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# Shortfalls in U.S. States' Revenues Mount

by Mary Jane Freeman

Dramatic news of significant revenue shortfalls in New Jersey, Michigan, and California, shows that *EIR*'s May 4 analysis of a twofold, dynamic process of decline in revenues among U.S. states was on the mark. And, the revenue decline is now accelerating as forecast.

The *EIR* analysis showed that the continued blowout of the stock market bubble, in conjunction with the contraction of the U.S. physical economy, especially manufacturing and "New Economy" high-tech industry components, is devastating state governments' ability to provide for their residents. Many U.S. states built up an inordinate reliance on revenues obtained by taxing Federal Reserve Chairman Alan Greenspan's speculative bubble economy. The wishful thinking of state officials and legislators that the nation is merely in a "temporary, mild recession," and that the stock market will rebound along with the real economy, couldn't be further from reality. The drastic reductions in state revenue projections portend hefty budget cuts over the coming months in basic, vital state programs, and/or siphoning of "rainy day" funds to cover the deficits. The only solution for state officials lies in forging a Federal-state coalition to promote the general welfare, as is embodied in Lyndon LaRouche's New Bretton Woods proposal to launch an economic recovery.

Budget battles in many state legislatures across the country are winding down, as most 2002 fiscal year budgets go into effect on July 1. Getting budgets passed this year became a battle, because the combined impact of job layoffs, a plummeting stock market, and rising energy bills has resulted in reduced revenues. The decade of surpluses, huge tax cuts, and unlimited spending has come to a screeching halt. Revenues are coming up tens of millions to billions of dollars short. The cumulative years of Gingrichite-inspired tax cuts have also deprived states of traditional revenue sources.

What is affected? On average, nationally, almost 70% of a state's revenues are spent on education and health care—about 48% on education and 21% on health care, including Medicaid. Ironically, any cuts in these areas further undermine the ability of the nation to reverse the 35-year decline of the real economy, and thus, it is only by "thinking big," to launch a full-scale FDR-style economic recovery as LaRouche outlines, that any state will be able to restore its tax base to build for the future.

### New Jersey and the Bubble Blow-Out

The unravelling of budgets with heavy reliance on the non-productive side of the economy is typified by New Jersey. In seven weeks, the state's nonpartisan Office of Legislative Services (OLS) revised its revenue projections downward by $600 million, going from a projected $1 billion shortfall in mid-April, to a $1.6 billion shortfall as of May 22. The shortfall is against then-Gov. Christie Whitman's January budget proposal for FY 2002. What occurred between these two projections? First, the official unemployment rate rose to 4.2% in April, up from 3.8% in March. Second, personal income taxes paid in were tallied. As OLS Revenue, Finance and Appropriations Section chief David Rosen testified before the State Assembly and Senate budget committees, "Nearly all of today's downward revision concerns the income tax."

Some OLS facts about New Jersey's revenue show just how vulnerable its economy is to the blow-out of the bubble. In fiscal year 2000-01, more than one-third (36.6%) of the state's General Fund Revenues derived from the Gross Income Tax (GIT), the state's personal income tax. A whopping 17-18% of the GIT comes from taxes on capital gains of stock sales, and another 2-3% from taxes on stock options. Since 1997, the GIT has grown four times faster than all other sources of revenue, and two-thirds of the state's revenue growth in this period came from GIT revenue. The GIT revenue from capital gains grew from about $235 million in 1994, to $1.4 billion in 2000, and the top 12% of taxpayers account for 72% of income taxes paid, which was nearly all income growth in the last decade. These market players and real estate moguls are soon to be has-beens.

Overall, 7.3% of New Jersey's total state revenues depend on just these two aspects of the bubble economy. Therefore, when Rosen testified that an additional $600 million hole, on top of the $1 billion one, just blew out their budget plans because of poor income tax performance, this is a very significant revelation. The *Newark Star Ledger* headlined its coverage of Rosen's testimony, "Stock Slump Sabotages State Budget," with the kicker, "Capital gains revenue expected to miss target by $400 million."

Rosen testified that the OLS derived its figure for the projected capital gains loss by looking at the "first quarterly estimated payments for tax year 2001," which were "substantially below expectations." The OLS expected this component to weaken "later in the tax year—reflecting lower levels of capital gains—but the change is already evident," he said. As if this hole were not big enough, Rosen, even after noting that the Nasdaq had "under-performed our expectations" and that it was the "primary generator of the capital gains boom," told legislators, "we are not revising our capital gains [growth projection] downward today." (The OLS had already projected a 25% decline in capital gains growth for fiscal year 2002, whereas the Governor's budget projects a 3.5% in-



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crease.) Rosen then wisely cautioned, "This forecast rests on relatively optimistic assumptions . . . that stock prices will rise for the rest of the year, . . . there will not be a national recession, . . . and New Jersey will fare better than" neighboring states. Herein lies the wishful thinking which blinds elected officials from taking adequate action to reverse an impending disaster.

