
April 14, 2020

States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession

By Elizabeth McNichol, Michael Leachman, and Joshua Marshall

The pressures on state and local finances from the COVID-19 pandemic and resulting economic fallout are mounting and will quickly become severe — significantly worse in the coming year than states and localities experienced during the worst year of the Great Recession. Federal policymakers have provided some emergency fiscal relief, but far too little to enable states and localities to respond to the immediate public health emergency, absorb increased program costs, and avoid sharp spending cuts that would deepen and prolong a recession. States urgently need more substantial fiscal support. Congress and the President should both provide additional Medicaid funding for states and additional, flexible fiscal relief.

States appear on the brink of shortfalls that — based on historical patterns — could total more than \$500 billion, mostly concentrated in a single fiscal year, the one that begins in less than three months. Even after accounting for the federal fiscal aid that’s been provided so far and states’ own rainy day funds that they can draw down, states still face shortfalls of as much as \$360 billion, *not including* the substantial new costs they face to combat the COVID-19 virus.

Moreover, Congress may need to enact a new fiscal relief package that is considerably *larger* than the figures above suggest, for several reasons. First, local governments, territories, and tribes also will need substantial additional fiscal relief. (See boxes on territories’ and tribal governments’ challenges below.)

Second, our projections of budget shortfalls are based on the historical relationship between unemployment rates and state tax revenue, but there are good reasons to think that this particular recession may have a much more damaging effect. For instance, sales tax revenues have plummeted at an unprecedented pace due to the social distancing required to contain the virus, and may not return to prior trend levels, since some consumption patterns may be permanently altered. And some of the initial data on actual revenue declines in states so far suggest a deeper decline than the historical pattern would suggest. (For instance, Maryland projects a 15 percent decline in its general fund for the current fiscal year, which ends in less than three months, a decline that is 50 percent higher than our projections suggest as an average across states.)

Finally, as noted above, our shortfall projections do not include new costs to states to address the COVID-19 virus. The scope and magnitude of these costs are unknown, but clearly substantial and

unprecedented. While federal aid provided to date will help cover some of these costs, it is not clear how much of them, or how long states and localities will continue to bear these costs. At any rate, the uncertainty about how deep and how long the economic crisis will last underscores the need for continuing fiscal aid that triggers on or off depending on future economic conditions.

States' costs are rapidly rising as they seek to contain the virus; a growing number have already allocated reserve funds to address the added costs that have emerged. Those costs will spike as businesses continue to lay off workers and incomes fall — forcing many more people to turn to Medicaid, unemployment benefits, and other forms of public assistance.

At the same time, state revenues are plummeting, knocking state budgets well out of balance. Sales tax revenues already are declining rapidly, and income tax withholding by businesses is also falling precipitously. The stock market's sharp drop will also soon show up in smaller quarterly income tax payments from wealthy households and corporations. While it is too early to tell what the pandemic's full impact will be on state, local, and territorial revenues, history and preliminary estimates suggest that states alone will face budget shortfalls of roughly \$105 billion in the current fiscal year (which ends June 30 in most states) and as much as \$290 billion in the upcoming fiscal year — a massive decline equal to more than a quarter of total state revenues.

Further, economists expect that unemployment is likely to remain elevated even into the second half of 2021, an indication that states will continue to face serious budgetary pressures. Unemployment projections from Goldman Sachs suggest that states may face another \$105 billion in shortfalls in their 2021-22 fiscal year.

In the absence of substantial federal aid, states — which must balance their operating budgets, even in a recession — and the localities they support will likely respond to these enormous budget shortfalls by laying off teachers and other public employees and slashing other spending. These layoffs and cuts will worsen the economy's fall and could cause long-term harm to families and communities.

The aid Congress has provided thus far falls far short of what states will need to avoid these harmful cuts. The Families First Coronavirus Response Act, enacted on March 18, temporarily increased the share of Medicaid payments paid by the federal government (known as the federal medical assistance percentage, or FMAP), which will provide states with about \$35 billion if the public health emergency lasts through the end of this calendar year.

The state fiscal aid provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act will provide additional support, but not enough. The largest form of aid in the CARES Act is the Coronavirus Relief Fund, which will provide up to about \$110 billion in aid to states, and another roughly \$30 billion in aid to populous cities and counties, all of which must be spent before the end of calendar year 2020.¹ This is substantial relief. But its usefulness could be *severely limited* if the Treasury Department interprets the bill's language to bar states from using the funds to close

¹ "How Will States and Localities Divide the Fiscal Relief in the Coronavirus Relief Fund?" CBPP, March 27, 2020, <https://www.cbpp.org/research/state-budget-and-tax/how-will-states-and-localities-divide-the-fiscal-relief-in-the>.

revenue shortfalls, as Treasury reportedly is considering doing.² The CARES Act also includes a \$30 billion Education Stabilization Fund, which could serve as fiscal relief. Other provisions in the CARES Act, such as funding for transit agencies and airports, will not provide much state budget support, since these funds will flow primarily to local governments or other governmental entities.

If states are not able to use *any* of the \$110 billion in the Coronavirus Relief Fund to close revenue shortfalls — that is, if Treasury adopts a restrictive interpretation — they will be left with the FMAP increase and the education funds (\$65 billion in total) from the CARES Act for this purpose. They would be about \$435 billion short of closing their projected shortfalls in the current, upcoming, and subsequent fiscal years. If, on the other hand, they can use all of the Coronavirus Relief Fund to close revenue shortfalls, states will need roughly another \$325 billion.

States can use their rainy day funds to close a portion of this gap, but those funds, as well, will fall far short of what's needed. State rainy day funds contained a total of \$75 billion as of the end of the last fiscal year. (The size of rainy day funds differs significantly by state.)³ Using all of these funds would leave roughly \$360 billion in remaining shortfalls, assuming they cannot use the Coronavirus Relief Fund to address the revenue crisis. Again, these figures include neither the added costs states face in containing the COVID-19 virus nor the shortfalls local governments face.

States will face the greatest challenges addressing shortfalls in the upcoming fiscal year, which starts on July 1 in most states. Unemployment is projected to peak at almost 15 percent in the July to September quarter — far higher than the peak of 10 percent in October 2009 during the Great Recession — and slowly fall to 7.4 percent by June 2021 according to Goldman Sachs.⁴ Other projections, including one by the Congressional Budget Office, show a *slower* decline in unemployment. Under any of these scenarios, the year ahead will be extremely damaging to state budgets, resulting in budget shortfalls much worse than even the worst year of the Great Recession and dwarfing the fiscal harm caused by the 2001 recession, unless Congress and the President provide significantly more aid. (See Figure 1.)

The highest priority for additional state fiscal relief should be an increase in the FMAP, beyond what was included in Families First, that adjusts with economic conditions and remains in place as long as unemployment remains elevated. This would provide fiscal relief that reaches states quickly, provides direct and meaningful support for state general funds throughout the full period of elevated unemployment, and — when it prevents states from cutting their Medicaid programs, in what are known as “maintenance of effort” provisions — protects against cuts to Medicaid eligibility and services at a time when medical coverage is especially important.

Adopting this type of an FMAP increase would give states substantial fiscal relief, but it wouldn't be enough on its own to fill the large budget shortfalls states will almost certainly face.

² Congressional Research Service, “The Coronavirus Relief Fund (CARES Act, Title V): Background and State and Local Allocations,” April 1, 2020, <https://crsreports.congress.gov/product/pdf/R/R46298>.

