

# Current Assessment of State Government Finances



**ECONOMIC PERSPECTIVES ON STATE  
AND LOCAL TAXES  
MAY 9, 2008**

**LUCY DADAYAN  
SENIOR POLICY ANALYST**



**Rockefeller Institute of Government**

The Public Policy Research Arm of the State University of New York

*Independent Research on Government Finances and Management*

# Outline



- **State tax revenue outlook**
- **Are we in recession?**
- **Current fiscal problems**
  - Revenues are weak
  - Employment is softening
  - Cost inflation is rising for states and localities



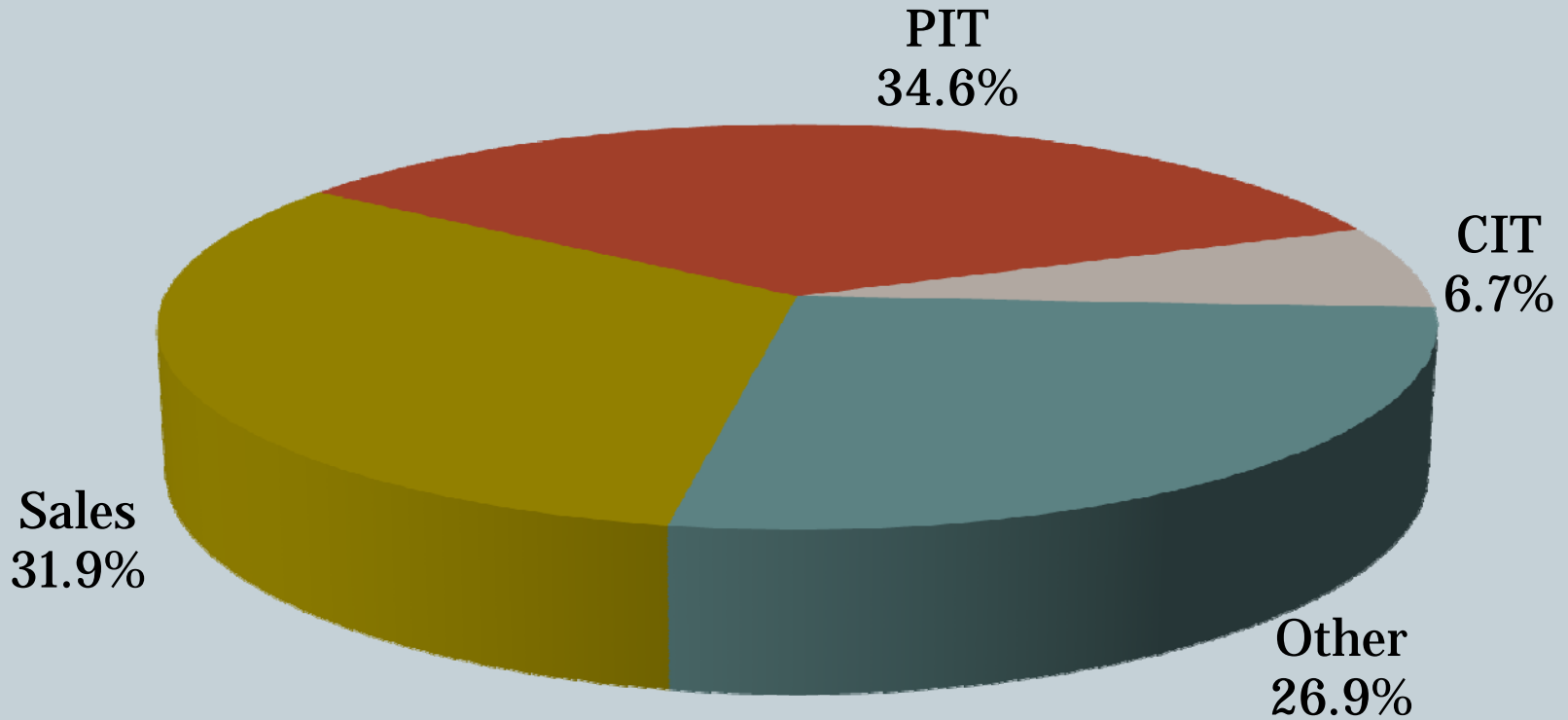
# **State tax revenue outlook**

# The overall revenue picture



- State tax revenues weakened further in Q1 of 2008 compared to Q1 of 2007
- Overall increase for state tax revenues was around 6.1% in Q2 of 2007
- Overall growth fell to 4.7% in Q3 of 2007, and 2.6% in Q4 of 2007
- First quarter of 2008 was weaker, at 1.8%, but still showed some growth in nominal terms

# Major tax sources, FY 2006



# Sales tax outlook

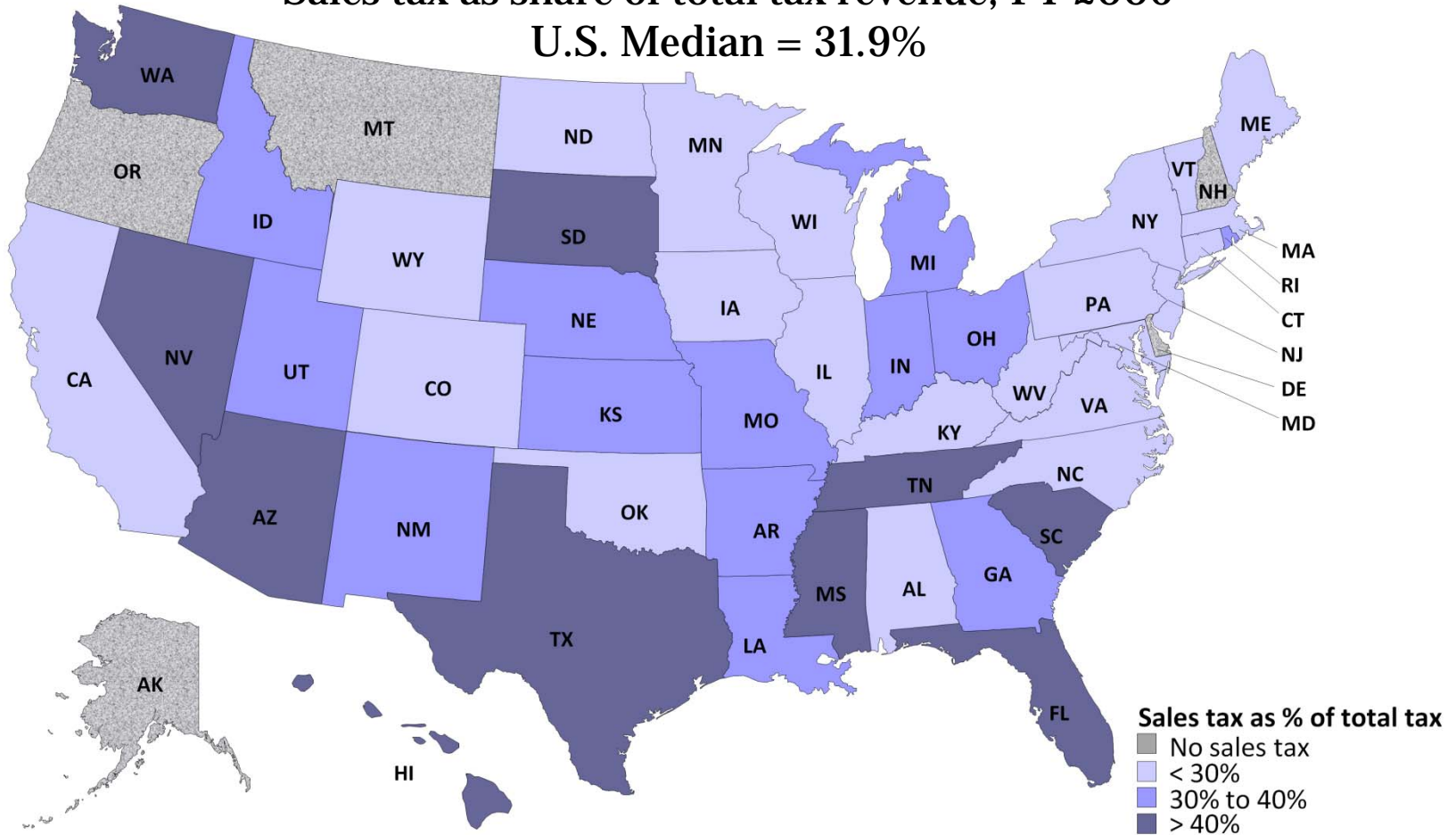


- Most southern states rely heavily on state general sales tax
- WA, TN, SD, FL, & NV rely most heavily on state general sales tax with over 50% of total tax revenue
- WA relies the most on revenue from the general sales tax with 61% (no PIT)

