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By The Numbers
Weak Revenue Forecasts, Large Uncertainties Ahead

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Summary

States are debating and negotiating budgets for fiscal year 2018, which starts on July 1st in forty-six states. Revenue forecasts play a crucial role in determining whether policymakers have room to cut taxes or raise spending, or must do the opposite. We examine below the latest available state forecasts, which will influence these decisions.

States have lowered their forecasts and expect tax revenue to grow more slowly than in the quarter-century before the Great Recession, despite recent strength in the economy. The median income tax forecast for fiscal year 2017 now calls for 3.6 percent growth, down from the previous median of 4.0 percent. The median sales tax forecast for 2017 anticipates 3.1 percent growth, down from the previous 4.2 percent. The median income tax forecast for 2018 is 4.1 percent growth, and the median sales tax forecast calls for 3.5 percent growth.

Revenue forecasters always worry about risks. In the latest forecasts, many forecasters have expressed concerns about uncertainties related to the global economy, political risks in Europe, potential federal policy changes from the new administration, Federal Reserve Board actions, and changing demographics.

Introduction

State revenue forecasts play a critical role in helping policymakers decide how much revenue will be available as they debate budgets for an upcoming fiscal year. The forecasts also help states determine whether they will close the current fiscal year in balance, have extra funds available for the upcoming year, or need to close budget gaps.

Recently, many states have prepared or updated forecasts for the 2018 fiscal year, which begins on July 1st in forty-six states. If projected revenue is lower than expected or desired, legislators and governors may decide to raise taxes, cut spending, or withdraw money from reserve funds. (Shortfalls can also lead them to generate funds in other ways such as through budget gimmicks.) If projected revenue is greater than expected, they may do the opposite.

Revenue forecasts vary significantly from state to state, reflecting many factors including state economic conditions, oil supplies and oil prices, financial and real estate market developments, reliance on capital gains, state-specific policy changes, and others.

The Rockefeller Institute has gathered the latest-available state revenue forecasts for income and sales tax (the two largest state taxes) for as many states as practical (forty-six states in this report). We calculate growth rates from the data we collect.

Table 1 shows actual collections for fiscal years 2015 and 2016 and the most recent forecasts for fiscal years 2017 and 2018, as well as the month and year of the forecast. Table 2 shows the year-to-year percentage changes we calculated from states' forecasts, and median percentage changes.

The forecast dates shown in Table 1 provide insight into the information states had available when they prepared their forecasts — more-recent forecasts are able to incorporate newer information about the economy and tax revenue collections. The last time we examined state forecasts, in November, about half the forecasts had been prepared in April 2016 or earlier.[1] The forecasts we report on here were prepared about eight months later; in twenty states forecast dates are between January and February 2017. Many of these new forecasts will underlie the budgets states adopt for fiscal year 2018.

After the previous forecasts had been prepared, many states experienced income tax shortfalls on April 2016 tax returns related to the weak stock market of 2015; a sales-tax slowdown; and year-over-year declines in payments of estimated income tax. They also witnessed a substantial rise in the 2016 stock market after a beginning-of-year dip, an acceleration in economic growth, and election of a president whose promised federal tax cuts could influence state tax collections even before cuts are enacted. Some of these changes may be reflected in the forecasts we report on below, and some may not, depending upon when forecasts were prepared.

On balance, the changes since our last analysis have led states to lower their tax-revenue forecasts. The median income tax forecast for fiscal year 2017 now calls for 3.6 percent growth, down from the previous median of 4.0 percent. The median sales tax forecast for 2017 anticipates 3.1 percent growth, down from the previous 4.2 percent. States lowered their forecasts of tax revenue growth for 2018 as well. Given that the economy and stock market improved between forecasts, we believe these revenue forecast revisions largely reflect revenue that came in below expectations.

