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State Revenue Flash Report

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State Tax Revenue Now Flat, for the First Time Since 2002 Recession: After Weak Third Quarter, Further Declines Likely Lie Ahead

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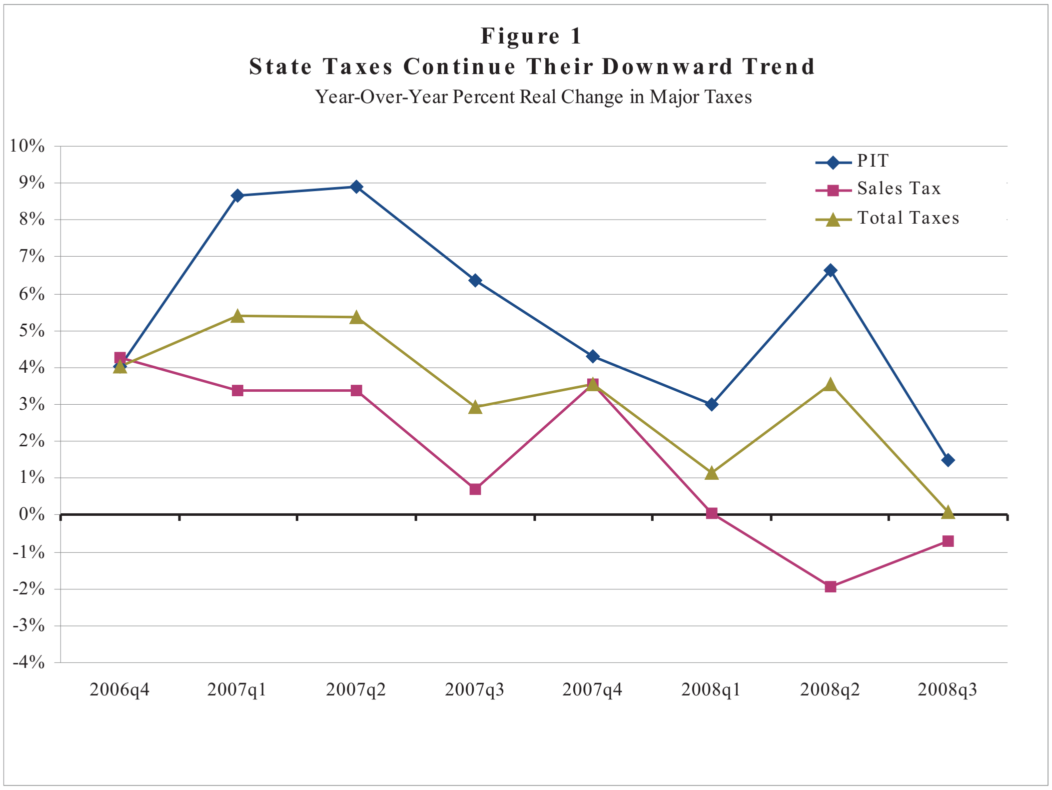
State tax collections continued their downward trend in the July-September quarter, according to preliminary data the Rockefeller Institute of Government gathered from 42 states. Total tax revenue for these states was essentially flat, rising by 0.1 percent over the same quarter last year. That rate of change was down sharply from the 50-state growth rate of 3.6 percent in the April-June quarter, and 17 states reported declines in total tax revenues from the same quarter of 2007.[1] After adjusting for economy-wide inflation of 2.7 percent, real tax revenue declined by 2.6 percent nationally and was down in 31 of the 42 states.[2]

We expect revenue collections to deteriorate further in coming quarters, with year-over-year change likely heading into negative territory for the first time since the last recession in 2002. Revenues are likely to be down substantially when income tax returns are filed in the April-June quarter of 2009, for reasons given in our last Revenue Report. We will provide a full report on the July-September quarter, and further analysis of the revenue outlook for the states, after Census Bureau data for the quarter are available.

As Figure 1 shows, the two largest taxes (income and sales taxes), as well as total taxes, have been trending downward. See Table 1 for national totals over the last two years, and Tables 2 and 3 for regional and state breakdowns of the most recent quarter.

