STATE REVENUE REPORT

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Third Quarter Revenue Still Strong But Signs of Weakness Appear

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HIGHLIGHTS

- ❖ July-September tax revenue grew 7.1 percent over the same period in 1999, the strongest third quarter in the ten years of tracking by the State Revenue Report.
- ❖ Personal income tax revenue led the way again, growing 11 percent.
- ❖ The sales tax, however, slowed considerably, to 4.7 percent from last quarter's 7.3 percent, and many states were particularly weak. This was only partly due to the effects of legislated tax cuts.
- ❖ Some states are seeing sudden weakness in withholding tax payments, although aggregate growth was still quite strong.
- ❖ Voters cut taxes some more in November, although a couple particularly huge cuts were not passed.
- ❖ States are beginning to be more cautious about the upcoming year's revenue growth, and may hold back on further tax cuts unless the economic/stock market picture brightens.

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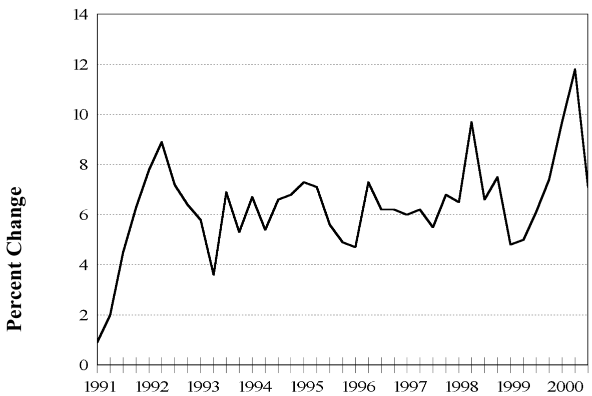


Figure 2. Real Quarterly Increase, 1991-2000

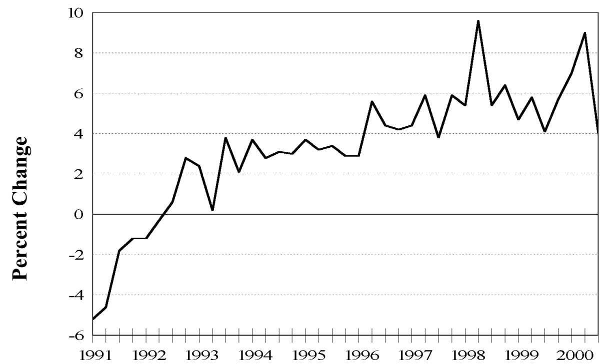


Table 1. Aggregate Change in Quarterly Tax Revenue, Adjusting for Legislated Tax Changes and Inflation

	Total Nominal Increase	*Adjusted Nominal Increase*	*Inflation Rate*	*Real Increase*
1994				
Jan.-Mar.	6.7%	6.3%	2.5%	3.7%
April-June	5.4	5.3	2.4	2.8
July-Sept.	6.6	6.1	2.9	3.1
Oct.-Dec.	6.8	5.8	2.7	3.0
1995				
Jan.-Mar.	7.3	6.6	2.8	3.7
April-June	7.1	6.4	3.1	3.2
July-Sept.	5.6	6.1	2.6	3.4
Oct.-Dec.	4.9	5.7	2.7	2.9
1996				
Jan.-Mar.	4.7	5.7	2.7	2.9
April-June	7.3	8.6	2.8	5.6
July-Sept.	6.2	7.4	2.9	4.4
Oct.-Dec.	6.2	7.5	3.2	4.2
1997				
Jan.-Mar.	6.0	7.4	2.9	4.4
April-June	6.2	8.3	2.3	5.9
July-Sept.	5.5	6.1	2.2	3.8
Oct.-Dec.	6.8	7.9	1.9	5.9
1998				
Jan.-Mar.	6.5	7.0	1.5	5.4
April-June	9.7	11.4	1.6	9.6
July-Sept.	6.6	7.1	1.6	5.4
Oct.-Dec.	7.5	8.0	1.5	6.4
1999				
Jan.-Mar.	4.8	6.5	1.7	4.7
April-June	5.0	8.0	2.1	5.8
July-Sept.	6.1	6.5	2.3	4.1
Oct.-Dec.	7.4	8.4	2.6	5.7
2000				
Jan.-Mar.	9.7	10.4	3.2	7.0
April-June	11.4	11.8	3.2	8.3
July-Sept.	7.1	7.7	3.5	4.1

Note: Inflation is measured by the Consumer Price Index.
Please call Fiscal Studies Program for pre-1994 data.

Table 2. Change in Quarterly Tax Revenue by Major Tax

	PIT	*CIT*	*Sales*	*Total*
1994				
Jan.-Mar.	7.6%	6.2%	6.9%	6.7%
April-June	1.3	9.1	9.0	5.4
July-Sept.	4.2	18.9	7.8	6.6
Oct.-Dec.	4.2	12.5	9.1	6.8
1995				
Jan.-Mar.	6.4	13.2	9.0	7.3
April-June	8.3	14.3	6.1	7.1
July-Sept.	6.3	8.0	5.2	5.6
Oct.-Dec.	5.6	7.9	4.2	4.9
1996				
Jan.-Mar.	7.1	(4.8)	5.6	4.7
April-June	11.3	0.9	6.8	7.3
July-Sept.	6.9	4.0	5.8	6.2
Oct.-Dec.	9.1	(3.0)	6.1	6.2
1997				
Jan.-Mar.	7.1	9.6	4.7	6.0
April-June	8.8	7.6	4.3	6.2
July-Sept.	8.4	(2.8)	5.8	5.5
Oct.-Dec.	8.3	4.5	5.3	6.8
1998				
Jan.-Mar.	9.3	2.3	5.6	6.5
April-June	19.5	(2.1)	5.3	9.7
July-Sept.	8.9	(0.2)	5.9	6.6
Oct.-Dec.	9.5	5.2	5.5	7.5
1999				
Jan-Mar.	6.6	(2.6)	6.1	4.8
April-June	6.0	(2.1)	7.3	5.0
July-Sept.	7.6	1.4	6.7	6.1
Oct.-Dec.	9.1	3.8	7.3	7.4
2000				
Jan.-Mar.	13.6	8.0	8.2	9.7
April-June	18.8	4.2	7.3	11.4
July-Sept.	11.0	5.7	4.7	7.1

Note: Please call Fiscal Studies Program for pre-1994 data.