Forecasts for the Current Fiscal Year, 2017

States generally expect tax revenue to remain weak in fiscal year 2017, with a very slight pickup in growth from 2016. Based on recent tax revenue data, we suspect many forecasts will be revised downward further. In fact, several states have already revised revenues forecasts downward in the postelection period.[2]

Personal income tax: The median state forecast for personal income tax growth is 3.6 percent for 2017, slightly faster than the actual growth rate of 2.8 percent in 2016. Fourteen states forecast slower growth in 2017 than in 2016. Four states — Arkansas, Maine, Oklahoma, and Tennessee — project declines.

As we discussed in the most recent *State Revenue Report*, in late 2016 taxpayers may have expected significant federal tax cuts in 2017 after the election of Donald Trump, who promised such cuts. Taxpayers, thus, had an incentive to push income out of the 2016 calendar year into calendar year 2017, possibly reducing state tax collections in fiscal 2017 and boosting them in fiscal 2018. (For a more detailed discussion of the possible effects, please see *State Revenue Report #106*.[3])

The federal government and some states appear to be anticipating a shift in income from 2016 to 2017. The most recent analysis from the Congressional Budget Office estimated a 10.4 percent decline in capital gains in 2016, despite the strong stock market, followed by an 11 percent bounce-back in 2017.[4] California's Department of Finance estimates that capital gains declined by 3 percent in 2016 and will decline by an additional 4 percent in 2017.[5] (The Legislative Analyst's Office in California commented that the governor's income tax estimate appears too low, and noted that the capital gains decline projected for 2017 seemed at odds with the governor's forecast of stock market growth.[6]) New York anticipates a capital gains decline of 3 percent in 2016 followed by 7 percent growth in 2017.[7] Many other states do not publish their capital gains assumptions, but we suspect they have greatly varying views about this volatile and difficult-to-predict source of income.

Sales tax: States expect slightly faster growth in sales tax collections in 2017. The median state forecast for sales tax growth is 3.1 percent, up from 2.6 percent in 2016. Seventeen states forecast slower sales tax growth in 2017 than in 2016. Five states — Kansas, Michigan, New Mexico, Oklahoma, and Wyoming — project declines.

Forecasts for the Upcoming Fiscal Year, 2018

States are forecasting that personal income and sales tax collections will grow slightly faster in fiscal 2018 than in 2017.

Personal income tax: The median income tax forecast calls for 4.1 percent growth in fiscal year 2018, up from 3.6 percent in 2017. Twenty-three of the forty income-tax states for which we have data anticipate faster growth, while seventeen expect slower growth. Two states — Ohio and West Virginia — expect year-over-year declines. The declines in Ohio are mostly attributable to an across the board reduction in personal income tax rates.

States that expect the greatest acceleration in income-tax growth (i.e., where 2018 growth is expected to be much faster than 2017 growth) generally are anticipating a growth slowdown in 2017. For example, the four states with broad-based income taxes that foresee the greatest acceleration in 2018 — Arkansas, Hawaii, Maine, and Oregon — all forecast that the income tax will slow substantially in 2017 from 2016.[8] The reversals might reflect technical factors affecting the timing of tax collections, or other important factors that forecasters in the states have identified.

Sales tax: The median sales tax forecast calls for 3.5 percent growth in fiscal year 2018, up from 3.1 percent in 2017. Approximately half of the states that have released sales tax forecasts expect accelerating growth in 2018, and half expect slowing growth. Two states — Connecticut and West Virginia — expect year-over-year declines.

The states expecting the greatest acceleration in sales-tax growth are the oil-dependent states of New Mexico, Oklahoma, Texas, and Wyoming, all of which had weak growth or outright declines in 2017. They may now be forecasting that the worst will be over after fiscal 2017.

States Worry About Revenue Uncertainty

Forecasting revenues accurately is a hard task, particularly in times of economic and political turbulence. Any economic or political disturbance in the global sphere can lead to revenue volatility, which impedes accurate revenue forecasting. As discussed in our previous reports, "Volatility can be compounded by federal policies that have unintended and hard to measure consequences at the state level."[9] Any significant policy change at the federal level can make the job of the forecaster much harder and add to fiscal and budgetary challenges for states. Furthermore, states continue to face fiscal challenges caused by the sharp decline in oil prices and by changing demographics.