The income tax, no longer buoyed by the "bump" from 2007 tax returns that boosted growth in the April-June quarter, slowed to 1.5 percent growth in July-September versus a year ago.[3]

This was a slowdown of 5.2 percentage points from last quarter's temporarily high 6.7 percent growth. The sales tax, down 0.7 percent, was below last year's amount for the second quarter in a row. The corporate income tax — a relatively small share of the typical state's tax revenue — was down 8.3 percent from last year.



The sales tax decline is particularly noteworthy because it reflects the leading edge of the just-beginning decline in consumer spending. According to Rockefeller Institute analysis of preliminary data from the Bureau of Economic Analysis, real consumption of durable and nondurable goods — an important component of state sales tax bases — declined by 1.9 percent in the quarter versus the same period last year. This was the largest such decline in 17 years and will be followed by further and possibly sharper declines, as the impact of layoffs, lower stock market values, lower housing prices, and shaken consumer confidence reduce the ability and willingness of consumers to spend. We expect further declines in the sales tax in coming quarters.

Among regions, the Far West was the weakest by far with a decline of 3.8 percent. At this point, only California, Hawaii, and Oregon are included, and the region may look slightly better when data for more states are available. The Southeast was next-weakest, with a decline of 2.4 percent. The preliminary data suggest that every region has weakened from last quarter, with the exception of the Southeast, which is down about as much this quarter as last quarter.

States with the highest tax revenue growth for the July-September quarter were: Vermont, Wyoming, and Maryland.

- In Vermont, the strong revenue growth was partially due to legal settlement of $6.03 million. However, according to the Department of Finance and Management, “given the instability in the national economy, we do not expect revenues to exceed targets for the remainder of the fiscal year ... we do not believe that the elevated revenues seen in September will continue in future months.”[4]

Table 1
Income Tax Slowed, Other Taxes Declined
Percent Change in State Tax Collections vs. Same Quarter Year Ago

Quarter	PIT	CIT	Sales	Total
2006q4	4.0	12.6	4.3	4.0
2007q1	8.7	14.8	3.4	5.4
2007q2	8.9	1.7	3.4	5.4
2007q3	6.4	(1.8)	0.7	2.9
2007q4	4.3	(8.8)	3.5	3.6
2008q1	3.0	(3.7)	0.1	1.2
2008q2	6.7	(7.6)	(1.9)	3.6
2008q3 (preliminary)	1.5	(8.3)	(0.7)	0.1

Notes: See the "Data Notes" Box.

- In Wyoming, the strong revenue growth is mostly attributable to higher prices for natural gas.
- In Maryland, the revenue growth is due to recent tax rate increases in almost all major taxes. Specifically, the sales tax rate increased from 5 percent to 6 percent in January of 2008, the corporate income tax increased from 7 percent to 8.25 percent, the tobacco tax doubled from $1 to $2 per pack, and there were increases in the personal income tax with several new, higher tax brackets.

While we do not yet have complete data on 8 states (see the "Data Notes" box), the news from the two largest missing states is not good:

- Preliminary collections in North Carolina were down 3.9 percent, reflecting a 5.9 percent sales tax decline, 0.1 percent growth in the income tax, and declines in most other taxes.[5]

Table 2
Far West And Southeast Were Weakest
Quarterly Tax Revenue by Region
July-September 2007 to 2008, Percent Change

	PIT	CIT	Sales	Total
United States	**1.5**	**(8.3)**	**(0.7)**	**0.1**
New England	0.6	6.6	3.2	2.4
Mid Atlantic	3.0	(3.5)	1.2	2.2
Great Lakes	2.8	18.5	1.4	1.9
Plains	3.6	(14.7)	1.4	1.4
Southeast	0.1	(15.9)	(3.3)	(2.4)
Southwest	(3.6)	(17.8)	3.3	2.6
Rocky Mountain	(1.5)	5.1	(3.7)	(0.8)
Far West	0.4	(19.7)	(5.6)	(3.8)

Source: Individual state data, analysis by Rockefeller Institute.