Introduction

Tax revenue continued to grow at a brisk pace in July-September of 2000 compared with the same period in 1999. The personal income tax led the way again, with 11 percent growth, and the corporate income tax continued to grow moderately. The sales tax which had been quite strong in recent months, slowed perceptibly in July-September, only partly due to legislated changes. Legislated tax changes had relatively little effect on tax revenue growth once again.

In November, citizens went to the polls and voted on a number of tax-related initiatives and referenda. Most of the ones that passed were tax cuts or limitations on tax growth (the latter mainly imposed on property taxes), although California eased such a limitation. A few states had sales tax increases, either to pay for other tax cuts or for education spending.

Tax Revenue Growth

Table 1 shows the history of tax revenue growth before and after adjusting for legislated tax changes and inflation. The table shows that, although July-September's 7.1 percent growth did not match April-June's astounding 11.4 percent increase, it was the strongest third quarter growth in the ten-year history of this publication. Legislated tax changes had only a relatively small effect on revenue growth in the quarter, as they have for the past year, and after adjusting for these, the picture remained about the same. What did make a difference was inflation, which has been increasing steadily for the past two years. Thus, real underlying growth was a moderate 4.1 percent.

As Table 3 shows, revenue growth was strong in most regions, even double-digit in the Rocky Mountains and the Far West. The Great Lakes and Southeast states looked quite slow by comparison, at 2.0 percent and 3.6 percent, respectively. These regions were least strong in the April-June quarter as well, although they were not as weak as in this quarter. Even after adjusting for the effects of legislated tax changes, they grew only 3.3 percent and 3.7 percent. (See Figure 3.)

Table 3. Change in Quarterly Tax Revenue by State, July-September, 1999 to 2000

	PIT	*CIT*	*Sales*	*Total*
United States	**11.0%**	**5.7%**	**4.7%**	**7.1%**
New England	**16.7**	**(1.6)**	**6.8**	**9.7**
Connecticut	18.6	(4.5)¶	4.9¶	6.6¶
Maine	5.1	(39.2)	(1.0)¶	(0.6)¶
Massachusetts	18.5	(4.4)	9.3	12.5
New Hampshire	NA	36.8	NA	7.0
Rhode Island	8.7	90.7	7.5	12.1
Vermont	7.4	9.0	4.7*	4.1
Mid-Atlantic	**11.8**	**2.6**	**5.4**	**7.9**
Delaware	(5.2)¶	(9.3)	NA	(0.5)¶
Maryland	9.7¶	6.6	8.7¶	6.7¶
New Jersey	14.0	11.0	5.1¶	10.0
New York	13.1	0.3	6.7¶	9.0¶
Pennsylvania	9.0	1.2	3.4	5.4¶
Great Lakes	**4.3**	**(0.3)**	**0.7**	**2.0**
Illinois	8.3¶	26.5¶	2.4¶	6.0¶
Indiana	1.2	(6.8)	(2.5)	0.1
Michigan	0.1¶	0.5¶	1.9	(0.3)
Ohio	9.4	(131.0)	(0.4)	4.4
Wisconsin	(1.1)¶	(15.5)	0.6	(1.9)¶
Plains	**8.6**	**12.8**	**2.6**	**7.9**
Iowa	9.5	6.6	0.8	5.1
Kansas	11.3	(7.6)	2.6	5.2
Minnesota	7.2¶	24.0	2.8	10.2¶
Missouri	ND	ND	ND	ND
Nebraska	10.8	7.4	1.9	6.2
North Dakota	4.5	8.0	6.3	9.9
South Dakota	NA	NA	6.2	6.3
Southeast	**5.2**	**(6.3)**	**3.8**	**3.6**
Alabama	(5.1)	(4.0)	0.3	(0.6)
Arkansas	7.3	1.9	2.1	4.1
Florida	NA	5.8	2.5¶	3.4
Georgia	9.1	(9.1)	10.6	7.7
Kentucky	8.1	23.7	0.4	4.6
Louisiana	(3.4)	35.6	13.6*	9.1*
Mississippi	5.9¶	(2.9)	1.4	3.6
North Carolina	5.0	(28.2)	2.4	0.0
South Carolina	8.5	10.6	5.3	5.0
Tennessee	NA	(9.1)	2.6	4.4
Virginia	4.2	(9.9)¶	4.3¶	1.7
West Virginia	4.5	8.4	1.2	1.1
Southwest	**10.2**	**33.1**	**6.7**	**7.2**
Arizona	10.5	40.0	9.4	12.7
New Mexico	20.2	42.0	9.0	18.0
Oklahoma	7.7	10.0	6.4*	9.3
Texas	NA	NA	6.2	5.2
Rocky Mountain	**11.4**	**10.8**	**7.7**	**10.2**
Colorado	13.5¶	42.1	8.3	13.3¶
Idaho	15.9¶	(7.2)	5.7	5.9¶
Montana	7.2	(43.1)	NA	14.2
Utah	5.8	18.7	8.0	7.0
Wyoming	ND	ND	ND	ND
Far West	**20.0**	**19.0**	**7.2**	**13.6**
Alaska	NA	127.8	NA	30.6
California	22.4	15.0	9.3	16.3
Hawaii	2.9	(29.2)¶	7.6¶	5.2¶
Nevada	NA	NA	6.6	2.3
Oregon	8.0	29.7	NA	9.3
Washington	NA	NA	0.5	3.0¶

