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The state of state budgets during COVID-19 and the Great Recession and how to respond

Prepared for the Vermont House Ways and Means
Committee Hearing

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Takeaways

- State budgets were in good shape before COVID-19
- State fiscal problems are deep and widespread but the severity varies
 - Depends on the state's economy, tax system, and virus cases
 - Congress's assistance has helped but is expiring
 - Generally recommend combination of tax increases, budget cuts
 - Federal aid and rainy day funds can help temper response
- States took substantial budget actions in FY 2020, but deficits and budget cuts likely will be larger in FY 2021
 - Uncertainty is huge and persistent problem

What states budgets looked like before COVID-19

States were generally in good fiscal shape

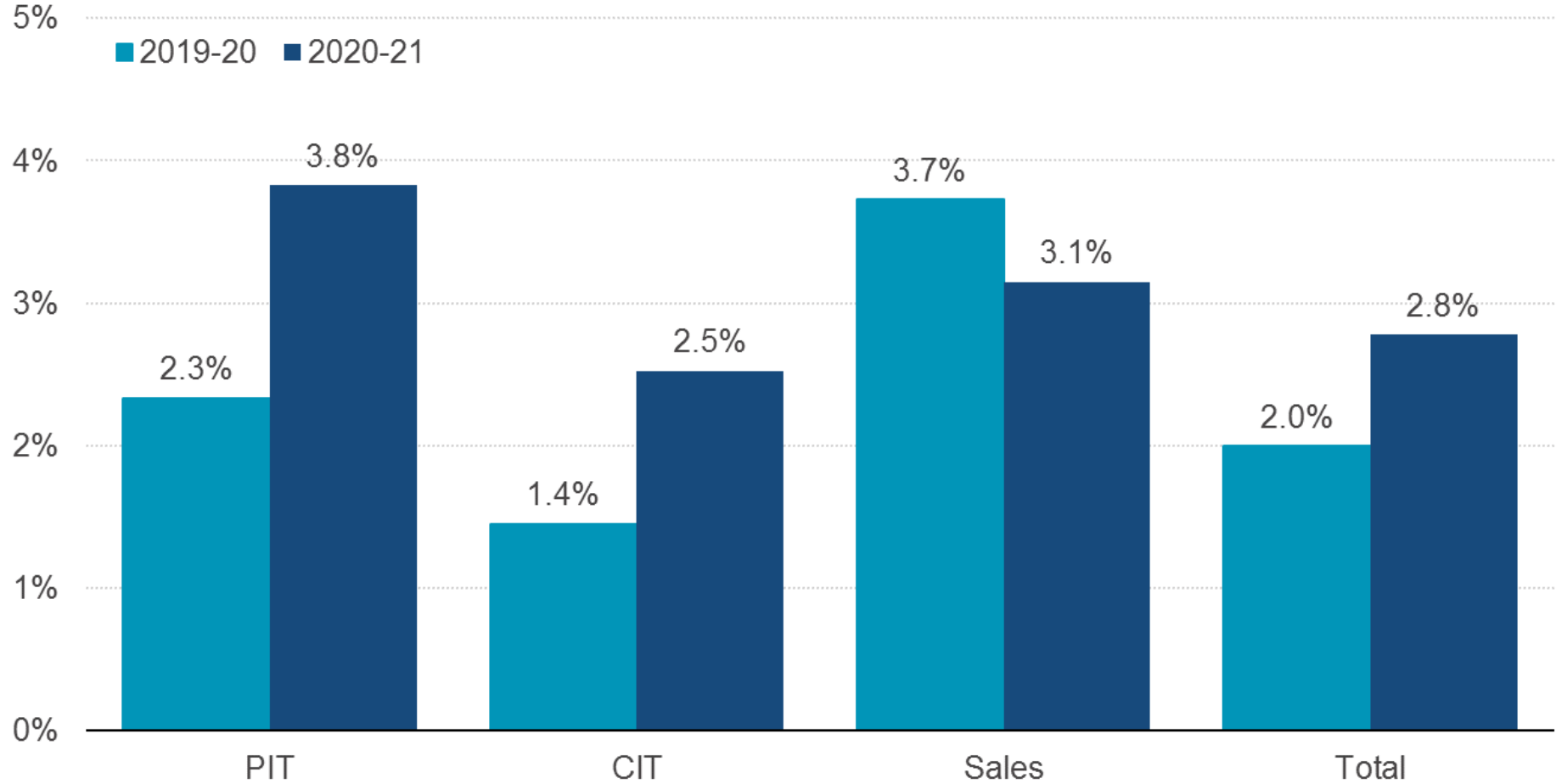
- State revenues were on track for a 10th consecutive year of growth
- No state was forced to make a mid-year budget cut in FY 2019
- NASBO: Median rainy day fund was 7.3% of expenditures in FY 2019—a record high (\$75.5 billion) VT 14%
 - Forecasting 7.8% in 2020, this compared to 4.6% in FY2007
- Vermont's RDF balance 14%
- Vermont's reform to TCJA, helped protect low and middle income families from tax increases, buffer from federal changes

