Revenue Trends

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10-Year Revenue Trends

-8

-6

-4

-2

0

2

4

6

8

10

12

14

1990-4

1991-3

1992-2

1993-1

1993-4

1994-3

1995-2

1996-1

1996-4

1997-3

1998-2

1999-1

1999-4

Total Nominal Increase Adjusted Nominal Increase Real Incr

Personal Income Tax Growth

(adjusted for legislated tax changes)

- 5

0

5

10

15

20

25

1990-4

1991-3

1992-2

1993-1

1993-4

1994-3

1995-2

1996-1

1996-4

1997-3

1998-2

1999-1

1999-4

April "surprises" are no longer surprising

Sales Tax Growth
(adjusted for legislated tax changes)

-4

-2

0

2

4

6

8

10

1990-4

1991-3

1992-2

1993-1

1993-4

1994-3

1995-2

1996-1

1996-4

1997-3

1998-2

1999-1

1999-4

Corporate Income Tax Growth (not adjusted for legislated tax changes)

- 10

-5

0

5

10

15

20

25

1991-1

1991-4

1992-3

1993-2

1994-1

1994-4

1995-3

1996-2

1997-1

1997-4

1998-3

1999-2

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Current Revenue Picture

l April-June 2000 tax revenue grew 11.4% over the same period in 1999 – the strongest growth in the ten years of SRR reports.
l Real growth – adjusted for the effects of legislated tax changes and inflation – was 8.3%, second only to two years ago (April-June 1998).
l This was the sixth year of good or excellent revenue growth, so it is off a very strong base.

Adjusting for legislated tax changes, almost every state saw strong growth

More than 8% (28)
5% to 8% (12)
Less than 5% (10)

Every Region Had Strong
Growth
lNearly half of the states had double-digit
total tax revenue growth
lFar West grew a whopping 24%, due
mainly to California’s 29% growth, but
helped by Alaska’s 60% and Oregon’s 19%
lNew England and Mid-Atlantic region
states also had double-digit increases

PIT Led Revenue Growth Once Again in April-June

Total 11.4%

Sales and Use 7.3%

Corporate Income 4.2%

Personal Income 18.8%

All Parts of PIT were strong
lWithholding has been very strong: 10% in
April-June, down slightly from 11% in
January-March (prime bonus season).
lEstimated tax payments for April-June (1st
two payments on TY 2000) were 18%.
lSince total PIT was up 18.8%, final
payments must have been even stronger.

States with Big PIT Surprises

l More than _ the states with PIT saw double-digit growth
l California led the pack, growing nearly 40%: 1999 PIT liability grew almost 25%!
l Other states with 20%+ in April-June: AL, GA, ID, KS, MA, NJ, OH*, OR*, VT, WI*.

* Affected by legislated tax changes that increased revenue gro

Sales Tax and CIT Growth

Contributed to Record 11.4%

l Sales tax has been stronger in the past year and a half than at any time since 1994/early 1995 – growing 7.3% in April-June
l Corporate income tax continued to grow, albeit still weakly (4.2% in April-June). It has been quite weak since the beginning of 1996.

Hard to find weakness, but not all states are booming
l Southeast was least strong region. Several states there had low (less than 5%) growth: FL, LA, MS, NC, SC and WV.
l Hard to tell in any quarter whether weakness is due to timing issues.
l Nine states have no PIT, so aren’t seeing that growth: TN almost enacted one.

States are reacting to revenue strength by cutting taxes
l 2000 was the seventh straight year of net
tax cuts.

l 14 states cut taxes significantly.
l Significant legislated tax cuts totaled $5.8 billion.
l More than half that amount, $3.4B, was from rebates / temporary tax cuts: all the glory, none of the risk of permanent cuts.

Rebates/temporary cuts

Pennsylvania Property $330

Ohio PIT $519

Missouri PIT $98

Minnesota Sales $635

Illinois Property $280

Colorado Sales $668

California Vehicle $887

State Tax Amount (mil.)

