving average of sales tax revenues, 2015q4 vs 2007q4
Adjusted for inflation & population change (U.S. average = **-0.3%**; U.S. median = **-0.4%**)



State government personal income taxes: Now above pre-recession level

State government personal income tax revenue since start of recession
Four-quarter moving average, adjusted for inflation

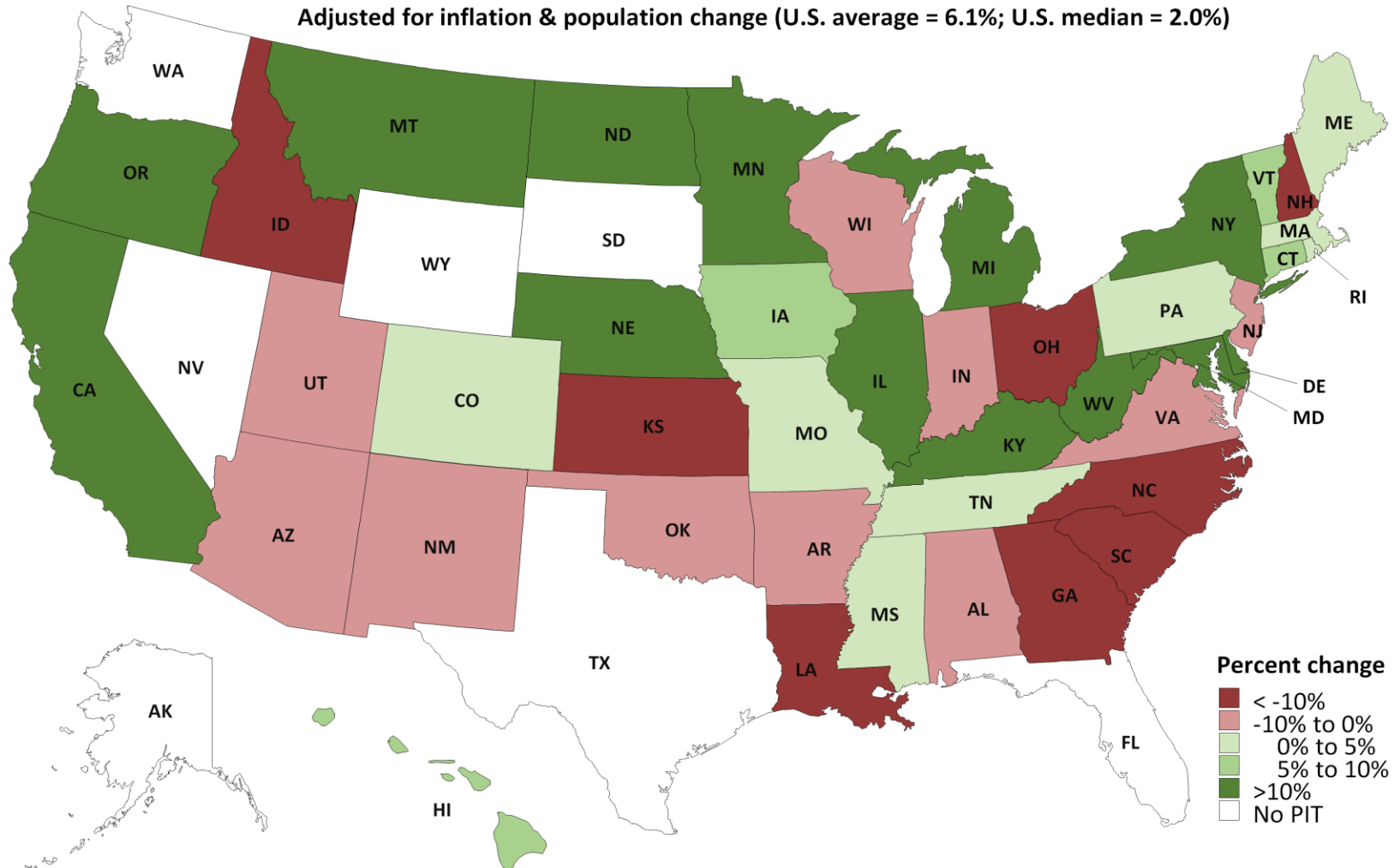


Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).

Notes: 4-quarter average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.

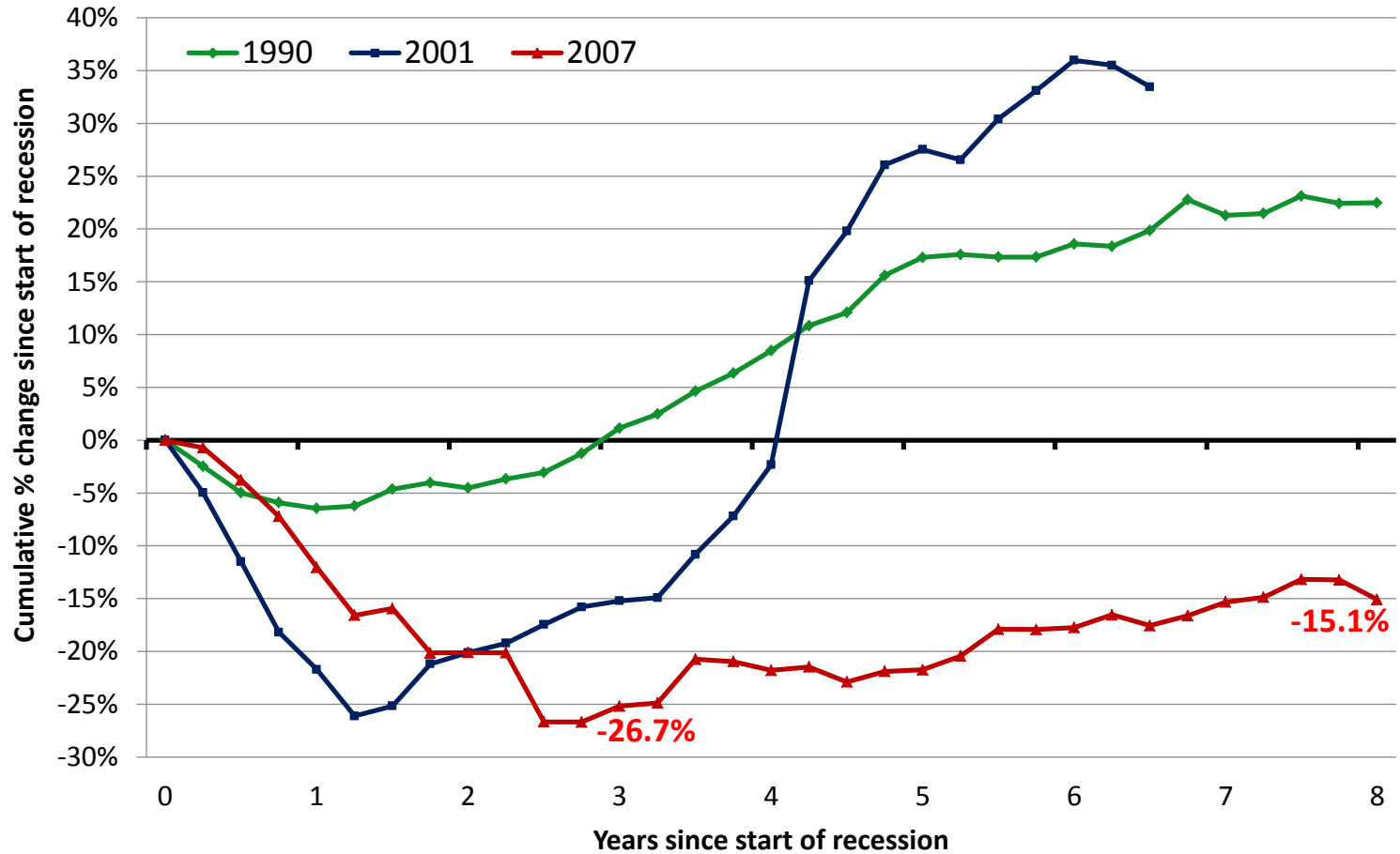
State PIT, adjusted for inflation & population growth, still below pre-recession in 18 states