Table 4. Change in Quarterly Tax Revenue, Adjusting for Legislated Tax Changes

	PIT	*Sales*	*Total*
1994			
Jan.-Mar.	7.4%	6.3%	6.3%
April-June	1.8	8.0	5.3
July-Sept.	4.4	6.8	6.1
Oct.-Dec.	4.4	7.5	5.8
1995			
Jan.-Mar.	6.1	7.5	6.6
April-June	7.5	5.1	6.4
July-Sept.	7.2	5.4	6.1
Oct.-Dec.	7.1	4.2	5.7
1996			
Jan.-Mar.	8.8	5.7	5.7
April-June	14.1	6.5	8.6
July-Sept.	9.1	5.9	7.4
Oct.-Dec.	11.2	6.4	7.5
1997			
Jan.-Mar.	10.0	5.0	7.4
April-June	12.8	5.0	8.3
July-Sept.	9.5	6.2	6.1
Oct.-Dec.	10.7	5.9	7.9
1998			
Jan.-Mar.	10.0	6.5	7.0
April-June	23.3	5.9	11.4
July-Sept.	9.3	6.4	7.1
Oct.-Dec.	10.2	5.9	6.9
1999			
Jan.-Mar.	9.9	6.2	6.5
April-June	12.4	7.3	8.0
July-Sept.	8.3	6.9	6.5
Oct.-Dec.	11.0	7.5	8.4
2000			
Jan.-Mar.	13.8	8.8	10.4
April-June	18.6	7.8	11.8
July-Sept.	11.6	5.6	7.7

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, page 13.)
For pre-1994 data, call the Fiscal Studies Program.

Key to Interpreting Tables

All percent change tables are based on year-over-year changes.
[1] June payment data not available.
* 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.
[2] September data not available.
NA means not applicable.
ND means no data.
Historical Tables (Tables 1, 2 and 4) have been shortened to provide data only back to 1994. For data through 1990, call the Fiscal Studies Program.

As has been the case for the past few years, the personal income tax outpaced the corporate income tax and sales tax as the main source of state tax revenue growth. Tables 2 and 4 show growth in the major tax sources and total tax revenue, before and after adjusting for the effects of legislated tax changes. The personal income tax has been strong since April-June of 1995, especially during the second quarter of each calendar year, which includes final personal income tax settlements. During that same period, the corporate income tax, which was quite strong in 1994 and 1995, has generally been weak. However, the third quarter of 2000 marks five consecutive quarters of growth for that tax, even if that growth was not particularly brisk. The big surprise was the sales tax, which slowed in the third quarter, after three years of steadily accelerating growth.

Personal Income Tax

July-September does not generally show us much about the personal income tax. Final returns are filed in April, and fourth quarter estimated tax payments aren't due until January in most states. Bonuses are generally paid in December and January as well. About the only things affecting the personal income tax in the third quarter, then, are underlying employment growth, possibly some effects from capital gains, through estimated tax payments, and the effects of stock options, which are often taxed through withholding as well as through estimated tax payments.

The stock option picture, while hard to piece together in any complete way, is an interesting one this quarter. Several states have mentioned some slowing in withholding, which they attribute to slowdowns in realization of stock options. After all, the stock market, and particularly the stock-option-heavy high-tech sector, has been off its peak for several months now. This bears some watching in the coming months.

In the short-term, however, the picture is quite bright. Third quarter personal income tax revenue grew 11 percent over the same quarter in 1999, or 11.6 percent after adjusting for legislated tax changes. This growth, once again, was faster than in any other third quarter in our ten years of track-

Figure 3
Percent Change in Tax Revenue by Region, Adjusted for Legislated Changes July-September, 1999 to 2000

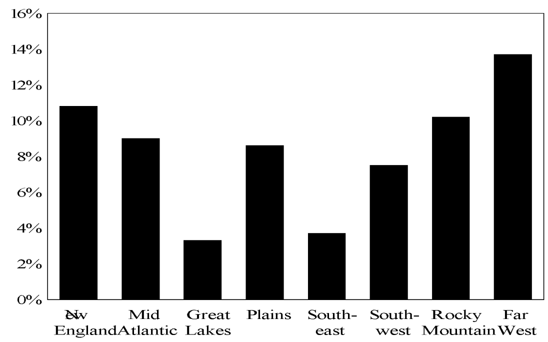


Figure 4
Change in Quarterly Tax Revenue by State, Adjusting for Legislated Changes, July-September, 1999 to 2000