Many states raised concerns about uncertainty and slow revenue growth in their most recent forecasts.

In California, the governor's budget highlighted the following concerns:

> California's economy and revenues are expected to continue to grow, although somewhat more slowly than assumed in the 2016 Budget Act. The General Fund revenue forecast has been reduced, reflecting lower growth in wages, proprietorship income, consumption, and investment.… The downgraded revenue forecast for *personal income tax* is driven by lower wage growth. Because much of the employment growth since May has come from workers newly entering or reentering the labor force, the pressure to increase wages is somewhat lower than had been expected.… The *sales tax* forecast has been reduced to reflect slower growth in consumer spending and business investment. California's high housing costs are reducing the amount of income available for consumers to spend on taxable goods. The reduced *corporation tax* forecast reflects continued weak performance for corporate tax receipts as well as lower profits due to growing labor costs.[10]

In Massachusetts, the commissioner for the Department of Revenue raised concerns during his testimony in the state's consensus revenue hearing:

> The level of uncertainty in both the economic and political spheres remains high.… [T]he outlook for FY18 is perhaps even more uncertain than would normally be the case at this date.… The major sources of forecast uncertainty include the economic policies of the incoming Trump administration, political risks in Eurozone including changes due to Brexit, the impact of the strong U.S. dollar, the potential for Federal Reserve rate hikes, and slower global economic growth.[11]

In New York, the state budget office cited several risks and concluded that changes in federal policy are unlikely to be a major risk in the short term:

> The Budget Division baseline forecast assumes no major shifts in Federal tax or spending policies at this juncture. The precise shape of any such policy changes is highly uncertain and the timing such that their impact on the forecast for the current year is likely to be small; taken as a whole, the policy announcements issued to-day by the incoming administration create both upside and downside risks to the forecast. The current outlook calls for stronger growth in 2017 than in 2016, as the strength of the domestic labor and housing markets competes with weak demand from overseas. But there are a number of significant risks to the forecast.[12]

The report went on to cite significant positive and negative risks, including the euro-area economy, uncertain and poorly measured growth in China, and risks related to oil prices and Federal Reserve policy.

In Ohio, state officials highlighted positive and negative risks to the forecasts:

> Much of the risk to the forecast is tied to uncertainty about the timing, nature, and effects of potential policy changes arising from the change in administrations in Washington, D.C. Major prominent unknowns include the fate of business-related regulations, corporate taxes, infrastructure spending, health care, and international trade. On the positive side, a scaling back of burdensome regulations may free businesses from some costly obligations, especially for companies in banking and the energy sector.… The key downside risk to the forecast is that anti-trade rhetoric leads to policies that, in combination with the strong dollar, greatly weaken U.S. exports, damage the import supply chain, and undermine domestic growth.[13]

In Oregon, state forecasters warned about the impact of changing demographics on state tax revenues:

> As the baby boom population cohort works less and spends less, traditional state tax instruments such as personal income taxes and

general sales taxes will become less effective, and revenue growth will fail to match the pace seen in the past.[14]

In Texas, the comptroller of public accounts highlighted the impact of oil prices on the state economy and the risks associated with revenue forecasts:

> Contraction in activity related to oil and natural gas production has been a drag on state economic growth.… This revenue estimate anticipates continued slow to moderate growth for the Texas economy and for revenue collections in fiscal 2017 and the 2018-19 biennium. Risks to the estimate include constant uncertainty around oil prices, national economic policies, and the possibility of slow global economic growth.[15]

In Vermont, the biannual *Economic Review and Revenue Forecast Update* prepared for the state's Emergency Board and Legislative Fiscal Office raised several concerns related to changing demographics and to uncertainty related to the new federal administration. They noted:

> Demographic developments continue to represent a significant headwind that now, and in the future, will affect Vermont revenues in a variety of ways.… [W]ith the aging of the large baby boom cohort, the median age of the population is rising. As fertility rates have declined … almost all State population growth has come from net in-migration. If in-migration does not become net positive in the coming years, there will be significant budgetary and revenue challenges that derive from this.

