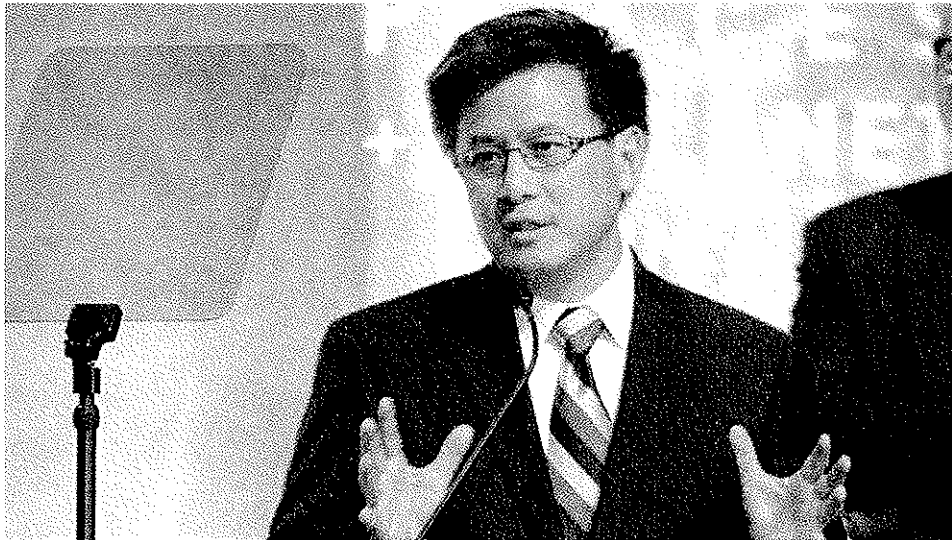




## States fear new era of deficits



By Reid Wilson - 09/18/16 06:00 AM EDT

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Local officials are raising alarms across the country about a potential economic slowdown that could blow holes in state budgets still struggling to get above water less than a decade after the worst recession in generations.

Preliminary budget data from the end of the 2016 fiscal year show tax revenue grew by just over 2 percent last year, well below historic norms — and below the growth rate of state spending and obligations.

States hoping they'd see their first surpluses since the recession are instead grappling with projected deficits.

"When you look at budget growth, I believe that most states are forecasting a slower rate of growth next year than they did this past year. So there seems to be some consensus that things are beginning to tighten," said Richard Eckstrom, South Carolina's comptroller general.

Budget analysts say states generally expect a 5 percent annual growth rate in their tax revenues. But the National Association of State Budget Officers, a nonpartisan group, said early indications showed total general fund tax collections rose only 2.3 percent in the last fiscal year, down from 5.2 percent in fiscal year 2015.

"That's a red flag right there," said Lucy Dadayan, a budget analyst at the Rockefeller Institute of Government at the State University of New York. "If we look at the nominal numbers, we see growth overall nationwide. But each state is in a different position."

Each state relies on a different tax scheme to make up its revenue.

Alaska, North Dakota and Wyoming rely heavily on extraction taxes from natural resources like oil and gas.

These states weathered the recession in relatively healthy positions but have seen their fortunes shift with a fall in commodity prices.

North Dakota legislators passed a measure earlier this month to deal with a \$310 million shortfall, even after the state drained its rainy day fund to cut a larger budget gap earlier this year.

New Mexico, too, expects a \$150 million to \$200 million shortfall, which experts blame on falling oil prices.

Many states blame lower business tax collections for a drop in their tax revenues.

In the first quarter of the year, business tax collections were down 5 percent, or nearly \$600 million, from the same quarter last year, according to data compiled by the U.S. Census Bureau. At the same time, individual income taxes and sales taxes each rose by just 2.4 percent.

Some traditional sources of state tax revenue have been in long-term decline.

Lower smoking rates mean less money generated by tobacco taxes. Higher fuel efficiencies in cars and trucks mean gas taxes bring in less money. Extraction taxes on natural resources have declined sharply over the short run as the commodity bubble bursts.

Income taxes tend to rebound fastest after recessions, and Dadayan said states that rely most heavily on them, such as California, New York, Connecticut and New Jersey, have seen more robust budget growth in recent years.

"It is true that state revenues overall, adjusted for inflation even, have recovered. So they're back above pre-recession levels. But we're getting close to nine years after the recession first hit, so that kind of growth over that period of time is not enough to keep up with increased enrollment in schools and more students in public colleges and long-term care and other Medicaid services," said Michael Leachman, director of state fiscal research at the left-leaning Center on Budget and Policy Priorities.

Louisiana economists expect a budget shortfall that could reach \$200 million. Jay Dardenne, the state commissioner of administration, told reporters this week that a deficit is "inevitable." In Oregon, rising costs and obligations outpacing revenue growth will force legislators to deal with a budget shortfall that could top \$1.3 billion. On Tuesday, Pennsylvania drew \$400 million on a line of credit to ensure the state's bank account wasn't overdrawn.

Even in South Carolina, where state tax revenue grew at a 4.3 percent rate in the last fiscal year, there is reason for concern. Eckstrom said tax revenues began slowing in recent months, and while just a few months may not indicate a trend, those figures represent worrying indicators.

"As the fiscal year began to come to a close, that sort of growth rate wasn't repeating itself, and for a few months we saw that growth rate decline," he said. "If we put together a month of August like we did in the month of July, the alarm bells will start ringing."

Clint Zweifel, Missouri's treasurer, said the fact that revenue streams had rebounded to pre-recession levels amounted to good news. His state took in nearly \$2.9 billion in the first quarter of 2016, a 21 percent increase over the depth of the recession. But budget volatility in recent years has taken a toll as legislators struggle to budget based on estimates of economic strength that can miss the mark.

"There's a huge cost to this volatility that happened in revenue from the financial crisis that can only be partially quantified," Zweifel said in an interview. Even modest growth instead of a recession, he said, would have meant billions more in spending on education and infrastructure. "The lost investment opportunity in things like human capital and education and infrastructure are huge."

California is a bright spot. The state's tax revenues are up 66 percent from the depths of the recession, according to first quarter figures, bolstered by capital gains taxes and a 2012 ballot initiative that extended income taxes on wealthy families.

The state sported a \$3 billion surplus in the last fiscal year, and legislators put some of that money away in a rainy day fund. While the national gross domestic product has risen haltingly, California's was up 4 percentage points last year.

But because of the state's reliance on income and capital gains taxes, officials there, too, are wary of any hint of a return to darker times.

"There's a sense of cautiousness" among state budget officials, said California Treasurer **John Chiang**. "This recovery has been slow, but it has been long, and we know that we've exceeded the average length of a recovery."

"We remember very clearly the impact of the last recession. So we want to make sure we do not replicate the pain of the last downturn in the economy," Chiang said.

**TAGS: John Chiang, California, North Dakota, Wyoming, taxes, State budgets**

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