

# Kiplinger's

PERSONAL FINANCE

**Kiplinger's Personal Finance, August 2008**

## *States Scramble to Pay the Bills*

*They're in a big bind, and budget shortfalls could linger for years.*

*By Anne Kates Smith*

It's easy these days to imagine a scenario in which your income isn't what you thought it would be, the people you're responsible for are needier than ever and prices just keep going up. Now you know what your state's governor feels like. After years of operating comfortably in the black, state governments are grappling with deficits.

**Some 27 states and the District of Columbia have dealt with or still face a combined shortfall of nearly \$50 billion going into the fiscal year that starts in July (when many state budgets must be balanced). States are experiencing the classic "nutcracker effect," says Robert Ward, deputy director of the Rockefeller Institute of Government. Tax revenues are growing more slowly than last year — or, in the case of sales taxes, declining. At the same time, the costs of state and local governments are rising faster than those in the broad economy: 6%, versus 3.9% for the official overall rate of inflation.**

Even if the U.S. economy improves before the end of 2008 (as we expect), states may struggle far longer. After the 2001 downturn, states ran budget gaps for three years, even though the recession lasted just eight months. And that was with property taxes still going strong. Now, as assessed real estate values catch up with dismal market realities, cities, counties and school systems are getting squeezed. "Localities will have a hard time for a good two to three years," says Scott Pattison, executive director of the Association of State Budget Officers.

Hardest hit are states where the housing bust has done the most damage: Arizona, California and Florida, plus a few others. Florida is in a double bind. Without a state income tax, it depends on sales and property taxes. According to state officials surveyed by the National Conference of State Legislatures, "The state is in the midst of a three-year decline in state revenues, unprecedented in the last 40 years."

In an election year, tax hikes are a last resort. It's easier to tap rainy-day reserve funds, which are dwindling from their peak of 11.5% of state expenditures in fiscal 2006 to 6.7% in 2008. Nevada is addressing a nearly \$900-million shortfall for fiscal 2009 with a 4.5% budget cut and by depleting its reserve fund of \$267 million.

Other states propose more novel fixes. California governor Arnold Schwarzenegger wants to securitize lottery revenues, giving Wall Street a stake in the proceeds in exchange for a \$15-billion loan. Pennsylvania is weighing a \$12.8-billion bid to lease its turnpike to private investors. Maine is selling stocks unclaimed by investors (and thus left for the state) for a \$9-million windfall.

Alaska, Louisiana, North Dakota and Wyoming, however, are fortunate because they receive taxes on natural resources, such as coal, oil and gas. The governor of Alaska even wants to give state residents a rebate in the form of a debit card, good for \$100 a month for heating oil, electricity, natural gas or gasoline. And high soybean and corn prices are boosting agricultural economies, including Iowa's.

A couple of Harvard academics propose smoothing state-budget bumps with tax-base insurance, an idea that might get some traction these days.