States Will Be Raising Their Economic Forecasts But May *Lower* Their Revenue Forecasts

Donald J. Boyd and Nicholas W. Jenny

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Alan Greenspan and many economic forecasters now think the recession is over and the national economy is in a recovery. This is good news for state governments, many of which released budgets in January and February based on a far more dire economic outlook.

In December, when states were putting budgets together, the "Blue Chip" consensus called for growth in real gross domestic product (GDP) in 2002 of 1.0 percent. States tend to budget conservatively, and many states planned on an even more subdued outlook: the median forecast by the 25 states from which we have obtained economic forecasts called for growth of only 0.5 percent.

Private forecasters have raised their outlook considerably: the March Blue Chip consensus is now at 2.0 percent and may go up again next month as forecasters incorporate recent good economic news into their models.

Viewed in isolation, this spells good news for state budgets. This should lead states to raise forecasts of economically sensitive items such as the sales tax and withholding. However, they may still lower revenue forecasts on the bottom line due to one very important fact: recent revenue collections have been far below budgeters' forecasts:

- Total tax collections in the October-December quarter declined by 2.7 percent, as an upcoming Rockefeller Institute of Government *State Revenue Report* will detail.

- Worse still, tax collections in January were devastating for states with income taxes. An estimated payment of income tax was due on January 15 in most states. Estimated payments reflect stock market and economic activity from last calendar year and typically are made by higher-income taxpayers with capital gains and other nonwage income. Some taxpayers make the payment in December, so they can deduct it from their federal taxes. The payments in December and January were dramatically worse than states expected. Of the 35 states for which we have complete information, the median payment was down 14.6 percent from the same period last year. This is a stunning reversal from last year, when payments were up 18.2 percent for the year as a whole. The table shows the percentage change in the December/January payment for all the states that are available.

- The January estimated payment can prove a harbinger of revenue from tax returns filed in April, and several state forecasters we spoke with now expect to lower substantially their forecasts for this important period.

Change in Estimated Payments
December 2001 - January 2002
Percentage Change Year-Over-Year

Vermont	(40.1)	Ohio	(13.9)
Delaware	(38.3)	Pennsylvania	(13.8)
New Jersey	(37.0)	Iowa	(12.5)
California	(36.9)	Oregon	(11.9)
Massachusetts	(35.7)	Kansas	(11.8)
Rhode Island	(32.9)	South Carolina	(9.7)
Georgia	(31.5)	Oklahoma	(9.5)
Colorado	(27.3)	Nebraska	(8.9)
Minnesota	(25.6)	North Dakota	(4.8)
Maine	(22.8)	Arkansas	(3.8)
New York	(22.7)	Indiana	0.9
Missouri	(22.0)	West Virginia	1.7
North Carolina	(19.8)	Hawaii	2.0
Michigan	(19.3)	Mississippi	4.3
Alabama	(18.8)	Louisiana	9.8
Virginia	(18.8)	Montana	17.6
Maryland	(16.9)	Arizona	103.3
Illinois	(14.6)		

The January shortfall, plus downward revisions for April and beyond could easily outweigh the good news from higher economic forecasts. (In fact, California's Legislative Analyst's Office recently forecast an additional $3.9 billion shortfall largely because revenue collections were so bad.)

Although a recovering economy is helpful to states, their budgets will continue to be buffeted by forces not reflected in simple measures of the economy. These forces, which include stock values that remain well below their peak, a drastic decline in taxable wages related to stock options, and rapidly accelerating Medicaid costs, will restrain direct state spending and state aid to local governments in the year ahead.

The net effect yields a seeming paradox: states with income taxes may revise revenue forecasts down at the same time that they raise their economic forecasts. This will add some unfortunate spice to this year's budget debates.

The Nelson A. Rockefeller Institute of Government is the public policy research arm of the State University of New York. Don Boyd is the Deputy Director of the Institute. Nick Jenny is a Senior Policy Analyst in the Institute's Fiscal Studies Program. Some data used in this report is from the Institute's state revenue database. For more, see the *State Revenue Report*.

Contact Information:
Nicholas W. Jenny
Fiscal Studies Program
The Nelson A. Rockefeller Institute of Government
411 State Street
Albany, NY 12203-1003
(518) 443-5833
(518) 443-5274(fax)
jennyn@rockinst.org
www.rockinst.org