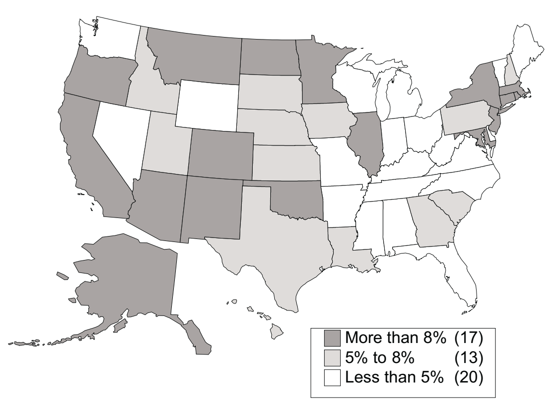
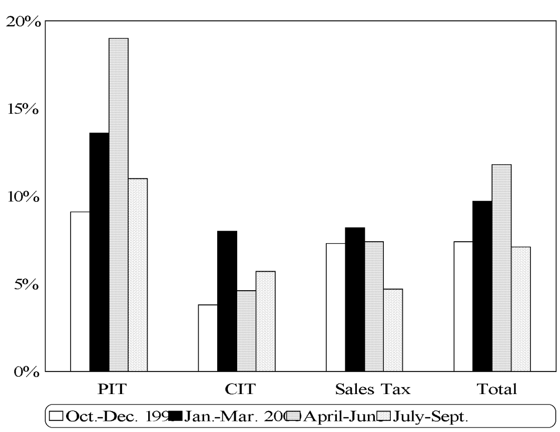


Figure 5
Change in Quarterly Tax Revenue by Tax, Last Four Quarters



ing, although it was slower than several recent first and second quarters. Eleven states had double-digit personal income tax growth.[1] Of these, none were affected by legislated changes that would have increased revenue growth, and a few had legislated cuts that significantly decreased it.

Amid this strong growth, declines in Alabama, Delaware, Louisiana and Wisconsin stand out starkly. Alabama's decline was probably caused by faster processing of personal income tax receipts this year – last year some had spilled over from June into July. Delaware's growth was depressed by tax cuts passed in 1999 to affect tax year 2000 revenue. Wisconsin's revenue was depressed by the current phase-in of that state's 1999 tax reform package. Louisiana still appears to be suffering from low job growth and a personal income tax structure that does not capture adequately what economic growth they do have.

Withholding

Table 5 shows year-over-year withholding growth for the four quarters of calendar 1999. Withholding is a good measure of current strength in personal income tax revenue, since it is based on current wages. It is also much less volatile than either of the other two components of the personal income tax, quarterly estimated/declared payments and final settlements, being based exclusively on wages.

However, wages are not as stable as they seem: both bonuses and stock options to high-income individuals are included in wage and withholding data, and these are far more volatile than regular paychecks. In addition, the fact that they accrue mostly to employees in the top tax brackets means that their relative importance in recent years has inflated the responsiveness of withholding tax growth in response to wage growth. This may account for the fact that many states have seen withholding grow much more strongly in recent quarters than available employment and wage growth data would seem to indicate.

In general, withholding growth has continued to be quite strong, as can be seen from Table 5. At 9.7 percent, it barely dipped below double-digits for the first time since October-December of last year. Since withholding growth was 10.1 percent last quarter, this does not indicate any sharp change from recent months. However, it might be seen as surprising in some ways that withholding is not weaker than it is, given that the stock market in general, and high-tech stocks in particular, are down off their peaks considerably, and have been for several months. Given the discussion above, one might expect bonuses and stock option activity to be shrinking. It is probably worth states' while to look for signs of such weakness. Note that the trend over the past few quarters has been generally, if gently, downward and – perhaps more significantly – that a few states have indicated that they have seen a sudden drop in withholding growth in the most recent months.

Nonetheless, the bottom line is that withholding is still quite strong, and even stronger after adjusting for the effects of legislated tax changes in states such as Delaware, Illinois, Michigan, Minnesota, Mississippi and Wisconsin.

Estimated Payments

Estimated tax payments offer a glimpse into revenue growth for tax year 2000, growth that won't be measurable until after April-June of 2001. Based on non-wage income, estimated tax collections are paid by some of the highest-income taxpayers, according to what they believe they will owe in taxes for the current year. The April-September period includes revenue from estimated tax payments for the first three quarters of tax year 2000, a slightly better picture than can be gleaned from the first two alone. Nonetheless, it is generally understood that estimated tax payers tend to base their early payments on what they owed the year before, rather than on what they expect to owe this year. This is because estimated taxpayers are granted safe harbor from penalties or fines for underpayment so long as early payments reflect a quarter of the prior year and final payments bring them within 90 percent of total liability. Nonetheless, the closer they get to the end of the year, the more they might be expected to make adjustments for major changes in their expected incomes – espe-

