



THE NELSON A.  
**ROCKEFELLER**  
**INSTITUTE**  
OF GOVERNMENT

# The Fiscal Environment & State Tax Reform

**The New Normal: Government  
Working More Efficiently**

**Session:**

***Tough Times: Case Studies of  
States Doing More With Less***

**A Conference of the Pew  
Center on the States**

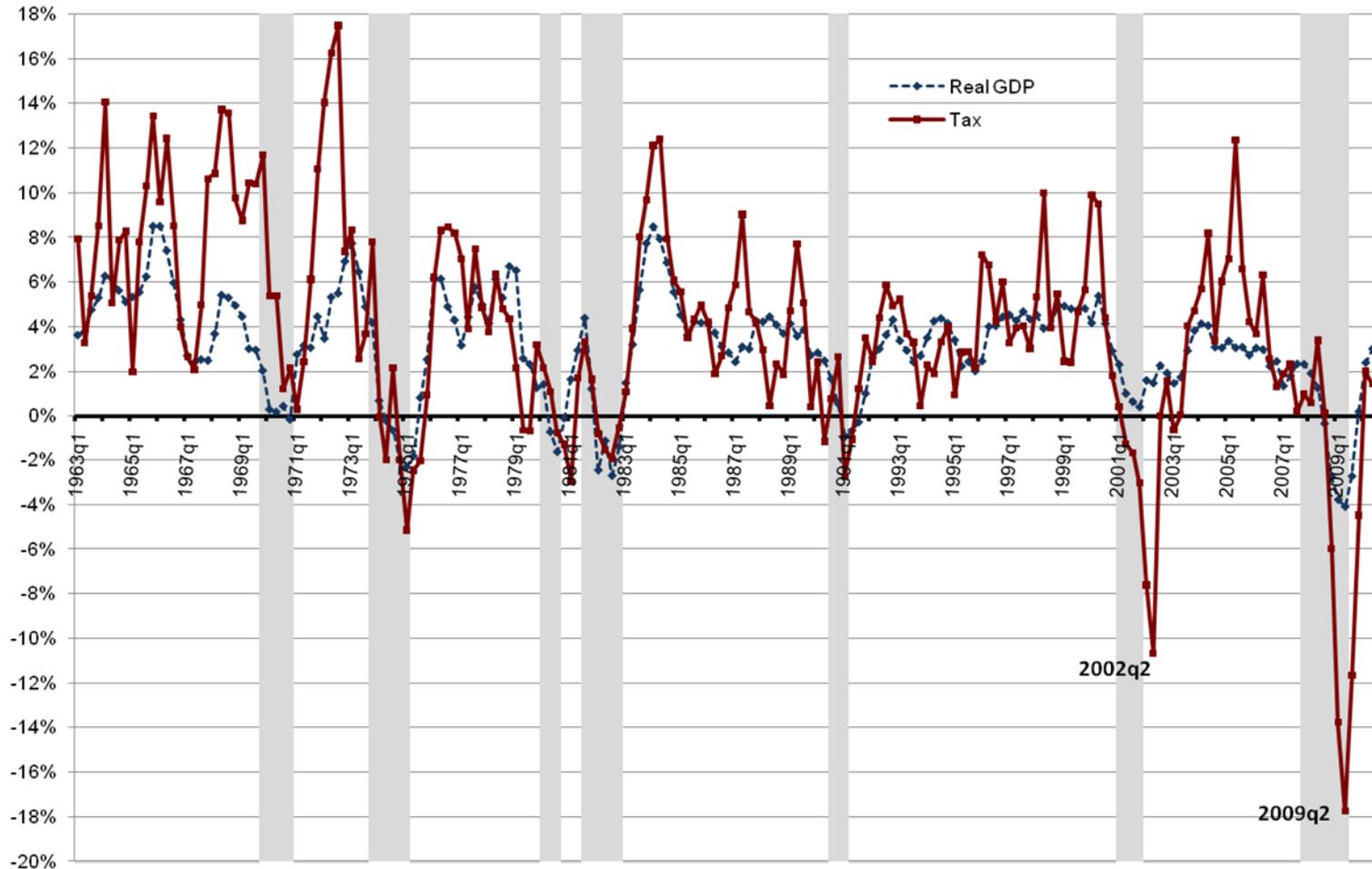
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# Worst state government tax declines in 5+ decades