Table 3
Percent Change in Tax Revenue, Early-Reporting States

Quarterly Tax Revenue by Major Tax, by States

July-September 2007 to 2008, Percent Change

	PIT	CIT	Sales	Total
United States	**1.5**	**(8.3)**	**(0.7)**	**0.1**
New England	**0.6**	**6.6**	**3.2**	**2.4**
Connecticut	(7.4)	18.9	21.0	1.6
Maine	4.5	(12.1)	3.2	1.3
Massachusetts	3.2	8.6	(2.3)	1.6
New Hampshire	NA	2.2	NA	(2.5)
Rhode Island	(4.2)	12.6	(2.0)	(2.1)
Vermont	4.8	(25.0)	(5.2)	32.8
Mid Atlantic	**3.0**	**(3.5)**	**1.2**	**2.2**
Delaware	1.4	11.4	NA	4.8
Maryland	3.3	43.0	13.8	9.0
New Jersey	(0.8)	2.8	(4.8)	(1.2)
New York	3.9	(12.0)	2.6	4.1
Pennsylvania	2.4	(7.8)	0.2	(2.1)
Great Lakes	**2.8**	**18.5**	**1.4**	**1.9**
Illinois	3.7	1.5	2.5	2.7
Indiana	(1.9)	(10.5)	2.7	(0.6)
Michigan	7.9	55.7	3.0	5.5
Ohio	(1.1)	NM	0.7	(0.6)
Wisconsin	4.5	(15.8)	(6.0)	0.2
Plains	**3.6**	**(14.7)**	**1.4**	**1.4**
Iowa	5.1	(6.1)	15.9	7.7
Kansas	2.3	(29.4)	1.8	0.8
Minnesota	5.7	(14.0)	(4.8)	0.0
Missouri	2.4	(14.5)	(2.5)	0.4
Nebraska	(1.7)	(8.5)	7.9	1.0
North Dakota	ND	ND	ND	ND
South Dakota	NA	NA	ND	ND
Southeast	**0.1**	**(15.9)**	**(3.3)**	**(2.4)**
Alabama	(0.4)	8.0	3.3	2.3
Arkansas	5.7	(10.7)	3.7	4.8
Florida	NA	2.9	(6.9)	(8.2)
Georgia	(2.4)	(6.8)	(3.1)	(2.6)
Kentucky	6.6	(49.8)	1.6	0.4
Louisiana	(12.0)	(35.7)	2.4	(1.0)
Mississippi	(1.9)	(14.6)	2.9	1.2
North Carolina	ND	ND	ND	ND
South Carolina	0.2	(16.7)	(12.5)	(1.2)
Tennessee	NA	(25.2)	(2.0)	(4.8)
Virginia	2.8	(14.5)	(3.9)	(1.2)
West Virginia	2.7	(38.4)	(4.5)	(1.5)
Southwest	**(3.6)**	**(17.8)**	**3.3**	**2.6**
Arizona	(4.9)	(27.4)	(7.3)	(7.8)
New Mexico	ND	ND	ND	ND
Oklahoma	(1.8)	8.8	4.8	8.4
Texas	NA	NA	5.2	4.0
Rocky Mountain	**(1.5)**	**5.1**	**(3.7)**	**(0.8)**
Colorado	5.0	(6.2)	(2.9)	1.7
Idaho	(5.1)	(1.2)	(5.2)	(4.3)
Montana	ND	ND	NA	ND
Utah	(12.6)	23.2	(3.4)	(3.8)
Wyoming	NA	NA	(5.5)	18.2
Far West	**0.4**	**(19.7)**	**(5.6)**	**(3.8)**
Alaska	NA	ND	NA	ND
California	0.0	(19.6)	(6.3)	(4.5)
Hawaii	1.0	(37.3)	1.8	1.5
Nevada	NA	NA	ND	ND
Oregon	3.9	(18.3)	NA	2.4
Washington	NA	NA	ND	ND

Source: Individual state data, analysis by Rockefeller Institute.

Notes: NA - not applicable; ND - no data, NM - not meaningful.

- ❖ Preliminary reports for Washington state suggest that year-over-year tax revenue declined.

