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House Budget Bill Provides Needed Fiscal Aid for States, Localities, Tribal Nations, and Territories

By Michael Leachman

The sizeable revenue shortfalls and added costs that many states, localities, tribal nations, and territories face due to COVID-19 call for added federal aid that's temporary but significant. The bill that the House Committee on Oversight and Reform will consider this week to meet its reconciliation instructions under the House budget resolution would provide this essential aid and help ensure a strong recovery. Congress should act quickly to provide this aid or risk more public-sector layoffs and cuts in services for families and businesses as states and localities balance their budgets.

Forty-three states plus the District of Columbia and Puerto Rico are now holding their first full legislative sessions since COVID-19 struck. Lawmakers' primary jobs will be to balance their budget for this fiscal year (which runs through June in most states) and write next year's budget. Without more federal aid, lawmakers facing hard budget choices due to the pandemic will impose another round of cuts — the last thing the country needs right now.

States and localities have shed 1.3 million jobs since last February — far more than the 750,000 lost in the aftermath of the Great Recession — as social distancing measures have temporarily reduced the need for some jobs (like bus drivers) and as state and local spending cuts have forced layoffs. Most of these jobs were lost last spring, but states and localities lost 100,000 employees in just the last four months.

The House plan includes $350 billion in grants to help states, localities, tribal governments, and U.S. territories like Puerto Rico deal with these shortfalls and avoid additional layoffs. Of that total, states would receive $195.3 billion; municipalities and counties would receive $130.2 billion ($65.1 billion each); tribal nations would receive $20 billion; and U.S. territories would receive $4.5 billion.

Each state would receive a base amount of $500 million — including the District of Columbia, which would be treated as a state and receive an additional amount to compensate for *not* being treated as a state in the CARES Act of March 2020. The remainder for state governments would be distributed based on each state's share of unemployed workers in the country, a reasonable proxy for the pandemic's impact on families and communities in each state. The amount for municipalities would be distributed using a formula employed by the Community Development Block Grant that is based largely on population and poverty, while the amount for counties would be distributed based on each county's share of the U.S. population.[1] Those are effective approaches for distributing aid quickly to cities and counties facing fiscal challenges and reasonable methods of distribution given the dearth of data available on city and county fiscal needs. (Estimates of how much each state, county, and city would receive are available on the House Committee on Oversight and Reform's website.[2]) Tribal governments would receive an equal share of $1 billion and the rest using a method to be determined by the Treasury Department, while territories would divide $2.25 billion equally and another $2.25 billion based on population.

These amounts would likely be sufficient in most cases to cover pandemic-induced revenue losses and some if not all of the increased costs these governments face, based on our present shortfall estimates, though budget forecasts are highly uncertain right now and the impact of the pandemic on government revenues varies a great deal across jurisdictions. In the hardest-hit places, such as those dependent on tourism or natural resource extraction, the amount provided might not be enough to fully repair the damage. That includes many tribal governments as well as many cities and counties, most of which have received no direct federal aid to date. In other places, particularly those where revenues have held up, the funds likely will be used primarily to cover the continued cost of fighting COVID-19, to help people and businesses survive and recover from the pandemic, and to prepare for fiscal strains likely in coming years as the pandemic's long-term damage becomes more apparent.[3]

Governments Face Revenue Losses Plus Unexpected Costs

A survey last fall by the National Association of State Budget Officers found that state revenues for fiscal year 2021 were coming in 10.8 percent below pre-COVID projections, a very large drop — especially since it accounted for the substantial federal stimulus enacted earlier in 2020.[4] The situation has improved somewhat since then, though it's not clear by how much. We estimate revenues are still roughly 6 percent below pre-COVID projections.

These revenue losses caused many states to scale back previous plans for this year; for example, Alabama, Florida, Georgia, and Kentucky reversed course on pay raises for teachers. Some of those new investments were built on pre-COVID projections of relatively strong revenue growth; the pandemic upended those projections, leaving states with revenues below what they need simply to cover existing payroll and services, let alone cover their increased costs.

