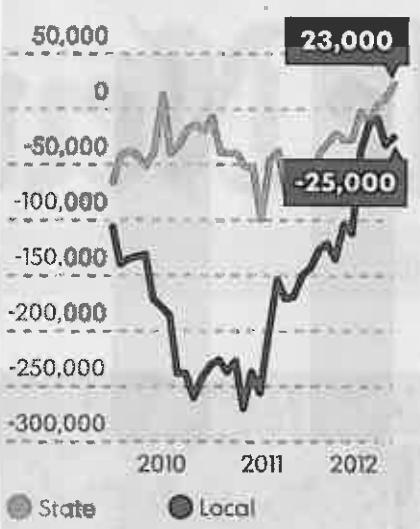
Finances of state, local governments brighten

ON THE MEND

Heavy layoffs in state and local governments are winding down after more than three years. Year over year change in employment:



Note 2012 through November
Source Bureau of Labor Statistics
JULIE SNIDER, USA TODAY

Paul Davidson
USA TODAY

State governments overall are starting 2013 in their best financial shape in several years.

As a result, states' improving health since they were wracked by the recession could help cushion any blow to the economy from federal tax hikes and likely spending cutbacks this year, economists say.

"The worst of (the recession-related problems) are behind us," says Don Boyd, senior fellow at the Rockefeller Institute of Government, which studies state fiscal issues.

Local governments still face stiff budget challenges, but their overall condition appears less dire.

City government spending will largely be unchanged in 2013 after four straight years of declines, says Michael Pagano, dean of the College of Urban Planning and Public Affairs at the University of Illinois-Chicago. Municipal revenue fell during the 3-year-old economic recovery because cities and counties depend heavily on property taxes, which were hammered by sharp declines in home values after the real estate bust.

But home values have stabilized and started rising in most places. Local sales tax and income tax revenue is increasing as job growth and consumer spending pick up.

States, which rely mostly on growing income tax and sales tax revenue, raised spending for the third straight year in fiscal 2013, which began in July. General-fund spending is up 2.2% after rising 3.4% in fiscal 2012, says Brian Sigritz of the National Association of State Budget Officers.

Boyd and Pagano caution that states and localities still face challenges that will limit growth, such as rising worker pension costs and falling federal funding.

After eliminating 653,000 jobs from 2008 to 2011, state and local governments have kept payrolls roughly stable this year, and Moody's Analytics expects them to add 220,000 jobs in 2013.

"The fiscal headwinds will be blowing hard in 2013," says Moody's chief economist, Mark Zandi, "but it isn't too much different" than 2012.