³ Michael Leachman and Jennifer Sullivan, “Some States Much Better Prepared Than Others for Recession,” CBPP, March 20, 2020, <https://www.cbpp.org/research/state-budget-and-tax/some-states-much-better-prepared-than-others-for-recession>.

⁴ Goldman Sachs, “The Sudden Stop: A Deeper Trough, A Bigger Rebound,” March 31, 2020.

Congress will also need to provide some other form of substantial federal fiscal relief. One option would be to extend the Coronavirus Relief Fund beyond the end of this year, offer substantially more funding, and eliminate the potential restrictions on its use to fill revenue shortfalls and thereby avert economically damaging state budget cuts or tax increases. This fund could also provide additional fiscal support for local governments, but doing so should not come at the expense of providing adequate aid to states.

Finally, what states need most are grants, not loans through the bond market or from the federal government (see box, “Federal Loans to States Are Not the Answer”). The CARES Act provides \$454 billion to the Federal Reserve System to buy public and private debt, including notes issued by states and localities.⁵ One purpose of this fund is to support the municipal bond market by purchasing debt that has already been issued. But the Federal Reserve has announced that it will go further and purchase newly issued short-term debt — that is, notes that mature in less than two years — which would effectively mean loans to states and localities that they’d have to repay. While these loans are helpful to states addressing immediate revenue declines while they look for longer-term solutions, they are no substitute for the direct aid that states need.

As noted above, the uncertainty about how deep and how long the economic crisis will last underscores the need for continuing fiscal aid that triggers on or off depending on future economic conditions. Congress can address these future needs by making the needed further increase in the FMAP match one that adjusts for future economic conditions, and by providing additional state fiscal relief that is flexible enough to enable states to address budget shortfalls in the years to come.

FIGURE 1

COVID-19 State Budget Shortfalls Could Be Largest on Record

Total state budget shortfall in each fiscal year, in billions of 2020 dollars



* Estimated based on CBPP calculations

Source: Pre 2014: CBPP survey; 2020 and following: CBPP calculations

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⁵ “Federal Reserve takes additional actions to provide up to \$2.3 trillion in loans to support the economy,” Board of Governors of the Federal Reserve System, April 9, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm>.

Pressures on States Are Mounting

The pressures on state finances from the COVID-19 pandemic already are mounting rapidly. States are ramping up public health efforts to track and contain the virus, increasing spending at public hospitals to handle more sick patients, increasing virus testing and education, and paying overtime to workers in call centers to field questions and direct people to resources. Unemployment claims are exploding, requiring states to hire many more eligibility workers and to pay for a much larger amount of unemployment benefits.

States' Public Health Costs Are Climbing

States are marshalling their resources to combat the COVID-19 virus. Already at least 20 states are considering or have enacted supplemental budget funding or transfers from rainy day funds to address mounting costs including staff and supplies for testing; pay for longer hours for nurses, doctors, and other staff; expansion of clinics; and protective equipment and cleaning.⁶ For example:

- California has authorized supplemental spending of up to \$1 billion for the governor to allocate to address this emergency. Michigan has appropriated \$125 million.
- Minnesota has transferred \$200 million from the general fund to a public health contingency fund. Arizona has transferred \$55 million from its budget stabilization fund to its public health emergencies fund. Maryland will allow the governor to transfer up to \$50 million from the Revenue Stabilization Account to fund costs related to the COVID-19 outbreak. And Georgia has transferred \$100 million from its Revenue Shortfall Reserve to combat the spread of the virus.
- States are also supporting local governments on the front line of responding to the health emergency. For example, California has appropriated \$100 million to send to local school districts for personal protective equipment and staff and supplies for cleaning. Washington State has transferred \$200 million from the state's rainy day fund to be distributed to state and local agencies to respond to the COVID-19 outbreak.

Unemployment Insurance Claims Are Exploding

The pace at which the economy is declining suggests that the emerging recession may be especially deep, even deeper than the Great Recession of 2007-09. In the most recent Department of Labor report, the number of insured unemployed people rose by 4.4 million in the week ending March 28 and the insured unemployment rate rose to 5.1 percent. But this is just the tip of the iceberg. New unemployment insurance claims for the week ending April 4 jumped by 6.6 million, bringing total claims for the last three weeks close to 17 million.⁷

⁶ National Conference of State Legislatures, "State Fiscal Responses to Coronavirus (COVID-19)," March 22, 2020, <https://www.ncsl.org/research/fiscal-policy/state-fiscal-responses-to-covid-19.aspx>.

⁷ Department of Labor, "Unemployment Insurance Weekly Claims," April 9, 2020, <https://www.dol.gov/sites/dolgov/files/OPA/newsreleases/ui-claims/20200592.pdf>.

The rising numbers of claims are overwhelming state unemployment offices.⁸

- Connecticut, which until recently typically received 3,000 to 3,500 new unemployment claims per week, received 30,000 claims between Saturday, March 14 and Tuesday, March 17.⁹ By the end of the month, the state had received over 250,000 claims and had quadrupled the number of staff working to process them from 20 to 80.¹⁰ The state deputy labor commissioner, who has been with the department for nearly three decades, said, “I’ve never seen anything like this. It’s unbelievable.”
- Florida’s claims hit a record for the week ended March 21 and then received three times that number the following week.¹¹
- Michigan’s state unemployment filing system crashed due to the overwhelming amount of claims.¹²

Pandemic Is Causing a Severe State Fiscal Crisis

This mounting state fiscal crisis will likely become much more severe. Most states are in the process of finalizing or have recently adopted their budgets for the coming fiscal year (which starts July 1 in most states) under the assumption that the economy would continue to grow over the next year.¹³ That assumption is no longer realistic. States have already begun to reduce their revenue estimates for the upcoming fiscal year substantially. While most states have rebuilt their rainy day funds and other reserves since the last recession, they are not adequate to address an economic shock of this size. Without substantially more emergency federal assistance, states will likely make deep spending cuts that will hurt the families and communities that depend on state and local services and slow the economy’s recovery from a recession.

State Revenues Plummeting

In the next few weeks, states will reduce their revenue estimates for the remainder of this fiscal year and the upcoming fiscal year, probably by a great deal.¹⁴ State tax collections will be rocked by both the immediate impact of the measures taken to stem the spread of the virus and the likely deep

⁸ Quoc Trung Bui and Justin Wolfers, “The Staggering Rise in Jobless Claims This Week,” *New York Times*, March 19, 2020, <https://www.nytimes.com/interactive/2020/03/19/upshot/coronavirus-jobless-claims-states.html>.

⁹ Stephen Singer, “Connecticut unemployment claims reach 30,000 since Friday as coronavirus takes toll on state’s economy,” *Hartford Courant*, March 17, 2020, <https://www.courant.com/business/hc-biz-unemployment-claims-20200317-uuiam6g2t5b6pczsouacogzenm-story.html>.

¹⁰ Chris Lundberg, CT Department of Labor gives update on unemployment applications, News8 wtnh.com, April 3, 2020, <https://www.wtnh.com/news/health/coronavirus/ct-department-of-labor-gives-update-on-unemployment-applications/>.

¹¹ Megan Assella and Katy Murphy, “States overwhelmed by previously unimaginable layoff numbers,” *Politico*, April 1, 2020, <https://www.politico.com/news/2020/04/01/unemployed-workers-benefits-coronavirus-159192>.

¹² *Ibid.*

¹³ National Association of State Budget Officers, “Proposed & Enacted Budget Links,” March 2020, <https://www.nasbo.org/resources/proposed-enacted-budgets>.

