

States Slammed by Tax Shortfalls

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The stumbling U.S. economy is forcing states to slash spending and cut jobs in order to close a projected \$40 billion shortfall in the current fiscal year.

That gap -- identified Wednesday in a survey by the National Conference of State Legislatures -- is more than triple the size of the previous year's. It is the result of broad economic weakness at the state and local levels that could cause pain throughout this year and into 2010. Sales-tax collections, for example, have been hurt by the housing slump and high gasoline prices, which are prompting cutbacks in consumer spending. Personal income-tax collections have been hit by rising unemployment, while corporate income-tax collections have been eroded by falling profits.

"We expect it to get worse before it gets better," said Corina Eckl, fiscal-program director of the National Conference of State Legislatures. The conference's new report describes the shortfalls states face in their budgeting process for the current fiscal year, which began in July.

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Summaries of regional activity

A separate survey of economic conditions by the Federal Reserve's 12 regional banks -- the "beige book" -- said economic activity was sluggish across most of the U.S. Consumer spending was "mixed, weak, or slowing" in nearly all areas, despite the distribution of billions of dollars in economic-stimulus checks.

The beige-book survey also said companies are increasingly worried about growth prospects and inflation. Indeed, also on Wednesday, discount chain Costco Wholesale Corp. warned that its profits will fall "well below" Wall Street's expectations for its fiscal fourth quarter ending Aug. 31. It blamed the speed of manufacturers' price increases.

Unlike the federal government, most states are required to balance their budgets. Most have so far resisted tax increases, instead opting for raising prices on things like tolls and college tuition, and cutting back on services like education and health care. Some chose one-time measures such as tapping rainy-day funds that were built up in flusher times. That could lead to future cutbacks if the economy doesn't bounce back in coming months.

The spreading economic weakness also is affecting localities, which are being ravaged by falling property-tax collections and a decline in state aid. In Minnesota, the city of Duluth plans to stop operating its Fun Wagon -- a free trailer stuffed with games and cookout supplies for a neighborhood party. Other services, including a city pool and a fire hall, also are being eliminated.

Several state-university systems are being forced to raise tuition and tighten their belts. Regents at the University of California and California State University system have raised undergraduate fees 7.4% and 10% annually, respectively, to cope with rising enrollment and other costs. For a University of California student, it represents an increase of \$490 to \$7,126, excluding miscellaneous fees charged by individual campuses.

Virginia Tech is raising its tuition for in-state undergraduates by nearly 11%. "For us it was a matter of, 'Are we going to take professors out of the classroom, or are we going to raise tuition?'" said Lawrence G. Hincker, associate vice president for university relations.

States are also reducing their payrolls and programs. Vermont is cutting about 400 jobs through attrition, while Tennessee is using buyouts and possibly layoffs to eliminate about 3,000 government jobs.

Social services have been hit hard. Ten states have made targeted cuts in Medicaid, while three have cut contributions to the Temporary Assistance for Needy Families program.

Bonnie Laughlin, a 52-year-old resident of Hiram, Maine, who cares for four foster children, has seen her daily reimbursement from the state for caring for the children decline from \$60 to \$52.50 per child this year. The state has also eliminated money for "respite care" -- when foster parents can get away from their kids -- as well as reimbursement for recreation activities for the children.

For instance, Ms. Laughlin has been paying for dance lessons for her 10-year-old autistic foster daughter, but she's not sure she'll be able to keep it up. "It definitely puts hardships on families," Ms. Laughlin said.

The Primary Culprit

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culprit. The decline in home sales has cut into real-estate transfer taxes. Construction spending and employment have declined. Fewer home sales have resulted in lower sales of home furnishings and washing machines, eating into sales taxes.

Of course, for many states, today's budget woes stem at least partly from expanding their services during the good times and not planning enough for the inevitable downturn.

Meantime, states are dealing with shortfalls of many kinds. According to the report by the association of state legislatures, 22 states are reporting sales taxes that are below forecast. In nine of those states, the collections were below forecasts that had already been reduced downward. Seventeen states had a shortfall in corporate income tax, 11 states were behind on personal-income taxes, and 11 were also behind on miscellaneous taxes such as insurance-premium taxes.

At the same time, costs are rising. Over the past several years, many states have taken over more of their K-12 education funding from local governments, while many others have expanded Medicaid.

Many energy-producing states have been spared some of this pain, and have actually benefited from rising food and gasoline prices. Texas, Wyoming and Colorado have all seen job and income growth continue to rise, which has helped them avoid budget problems.

In Massachusetts, state officials are trying to close loopholes that let companies reduce their tax bills in part by shifting income out of state. "You couldn't afford to simply waste \$500 million a year by allowing tax avoidance," says Noah Berger, executive director of Massachusetts Budget and Policy Center, a Boston think tank. The state says it expects to generate \$291 million from its crackdown on corporate tax loopholes.

In Illinois, Gov. Rod Blagojevich unilaterally cut \$1.4 billion from the \$59 billion budget the legislature sent him in May. The state says it expects to save an additional \$500 million through belt-tightening at state agencies.

Heavy Cuts

The governor's changes include heavy cuts in spending for education and health care. The state plans about \$600 million in health-care cuts, including making hospitals and nursing homes wait longer for Medicaid reimbursements.

Health services, among states' fastest growing costs, are being cut across the country. Ohio is closing two mental-health facilities as state agencies look to shed \$733 million. The state is also cutting a program that provides free nicotine patches to smokers.

Virginia's funding for hospitals and nursing homes to care for the poor and elderly was reduced by \$76 million over the next two fiscal years, according to an analysis by the Commonwealth Institute for Fiscal Analysis in Richmond, Va. Maine is cutting money for foster care, mental-health services and "flexible funding," which social workers can spend on specific needs for clients.

"Our concern is the fact that the government has assumed responsibility for these things, and now they're basically saying, 'We can't do it anymore,'" says Richard Farnsworth, executive director of Portland, Maine-based Woodford Family Services. "Now the question is, 'Who's going to do it?'"

It's not just humans who are feeling the squeeze. Maine has already closed one fish hatchery, and the state isn't expected to offset the rising price of fuel and fish food, said fishery biologist Forrest Bonney. "In recent years we expanded our stocking program, however all of a sudden we're faced with the additional expense of feeding and transporting" fish, Mr. Bonney said.

--A.J. Miranda, Philip Shishkin, Jim Carlton and Alyssa Abkowitz contributed to this article

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