Perhaps the most notable state fiscal event since our last revenue report is that New York published its midyear update to the budget, announcing that a $1.5 billion gap had opened up in the current year and that the gap for 2009-10 had nearly doubled, to $12.5 billion.[6]

The largest impact was in the income tax, where their forecast was driven downward by the expectation of a 36 percent decline in capital gains and a 43 percent decline in financial sector bonuses. These factors are not unique to New York: The capital gains decline will reverberate in most income-tax-reliant states, and the financial services decline will affect many states but will be more concentrated in a few. We will analyze these issues in our next full report.

We expect further revenue shortfalls and midyear budget cutting among states as the fiscal year progresses. Governors and budget offices are working hard now to prepare budgets for the 2009-10 fiscal year, most of which will be released in December and January. Those budgets will include policy proposals designed to close yawning budget gaps, and are likely to include significant cuts in many areas. Undoubtedly some states will include tax increases as well, but that is hard to predict. Often the "T"-word cannot be spoken until after significant spending cuts have been considered and accepted.

Endnotes

1 A recent report by the Center on Budget and Policy Priorities (CBPP) on tax collections in 15 states noted that tax data were extremely weak, and declined after adjusting for inflation using the Consumer Price Index. Our data for overlapping states are very consistent with the data in that report, but our later reporting date allows us to include more states. In addition, we have adjusted for inflation using the gross domestic product price index from the Bureau of Economic Analysis, which was not available at the time of that report. The GDP price index, which measures economy-wide inflation, shows somewhat slower price growth than the Consumer Price Index used in the CBPP report.

2 Adjusted using the gross domestic product price index from the Bureau of Economic Analysis.

3 This boost was discussed in the *State Revenue Reports* for the January-March and April-June quarters.

4 Department of Finance and Management, "Monthly Revenue Reports," September 2008, available from http://finance.vermont.gov/reports_and_publications/revenues.

5 Office of the State Comptroller, "State of North Carolina General Fund Monthly Financial Report," September 30, 2008.

6 Laura Anglin, "Mid-Year Financial Plan Update 2008-09 through 2011-12," New York State Division of the Budget, October 28, 2008, www.budget.state.ny.us/budgetFP/myu2008/Final0809MidYearUpdate.pdf.

Data Notes

Data for the most recent quarter were collected directly from states by the Rockefeller Institute of Government and are preliminary and generally will not be available for all 50 states. The 8 states for which we do not have full data for the quarter reported on here are: Alaska, Montana, Nevada, New Mexico, North Carolina, North Dakota, South Dakota, and Washington.

Data for earlier quarters are from the U.S. Bureau of the Census. These data generally are for all 50 states. Thus, not only are data collection methods for the current quarter different from prior quarters but the states included are different as well. While it is technically possible to remove this quarter's missing states from the Census Bureau data for earlier quarters, to provide more-comparable data over time in these "Flash" Reports, we believe that would slow down the release of the report and could also be confusing. Instead, we strike a compromise, waiting until we have data for geographically dispersed states, including most large states.

The two data sets use different data sources and always will have some differences. We use the data we collect directly to get the earliest possible read on what is happening to state government finances, and we use the Census Bureau data to get a slightly less timely but more comprehensive, comparable, and rigorous view of what has happened across states and over time.

The "Total Tax" data collected by the Rockefeller Institute are for a set of taxes that often is somewhat more volatile than the full set of taxes reported on by the Census Bureau and so this number can be more "bouncy" in our data than in the Census data and will be subject to revision when Census data are available. (For example, our data do not generally include motor fuel taxes deposited to dedicated funds. Because these taxes, which are included in Census Bureau data, tend to be relatively stable, the overall Census Bureau totals tend to be more stable over time than our reported totals.) There will be revisions in tax revenue growth rates for individual taxes and individual states when the full Census Bureau data are available.

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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.

This report was researched and written by Donald J. Boyd, senior fellow, and Lucy Dadayan, senior policy analyst. Michael Cooper, the Rockefeller Institute's director of publications, did the layout and design of this report, with assistance from Michele Charbonneau.

Additional information is available at www.rockinst.org.