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[1] Counties in the U.S. territories would also receive their share of this amount. In addition, the District of Columbia would be treated as a county for purposes of distributing this portion of the funding.

[2] House Committee on Oversight and Reform, "Chairwoman Maloney Announces Markup of Coronavirus Relief Measures, February 9, 2021, https://oversight.house.gov/news/press-releases/chairwoman-maloney-announces-markup-of-coronavirus-relief-measures.

[3] Elementary and secondary schools, as well as colleges and universities, also need significant aid to respond to the extraordinary, unexpected costs caused by COVID-19. For more, see Nicholas Johnson and Victoria Jackson, "House Bill to Implement Biden COVID-Relief Plan Includes Much-Needed K-12 Funding," CBPP, February 9, 2021, https://www.cbpp.org/research/state-budget-and-tax/house-bill-to-implement-biden-covid-relief-plan-includes-much-needed.

[4] National Association of State Budget Officers, *Fiscal Survey of the States,* Fall 2020, https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO_Fall_2020_Fiscal_Survey_of_States_S.pdf.

Meanwhile, revenues also fell sharply in cities and counties, including drops in local sales taxes as well as parking and traffic fees, hotel taxes, restaurant and alcohol taxes, toll revenue, business permits, and the like. Aggregate municipal revenue fell 13 percent over the first fiscal year since the pandemic hit, a November survey by the National League of Cities suggests. (Revenues didn't drop in all municipalities; the decline was 21 percent among those losing revenue.)[5] Counties, whose revenue base typically also includes sales taxes and various fees and charges, took a hit roughly in line with that of municipalities.[6]

Setting aside the longer-term costs of forgone investments and looking only at these more fundamental fiscal effects, we estimate that states, localities, tribal nations, and U.S. territories currently face total shortfalls of about $300 billion through fiscal year 2022, after subtracting federal aid provided to date.[7] If states fully spend the roughly $75 billion in reserves they held heading into the pandemic, that estimate drops to $225 billion. To be clear, these estimates only account for revenue losses resulting from the pandemic plus normal cost increases states and local governments face, such as wage inflation, population growth, and — in the case of states — increased Medicaid costs as more people turn to that program in a recession.

Our estimates don't include states' and localities' costs to continue fighting COVID-19 (including the new, more contagious strains of the virus), such as personal protective equipment, testing, contact tracing, and increasing public health awareness. Nor do they include the added costs of providing services effectively and safely during a pandemic, such as training and equipping public employees who must regularly interact with other people.

Our estimates also don't include state and local costs to help people and businesses facing extreme hardship due to the pandemic.[8] Nearly 1 in 5 adult renters are behind on rent and more than 1 in 3 adults are having trouble paying for usual household expenses, with rates especially high among people of color, according to the latest data. While federal aid to jobless workers and others has helped, the large share of adults still struggling to meet basic needs makes clear that it hasn't been enough. The House budget resolution would increase temporary federal food and housing

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[5] The National League of Cities' survey found that the financial health of 69 percent of municipalities had been hurt by COVID, and that — of those — 90 percent had seen an average revenue decline of 21 percent. That translates to a roughly 13 percent decline for all municipalities. See Anita Yadavalli, Joshua Pine, and Spencer Wagner, "Over Two-Thirds of Cities Say Condition Will Worsen Without Federal Stimulus," National League of Cities, December 1, 2020, https://www.nlc.org/article/2020/12/01/over-two-thirds-of-cities-say-condition-will-worsen-without-federal-stimulus/.

[6] A survey by the National Association of Counties in June/July 2020 found an aggregate revenue decline of $114 billion through fiscal year 2021. While economic conditions have improved since the survey was conducted, there's little question that county finances remain badly damaged.