# State reliance on general sales tax

Sales tax as share of total tax revenue, FY 2006

U.S. Median = 31.9%



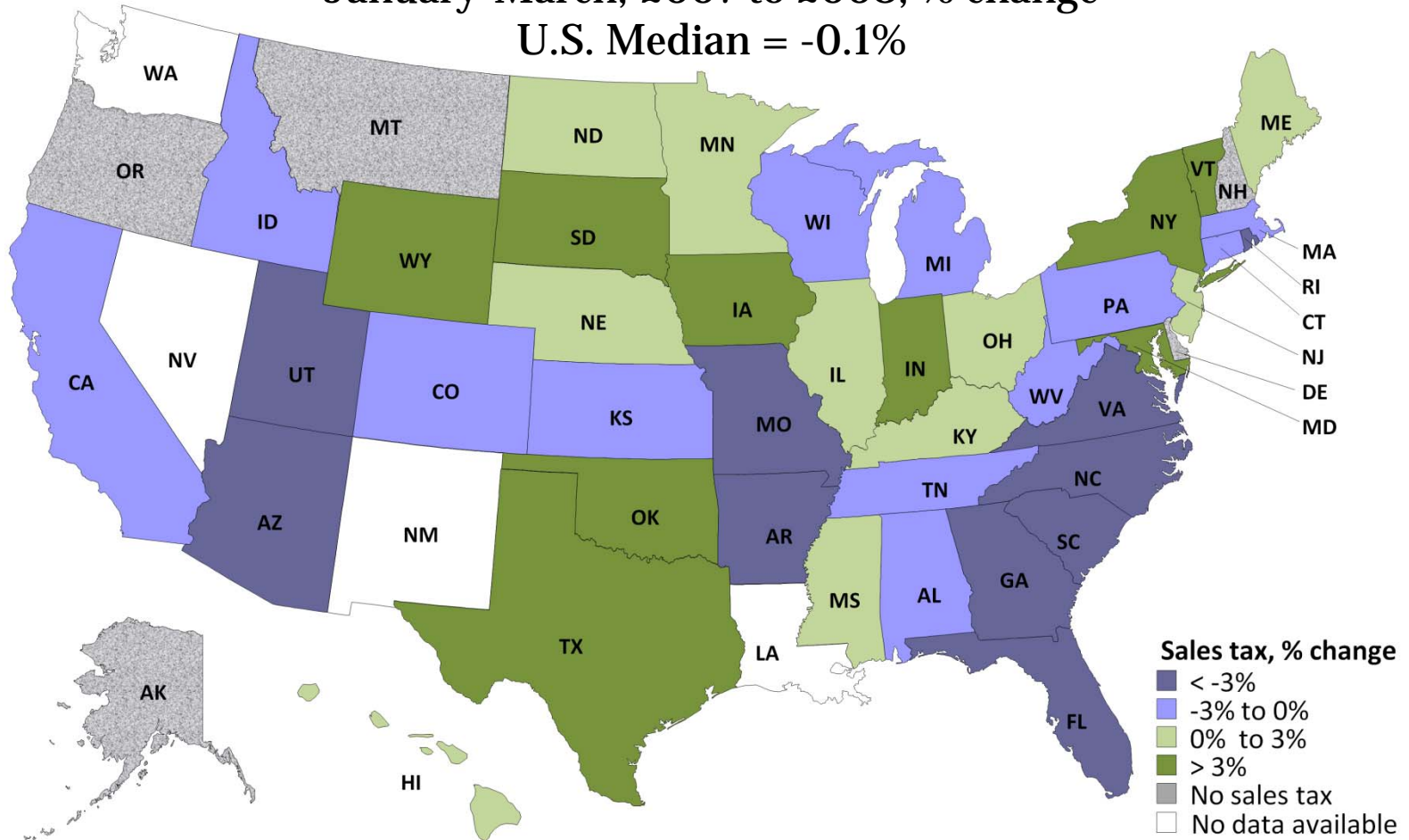
# State sales tax declines in 22 states



- With 41 of 45 sales-tax states reporting so far, 22 states had sales tax declines in Q1 of 2008, compared to the same quarter last year
- Nine of the declining states are in the Southeast, with a total sales tax decline of 3.8%
- State sales tax revenue declined by 0.1% for the nation as a whole, the first such decline since the first quarter of 2002

# Quarterly state sales tax revenue

January-March, 2007 to 2008, % change  
U.S. Median = -0.1%



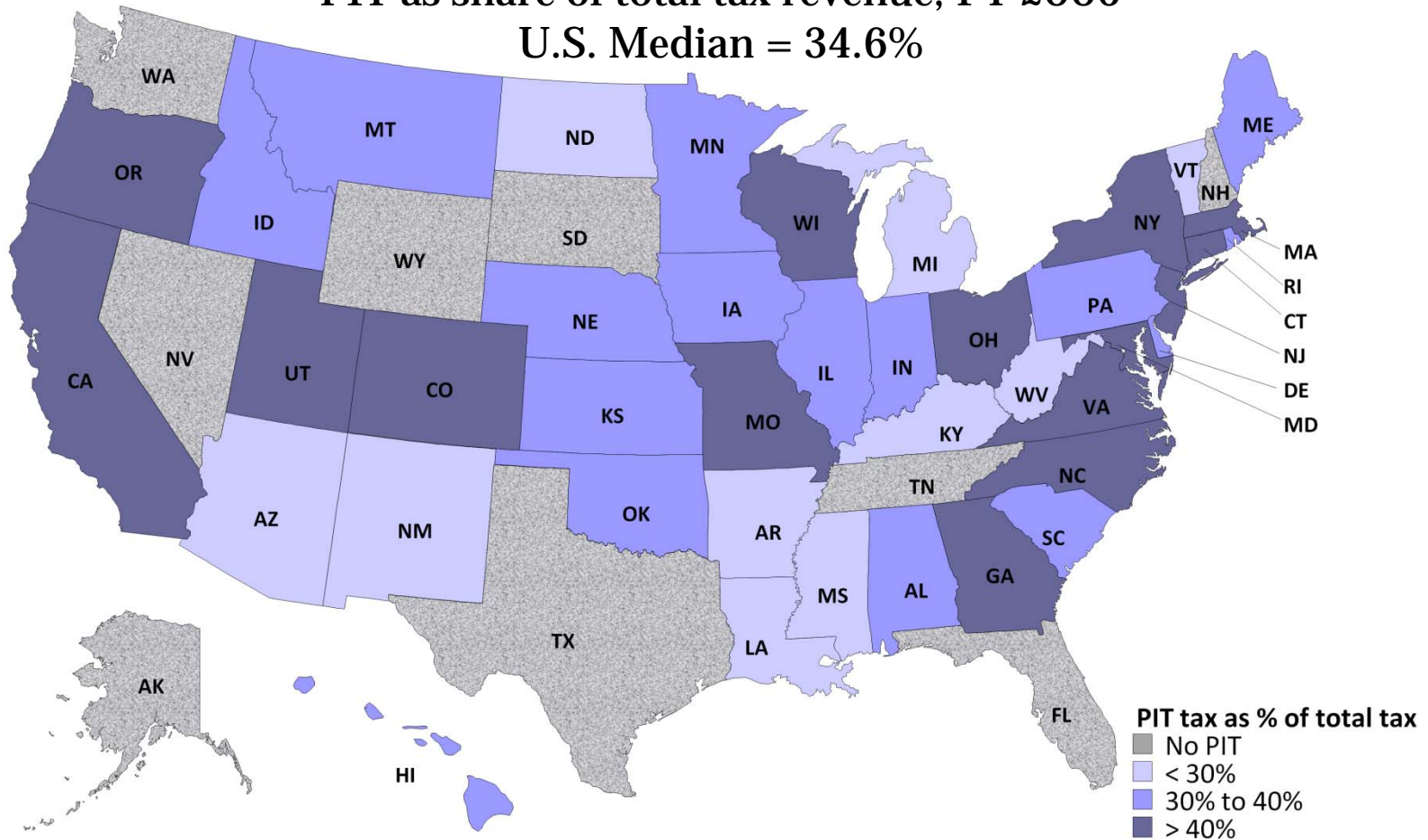
# Personal income tax outlook



- State revenue from PIT for the nation averaged 34.6% in FY 2006, but states vary widely
- OR, MA, NY, & VA rely most heavily on PIT with over 50% of total tax revenue
- OR relies the most on revenue from PIT with 71% (but no sales tax).

