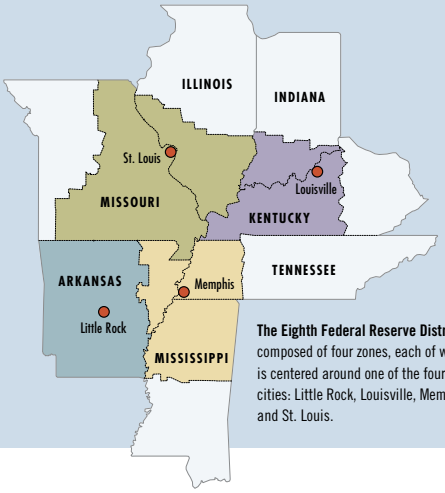
Recession Takes Toll on Eighth District Tax Collections

By Thomas A. Garrett



The Eighth Federal Reserve District is composed of four zones, each of which is centered around one of the four main cities: Little Rock, Louisville, Memphis and St. Louis.

Amidst the current recession, declining state tax revenue and an increasing demand for government services—such as Medicaid, unemployment insurance and various other social programs—are putting increased pressure on state government budgets. State governments estimate a $230 billion gap between expected expenditures and expected revenue between fiscal year 2009 and fiscal year 2011.[1] That figure represents roughly 12 percent of total annual state government revenue (about $1.8 trillion) for recent years.

One culprit behind these gaps is the large decline in states' major sources of tax revenue—personal income, corporate income and taxable retail sales.[2] Revenue from these taxes for fiscal year 2009 was down 6.6 percent, 15.2 percent and 3.2 percent, respectively, from fiscal year 2008 levels.[3]

As with states across the country, tax revenue for each of the seven states in the Eighth Federal Reserve District is generally lower as a result of the current recession. Table 1 lists state revenue from the sales tax, the personal income tax and the corporate income tax, all for fiscal year 2008 (pre-recession) and fiscal year 2009. In addition, the percentage change between the two fiscal years is given. Total state tax revenue for the 50 states combined and for the seven District states combined is also included.

In four of the seven District states, sales tax revenue for fiscal year 2009 was lower than in fiscal year 2008. Illinois experienced the largest decrease (–7.5 percent), followed by Tennessee (–5.5 percent) and Missouri (–3.7 percent). Sales tax revenue in Arkansas increased by 1.1 percent between fiscal year 2008 and fiscal year 2009. In total for the seven states, the percentage decline in sales tax revenue (–3.8 percent) was slightly greater than the decline for all 50 states (–3.2 percent). The decline in sales tax revenue for the seven states was less than the decline in personal income tax revenue (–5.1 percent) and corporate income tax revenue (–20.3 percent).

Personal income tax revenue declined in six of the seven District states between fiscal year 2008 and fiscal year 2009. Illinois and Tennessee experienced the largest declines of –8.8 percent and –30.1 percent, respectively. It is important to note that Tennessee's personal income tax only applies to dividend and interest income, not wage income (which is the largest component of personal income) as in the other six states. Thus, a reduction in Tennessee's much smaller personal income tax base yields a larger percentage decrease than an equal reduction in other states. Mississippi was the only state to experience a positive, albeit small, increase in personal income tax revenue (0.4 percent). As a whole, the decline in personal income tax revenue in the seven states (–5.1 percent) was less than that of the 50 states (–6.6 percent).

Corporate income tax revenue declined in all seven states from fiscal year 2008 to fiscal year 2009. The largest declines were in Kentucky (–44.4), Illinois (–22.0 percent) and Missouri (–21.1 percent). Of the seven states, Indiana experienced the smallest decline in corporate income tax revenue (–9.7 percent). For the seven states, corporate income tax revenue decreased by a greater percentage (–20.3 percent) than did sales tax revenue (–3.8 percent) and personal income tax revenue (–5.1 percent). In addition, the decline in corporate income tax revenue for the seven states was about 33 percent greater than that of the 50 states (–20.3 percent versus –15.2 percent, respectively).

Total tax revenue (defined here as sales tax revenue + personal income tax revenue + corporate income tax revenue) for each state is shown in the last three columns of Table 1. All seven states experienced a decline in total tax revenue between fiscal year 2008 and fiscal year 2009, with the declines ranging from a high of –9.6 percent in Illinois to a low of –2.2 percent in Mississippi. The decline in total tax revenue for the seven states (–6.0 percent) was slightly less than that of the 50 states (–6.1 percent).

Differences across the States

Although the majority of Eighth District states experienced a decline in revenue from the three major taxes, the magnitude of the decline across states is quite different. One reason is that various tax bases may be more affected by an economic slowdown than others, and this effect may be different across states. For example, a reduction in retail sales will reduce sales tax revenues, whereas a reduction in employment will more likely influence personal income tax revenue and corporate income tax revenue. Thus, the degree to which an economic contraction affects consumption, employment and income in each state can explain part of the difference in the performance of the three tax revenue sources across the states.