Solid revenue growth was forecast before COVID-19



Revenue forecasts prior to COVID-19 in 48 states

Percent change



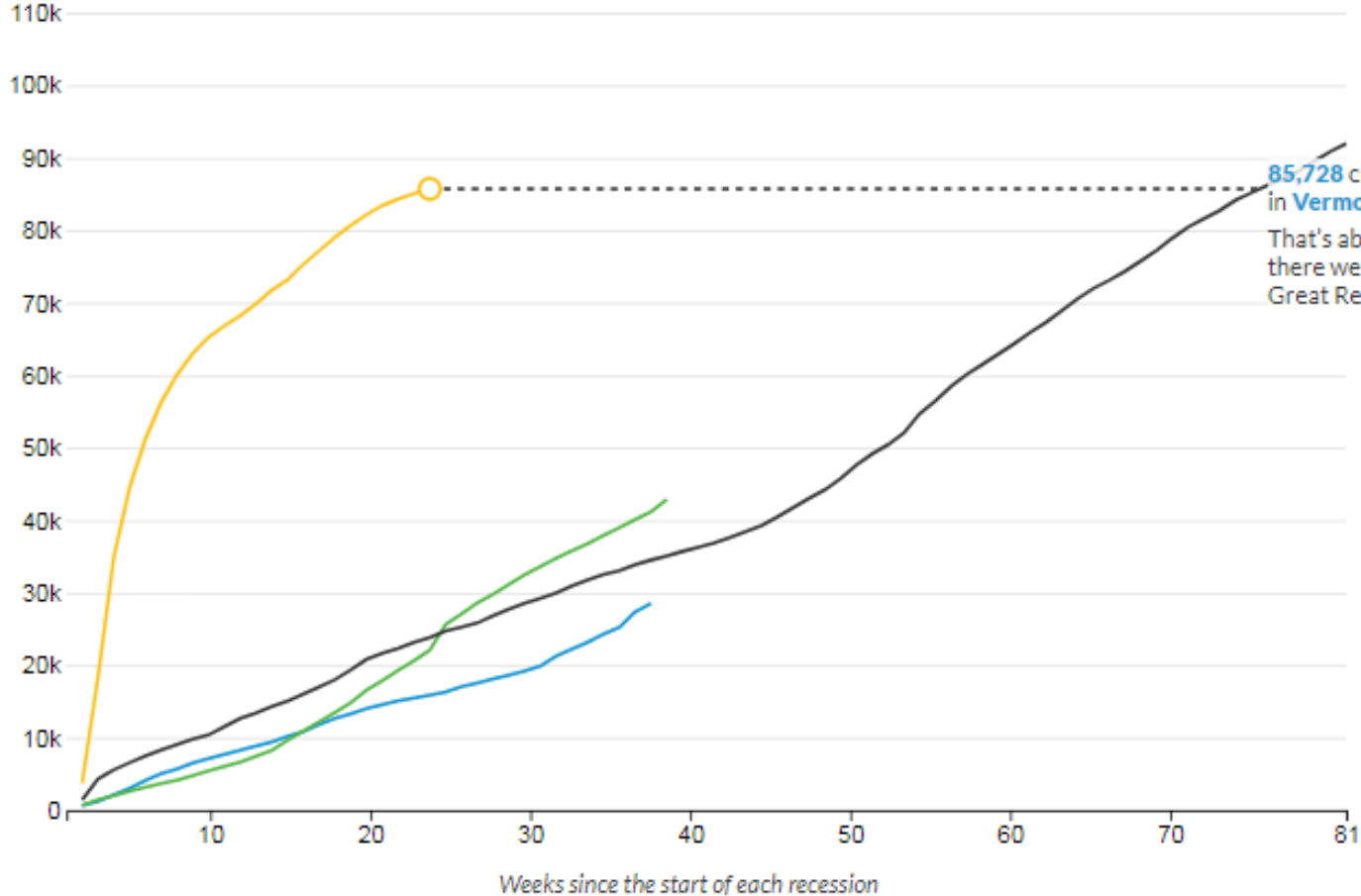
What state economies and budgets look like after COVID-19

The COVID-19 recession is not a typical recession

Vermont Unemployment Insurance Claims as of August 27, 2020

1990 recession Beginning 7/14/1990
2001 recession Beginning 3/17/2001
Great Recession Beginning 12/15/2007
COVID-19 pandemic Beginning 3/14/2020

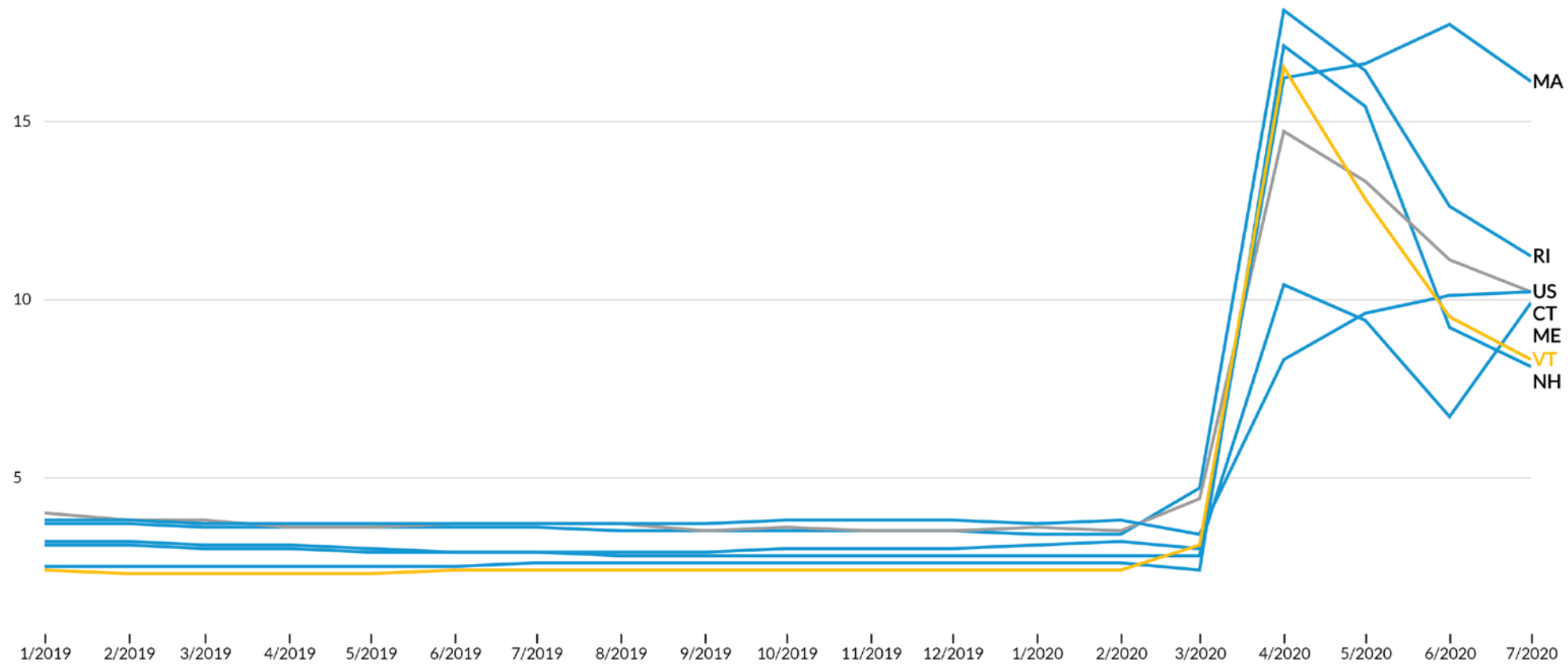
Total Unemployment Insurance claims



85,728 claims have been filed in Vermont over 23 weeks. That's about as many claims as there were at week 75 in the Great Recession.

Vermont's unemployment rate is lower than the nation's and most of its neighbors, but ...

