Fiscal Effects of COVID-19 on State and Local Budgets

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Why Worry About State and Local Revenues?

Balanced budget requirements: when revenues fall, need to cut spending or increase taxes.

This is bad for people in the state. Better to smooth through the cost of a shock over many years.

Bad for the economy.

- State and local government a big player. Account for 13% of employment.
- Extremely slow recovery in state and local sector following Great Recession slowed overall economic recovery.

This Recession is Different

Last spring, many people were warning about huge revenue losses given surge in unemployment. But losses much smaller than anticipated.

Unemployment fell faster than anticipated.

Relationship between unemployment and revenues different than in past recessions.

- This recession an “especially” low-income recession, meaning loss of tax revenues is less.
- UI benefits taxable in most states, so large increases in UI protected income tax revenues.
- Stock market and housing market have done well – capital gains and property taxes robust.
- BUT – larger declines in sales taxes and other taxes– especially related to transportation.

What is condition of state and local budgets?

Reasonable estimate is that losses will be about $350 billion over 3 years (2020-2022).

States and local governments have received about $400 billion in aid—none of it meant to cover general revenue losses, but much of it probably relatively flexible.

But COVID also created new expenses. Unclear how much.

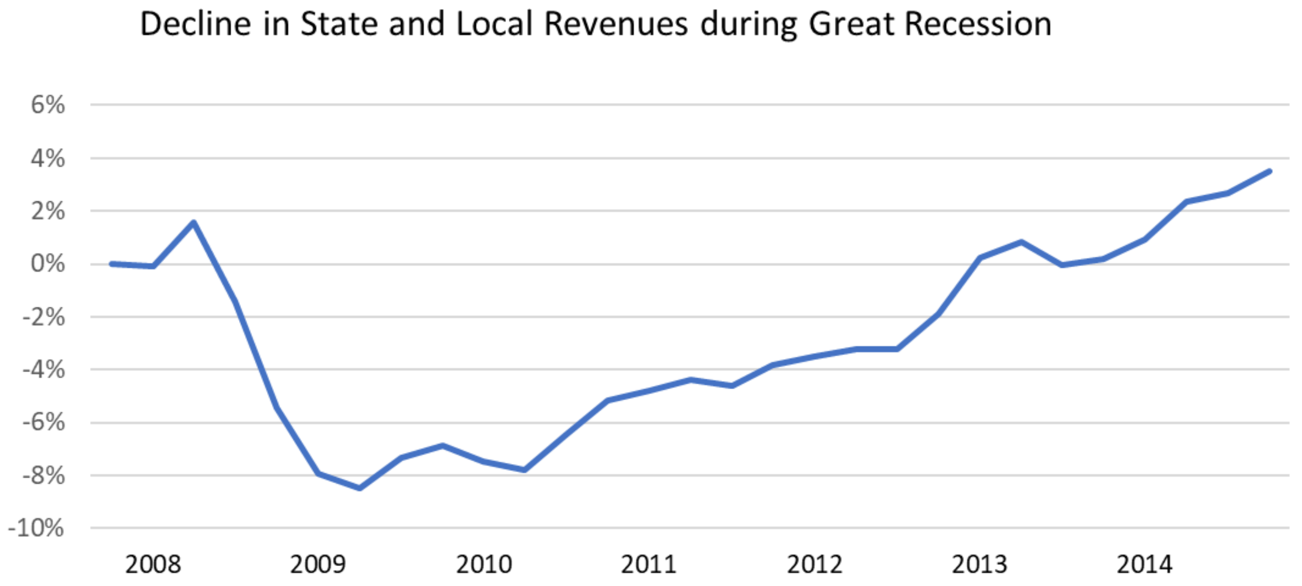
And some states—particularly those dependent on tourism and energy—are facing difficult budget conditions and there is a lot of heterogeneity within states too.