¹⁴ CBPP, “States Start Grappling With Hit to Tax Collections,” April 2, 2020, <https://www.cbpp.org/research/state-budget-and-tax/states-start-grappling-with-hit-to-tax-collections>.

COVID-induced recession. As businesses lay off workers and self-employed workers lose income, people and businesses will spend less, reducing state and local sales tax revenue. Quarterly income tax payments from the wealthy and corporations will also sharply decline as the stock market collapse filters through to capital gains income.

States have only just begun to forecast the pandemic's likely impacts on their revenues based on the best economic projections available and their experience with past recessions and other shocks to state economies. The early reports are sobering, and as the full scale of the downturn becomes clearer, revenue projections will fall further.

States face an immediate problem for the remaining months of this fiscal year because sales tax collections are likely already declining and income taxes withheld from paychecks will begin to drop soon as workers are laid off. In addition, the federal government has delayed the federal income tax deadline (which many states also use) from April 15 to July 15, which will lower revenue and increase costs in the next three months in most states.

But it's more than just a timing shift. There's a strong possibility that the delayed revenues will also be substantially less than expected if small businesses facing bankruptcy or out-of-work individuals can't make their tax payments in July, making next year's problems even worse. Maryland's revenues could fall as much as \$2.8 billion (15 percent) between now and June, according to the state's comptroller.¹⁵ Arkansas expects \$353 million less in revenue this fiscal year, with \$193 million of this drop due to the filing extension and the remainder due to lower collections. Michigan projects a decline of between \$1 and \$3 billion this fiscal year alone.¹⁶

And early state estimates show that revenues for the next fiscal year could fall as much or more than they did in the worst year of the Great Recession. New York and Colorado, for example, project revenue drops of 13 percent or more if the recession is deep.

Another group of states are facing a double threat. States with a high concentration of oil-related industries are seeing a decline in economic activity and tax collections because of plunging oil prices on top of COVID-19-related effects and the recession. For example, Alaska is projecting a \$700 million decline in revenues in the coming fiscal year due to the oil price drop, and New Mexico could see a \$1.5 to \$2 billion drop.¹⁷

¹⁵ Comptroller Provides Updated Revenue Forecast in Light of COVID-19, April 10, 2020.

¹⁶ Arkansas Department of Finance and Administration, Official Forecast of General Revenue Available for Distribution, March 23, 2020, https://www.dfa.arkansas.gov/images/uploads/budgetOffice/fy20_gr_forecast_revised.pdf; Jonathan Oosting, "Michigan axes \$80M in pork spending, shifts spending to fight coronavirus," *Bridge*, March 30, 2020, <https://www.bridgemi.com/michigan-government/michigan-axes-80m-pork-spending-shifts-spending-fight-coronavirus>.

¹⁷ Tim Bradner, Alaska Department of Revenue issues updated forecast, *Mat-Su Valley Frontiersman*, April 6, 2020, https://www.frontiersman.com/news/coronavirus/alaska-department-of-revenue-issues-updated-forecast/article_15e6d4c6-7881-11ea-a78c-03303894fb66.html. Kevin Robinson-Avila and Dan Boyd, "Oil and gas industry faces huge loss," *Albuquerque Journal*, March 19, 2020, <https://www.abqjournal.com/1434329/special-session-talk-intensifies-amid-oil-price-downturn.html>.

It is impossible to predict with any certainty what the precise impact of the pandemic will be on the economy, but economists can give some sense of the scope of the problem from prior recessions and other indicators.¹⁸ Major private sector economists are projecting a significant decline in gross domestic product in the second quarter.¹⁹

These projections incorporate the effects of the large rise in unemployment. The Economic Policy Institute, for example, projects a loss of 20 million jobs by the summer. That would translate to an unemployment rate of 15.6 percent by summer, up from 3.5 percent in February and 4.4 percent in March.²⁰ The Congressional Budget Office projects an unemployment rate of 12 percent by the third quarter (July to September) that stays high into 2022.²¹ Goldman Sachs also projects an unemployment peak of 15 percent by the third quarter (July to September) but warns that there will likely also be many additional people who want a job but are not actively looking because of the lack of available jobs (they must be actively looking to be officially classified as unemployed).²² In the 2001 recession, the unemployment rate rose only 1.8 points, to 5.8 percent; in the Great Recession it hit 9.8 percent, a rise of 4.8 points.

Higher unemployment and the plummeting stock market will depress state income tax collections, which make up 37 percent of state tax revenue. Some 69 percent of taxable income comes from wages, which will shrink as businesses lay off workers and self-employed workers begin to lose income.

Additionally, the stock market drop will turn the capital gains of the last ten years into capital losses, and dividend income will decline. Capital gains and dividends make up 12 percent of adjustable gross income on average but comprise a much higher share of high-wealth individuals' income. About 69 percent of capital gains go to the top 1 percent of taxpayers.²³ In states with graduated income taxes, these wealthy taxpayers are taxed at higher rates, so drops in investment income have a larger effect on collections.

¹⁸ Josh Barro, "Nobody Knows How Hard Coronavirus Will Hit the Economy — or Even Their Own Company," *New York*, March 17, 2020, <https://nymag.com/intelligencer/2020/03/how-hard-will-coronavirus-hit-the-economy-nobody-knows.html>.

¹⁹ *Wall Street Journal*, "Newsletter: How Deep and How Long for a Downturn?" March 17, 2020, <https://blogs.wsj.com/economics/2020/03/17/newsletter-how-deep-and-how-long-for-a-downturn/>.

²⁰ David Cooper and Julia Wolfe, "Nearly 20 million workers will likely be laid off or furloughed by July," Economic Policy Institute, April 1, 2020, <https://www.epi.org/blog/nearly-20-million-jobs-lost-by-july-due-to-the-coronavirus/>.

²¹ Phillip L. Swagel, "Updating CBO's Economic Forecast to Account for the Pandemic," Congressional Budget Office, April 2, 2020, <https://www.cbo.gov/publication/56314>.

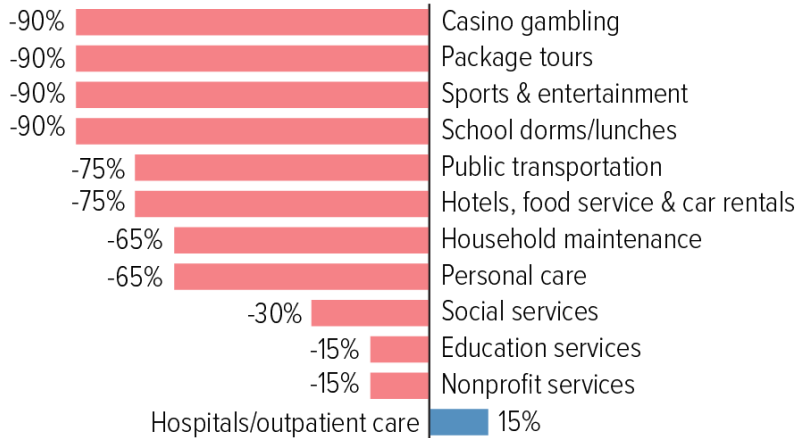
²² Goldman Sachs, *op. cit.*

²³ Elizabeth McNichol, "State Taxes on Capital Gains," CBPP, December 11, 2018, <https://www.cbpp.org/research/state-budget-and-tax/state-taxes-on-capital-gains>.