Percent change in 4-quarter moving average of PIT revenues, 2015q4 vs 2007q4
Adjusted for inflation & population change (U.S. average = 6.1%; U.S. median = 2.0%)



State government corporate income taxes: There is **NO** recovery

State government corporate income tax revenue since start of recession
Four-quarter moving average, adjusted for inflation

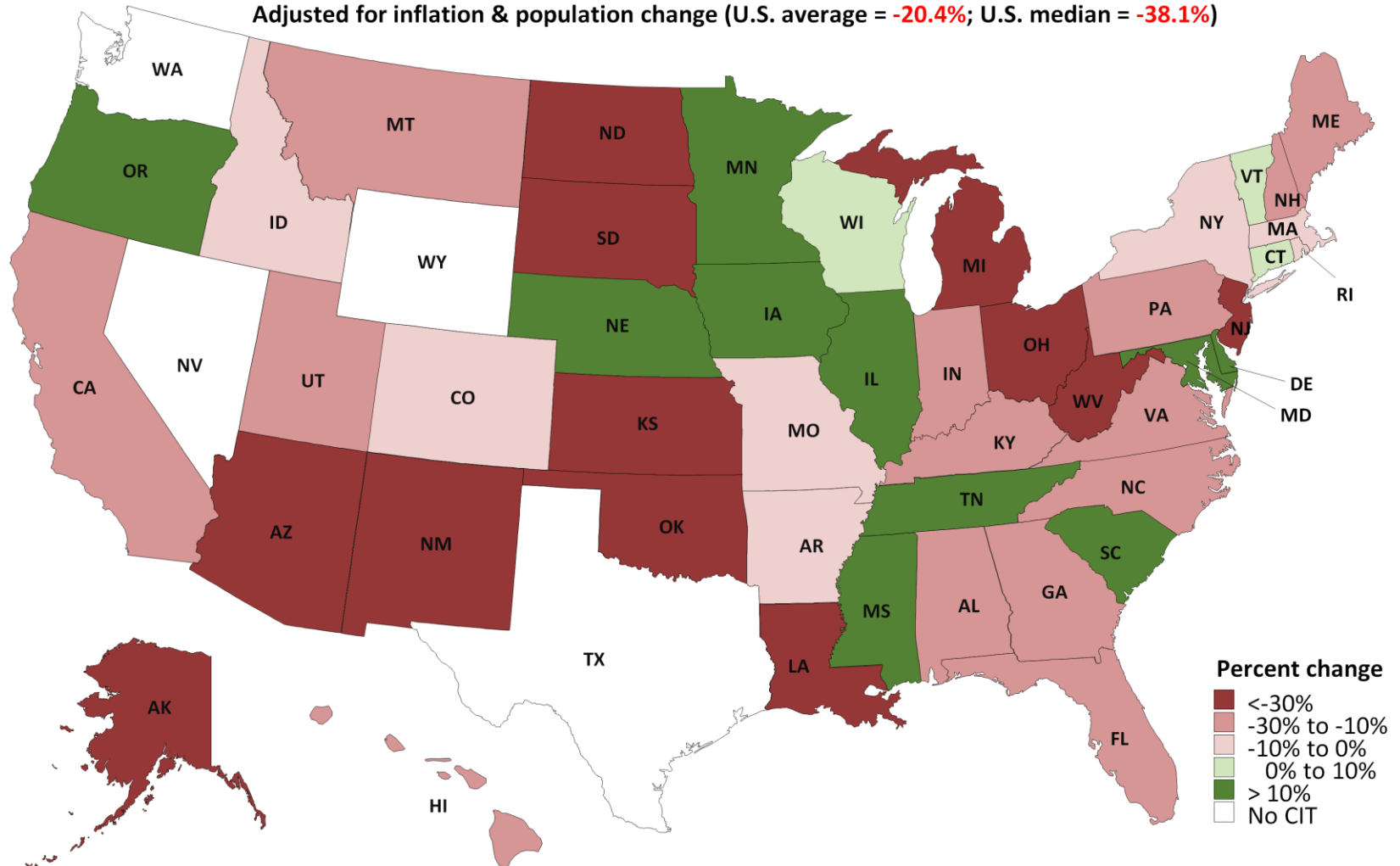


Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).

Notes: 4-quarter average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.

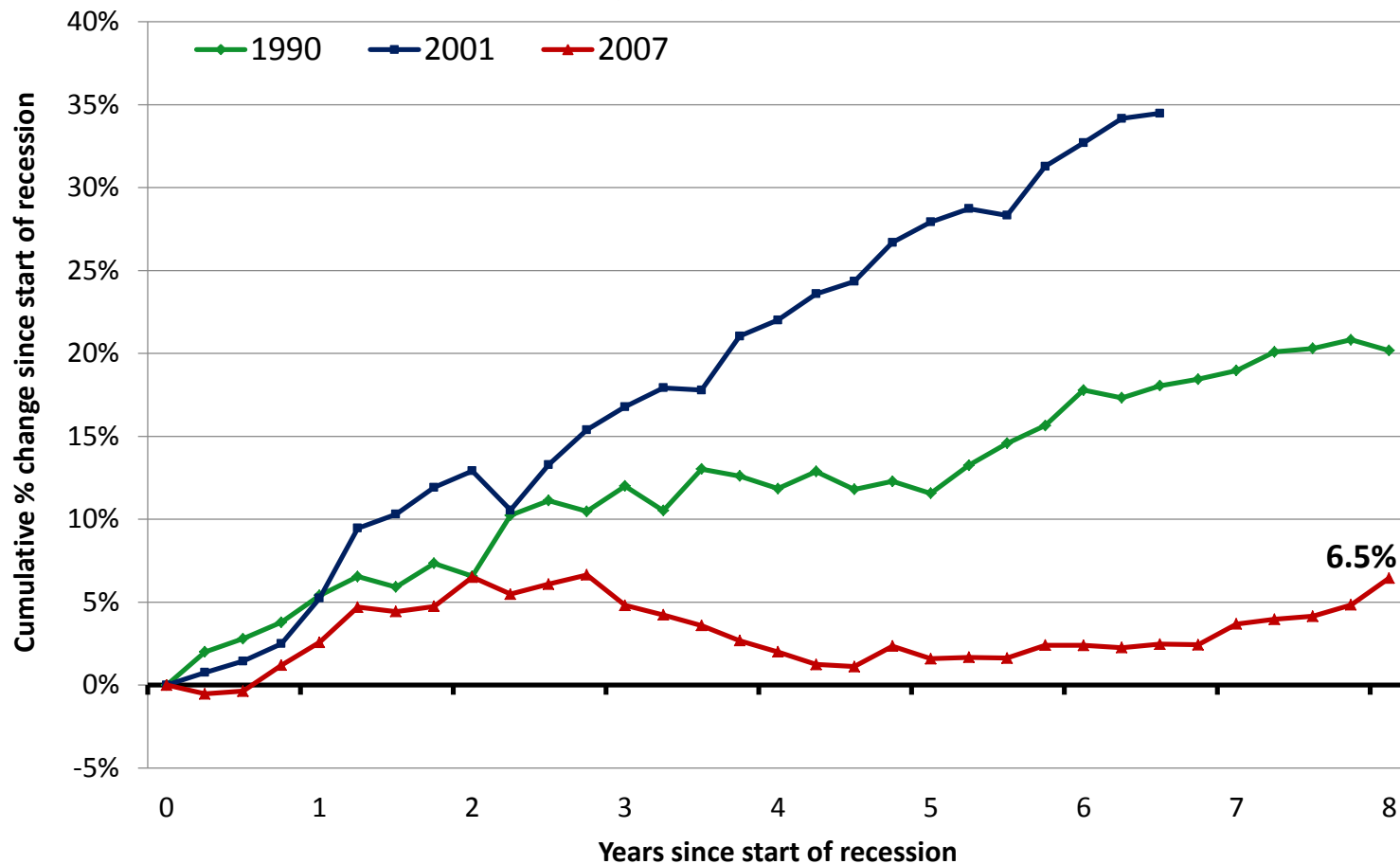
State CIT, adjusted for inflation & population growth, still below pre-recession in 33 states

