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After housing bust, hard times in Arizona

State and local governments tighten belts as tax revenues fall, a ripple effect of the housing slump.

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MESA, ARIZ.

Phoenix city officials are considering eliminating some 500 jobs, closing public pools for an additional two months each year, and reducing the hours of city museums and community centers to combat a \$67.1 million projected shortfall in revenues this year.

In Tucson, Ariz., officials are reducing employee travel, equipment purchases, and hiring to deal with forecasts that they the city will take in \$12 million less than anticipated this year.

Mesa, Ariz., has asked its departments, the biggest of which is public safety, to cut expenditures by 5 percent to meet a projected \$15 million to \$16 million shortfall.

Gov. Janet Napolitano (D) announced a hiring freeze across the state's executive agencies on Feb. 21 to help meet an estimated budget shortfall of \$1.15 billion this year. The state legislature is considering other belt-tightening measures, as well.

The state of Arizona and all its cities and towns are confronting huge revenue shortages this year, mainly because sales-tax revenues are far below projected levels. In fact, Arizona has the dubious distinction – along with California, Nevada, and Florida – of leading the country in the current economic slide.

"Those four states are where the housing bubble was the biggest, where investors and speculators had a significant presence," says Marshall Vest, an economist at the University of Arizona's Eller College of Management in Tucson. "Those states saw a higher use of subprime mortgages. These are the states that have been in recession for several months already."

Consumers in Arizona, Dr. Vest says, lived beyond their means for the past seven years. It was easy for them to tap the equity in their houses and to get very low interest rates on credit cards. So when the housing bubble burst, housing prices declined, along with the equity homeowners enjoyed, and banks began to tighten up on credit. That meant people had much less money to spend.

"In addition to that, we had 6 percent employment growth just two years ago. Today it is essentially zero," Vest says. Arizona's economy peaked in August and has been shrinking ever since, he says. It's been in recession, he adds, since the third quarter of 2007.

Arizona is a little different from other states in that property tax isn't the main source of revenue for state and city governments here. They rely more on sales taxes and income taxes. So when both earnings and spending are curtailed, so are the monies that local governments collect.

"The sales-tax side is the other chip to fall," says Chris Hoene, director of policy and research at the National League of Cities in Washington. "For the past decade, there's been a much stronger connection between housing

values and consumer spending than was perhaps previously thought."

That's because, he says, people used the values of their homes for second mortgages to make other large purchases. And those large purchases, usually cars, appliances, and assorted luxury items, led to the collection of more sales tax. When those purchases fell off, so did the sales-tax collections.

As a result, government entities here are tightening their collective belts. In Mesa, for example, the third largest city in Arizona and the 38th largest in the country, officials are struggling to cut spending to make up for the projected shortfalls.

The city's operating and maintenance budget is about \$328 million this year, according to Chuck Odom, Mesa's budget director. Of that, 66 percent is dedicated to public safety. So when the city asked the police and fire departments to come up with cuts equaling 5 percent, it represented a significant burden.

For the police department alone, that means a \$7.2 million reduction in expenses. Its tentative plan calls for a reevaluation of all open positions before they are filled, a curtailment of overtime hours that now total about 4,000 hours per month, and a rethink of capital expenditures.

Such cuts are difficult, and the residents of Mesa are understandably concerned, Mr. Odom says. The city council will hold public hearings throughout the spring on the proposed cuts.

Phoenix and Tucson are adhering to similar processes, while the state legislature and the governor are jointly working on plans to reduce the state's spending.

If there's any reason for cheer, it's that the state has been in this position before, and it not only came out of it, but also came out of it with unprecedented growth to lead the country as the fastest-growing state last year.

"There have been seven nationwide recessions since 1960, and each time we've bounced back," Vest says. "The two most recent recessions, in the early 1990s and 2001, were both short and mild. So far there's no reason to believe this is any different than the last two."

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