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ON THE WEB

States' Tax Receipts Rise, Leading to Some Surpluses

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ASHINGTON, May 2 — States across the country are reporting stronger tax collections this spring for the first time in three years, fueling hopes that the bleakest budget-cutting days of the economic downturn are over, state officials and fiscal experts say.

From Florida to Oklahoma to Oregon, tax revenues are up in recent months from the same period last year, the first consistent increases many states have experienced since Wall Street's bubble burst in 2001.

"Our economy has bottomed out and is improving slightly," said Ken Rocco, a fiscal officer for the Oregon Legislature, echoing the comments of many state budget officials.

Stronger-than-anticipated tax revenues combined with tight spending practices over the past few years are allowing 32 states to finish their 2004 fiscal years with surpluses, according to a survey by the National Conference of State Legislatures.

But most of those surpluses are small and a dark cloud remains: tax revenues are not growing fast enough to offset the rapidly rising costs of Medicaid, pensions and education, which account for most state spending.

As a result, 33 states faced projected revenue shortfalls in their 2005 budgets, and about 20 are still struggling to close them, the survey, released last week by the conference, said. Most states' fiscal years begin on July 1 or Oct. 1.

According to the survey, 30 states reported in March that personal income tax collections were at or above projections. In 36 states, sales taxes were coming in at levels as good as or better than forecast. And corporate income taxes were coming in on or above target in 37 states.

California has the worst budget problem by far, projecting a $15 billion gap in its 2005 budget. But for most states, the estimated shortfalls are significantly smaller than the yawning gaps they had to close in recent years, experts said.

"Yes, revenues are improving, but for almost all states, it is not enough," said Robert Kurtter, senior vice president for state ratings at Moody's Investors Service. "Fiscal '05 is continuing to be a difficult budget year."

Experts said it would take significantly longer than a few months of improved tax collections to lift states out of their financial holes. Though the recession was short-lived, tax revenues have been down in most states partly because hiring and the stock market — an increasingly important factor in state revenues — have not returned to their peak pre-recession levels.

Most states compensated for the lost revenue by cutting programs, raising tuition and fees, or borrowing, experts said. Only a few raised taxes during the downturn. As a result, many states are spending only slightly more today than they were five years ago, causing pent-up demands to spend in many legislatures.

Governors expect expenditures for their 2005 fiscal years to rise 2.8 percent from 2004, well below the 26-year average of 6.2 percent, the National Governors Association, which released its own survey of budgets on Monday, said. The growth in spending is up from the 0.6 percent increase in the last fiscal year, which was the smallest increase in 20 years, the association said.

"During the previous downturn in 1991, two-thirds of states filled their shortfalls by increasing taxes," said Raymond C. Scheppach, executive director of the governors' association. "This time, you've got the flip of that. Most states filled shortfalls by cutting budgets."

"We're going to need two to three years of fairly robust revenue growth to get it all comfortable," Mr. Scheppach added.

Despite the problems, budget directors expressed relief that state revenues were no longer shrinking.

According to the survey by the legislatures' conference, eight states reported that revenues from all major taxes were higher than expected, a clear sign of economic recovery. Those states were Alabama, Delaware, Florida, Iowa, Maryland, New Jersey, Oklahoma and Tennessee.

In Alabama, where voters last fall rejected a proposal by Gov. Bob Riley, a Republican, to increase taxes, improved tax collections this year have allowed the state to increase education aid.

Oklahoma has had even stronger growth, recording eight consecutive months of tax revenues above the previous year's levels. After experiencing the sharpest decline in tax collections in two decades last year, lawmakers responded to the good reports by calling for tax cuts and spending increases.

"We've hit bottom and are starting out of the trough," said Scott Meacham, finance director for Gov. Brad Henry, a Democrat.

But many more states are finding that improved revenues are not offsetting rising costs, particularly for Medicaid, which is expanding at rates of more than 10 percent in most states. Many of those states are looking at new cuts or new sources of revenue, like raising cigarette taxes or legalizing gambling.

Virginia, for example, has struggled to close a $6 billion shortfall over the last two years by trimming state jobs and programs. This year, its tax revenues have steadied. But Gov. Mark Warner, a Democrat, still projects that spending growth will outpace revenues by more than $600 million a year for years.

To close the gap, he has proposed overhauling the state tax system, cutting some taxes and increasing others to raise more than $1 billion in additional revenues over two years. After a contentious debate in which House Republicans proposed smaller increases and Senate Republicans sought much larger ones, a compromise was struck last week that approximated Mr. Warner's proposal.

The plan calls for increasing the sales and cigarette taxes, closing corporate tax loopholes and freezing a scheduled car tax reduction, while reducing income taxes for many residents and food taxes.

R. Kirk Jonas, deputy director of a nonpartisan commission that analyzes state finances for the Virginia Legislature, said lawmakers felt compelled to accept new taxes because they were tired of cuts and because tax revenues, while steadier, were still not abundant.

"The economy is not growing that strongly," Mr. Jonas said.

Maryland has experienced stronger revenue growth than Virginia this year. But it is also facing chronic shortfalls, partly due to big increases in aid to public schools passed by the Legislature. The state is projecting an $800 million shortfall for 2006, growing to $1 billion the next year, even with improving tax collections.

Gov. Robert L. Ehrlich Jr., a Republican, has called for legalizing slot machines to raise money and has vowed to reject any broad-based tax increases. But Democrats who control the House of Delegates say they will not accept his gambling plan unless it is linked to tax increases.

However, James C. DiPaula Jr., budget secretary for the governor, said: "We've spent our way into this problem. We shouldn't be trying to tax our way out of it."

Some states are reporting only minimal revenue improvements, particularly in Midwestern manufacturing states like Michigan, Wisconsin, Indiana and Ohio, which have been hit hardest by layoffs.

In Ohio, Gov. Bob Taft, a Republican, announced in March a budget shortfall of $372 million for 2005. Having struggled through three years of deep budget cuts, Mr. Taft began imposing a new round last week, eliminating some state jobs and reducing the state vehicle fleet, among other steps.

Tim Keen, the assistant state budget director, said personal income and corporate taxes were meeting projections for the first time in years. But they will have to grow much faster to offset anticipated losses in federal aid and increases in Medicaid costs next year, he said.

"This recession might have been over quickly, but we were hit much more severely," Mr. Keen said.