Report: Most states' tax revenues declined in the first quarter of 2016

David M. Kall | Wednesday, October 5, 2016

In September, the Nelson A. Rockefeller Institute of Government (Institute) issued a report titled *Weak Stock Market and Declines in Oil Prices Depressed State Tax Revenues*, in which it observed in the subtitle that falling state tax revenues in the second quarter raise a yellow flag for state budgets.

The bottom line

Total state tax revenue from all sources, including sales, personal income, corporate income, and property taxes, grew by 1.6 percent in the first quarter of 2016. But preliminary data for the second quarter, the most recent quarter for which the Institute has complete records, indicate declines of 2.1 percent. Ultimately, the outlook for state budgets in fiscal year 2016-17, which began on July 1 in 46 states, remains "gloomy."

This deterioration appears to be driven by several things. The first is 2015's weak stock market, as measured by the S&P 500 Index. That index gained only 5.7 percent, as measured by the calendar year average. Additionally, the Index declined significantly in the first half of 2016, though growth has now resumed. This measure is relevant because the stock market has an impact on personal income tax revenue collections.

The second driver is slowing growth in sales tax and withholding collections. With respect to sales taxes, the Institute points out that consumers have been spending less on durable and non-durable goods, such that year-over-year growth in the nominal consumption of durable goods slowed from 5.9 percent to 2.7 percent in the first quarter of 2016.

Consumption of non-durable goods, those that are used immediately like food and clothing, also waned in 2015, though it rallied in 2016. Last year, although oil and gas prices sharply declined, consumers did not offset their reductions in spending on gasoline and other energy goods with increases in non-durable taxable items. As a result, oil producing states were hit hard by price and production weakness, which led to a drop in severance tax revenues and a slowing of these states' economies in general.

As for the collection of withholdings, this is a good indicator of the current strength of personal income tax revenue because it comes largely from current wages, and is much less volatile than estimated payments or final settlements. Withholding growth in calendar year 2015 averaged 3.5 percent. In the first quarter of 2016, it was 4.6 percent, and in the second quarter, it slowed to 2.7 percent.

Thirty-four states reported growth in withholdings in the first quarter of 2016, while seven had decreases. Oregon, Idaho, and Georgia had the greatest growth, at 8.5 percent, 8.2 percent and 6 percent, respectively. Withholdings in North Dakota, New Mexico, and Oklahoma dropped the most, by 33.8 percent, 10.9 percent, and 6.3 percent, respectively.

Corporate income taxes is another component in the Institute's gloomy outlook. This category declined by 4.5 percent in the first quarter of 2016, compared with average growth of 0.1 percent in the four previous quarters. The data for the second quarter of 2016 suggest another reduction in corporate income tax revenues, by 9.2 percent.

On a brighter note, localities have not been hit as hard as state governments. This is because they rely more on property taxes, which have been relatively stable, with a small acceleration of 5.7 percent in the first quarter of 2016, compared to average growth of 3.2 percent in the prior four quarters. That said, local governments that rely more on sales or income tax revenues, or funding from oil and gas production, have done worse than average.

Key findings

Although total tax revenues in 37 states grew in the first quarter of 2016, these four did especially well:

1. Alaska, with 59.8 percent growth;
2. South Carolina, with 19.9 percent growth;
3. Louisiana, with 16.8 percent growth; and
4. Georgia, with 13.5 percent growth.

It should be noted that the growth figure for Alaska, an oil dependent state, is so strong only because revenue collections for the first quarter of 2015 were very weak, reflecting a decline of 83 percent.

The states that fared the worst are, like Alaska, oil and mineral dependent. Six of the 13 worst performers overall are the following oil and mineral dependent states:

1. North Dakota, with -30 percent growth;
2. Wyoming, with - 14 percent growth
3. Oklahoma, with -13.6 percent growth;
4. West Virginia, with - 6.5 percent growth
5. Texas, with -4.7 percent growth; and
6. New Mexico, with -4.6 growth.

Ohio's overall tax revenue for the quarter was relatively flat, declining just 0.8 percent. Nevertheless, the Buckeye State was notable for the significant personal income tax changes that are expected to reduce revenue for total fiscal year 2016 by $1.1 billion. This is the result of legislation that reduced income taxes across the board, increased the small business tax deduction for pass-through entities, and expanded personal exemptions and the earned income tax credit. In April, we explained Governor Kasich's rationale for his tax cuts, and his plans for more in 2017.

California, another state with an earned income tax credit, enacted in 2015, is expected to see decreased revenue from the personal income tax by about $380 million in fiscal year 2016. In May of last year, we wrote about the surge in general revenue funds that lead to Governor Brown's enactment of the credit. Overall, California's tax revenue grew by 3.7 percent in the first quarter.

In the area of sales tax revenues, the median growth figure is 3.1 percent for total fiscal year 2016, and 3.8 percent for 2017. However, three states, Michigan, Connecticut, and New York, are projecting declines in this category. Michigan also saw a decline in personal income tax collections, one of the largest among the states, at 20.5 percent. Overall, Michigan experienced a decline of 3.8 percent in quarterly state tax revenues.

Conclusion

Ultimately, the decline in state government tax revenue was significant in the first quarter of 2016. The Institute identified declines in oil prices and the weak stock market as the main culprits, which raises a yellow flag for state budgets.

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Team member bio