STATES NEED MORE FEDERAL SUPPORT TO PROTECT COMMUNITIES AND FAMILIES FROM ECONOMIC HARDSHIP

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As they face $500 billion in possible budget shortfalls, states need additional Medicaid funding and fiscal support.

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 support, 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 – and it should be tied to labor market conditions so states continue to receive help until their job markets and budgets have begun to firmly recover.

States appear on the brink of shortfalls that could total more than $500 billion, mostly concentrated in a single fiscal year – the one that begins in July of this year. Even after accounting for the federal fiscal aid that's been provided so far and states' own rainy day funds that they can draw from, states still face shortfalls of as much as $360 billion, *not including* the substantial new costs they face to combat the COVID-19 virus. (Local governments, territories, and tribes will also need significant additional fiscal support.)

States' costs are rapidly rising – and will continue to spike – as they seek to contain the virus and the economic fallout. At the same time, state revenue will soon plummet, knocking state budgets out of balance.

In the absence of substantial federal aid, states – which must balance their 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.

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FIRST WAVES OF FEDERAL SUPPORT WILL HELP, BUT MORE WILL BE NEEDED

The aid Congress and the President have provided thus far falls much too short of what states will need to avoid harmful cuts. Here's what has been approved:

- **The Families First Coronavirus Response Act** temporarily increased the federal 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 year.
- **The Coronavirus Aid, Relief, and Economic Security (CARES) Act** provided additional support. 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 2020. This is substantial support, but its usefulness could be severely limited if the Treasury Department interprets the bill as barring states from using the funds to close revenue shortfalls – an action the Treasury is reportedly considering. The CARES Act also includes a roughly $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.

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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If states are not able to use any of the $110 billion in the Coronavirus Relief Fund to close revenue shortfalls, they will be left with just $65 billion for this purpose, leaving them about $435 billion short of closing their projected shortfalls in the current, upcoming, and subsequent fiscal years.

States can use their rainy day funds to close a portion of this gap, but those funds will fall far short of what's needed. Even after using the $75 billion in state rainy day funds, states would still have roughly $360 billion in remaining shortfalls, assuming they cannot use the Coronavirus Relief Fund to address the revenue crisis.

In fact, Congress may need to enact a larger fiscal relief package than the figures above suggest, for several reasons. First, local governments, territories, and tribes will also need substantial additional fiscal relief. 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. And finally, 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 they are clearly substantial and unprecedented.

WHAT STATES NEED TO PROTECT COMMUNITIES AND FAMILIES FROM HARDSHIP

The highest priority for Congress should be an additional FMAP increase that adjusts with economic conditions and remains in place as long as unemployment remains elevated. This would give states substantial fiscal support, but it wouldn't be enough on its own to fill the large budget shortfalls states will almost certainly face.

Congress should also provide additional federal fiscal support. 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. This fund could also provide additional help for local governments, but doing so should not come at the expense of providing adequate aid to states.

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 enacting substantial new state fiscal relief now that is flexible enough to enable states to address budget shortfalls in the years to come.

SPENDING CUTS WOULD 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.

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.

The federal government's major fiscal policy response to the downturn, the American Recovery and Reinvestment 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. For example, at least partly due to these cuts, states across the country now have:

- Weaker unemployment insurance systems
- Crumbling public infrastructure
- Major teacher shortages
- Much higher tuition at public universities, with particularly harmful effects for low-income students and students of color

To prevent these and other deep spending cuts, it is essential that the federal government provide states adequate, long-lasting fiscal support.