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STATE REVENUE FLASH REPORT

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State Tax Revenue Declined Sharply in Fourth Quarter

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The October-December quarter of 2008 brought troubling news for states. Preliminary tax collection data for the quarter show widespread declines for most states for all three major sources of tax revenue, as well as overall taxes.

Total tax revenue declined in 35 of 47 early-reporting states, with 21 states seeing declines from all three major sources of tax revenue — sales, personal income, and corporate income. We expect revenue collections will deteriorate even further in the coming quarters, based on recent developments in the economy and early data from January 2009. We will provide a full report on the October-December quarter, and further analysis of the 2009 outlook for the states, after Census Bureau data for the quarter are available.

The Rockefeller Institute's compilation of data from individual states shows collections from major tax sources were $141.8 billion in the fourth quarter of 2008, compared to $147.1 billion in the same quarter of 2007. Sales tax declines represented $3.3 billion of the total, $5.4 billion loss for the period. Overall tax revenue declined by 3.6 percent in nominal terms, the weakest performance since a 9.4 percent year-over-year decline in the second quarter of 2002. After adjusting for inflation, tax revenues declined by 5.6 percent in the fourth quarter compared to the same quarter of 2007. Corporate income tax saw the sharpest decline at 9.3 percent, followed by sales tax and personal income tax at 5.9 and 0.4 percent, respectively.

The overall picture for total taxes and personal income tax is worse if we exclude revenue numbers for a single state, Oregon. Its reported revenue growth over the year was unusually high because the state returned over $1 billion to personal income taxpayers in the October-December quarter of 2007. Due to a lack of surplus revenue in 2008, Oregon did not make such rebate payments this year. Excluding Oregon, the total state tax revenue for the nation would be down 4.3 percent, and personal income tax down 2.2 percent.

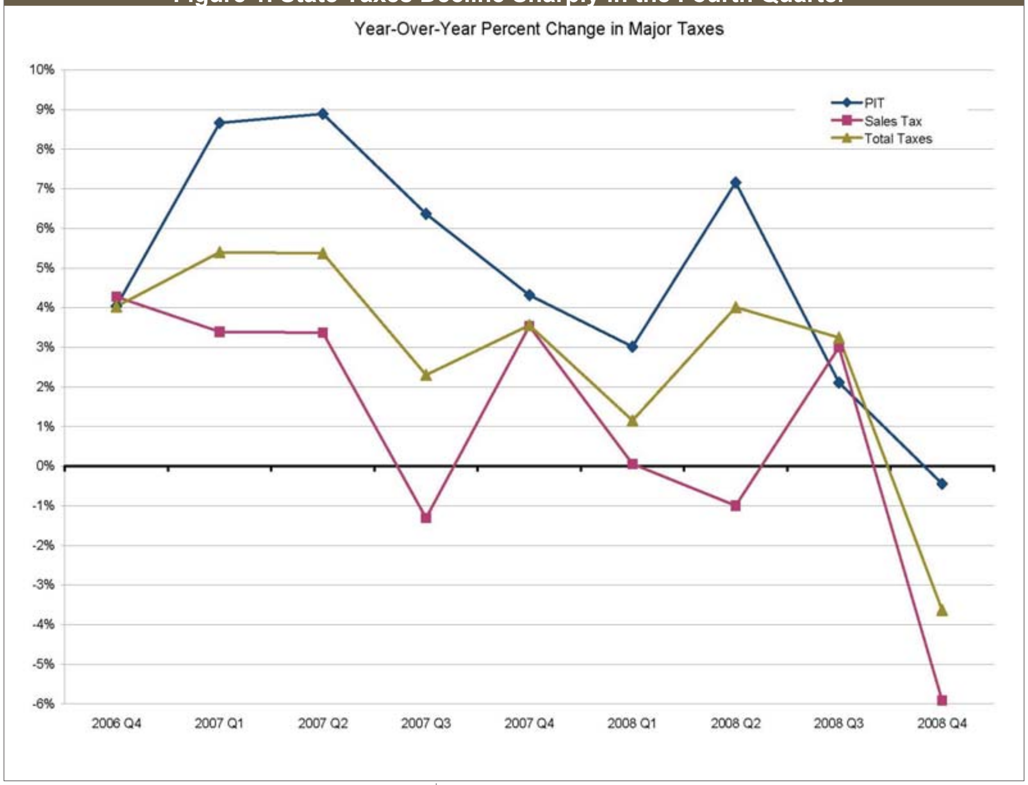
Personal income tax revenue made up nearly 40 percent of total tax revenue reported in the fourth quarter. With 38 of 41 personal income tax states reporting so far, 22 states saw declines compared to the same quarter of last year, Utah seeing the great decline at 17.4 percent.

