The Six States Where Taxes Are Soaring

March 19, 2012 by Douglas A. McIntyre

As the economy struggles to recover, state and federal budget deficits continue to be the subject of increased attention. Just last week, the congressional budget office said that President Obama's budget will produce a $1.3 trillion deficit in 2012 if enacted. It would be the fourth straight year of $1 trillion-plus deficits.

Read The Six States Where Taxes Are Soaring

Many states have not been faring much better in their attempts to balance the budget. The recent recession resulted in some of the worst declines in state revenue since World War II, according to a recent report on state budgets by the Brookings Institution. In fiscal year 2010, a record 43 states faced budget deficits. In their fight to shrink their deficits, states have cut spending by slashing programs and lowering costs, while increasing revenue mostly by raising taxes.

According to the Brookings report, a whopping 40 states raised taxes between fiscal year 2009 and 2011. Only eight cut taxes. Based on the report, 24/7 Wall St. examined the six states that increased revenue from taxes by 9% or more during the period. While these states increased revenue the most, spending cuts appear to be critical to managing deficits for nearly all of the states.

The media has focused on taxes, pointing out that revenue from all state taxes increased by nearly $24 billion in 2010, the largest nominal increase on record. However, the $24 billion, which reflects a 3.5% increase over the previous year's revenue, "was actually less in percentage terms than during prior recessions in the 1980s and 1990s," Tracy Gordon, author of the report, said in an email to 24/7 Wall St. "The bulk of tax increases were in a few large states, like California and New York, and have now expired," Gordon added.

In reality, while taxes have played a part, nearly all of the states have been forced to cut government services to balance their budgets. In the 2011 fiscal year, 29 states made cuts to services benefiting the disabled and elderly, 34 reduced funds for K-12 and early education, and all but six states reduced positions, benefits or wages of government employees.

The states that raised revenue from taxes the most are no different. Of the six states that raised tax revenue the most, five recently cut services in at least two of the following areas: public health, the elderly or disabled, K-12 and early education, higher education, and the state workforce. Two states cut services in four of these and two cut funding for all five.

Interestingly, several of the states that raised taxes the most had among the most generous programs for residents. Three of the six states spent among the absolute most per capita in fiscal year 2008, the most in recent year for which data is available. The same year, four of the six spent over $4,600, far more than the national average of $4,114 per person.

Several of the states that increased revenue from taxes the most had among the worst budget gaps during the recession. In 2010, California, Illinois, New York and Rhode Island, all of which increased revenue from taxes by over 9%, had among the highest deficits, exceeding 30% of general funds. California faced a gap of more than 50%, second only to Arizona. Despite cutting spending and increasing tax revenue, many of these states have continued to experience major shortfalls. Projected budget deficits for California, New York and Illinois remain among the highest in the country.

Many of the states with the largest budget gaps, including half of the states that increased tax revenue the most, also experienced the sharpest declines in their housing markets. Seven of the top 10 states with the biggest deficits in 2010 also had among the worst declines in home values in the country from their prerecession peaks. California, Rhode Island and Illinois had among the 15 sharpest declines of all 50 states.

In addition to a downturn in the housing market, a number of the states that increased revenue from taxes the most also experienced weak labor markets, as well as slow growth in median income and in GDP. Between 2006 and 2010, four out of the six states had among the smallest increases in GDP. Currently, California, Rhode Island and Illinois have among the highest unemployment rates in the country. While a lower GDP and labor market would lower tax revenue by itself, increases in the taxes rates of these states likely contributed to the increase in tax revenues.

24/7 Wall St. relied on Brookings Institution’s 2012 report, “What States Can, and Can’t Teach the Federal Government About Budgets,” to identify the six states where tax revenue as a percentage of total revenue increased more than 9% between 2009 and 2011. The Center for Budget Policies and Priorities provided data on state spending and budget shortfalls. Annual tax revenue data was obtained from the U.S. Census Bureau and the Tax Foundation. The amounts states spend on unemployment benefits, education, Medicaid, Medicare and pensions is from an independent analysis by 24/7 Wall St. based on data collected by the National Employment Law Project, The Urban Institute and Kaiser Commission on Medicaid and the Uninsured, Centers for Medicare and Medicaid Services, Center for Retirement Research at Boston College on defined benefit plans, the Administration for Children and Families.

These are the six states where tax revenues are soaring.

1. Delaware
> Increase in personal income tax: none
> Expenditure per capita (2008): $6,800 (3rd highest)
> 2009 budget shortfall: 12.2% (18th highest)
> Home price decline from peak: 20.3% (16th largest)

In the past three years, the state of Delaware spent $6,800 per person in its annual budget, approximately two-and-a-half times as much as Nevada. The state’s government spent the 10th-most per person in the country on Medicare in 2009, and the 13th-most per person on pensions. In its fiscal year 2011 budget, the state was forced to address an 11.4% budget gap by cutting funds to education and the state workforce.

Despite these cuts, the recession has weighed heavily on the state’s budget. Delaware has experienced among the biggest declines in home values in the country over the past five years. The state raised tax revenues to help address the resulting budget gap. These hikes included at least 5% increases in corporate and cigarette taxes. The state also temporarily raised the cap on the corporate franchise tax from $165,000 to $180,000. As a result of these and other changes, state tax revenue increased by more than 9% between 2009 and 2011.

Also Read: The 10 Largest Hedge Funds in America

2. California
> Increase in personal income tax: more than 5%
> Expenditure per capita (2008): $4,196 (25th lowest)

> **2009 budget shortfall:** 36.7% (2nd highest)
> **Home price decline from peak:** 46.7% (3rd largest)

Since 2009, few states have had more serious budget challenges than California. Spending growth has far outpaced economic growth since 1991, and the gap continues to widen today. For years, the state has been one of the biggest-spenders in the country. TANF (Temporary Assistance for Needy Residents)-eligible residents receive $537 per month for 42.4 months — the second largest amount in the country and the seventh-longest period. The state also spends a great deal on pension beneficiaries.

