The state and local sector is viewed as a sup-
ernational fund has neither a stimulative nor re-
flationary behavior of policy as does the federal government; this approach im-
state and local governments. NIPA data do not
percent change at average annual rates. 
percent change in receipts resulting from a 1
percent of state and local revenues; by
percent change in receipts to changes in income and is defined as: 
where 
= income elasticity, 
= percent change in receipts, 
= percent change in income.

Economic Commentary examines the behavior of the state and local sector's budget during postwar business contractions.

The cyclical behavior of nearly all state and local governments is constrained by laws that prevent their supporting daily operations through the issuance of debt. Therefore, state and local governments must accumulate surpluses during periods of strong economic activity to finance expenditures during periods of economic downturn. Consequently, state and local governments only show surpluses in their annual budget. These funds, however, does not reflect the government borrowing constraints on state and local operating budgets, because the data consolidate many different funds along with current operating budgets. NIPA data are shown in Table 1.

State and local governments, for example, maintain social insurance funds, which are shown as a surplus in the budget. Federal government social insurance programs, however, show surpluses that are not included in the NIPA data.

The experience in the immediate preceding and subsequent business expansions. The only exception to this general pattern occurred during the 1929-1932 business downturn, when state and local revenues fell 9 percent. This is because of severe deflationary forces. However, in the 1949-1953 and 1953-1957 recessions, state and local receipts fell 6 percent. This is because of the growth in the overall economy that results in higher tax payments.
State and Local Finances in Recession and Inflation

During the year in which a business contraction occurs, state and local expenditures rise. In severe business contractions, weights cutbacks in other spending categories, such as police, fire, and education, are not easily cut, while others, namely welfare and unemployment compensation, automatically rise during a recession. Consequently, spending cuts probably occur in a narrow range of functions, making it difficult to predict how total state and local expenditures would respond during a business contraction.

In the past five business contractions, expenditures generally increased in the recessions than in the immediately preceding and subsequent business expansions. There have been two exceptions to this pattern. In the long business expansion of 1961 to 1969, secular demands for expanded state and local services grew rapidly. During the 1973-75 recession, the most severe U.S. business contraction since the 1930s, state and local expenditures far exceeded the growth of total expenditures; aggregate state and local employment has not fallen during contractions as it has in the private sector (see table 2). State and local governments may restrict hiring, but collectively they do not lay off workers during economic downturns.

In three of the five recessions, including the 1973-75 recession, wages and state and local employment generally has not fallen during contractions as it has in the private sector (see table 2). State and local governments may restrict hiring, but collectively they do not lay off workers during economic downturns.

Although many state and local governments resort to "limitations on personnel" as state and local expenditure adjustments, aggregate state and local employment has not fallen during contractions as it has in the private sector (see table 2). State and local governments may restrict hiring, but collectively they do not lay off workers during economic downturns. In three of the last five recessions, including the 1973-75 recession, wages and state and local employment accelerated relative to the previous expansionary period. The fast pace of employment during the 1973-75 recession...