Legislative Solutions

★ Report from the Capitols ★

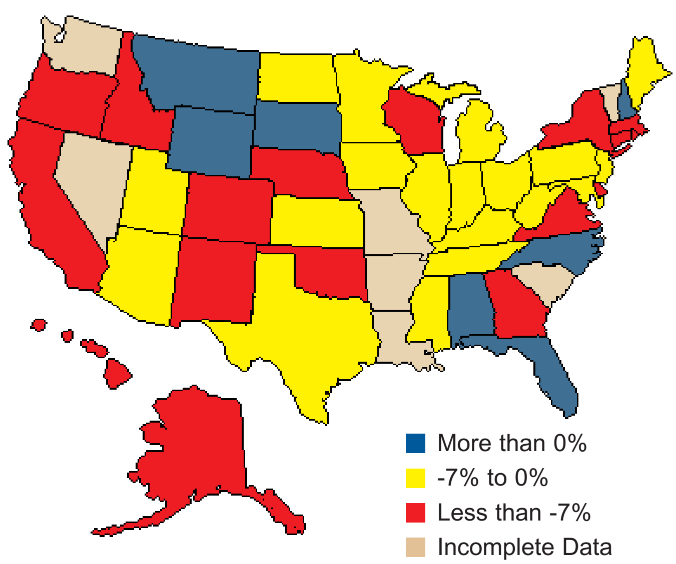
State Tax Revenues Fall Again - The bad news for state governments has continued into 2002 despite the prospects for an economic recovery. The Nelson A. Rockefeller Institute of Government reported that preliminary revenue numbers for the January-March 2002 quarter show that total state tax revenues declined by 8 percent, the third - *and largest* - year-over-year drop in a row.[i]

The Institute reported that all major tax sources continued to weaken, especially income tax collections for the quarter, which declined by 14.4 percent from the first quarter of 2001. Sales tax collections had remained positive during the slowdown, but nationwide turned negative by declining 1 percent from Q1, 2001.

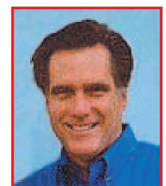
"The first four months are a bell-weather for year-long personal income tax revenues, and right now it's looking rather ominous," said Nicholas Jenny, fiscal analyst at the Institute.

➔ *(Cont.)*

Change in Quarterly Tax Revenue
Q1 2001 vs. Q1 2002



Election Picture Looking Clearer - Thirty-six states will hold gubernatorial elections this year, and largely due to term limits, twenty do not involve the incumbent Governor. Last year's gubernatorial elections in New Jersey and Virginia saw Democrats wrestle control away from Republicans for the first time in years. The momentum from these victories may carry over to other states this year, but many believe the popularity of President George W. Bush will have a positive effect for Republicans. Battle lines are being drawn as recent primaries have narrowed the choice of candidates.


Romney

Massachusetts Democrats are attempting to block Republican candidate Mitt Romney's bid for Governor. Romney was president of of the Salt Lake Olympic Committee and, according to tax records, maintained his permanent residency in Utah. This could make Romney ineligible to run because Massachusetts has a seven-year residency requirement for candidates.[ii]

Elsewhere, Iowa Gov. Tom Vilsack (D) is facing a challenging re-election against Doug Gross (R), former Chief of Staff to Gov. Terry Branstad, while former U.S. Secretary of Energy Bill Richardson (D) is making his bid in New Mexico against state Rep. John Sanchez (R). The campaigns were a lesson in contrast as Richardson ran unopposed for the Democratic nomination and Sanchez won a hard-fought three-way Republican primary.

Oregon Supreme Court justice Ted Kulongoski will face off against Republican challenger Kevin Mannix in Oregon to replace popular, term-limited Governor John Kitzhaber (D). Down south, Florida Gov. Jeb Bush (R) is up for re-election and will likely face former U.S. Attorney General Janet Reno (D), whose nomination is expected in September.

➔ *(Cont.)*

[i] "The Rockefeller Institute State Fiscal News: Vol. 2, No. 6", Nicholas W. Jenny, *The Nelson A. Rockefeller Institute of Government*, May 16, 2002.

[ii] "Democrats Challenge Romney Run", *thebostonchannel.com*, June 7, 2002.

Tax Revenues Fall Again (Cont.) - "Our survey shows that personal income tax collections have come in below the projections of almost every state - with at least a dozen off by ten percent or more," he said.

Why are certain states recovering faster than others? The answer seems associated with the type of tax on which a state relies. While states with no income tax did not benefit as greatly from the economic boom of the 90's, their tax base has recovered more quickly than income tax reliant states. As a result, the economic recovery is showing up in states such as Florida, New Hampshire, South Dakota, Tennessee, Texas and Wyoming where they tended to have either a smaller decline or even an increase in their tax revenues.

While sales tax is considered a more current revenue source and the economic recovery is showing up in those numbers, income tax returns are a lagging indicator. States reliant on income taxes continue to experience a decline in tax revenues despite the recovering economy. Revenue derived from capital gains taxes, which buoyed coffers through the 90's, has all but dried up. Predictably, California and New York are high on the list of states with declining tax revenues. California's tax revenues (#2 on the list) declined 20 percent and New York (#6) declined 13.5 percent from Q1, 2001.

Other states notable for declining taxes in the first quarter are: Alaska (#1) 38 percent, Delaware (#3) 15.2 percent, Oregon (#4) 15.1 percent and Massachusetts (#5) 14.7 percent. States which are benefiting most from the recovery are New Hampshire - steadfastly anti-income tax, which saw a 21.1 percent increase in tax revenues from Q1, 2001, North Carolina with a 3.4 percent gain and Wyoming, which enjoyed a 3.2 percent increase.

States have experienced an estimated $40-50 billion budget shortfall in fiscal year 2002. To assist states, which are required to balance their budgets, through the downturn, The National Governors Association has asked Congress to pass legislation to increase the Federal share of Medicaid (FMAP) by 1 percentage point for each state for an 18-month period beginning April 1, 2002. This would be worth approximately $3.7 billion to all states and territories. Such relief would be greatly welcomed in state capitols around the country. ■

Elections (Cont.) - The other states holding gubernatorial elections are Alabama, Alaska, Arizona, California, Colorado, Connecticut, Georgia, Hawaii, Idaho, Illinois, Kansas, Maine, Maryland, Michigan, Minnesota, Nebraska, Nevada, New Hampshire, New York, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, Wisconsin, and Wyoming. ■

Good Times Have Come To An End At Statehouses - As state revenues fall precipitously, legislators can no longer enjoy the pleasure of debating how much money to give back to citizens. Instead, states are facing unenviable choices of large budget cuts or raising taxes.

A 1999 report released by the Center on Budget and Policy Priorities predicted this scenario during the peak of the economic expansion. The report accurately warned that states which increased spending and cut taxes in the face of larger-than-expected revenue growth during the 90's would not have sufficient "rainy day" funds to deal with a mild recession, such as the one at the start of the 1990s.

During the "happy days" of the 90s, state budgets doubled in size, setting records for government spending. According to the American Legislative Exchange Council, most states now spend between $800 and $1,000 more per person than they did in 1990-and that's after adjusting for inflation. Combined with revenue shortfalls from a failing economy, states are not only ill-prepared for the slowdown, but are gritting their teeth at the decisions they don't want to make. California, New York, and Virginia are in particular trouble: Their combined budgets are nearly $20 billion in the red. "We didn't get a rainy day," New York governor George Pataki announced in his budget message earlier this year, "we got a monsoon."[iii] ■

[iii] "Governors and drunken sailors", Stephen Moore, *National Review*, June 3, 2002.