Revenue Losses Much Smaller than in GR

This recession: real own-source revenues (revenues ex. federal grants):

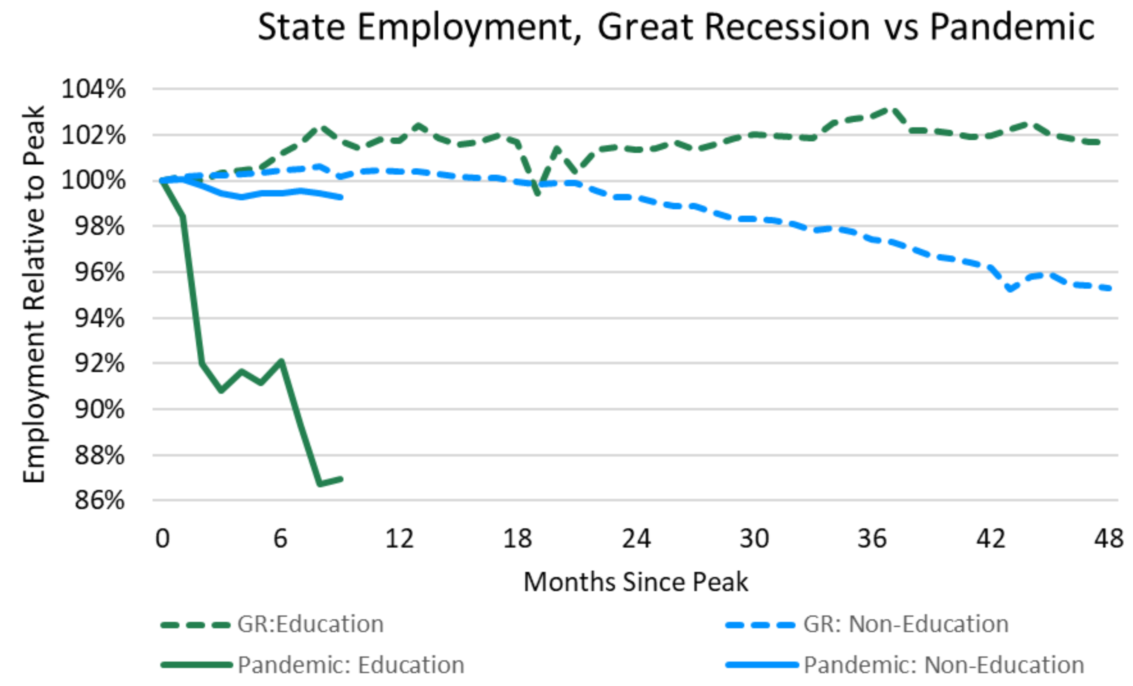
About 3¼% below 2019 level in 2020, about equal to 2019 by 2021.

GR – fell about 8% and stayed below pre-recession level for years.