Percent change in 4-quarter moving average of CIT revenues, 2015q4 vs 2007q4
Adjusted for inflation & population change (U.S. average = -20.4%; U.S. median = -38.1%)



Local government property taxes: Continued but soft growth

Local government property tax revenue since start of the recession
Four-quarter moving average, adjusted for inflation

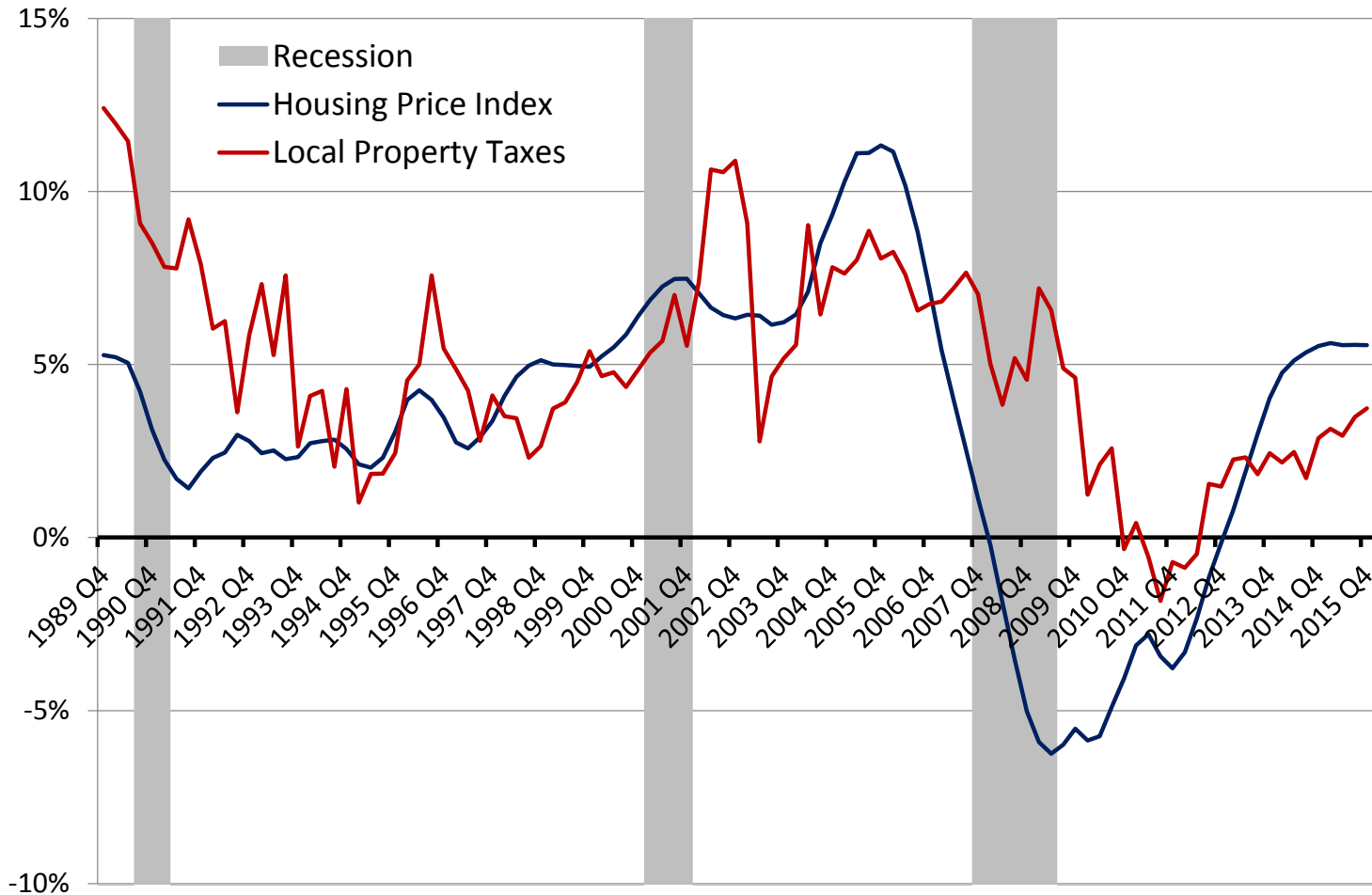


Sources: U.S. Census Bureau (taxes) and Bureau of Economic Analysis (GDP).

Notes: 4-quarter average of inflation-adjusted tax revenue. Data are shown only until the start of the next recession.

Continued growth in local government property taxes & housing prices

Year-over-year percent change in housing prices vs. local property taxes
Four-quarter moving average



Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue (local property taxes) and Federal Housing Finance Agency, House Price Indexes data (all transactions).