Permanent PIT cuts

MN $224

WI $319

ME $25

ID $27

CO $113

State PIT cut (mil.)

Other Permanent Cuts
SD*Property tax cut$23
PABusiness tax cut$271
NE*Property tax cut$30
MNCar tax cut$150
FLIntangibles tax cut$210
Gas tax cut and$180
hospital tax repeal
CT
StateType of Cut(s)Amount (mil.)
* Local property tax cut, being replaced with state funds

What affects states’ PIT

growth?

l Elasticity of a state’s PIT determines how much it responds to growth (range 1.2-1.6)
– Highest elasticity PIT: CA, CT, NE, NM, RI
l Type of income growth also affects elasticity. Current elasticities ~ 2.0+
– Income currently growing fastest at top of wage scale / tax brackets: # taxpayers, amount of non-wage income shooting up in recent years.

Capital Gains Importance

l Last big peak of PIT was in 1998. Capital gains in tax year 1997 grew 45% over 1996. Only 7% of ’97 AGI, CG was about 23% of ’96-’97 growth.
l Capital gains have been known to drop by as much as 50% in any year.
l Hard to know how a market drop affects short and longer-term picture for capital gains:
– Small drop could lead to locking in of long-term gains.
– Big drop mean a quick turn-around from gains to losses for investors and states.

Which states are most

affected by capital gains?
l Capital gains most affect total revenue picture of states with:
– Heavy PIT reliance
– Taxpayers with lots of capital gains (investors)
– Progressive tax structures
l Looking at the first two only,
– Highest risk: CO, OR, NY, CT, CA
– Lowest risk: states with no PIT, plus ND, WV, MS, AR,
SC

Sales tax: people have been spending rather than saving

Short term risks for sales tax

l Stock market: if people lose money on the stock market, they feel less rich and may save more.
l Consumer confidence: if jobs start looking a trifle less secure, they are likely to save more.
l General impact of economic slowdown on consumption: people pull back on larger, more commonly taxed items like durable goods. That they maintain spending on groceries may not even help states where those aren’t in the tax base.

Long-term sales tax picture: the base is eroding

Internet tax decisions may
also erode the base
lIf goods and services sold over the internet
are exempted from the sales tax, the base
will seriously erode.
lEven if these remain on a par legally with
catalogue sales, the base will erode as
internet shopping increases in popularity.
lNV, FL, TX, TN and WA have most to
lose*
* Based on study by Bruce and Fox, 2000.

How are states fixed for a

“rainy day”?
l 1998 fund balances averaged 9.2% of spending* l FY 1980 fund balances were 9%, and states depleted those AND raised taxes by 27% of spending over 1980-85 in order to survive that recession

l States raised taxes by 13% of spending in 1989-1994 compared to a reserve drawdown of 3.7%

* NASBO / NGA Fiscal Survey of the States

The Good
lStates have more revenue growth than ever
lThey have been socking some away in rainy
day funds
lTax cuts and spending increases have been
happily sharing the legislative stage
lThere is no recession on the horizon, as far
as anyone can see

The Bad
lRevenue is based on very volatile sources,
especially giant PIT increases
lStates don’t generally have enough in rainy
day funds to sustain current programs in
even a mild recession
lMarkets are down again this year
lOil prices up; euro down

The Bottom Line

l States will probably continue to implement tax cuts, with a percent of these being rebates or cuts that are contingent on revenue growth.
l Rapid PIT and even sales tax growth rates are almost certainly unsustainable.
l The longer this continues, the harder it is politically to make conservative estimates.

Reports on this topic
lState Revenue Report: quarterly series.
Most recent issue is #41, on April-June
2000.
lUpcoming State Fiscal Brief #60, “2000
Tax and Budget Summary”
lState Fiscal Issues and Risks at the Start of
a New Century

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l Suggestions welcome, contact Liz Davis,
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