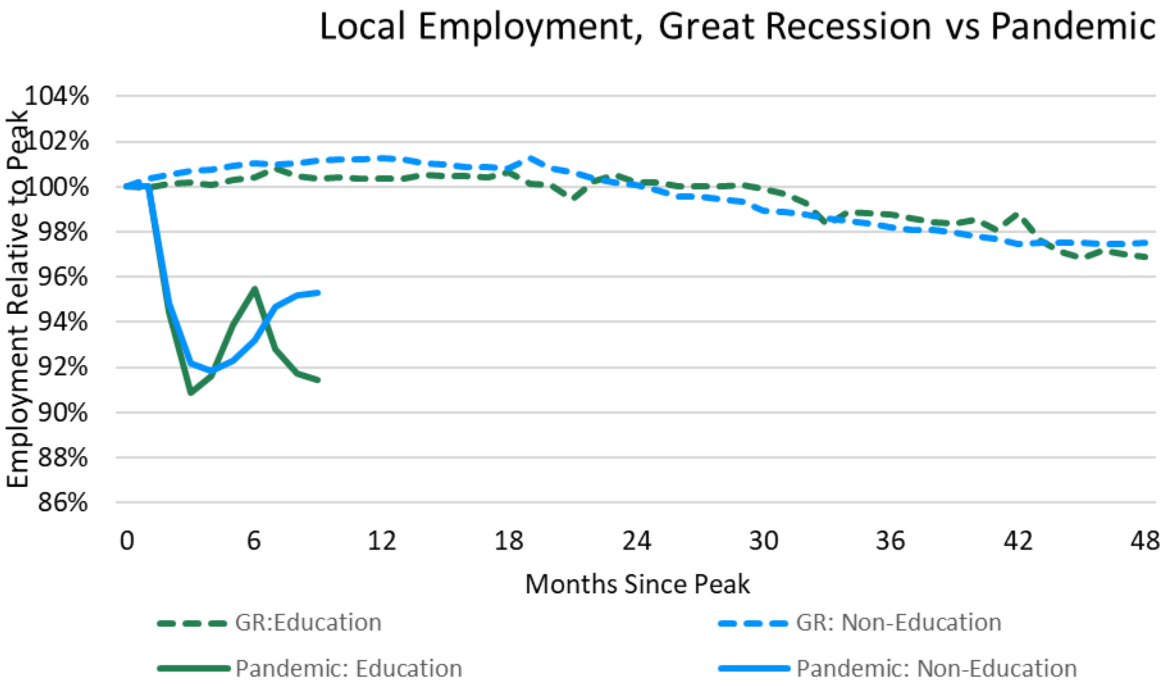


Percent decline in inflation-adjusted own source revenues (revenues less federal grants) relative to 2007 Q3.
Source: Bureau of Economic Analysis.

But Employment (Especially Education) Has Fallen Much More
(Solid lines pandemic – dotted lines GR)
(Green is education – Blue is non-education)



Seasonally adjusted monthly employment relative to December 2007 for GR and February 2020 for pandemic. Source: BLS.