Oil & Trouble

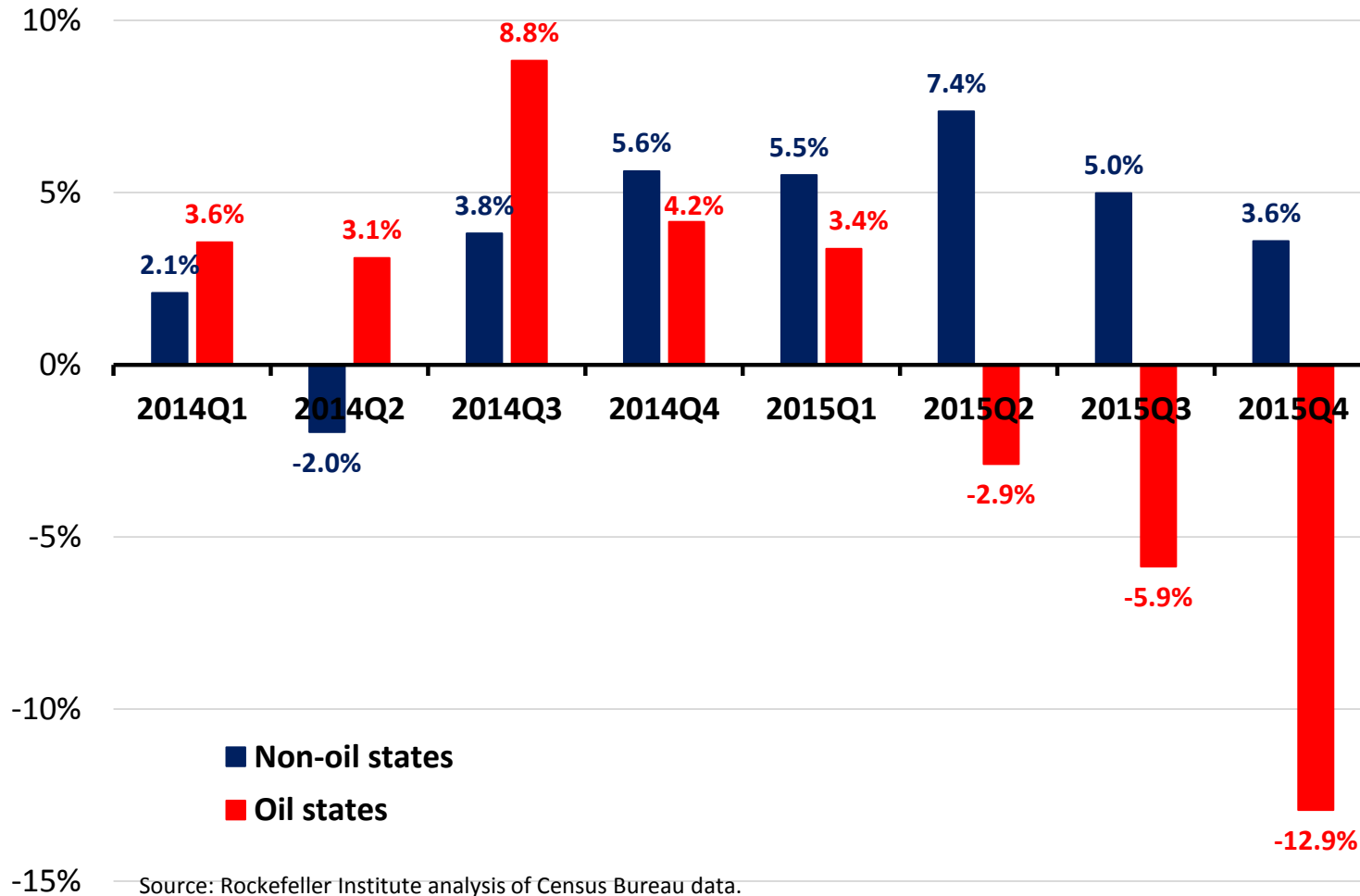


Oil & coal states: Economy, employment, taxes

State	Mining industries as share of state GDP, 2013			Employment change, March 2016 vs. January 2015	Severance taxes as % of total taxes (FY 2014)	Percent change, 4-quarters ending December 2015 vs. year earlier		
	Oil & gas extraction	All other mining activities	Total mining			Severance taxes	Other taxes	Total taxes
Alaska	22.1%	6.4%	28.4%	-0.6%	72.4%	-86.6%	-31.0%	-63.6%
North Dakota	6.4%	8.3%	14.6%	-5.6%	53.8%	-44.7%	-1.4%	-25.2%
Louisiana	7.5%	2.6%	10.1%	-1.0%	8.9%	-36.2%	-4.5%	-7.1%
Wyoming	14.9%	18.2%	33.1%	-3.6%	39.0%	-19.5%	4.6%	-4.8%
Oklahoma	11.4%	2.9%	14.3%	-0.7%	7.5%	-48.1%	-0.6%	-4.3%
New Mexico	6.1%	3.5%	9.6%	0.4%	18.5%	-37.5%	5.4%	-2.7%
Texas	11.6%	2.1%	13.8%	1.6%	10.9%	-44.2%	2.7%	-2.4%
West Virginia	2.0%	11.4%	13.4%	-1.4%	12.7%	-24.6%	1.9%	-1.6%
Oil & coal states	10.9%	3.1%	14.0%	0.6%	16.4%	-35.5%	2.9%	-3.2%
Other states	0.4%	0.5%	0.9%	2.4%	0.2%	-20.7%	6.6%	6.6%
United States	1.8%	0.9%	2.7%	2.1%	2.1%	-43.5%	5.4%	4.5%

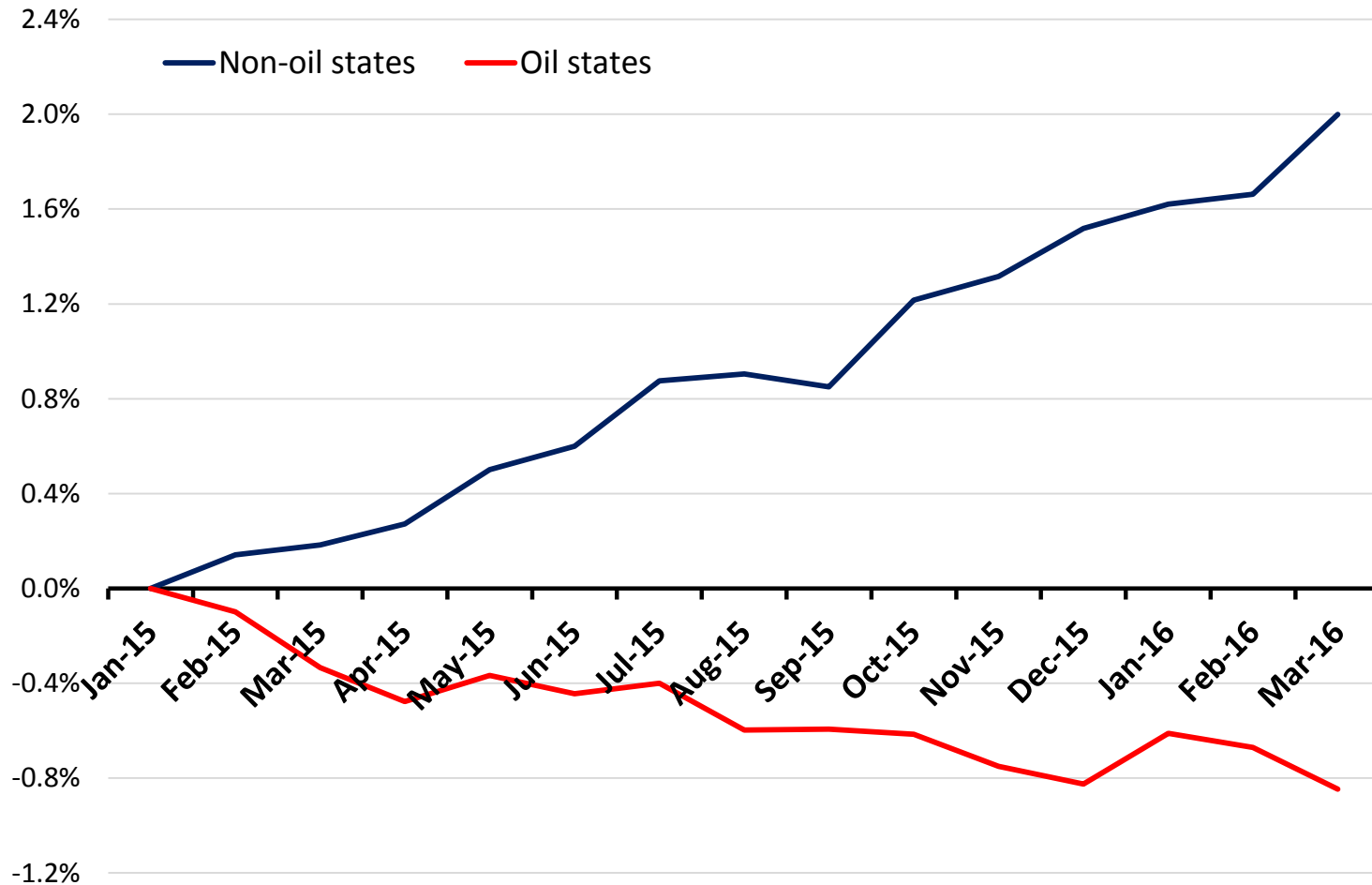
Oil & coal states: 3 consecutive quarterly declines in state taxes

Year-over-year percent change in state government taxes



Oil & coal states: Declines in employment

Cumulative percent change in employment



Source: Rockefeller Institute analysis of Bureau of Labor Statistics data.