With 43 of 45 sales tax states reporting so far, fully 35 had sales tax declines compared with the same quarter last year. Eight reported double-digit declines (see Figure 1 and Table 1).

HIGHLIGHTS

- Overall state tax revenues fell by 3.6 percent in the fourth quarter of 2008, compared to the same quarter a year earlier. The decline was widespread, with three-quarters of reporting states reporting collections turning downward.
- Weaker sales tax revenue represented the bulk of the decline, with a 5.9 percent year-over-year decrease. Personal income tax collections fell more modestly, by 0.4 percent, while corporate tax collections dropped 9.3 percent. This is the first time since 2002 that revenues from all three major sources declined.
- States will very likely face deeper revenue shortfalls as the fiscal year progresses, based on recent economic developments and very early data for 2009.

Figure 1. State Taxes Decline Sharply in the Fourth Quarter



Among the corporate income tax states, 30 of 42 reporting states saw declines for the fourth quarter compared to the same quarter of the previous year, 27 with double-digit declines.

As Table 2 shows, all regions saw declines in total tax collections (for state-by-state patterns see Figure 2). The Rocky Mountain region was the weakest by far in terms of personal income, corporate income, and total tax revenue collection. Even though Montana is excluded from the region at this point, it is unlikely that the region will look better when data from Montana become available. The Plains region saw the smallest decline in total tax revenues, at 0.3 percent. The region had only slight growth of 0.4 percent in sales taxes, and 2.5 percent growth in personal income tax. But even in the Plains region, most states did poorly. North Dakota is about the only state in the country that is doing well, and its sales tax was up 14.4 percent. Iowa's sales tax was up 20.7 percent, but this was due to a sales tax increase enacted last year. The sales tax was down 3.8 percent on average in the other Plains states.

Table 1. All Major 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)	(1.3)	2.3
2007q4	4.3	(8.8)	3.5	3.6
2008q1	3.0	(3.7)	0.1	1.2
2008q2	7.2	(7.3)	(1.0)	4.0
2008q3	2.1	(5.4)	3.0	3.2
2008q4 (preliminary)	(0.4)	(9.3)	(5.9)	(3.6)

Notes: See the "Data Notes" Box.