In addition, the forecasting group in Vermont highlighted risks associated with the new administration's potential policies, and including a potential trade war with China.

> The primary macroeconomic forecast risks are associated with policy actions that may be pursued by the new Trump Administration - and uncertainty between what has been said and what may be done. While possible that some of the more extreme Trump proposals will be tempered by legislative processes and the realities of governing, there is a risk that erratic talk will turn into erratic policies and/or erratic policy implementation. The most pronounced economic threat comes from tariff threats and trade war risks – especially with China.… Potentially seismic changes in fiscal and monetary policy resulting from Trump economic policies also represent a forecast risk. After years of fiscal austerity and monetary stimulus, planned stimulative spending would trigger a reversal of monetary policy that could generate significant volatility in stock, bond and commodity prices. This transition, if abrupt, could slow growth and create financial instability.

However, the same forecast group also said,

> Most macroeconomic analyses to date suggest stated Trump economic policies could result in slightly stronger near term growth potential, especially if infrastructure spending and tax cuts are quickly enacted, with lower longer term growth and higher inflation due to the deficits that could accompany such policies. [16]

The demographic, economic, and policy risks raised by the states are real and could have negative consequences on state revenues and their economies both in the short-term and in the longer-term. There are positive risks as well: the potential for faster-than-expected economic growth or higher inflation could be good for state tax revenue. But state budget officials, with the responsibility to keep budgets balanced, understandably pay particular attention to downside risks.

Conclusion

Although state forecasts generally call for faster growth in 2018 than in 2017, the forecasted acceleration is quite small and revenue is forecasted to grow more slowly. In general, forecasted growth both for income tax and sales tax is much slower than historical growth rates, which averaged around 7 percent between 1981 and 2007, right before the start of the Great Recession. The overall picture is of continued, but sluggish, growth in fiscal years 2017 and 2018. The weak revenue forecasts reflect anticipated slow economic growth, low oil prices, the changing consumption and spending habits of Americans, long-term demographic changes, and anticipation of tax policy changes at the federal level that will have direct impact on state budgets, among other factors.

