Falling Tax Revenues Slam States

- SEPTEMBER 30, 2009

By CONOR DOUGHERTY

State tax revenues in the second quarter plunged 17% from a year earlier as rising unemployment and reduced spending hurt sales- and income-tax collections, according to Census Bureau figures released Tuesday.

The decline was the sharpest since at least the 1960s. The biggest drop among major revenue sources was in state income taxes, which were down 28% from a year ago. Sales-tax revenues fell 9%. About two-thirds of state revenues are derived from sales and income taxes. The numbers aren't adjusted for inflation or changes in tax rates.

The steep declines show how the recession continues to cripple state finances, despite support from the federal stimulus package and signs of a nascent recovery in economic activity.

"This brings really bad news for almost every single state and leaves them with unprecedented budget crises," said Lucy Dadayan, a senior policy analyst with the Nelson A. Rockefeller Institute of Government at the State University of New York.

Falling revenues, combined with growing demand for social programs like Medicaid, have forced states to slash spending and scramble to raise revenue through changes including new taxes, legalized slot machines and pricier fishing licenses.

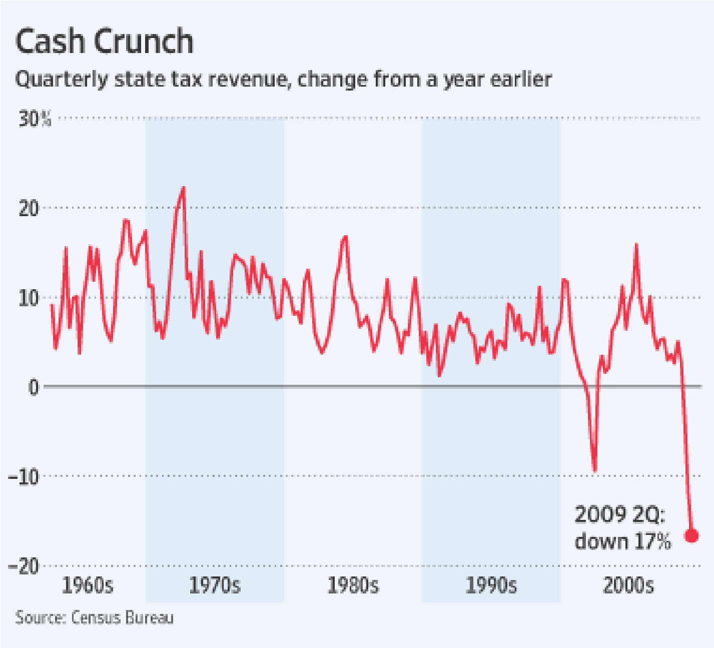
But with tax collections continuing to decline, many have been forced to reopen budgets after they have been passed to push through even bigger cuts to staffing and services. States, unlike the federal government, are generally required to balance their budgets.

In Michigan, stalled budget negotiations between the governor and the legislature could force state government to shut down if a deal isn't reached by Wednesday night. The governor would likely have to take emergency steps to keep essential services, such as hospitals and prisons, operating. "We remain optimistic that we will have a budget in place," says Liz Boyd, a spokeswoman for Gov. Jennifer Granholm.

Some cash-strapped states are rethinking the level of services the government provides. In Louisiana, a commission next month will ponder ideas including cutting 15,000 state jobs, about 13% of the total, in the next three years and eliminating money-losing toll collections on a New Orleans bridge.

"Anything is fair game," said Amber King, a public information officer for state Treasurer John N. Kennedy, who serves on the "streamlining commission." The group is supposed to make final recommendations by mid-December, she said.

Some of the sharpest tax declines were in states that have been among those hit hardest by the recession, particularly those with high concentrations of jobs in the battered housing sector. In Arizona, overall tax revenues fell 27% in the second quarter. Tax revenues fell 12% in Florida and 14% in California.



States across the country saw big declines in personal income taxes, the largest single source of state funding, representing about a third of states' overall revenues. Eleven states -- including California, New York and Wisconsin -- saw personal income taxes fall more than 30%.

Corporate income taxes, which tend be volatile and generally account for only a small portion of state revenues, rose 3%.

Despite signs that the recession is abating, many analysts don't foresee state revenues rebounding anytime soon. Economists widely expect the national unemployment rate, 9.7% in August, to remain around 9% through 2010, keeping pressure on wages and incomes. At the same time, after losing trillions in wealth, many consumers are paying down debt and paring back spending -- reducing sales taxes.

"The decline in tax revenue collections indicates that states will likely continue facing weak tax revenues for the quarters ahead," the Rockefeller Institute's Ms. Dadayan said. For many states, even grim revenue projections are turning out to be too high. Lower-than expected revenues caused Massachusetts's governor to cut the budget four times during the fiscal year that ended in June, including drawing down reserves from a rainy day fund and eliminating unfilled jobs.

History may repeat itself: With revenues still weaker than expected, the state could be forced reopen the budget as early as next month, said a spokesman for the state's Executive Office for Administration and Finance.

—Leslie Eaton contributed to this article.

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