Gambling Fever

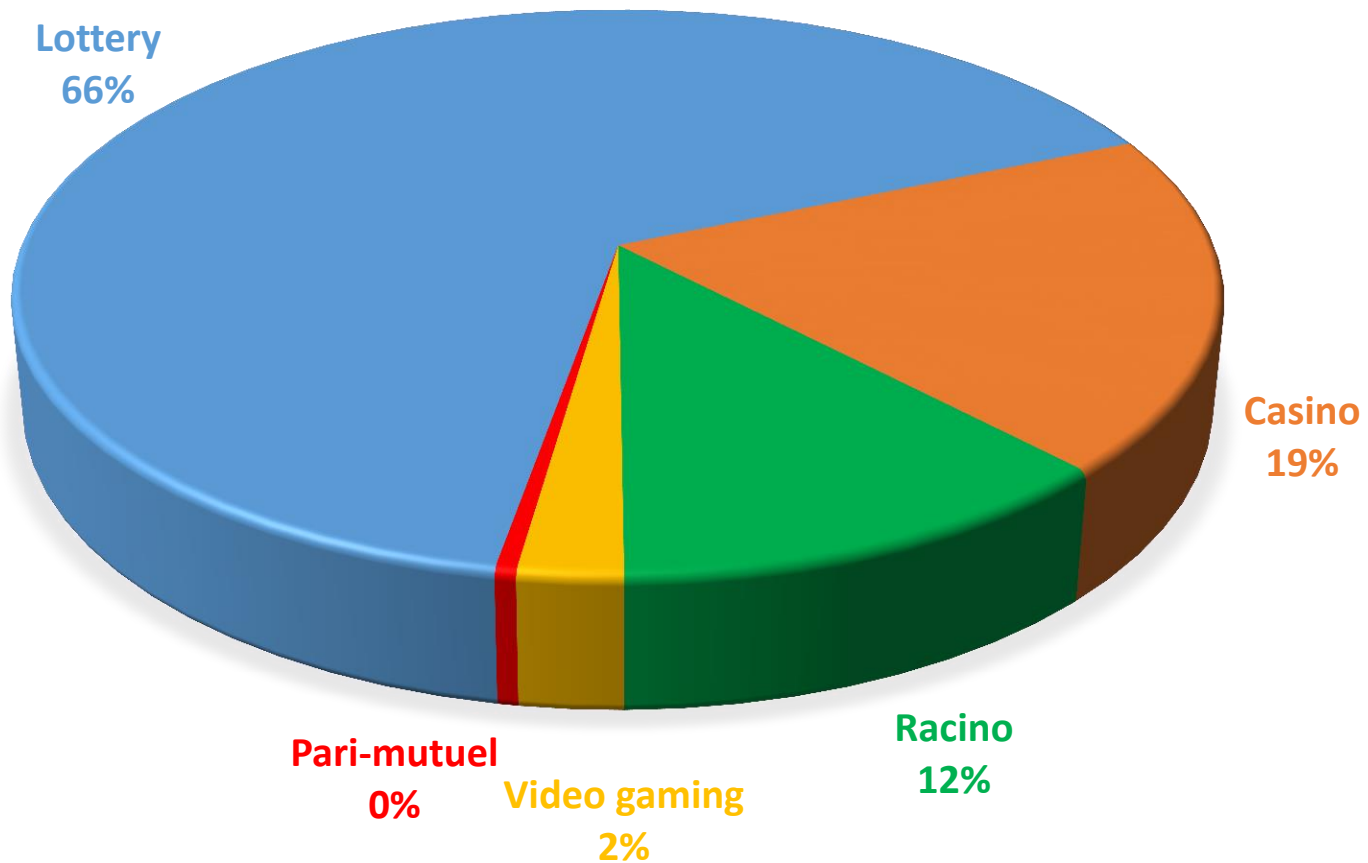


Gambling availability & expansion

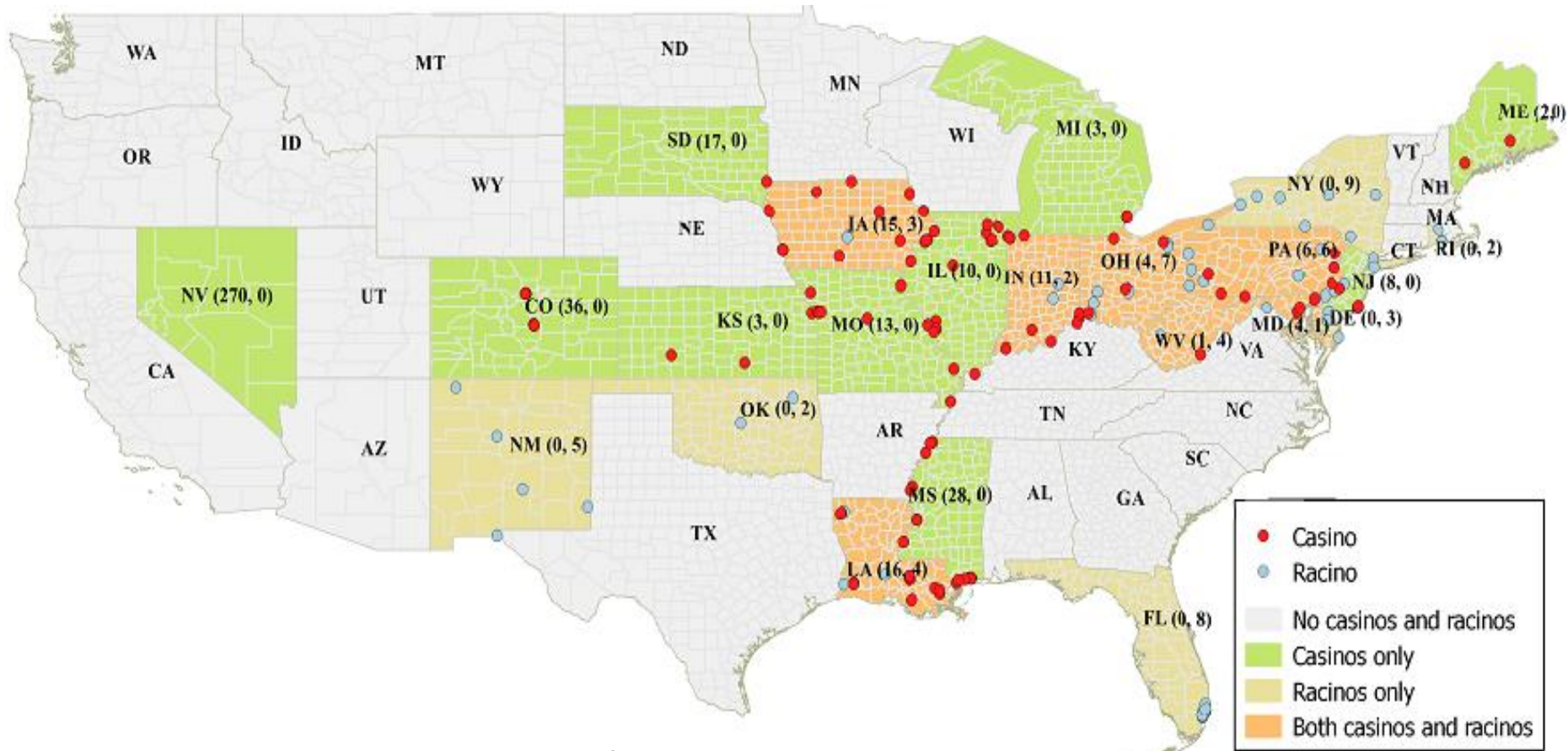
Gambling Type	# of states	Period when gambling was adopted			
		Pre-1990	1990-2000	2001-2007	2008-2015
Lottery	44	32	5	5	2
Casinos	18 (+2)	4	7	2	5 (+ NY&MA)
Racinos	13	0	6	5	2
Pari-Mutuel	43				
Indian Casinos	28				

Shares of Gambling Revenues, FY 2015

Lottery Still The Big Player in Gambling



Geographic Distribution of Casinos & Racinos as of 2015



Notes: Casino locations are not shown for NV and SD.