Table 5. Change in Personal Income Tax Withholding by State, Last Four Quarters

	1999	*2000*		
	Oct-Dec	*Jan-Mar*	*Apr-Jun*	*July-Sept*
United States	**9.4%**	**11.1%**	**10.1%**	**9.7%**
New England	**9.0**	**12.3**	**12.4**	**13.2**
Connecticut	9.7	8.9	11.8	10.6
Maine	15.9¶	11.2	14.3	9.9
Massachusetts	8.2¶	14.5	12.8	15.1
Rhode Island	5.4¶	4.1	7.6	8.7
Vermont	15.0	11.1¶	12.1	7.5
Mid-Atlantic	**9.8**	**14.3**	**11.2**	**9.7**
Delaware	(7.4)¶	(7.0)¶	(5.7)¶	(7.0)¶
Maryland[2]	6.5¶	10.4	7.9	3.9
New Jersey[1]	14.3	11.2	20.9	9.9
New York	11.7¶	18.6	12.4	11.7
Pennsylvania	6.2	8.4	8.5	10.1
Great Lakes	**6.5**	**8.3**	**4.5**	**3.2**
Illinois	6.1	7.6	5.5	6.7¶
Indiana	7.6	5.2	4.8	7.4
Michigan	7.2	8.1¶	(0.1)¶	(1.1)¶
Ohio	5.9	7.5	5.2	7.5
Wisconsin	5.8	13.0	8.1	(7.6)¶
Plains	**5.0**	**1.5**	**7.0**	**6.9**
Iowa	6.2	(1.2)	13.9	2.8
Kansas	9.3	9.6	10.7	12.7
Minnesota	(1.5)¶	(0.3)¶	0.6¶	5.5¶
Missouri	8.4	(2.0)	10.8	8.8
Nebraska	8.6	11.0	9.4	7.8
North Dakota	7.2	7.9	10.2	5.7
Southeast	**8.8**	**7.1**	**9.0**	**8.0**
Alabama	4.0	3.3	9.3	9.0
Arkansas	3.2	5.1¶	6.4	8.4
Georgia	2.6	11.5	14.5	12.7
Kentucky	12.3	2.6	ND	ND
Louisiana	4.4	11.1	8.8	(4.6)
Mississippi	9.0¶	5.9	5.7	6.0¶
North Carolina	8.2	7.6	8.1	8.4
South Carolina	8.5	6.7	5.8	5.7
Virginia	18.4	5.7	7.8	6.8
West Virginia	7.2	3.9	5.6	5.2
Southwest	**11.6**	**8.5**	**9.1**	**9.8**
Arizona	8.0	14.2	9.3	9.5
New Mexico	ND	ND	10.5	15.4
Oklahoma	16.3¶	2.2	8.4	8.2
Rocky Mountain	**4.4**	**9.6**	**8.6**	**10.9**
Colorado	2.7¶	8.4¶	7.3¶	13.2
Idaho	8.2	10.5	17.4	15.5
Montana	9.2	4.2	6.3	7.3
Utah	4.8	13.0	7.4	5.0
Far West	**15.4**	**17.9**	**17.3**	**17.4**
California	17.3	19.7	19.0	19.3
Hawaii	(3.2)¶	(0.4)¶	6.6	4.2
Oregon	9.1¶	10.8	10.1	9.6

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.

Table 6. Estimated Payments/Declarations

	April-Sept. (First three payments)	*July-Sept. (Third payment only)*
Average	**17.6%**	**17.2%**
Alabama	20.2	7.3
Arkansas	0.9	4.3
California	36.5	36.1
Colorado	14.1	0.8
Connecticut	11.0	18.4
Delaware	2.5	1.2
Georgia	13.5	5.7
Hawaii	1.4	1.4
Illinois	9.7	7.8
Indiana	(2.0)	(20.9)
Iowa	13.5	10.6
Kansas	11.1	8.0
Louisiana	7.1	4.2
Maine	7.5	6.5
Maryland	22.5	17.5
Massachusetts	16.6	9.7
Michigan	14.8	10.0
Minnesota	6.3	17.0
Mississippi	0.8	5.6
Missouri	13.7	26.9
Montana	21.6	18.9
Nebraska	12.8	12.7
New Jersey[1]	18.9	19.6
New Mexico	6.8	6.1
New York	12.6	16.3
North Carolina	7.5	6.6
North Dakota	6.7	3.0
Ohio	22.4	21.2
Oklahoma	3.3	4.0
Oregon	7.1	6.0
Pennsylvania	6.7	7.1
Rhode Island	15.0	19.8
South Carolina	5.2	7.6
Vermont	15.8	11.5
Virginia	10.7	10.9
Wisconsin	19.2	13.7

cially if they expect to earn radically less in the current year than in the one preceding it.

Table 6 shows the period encompassing the first three quarterly payments for tax year 2000 and the July-September quarter, which includes the third payment only for most states. Payers of the estimated tax do not appear to have changed their behavior notably in the third quarter. This may indicate that these taxpayers anticipate another good year for investment and other non-wage income, despite the recent rockiness on the stock market. On the other hand, if this strength is due to overpayments by these richer tapayers, the coming April could be very lackluster.

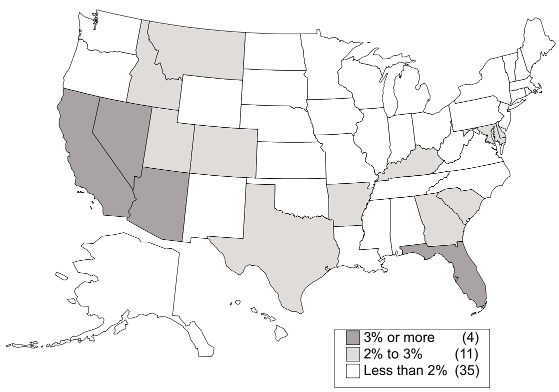
General Sales Tax

The sales tax had a sudden dip in growth in the July-September quarter (see Table 3). Although its 4.7 percent growth rate was not shockingly low, especially once adjusted for the effects of several large cuts (5.6 percent), it was still not anywhere near last quarter's 7.3 percent growth, let alone January-March's 8.2 percent. This is particularly odd, as the sales tax had been steadily increasing in strength for the past year and a half.

It is impossible to tell yet whether this decrease signals a trend of any kind. However, it would not be entirely surprising if this tax's growth did fall off a bit in the near to medium term. For one thing, higher fuel prices are already affecting the sales of highly priced, gas-guzzling sport utility vehicles. Consumers may also be affected by the more amorphous "wealth effect" of the stock market – that is, as market-invested assets lose value at a rapid rate, investors feel less wealthy, regardless of the fact that their prior wealth was only on paper. Faced with this situation, those individuals may put off larger purchases in the near term, until they find out if this is a temporary setback or a long-term change in their fortunes. Interestingly, as well, the savings rate has plummeted during the 1990s, reaching unsustainable levels, so many economic forecasters expect a slowdown in consumption, even without the aforementioned factors.

