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## *Slipping Tax Revenues Pinch State Budgets*

*By Conor Dougherty*

Slack consumer spending and falling corporate profits are hurting tax revenues, forcing states to make painful cuts in their budgets.

In Florida, students are facing hotter classrooms and could take fewer field trips as public schools pare spending. In Nevada, planned upgrades of locks and security key-card systems at state psychiatric hospitals have been put on hold. Kentucky's public defenders are considering dropping certain cases, including involuntary-commitment cases and small misdemeanors that might include petty theft and minor assault.

**During the past three months of 2007, state tax revenues were up just 2.3% from a year earlier — the slowest growth since 2003, according to a report released Monday by the Nelson A. Rockefeller Institute of Government at the State University of New York. Tax revenues fell 4.3% after adjusting for inflation and tax changes that took effect last year.**

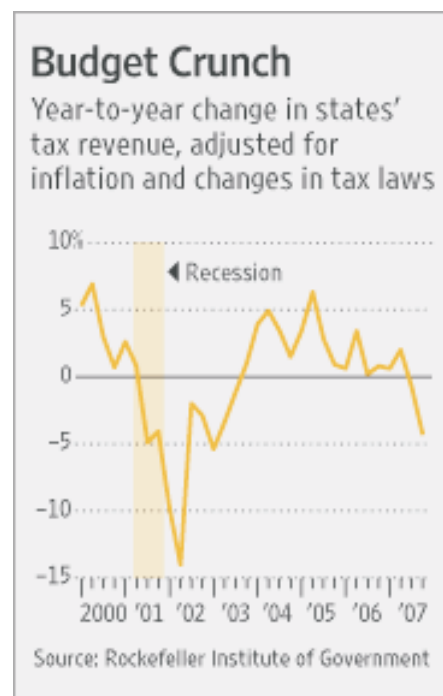
**At the same time, rising costs and increased demand for services are ratcheting up pressure on state budgets. "States are experiencing a classic nutcracker effect, and the result of that is likely to be a squeeze on states' ability to fund services," said Robert Ward, the institute's deputy director.**

Economic growth ground nearly to a halt in the last three months of 2007 and has likely weakened further since then; many economists say the U.S. is on the verge of a recession or is in one. The slowdown has damped income and spending by individuals and companies, reducing the states' take through income and sales taxes.

This reduced spending could further slow a faltering economy. State and local government accounted for 13% of the nation's gross domestic product in the fourth quarter. Increases in government spending were part of the reason the economy didn't contract at the end of last year.

The report showed that sales-tax revenues increased 1.9% in the last three months of 2007 compared with a year earlier, the slowest rise since 2003. Personal-income taxes increased 3.8%. Corporate taxes decreased 15.7%, reflecting weak corporate profits and the write-downs taken by Wall Street firms holding mortgage securities whose values tumbled.

States get most of their money from income and sales taxes, so the real-estate slump doesn't directly hurt them much (although local governments are ail-



ing from lower property taxes). But falling real-estate prices make consumers feel poorer and spend less. Also, when fewer homes are being sold, there are fewer purchases of big-ticket items such as sofas and washing machines.

Unlike the federal government, most states are required to balance their budgets. And as the economy has weakened in recent months, state agencies have frozen hiring and cut back on overtime.

In western Florida, officials at the Lee County School District began this year expecting budget cuts of about 5%, or about \$8 million. Now they figure they'll have to make cuts of \$30 million. The district is eliminating unfilled jobs, laying off administrative staff and cutting back on overtime.

“At this point, no one here is going to project anything past a week,” said Joe Donzelli, a spokesman for the Lee County School District. “We’re expecting next year to be worse.

In Alabama, proposed cuts to the Public Health Department would leave some people without AIDS medication and would reduce the number of children who receive state-sponsored health insurance. The department may also have to cut back on subsidized screenings for breast and cervical cancer for about 1,500 women, said Donald Williamson, the state health officer. Based on the current rate at which tumors are discovered, Dr. Williamson said that equates to about 20 cancer cases that wouldn't be diagnosed.

Another issue: Inflation is hitting state and local government especially hard. That is because some of their biggest costs — employee compensation, including benefits, building materials and energy — are rising much faster than overall prices. From the fourth quarter of 2006 to the fourth quarter of last year, prices for state and local expenditures rose 6.1%, compared with an increase of 2.6% for the broader economy.