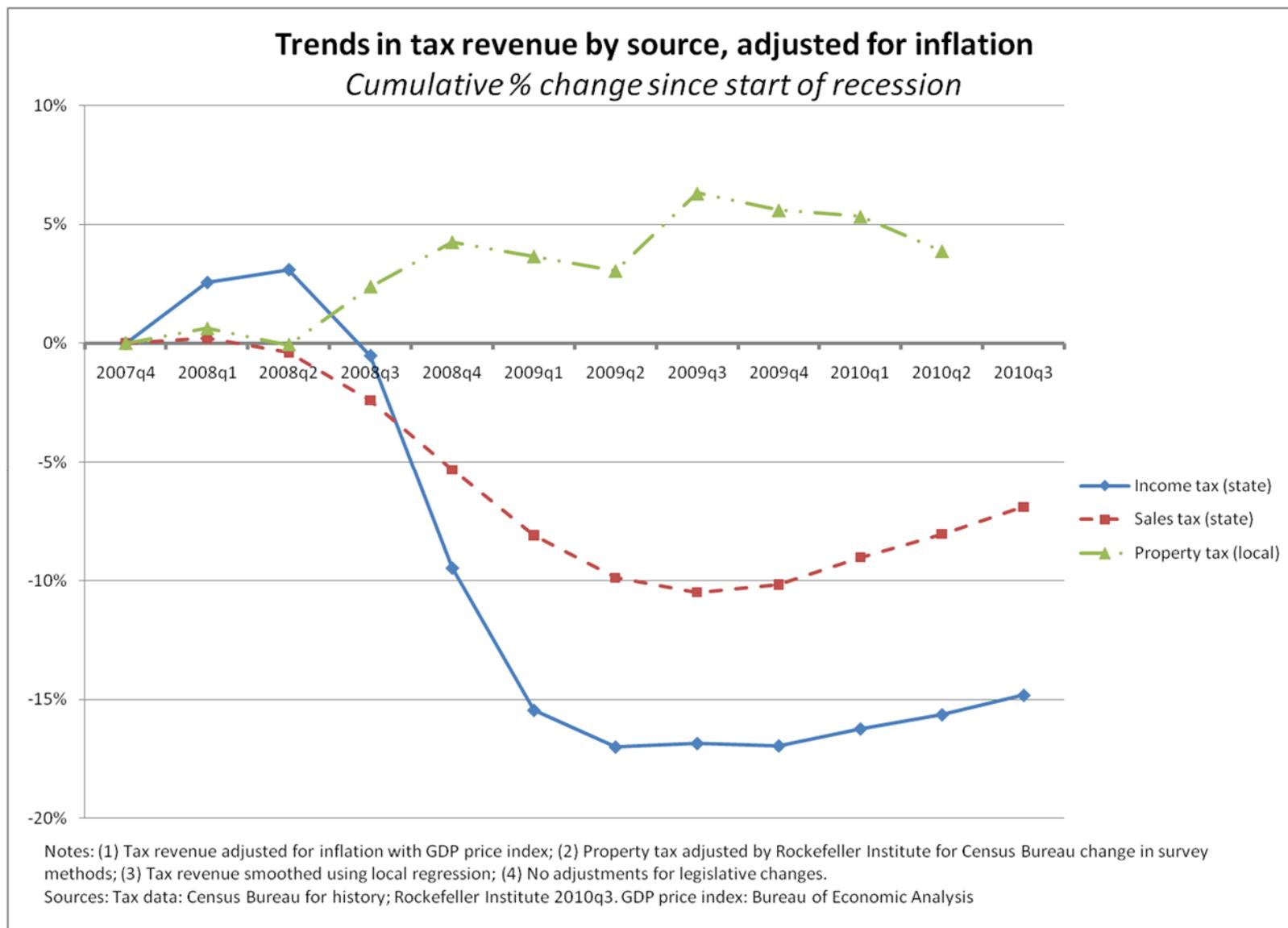
- worse than 2001 recession, worse than economy suggests -

Real state government taxes and real GDP  
- % change vs. year ago -



Sources: Taxes: Census Bureau with Rockefeller Institute adjustment for 2010q2. Real GDP, and GDP price index: Bureau of Economic Analysis  
Notes: (1) Tax revenue adjusted for inflation using GDP price index; (2) No legislative adjustments; (3) Recession periods are shaded.