Table 2. Rocky Mountain and Far West Were Weakest

Quarterly Tax Revenue by Region

October-December 2007 to 2008, Nominal Percent Change

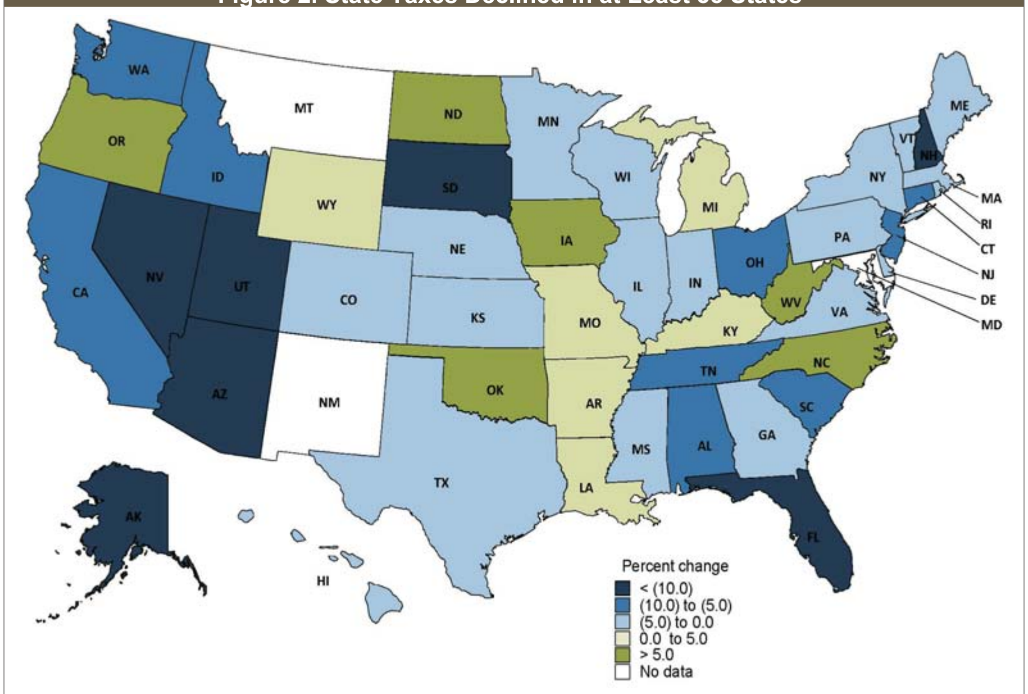
	PIT	CIT	Sales	Total
United States	**(0.4)**	**(9.3)**	**(5.9)**	**(3.6)**
New England	(3.7)	(20.6)	(8.4)	(4.5)
Mid Atlantic	0.2	(4.5)	(5.9)	(2.3)
Great Lakes	(3.1)	27.1	(6.2)	(2.6)
Plains	2.5	(29.4)	0.4	(0.3)
Southeast	1.5	(13.4)	(6.5)	(3.3)
Southwest	(3.5)	(16.2)	(0.6)	(4.5)
Rocky Mountain	(7.3)	(41.4)	(9.6)	(8.7)
Far West	0.8	(17.8)	(9.8)	(5.9)

Source: Individual state data, analysis by Rockefeller Institute.

Employment Conditions

Employment data for the fourth quarter of 2008 illustrate the underlying economic weakness behind declining tax revenues. Overall, year-over-year employment growth for the nation has declined almost continuously since the first quarter of 2006, but this is the first quarter that employment saw a drop as large as 1 percent, according to preliminary data from the Bureau of Labor Statistics. Employment declined in 45 states in the fourth quarter of 2008 compared to the third quarter of 2008 (see Figure 3). The states that added jobs in the fourth quarter were Alaska, North Dakota, Oklahoma, Texas, and Wyoming, with Wyoming seeing the highest increase at 0.8 percent.