Unemployment rate *(percent, seasonally adjusted)*

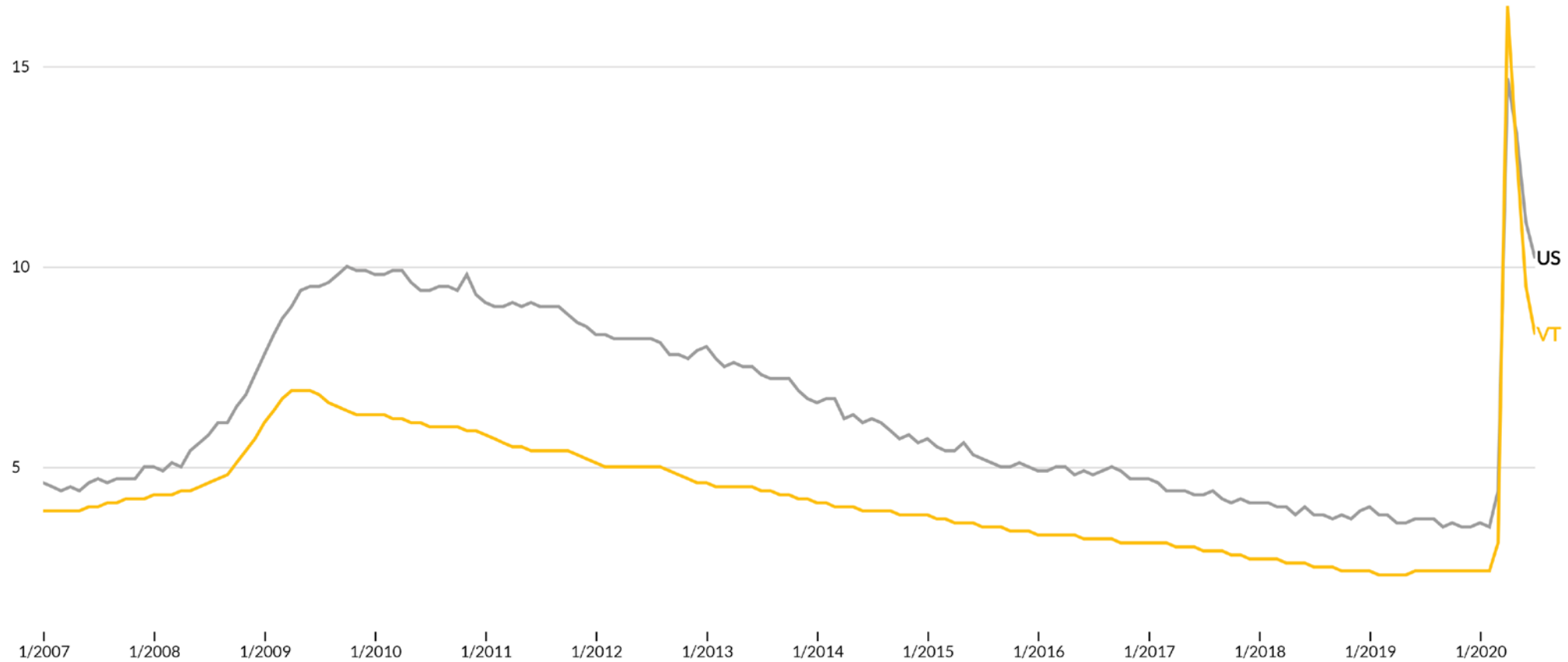


Source: Bureau of Labor Statistics via the State Economic Monitor

... it's higher than at any point during the Great Recession



Unemployment rate *(percent, seasonally adjusted)*

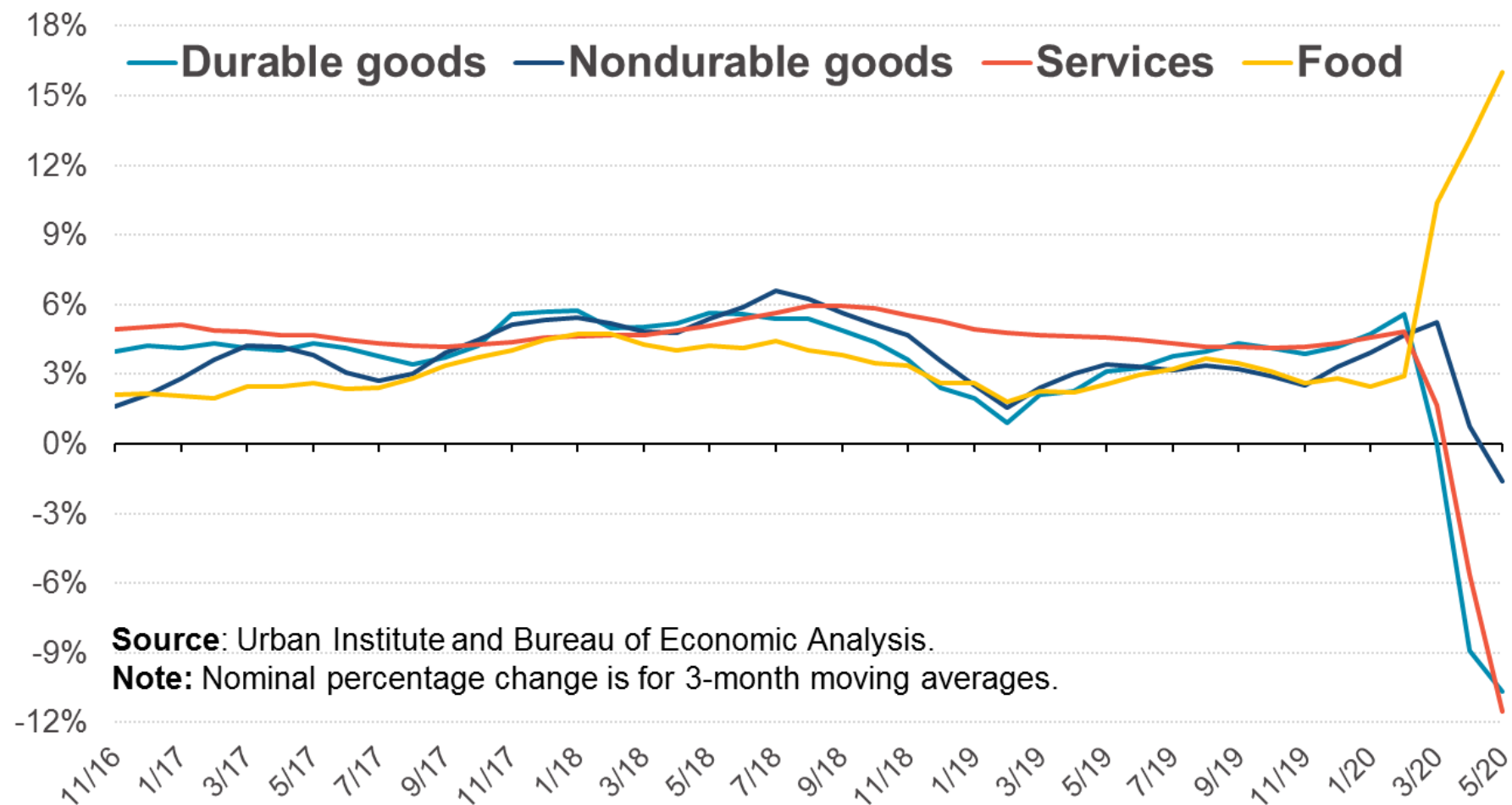


Source: Bureau of Labor Statistics via the State Economic Monitor

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Sharp decline in most (but not all) spending