# State reliance on personal income tax

PIT as share of total tax revenue, FY 2006  
U.S. Median = 34.6%



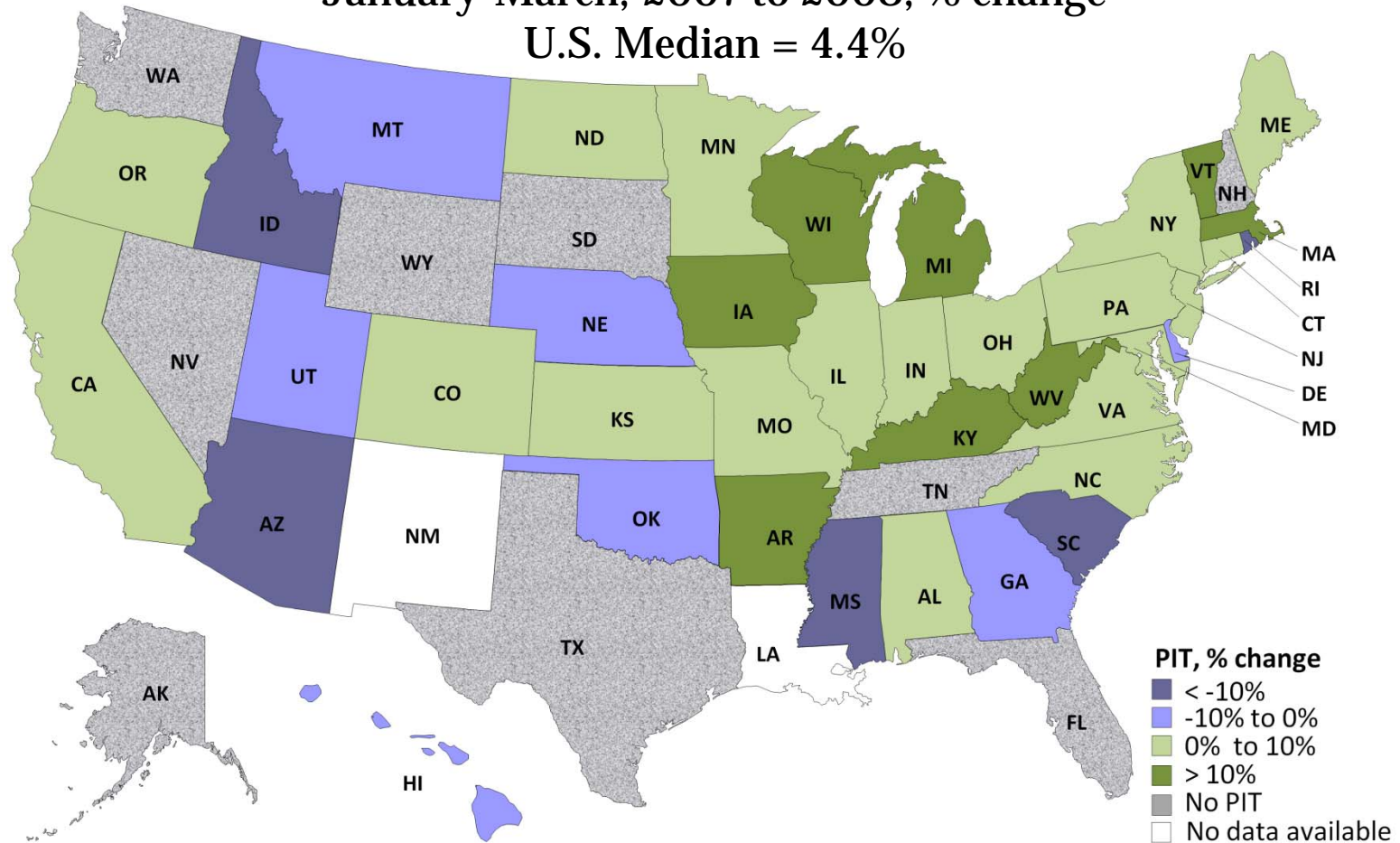
# State PIT declines in at least 12 states



- With 39 of 41 PIT states reporting so far, 12 states had PIT declines in Q1 of 2008
- Five states had double-digit declines (MS, AZ, SC, ID, & RI)
- The PIT was weakest in the Southwest region - quarterly collections were down at 14.4%
- State PIT revenue increased by 4.4% for the nation as a whole

# Quarterly state PIT revenue

January-March, 2007 to 2008, % change  
U.S. Median = 4.4%



# Corporate income tax outlook



- State revenue from CIT averaged 6.7% in FY 2006 – again, wide variation among states
- AK, NH, WV, DE, and KY rely most heavily on CIT with over 10% of total tax revenue
- AK relies the most on revenue from the CIT tax with 33.1% (no PIT or sales tax)



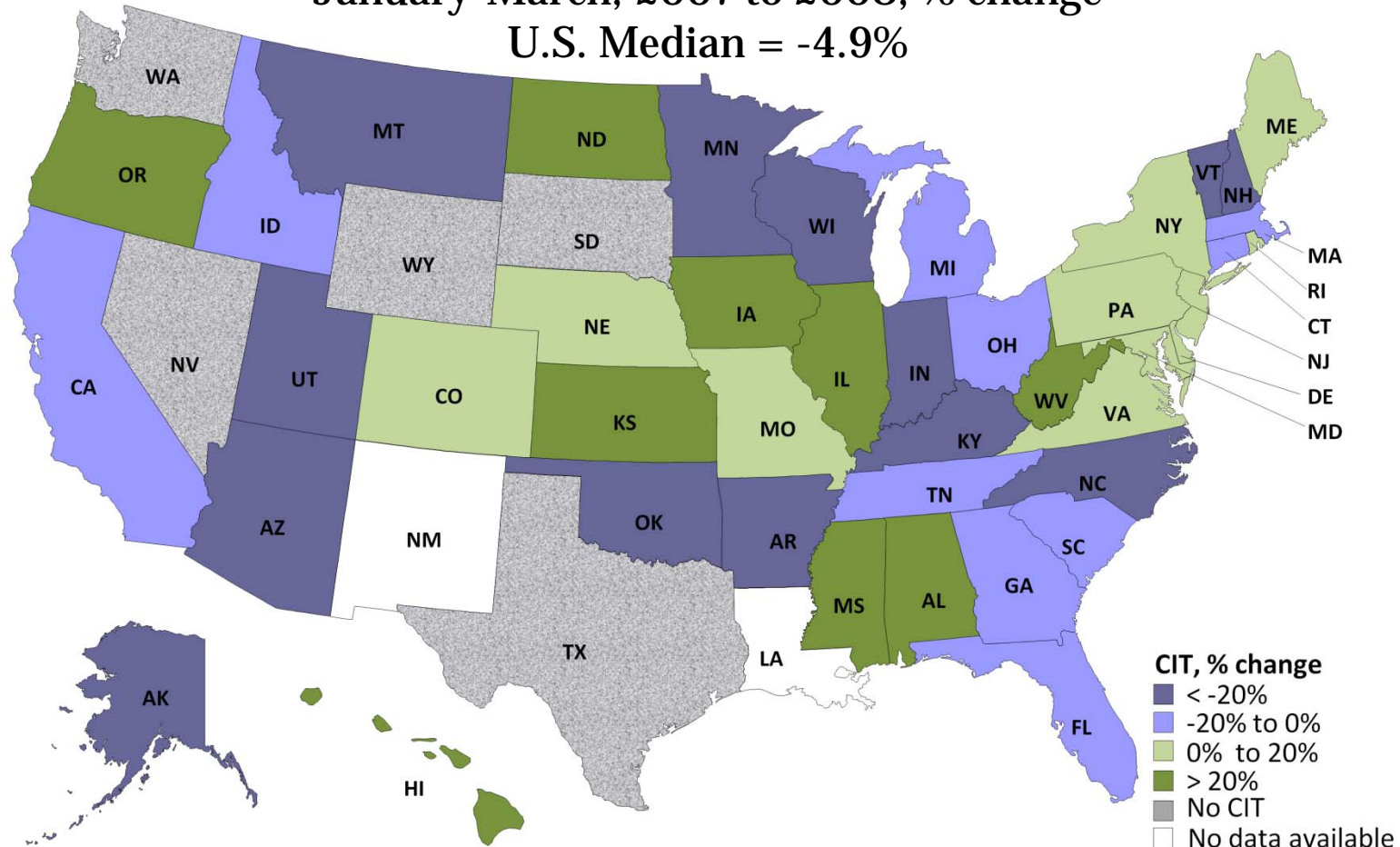
# State CIT declines in at least 24 states



- With 43 of 45 PIT states reporting so far, 23 states had CIT declines in Q1 of 2008
- 18 states had double-digit declines, and collections nationwide dropped an average 4.9%
- All regions, except for the Mid-Atlantic reported declines
- The CIT was weakest in the Southwest region -- quarterly collections were down at 56.5%