Two states, Georgia and Louisiana, saw double-digit growth in July-September (compared with six last quarter and 11 the quarter before that). Louisiana's growth was inflated by a couple of legislated tax increases, particularly the re-imposition of one cent on its four-cent sales tax on groceries. By contrast, three states – Indiana, Maine, and Ohio – had sales tax declines. Although Maine's was due to a rate cut and snack food exemption, neither of the other states' decreases could be ex-

Figure 6
Change in Non-Farm Employment
July-September, 1999 to 2000



plained away entirely by legislated tax changes. While it's always hard to tell anything about overall trends in a state from a single quarter, it may be significant that losses are being seen already. Indiana did suspend the gas tax during that period, but it seems unlikely that that had enough of an impact to explain that state's weakness. Ohio's decrease came out of nowhere – after healthy growth in April-June.

Corporate Income Tax

Corporate income tax collections rose 5.7 percent in the third quarter of 2000, marking the fifth consecutive quarter of growth for this tax source. (See Table 3.) It is interesting that corporate income tax should begin to recover from its five-year doldrums right about the time that the sales tax is declining, but this growth is hardly astonishing in light of the double-digit increases it sported during the first years of recovery from the recession of the early 1990s. States have not, in general, been too focused on the corporate income tax, however, since it represents a small share of most states' revenues, and since the personal income tax growth has been so much in the limelight. It is also by far the most volatile of the major state-level taxes, since payments or refunds of a small number of companies often cause large fluctuations and often have little to do with the current situation of the company or with newly legislated tax provisions.

Underlying Reasons for Trends

These revenue changes reflect three kinds of considerations: differences in state economic growth rates, how this growth affects each state's tax system, and tax changes legislated recently.

State Economies

One of the primary factors that affect state revenue growth is, obviously, the strength of that state's economy. This can be relatively hard to measure except in retrospect, as most data on state economies is available only many months later. Non-farm employment, tracked by the Bureau of Labor Statistics, is about the only broad-based, timely, high-quality economic data available for all 50 states and it provides a good measure of the "real" economy in the states.

There are some problems inherent in using these data as an indicator of revenue growth. For one thing, most taxes are based upon nominal measures such as income, wages, and profits, rather than employment, but these data are either not available at the state level, or not available on a timely basis. For another, employment data can be subject to large, retroactive revisions. In the past several years, these revisions have generally been upward.

Another major problem with using employment growth to track economic strength is that, in recent years, many states – especially in the Midwest – have found that their economies are bumping up against full employment. Although this may cause economic slowing or wage inflation, it certainly does not indicate that the residents of that state are in the same situation as a state with high unemployment and low employment growth. In many cases, in fact, the states with the highest employment growth have been those with relatively higher unemployment rates to begin with.

Table 7 shows year-over-year employment growth for each state and for the nation in each of the past four quarters. Figure 6 maps July-September's growth over the same period last year. According to the BLS's national data, the fourth quarter grew 2.0 percent over last year.[2]

Table 7. Non-Farm Employment Growth, July-September, 1999 to 2000

United States	**2.0%**
Sum of States	**1.9**
New England	**1.4**
Connecticut	1.4
Maine	1.8
Massachusetts	1.5
New Hampshire	0.7
Rhode Island	1.2
Vermont	1.9
Mid-Atlantic	**1.3**
Delaware	2.7
Maryland	2.1
New Jersey	1.3
New York	1.8
Pennsylvania	0.2
Great Lakes	**0.8**
Illinois	0.8
Indiana	0.8
Michigan	0.8
Ohio	0.8
Wisconsin	0.6
Plains	**1.2**
Iowa	1.9
Kansas	1.8
Minnesota	1.5
Missouri	1.2
Nebraska	(0.6)
North Dakota	0.1
South Dakota	0.8
Southeast	**2.1**
Alabama	0.8
Arkanas	2.5
Florida	4.2
Georgia	2.4
Kentucky	2.1
Louisiana	0.6
Mississippi	(1.0)
North Carolina	1.1
South Carolina	2.3
Tennessee	1.4
Virginia	1.8
West Virginia	0.7
Southwest	**2.9**
Arizona	4.5
New Mexico	2.0
Oklahoma	2.0
Texas	2.8
Rocky Mountain	**2.6**
Colorado	2.9
Idaho	3.0
Montana	2.5
Utah	2.1
Wyoming	1.6
Far West	**2.8**
Alaska	1.5
California	3.1
Hawaii	1.6
Nevada	4.4
Oregon	1.1
Washington	1.9

This represents some slowing from the 2.2 percent - 2.4 percent growth of the three prior quarters, but it is difficult to read much into this, as the numbers are subject to considerable revision periodically, and September's figures are preliminary.

As has been the case during most of the recent recovery, employment growth has been fastest in the western regions of the country. The Southwest and Far West states had the strongest growth, averaging 2.9 percent and 2.8 percent, respectively, with the Rocky Mountain region at 2.6 percent. The Great Lakes states had the lowest average growth, at 0.8 percent. Five states – Arizona, California, Florida, Idaho and Nevada – saw growth of three percent or more. Two states, Mississippi and Nebraska, saw employment decline.

Nature of the Tax System

Even if there were some perfect measure of the economy, states' tax systems do not all react to similar economies in the same way. States that rely heavily on the personal income tax tend to have larger increases during periods of economic growth. The more progressive the tax structure is, the faster tax revenue grows relative to income, especially if the state's tax brackets are not indexed to offset the effects of inflation. States that rely mostly on sales taxes do not see this same elastic revenue growth, and those few that rely almost exclusively on corporate income or severance taxes often see wild swings in revenue. Severance taxes are taxes on the removal of natural resources, such as oil and lumber.