Year-over-year percent change in personal consumption spending

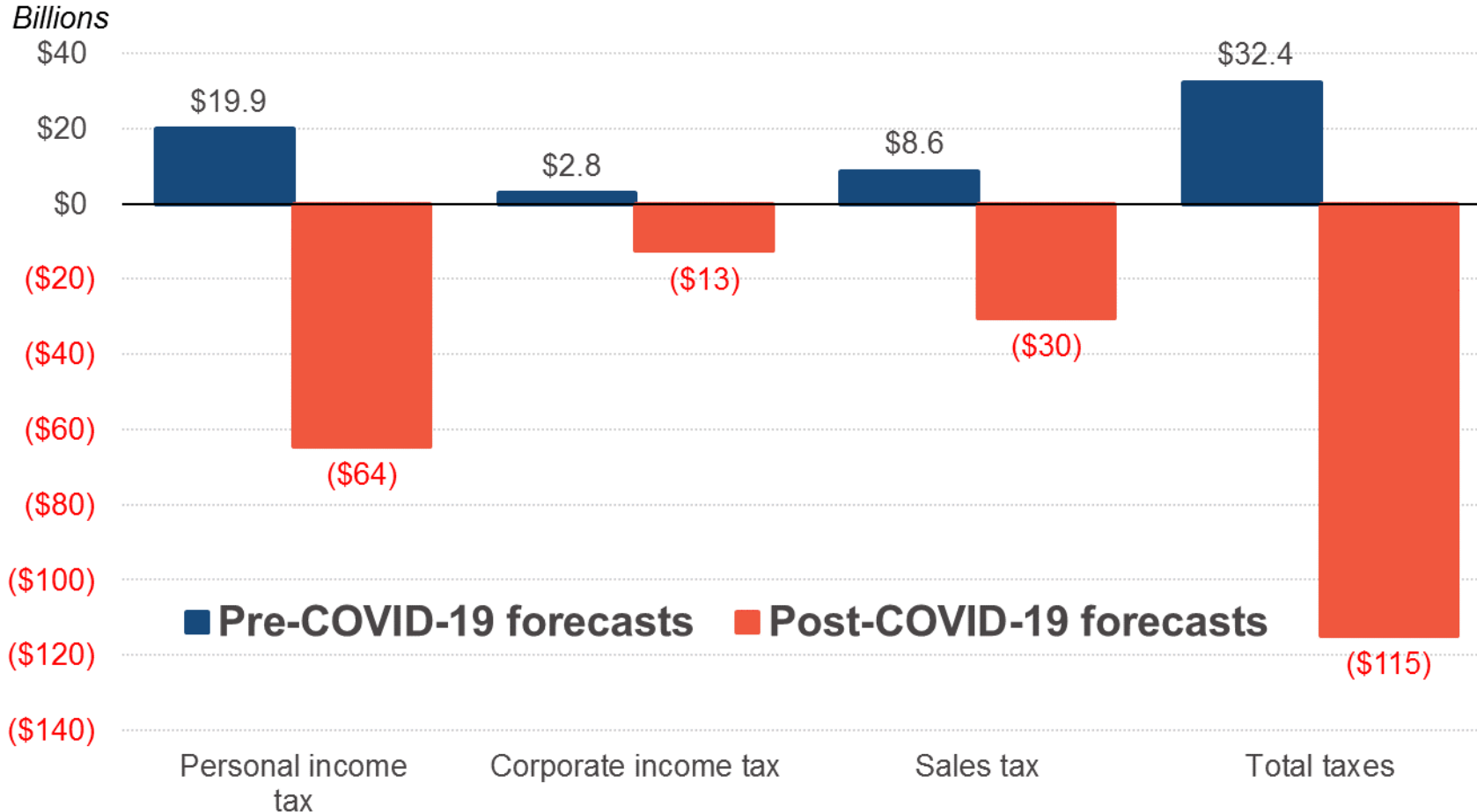


Source: Urban Institute and Bureau of Economic Analysis.

Note: Nominal percentage change is for 3-month moving averages.