# Quarterly state CIT revenue

January-March, 2007 to 2008, % change  
U.S. Median = -4.9%

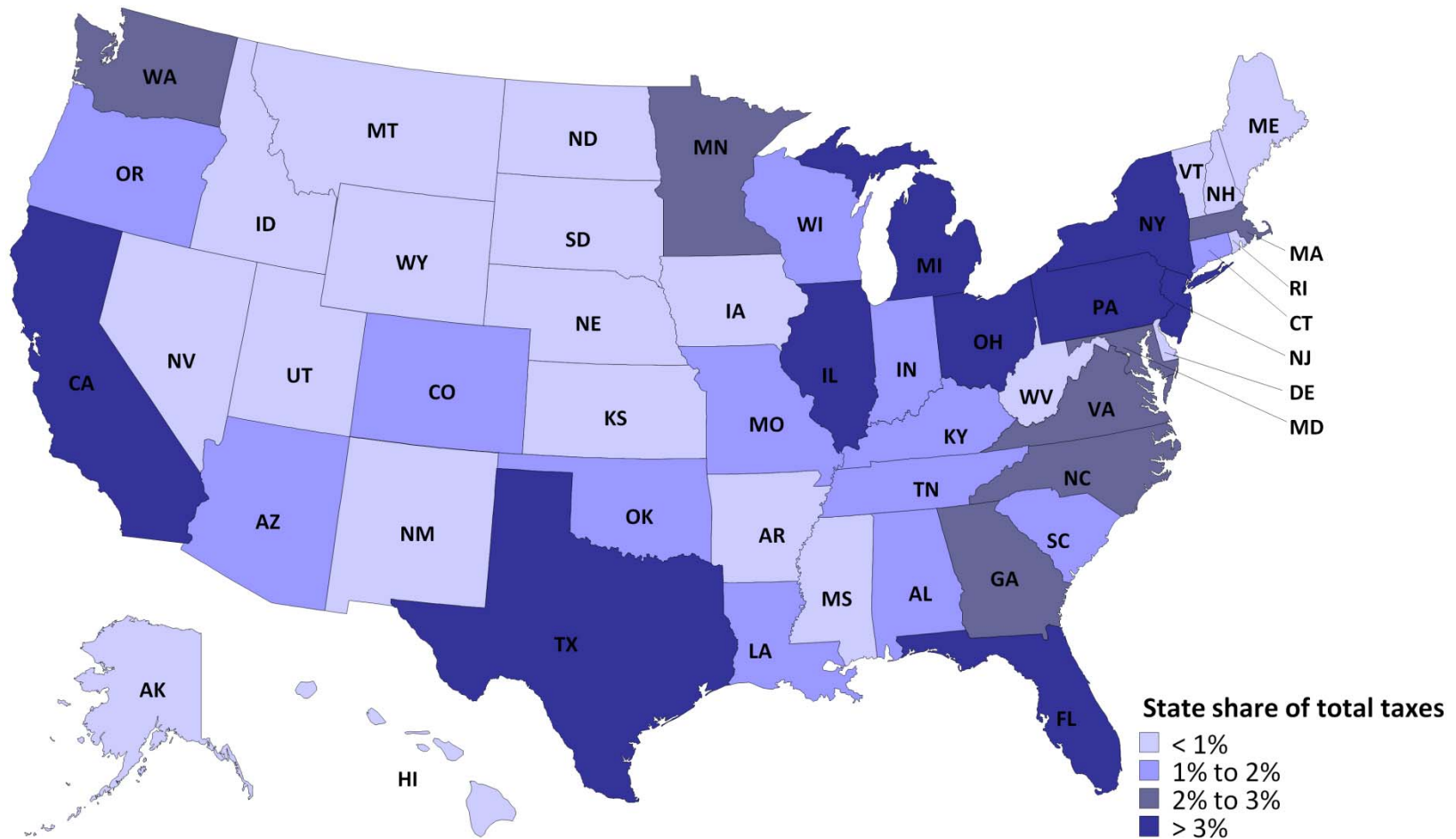


# Total tax outlook



- Tax revenue collected from 9 largest states makes up over 50% of total tax revenue
- California's share of total tax revenue is the highest at 15.7%
- Tax revenue collected from 21 smallest states makes up less than 12% of total tax revenue
- SD and ND have the lowest share of total tax revenue at 0.2%

# State share of total taxes, FY 2006



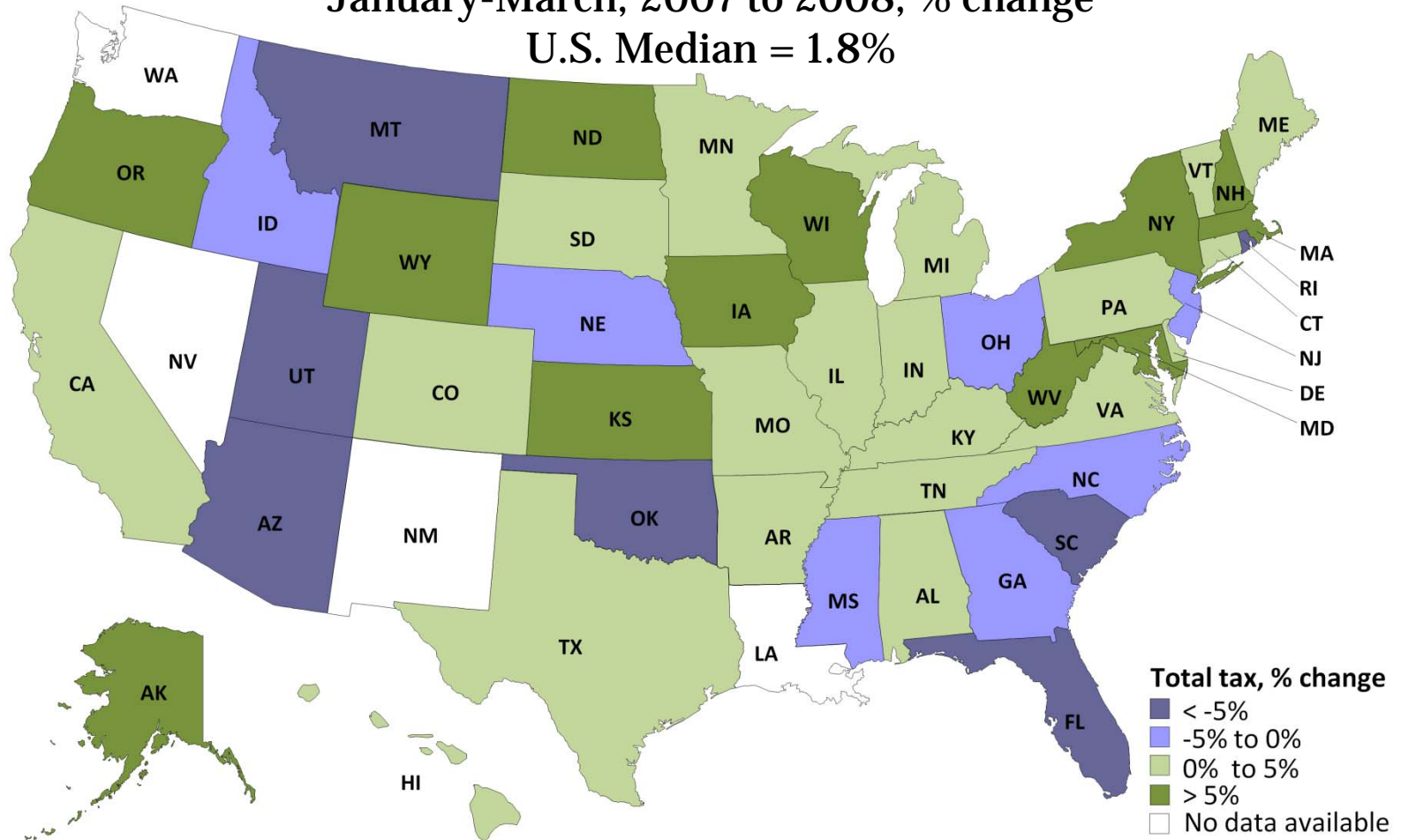
# State total tax declines in 14 states



- With 46 states reporting, 14 states had total tax revenue declines in Q1 of 2008
- Three states had double-digit declines (AZ, MT, FL)
- Total tax revenue was weakest in the Southeast and Rocky Mountain regions, with declines of 2.6% & 2.1% respectively
- State total tax revenue increased by 1.8% for the nation as a whole

# Quarterly state total tax revenue

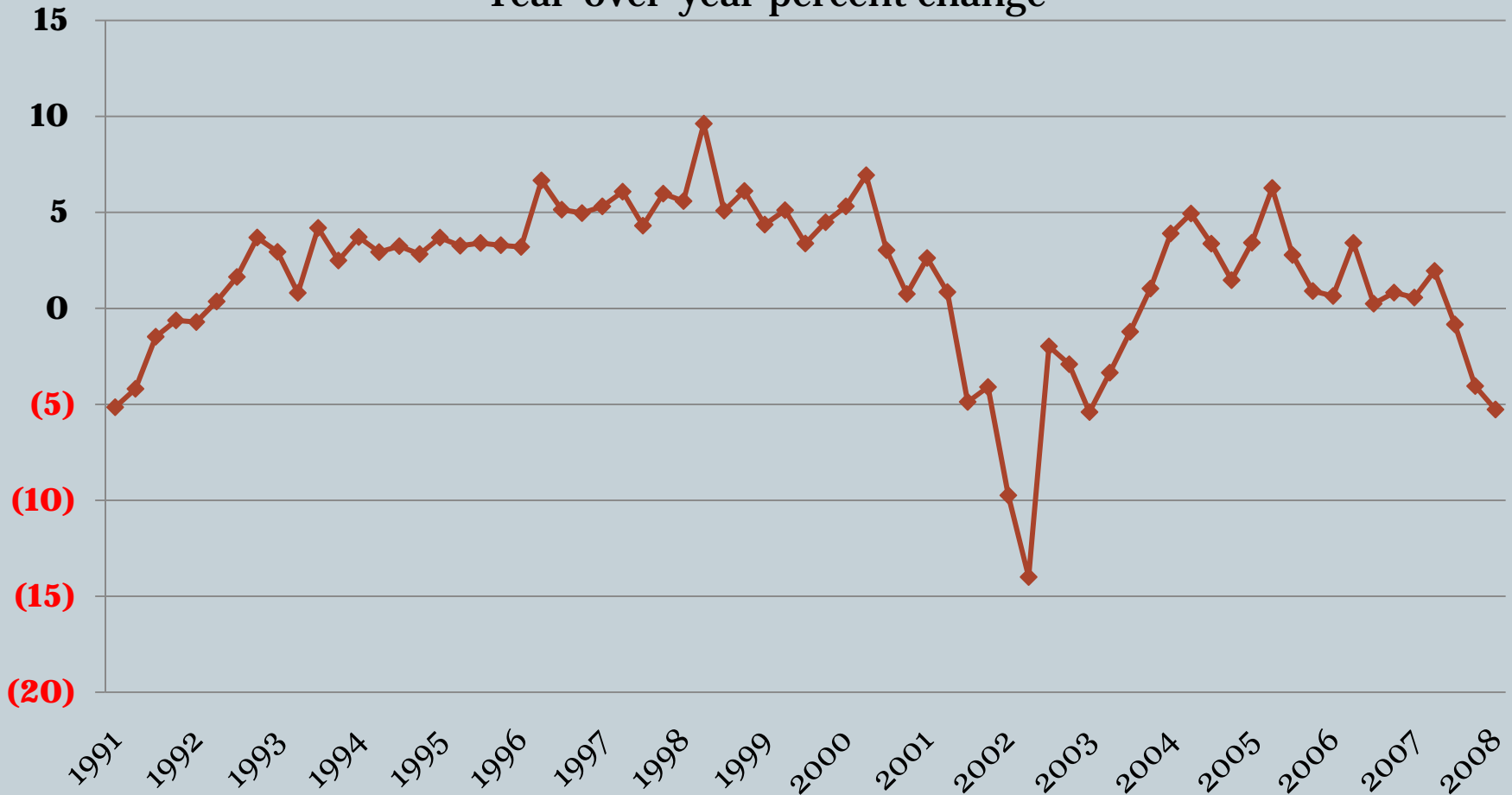
January-March, 2007 to 2008, % change  
U.S. Median = 1.8%



# Real adjusted tax revenue, 1991-2008



Year-over-year percent change



Source: Individual state data, legislated tax changes by NCSL and inflation by BEA. Analysis by Rockefeller Institute.