The recession has made California's structural deficits larger. Median home values fell by 46.7% from their peak in 2006, and median household income barely increased since then, much less than the average state. In 2010, the state had a $45.5 billion budget shortfall, or 52.8% of its general fund — the largest in nominal terms and the second-worst in the country as a percentage of general fund. Enormous budget gaps have forced the state to cut funding to nearly every major program. The state also has raised taxes substantially, including increases of 5% or more in sales tax, personal income tax, and corporate income tax, which together contribute to an overall increase in revenue from taxes of over 9%.

3. Illinois
> **Increase in personal income tax:** more than 5%
> **Expenditure per capita (2008):** $3,772 (16th lowest)
> **2009 budget shortfall:** 15.1% (11th highest)
> **Home price decline from peak:** 21.7% (13th largest)

Illinois consistently has had among the largest budget shortfalls in the country since 2009. It also was hit extremely hard by the recession. Since its prerecession peak, home values have declined by more than 20%, which is among the worst declines in the country. GDP grew a relatively modest 8.2% between 2006 and 2010, while the average state's GDP grew at least 10%.

In 2011, the state's continued financial problems led to a $13.5 billion budget gap, representing 40.2% of the state's general fund. It was the second-worst budget gap in the country. The state was forced to make spending cuts in all five major categories, including $311 million in cuts to school education in 2011. The state also increased the corporate tax rate from 4.8% to 7% and increased personal income tax from 3% to 5% as part of the fiscal year 2012 budget agreement. The state estimates these measures will raise approximately $7 billion.

Also Read: American Companies Running Out of Cash

4. New York
> **Increase in personal income tax:** more than 5%
> **Expenditure per capita (2008):** $5,353 (12th highest)
> **2009 budget shortfall:** 13.2% (16th highest)
> **Home price decline from peak:** 8.3% (16th smallest)

According to the Tax Foundation, New York has been spending approximately 144% more per person each year than it did in 1977, the first year with recorded data. In 2009, New York spent $18,126 per pupil, more than any other state. It also spent $9,056 per Medicare recipient, also more than any other state.

When creating the fiscal year 2012 budget, legislators confronted a $10 billion deficit, or 17.6% of the total available funds. For that budget, the state was forced to cut funding for the SUNY colleges by 7.6%. Yet, these cuts, and others like it, have not been enough to balance the budget. The state has raised tax revenues by at least 9% between 2009 and 2011, partially by increasing personal income and cigarettes taxes by 5% or more.

5. Rhode Island
> **Increase in personal income tax:** between 1% and 5%

> **Expenditure per capita (2008):** $6,093 (5th highest)
> **2009 budget shortfall:** 26.6% (3rd highest)
> **Home price decline from peak:** 27.0% (7th largest)

Between 1977 and 2008, the state of Rhode Island has doubled its spending to $6,093 per person. The increase was driven by some of the biggest state programs in the country. In paying out unemployment benefits, the state covers 46.5% of weekly wages, the second-highest percentage of any state. Rhode Island is also among the top ten per capita spenders for education, Medicaid, and pensions.

According to Brookings, the state's tax revenue has been declining for decades as a result of a loss of manufacturing jobs. The slowing economy rebounded briefly during the housing boom leading up to the recent recession. Unfortunately, the real estate market collapse has put the state in an even worse position than it was before. Rhode Island has been forced to make across-the-board cuts in spending as well as increase taxes. The state increased cigarette taxes by more than 5%, and it raised personal income tax between 1% and 5%.

Also Read: American Cities Where Manufacturing is Booming

6. Wisconsin
> **Increase in personal income tax:** more than 5%
> **Expenditure per capita (2008):** $3,990 (21st highest)
> **2009 budget shortfall:** 11.7% (20th largest)
> **Home price decline from peak:** 12.8% (16th smallest)

Compared to the other states on this list, Wisconsin was not hit as hard by the recession. Home prices declined a more manageable 12.8%. Just 4.9% of homes were either in foreclosure or delinquency at the end of last year. As of March, the state had an unemployment rate of just 6.8%, the 17th-lowest in the country. Despite all of these positive economic signs, Wisconsin has still had budget difficulties.

In 2009, Wisconsin's budget shortfall was better than the most of the states, at 12.8% of the general fund. However, that gap has worsened each year. In 2010, the shortfall was 23.7%, tied for 22nd-highest in the country. By 2011, the gap had reached 24.9% of available funds, the fifteenth-highest in the U.S. In an attempt to raise tax revenue, the state increased income taxes and cigarette taxes at least 5% between 2009 and 2011. The state also raised sales taxes substantially during that time.

Editors Note: 24/7 Wall St. relied on data compiled by Brookings Institution to identify the six states that have increased the percent of revenue from taxes by over 9%. Brookings has since revised that data based on new information which was not available to it or 24/7 Wall St. at the time of publication. An earlier version of this article identified West Virginia as one of the states that had increased the percent of revenue from taxes by over 9%. In fact, according to the Brookings' revision, West Virginia decreased the percent of its revenue from taxes by less than 1%. Also according to the Brookings' revision, Wisconsin, which was not included in 24/7 Wall St.'s original article, had its percent of revenue from taxes increase by more than 9% and is now included in 24/7 Wall St.'s coverage.

Michael B. Sauter and Ashley C. Allen

Posted in Investing, Special Report | Comments Off

March 27, 2014