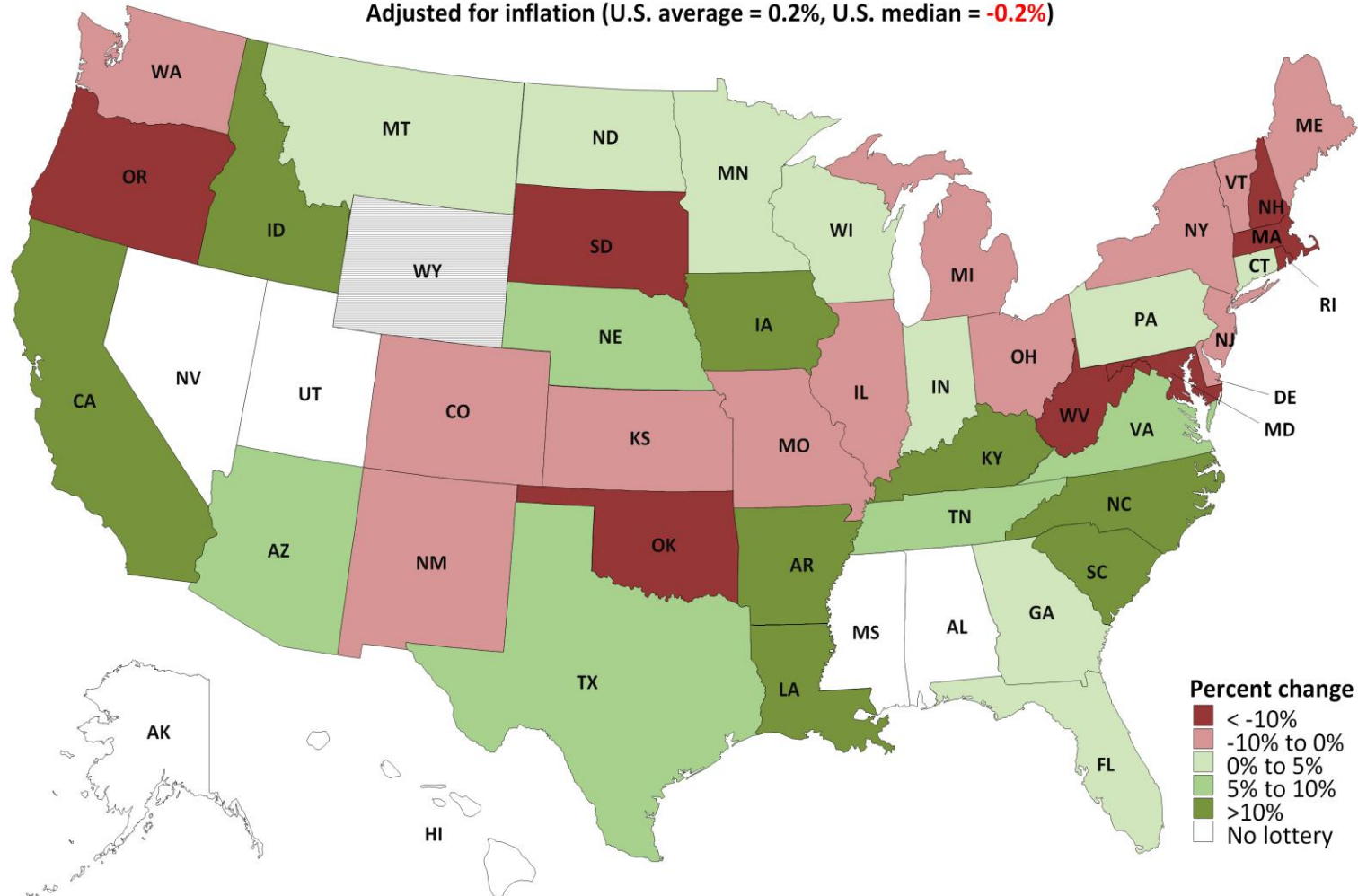
MA & NY legalized casino operations but didn't have operational casinos at the end of FY 2015. Number of facilities is in parentheses. Each dot represents a facility but dots overlap in certain states (e.g., CO), where facilities are highly concentrated in a small geographical area.

Casino & racino tax & fee revenues: Clearly cannibalization

State	\$ millions, adjusted to inflation			% change	CAGR	% change	\$ change
	FY 2008	FY 2014	FY 2015	FY 2014-15	FY 2008-15	FY 2008-15	FY 2008-15
United States	\$8,248.5	\$8,592.0	\$8,686.4	1.1%	0.7%	5.3%	\$437.9
"Older" casino/ racino states	\$7,255.3	\$6,144.7	\$6,073.0	-1.2%	-2.5%	-16.3%	(\$1,182.3)
Colorado	120.3	106.2	110.1	3.6	(1.3)	(8.5)	(10.2)
Delaware	236.9	166.0	151.0	(9.1)	(6.2)	(36.3)	(85.9)
Illinois	776.4	523.2	498.3	(4.8)	(6.1)	(35.8)	(278.1)
Indiana	910.7	662.3	617.9	(6.7)	(5.4)	(32.1)	(292.8)
Iowa	339.4	303.3	305.0	0.6	(1.5)	(10.1)	(34.4)
Louisiana	596.5	506.0	534.9	5.7	(1.5)	(10.3)	(61.5)
Maine	22.7	51.5	51.7	0.5	12.5	127.9	29.0
Michigan	332.2	267.3	273.5	2.3	(2.7)	(17.7)	(58.6)
Mississippi	383.2	251.0	250.2	(0.3)	(5.9)	(34.7)	(133.0)
Missouri	476.6	444.4	440.9	(0.8)	(1.1)	(7.5)	(35.7)
Nevada	1,089.8	924.0	909.9	(1.5)	(2.5)	(16.5)	(179.9)
New Jersey	523.5	260.9	241.2	(7.6)	(10.5)	(53.9)	(282.3)
New Mexico	74.6	67.8	70.6	4.1	(0.8)	(5.4)	(4.0)
New York	545.7	949.6	943.7	(0.6)	8.1	72.9	398.0
Oklahoma	12.0	20.9	20.6	(1.2)	8.1	72.3	8.7
Rhode Island	327.0	324.4	327.2	0.9	0.0	0.1	0.2
South Dakota	17.7	16.4	16.1	(2.0)	(1.4)	(9.3)	(1.6)
West Virginia	470.2	299.6	310.2	3.5	(5.8)	(34.0)	(160.0)
"New" casino/ racino states	\$993.2	\$2,447.2	\$2,613.4	6.8%	14.8%	163.1%	\$1,620.2
Florida	134.1	176.2	182.6	3.6	4.5	36.2	48.5
Kansas		96.8	98.6	1.8			98.6
Maryland		383.7	445.5	16.1			445.5
Ohio		426.8	527.5	23.6			527.5
Pennsylvania	859.1	1,363.7	1,359.2	(0.3)	6.8	58.2	500.1

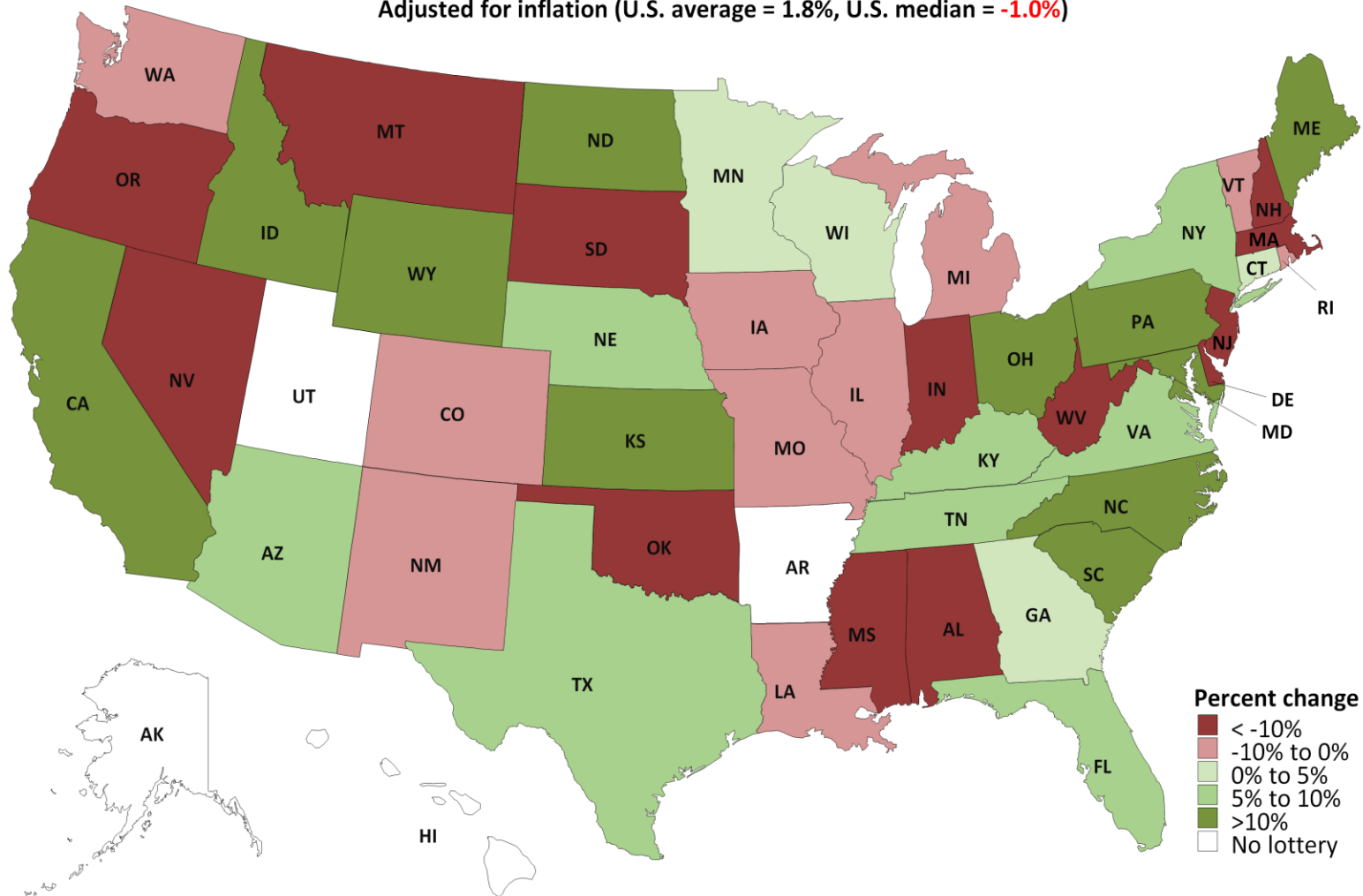
Lottery revenues: Not much growth between 2008 & 2015; declines in 21 states