A related reason is the degree to which each state relies on, as a percentage of total tax revenue, each source of revenue. As seen in Table 2, the seven states each rely on each source of revenue to varying degrees. For example, 25 percent of total tax revenue in Missouri is from the state's sales tax,

TABLE 1

Tax Collections, Eighth District States ($ millions)

	Sales Tax Revenue			Personal Income Tax Revenue			Corporate Income Tax Revenue			Total Tax Revenue		
State	FY2008	FY2009	% Change	FY2008	FY2009	% Change	FY2008	FY2009	% Change	FY2008	FY2009	% Change
Arkansas	2,111	2,135	1.14	2,345	2,271	–3.16	318	258	–18.87	4,774	4,664	–2.30
Illinois	7,215	6,674	–7.50	10,320	9,417	–8.75	1,860	1,450	–22.04	19,395	17,541	–9.56
Indiana	5,534	5,426	–1.95	4,838	4,726	–2.32	910	822	–9.67	11,282	10,974	–2.73
Kentucky	2,878	2,878	0.00	3,483	3,365	–3.39	435	242	–44.37	6,796	6,485	–4.58
Mississippi	1,947	1,950	0.15	1,542	1,548	0.39	501	403	–19.56	3,990	3,901	–2.23
Missouri	1,931	1,860	–3.68	5,210	5,084	–2.42	459	362	–21.13	7,600	7,306	–3.87
Tennessee	6,851	6,475	–5.49	292	204	–30.14	1,620	1,328	–18.02	8,763	8,007	–8.63
7 State Total	28,467	27,398	–3.76	28,030	26,615	–5.05	6,103	4,865	–20.29	62,600	58,878	–5.95
50 States	214,217	207,358	–3.20	276,155	257,805	–6.64	50,772	43,034	–15.24	541,144	508,197	–6.09

SOURCE: National Governors Association and the National Association of State Budget Officers (2009). Total tax revenue is the sum of the three individual taxes.

whereas over 78 percent of total tax revenue in Tennessee is from the state's sales tax. Similarly, 69 percent of total tax revenue in Missouri is from the personal income tax, compared with only 3.3 percent in Tennessee. Thus, equal drops in retail sales activity (assuming constant tax rates and exemptions) will influence total tax revenue much more in Tennessee than in Missouri.

TABLE 2

Tax Revenue as Percentage of Total Tax Revenue (2008)

State	Sales Tax %	Personal Income Tax %	Corporate Income Tax %
Arkansas	44.2	49.1	6.7
Illinois	37.2	53.2	9.6
Indiana	49.1	42.9	8.1
Kentucky	42.3	51.3	6.4
Mississippi	48.8	38.6	12.6
Missouri	25.4	68.6	6.0
Tennessee	78.2	3.3	18.5
50 States	39.6	51.0	9.4

NOTE: Percentages are computed using the data in Table 1. Numbers may not add up to 100 percent due to rounding.

Looking Ahead

States will continue to face budget pressure until economic conditions improve. Improvement in revenue streams from the sales tax, the personal income tax and the corporate income tax is dependent upon, broadly speaking, increased consumer spending and greater employment and business investment. Slow or stagnant growth in one or more of these areas will hinder growth in total tax revenue, especially in those states that generate the majority of their tax revenue from only one or two taxes.

Certainly, there are factors other than the three major taxes that will influence a state's fiscal health. Increased federal money to state governments as a result of the American Recovery and Reinvestment Act (the stimulus package) may provide a temporary boost to state government revenue. Reductions in expenditure on various state-funded programs, such as higher education, social services and corrections, have occurred in dozens of states in fiscal year 2009, with further cuts likely in the next year or two. Finally, many states are considering tax increases in fiscal year 2010 and fiscal year 2011.

Regardless of the actions taken by state governments to shore up their balance sheets, only an economic recovery will provide for growth in state tax revenue. As long as state governments rely on revenue sources that are linked to economic performance and fail to adequately save during prosperous times, it is certain that states will once again find themselves facing budget shortfalls during the next economic slowdown. Ω

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ENDNOTES

1. All tax data presented here are from National Governors Association and the National Association of State Budget Officers.
2. State governments obtain revenue from sources other than sales taxes, personal income taxes and corporate income taxes. These sources include excise taxes, user fees, federal government transfers, license fees and selective sales taxes (sales taxes on specific goods, such as tobacco). About 40 percent of general fund revenue is from the personal income tax, 33 percent is from the sales tax and 8 percent is from the corporate income tax.
3. The fiscal year for most states, including all of those in the Eighth District, ends June 30. The exceptions are: Alabama and Michigan, Sept. 30; Nebraska and Texas, Aug. 31; and New York, March 31.

REFERENCES

National Governors Association and the National Association of State Budget Officers. *The Fiscal Survey of States,* June 2009. See www.nasbo.org/Publications/PDFs/FSSpring2009.pdf.