State revenue forecasts collapsed after COVID-19

State revenue forecasts for FY 2020 and FY2021 in 27 states



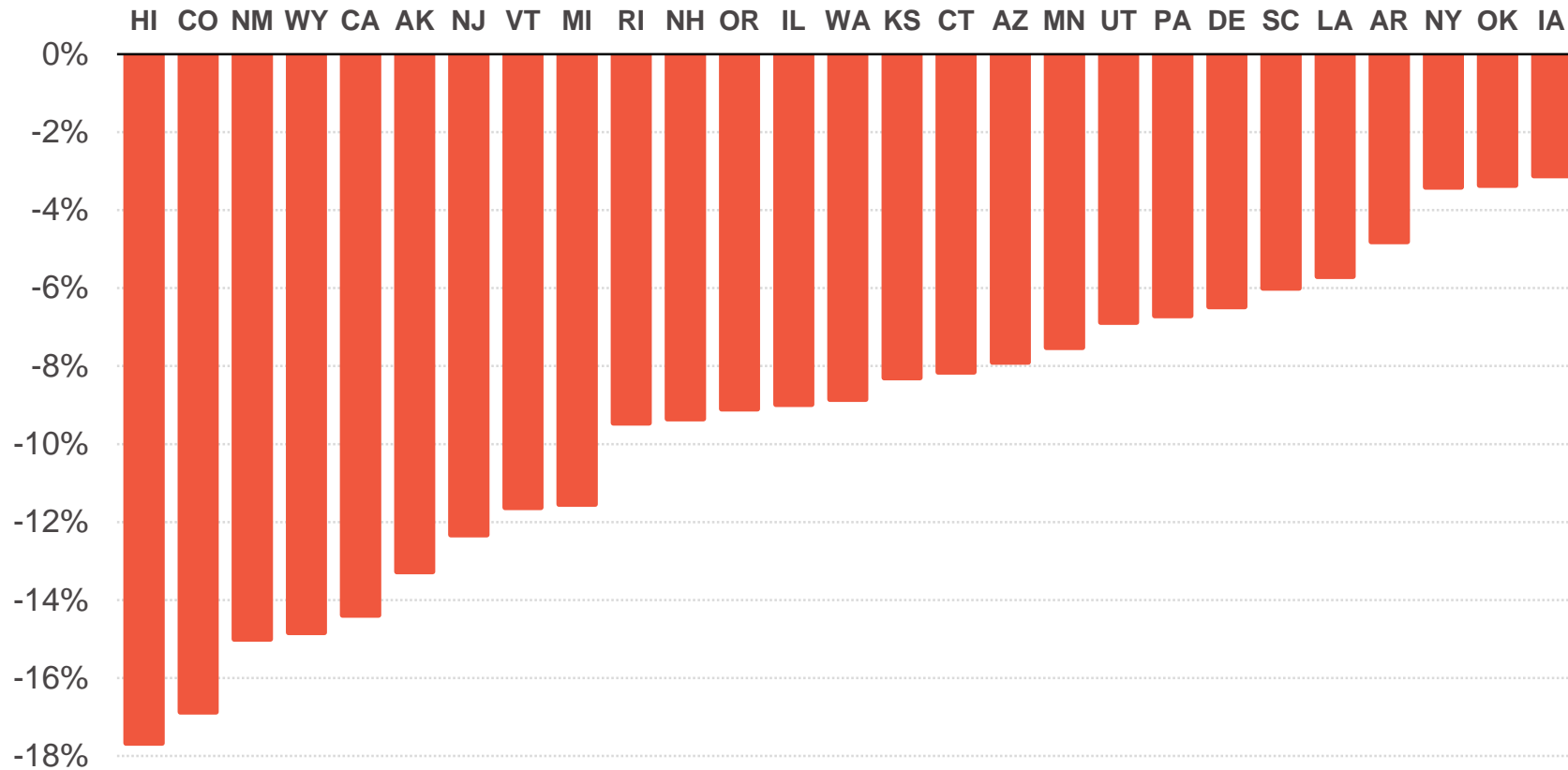
Extrapolated to 50 states:

Combined \$200 billion shortfall in FY20 & FY21

Anticipated declines in 2021 worse, especially in tourism and energy dependent states.

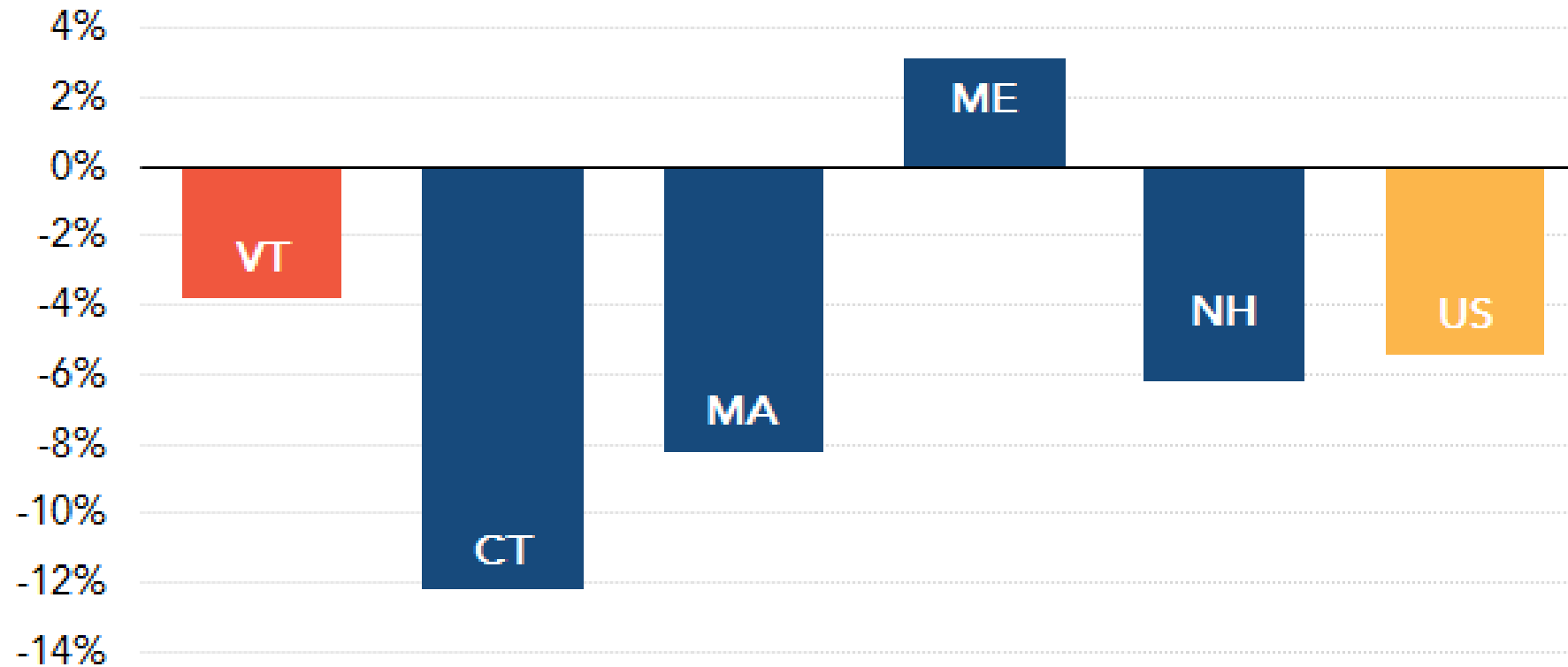


Percent change in revenue estimates compared to pre-COVID-19 estimates



Revenue declines in fiscal year 2020

Percent change in total state tax revenue
FY 2019 vs. FY 2020



Source: State fiscal agencies. Rhode Island has not yet reported data.