FIGURE 2

Service Industries Hardest Hit By COVID-19 Outbreak

Projected change in spending in late March and April compared to pre-COVID-19 estimates



Source: Goldman Sachs

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Sales tax collections will also fall because the rise in unemployment will reduce consumer spending significantly.²⁴ Sales taxes, which make up 32 percent of state tax revenue and 13 percent of local government tax revenue, depend on retail sales. Aside from purchases of food (which is often exempt from the sales tax) and essential household supplies, consumers are shopping and spending less as they avoid going out. The hospitality and travel industries will be hard hit, at least in the short term, as states order restaurants and bars to close and travel is limited. These drops will depress general sales tax collections, special taxes such as alcohol taxes, and higher taxes levied in some states on restaurant meals as well as local and state hotel taxes.

Disrupted supply chains, business shutdowns, and social distancing are reducing sales substantially. Goldman Sachs has estimated that consumer spending in service industries will fall in late March and April compared to its original projections for this period. (See Figure 2.) For the hardest-hit sectors (sports and entertainment, casinos, and package tours), it expects spending to plummet by 90 percent, while public transit, hotels, restaurants, and car rental agencies are expected to see declines of 75 percent.²⁵

State taxes on corporate profits, which currently make up about 5 percent of state tax revenue (\$48 billion in state fiscal year 2018), are also likely to drop sharply. Corporate profits are the difference between corporate receipts and corporate expenses — a narrow margin. Accordingly, increases in corporate expenses (such as those that might result from having to bid more for production inputs at a time when foreign supply chains have shut down) and revenue drops

²⁴ CBPP Calculations of IRS 2017 income tax statistics.

²⁵ “US Daily: A Sudden Stop for the US Economy,” Goldman Sachs, Economics Research, March 20, 2020, <https://www.goldmansachs.com/insights/pages/gs-research/us-daily-20-mar-2020/report.pdf>.

resulting from decreased customer demand can have a disproportionate impact on the size of that margin and thus the corporate tax base. During the Great Recession, quarterly state corporate tax receipts fell 38 percent from the fourth quarter of 2007 (when the recession began) to their lowest point in the fourth quarter of 2008. They did not regain their pre-Great-Recession peak in nominal terms until the first quarter of 2019 and have yet to do so after taking inflation into account (although that is due in part to state policy changes that have reduced the yield of the tax).

Tribal Governments' Challenges Are Growing

By providing \$8 billion for 574 federally recognized tribes in the Coronavirus Relief Fund, the CARES Act marked a historic federal recognition of tribes — contrasting sharply with the 2009 Recovery Act, which excluded tribes from its major state fiscal relief. Still, policymakers will need to include more stimulus funding for tribes in future relief bills because they're especially vulnerable to COVID-19's health and economic effects.^a

American Indian and Alaska Native families are more vulnerable to the pandemic than U.S. residents overall due to the legacies of colonialism, racism, and the federal government's failure to support these communities' social and economic well-being.^b That has left tribal governments facing unique challenges in the current environment, including:

- **A higher risk of COVID-19 complications.** Despite health disparities between American Indians and Alaska Natives and the overall population, the federal Indian Health Service budget was meeting just half of tribal health needs even before COVID-19, the U.S. Commission on Civil Rights reported. The pandemic will stretch those funds to the breaking point. American Indians and Alaska Natives also have higher rates of underlying medical conditions^c — such as heart disease, lung disease and asthma, diabetes, kidney and liver disease, and immune-compromising diseases — putting them at higher risk for COVID-19's more dangerous effects.
- **Housing and demographic challenges.** Federal underfunding of tribal governments and communities has created a housing shortage on reservations that makes it hard for families to practice the social distancing needed to combat the virus. Sixteen percent of American Indian and Alaska Native households in tribal areas are overcrowded, compared to just 2 percent for all U.S. households. And while older people generally are among those more susceptible to the virus' health effects, that's especially true for American Indian and Alaska Natives: 10 percent of those aged 50 and older live in multigenerational households,^d versus 6.5 percent of their counterparts in the general population, partly given many tribal cultures' emphasis on community and multigenerational living.
- **Historic economic challenges.** The virus and the sharp economic downturn that's gathering momentum are disproportionately affecting large and important sections of tribal economies: gaming, tourism, hotels and conferences, retail, and resource and energy development. And unlike federal, state, and local governments, many tribal nations lack a tax base. Instead, they use tribal enterprises and member-owned businesses to generate vital revenue for public health, education, child care, and public safety, as well as for general government operations. Tribes are often their region's largest employers and among the state's largest, employing both Native and non-Native workers.

All of that makes it incredibly hard for tribal governments to respond to COVID-19 and the coming recession. Moreover, the federal government has been slow to help tribes during this crisis. Only half of tribal governments surveyed as of March 13 had received COVID-19-related information from the federal or state governments, according to the National Indian Health Board, and fewer than a fifth had received money, technical assistance, or supplies. Most alarming: only 3 percent had diagnostic kits and some tribal communities reported receiving five or fewer test kits.

Given tribal communities' vulnerabilities, policymakers will need to do more in future aid packages to address their health, housing, and economic challenges.

a National Congress of American Indians, "Stimulus Priorities," March 20, 2020, <http://www.ncai.org/Covid-19/indian-country-priorities-for-covid19-stimulus-package>.

b U.S. Commission on Civil Rights, "Broken Promises: Continuing Federal Funding Shortfall for Native Americans," December 2018, <https://www.usccr.gov/pubs/2018/12-20-Broken-Promises.pdf>.

c "Profile: American Indian/Alaska Native," U.S. Department of Health and Human Services Office of Minority Health, March 28, 2018, <https://www.minorityhealth.hhs.gov/omh/browse.aspx?lvl=3&lvlid=62>.

d Nancy Pindus *et al.*, “Housing Needs of American Indians and Alaska Natives in Tribal Areas: A Report From the Assessment of American Indian, Alaska Native, and Native Hawaiian Housing Needs,” U.S. Department of Housing and Urban Development Office of Policy Development and Research, January 2017, <https://www.huduser.gov/portal/sites/default/files/pdf/HousingNeedsAmerIndians-ExecSumm.pdf>.

e Maria Givens, “The coronavirus is exacerbating vulnerabilities Native communities already face,” Vox, March 25, 2020, <https://www.vox.com/2020/3/25/21192669/coronavirus-native-americans-indians>.

Recent Recessions Give a Sense of the Coming State Revenue Losses

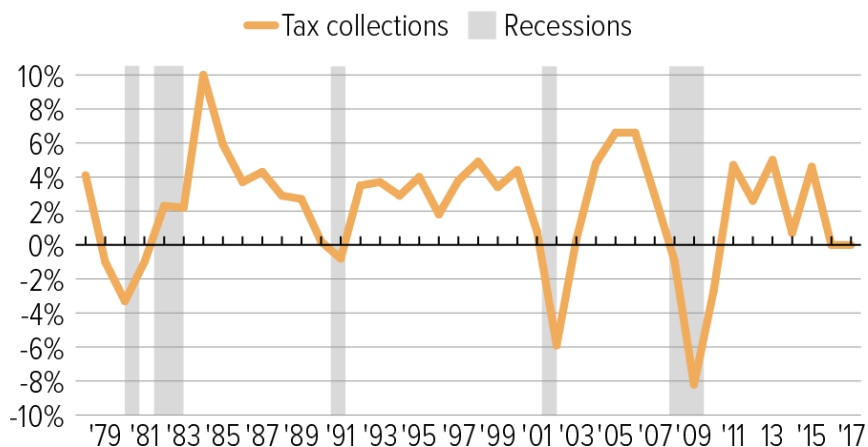
Revenue losses during economic downturns lead to state budget shortfalls because states must maintain education, health care, public safety, transportation, and other services. In addition, they incur new costs assisting those who have lost jobs and income as a result of the downturn.