This pattern has played out particularly strongly over the course of the past few years. Most states with personal income taxes have had extremely strong growth, partly because the incomes of upper-income (and thus upper-bracket) taxpayers have been growing at a much more rapid pace than those of middle-income taxpayers. Because their incomes are based upon volatile sources, such as stock options and capital gains, growth in the personal income tax has also been far more subject to wild swings than it would ordinarily be. A market downturn that affects relatively few wage earners could turn gains into losses for investors, sharply contracting a hitherto rich source of revenue almost overnight.

Tax Law Changes Affecting This Quarter

The final element that affects trends in tax revenue growth is legislated tax changes. When states artificially boost or depress their revenue growth with tax increases or cuts, respectively, it is very difficult to draw any conclusions about their current fiscal condition. That is why this report attempts to note where each state's revenue growth has been significantly affected by such changes. We also occasionally note when some large change in the manner of processing receipts has had a major impact on revenue growth, even though these are not due to legislation, as it helps the reader to know that the number is not indicative of underlying growth trends.

Although there were a number of major legislated changes in individual states affecting third quarter revenue growth, the aggregated effect of all of them was relatively minor. Actual revenue growth was 7.1 percent, and if there had been no legislated tax changes at all, it would have been 7.6 percent.

As has been the case for a while now, the personal income tax was relatively unaffected by legislated cuts, in aggregate, accounting for just under \$240 million of the \$562 million in net cuts. July-September is generally a lighter month for personal income tax cuts, since many such cuts are not subtracted from withholding. However, many are, and Delaware, Illinois, Maryland, Michigan, Minnesota and Wisconsin all had cuts of more than \$10 million. No states had major personal income tax increases affecting the quarter, and unlike in some recent quarters, no state had a triple-digit change in either direction.

The sales tax accounted for nearly two-thirds of the net cuts, or just under \$350 million. Florida and New York's sales tax cuts accounted for almost two-thirds of the total net sales tax cut. New York's biggest cut was from permanently exempting clothes under \$100 from the sales tax. Florida's was part of an overall revenue-neutral move to start sharing sales tax revenue with local governments (rather than cigarette tax collections).

Table 8. Approved Tax Related Ballot Measures

Arizona	Sales tax increase of 0.6% to provide \$445 million per year for schools.
Arkansas	Property tax relief, including an assessment increase limitation and homeowner credit. (This will trigger a 0.5% sales tax increase as an offset, although this was not mentioned in the ballot language.)
California	Change in property tax limitation: school bonds may be passed with 55% of the vote in local districts (down from a two-thirds supermajority).
Massachusetts	Personal income tax rate cut: flat rate will be phased down from 5.85% to 5%, at a cost of about \$1.2 billion per year.
Montana	Inheritance tax repeal: approximate cost is \$13.5 million per year.
Oregon	Personal income tax cut: higher limit on deduction of federal income taxes, at a cost of about \$130 million per year.
South Carolina	Two "car tax" type amendments: a vehicle property tax cut by 43%. Another amendment allowed counties to totally eliminate car, plane, and boat taxes in favor of a local sales tax of up to two percent.
Washington	General tax relief: Repeals and refunds all tax and fee increases in second half of 1999, and retroactively limits property tax valuation increases. (Currently beeing challenged in court.)

Other tax cuts affecting the quarter were swamped by Florida's cigarette tax revenue increase under the same law mentioned above. Thus, changes to other taxes had a slight positive influence on revenue growth.

Initiatives and Referenda in 2000

State legislatures were not in session during the past few months, but that did not mean inaction on the tax front. In November, voters in several states decided on ballot measures that will have significant impacts on revenues. As Table 8 shows, voter-approved measures generally fell into one of two categories: tax cuts and overall revenue-neutral shifts of tax burden. Generally, the tendency was toward cutting or limiting the growth of (usually local) property taxes or cutting other unpopular taxes, such as the personal income, estate or "car" taxes, occasionally paying for such cuts and limitations by increases to the sales tax. The two exceptions to this trend were both education-related: Arizona will dedicate its sales tax increase to schools; and California eased its supermajority requirement for passing local school district bond measures.

Voters rejected several very large tax cutting initiatives this November as well. One rejected initiative in Colorado would have cut most state taxes by $25 a year per taxpayer, until nearly all but the sales tax were eliminated. Oregon voters rejected a one billion dollar initiative to make federal income taxes fully deductible on state personal and corporate income taxes. Oregon also refused to limit state spending to 15% of state personal income and to require referenda for all tax and fee increases.

Conclusions

July-September was a generally strong quarter, but it may have within it the first hints of a slowdown in state tax revenues. The personal income tax, while still quite strong, may be falling off in a few states, especially in withholding, which contains taxes on bonuses and stock options for high-tax-bracket individuals. This will bear some watching in the coming months, as will end-of-year estimated income tax payments. The sales tax, however, is possibly even more interesting, being a leading indicator of potential trouble in the economy. Its slowdown from 7.3 percent to 4.7 percent this quarter (and much lower in some states) is worrying many revenue estimators. It will also bear watching to see whether this is a statistical blip or a longer-term trend, as it could signal a cooling off period for state revenue in general. If more bad news appears in the next few months, states may hold off on exacting more major tax cuts in their upcoming sessions.

Endnotes

1 Arizona, California, Colorado, Connecticut, Idaho, Kansas, Massachusetts, Nebraska, New Jersey, New Mexico and New York.