Percent change in lottery revenues, FY 2008 vs FY 2015
Adjusted for inflation (U.S. average = 0.2%, U.S. median = -0.2%)



Gambling revenues: Weak growth between 2008 & 2015; declines in 23 states

Percent change in major sources of gambling (excludes Indian Casinos) revenues, FY 2008 vs FY 2015
Adjusted for inflation (U.S. average = 1.8%, U.S. median = -1.0%)



Lessons from gambling revenues: Short-term relief, long-term disappointment

- Gambling is **NOT** recession-proof
- Gambling expansion brings in more revenue, until a saturation point is reached
- Some new revenue represents a shift, rather than net growth
- Future growth in gambling revenue will not keep pace with tax revenue, or spending
 - If gambling revenue is intended to support part of the overall budget, gaps may emerge in future years
- Gambling is a slow-growing revenue source & not a solution in the never-ending quest to balance the budget

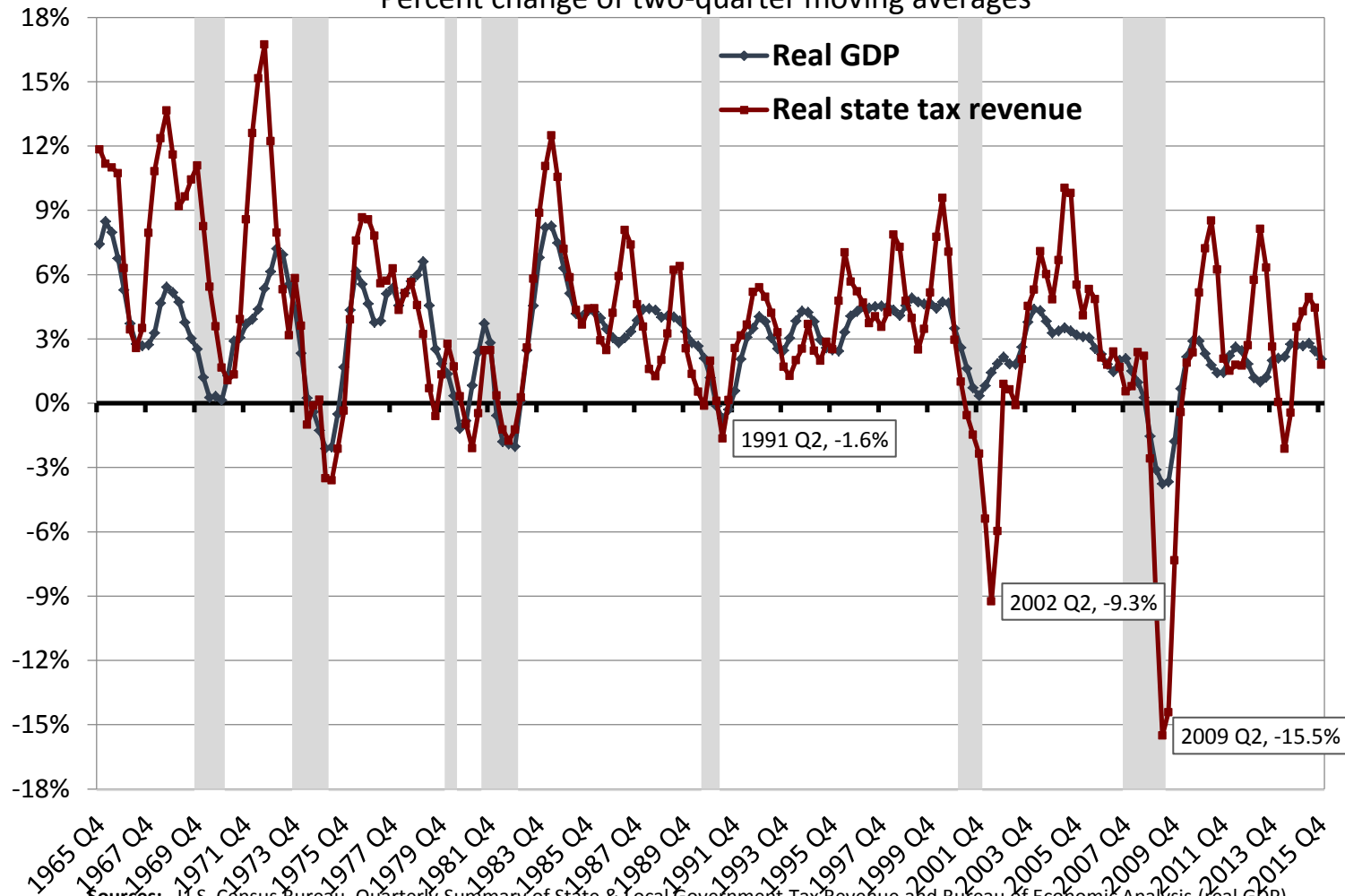
Growing revenue volatility & fiscal challenges

- Tax revenue increasingly more volatile
- More reliant on economically sensitive taxes
- Income taxes rely more heavily on volatile income – capital gains, bonuses
- Sales tax bases are eroding
- Many services hard to tax: politically, legally, administratively
- Goods and services sold over the Internet
- Rainy day funds not large enough
- Single-year cash balance is the goal:
 - Gimmicks, one-time solutions
 - Higher reliance on more regressive taxes
- No serious multi-year financial planning