State budget shortfalls reached about \$230 billion in 2010, the worst year of the last recession, (adjusted only for inflation, and not including city and county shortfalls). The gaps between available resources and the amount of funds needed to maintain services for state residents totaled more than \$600 billion between fiscal year 2009 and fiscal year 2013.

FIGURE 3

State Tax Collections Drop During Recessions

Percent change in annual tax collections, fiscal years 1976-2017



Source: CBPP calculations of census data

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In the two most recent recessions, sales tax receipts dropped first and income tax revenues followed soon after with larger declines. In the relatively mild recession of 2001, annual state tax collections dropped \$25 billion (4.5 percent) between 2001 and 2002. In the Great Recession, state tax collections dropped by \$100 billion (11.0 percent) between 2008 and 2010. (See Figure 3.) An 11 percent decline in state tax collections would total \$110 billion today. In a typical year, state tax collections would grow by about 3.5 percent or \$35 billion, enough to cover normal growth in costs like school enrollment and inflation.

In very rough terms, then, a recession the size of the Great Recession could cause a swing in state tax revenues from \$35 billion in growth to \$110 billion in loss, a net loss of \$145 billion in annual tax revenues. But current economic projections suggest that this recession will be considerably deeper than the Great Recession.

Examining the relationship between unemployment and state tax collections is another way to estimate the potential revenue loss. Estimates prepared based on recent recessions suggest that each 1 percentage point increase in unemployment leads to a \$41 billion drop in state tax revenues plus an increase in Medicaid costs, for a total impact of \$45 billion.²⁶

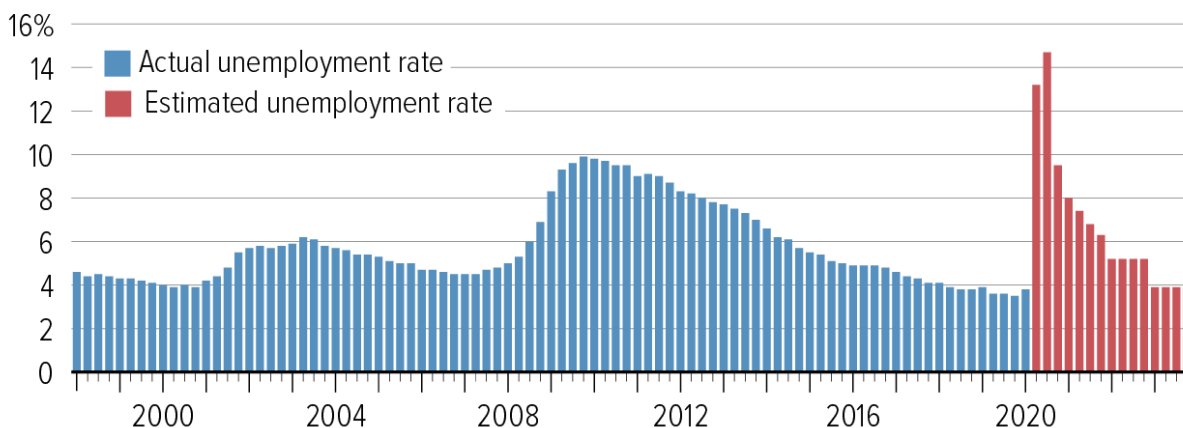
Goldman Sachs projects that the average unemployment rate in fiscal year 2021 will be 9.9 percent, up from the 3.6 percent average in the 12-month period ending in February 2020. (See Figure 4.) That increase in unemployment of over 6 percentage points would result in a revenue decline of over \$290 billion. In addition, the current job losses will lead to estimated state shortfalls of \$105 billion this fiscal year, and the lingering effects of the recession will likely result in another \$105 billion in shortfalls in fiscal year 2022.

All told, based on that rule of thumb, *states will face estimated shortfalls of some \$500 billion between now and 2022*. Because of physical distancing measures and direct costs to respond to the virus, this recession is likely to result in even deeper revenue declines, as well as larger increases in state costs, than that rule of thumb would suggest. And the full impact on state and local governments will be larger as local governments will also lose significant tax revenue.

²⁶ Matthew Fiedler, Jason Furman, and Wilson Powell III, “Increasing Federal Support for State Medicaid and CHIP Programs in Response to Economic Downturns,” Brookings Institution, May 2019, https://www.brookings.edu/wp-content/uploads/2019/05/ES_THP_FFP_web_20190506.pdf. Note: The pandemic-induced recession is different from previous recessions in a number of ways including how swiftly and how far employment will drop. Thus, the actual relationship between unemployment and state revenues in this downturn may differ from the historical pattern.

FIGURE 4

Response to COVID-19 Driving Skyrocketing Unemployment



Source: Actual: Bureau of Labor Statistics; Estimated: Goldman Sachs quarterly estimates from 2020 and 2021 and annual estimates for 2022 and 2023, (April 1 2020)

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State Budget Reserves Won't Be Enough to Close Gaps

States can draw on reserves to help them cover some of these near-term costs, but these reserves likely will prove far from adequate. Most states acted responsibly and took advantage of the economic expansion to restore their rainy day funds, which are reserves designated for use when revenues drop unexpectedly or when unanticipated spending needs arise. The median state rainy day fund stood at 7.6 percent as a share of general fund expenditures at the end of the last fiscal year, higher than just before the last recession, when it equaled 5 percent of expenditures.

Many states also maintain reserves that are not designated for specific purposes or they end fiscal years with unspent balances. States can use the combination of designated rainy day funds and other balances to weather situations when revenues decline or spending needs rise unexpectedly. State rainy day funds combined with other balances totaled 11.6 percent of spending in 2006, the high point before the Great Recession. But in that recession, rainy day funds and other reserves enabled states to cover only about 9 percent of their budget shortfalls. (See Figure 5.)

States are somewhat better prepared this time, with rainy day funds and other balances totaling 13.0 percent of spending in 2019.²⁷ State rainy day funds held a total of \$75 billion at the end of fiscal year 2019, far below the projected budget shortfalls. But even combined with other reserves, it's unlikely that those funds will be close to enough for states to avoid deep spending cuts, tax

²⁷ National Association of State Budget Officers, "The Fiscal Survey of States: An Update of State Fiscal Conditions," Fall 2019, https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO_Fall_2019_Fiscal_Survey_of_States_S.pdf.