Additional pressures on the spending side

- Public health emergency
 - Testing, PPE, hospitals, etc.
- Medicaid
 - Urban Institute estimates non-elderly Medicaid enrollment will increase by 8 million to 26 million people (16% to 53%) during the COVID-19 recession
- Education
 - Preparing for in-person and online learning, simultaneously, is challenging and possibly costly for both K-12 education and higher education
 - Lots of uncertainty

How states are addressing the budget crisis

46 states began FY 2021 on July 1st

- 43 states enacted FY 2021 budgets, of which 16 had enacted a biennial budget during their 2019 legislative session
- New Jersey signed 3 month budget, shifted start of budget year.
- Vermont budgeted for first quarter of FY2021, MA, RI, MI, PA, SC fund short term, hoping for federal aid and more information about revenue levels from delayed payments
- Preliminary indications, revenues lower than prior year but higher than expected this Spring

Federal assistance to states and localities so far

- \$1 billion for the public health response (Phase 1)
- \$40 billion in additional Medicaid funds (Phase 2)

CARES Act

- \$150 billion for a Coronavirus Relief Fund dedicated to state and local governments
 - For costs related to COVID-19 not otherwise accounted for and limited to CY 2020
- \$30 billion for an Education Stabilization Fund (half K-12; half higher education)
- \$25 billion for mass transit agencies
- \$5 billion in Community Development Block Grants
- \$3.5 billion for Child Care Development Block Grants
- New congressional action – delayed (maybe end of month) but state aid most far apart – much less than what originally proposed

State actions thus far

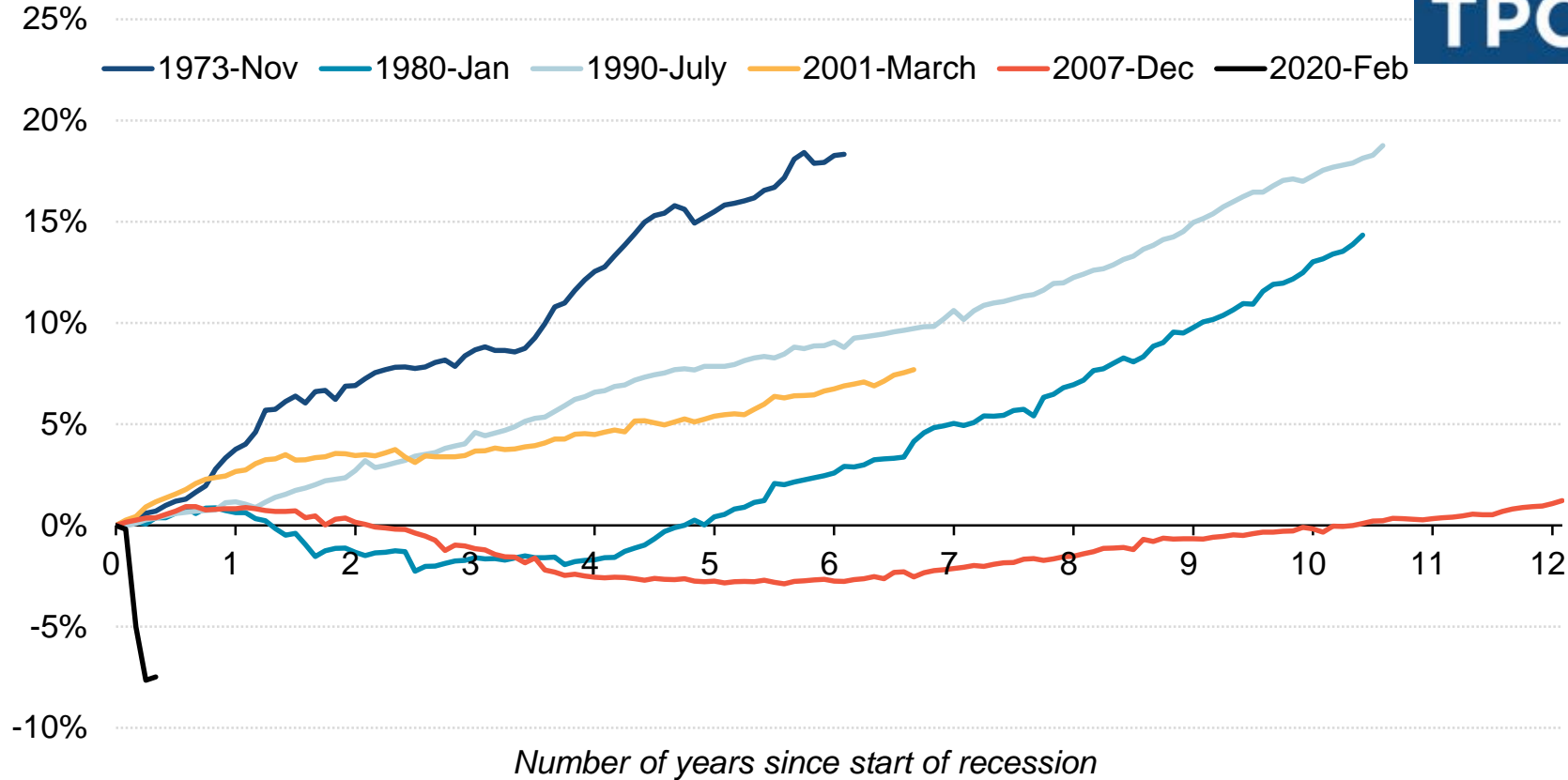
- States have begun spending down rainy day funds – but also aware worse is coming
- Tax actions limited thus far
 - Some states (CO, CT, GA, NC, NM, NY) decoupled from CARES Act changes to NOLs
 - Vermont changes to TCJA helped limit exposure.
 - California suspended NOLs (taxpayers w/ \$1 million+) for 2020, 2021, and 2022—but extended carryover period for three years for anyone affected by the suspension
 - Colorado curtailed some corporate tax expenditures
- Widespread FY2020 budget cuts
 - Temporary shifts, furloughs and some layoffs
- Even larger cuts expected in FY2021 especially if Federal aid not forthcoming, or infection rates increase
 - Across the board, and some targeted