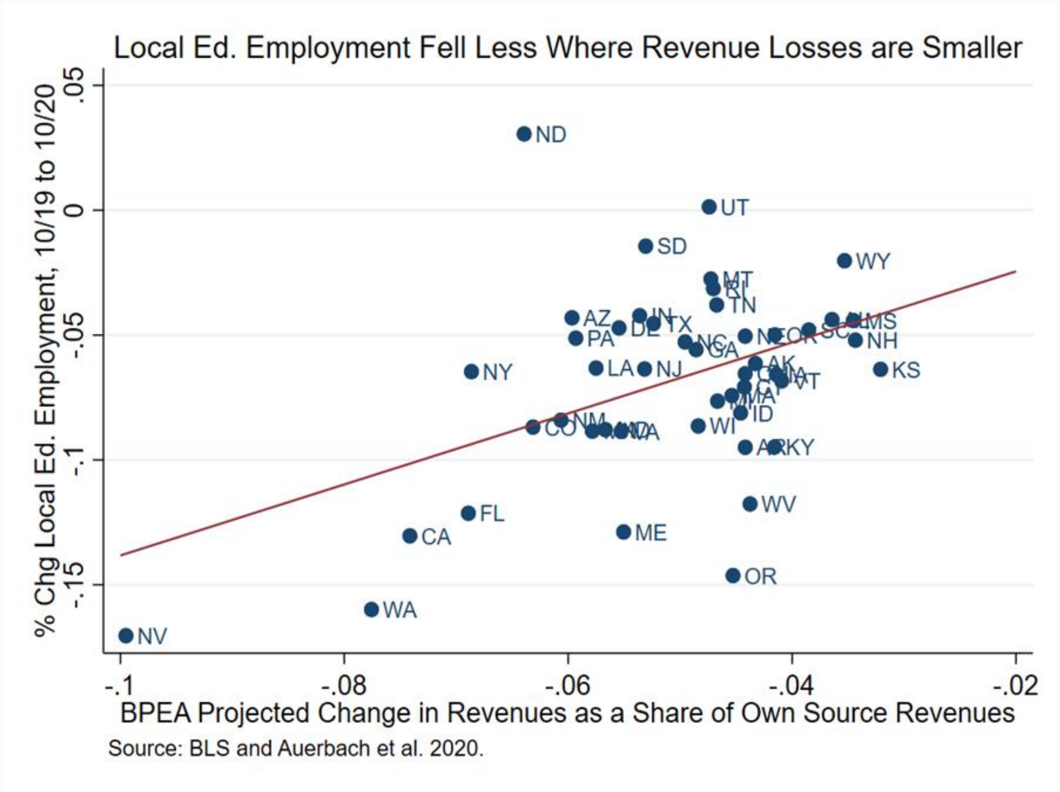


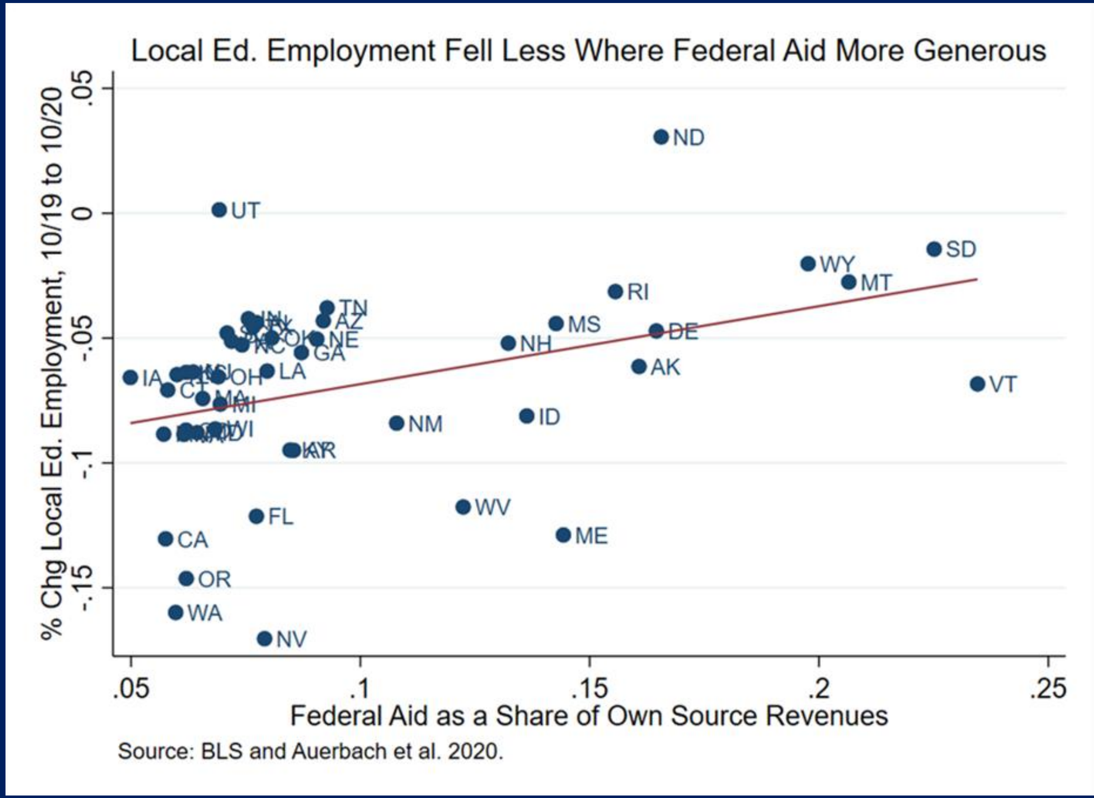
Seasonally adjusted monthly employment relative to December 2007 for GR and February 2020 for pandemic. Source: BLS.

Why has Employment Declined so Much?

Social Distancing: Fewer bus drivers, cafeteria workers, park employees, DMV employees, required with virtual schooling and closed/limited capacity of public services.

Some evidence (next slide) that tight budgets affected local education employment. Likely reflects cuts from states to local governments in the spring.





Would More Aid Help Increase Spending? Yes.

Local education clearly affected by aid.

Given reduction in learning – especially of poorer kids – need for remedial education extremely high. This will require $ (as well as creativity.)

Hard to find empirical relationship between spending and employment, but states overall might be cautious after being scarred by GR: More $ would help reassure state and local governments that is ok to start spending again.

Some state and local governments in financial distress -- $ would help.