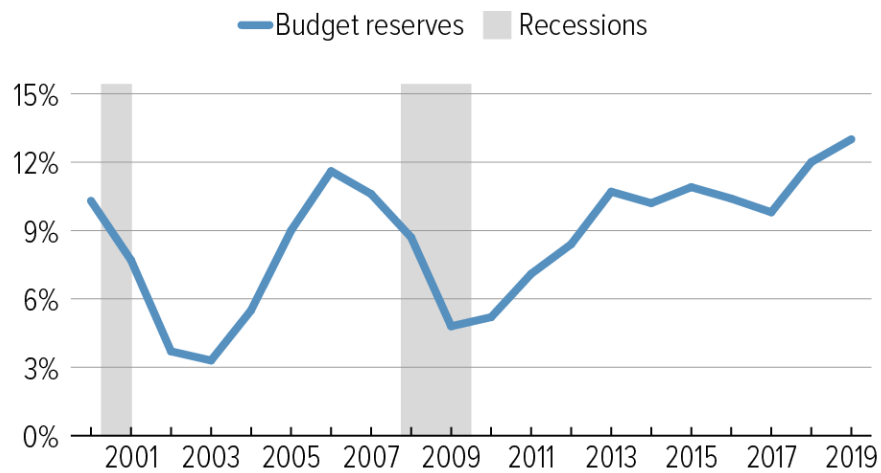
increases, or both as they deal with the costs of the COVID-19 response and a recession. Moody's estimated in October 2019 that only about 13 states were prepared for a severe recession.²⁸

As noted above, several states, including Maryland and Washington, have already begun to draw down reserves to fund increased public health and other costs. Puerto Rico's Financial Oversight and Management Board has also approved the use of \$160 million from the Commonwealth's Emergency Reserve to deal with the virus.²⁹

FIGURE 5

State Budget Reserves Climbed During Economic Expansion

Total balances as share of general fund expenditures



Source: NASBO Fiscal Survey of the States

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²⁸ Sarah Crane and Colin Seitz, "Stress-Testing States 2019," Moody's Analytics, October 2019, <https://www.moodyanalytics.com/-/media/article/2019/stress-testing-states-2019.pdf>.

²⁹ David A. Lieb, "States turn to cash reserves as coronavirus strains budgets," Associated Press, March 15, 2020, <https://apnews.com/2121f9adf0b53e6a8b3abcdcae2562c3>; National Association of State Budget Officers, "Summaries of State Actions," March 13, 2020, <https://www.nasbo.org/mainsite/resources/coronavirus-resources/summaries-state-actions>.

Federal Loans to States Are Not the Answer

The CARES Act provides \$454 billion to the Federal Reserve System to buy public and private debt, including notes issued by states and localities.^a One purpose of this fund is to support the municipal bond market by purchasing debt that has already been issued. But the Federal Reserve has announced that it will go further and purchase newly issued short-term notes — that is, debt that matures in less than two years — which would effectively mean making loans to states and localities. While these loans are an important way to help states address immediate revenue declines while they look for longer-term solutions, they are no substitute for the direct aid that states need. And making it easier for states to borrow money to cover the revenue shortfalls they are facing as a result of the pandemic rather than providing grants won't be workable for all states. Some states might not be able to borrow these funds, and many that could wouldn't want to because it would worsen the difficult fiscal situation they'll face after the effects of COVID-19 fade.

The constitutions of four states (Arizona, Colorado, Indiana, and Nebraska) prohibit debt altogether, which could make it impossible for them to accept the loans.^b At least 12 other states require voter approval of debt backed by general tax revenue,^c which this debt would be. It would take time until such measures could be placed on state ballots and voted on.

State balanced budget requirements may well constrain states' ability to borrow under the new Federal Reserve Program even further. According to a compilation by the National Conference of State Legislatures, 38 states cannot carry a deficit from one fiscal year into the next (or, if the state enacts a two-year budget, from one biennium into the next).^d As a result, the many states with fiscal years beginning on July 1, 2020 may have to wait until then to borrow from the Fed and may have to repay any loans by June 30, 2021.

Even states that didn't face these barriers would likely be hesitant to rely too heavily on loans, which would add to the budgetary obligations they'll face when economic conditions improve.

In response to sharp increases in unemployment, states often borrow heavily from the federal unemployment insurance trust fund to finance the basic 26 weeks of unemployment benefits for which they are responsible. In the wake of the Great Recession, 36 states borrowed \$40 billion, debt that they did not fully pay off until 2018 — a decade after the recession began. (Since this is borrowing for a state trust fund rather than for state general fund expenses, the legal limitations noted above do not apply.)

States' budget reserves will help them cope with the coming large drops in revenues, but those reserves will be depleted in most states by the time the economy recovers. If states do not rebuild them when the economy recovers, they'll be much less prepared for the next recession — and more likely to need substantial federal help when it hits. Paying back these loans would compete with, and in many cases render impossible, the rebuilding of reserves.

States also will have to repay any money they've borrowed from themselves (e.g., from state pension funds and future revenue streams) to balance their budgets as the economy recovers.

And states will need additional revenues to restore an appropriate level of public services in the aftermath of the deep cuts they may make in education and other critical areas.

Facing these pressures, states will be hard pressed to raise billions of dollars more in taxes or make billions of dollars more in budget cuts to repay federal loans.

We can't afford to rely too heavily on loans, which will provide only temporary aid to states to help them weather the economic downturn. With the economy weak, high unemployment looming, and state revenues faltering, Congress should give the states grants, not loans.

a "Federal Reserve takes additional actions to provide up to \$2.3 trillion in loans to support the economy," Board of Governors of the Federal Reserve System, April 9, 2020.

b “Strategies for Managing State Debt,” Pew Charitable Trusts, June 2017,

https://www.pewtrusts.org/~media/assets/2017/06/sfh_strategies_for_managing_state_debt_final.pdf.

c An additional nine states require voter approval in certain circumstances, such as to exceed a statutory limit or as an alternative to legislative approval.

d National Conference of State Legislatures, “NCSL Fiscal Brief: State Balanced Budget Provisions,” October 2010, <https://www.ncsl.org/documents/fiscal/StateBalancedBudgetProvisions2010.pdf>. See also National Association of State Budget Officers, “Budget Processes in the States,” Spring 2015, pp. 52-54, <https://www.nasbo.org/reports-data/budget-processes-in-the-states>.

Spending Cuts Will Hurt Families and Communities, Slow Economic Recovery

Deep state spending cuts hurt the families and communities that depend on state services, and they slow the economy’s recovery from a recession. After the Great Recession, state and local spending cuts were a drag on the economy’s growth for years after the recession ended. They seriously damaged their education systems and other public investments that (when properly funded) promote opportunity and reduce inequities. And states often don’t fully restore the areas that they cut, making further spending cuts especially harmful.³⁰

That’s what happened in the Great Recession, when states faced budget shortfalls of more than \$600 billion. While emergency federal aid and state reserve drawdowns helped reduce the damage, states cut spending by \$290 billion and raised taxes and fees by \$100 billion to close the budget gaps. (Tax and fee increases also can slow the economy in a recession, but typically to a lesser extent than spending cuts.³¹) These steep state and local spending cuts, which included steep layoffs, added to the economy’s freefall and were a drag on the economy’s growth for years after the recession ended.

States and localities started laying off workers in summer 2008, the start of the first state budget cycle under the recession. Layoffs then continued *for the next five years*; by summer 2013 states and localities had laid off nearly 750,000 people. Over the recovery’s official first two years — June 2009 to June 2011 — the private sector added about 1.3 million jobs, but states and localities cut 450,000 jobs.

Further, during the last recession and its aftermath, many states and localities took steps that worsened racial and class inequities. For instance, instead of protecting the quality of public schools, keeping college costs down, and properly maintaining public infrastructure such as clean water systems and transportation networks — all crucial for expanding quality of life and economic opportunity — most states and localities relied heavily on cuts to these investments. In the years after 2010, many states concentrated even more financial power in the hands of a privileged few by cutting taxes for wealthy households or corporations, which precipitated even more public service funding cuts. And various states worsened inequities in other ways, such as by cutting unemployment benefits and increasing criminal legal fees that often result in jailing people for being poor.

³⁰ Michael Leachman, Elizabeth McNichol, and Erica Williams, “States Can Make Progress Against Racial and Economic Inequities, Even in a Recession,” CBPP, forthcoming.

