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State budgets tenuous heading into '08
 By Pamela M. Prah, Stateline.org Staff Writer

States awash in surpluses for the past two years are now trading water, with several desperately looking for lifelines to help them get out of budget trouble.

A slumping housing market and skimpier sales tax collections are busting budgets from California to Florida at a time when national job growth is slug-

gish and consumer confidence is at a nearly two-year low.

“The forecast is looking pretty grim,” Sujit M. CanagaRetna, a state tax expert for the Council of State Governments, said. “The implications for states are serious.”

Experts say it’s too early to tell if all state budgets will spiral into massive deficits in the coming year, but some states already see gaps in their ledgers:

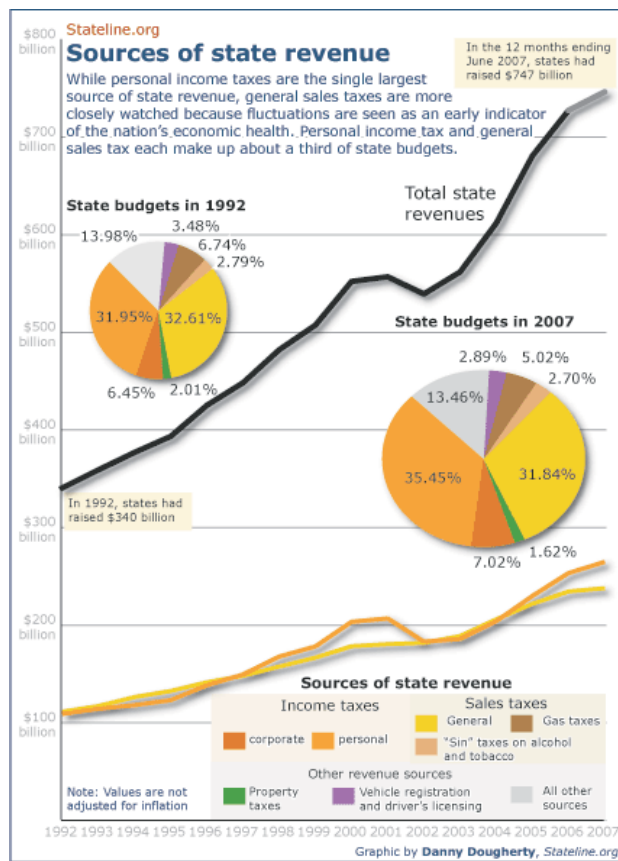
The Florida Legislature is expected to vote this Friday (Oct. 12) on a deal to dig itself out of a \$1 billion hole through cuts in education, health care and courts.

Michigan was pushed to the brinks of a state-wide government shutdown because it first had to erase an \$800 million deficit for its current fiscal year before it could pass a new budget for an Oct. 1 deadline. The new package relies on hikes in the personal income and sales tax and new taxes on an array of services.

Maryland needs to bridge a looming \$1.7 billion deficit. Gov. Martin O’Malley (D) has pitched bumping up personal income, sales and tobacco taxes and relying on slot-machine gambling to gin up \$550 million for the state.

Both Arizona and Virginia are looking at more than \$600 million shortfalls in their current two-year budgets. Layoffs, hiring freezes and tapping rainy day funds are among ideas under consideration.

Nasty budget brawls broke out this year in California, Georgia, Illinois and Rhode Island as [states’ financial picture appears in transition](#). (Wisconsin is the only state in the country without a budget plan yet for the new current fiscal year, which for all but four states began July 1.)



The stalled housing market is pinching states across the board, but more severely for states such as Arizona, California, Nevada and Florida that rely heavily on real estate taxes. A drop in home sales and prices mean states take a smaller cut — both in real-estate-related taxes and sales tax as most people who buy homes also purchase new appliances and carpeting and spend big money on home-improvements. Florida, for example, is particularly dependent on sales tax revenue since it does not have a state income tax.

Linked to the cooling housing market is the rise of [foreclosures on home mortgages](#). The highest default rates are connected to “subprime” loans given to riskier borrowers with credit problems or little credit history. These loans now are dubbed as “NINJA” loans, meaning they required “No Income, No Job and No Assets” of the borrower. An abundance of foreclosed homes that can’t be sold can lower property values, which can lower a community’s property taxes.

The booming housing market also filled state coffers in another way. With interest rates low, many homeowners refinanced, tapping into their home for easy equity, splurging on renovations or major purchases. The sales tax on these big-ticket items can bring in a significant chunk of change for a state’s budget. The sales tax on new car purchases, for example, accounted for 15.4 percent of Ohio’s total state sales tax collections in 2002.

While personal income taxes are the largest single source of state tax revenue, the flow of money from the sales tax is more closely watched since its fluctuations are viewed as an early indicator of the health of the nation’s economy.

The latest figures show that the growth in sales tax for the second quarter was one of the lowest in four years at 6.1 percent and “matched rates last seen as the nation was emerging from the last recession,” according to the [Nelson A. Rockefeller Institute of Government’s state revenue report](#).

Not all states are feeling the squeeze for the same reason. Michigan’s [“one-state recession”](#) is blamed on the state’s heavy reliance on the failing U.S. auto industry. The well-being of Illinois and Ohio depends, in large part, on the economic performance of the manufacturing sector.

[New York is closely watching Wall Street](#), which in good times can account for up to 20 percent of state revenue. A booming stock market means higher corporate profits and hefty bonuses for investment bankers, with the state getting a cut. The health of the financial service sector also plays a big role for Connecticut and Massachusetts because of their large banking and insurance communities there.

Part of the problem, some critics say, is that states need to be more realistic in their budget projections and watch their spending more closely. “Budget woes have a lot to do with economic forecasts. Were prior economic forecasts a little too rosy?” Chris Edwards, director of tax policy at Cato, a libertarian think tank, said.

Curtis Dubay, an economist with the Tax Foundation, a Washington, D.C., think tank, said, “States that are having budget problems at this time need to look at their spending priorities, not so much at their tax revenue The only reason a state would even be thinking about a budget deficit would be because of out-of-control spending.”

Many states have been on a spending spree for the past two years. Minnesota last year doled out \$522 million for a new baseball stadium for the Minnesota Twins, for example, while this year, Alabama forked over \$400 million in tax breaks and other incentives to land a German steel mill.

After the highs of the past two years, states can’t, and don’t expect, another banner budget year. But the long-term outlook is not expected to be as bad as the early part of this decade.

“Some folks are jumping to the conclusion that we are at the beginning of a downward cycle, but this is not another 2001-2003 period when all states went down and down dramatically,” Scott D. Pattison, executive director of the National Association of State Budget Officers.

The national recession after the 9/11 terrorist attack plunged states into the worst economic conditions since the Great Depression. States were forced to close \$264 billion in budget gaps over five years beginning in 2001.

Pattison said states enjoyed higher-than-normal growth rates in tax revenue in the past few years. “We’re getting back to normal rates,” he said.