Worst state gov. tax declines in 5+ decades; Greater revenue volatility

Year-over-year percent change in inflation-adjusted state gov. taxes & real GDP

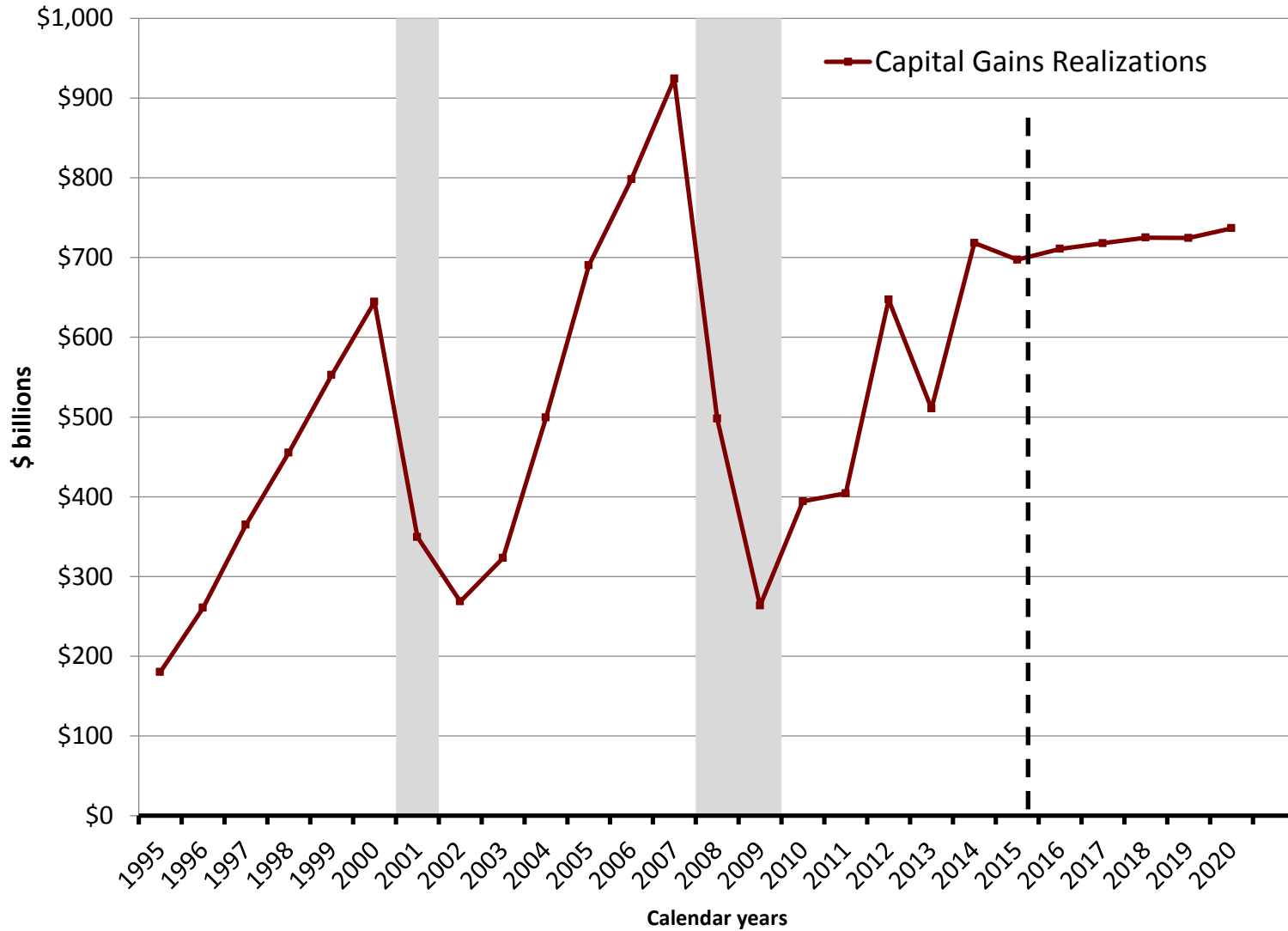
Percent change of two-quarter moving averages



Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (real GDP).

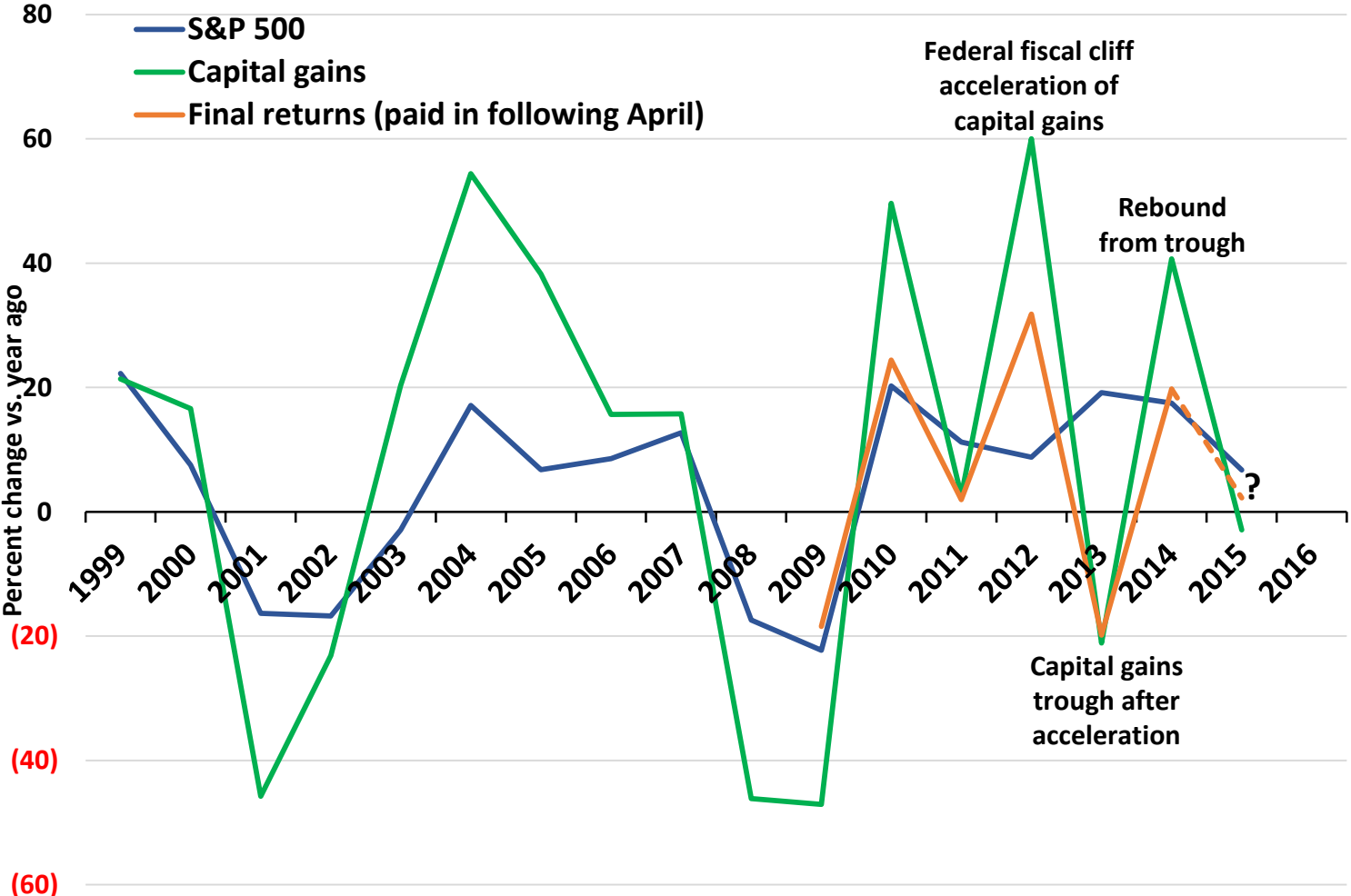
Notes: (1) Percentage change of two-quarter moving averages; (2) No legislative adjustments; (3) Recession periods are shaded.

Capital gains: Still below 2007 levels



Sources: Congressional Budget Office.

Percent change in S&P 500, capital gains, & April final returns, by tax year



Notes: (1) S&P 500 is calendar year average of daily adjusted closes; (2) Capital gains for 2015 are estimated by the CBO; (3) Final returns is median of state percentage changes; 2015 value (to be paid with April 2016 returns) is the authors' rough guess. Sources: (1) S&P 500 (Yahoo); (2) Capital gains (CBO, www.cbo.gov/publication/51129); (3) Final returns (Rockefeller Institute).

Fiscal reality & outlook

- State & local gov't finances hit hard by recession & financial crisis, much harder than economy
- The revenue recovery is weak & prolonged
- Differing fiscal, tax & economic structures play important roles
- Many states face fiscal stresses
 - Growing revenues volatility
 - Additional fiscal pressures in oil/coal states
 - AK, LA, NM, ND, OK, TX, WV, WY
 - Additional fiscal pressures in states with large pension liabilities:
 - CT, KS, IL, NJ, PA
- Long-term spending pressures
- Without significant policy changes, long-term fiscal sustainability is under threat

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The State University
of New York

**Rockefeller
Institute of Government**

*The Public Policy Institute of the
State University of New York*

411 State Street
Albany, NY 12203-1003
www.rockinst.org

Lucy Dadayan
Senior Policy Analyst
ldadayan@albany.edu