# Regional tax revenue conditions



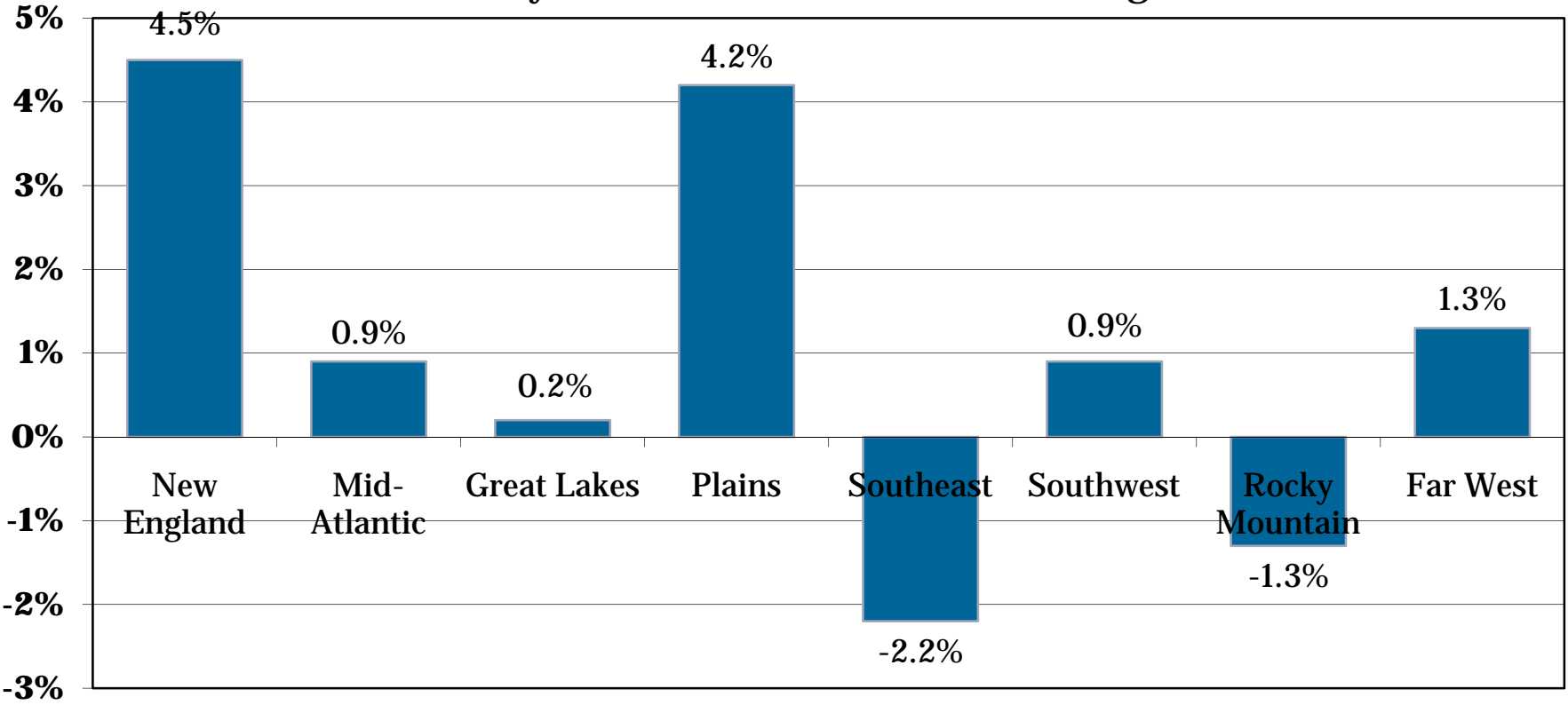
January-March, 2007 to 2008, nominal % change

Region	PIT	CIT	Sales	Total
Southeast	1.4	(10.6)	(3.8)	(2.6)
Rocky Mountain	(2.1)	(17.3)	(1.8)	(2.1)
Southwest	(14.4)	(56.5)	4.9	0.4
Great Lakes	8.3	(9.6)	0.5	2.6
Far West	2.9	(7.6)	(0.6)	3.2
Mid Atlantic	5.1	16.2	2.4	3.6
Plains	5.5	(10.6)	0.3	3.8
New England	10.2	(9.2)	(0.9)	5.3

# Real change in tax revenue



Adjusted for legislated changes  
January-March, 2007 to 2008, % change



Source: Individual state data, analysis by Rockefeller Institute.

# Most troubled states



January-March, 2007 to 2008, nominal % change

State	PIT	CIT	Sales	Total
Arizona	(21.0)	(50.2)	(4.7)	(13.6)
Montana	(5.9)	(41.0)	NA	(10.8)
Florida	NA	(8.9)	(6.0)	(10.3)
South Carolina	(18.7)	(15.7)	(7.6)	(8.1)
Rhode Island	(12.2)	2.5	(5.5)	(6.2)
Oklahoma	(4.2)	(60.9)	6.8	(5.8)
Utah	(1.3)	(39.2)	(4.7)	(5.6)
Georgia	(4.9)	(11.4)	(3.0)	(3.8)
North Carolina	2.4	(46.0)	(4.1)	(3.0)

# Tax outlook in New England states



January-March, 2007 to 2008, nominal % change

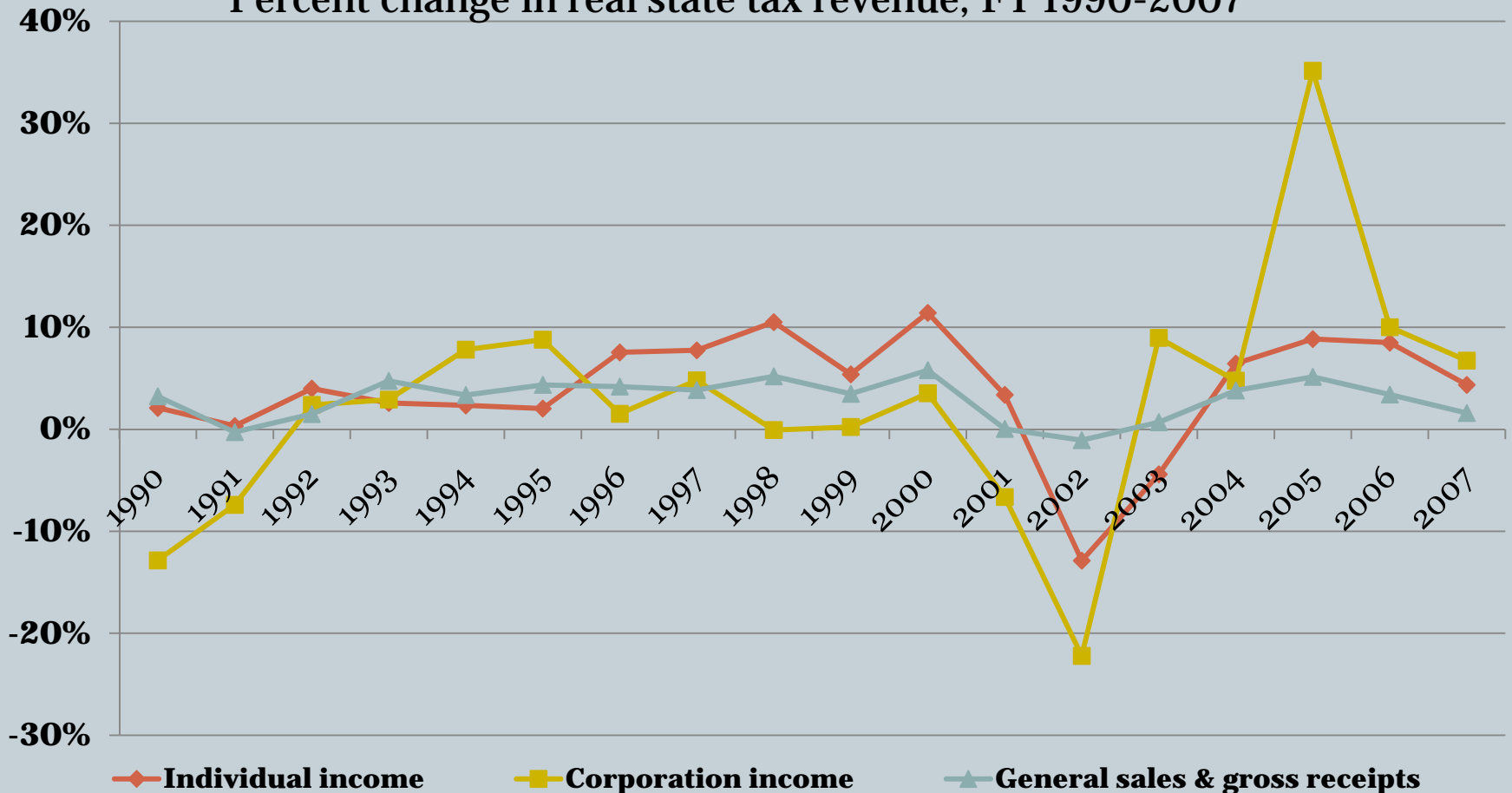
Nominal change	PIT	CIT	Sales	Total
<b>United States</b>	<b>4.4</b>	<b>(4.9)</b>	<b>(0.1)</b>	<b>1.8</b>
<b>New England</b>	<b>10.2</b>	<b>(9.2)</b>	<b>(0.9)</b>	<b>5.3</b>
Connecticut	6.8	(15.4)	(0.2)	1.9
Maine	4.6	8.4	0.3	2.8
Massachusetts	14.7	(6.9)	(1.4)	9.6
New Hampshire	NA	(23.3)	NA	5.6
Rhode Island	(12.2)	2.5	(5.5)	(6.2)
Vermont	13.5	(21.6)	4.9	1.5