# Sales & PIT recovering but way below pre-recession peak Property tax appears to be weakening



# Nominal state tax revenue in 48 states is lower than two years earlier– much lower, in most states

| <b>Percent change in state government tax revenue</b>                     |                      |                       |              |
|---|----------------------|-----------------------|--------------|
| <i>Year ending June 2010 vs. two years earlier</i>                        |                      |                       |              |
|   |                      |                       |              |
|   | <b>Sum of states</b> | <b>-10.8%</b>         |              |
| <b>Alaska</b>   | <b>-41.4%</b>        | <b>Maryland</b>       | <b>-9.7%</b> |
| <b>Louisiana</b>  | <b>-20.9%</b>        | <b>Massachusetts</b>  | <b>-9.7%</b> |
| <b>New Mexico</b>   | <b>-19.4%</b>        | <b>California</b>     | <b>-9.4%</b> |
| <b>Georgia</b>  | <b>-19.4%</b>        | <b>Tennessee</b>      | <b>-9.2%</b> |
| <b>Idaho</b>  | <b>-19.2%</b>        | <b>Indiana</b>        | <b>-8.8%</b> |
| <b>Arizona</b>  | <b>-18.8%</b>        | <b>New York</b>       | <b>-8.6%</b> |
| <b>South Carolina</b>   | <b>-18.2%</b>        | <b>Mississippi</b>    | <b>-7.1%</b> |
| <b>Utah</b>   | <b>-16.6%</b>        | <b>Kansas</b>         | <b>-7.1%</b> |
| <b>Ohio</b>   | <b>-16.5%</b>        | <b>Rhode Island</b>   | <b>-6.9%</b> |
| <b>Oklahoma</b>   | <b>-16.4%</b>        | <b>Minnesota</b>      | <b>-6.1%</b> |
| <b>Colorado</b>   | <b>-16.0%</b>        | <b>Kentucky</b>       | <b>-5.9%</b> |
| <b>Connecticut</b>  | <b>-15.7%</b>        | <b>North Carolina</b> | <b>-5.7%</b> |
| <b>Illinois</b>   | <b>-14.6%</b>        | <b>Hawaii</b>         | <b>-5.4%</b> |
| <b>New Jersey</b>   | <b>-14.0%</b>        | <b>New Hampshire</b>  | <b>-5.2%</b> |
| <b>Texas</b>  | <b>-13.8%</b>        | <b>Maine</b>          | <b>-5.2%</b> |
| <b>Wyoming</b>  | <b>-13.8%</b>        | <b>Pennsylvania</b>   | <b>-5.0%</b> |
| <b>Montana</b>  | <b>-12.8%</b>        | <b>West Virginia</b>  | <b>-4.6%</b> |
| <b>Nebraska</b>   | <b>-11.3%</b>        | <b>Arkansas</b>       | <b>-3.8%</b> |
| <b>Virginia</b>   | <b>-11.3%</b>        | <b>Iowa</b>           | <b>-2.8%</b> |
| <b>Missouri</b>   | <b>-11.2%</b>        | <b>Vermont</b>        | <b>-2.3%</b> |
| <b>Alabama</b>  | <b>-10.8%</b>        | <b>Wisconsin</b>      | <b>-2.2%</b> |
| <b>Michigan</b>   | <b>-10.7%</b>        | <b>Oregon</b>         | <b>-1.2%</b> |
| <b>Florida</b>  | <b>-10.6%</b>        | <b>South Dakota</b>   | <b>-0.7%</b> |
| <b>Washington</b>   | <b>-10.6%</b>        | <b>Nevada</b>         | <b>0.7%</b>  |
| <b>Delaware</b>   | <b>-10.2%</b>        | <b>North Dakota</b>   | <b>14.4%</b> |
| Source: U.S. Bureau of the Census and Rockefeller Institute of Government |                      |                       |              |

Note: Although Nevada's 2010 tax revenue was above 2008, it was below 2007 and barely above 2006.

# Outlook

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- State *revenue* crisis is ending, but *fiscal* crisis continues.
- Slow economic recovery means revenue growth likely to be modest.
- Lagged spending pressure from Medicaid and pensions
- “Cliff”: Temporary federal aid to decline by \$66b in FY 2012.
- Most state budgets far from balanced on recurring basis. Many larded up with gimmicks. CA \$19b plan was 2/3 temporary. IL delaying bill payments.
- Many local gov'ts hurting, more pain to come as property taxes weaken and state aid is cut.
- A good environment for tax reform?

# Commonly accepted principles of taxation and tax reform

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- *Adequacy* – sufficiency, stability
- *Equity* – horizontal, vertical
- *Economic impact* – minimize distortion
- *Costs* - easy to comply with & administer
- *A system* - Must consider whole system – state-local, all major sources
- Economists' mantra - Repeat:  
Broad base, low rates, broad base, low rates,  
broad base, low rates, broad base, low rates,  
broad base, low rates, BBLR, BBLR, ...

# Unfortunately, principles often conflict with each other!

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- Steeply progressive income tax may meet some policymakers' equity goals, but it is volatile and high marginal rates are distortionary
- Sales tax on food and services may be stable and less-distortionary, but will violate some policymakers' equity goals
- Crucial to think about system as a whole. Problematic individual options can work together as part of a larger package – e.g., sales tax on food plus low-income credit?

# Practical considerations

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- Are packages that create winners and losers harder to enact than those that create just winners or just losers?
- Having your ducks in a row
  - Good rationale – *why* we are doing this
  - Good analysis – who is affected and how
  - Public information campaign
  - No policy surprises – tax reform is complex
- Small steps or throw all balls up in the air?  
Fiscal strategy vs. political strategy
- Persistence – tax reform often takes many years, multiple false starts



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