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States' coffers are feeling a pinch: Housing bust and falling sales-tax revenues remind some officials of the period before 2001 recession.

By Daniel B. Wood

Los Angeles — Florida is working in special legislative session to cut property taxes as a way to stimulate consumer spending.

Nevada has called for a 5 percent cut in the budgets of all state agencies.

Michigan has expanded its sales tax to cover luxury services such as massages, manicures, and skiing, which were not taxed previously, and has increased the income-tax rate from 3.9 percent to 4.35 percent.

With at least a quarter of US states collecting less money than anticipated from sales taxes, and many others barely holding even with inflation in their overall revenues, state budgets appear to be headed for tough times, say several economists. Closing the gap may require states to use creative measures, these same economists predict. With a falling housing market, several experts see troubling economic warnings similar to those that preceded the US recession in 2001.

This time, they say, states would probably be on shakier ground because they won't have the years of fat that the 1990s stock-market boom provided.

"Many of the indicators, from sales-tax receipts to national debt to purchase of US treasury bonds, are similar to the year 2000," says Philippa Dunne, a co-editor of The Liscio Report on the economy. "But this time, states may have to take more drastic measures because they won't be coming out of a decade in which they had tons of money."

Why housing market downturn is key sign

The receding housing boom is affecting nearly every state and is a key indicator, say Ms. Dunne and others, because it produces a domino effect, colliding with the consumer purchases that feed state treasuries via sales taxes. On average, about one-third of state income comes from sales taxes on consumer items.

"When people are not buying homes, they are not buying appliances and furniture and other big-ticket items to go inside them," says Robert Ward of the Rockefeller Institute of Government in Albany, N.Y.

Also related to the diminishing sales-tax receipts is the dwindling equity in homes, exacerbated by the raft of foreclosures nationwide. Nevada, Florida, California, Arizona, and Michigan have been hit the hardest by declines in the housing market according to the number of houses and condos bought and sold.

"People use the equity in their homes as a cash machine by taking out additional home- equity lines … and when that is gone or tapped out, it means smaller lending support for consumer spending for all goods," says Mark McMullen, a senior economist in Portland, Ore., for Economy.com. "There is going to continue to be a headwind for consumer spending and job gains, both of which weaken the state tax base."

Both stock market and state spending up

Others are more sanguine, noting two trends: The stock market is doing well, and state spending in 2007 grew 8.6 percent over the previous year, two points above the 30-year average.

"Many states say they are experiencing uncertainty and a heightened awareness over dropping revenues, but no one to date is ringing the bell to say we are in deep trouble," says Arturo Perez, an economist with the National Conference of State Legislatures.

What most bears watching is the intangible factor of consumer confidence. “Tax collections can change overnight with good news or bad,” he says. “The extreme was 9/11, but there are other things like unexpected jumps in unemployment claims, a drop in the stock market, a rise in oil prices, international instability, or a combination. We have not yet seen a rise in unemployment or a decline in the stock market.”

Nevada loses big source of revenue

But states report that the general drop in consumer confidence nationwide is having an effect in their state. Clark County, Nev., for instance, has seen housing values drop as much as 20 percent, as reported by the Las Vegas Sun. A falloff in out-of-state visitors to Nevada casinos has socked one of the state government’s biggest sources of income: gambling.

“People’s perceptions of their net worth have dropped, and they continue to be bombarded by media saying everything is headed south, which affects consumer confidence,” says Reese Tietje, chief planner of the Nevada Department of Administration.

Besides dwindling sales-tax receipts, Mr. Tietje reports that what Nevada’s government has collected from gambling operations was off 4.41 percent in August 2006 compared with August 2007 – nearly $50 million in just the month of August. Nevada has announced a freeze for all state hires and is asking every state agency to reduce its budget by 5 percent. Those include cuts of $50 million for the Department of Health and Human Services and $30 million by the state university system.

California signs deal to expand gambling

Part of Nevada’s reduced gambling income and tax receipts comes from changes next door in California, observers say. When times get tough, many stop crossing the border to gamble in Las Vegas’s ritzy casinos, opting instead for smaller Indian casinos in their own area. California Gov. Arnold Schwarzenegger (R) recently signed a pact with Indian tribes that will expand gambling in the state in an effort to close a $6.1 billion budget deficit. Such operations are expected to produce $9 billion in revenue for the state’s treasury over 20 years.

Besides scrambling to cut corners, states expect to tap into rainy-day funds, but they won’t have the option of billions in tobacco-company settlements that helped to bail them out when things started getting tough in 2001. One-time fixes, however, will not be enough to bail out many states.

Michigan, for one, is struggling with a poor economy, resulting mostly from losing 300,000 auto industry jobs in the past seven years. After failing to close a $1.7 billion gap by Oct. 1, the state government partially shut down. The legislature helped end the shutdown in the early morning by agreeing on two new measures: an expanded sales tax and a rise in income tax. The taxes will cover only about $1.3 billion of the budget shortfall, says Leslee Fritz, spokeswoman for the Michigan State Budget Office.