New Jersey is the nation's eighth-largest economy, primarily based on the finance, real estate, and insurance sectors, but it also has the nation's twelfth-largest manufacturing base. The rise in its March to April unemployment rate parallels the national unemployment rise, which was primarily in the manufacturing sector (see *EIR,* May 18, 2001). Rosen reported that the other "almost 70%" of the GIT comes from the employer withholding tax. The OLS expected "slower growth" in it, but found that, in just "two months," this tax source "has fallen below the level of last year." Thus, New Jersey's economic well-being is poised to take a double hit.

## Michigan: The Physical Economy Crumbles

Unlike New Jersey, Michigan's economy is heavily based on manufacturing and durable goods production—both of which have suffered from the 30-odd years of "post-industrial" takedown of the national economy. The end-of-May news from Michigan, was that a $592 million shortfall is expected in the current fiscal year, and a $741 million shortfall is expected for the next. Michigan's fiscal year runs from October to September. To patch the $592 million hole for this fiscal year, among other cuts, state agencies will trim spending, and a hiring freeze is in effect. In Lansing, the state capital, Democratic legislators are up in arms over cuts to health care, day care, and workplace safety programs, and technical education centers, which Gov. John Engler and the majority Republicans proposed. Democrats blame the current spending dilemma on Engler's "excessive tax cuts made at the expense of working families." The ranking Democrat on the House Appropriations Committee, A.T. Frank (Saginaw Township), chided House Republicans, "With the economy taking a turn for the worse, we cannot afford to play politics with the quality of life of Michigan residents. We must prioritize how we can help people."

The Republican-controlled House approved a 2001 supplemental budget with cuts, but it was short of a two-thirds vote required to make the cuts immediate; Engler has threatened to intervene to make them so.

Income tax revenue in Michigan accounts for 20.5% of the state's total revenue. Almost 80% of these tax revenues come from the withholding component, and 20-25% of that derives from manufacturing and durable-goods-producing jobs. The Michigan House Fiscal Agency reports that from October 2000 through April 2001, net income tax collections totalled $3.4 billion, down $358 million, or 9.4%, from the first two quarters of FY 1999-2000. Comparing second-quarter FY 2000-01 to second-quarter FY 1999-2000, net income tax collections are 12.6% lower this year, a small portion of which is due to Engler's tax cut.

It is not surprising that Michigan, the sixth-largest manufacturing economy of the United States, is experiencing this revenue loss. The March-April news of the largest two-month increase in ten years of wage and salaried job losses, increased the national unemployed from 6.088 million to 6.402 million, and put the U.S. Department of Labor's Bureau of Labor Statistics' official (but fraudulent) unemployment rate at 4.5%. Michigan had a tiny up-tick (0.1%) in April employment, causing its unemployment rate to decline to only 4.6%, which was still above the national jobless average. But, as Michigan's Department of Treasury's Office of Revenue and Tax Analysis reports in its April 2001 Economic Update, "Monthly unemployment rates fluctuate due to statistical sampling errors and data revisions. Therefore, Michigan's three-month average of 4.7% may be a better measure." And, like the national unemployment picture, the largest loss of jobs in Michigan is in the goods-producing sector. But across the state, unemployment rates range from a low 2.8% to a high 12.4%, and "personal income growth is projected to slow to 2.6% in 2001, down from 6.2% growth in 2000."

## California: A $4.2 Billion Hole

In California on May 14, Gov. Gray Davis (D) announced a $4.2 billion revenue shortfall for the 2001-02 fiscal year. The *Sacramento Bee* put it this way: "State revenue . . . plunged with the stock market, leaving a $4.2 billion hole." Indeed, as *EIR* reported, a stunning 18.5% of California's personal income tax (PIT) revenue comes from tax on capital gains. This represents 10.1% of all California's General Revenue income. But it is worse: add in tax on stock options, and the numbers are 37% of PIT and 20.2% of General Revenue. As these upper-income-bracket taxpayers have less, they stop buying those high-priced cars, homes, vacations, etc., and sales tax revenue drops, too. With Davis' announcement, California's vulnerability to Wall Street's whims has exploded.

Davis' proposed budget cuts include $1.3 billion in one-time infrastructure projects, $250 million in payments to local governments, a 2.5% across-the-board cut in state spending (except departments related to public safety or money-makers for the state), and a draining of the rainy-day fund by $900 million. He has attempted to keep education and public safety spending intact. But California's hole can get much bigger soon, if the August sale of bonds to repay the state treasury for the exorbitant—so far $7 billion—energy purchases, falters. The Governor is counting on those bond sales to ease the impact of the $4.2 billion hole. But Davis knows this is risky. "If anything else goes wrong, like a natural disaster or some precipitous drop in the economy, then we could be in real trouble," he said.