Tax reliance (%)	PIT	CIT	Sales	Other
<b>New England</b>	<b>45.5</b>	<b>8.2</b>	<b>21.9</b>	<b>24.4</b>

# State tax volatility



Percent change in real state tax revenue, FY 1990-2007



Source: U.S. Census Bureau

# While revenue weakens, costs rise sharply

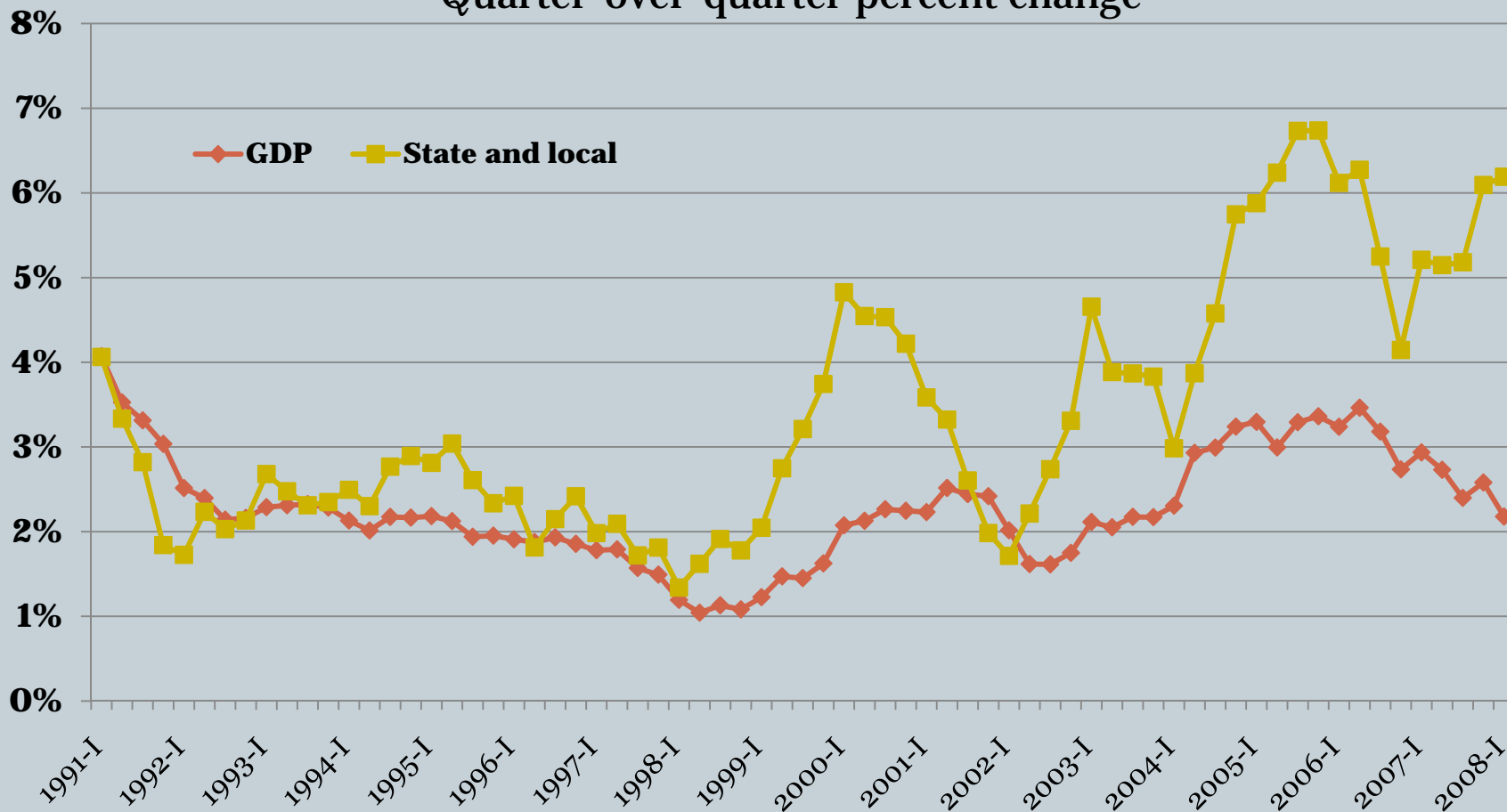


- Inflation for state/local services has diverged from overall measures of inflation – an increase of 6% in 2007, nearly twice the increase in the overall GDP price index
- State/local government price index has been far above overall index for the last four years
- Petroleum prices (diesel fuel, construction) and employee benefit costs may be key factors

