State of the States: Pandemic-Driven Budgeting Innovations

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How COVID-19 is Affecting State and Local Government Budgets

Prepared for *State of the States: Pandemic-Driven Budgeting Innovations*

July 8, 2020
Tracy Gordon
July 1st marked a new fiscal year in 46 states

- So far, 42 states have enacted fiscal 2021 budgets, including 17 with biennial plans adopted last year (some revised already)

- New Jersey attracted headlines for extending its fiscal year until October. But many states passed only temporary budgets, for example:
  - **Massachusetts**: one-month budget for July
  - **Pennsylvania**: funds all agencies except schools only until December
  - **Rhode Island**: authorizes monthly spending at fiscal 2020 levels
  - **South Carolina**: continuing resolution until September
  - **Vermont**: three-month spending plan expected to be revised in August

- Other states passed placeholder budgets using optimistic revenue and federal aid assumptions that will need to be revisited
States had projected ending fiscal 2020 with their highest reserves on record

Rainy Day Balances by State, Fiscal Year 2020
Balances as share of general fund expenditures

Source: National Association of State Budget Officers
Note: Grey indicates data were unavailable or incomplete for fiscal year 2020.
They had projected solid revenue growth, but now all expect shortfalls because of COVID-19

Extrapolating to all 50 states suggests $75 billion shortfall in fiscal 2020, $125 billion in fiscal 2021

**FIGURE 1**
Anticipated revenue shortfalls in 27 states

<table>
<thead>
<tr>
<th>Dollars in billions</th>
<th>Personal income</th>
<th>Corporate income</th>
<th>Sales</th>
<th>Total revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>($0)</td>
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</tbody>
</table>

Note: In addition to income and sales taxes, total revenues also include all other revenue sources such as motor fuel taxes or severance taxes.
Tourism- and energy-dependent states among the worst off in expected revenue declines

Figure 3
Anticipated revenue shortfalls in FYs 2020 and 2021 combined
Percent change in revenue estimates compared to pre-COVID-19 estimates
Some personal income tax declines are because of filing deadline extensions

California Personal Income Tax Revenues Collected Compared to Governor's Estimate

Source: California State Controller's Office, April 2020 California Personal Income Tax Daily Revenue Tracker
Other personal income tax declines driven by lost wages and jobs

Unemployment Insurance Claims as of July 2, 2020

Total Unemployment insurance claims

Weeks since the start of each recession

Source: US Department of Labor

Notes: Data are not seasonally adjusted. The start and end dates of Unemployment Insurance claims for prior recessions correspond to the economic downturn dates defined by the National Bureau of Economic Research.
And depressed consumption is driving down sales taxes

Year-over-Year Change in Spending

Source: Bureau of Economic Analysis.
Note: Nominal, 3-month moving averages.
On spending side, concerns about safety net

- Urban Institute researchers project non-elderly Medicaid enrollment will increase anywhere from 8 to 26 million people (16-53%) depending on unemployment, responsiveness of private insurance

- States are already accessing federal loans to pay UI claims (13 states and territories now authorized to borrow $17 billion)
Historically based models suggest state and local budget problems could get worse

- **Fiedler, Furman, and Powell (FFP)** estimate a 1 percentage point unemployment increase leads to $45 billion state budget gap
  - Based on this relationship and CBO May 2020 forecast, **CBPP** projects cumulative $615 billion state budget gap through fiscal 2022

- **Bartik** calculates a 1 percentage point unemployment increase creates an additional $22 billion budget gap for localities
  - Based on this relationship and slightly different CBO projections, **NLC** estimates a $360 billion three-year gap in cities and towns

- **Moody’s Analytics** calculates $500 billion in state and local budget gaps through fiscal 2022, $750 billion if more severe double dip recession
Many sources of uncertainty, including:

- Severity and duration of COVID-19 pandemic
- Federal, state, local public health actions
- Behavioral responses to those actions
- Exposure of various industries and sectors
- Exposure of various state and local revenue sources
- Effectiveness of federal fiscal and monetary policy actions
- Future federal actions, including aid for states and localities
Federal actions so far…

- **3/6 Supplemental Appropriations Act**: $8.2 billion with ~$1 billion for state and local governments, mainly for public health
- **3/18 Families First Coronavirus Relief Act**: $105 billion with ~$40 billion for states and localities through boost in Medicaid matching rate (FMAP)
- **3/27 CARES Act**: $2.3 trillion with ~$200 billion for states and localities
  - Coronavirus Relief Fund ($150 billion)
  - Education grants (~$30 billion, ½ for K-12 and ½ for higher ed)
  - Transit grants ($25 billion)
- CARES also set aside $35 billion to set up a $500 billion Fed Municipal Liquidity Facility available to states; cities >250k and counties >500k population; state designated cities, counties, and revenue bond issuers
... helpful, but not up to magnitude or timing of challenge

- **Families First** FMAP boost tied to public health emergency

- **CARES** Coronavirus Relief Fund explicitly not for revenue shortfalls, covers COVID expenses through December 2020

- **Municipal Lending Facility** has limited reach and addresses liquidity, not solvency issues; unknown interactions with state balanced budget rules and debt limits including limits on state ability to issue debt on behalf of localities
Other pending federal legislation

- **HEROES Act** would provide $500 billion in flexible fiscal relief to states, $375 billion to localities plus education, highways, transit, public health funds (about $1 trillion total)

- **SMART Act** would send states $484 billion, of which about one third must go to localities (half to cities, half to counties)

- **Jobs for Economic Recovery Act** would boost FMAP based on unemployment rates with maintenance of effort for employment and training programs
State and local job cuts so far

State and Local Government Employment
Cumulative monthly job losses (%) by sector (indexed to August 2008)

Concerns about service cuts and fiscal drag

State and Local Government Contributions to Real GDP Growth

Percentage change (%)

Source: Bureau of Economic Analysis