Table 1. State Revenue Forecasts for Income and Sales Tax

State	Forecast Month	Personal Income Tax ($ millions) FY 2015 Actual	FY 2016 Actual	FY 2017 Forecast	FY 2018 Forecast	Sales Tax ($ millions) FY 2015 Actual	FY 2016 Actual	FY 2017 Forecast	FY 2018 Forecast
United States		334,464	343,901	355,846	368,478	240,350	247,228	254,505	262,746
Alabama	Feb-17	3,725	3,722	3,859	3,976	1,927	1,935	2,008	2,081
Arizona	Jan-17	3,761	3,957	4,099	4,283	4,191	4,299	4,487	4,677
Arkansas	Nov-16	2,664	2,782	2,741	2,889	2,198	2,290	2,396	2,441
California	Jan-17	76,268	79,438	83,136	85,866	23,242	24,789	24,994	25,179
Colorado	Dec-16	6,350	6,527	6,869	7,281	2,880	2,894	3,068	3,208
Connecticut	Jan-17	9,151	9,175	9,438	9,739	4,205	4,182	4,249	3,884
Delaware	Dec-16	1,252	1,287	1,332	1,390	N/A	N/A	N/A	N/A
Florida	Dec-16	N/A	N/A	N/A	N/A	21,063	21,998	23,060	24,189
Georgia	Jan-17	9,679	10,440	10,895	11,455	5,390	5,480	5,631	5,849
Hawaii	Jan-17	1,988	2,116	2,120	2,246	2,993	3,206	3,347	3,501
Idaho	Jan-17	1,471	1,513	1,591	1,667	1,219	1,303	1,380	1,447
Illinois	Feb-17	15,913	13,806	13,911	14,484	8,030	8,063	8,155	8,305
Indiana	Dec-16	5,233	5,218	5,400	5,596	7,195	7,223	7,400	7,618
Iowa	Dec-16	4,207	4,356	4,608	4,854	2,753	2,811	2,865	2,990
Kansas	Nov-16	2,278	2,249	2,280	2,320	2,485	2,659	2,620	2,645
Louisiana	Jan-17	2,886	2,878	2,881	2,929	2,701	2,938	3,741	3,798
Maine	Dec-16	1,522	1,543	1,486	1,551	1,195	1,274	1,334	1,375
Maryland	Dec-16	8,346	8,518	8,991	9,390	4,351	4,444	4,593	4,741
Massachusetts	Dec-16	14,449	14,394	14,986	15,628	5,774	6,055	6,206	6,480
Michigan	Jan-17	8,980	9,368	9,730	10,044	7,819	7,874	7,838	7,957
Minnesota	Nov-16	10,403	10,739	11,083	11,754	5,131	5,233	5,379	5,604
Mississippi	Nov-16	1,743	1,769	1,840	1,896	2,261	2,300	2,326	2,388
Missouri	Jan-17	6,891	7,158	7,524	7,849	2,014	2,103	2,147	2,188
Montana	Nov-16	1,176	1,185	1,231	1,306	N/A	N/A	N/A	N/A
Nebraska	Oct-16	2,205	2,221	2,345	2,445	1,535	1,528	1,585	1,640
Nevada	Dec-16	N/A	N/A	N/A	N/A	1,033	1,077	1,140	1,201
New Jersey	Feb-17	13,250	13,356	13,940	14,435	8,875	9,245	9,442	9,616
New Mexico	Dec-16	1,340	1,327	1,331	1,346	2,167	2,022	1,919	2,061
New York	Nov-16	43,709	47,055	48,089	50,328	15,385	15,725	16,128	16,863
North Carolina	Feb-17	11,079	11,905	12,068	12,314	6,252	6,560	7,064	7,394
Ohio	Jan-17	10,397	10,053	10,415	9,421	10,525	10,959	11,090	11,436
Oklahoma	Dec-16	2,161	1,990	1,915	1,931	2,224	2,063	2,025	2,106
Oregon	Dec-16	7,330	7,763	7,916	8,447	N/A	N/A	N/A	N/A
Pennsylvania	Nov-16	12,107	12,506	12,993	13,489	9,493	9,795	10,096	10,361
Rhode Island	Nov-16	1,228	1,217	1,268	1,316	964	972	1,014	1,038
South Carolina	Nov-16	3,661	3,833	4,062	4,240	2,657	2,819	2,875	3,015
South Dakota	Dec-16	N/A	N/A	N/A	N/A	837	861	975	1,013
Tennessee	Jan-17	303	322	265	272	7,706	8,267	8,564	8,861
Texas	Jan-17	N/A	N/A	N/A	N/A	28,911	28,246	28,805	30,383
Utah	Nov-16	3,158	3,370	3,561	3,733	1,715	1,779	1,850	1,932
Vermont	Jan-17	706	747	770	795	365	371	382	397
Virginia	Dec-16	12,329	12,556	12,914	13,380	3,235	3,296	3,386	3,446
Washington	Nov-16	N/A	N/A	N/A	N/A	8,793	9,563	10,038	10,390
West Virginia	Jan-17	1,840	1,803	1,914	1,834	1,228	1,231	1,285	1,259
Wisconsin	Jan-17	7,326	7,741	8,050	8,360	4,892	5,066	5,215	5,370
Wyoming	Jan-17	N/A	N/A	N/A	N/A	544	432	405	420

Source: Individual state data collected by the Rockefeller Institute of Government.
Notes: Data are missing for Kentucky and North Dakota. In addition, no data are reported for Alaska and New Hampshire as both states don't have either personal income or sales tax.