# Price indexes for GDP, 1991-2008



Quarter-over-quarter percent change



Source: U.S. Bureau of Economic Analysis, NIPAs



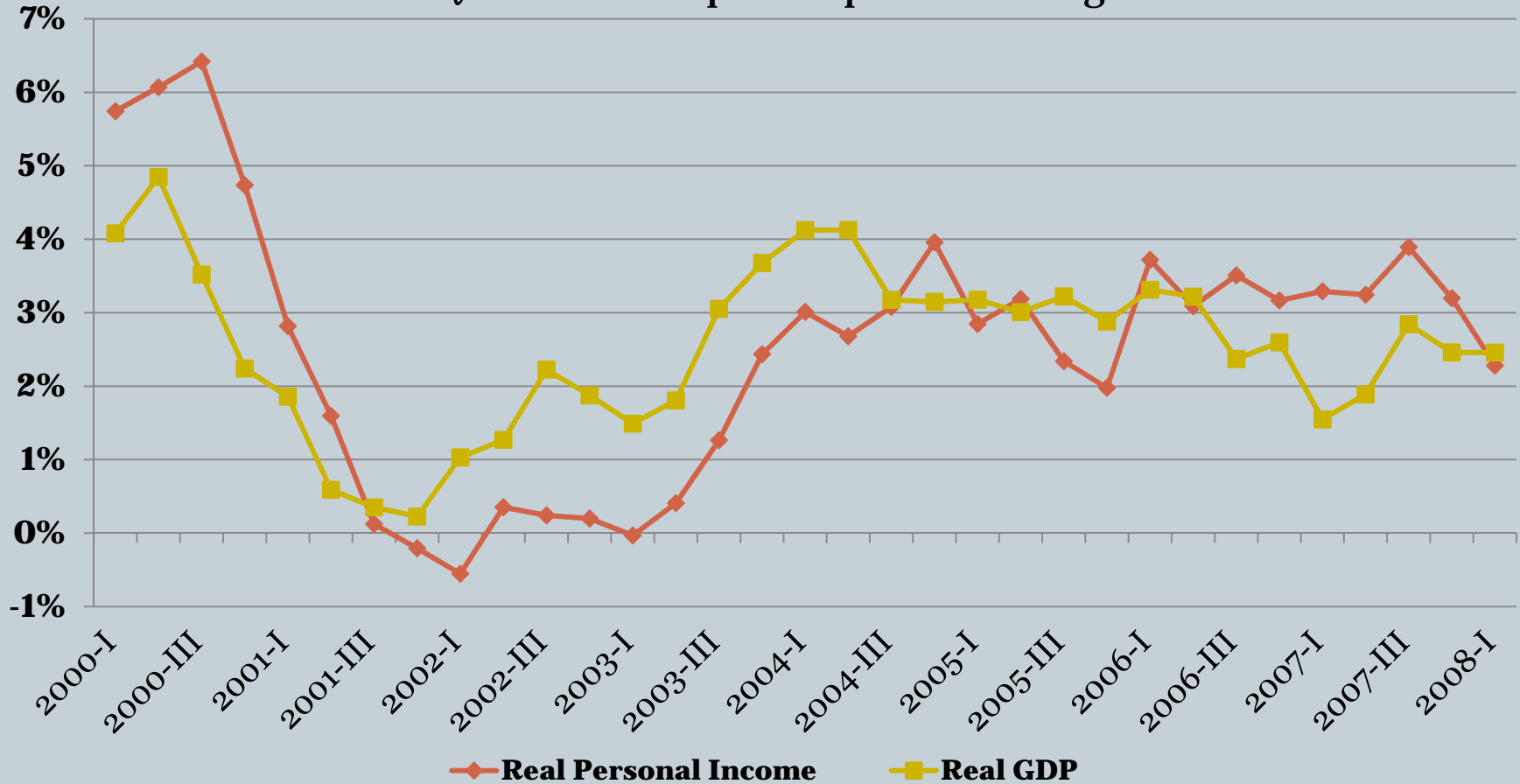
**Are we in recession?**

**The answer doesn't matter –  
many states are feeling the  
pinch**

# Real GDP & personal income, 2000-08



Quarter-over-quarter percent change

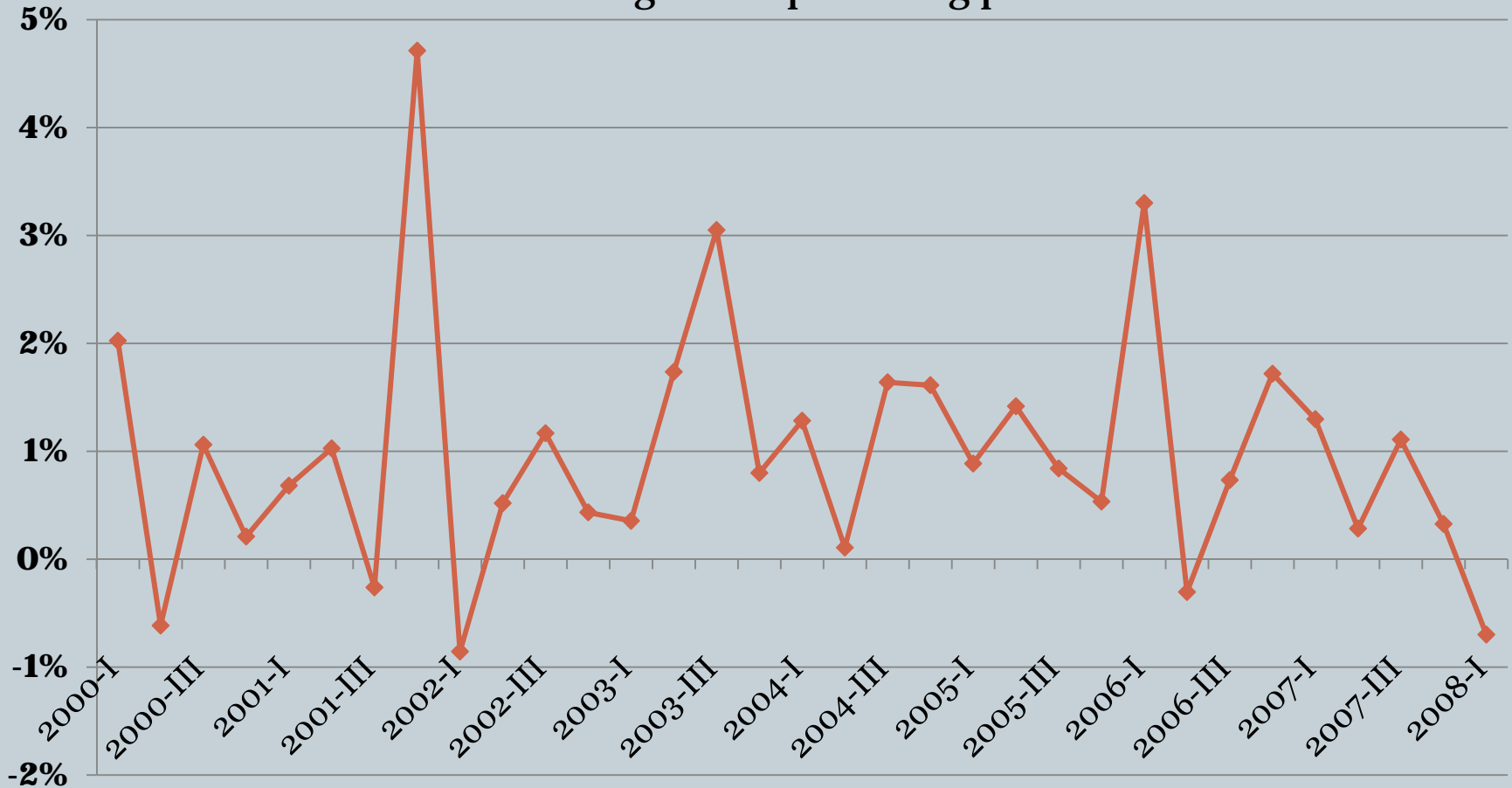


Source: U.S. Bureau of Economic Analysis, NIPAs

# Trends in real retail sales, 2000-08



Percent change from preceding period

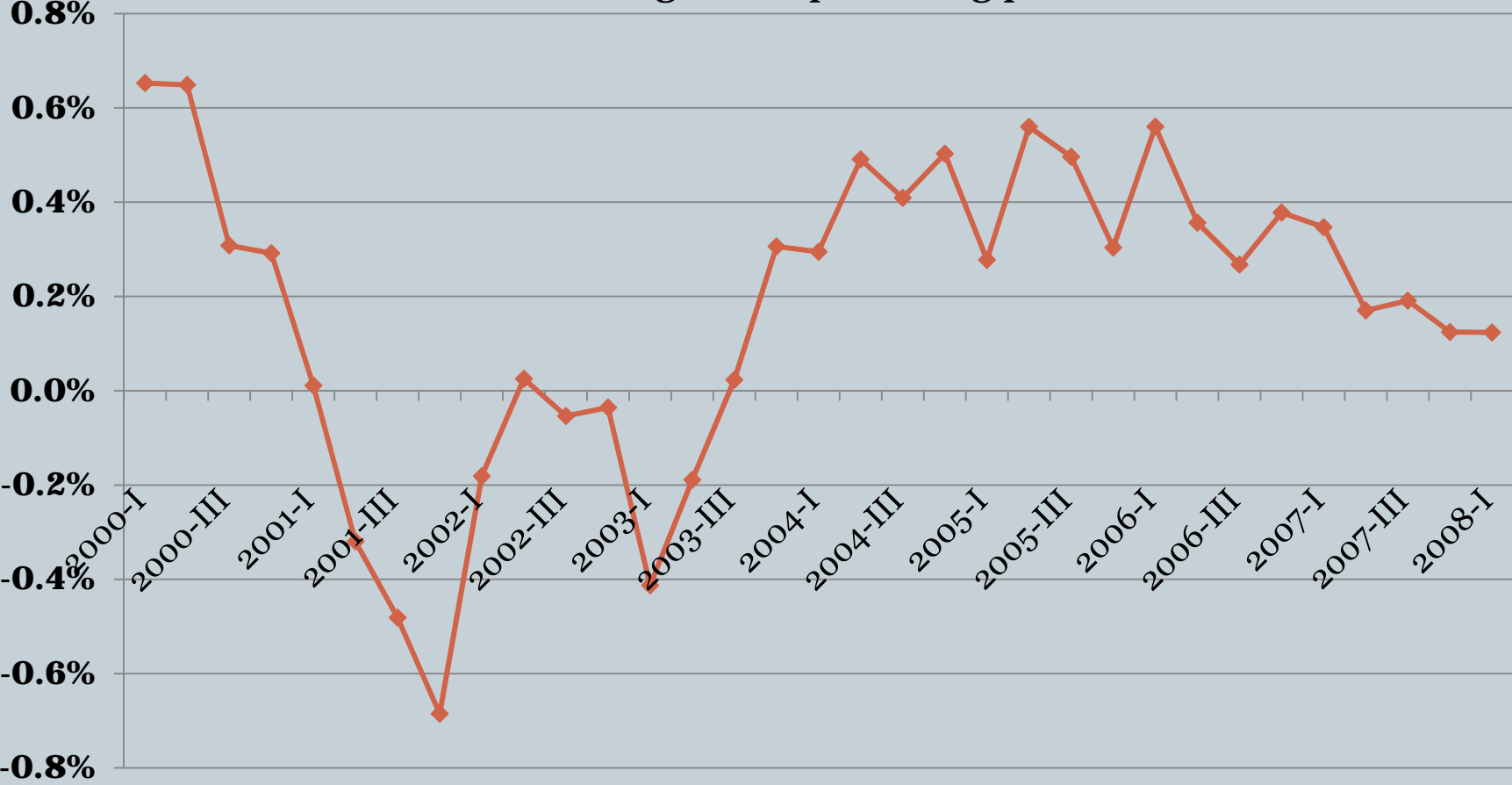


Source: U.S. Bureau of Economic Analysis, NIPAs Table 6U

# Trends in employment, 2000-08



Percent change from preceding period



Source: U.S. Bureau of Labor Statistics

# Economists on Recession



- “I believe the U.S. economy is now in recession. Could this become the worst recession we have seen in the postwar period? I think the answer is yes.” (Martin Feldstein, NBER's president, March 14, 2008)
- “There is more than a 50% chance the US could go into recession.” (former Federal Reserve chairman Alan Greenspan, April 6, 2008)

# States in recession in 2008



According to Moody's 9 states are in recession:

- Arizona
- California
- Florida
- Michigan
- Nevada
- Ohio
- Rhode Island
- Tennessee
- Wisconsin

In FY 2006, one-third of the total tax revenue came from these 9 states.