Steepest cuts in state-local government employment



State and local government employment in selected recessions

Cumulative percent change since start of recession

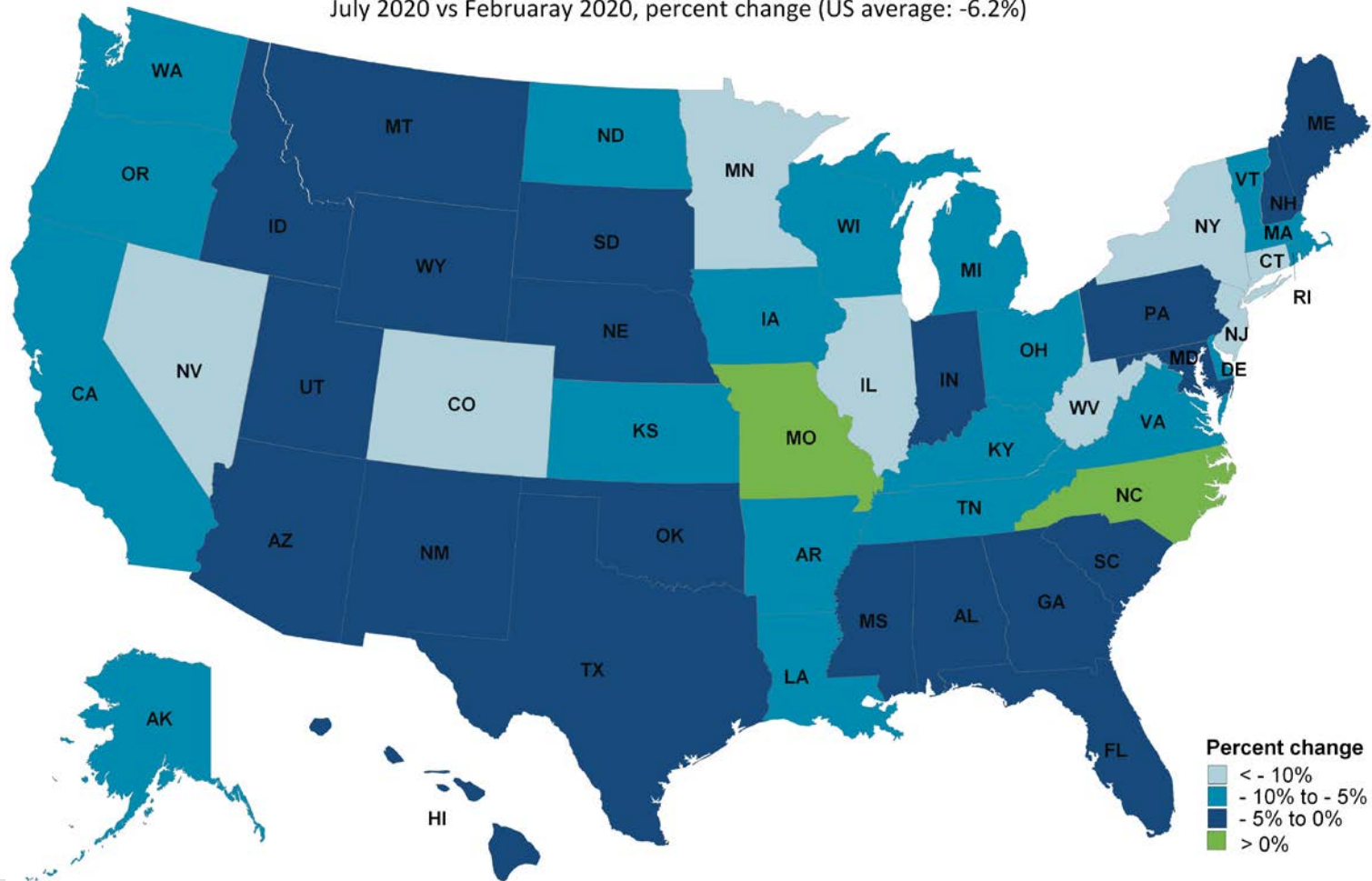


Source: US Bureau of Labor Statistics (CES, seasonally adjusted).

Note: Data are shown until the start of the next recession.

State-local government employment down by over 1.2 million or 6.2 percent since February

State & local government employment
July 2020 vs February 2020, percent change (US average: -6.2%)

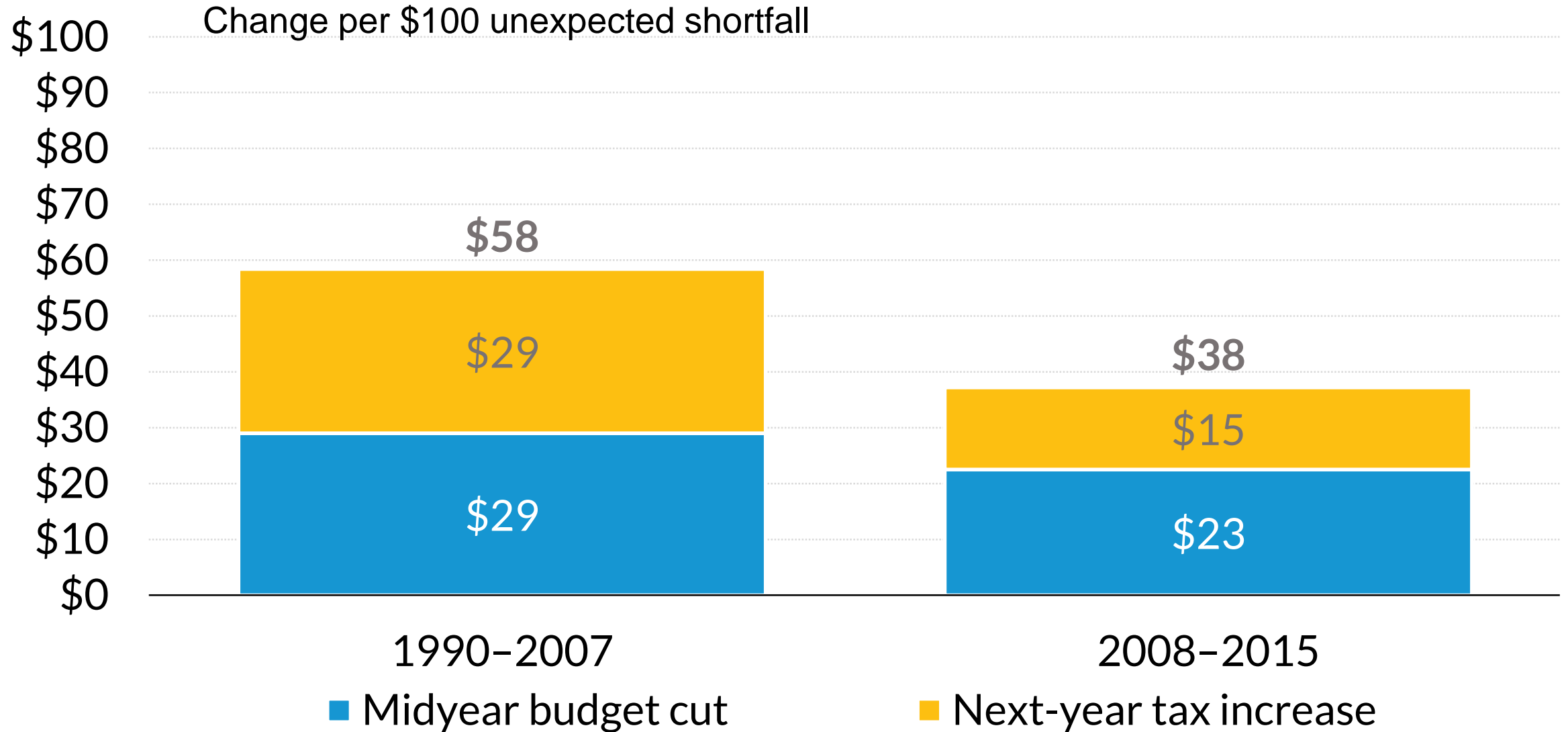


Lessons from Great Recession and going forward

State (and local) governments have balanced budget requirements

- Possible reaction to deficits
 - Federal Aid
 - Spend down rainy day funds
 - Shift/Defer spending
 - Budget cuts
 - Tax/Revenue Increases
- Combination necessary
 - More flexibility higher level of government
 - Often stress pushed down

