BETTER CHOICES

In Good Company: How Other States are Tackling Their Fiscal Crises

New Mexico is not alone in its budgetary woes. Across the nation, the slow economy is driving down state revenues by unprecedented proportions. The result is that 48 states are facing a deficit.[1]

Official revenue estimates predict a $433 million budget shortfall in New Mexico this fiscal year, or about 8 percent of our $5.5 billion budget. Many states face much higher budget gaps than ours. On average, state shortfalls equal 24 percent of their annual budget.

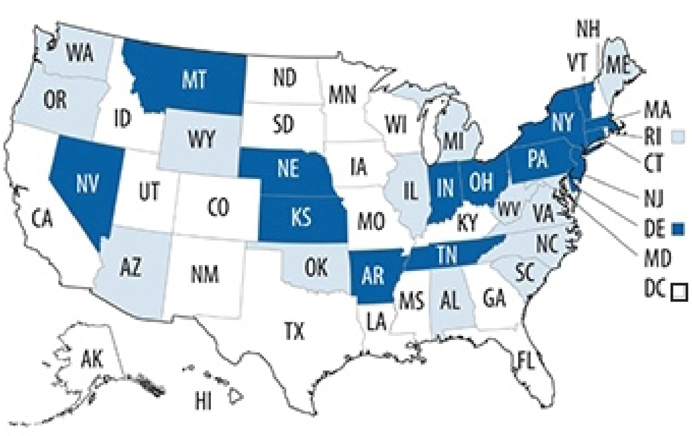
As we make the serious decisions about how to balance the budget, it is helpful to look at what other states are doing to balance theirs, as well as what they did in past recessions.

Lessons from Past Recessions

During the 2001 recession, the states in the deepest budget holes that raised taxes recovered from the recession just as quickly (if not faster) than other states.

States That Raised Taxes in the Last Recession

Net tax increases as a percent of the previous year's tax revenue, late 2001-2004.



Source: Center on Budget and Policy Priorities calculations of data from the Census Bureau, the National Conference of State Legislatures, and state fiscal offices.

Any spending reductions from increased taxes on high income groups were surpassed by revenue gains. Conversely, a number of states that did not raise taxes, or implemented tax cuts during the last recession, subsequently saw slower-than-average economic growth in personal income and employment.[2]

Raising New Revenue

States are responding to the current recession with a number of measures. All but four states are employing a combination of drawing down reserve funds, maximizing the use of federal dollars, and raising new revenue.[3]

At least 30 states have already enacted tax increases, closed loopholes, restricted tax credits, increased tobacco taxes, raised tuitions, or implemented other revenue-raising measures, and several more are considering such measures.[4] Even South Dakota and Wyoming, with budget shortfalls of just 3 percent and 2 percent respectively, have raised taxes. These tax increases are being enacted in states with both Democratic and Republican governors and legislatures.

Tax changes enacted in 2009 include:

- ***Personal income taxes*** addition of new upper-income tax brackets, increased rates, and reduction of various credits, exemptions and deductions (11 states)
- ***Business taxes*** increased (at least 11 states)
- ***Excise taxes*** increased on tobacco and alcoholic beverages (at least 15 states)
- ***Sales taxes*** applied to more goods and services, increased rates (12 states)

Examples of 2009 Personal Income Tax Changes

• **California** Increased the tax rate by 0.25 percent on each income bracket and reduced tax credits for dependents. Will generate an estimated ***$5 billion*** in 2010.

• **Oregon** Added two brackets for high-income levels, differentiated for single or joint filers. Will generate an estimated ***$230 million*** annually.

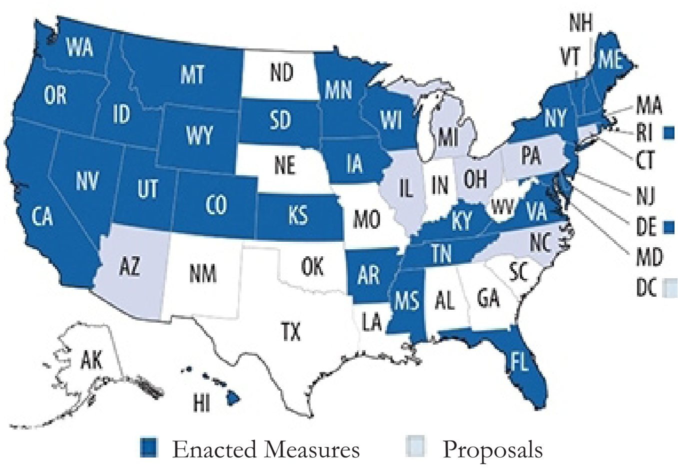
• **Hawaii** Temporarily created new brackets for high-income levels and raised the rates by 1 percent each bracket. Raised the standard deduction and personal exemption by 10 percent to reduce tax bills for low- and moderate-income families. Will generate an estimated ***$100 million*** over a 2-year period.

• **New York** Temporarily increased tax rates on highest income filers, limited itemized deductions, and reduced the credit on New York City personal income tax. Will generate an estimated ***$5 billion*** annually.

• **New Jersey** Temporarily increased income taxes on the top three tiers of households by 1.6 to 1.8 percent. Will generate an estimated ***$1 billion*** in 2010.

States Raising New Revenue, 2009

Lawmakers in 37 states have enacted or are considering proposals to increase taxes and fees (as of July, 2009).



Virtually every Western state, except New Mexico and Arizona, has chosen to raise new revenue.
Source: Center on Budget and Policy Priorities

Examples of 2009 Business Tax Changes

• **Wisconsin** Instituted unitary combined reporting, which makes it impossible to shelter income in other states and improves equity between the treatment of in-state and multi-state corporations. Will generate an estimated ***$75 million*** annually.

• **Oregon** New tax rates and tax brackets depending upon the amount of sales. Will generate an estimated ***$300 million*** over two years.

• **Nevada** Altered business payroll taxes. Will generate an estimated ***$346 million*** over two years.

Making Economic Sense

Tax increases to the highest income brackets makes the most economic sense during a recession because it does not slow spending as much as do budget cuts. When states cut spending, they lay off employees, cancel contracts with vendors, eliminate or lower payments to businesses and organizations that provide direct services, and cut benefit payments to individuals. When that happens, the companies, organizations and individuals have less money to spend. This directly removes jobs and spending from the economy.

Tax increases can also remove demand from the economy by reducing the amount of money people have to spend. However, when that reduction is limited to the highest income earners the effect is minimized because much of the money comes from savings and so does not diminish economic activity.[5]

New Mexico has an opportunity to strengthen the economy through measures that have demonstrated success in the past and in other states.

Endnotes

1 Montana and South Dakota are the only states without a budget shortfall.
2 "Tax Measures Help Balance State Budgets: A Common and Reasonable Response to Shortfalls," by Nicholas Johnson, Andrew C. Nicholas, and Steven Pennington; Center on Budget and Policy Priorities, July 9, 2009.
3 Ibid
4 "New Fiscal Year Brings Continued Trouble for States Due to Economic Downturn; Federal Economic Recovery Funds Providing Some Relief," Updated August 12, 2009, Center on Budget and Policy Priorities.
5 "New Fiscal Year Brings No Relief From Unprecedented State Budget Problems," by Iris J. Lav and Elizabeth McNichol, August 12, 2009, Center on Budget and Policy Priorities.