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1Q Losses in State Tax Revenue Could Spark Budget Cuts

By Lynne Funk

State tax revenues weakened during the first quarter of the year and could lead to fiscal 2009 budget cuts in the coming months, according to a report released this week by the Rockefeller Institute that joins a group of recent studies predicting deeply troublesome times ahead for states.

The institute's latest quarterly report shows that state tax revenues increased only 1.7% from January to March compared with the same quarter a year ago. The forecast is on par with a report by the National Conference of State Legislatures released in late-April, and one by the National Governors Association and the National Association of State Budget Officers in mid-June, both of which said that state tax collections are falling and budgets will need to be scaled back as a result.

The meager percentage increase of tax revenues collected in the first quarter of 2008 marks the slowest growth rate since 2003, the Rockefeller report said.

"To date, the tax revenue weakness has been mild when compared with past recessions," the institute's senior fellow and study co-author Don Boyd said in a release. "However, the seeds of greater fiscal stress are already sown — economic weakness is spreading rapidly and tax revenue from the continuing base should be very weak in the April-June quarter, although perhaps partially masked by payments with 2007 tax returns."

But the rough times will grow even worse after June, the report said.

"Many states finalized their 2008-09 budgets during the April-June quarter, when conditions may have misled forecasters into revenue projections that were too rosy," Boyd said. "Governors in some states may, then, face difficulty implementing their new budgets — raising the prospect of potential mid-year cuts and other actions to eliminate emerging gaps."

The institute based the report on information collected from officials in state revenue departments and in some cases from state budget offices and legislative staff.

From that information, the Rockefeller Institute found that for the first time in six years, sales tax collections — one of the largest portions of state tax revenues — were flat.

Fifteen states' revenues declined during the quarter, compared to the same time a year earlier.

Personal income tax revenue increased 4.4% during the first quarter of 2008 when compared to the same period a year earlier, and they were up slightly when compared to the last quarter of 2007. Corporate income tax declined for the third consecutive quarter, by about 5.1%. And sales tax collections slightly declined by 0.04%, according to the report.

Overall, states collected $155.3 billion during the first quarter of 2008. About $64 billion, or 41%, came from personal income taxes.

About $55 billion, or 35%, came from sales taxes, and about $10 billion came from corporate income taxes. States collected another $26.3 billion in taxes from other sources during the first quarter.

The New England states showed the strongest overall revenue growth of about 5.3%, while the Southeast states saw revenues decline by about 2.6%, the report said.

Total collections were up more than 10% in Alaska, Iowa, North Dakota, and West Virginia, which are energy-producing states and generally have been faring better during the national economic downturn.

Arizona, Montana, and Florida faced declines of more than 10%, while Georgia, Idaho, Mississippi, Nebraska, Nevada, New Jersey, North Carolina, Ohio, Oklahoma, Rhode Island, South Carolina, and Utah showed smaller declines.

The NCSL report more explicitly said that sagging state revenue growth for fiscal 2008 would bring more than 20 states to face fiscal 2009 budget gaps that collectively exceed $26 billion.

That report, “State Budget Update: April 2008,” said states also face the problem of keeping fiscal 2008 budgets afloat on top of dealing with those growing fiscal 2009 gaps.

The NCSL cited slowing or declining revenue from personal income, general sales, and corporate income taxes as the reason for the states’ woes, noting that two-thirds of state legislatures were “concerned” about fiscal 2009 revenue performance.

And the NGA and NASBO, which released their Fiscal Survey of States report in mid-June, said that states could continue to face financial troubles over the next three to four years as the nation’s economic downturn drags on.

The groups said then that states have been most hurt by a slowdown in revenue collections, mirroring the tax collection estimates of sales, personal income, and corporate income that the Rockefeller report made: a mere 1.7% higher than fiscal 2007. But “this average contains a range of performance with a considerable weakening of the sales tax and a decrease in corporate tax,” the report said. Revenue estimates are below expectations in 20 states, on target in 14 states and exceed expectations in only 15 states, according to the NGA.

NGA officials noted that unemployment numbers generally peak near the end of a downturn and that states have yet to face a drop in personal income tax collections as a result of rising unemployment, which could decrease revenue expectations further.