³¹ Nicholas Johnson, “Budget Cuts or Tax Increases at the State Level: Which Is Preferable When the Economy Is Weak?” CBPP, updated April 28, 2010, <https://www.cbpp.org/research/budget-cuts-or-tax-increases-at-the-state-level>.

The federal government’s major fiscal policy response to the downturn, the American Reinvestment and Recovery Act, limited the harm done by helping states avoid further budget cuts, saving jobs, and reducing the struggles of many of those hit hardest by the downturn. But states themselves often chose policies that made things worse.³² For example, at least partly due to these cuts, states across the country now have:

- **Weaker unemployment insurance (UI) systems.** UI helps jobless workers and their families make it through the difficult period after a layoff. The assistance — which workers effectively pay for themselves through lower wages that they would otherwise be paid — is crucial both to families and the broader economy during a recession, since those families can sustain at least a portion of their consumption. After the Great Recession, though, some states sharply reduced the assistance jobless workers may receive by, for example, cutting back on the number of weeks workers receive benefits. Further, UI systems nationally are antiquated, built for an economy in which far fewer workers than today were employed part time or as independent contractors. Many states have failed to adopt available reforms that would address that issue, leaving many workers ineligible for regular state benefits. The CARES Act provides substantial federally funded UI benefits that jobless workers can receive in coming months, but these are time limited, and next year — when they are no longer available — the weaknesses in state systems will once again be evident.³³
- **Crumbling public infrastructure.** State and local spending on infrastructure as a share of the economy declined steeply during the Great Recession and has continued to fall. Infrastructure spending as a share of GDP is now lower than it has been since the 1950s despite a clear need.³⁴
- **Major teacher shortages.** Deep state funding cuts led to teacher layoffs and cuts in teacher compensation relative to other similarly qualified workers.³⁵ As of 2018, schools nationwide needed about another 110,000 qualified teachers, according to the best available estimate.³⁶

³² See Elizabeth McNichol, “Out of Balance,” CBPP, April 18, 2012, <https://www.cbpp.org/research/out-of-balance>; and Michael Leachman and Chris Mai, “New CBO Report Finds Hundreds of Thousands of People Still Owe Their Jobs to the Recovery Act,” CBPP, updated May 12, 2012, <https://www.cbpp.org/research/new-cbo-report-finds-hundreds-of-thousands-of-people-still-owe-their-jobs-to-the-recovery?fa=view&id=3784>.

³³ For a summary of the federally funded UI improvements in the CARES Act, see Sharon Parrott *et al.*, “CARES Act Includes Essential Measures to Respond to Public Health, Economic Crises, But More Will Be Needed,” CBPP, March 27, 2020, <https://www.cbpp.org/research/economy/cares-act-includes-essential-measures-to-respond-to-public-health-economic-crises>.

³⁴ Elizabeth C. McNichol, “It’s Time for States to Invest in Infrastructure,” CBPP, updated March 19, 2019, <https://www.cbpp.org/sites/default/files/atoms/files/2-23-16sfp.pdf>.

³⁵ Sylvia A. Allegretto and Lawrence Mishel, “The teacher pay gap is wider than ever: Teachers’ pay continues to fall further behind pay of comparable workers,” Economic Policy Institute, August 9, 2016, <https://www.epi.org/files/pdf/110964.pdf>.

³⁶ Lieb Sutchter *et al.*, “A Coming Crisis in Teaching? Teacher Supply, Demand, and Shortages in the U.S.,” Learning Policy Institute, September 2016, https://learningpolicyinstitute.org/sites/default/files/product-files/A_Coming_Crisis_in_Teaching_REPORT.pdf.

Further, many of the teachers already in the classroom are not fully certified or lack educational background in the primary subject they are teaching.³⁷

- **Much higher tuition at public universities, with particularly harmful effects for low-income students and students of color.** Deep state funding cuts have had major consequences for public colleges and universities since states fund over half of the costs of teaching and instruction at these schools. Over the last decade, annual published tuition at four-year public colleges has risen by 37 percent, even after adjusting for inflation.

Congress Should Provide Substantial Additional State Fiscal Relief

The aid federal policymakers have provided thus far falls far short of what states will need to avoid harmful cuts. As described above, states appear on the brink of shortfalls that could total an estimated \$500 billion, mostly concentrated in a single state fiscal year — the one that begins in less than three months. Congress has provided some fiscal aid to states, and states have rainy day funds they can draw down, but — even after accounting for these forms of revenue — states still face shortfalls of as much as \$360 billion, not including the substantial new costs they face to combat the COVID-19 virus.

The FMAP increase in the Families First legislation will provide about \$35 billion if the public health emergency lasts through the end of this calendar year. The state fiscal aid provisions in the CARES Act will provide additional support, but not enough. The Act's Coronavirus Relief Fund will provide up to about \$110 billion in aid to states, and another roughly \$20 billion in aid to populous cities and counties, all of which must be spent before the end of calendar year 2020. While this is a substantial amount, its usefulness could be severely limited if Treasury interprets the bill's language to bar states from using the funds to close revenue shortfalls, as it reportedly is considering doing.³⁸ The CARES Act also includes a \$30 billion Education Stabilization Fund, which could serve as fiscal relief but requires states to sustain their pre-crisis school funding levels unless the Department of Education grants an exception. Other provisions in the Act, such as funding for transit agencies and airports, will not provide much state budget support, since these funds will flow primarily to local governments or other governmental entities.

If states are not able to use *any* of the \$110 billion in the Coronavirus Relief Fund to close revenue shortfalls — that is, if Treasury adopts a restrictive interpretation — they will be left with the FMAP increase and the education funds (\$65 billion in total) from the CARES Act for this purpose. They would be about \$435 billion short of closing their projected shortfalls in the current, upcoming, and subsequent fiscal years. If, on the other hand, they can use all of the Coronavirus Relief Fund to close revenue shortfalls, states will need roughly another \$325 billion.

States can use their rainy day funds to close a portion of this gap, but those funds, as well, will fall far short of what's needed. State rainy day funds contained a total of \$75 billion as of the end of the last fiscal year. (The size of rainy day funds differs significantly by state.)³⁹ Using all of these funds

³⁷ Emma García and Elaine Weiss, "The teacher shortage is real, large and growing, and worse than we thought," Economic Policy Institute, March 26, 2019, <https://www.epi.org/files/pdf/163651.pdf>.

³⁸ Congressional Research Service, "The Coronavirus Relief Fund (CARES Act, Title V): Background and State and Local Allocations, April 1, 2020, <https://crsreports.congress.gov/product/pdf/R/R46298>.

³⁹ Leachman and Sullivan, *op. cit.*

would leave roughly \$360 billion in remaining shortfalls, assuming they cannot use the Coronavirus Relief Fund to address the revenue crisis.

Further, these shortfall figures are for *states only*. Local governments and tribes also need additional fiscal relief, as discussed below.

Congress and the President should provide both additional Medicaid funding for states, and additional, flexible fiscal support. For example, they could extend a modified version of the Coronavirus Relief Fund without restrictions on states' use of these funds to close revenue shortfalls.

While forecasters including the Congressional Budget Office and Goldman Sachs project unemployment will remain elevated through next year, Congress should design additional aid to *automatically* respond to economic conditions, so that states would receive less assistance if these projections prove too pessimistic, but more if unemployment remains elevated through 2022 and beyond.