State responses tempered during the Great Recession



Lessons from the last recession

- Immediate reaction smaller because of federal aid, rainy day funds
- Recovery was long and weak
 - Spending recovery slow in many places only strong in last few years
 - *Education and health-care*
 - *Reduced local aid*
 - *Cut/reform employee benefits (or made employees contribute more)*
 - *Opportunity for reform - automation*
 - Revenue changes varied across states
 - *Bifurcation – some increased progressive income taxes, others cut*
 - *Little evidence changing structures affected growth*
 - *Tobacco tax increases*
 - *Increases in fees and charges*

Options for reform

- Tax increases are hard, especially during a recession
- Many revenue sources (tourism taxes) increased in prior recessions but are less useful due to COVID
- Expansion to broaden sales tax base – VT base narrow, expand to services, durables
- Vermont less reliant on income tax than other states – recovery K-shaped, opportunity for introducing additional top rate or broadening brackets, but higher rate than some
- Introducing legislation to tax marijuana – in line with other states where legalized but accounts for about .5% general revenue in states that tax
- Cigarette taxes – \$3.08 rate higher than national average (1.70) but lower than most neighboring states (not NH)
- Alcohol taxes – in middle of national rates, higher than NY and MA

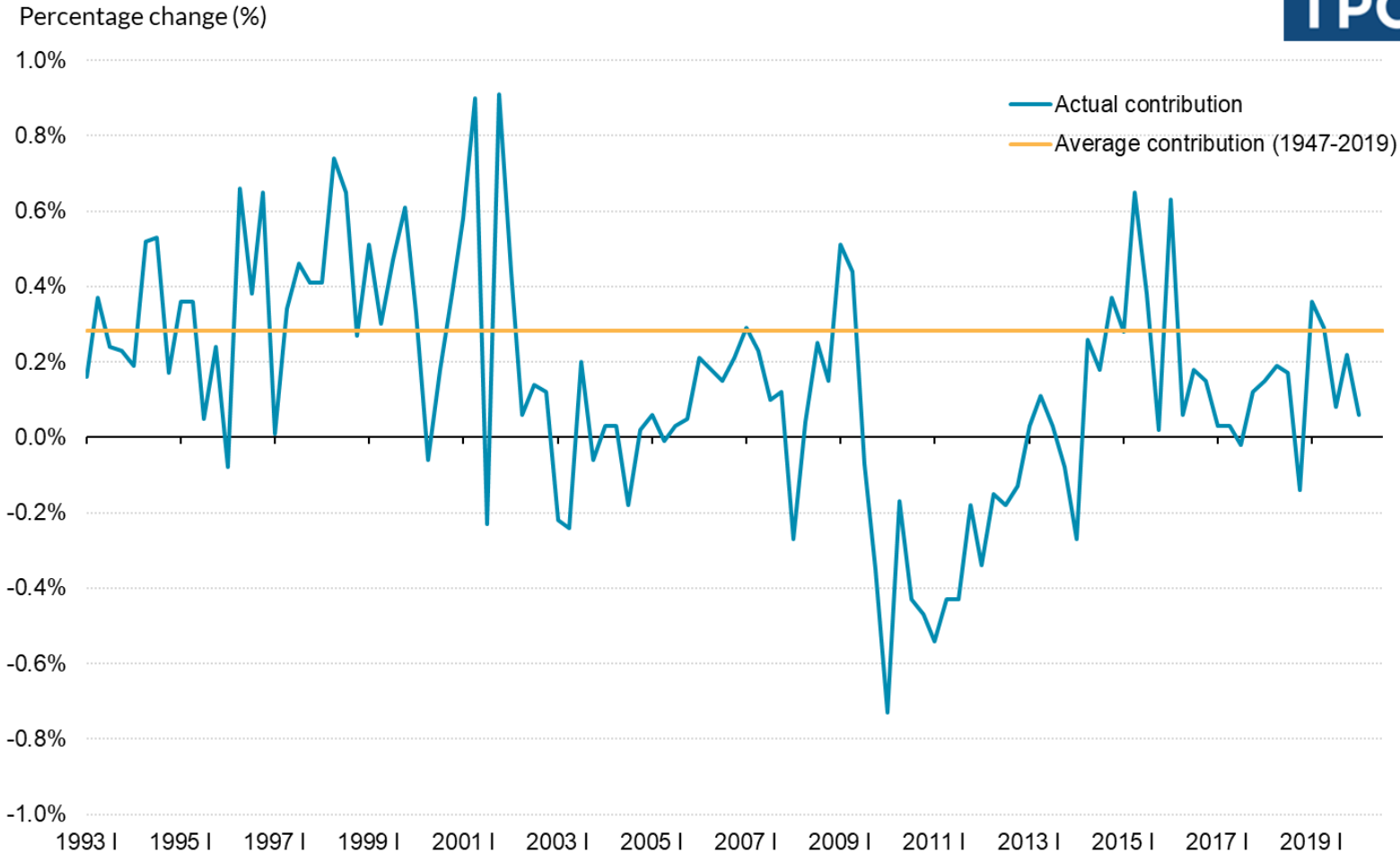
Options for reform (continued)

- Spending cuts can be delays, shifting funds across accounts
- Some spending increases needed to respond to public health concerns
- Making targeted, thoughtful cuts more strategic
 - But can be more difficult politically
- Across the board cuts can disproportionately affect certain (vulnerable) populations
- Important to understand how cuts in one department can affect other costs
 - Delays in trials can increase jail costs
 - Might be incentive/opportunity for reform
 - Need to avoid prior mistakes

Concerns about service cuts and fiscal drag



State and Local Government Contributions to Real GDP Growth



Source: Bureau of Economic Analysis

Thank You!
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