2 September's numbers were preliminary for the national employment estimates only.

Table 9: State Tax Revenue July-September, 1999 and 2000 (millions)								
	1999				*2000*			
	Personal Income	*Corporate Income*	*Sales*	*Total*	*Personal Income*	*Corporate Income*	*Sales*	*Total*
United States	**$39,413**	**$6,912**	**$38,924**	**$100,316**	**$43,763**	**$7,306**	**$40,747**	**$107,465**
New England	**2,927**	**374**	**1,718**	**6,105**	**3,414**	**368**	**1,835**	**6,698**
Connecticut	540	48	463	1,308	640	46	486	1,393
Maine	201	34	174	471	212	21	172	468
Massachusetts	1,908	245	867	3,495	2,261	234	948	3,932
New Hampshire	NA	29	NA	243	NA	39	NA	260
Rhode Island	184	10	162	394	200	19	174	442
Vermont	94	8	52	196	101	9	55	204
Mid Atlantic	**8,344**	**1,589**	**5,108**	**17,756**	**9,325**	**1,629**	**5,384**	**19,156**
Delaware	183	20	NA	374	173	18	NA	373
Maryland	733	95	393	1,386	804	102	427	1,479
New Jersey	1,027	271	913	2,648	1,171	300	960	2,913
New York	4,912	835	2,026	9,109	5,554	837	2,161	9,927
Pennsylvania	1,489	368	1,777	4,237	1,622	373	1,837	4,465
Great Lakes	**6,868**	**1,148**	**6,439**	**17,044**	**7,161**	**1,145**	**6,485**	**17,383**
Illinois	1,726	211	1,492	4,130	1,870	267	1,528	4,379
Indiana	902	220	928	2,701	913	206	905	2,703
Michigan	1,688	538	1,923	5,188	1,690	541	1,959	5,172
Ohio	1,564	17	1,515	3,206	1,711	(5)	1,508	3,346
Wisconsin	989	161	581	1,819	978	136	584	1,784
Plains	**2,477**	**359**	**2,204**	**5,482**	**2,691**	**405**	**2,261**	**5,914**
Iowa	487	55	426	1,030	533	59	430	1,083
Kansas	397	70	414	948	442	65	425	998
Minnesota	1,287	182	945	2,602	1,380	226	971	2,868
Missouri	ND	ND	ND	ND	ND	ND	ND	ND
Nebraska	261	37	223	560	290	39	227	595
North Dakota	44	16	82	184	46	17	87	202
South Dakota	NA	NA	115	158	NA	NA	122	168
Southeast	**7,793**	**1,381**	**10,092**	**22,665**	**8,195**	**1,294**	**10,480**	**23,484**
Alabama	590	60	423	1,441	560	58	425	1,432
Arkansas	372	68	423	917	399	69	432	955
Florida	NA	203	3,234	4,125	NA	214	3,316	4,265
Georgia	1,518	203	1,167	3,134	1,656	185	1,290	3,375
Kentucky	630	70	659	1,512	681	87	662	1,582
Louisiana	353	37	495	1,196	341	50	563	1,306
Mississippi	275	61	580	1,227	292	59	588	1,270
North Carolina	1,657	314	854	3,049	1,740	225	875	3,050
South Carolina	660	49	320	1,155	716	54	337	1,213
Tennessee	NA	146	1,159	1,776	NA	133	1,189	1,854
Virginia	1,517	139	550	2,503	1,580	125	574	2,546
West Virginia	221	31	228	629	231	34	231	636
Southwest	**1,140**	**178**	**5,254**	**9,369**	**1,257**	**237**	**5,608**	**10,048**
Arizona	557	128	675	1,360	615	179	739	1,533
New Mexico	108	9	195	378	130	13	212	446
Oklahoma	475	42	347	1,072	512	46	369	1,172
Texas	NA	NA	4,037	6,559	NA	NA	4,288	6,897
Rocky Mountain	**1,434**	**159**	**1,001**	**2,874**	**1,598**	**176**	**1,078**	**3,167**
Colorado	787	59	461	1,347	893	83	499	1,526
Idaho	183	26	197	496	212	25	208	525
Montana	113	32	NA	169	122	18	NA	193
Utah	351	42	343	862	371	50	371	923
Wyoming	ND	ND	ND	ND	ND	ND	ND	ND
Far West	**8,432**	**1,724**	**7,107**	**19,021**	**10,122**	**2,052**	**7,616**	**21,615**
Alaska	NA	56	NA	212	NA	129	NA	277
California	7,158	1,569	4,763	14,112	8,760	1,804	5,205	16,418
Hawaii	278	14	372	736	286	10	401	774
Nevada	NA	NA	474	631	NA	NA	505	646
Oregon	996	84	NA	1,114	1,076	109	NA	1,218
Washington	NA	NA	1,498	2,216	NA	NA	1,505	2,283

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 forty-second 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 most states is motor fuel taxes. Taxes on health-care providers to fund Medicaid programs are excluded as well.

California: non-general 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 corporation 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 non-economic 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.

This report contains third calendar quarter revenue data for 48 states. Missouri and Wyoming were unable to provide data prior to the publication of this report.

About The Nelson A. Rockefeller Institute of Government's Fiscal Studies Program

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. Donald J. Boyd, who has spent two decades analyzing state and local fiscal issues, is director of Fiscal Studies.

This report was written by Elizabeth I. Davis, the Program's Senior Policy Analyst. Graduate assistant Nicholas Jenny assisted with much of the data gathering and analysis. Michael Cooper, the Rockefeller Institute's Director of Publications, did the layout and design of this report, with assistance from Michele Charbonneau.

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