Provide Additional Medicaid Funding for States

Congress' priority should be to immediately increase the modest, time-limited FMAP boost linked to the public health emergency included in the Families First legislation.⁴⁰ Those increases should take effect now and continue until economic indicators signal that the economic downturn has ended and a recovery has taken hold. For example, the Take Responsibility for Workers and Families Act, introduced in the House, would provide additional increases in federal Medicaid match rates that would rise based on state unemployment rates and would end only when unemployment rates return to normal levels.

Securing a provision structured along these lines should be a top priority for the next COVID-19 response bill. FMAP increases, unlike other forms of fiscal relief, automatically adjust based on the costs that states are facing, allowing Congress to direct relief to the most affected states and to continue aid until it's no longer needed. Crucially, extending an FMAP increase would also make it possible to continue maintenance-of-effort requirements that keep states from cutting Medicaid coverage and eligibility.

Congress should also increase the Medicaid expansion match to 100 percent for the duration of the public health emergency. The Affordable Care Act's (ACA) Medicaid expansion covers over 4 million people aged 50-64 (about a quarter of the expansion population) as well as millions of people of all ages whose chronic health conditions put them at elevated risk for COVID-19. Encouraging states that haven't expanded Medicaid under the ACA to do so would be among the highest-impact ways to expand coverage, make sure more people get tested and treated for the virus, prevent sharp increases in uninsured rates if people lose their jobs due to an economic downturn, and provide additional fiscal stimulus.

⁴⁰ Jennifer Sullivan, "Medicaid Funding for States Can't Wait," CBPP, March 12, 2020, <https://www.cbpp.org/blog/medicaid-funding-boost-for-states-cant-wait>.

Provide Additional Needed State and Tribal Fiscal Relief

Adopting an FMAP increase tied to state unemployment rates as described above would give states substantial fiscal relief, but not enough to fill the large budget shortfalls they'll almost certainly face. The FMAP increase in the Take Responsibility for Workers and Families Act is calibrated to cover about two-thirds of the budget shortfalls states will face as unemployment rises above a threshold level.⁴¹ States would need additional fiscal relief even if federal policymakers enacted that FMAP provision in full, and especially if they enacted a scaled-back version.

If Congress fails to adopt this improved FMAP policy soon, and without additional fiscal relief, states will face a severe fiscal crisis. One option would be to extend the Coronavirus Relief Fund beyond the end of this calendar year, offer substantially more funding, and eliminate the potential restrictions on its use to fill revenue shortfalls, and thereby avert economically damaging state budget cuts or tax increases.

As noted in the box above, American Indians and Alaska Natives are particularly vulnerable to COVID-19, and many tribal revenue systems are especially threatened. As such, Congress will need to take additional steps to assist with the severe fiscal challenges tribes face. For example, the \$8 billion set aside for tribes included in the Coronavirus Relief Fund falls far short of the amount tribes will need and additional funds should be provided in any new package. The National Congress of American Indians recommends an additional \$12 billion, to total at least \$20 billion.⁴² In addition, Congress should provide funds to address specific urgent needs, such as increased Indian Housing Development block grants that provide federal funding for affordable housing on Indian reservations and Indian areas.

Include Aid to Local Governments While Providing Adequate State Fiscal Relief

Local governments — which provide crucial government services including clean water, health services, assistance to seniors, fire and other public safety services, and community assets such as parks and libraries — also face a difficult fiscal crisis in the year or two ahead, compounding the harm the recession may do to families and communities across the country. The local fiscal crisis has already begun since localities typically rely, though to a lesser extent than states do, on sales and income taxes and other revenue sources that are falling precipitously. At the same time, since localities rely much more heavily on property taxes — which will hold up better in the short term — localities' fiscal crisis is more likely to build in the year ahead. If the downturn causes property values to decline, as some predict, localities' fiscal crisis won't peak until properties are newly assessed, which can happen a year or more after the values fall.⁴³ Historically, local government revenues have

⁴¹ For more details, see Matthew Fiedler and Wilson Powell III, "States will need more fiscal relief. Policymakers should make that happen automatically," USC-Brookings Schaeffer on Health Policy, April 2, 2020, <https://www.brookings.edu/blog/usc-brookings-schaeffer-on-health-policy/2020/04/02/states-will-need-more-fiscal-relief-policymakers-should-make-that-happen-automatically/>.

⁴² National Congress of American Indians, "Stimulus Priorities," March 20, 2020, <http://www.ncai.org/Covid-19/indian-country-priorities-for-covid19-stimulus-package>.

⁴³ Jacob Passy, "America's housing market is showing the first signs of trouble from the coronavirus pandemic," MarketWatch, April 6, 2020, <https://www.marketwatch.com/story/americas-housing-market-is-showing-the-first-signs-of-trouble-because-of-the-coronavirus-pandemic-2020-04-02>.

been significantly more stable than state revenues, since property tax revenues fluctuate much less than the sales and income taxes that states rely upon.

Like states, local governments must balance their budgets, so in the absence of fiscal relief, revenue shortfalls will lead to layoffs and other cuts that will worsen the downturn. Congress could target a portion of the aid in its next COVID-19 legislation to local governments, including relatively small cities and counties. This important aid should not, however, come at the expense of adequate aid to states. In addition, such aid should be provided through a mechanism that is simple for Treasury to administer, to speed the arrival of fiscal relief before localities begin making cuts.

Under the CARES Act's Coronavirus Relief Fund, localities will receive roughly 21 percent of total state allocations.⁴⁴ Congress could consider duplicating the share of total state allocations provided to localities through the Coronavirus Relief Fund. Under this scenario, Congress would provide local governments with \$1 in local aid for roughly every \$3.60 in state aid.

Finally, Congress should consider additional direct aid to local governments, including for public transit systems, which have lost much of their fare revenue as a result of stay-at-home directives — losses that many of these systems will likely have difficulty recovering from and that will further strain local budgets, risking cuts in other important public services.

CARES Act Aid to the District of Columbia and Territories Falls Short

The CARES Act includes aid to the District of Columbia and territories, but the amount falls far short of what they need.

Under the Coronavirus Relief Fund, the District of Columbia is not classified as a state and thus received less than half the minimum \$1.25 billion that states did. But the District faces the same growing costs and falling revenues as the states. It was treated as a state in the 2009 Recovery Act and is included with states in the CARES Act Education Stabilization Fund.

Territories need additional aid, too. For example, the most populous of the territories — Puerto Rico — faces extraordinary difficulties in containing and responding to the COVID-19 pandemic. Unlike the rest of the country, Puerto Rico experienced an extended period of economic adversity even before the current crisis. The Commonwealth has faced a virtually uninterrupted economic decline since 2006, as it has confronted multiple powerful economic shocks including hurricanes, earthquakes, and bankruptcy. Other territories, such as the U.S. Virgin Islands, have also faced acute economic stress over the last couple of years.

The District of Columbia should be treated as a state in future allocations of federal aid *and receive additional aid* because of the inadequate amount it received under the CARES Act. Puerto Rico and all the territories should also receive additional aid in recognition of the multiple challenges they face.

⁴⁴ See “How Will States and Localities Divide the Fiscal Relief in the Coronavirus Relief Fund?” CBPP, <https://www.cbpp.org/research/state-budget-and-tax/how-will-states-and-localities-divide-the-fiscal-relief-in-the>. This estimate assumes that Treasury will not allow overlapping jurisdictions such as Cook County and the City of Chicago to double count the same residents. If Treasury does allow this sort of double-counting, localities overall will receive a somewhat higher share of total state allocations.