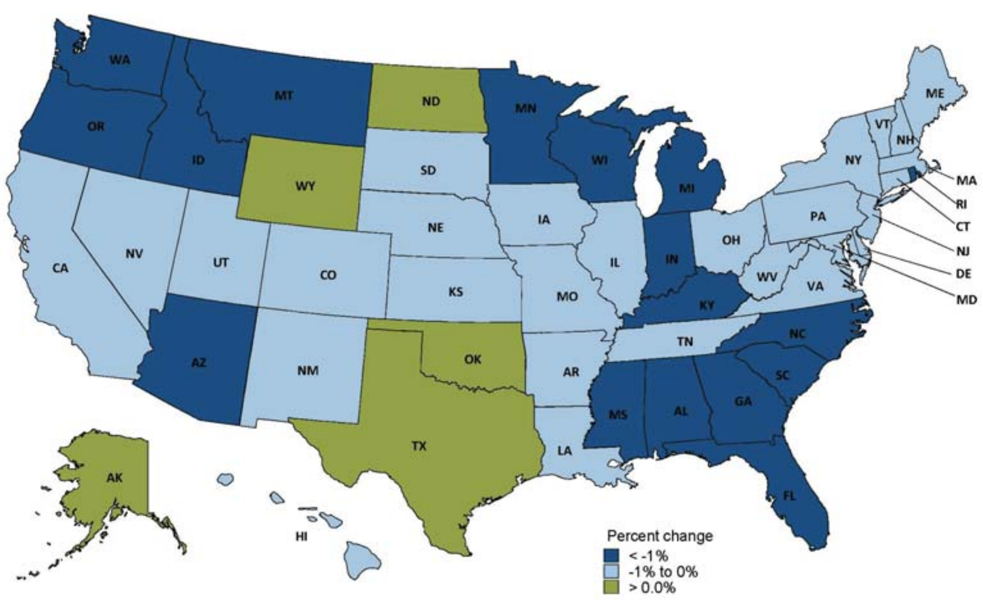
Figure 2. State Taxes Declined in at Least 35 States



The Outlook

Early data for 36 states reporting results for January so far show that tax revenue collections worsened further compared to the same month of last year. Deeper revenue shortfalls and more budget cuts are likely on the way for most states as the fiscal year progresses. As discussed in a recent report by the Rockefeller Institute, tax revenues generally fall sharply after a recession for two or more years

Figure 3. Employment Declined in at Least 45 States in the Fourth Quarter of 2008



before any recovery.[1] As the National Conference of State Legislatures reports, "Lawmakers were aware of the slowing economy when drafting their FY 2009 budgets, but none could have foreseen a collapse of the magnitude that has stricken state finances."[2]

Recent economic news likely portends continued weakening of tax revenues in 2009. Further declines in employment, with more than 600,000 jobs lost nationwide in both January and February, will dampen sales and income-tax collections. After the Bureau of Economic Analysis reported a sharp, 6.2 percent drop in gross domestic product during the final quarter of 2008, many economists downgraded earlier predictions for recovery later in 2009. Sales of new one-family homes in January were 48 percent below the year-ago level. As of early March, the S&P 500 index was down more than 20 percent from the start of 2009. All these indicators point to more, potentially deeper, trouble for states in the year ahead.

Data Notes

Data for the most recent quarter were collected by the Rockefeller Institute of Government. They are preliminary and generally will not be available for all 50 states. The three states for which we do not have data for the quarter reported on here are: Maryland, Montana, and New Mexico. Data for earlier quarters are from the U.S. Bureau of the Census.

The two data sets use different data sources and will always have some differences. The Rockefeller Institute collects data from 50 states to get the earliest possible read on what is happening to state government finances, and we use the Census Bureau data to get a perspective that is slightly less timely but more comprehensive and more comparable 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. So this number can be more "bouncy" in our data than in the Census data and can be subject to considerable change when Census data are available.

Table 3. Percent Change in State Tax Revenue

Quarterly Tax Revenue by Major Tax, Early Reporting States
October-December 2007 to 2008, % change

