

Growth and Variability in State Tax Revenue

An Anatomy of State Fiscal Crises

Randall G. Holcombe
and Russell S. Sobel

Contributions in Economics and Economic History
Number 189



Greenwood Press
Westport, Connecticut • London

Contents

<i>Illustrations</i>	ix
<i>Preface</i>	xv
1. Revenues and Expenditures: The Components of Crisis	1
State Revenue and Expenditure Trends	3
New Taxes and Revenue Growth	7
Federal Aid to States and State Fiscal Crises	7
Recessions and Crisis	12
The Problem in Context	13
Cyclical Variability: The Fundamental Problem	14
Fiscal Crises: The Key Factors	15
2. State Government Spending	19
State Versus Local Government Spending	20
Changes in the Components of State Government Spending	23
Education	26
Welfare	27
Health Care	30
Corrections	31
Highways	32
Conclusion	33
3. State Government Taxes	35
The State Tax Base	35
State Sales Taxes	38
State Income Taxes	40
Are State Income and Sales Taxes Necessary?	44
Taxes on Motor Fuels	45

Severance Taxes	47
Other Revenue Sources	48
State Versus Local Taxes	51
Differences Among the States	52
Revenues from the Federal Government	53
State Taxes over the Revenue Cycle	55
 4. Budgeting for Stability: Some Principles	 61
State Fund Structures	62
The Stability of Major State Tax Sources	66
A Comparison	72
 5. Measuring Cyclical Variability	 75
The Income Elasticity of Tax Bases Over the Business Cycle	76
Standard Model of Tax Revenue	77
The Stationarity of Tax Bases and Income	78
Estimates of Tax Base Elasticity	84
The Difference between Short-Run and Long-Run Elasticity	86
Alternative Measures of Revenue Variability	88
Stability of the Elasticity Estimates	89
Conclusions about Tax Elasticity Estimation	93
 6. The Cyclical Variability of State Government Revenues	 97
Variability of Total Revenues Over the National Business Cycle	98
Variability of Total Revenues Over the State Business Cycle	104
Variability of Tax Revenues Over the Business Cycle	105
Some Overall Trends	111
A Statistical Comparison of the Elasticity Estimates	115
Conclusion	120
 7. The Variability of State Income and Sales Taxes	 121
Tax Bases, Tax Revenues, and the Income Base	122
Cyclical Variability of State Individual Income Taxes	123
Cyclical Variability of State Retail Sales Taxes	129
Comparing the Growth and Variability of Income and Sales Taxes	138
Conclusion	141
 8. Is There a Trade-Off between Variability and Growth in State Government Tax Bases?	 145
Cross-Sectional Trade-Offs Among the States	146
Trade-Offs in Tax Bases Versus Tax Revenues	152
Within-State Trade-Offs Between Sales and Income Taxes	155
Conclusion	159
 9. The Role of Rainy Day Funds in Easing State Fiscal Crises	 161
State Fiscal Policy and the Role of Budget Stabilization Funds	162
The Impact of Recessions on State Finances	164
Measuring State Fiscal Stress during the 1990–1991 Recession	166

The Impact of Rainy Day Funds on State Fiscal Stress	170
State Surpluses and Fiscal Stress	172
Rainy Day Funds and Available Surplus Balances	176
Conclusion	177
10. Conclusion	183
Revenues and Expenditures	184
The 1950s and 1960s Versus the 1970s and 1980s	187
The Problem of Cyclical Variability	189
Can Cyclical Variability of State Government	190
Revenues be Reduced?	
Mitigating State Fiscal Crises	191
Conclusion	193
<i>Bibliography</i>	195
<i>Index</i>	201