[7] Our shortfall estimates begin with the National Association of State Budget Officers' survey of each state's updated revenue projections. We made adjustments to reflect state budget announcements after the survey and to incorporate shortfalls resulting from certain rising costs, like increased Medicaid caseloads and normal cost increases due to inflation and population growth (though we didn't incorporate cost increases due directly to fighting COVID and mitigating its effects). We also added estimates of shortfalls faced by cities, counties, tribal nations, and U.S. territories. We then subtracted federal aid provided to date that states can use to cover revenue losses in their general fund.

[8] CBPP, "Tracking the COVID-19 Recession's Effects on Food, Housing, and Employment Hardships," updated January 28, 2021, https://www.cbpp.org/research/poverty-and-inequality/tracking-the-covid-19-recessions-effects-on-food-housing-and.

assistance, but given the magnitude of the crisis, states and localities likely would still need to provide additional aid to help individuals and families get through the crisis and recover from it. Indeed, given gaps in federal relief measures, some states and localities have stepped in over the last 11 months with measures such as creating emergency assistance programs to help families avert eviction, further straining their budgets.

Finally, very little data are available yet on how the virus' resurgence in late 2020 is affecting revenues for states, localities, tribal nations, and territories, but it can't have reduced their costs or challenges.

Policymakers Should Take Care Not to Misuse J.P. Morgan Analysis

Some lawmakers have misused a J.P. Morgan analysis of state revenue collections through December 2020 to argue that states have few fiscal needs.[a] The analysis finds improvement in state tax revenue collections in the last quarter of 2020, and that revenues came in close to flat across calendar year 2020 compared to 2019.[b] That's helpful information, but federal policymakers weighing how much state and local aid to provide should keep in mind that J.P. Morgan's analysis is not intended as a full assessment of state and local need. The analysis:

- Doesn't include the substantial fiscal needs of cities and counties, which depend on revenue sources that have fallen sharply such as parking fees, hotel charges, and local restaurant taxes, as well as sales taxes (and whose costs are up significantly as well). It also excludes the extreme fiscal needs of tribal nations and U.S. territories.
- Doesn't include the cost of maintaining existing services. Last year's revenues aren't enough to cover the cost of the same services this year. Further, states based their pre-COVID budgets on the revenues they expected to collect during the fiscal year, not on how much they collected in the past.
- Doesn't include any of the costs states and localities face to fight COVID or those associated with helping people and businesses struggling due to the pandemic or helping them recover after it ends. J.P. Morgan's analysis itself makes this point, acknowledging that "many states are still seeing budget gaps, given higher COVID-19 expenditures, contact tracing, vaccine rollout, and greater social service needs."
- Captures only part of the revenue impact of COVID-19's resurgence. Daily COVID deaths were declining nationwide into mid-October, and did not begin to rise rapidly until November. State tax revenue, meanwhile, lags. For example, states did not receive November's sales tax collections until December (and even then, only a portion of the total, as some taxes are paid quarterly). Most income tax collections have an even greater lag; most people will pay 2020 income taxes in 2021.
- Considers only tax revenue, which is a subset of state revenue. The analysis excludes other forms of state revenue, notably various fees and charges including highway tolls and business license fees that are likely down significantly. It's also not clear whether the tax data J.P. Morgan collected includes all state taxes, or only a subset of them. Gas tax revenue, for example, is down across the country, but the analysis does not mention this form of tax.
- Reports calendar year data though no state budgets by the calendar year. Relatively strong growth in early 2020 before the pandemic hit masks its effects on state revenues in the analysis.
- Finally, using J.P. Morgan's calendar year 2020 data reveals little about states' needs in coming years, as the nation recovers from the pandemic. Typically the revenue impact of recessions on states and localities lags growth in the national economy.

[a] See, for example, Jon Greenberg, "Sen. Rick Scott misrepresents COVID-19's toll on state finances," *Tampa Bay Times,* February 8, 2021, https://www.tampabay.com/news/florida-politics/2021/02/08/sen-rick-scott-misrepresents-covid-19s-toll-on-state-finances-politifact/.

[b] Peter DeGroot, Ye Tian, and Daniel Zheng, "Municipal Markets Weekly," J.P. Morgan, January 29, 2021.