	PIT	CIT	Sales	Total
United States	**(0.4)**	**(9.3)**	**(5.9)**	**(3.6)**
New England	**(3.7)**	**(20.6)**	**(8.4)**	**(4.5)**
Connecticut	(7.9)	(77.0)	(13.3)	(8.5)
Maine	(1.0)	(11.9)	(7.8)	(3.9)
Massachusetts	(1.9)	11.7	(5.2)	(1.4)
New Hampshire	NA	(37.0)	NA	(11.6)
Rhode Island	(4.1)	(11.0)	(4.3)	(2.8)
Vermont	(0.6)	(42.2)	(0.8)	(4.4)
Mid-Atlantic	**0.2**	**(4.5)**	**(5.9)**	**(2.3)**
Delaware	(0.0)	NM	NA	(2.1)
Maryland	ND	ND	ND	ND
New Jersey	(0.3)	(24.0)	(7.7)	(6.8)
New York	(0.4)	11.9	(6.3)	(0.2)
Pennsylvania	2.6	(9.0)	(3.7)	(2.4)
Great Lakes	**(3.1)**	**27.1**	**(6.2)**	**(2.6)**
Illinois	(2.4)	(10.1)	(6.6)	(4.1)
Indiana	(1.4)	23.9	(3.6)	(2.4)
Michigan	0.2	88.7	(9.3)	2.4
Ohio	(7.3)	(24.7)	(8.1)	(7.6)
Wisconsin	(3.6)	(34.1)	0.8	(2.6)
Plains	**2.5**	**(29.4)**	**0.4**	**(0.3)**
Iowa	(1.1)	(21.7)	20.7	5.1
Kansas	3.3	(15.2)	(3.9)	(2.0)
Minnesota	1.4	(56.4)	(4.5)	(3.5)
Missouri	7.4	4.2	(2.5)	2.5
Nebraska	(4.6)	2.6	(0.7)	(2.4)
North Dakota	11.6	(25.9)	14.4	10.2
South Dakota	NA	NA	(10.7)	(11.8)
Southeast	**1.5**	**(13.4)**	**(6.5)**	**(3.3)**
Alabama	(2.2)	(35.4)	(9.8)	(5.7)
Arkansas	1.4	17.6	0.3	1.6
Florida	NA	(20.6)	(10.5)	(15.6)
Georgia	(3.5)	(28.6)	1.6	(2.9)
Kentucky	7.7	(23.7)	(2.7)	2.2
Louisiana	1.1	4.7	(0.7)	1.3
Mississippi	3.8	(0.1)	(0.7)	(0.3)
North Carolina	2.6	48.7	(9.7)	6.1
South Carolina	(5.1)	(68.8)	(5.9)	(6.7)
Tennessee	NA	(23.9)	(7.5)	(7.3)
Virginia	5.3	(37.7)	(11.5)	(3.5)
West Virginia	12.2	(9.4)	11.6	9.0
Southwest	**(3.5)**	**(16.2)**	**(0.6)**	**(4.5)**
Arizona	(8.3)	(25.0)	(13.1)	(11.6)
New Mexico	ND	ND	ND	ND
Oklahoma	3.3	10.0	11.1	9.6
Texas	NA	NA	0.7	(5.0)
Rocky Mountain	**(7.3)**	**(41.4)**	**(9.6)**	**(8.7)**
Colorado	(0.5)	(41.6)	(5.1)	(4.6)
Idaho	(8.1)	(17.1)	(11.3)	(7.9)
Montana	ND	ND	NA	ND
Utah	(17.4)	(51.1)	(16.8)	(16.5)
Wyoming	NA	NA	(0.3)	4.6
Far West	**0.8**	**(17.8)**	**(9.8)**	**(5.9)**
Alaska	NA	(59.6)	NA	(15.1)
California	(8.4)	(15.4)	(9.8)	(9.4)
Hawaii	4.3	NM	(9.1)	(4.3)
Nevada	NA	NA	(12.7)	(11.7)
Oregon	314.9	(48.9)	NA	184.6
Washington	NA	NA	(9.0)	(7.4)

Source: Individual state data, analysis by Rockefeller Institute.
Notes: NA - not applicable; ND - no data, NM - not meaningful.

Endnotes

1 See Donald J. Boyd, “What Will Happen to State Budgets When the Money Runs Out?” Rockefeller Institute of Government, February 19, 2009.

2 See National Conference on State Legislatures, “Update on State Budget Gaps, FY 2009 & FY 2010,” February 6, 2009.

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This report was researched and written by Senior Policy Analyst Lucy Dadayan and Senior Fellow Donald J. Boyd. Michael Cooper, the Rockefeller Institute’s director of publications, did the layout and design of this report, with assistance from Michele Charbonneau. Robert B. Ward, deputy director of the Institute, directs the Fiscal Studies Program.

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