**Source:** Moodys, April 29, 2008



# Current fiscal problems

# State fiscal situation: CBPP's assessment

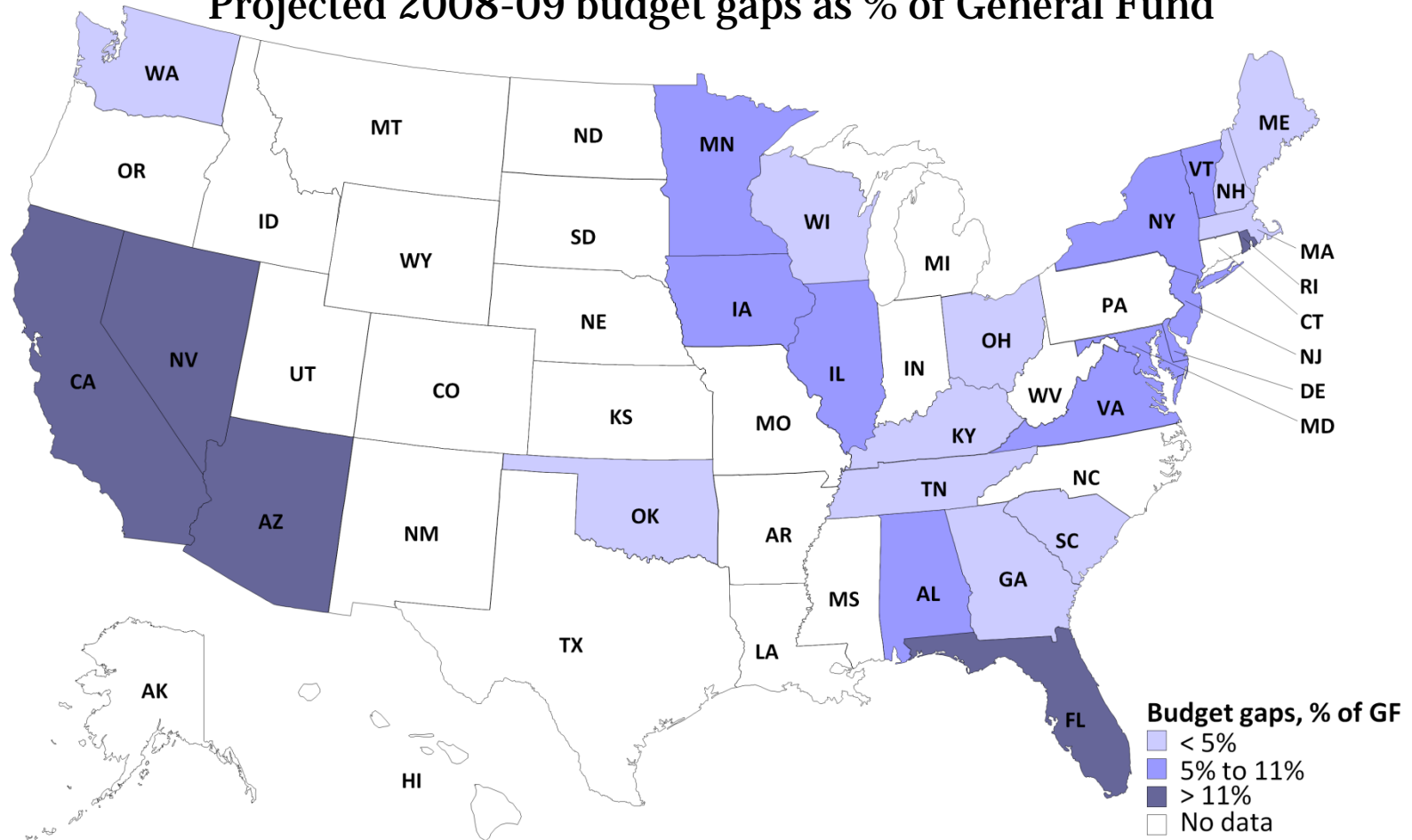


- 28 states already faced state budget shortfalls for FY 2009
- The state budget gap is about \$40.1-\$42.1 billion, averaging 8.4-8.8% of state's general fund budgets
- Three states (CT, MO, & TX) are projecting budget gaps in FY 2010 or beyond

# State budget gaps



## Projected 2008-09 budget gaps as % of General Fund



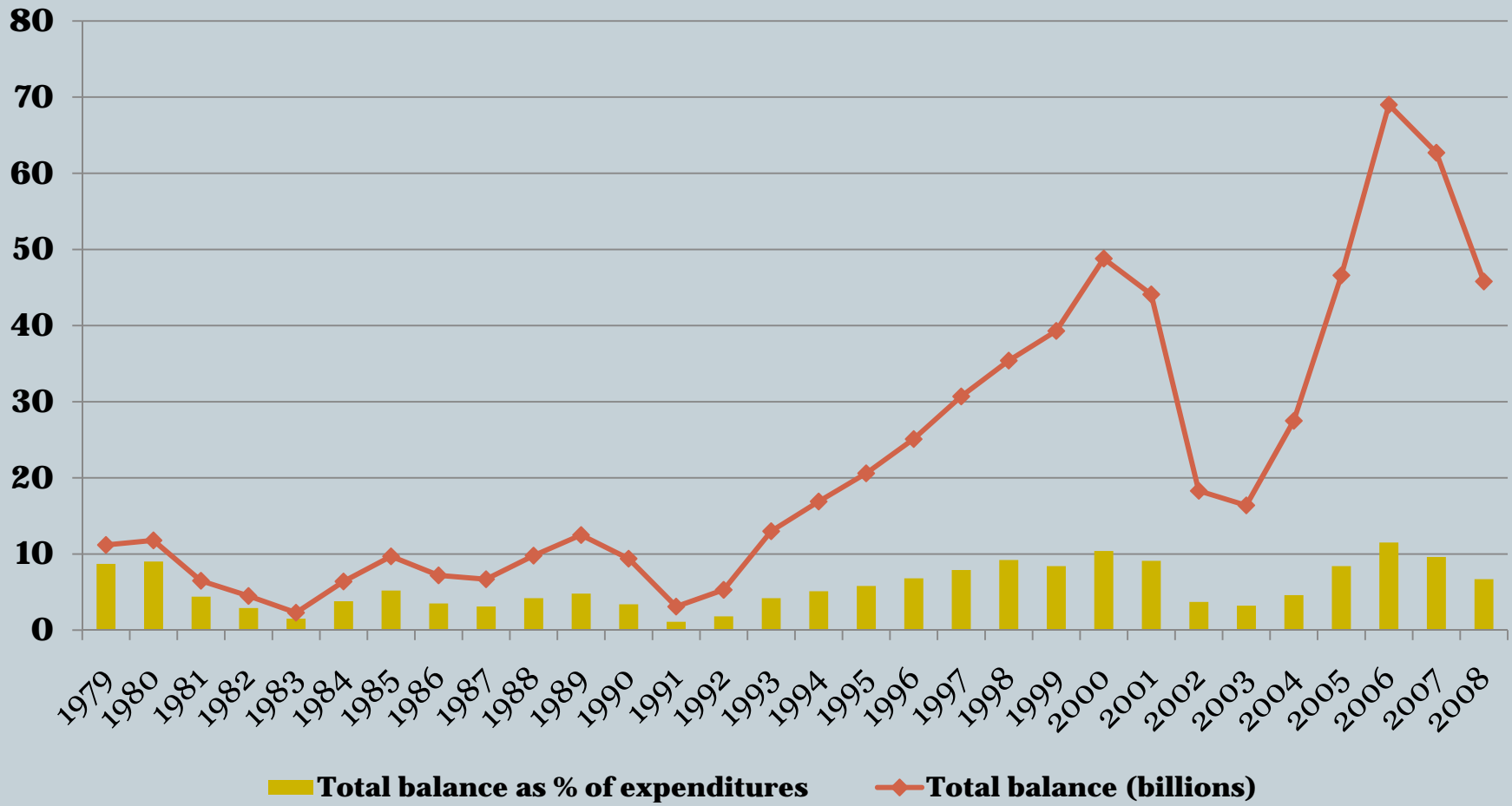
Source: Center on Budget and Policy Priorities

# Three common state responses



- Using reserves
- Midyear budget cuts
- Raising taxes

# Year-end balances and balances as a percentage of expenditures



Source: National Association of State Budget Officers (NASBO)



# Summary



- Outlook for 2008 is cloudy, at best
- Sales tax revenue decline (1<sup>st</sup> time since first quarter of 2002)
- Weakening employment, PIT, and total tax revenue
- If cost inflation for states/localities continues to outpace overall inflation, services will suffer or taxes will have to go up



Rockefeller Institute of Government

The Public Policy Research Arm of the State University of New York

*Independent Research on Government Finances and Management*



**Thank you!**

Lucy Dadayan  
dadayanl@rockinst.org