Table 2. Percentage Change in State Forecasts						
State	Personal Income Tax			Sales Tax		
	2015 vs 2016	2016 vs 2017	2017 vs 2018	2015 vs 2016	2016 vs 2017	2017 vs 2018
US Median	2.8	3.6	4.1	2.6	3.1	3.5
Alabama	(0.1)	3.7	3.0	0.5	3.7	3.6
Arizona	5.2	3.6	4.5	2.6	4.4	4.2
Arkansas	4.4	(1.5)	5.4	4.2	4.6	1.9
California	4.2	4.7	3.3	6.7	0.8	0.7
Colorado	2.8	5.2	6.0	0.5	6.0	4.6
Connecticut	0.3	2.9	3.2	(0.5)	1.6	(8.6)
Delaware	2.8	3.5	4.3	N/A	N/A	N/A
Florida	N/A	N/A	N/A	4.4	4.8	4.9
Georgia	7.9	4.4	5.1	1.7	2.8	3.9
Hawaii	6.5	0.2	5.9	7.1	4.4	4.6
Idaho	2.9	5.1	4.8	6.9	5.9	4.9
Illinois	(13.2)	0.8	4.1	0.4	1.1	1.8
Indiana	(0.3)	3.5	3.6	0.4	2.5	2.9
Iowa	3.5	5.8	5.3	2.1	1.9	4.4
Kansas	(1.3)	1.4	1.8	7.0	(1.5)	1.0
Louisiana	(0.3)	0.1	1.7	8.8	27.4	1.5
Maine	1.4	(3.7)	4.4	6.6	4.7	3.1
Maryland	2.1	5.6	4.4	2.2	3.3	3.2
Massachusetts	(0.4)	4.1	4.3	4.9	2.5	4.4
Michigan	4.3	3.9	3.2	0.7	(0.5)	1.5
Minnesota	3.2	3.2	6.1	2.0	2.8	4.2
Mississippi	1.5	4.0	3.0	1.8	1.1	2.6
Missouri	3.9	5.1	4.3	4.4	2.1	1.9
Montana	0.8	3.9	6.1	N/A	N/A	N/A
Nebraska	0.7	5.6	4.3	(0.5)	3.7	3.5
Nevada	N/A	N/A	N/A	4.2	5.9	5.4
New Jersey	0.8	4.4	3.5	4.2	2.1	1.8
New Mexico	(0.9)	0.3	1.1	(6.7)	(5.1)	7.4
New York	7.7	2.2	4.7	2.2	2.6	4.6
North Carolina	7.5	1.4	2.0	4.9	7.7	4.7
Ohio	(3.3)	3.6	(9.5)	4.1	1.2	3.1
Oklahoma	(7.9)	(3.7)	0.8	(7.2)	(1.8)	4.0
Oregon	5.9	2.0	6.7	N/A	N/A	N/A
Pennsylvania	3.3	3.9	3.8	3.2	3.1	2.6
Rhode Island	(0.8)	4.1	3.8	0.9	4.4	2.4
South Carolina	4.7	6.0	4.4	6.1	2.0	4.9
South Dakota	N/A	N/A	N/A	2.9	13.2	3.9
Tennessee	6.3	(17.8)	2.6	7.3	3.6	3.5
Texas	N/A	N/A	N/A	(2.3)	2.0	5.5
Utah	6.7	5.7	4.8	3.7	4.0	4.4
Vermont	5.8	3.1	3.2	1.7	3.1	3.8
Virginia	1.8	2.9	3.6	1.9	2.7	1.8
Washington	N/A	N/A	N/A	8.8	5.0	3.5
West Virginia	(2.0)	6.2	(4.2)	0.2	4.4	(2.0)
Wisconsin	5.7	4.0	3.9	3.6	2.9	3.0
Wyoming	N/A	N/A	N/A	(20.6)	(6.3)	3.7

Source: Individual state data, analysis by the Rockefeller Institute.
Notes: Data are missing for Kentucky and North Dakota. In addition, no data are reported for Alaska and New Hampshire as both states don't have either personal income or sales tax.

Endnotes

1 For previous state revenue forecasts see Lucy Dadayan and Donald J. Boyd, *Widespread Declines in State Tax Revenues in the Second Quarter of 2016*, State Revenue Report #105, (Albany: The Nelson A. Rockefeller Institute of Government, November 2016), http://www.rockinst.org/pdf/government_finance/state_revenue_report/2016-11-30-srr_105.pdf.
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