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States Continue to Face Large Shortfalls Due to COVID-19 Effects

By Elizabeth McNichol and Michael Leachman

The restoration of a portion of the jobs lost as a result of COVID-19, as reflected in the Labor Department’s recent jobs reports, is welcome news. Nevertheless, the economy remains in a deep recession, and state and local governments have been hit particularly hard. We now project that the state budget shortfalls expected from COVID-19’s economic fallout will total a cumulative \$555 billion over state fiscal years 2020-2022. This figure is for state shortfalls only and does not include the additional shortfalls that local and tribal governments and the U.S. territories face.

The private-sector job market performed somewhat better in May and June than many economists had expected, and this has led to some improvement in the outlook for the period ahead. That, in turn, has somewhat moderated the size of the shortfalls states face now and in the coming years. But states remain in dire straits; in just four months, state and local governments have furloughed or laid off 1.5 million workers¹ — twice as many as in all of the Great Recession. While some of those workers, such as school bus drivers and college security staff, are often furloughed during the summer, many of these and other workers stand to lose their jobs permanently in the coming weeks as states cut spending to balance their budgets — unless the federal government provides substantially more aid. Moreover, the surge in new infections in recent weeks is leading some states and localities to pause or reverse steps they have taken or planned to “re-open” the economies, and our estimates here could prove too optimistic.

Our new shortfall figure — which is based on the Federal Reserve Board’s most recent summary of economic projections,² issued June 10, and the Congressional Budget Office’s (CBO) July

¹ Bureau of Labor Statistics, “Employees on nonfarm payrolls by industry sector and selected industry detail,” June 5, 2020, <https://www.bls.gov/news.release/empsit.t17.htm>.

² Federal Reserve, “Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2020,” June 10, 2020, <https://www.federalreserve.gov/monetarypolicy/files/fomcproptabl20200610.pdf>.

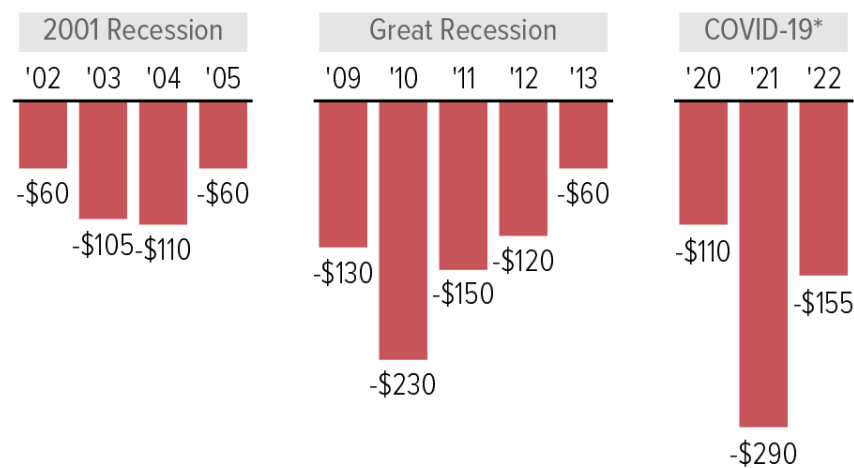
projections³ — is lower than our estimate of last month prepared before the updated CBO forecast was released, but higher than our April projection.⁴

The projected shortfall for 2021 fiscal year, which began on July 1 for most states, is much deeper than the shortfalls faced in any year of the Great Recession (see Figure 1). These figures underscore the continued urgency of the President and Congress enacting substantially more fiscal relief and maintaining it for as long as economic conditions warrant.

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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Federal Reserve economists project that unemployment — which averaged 13 percent in the second quarter (April through June) according to the Bureau of Labor Statistics — will peak this quarter and still be at 6.5 percent at the end of 2021, a year and a half from now. CBO’s projection is grimmer — unemployment will remain at 10.5 percent in the last quarter (October-December) of 2020 and stand at a still-quite-high 7.6 percent at the end of 2021, it estimates. Both economic projections take into account the aid that the federal government has already enacted for businesses, individuals, and state and local governments.

³ Congressional Budget Office, An Update to the Economic Outlook: 2020 to 2030, July 2020, <https://www.cbo.gov/publication/56442>.

⁴ Our estimates prepared before June were based on an average of Goldman Sachs’ forecast and CBO’s forecast; we are no longer using the Goldman Sachs forecast because it assumes that additional federal aid will be enacted. Changing to the Federal Reserve Board projections does not affect the results substantially.

Our estimate of \$555 billion in shortfalls over state fiscal years 2020-2022 is based on the historical relationship between unemployment and state revenues⁵ and on the average of the CBO and Federal Reserve Board projections.

The estimate demonstrates that the federal aid that policymakers have provided to date, while helpful, will fall far short. Revised Treasury Department guidance indicates that states can use some of the aid provided in the CARES Act to cover payroll costs for public safety and public health workers through December 30, but even adding that to other existing federal aid likely won't cover much more than \$100 billion of the state shortfalls, leaving nearly \$455 billion unaddressed.

States hold \$75 billion in their rainy day funds, a historically high amount, but far too little to meet the unprecedented challenges they now face. And, even if states use virtually all of it to cover their shortfalls, that would still leave them nearly \$400 billion short. The shortfalls that local governments, tribes, and territories face are *in addition* to this.

States must balance their budgets every year, even in recessions. Without additional, substantial federal help, they likely will deeply cut critical program areas such as education and health care, lay off teachers and other workers in even greater numbers, and cancel contracts with many businesses. Those steps would worsen the recession, delay the recovery, and further harm families and communities. State and local cuts in health care also could shortchange coronavirus response efforts. The large shortfalls could lead states and localities to raise taxes and fees as well.

The coronavirus relief bill that the House passed on May 15, the Heroes Act, includes substantial state and local fiscal relief,⁶ both by providing flexible grant aid and by strengthening and extending the temporary increase in the federal share of Medicaid costs in the Families First Coronavirus Response Act — a particularly effective and efficient form of aid that alleviates state budget pressures and protects health coverage. States need robust aid of this nature to avoid making cuts that would further weaken an already weak economy and cause further widespread hardship.

⁵ Matthew Fiedler and Wilson Powell III, “States will need more fiscal relief. Policymakers should make that happen automatically.” Brookings Institution, 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/>.

⁶ CBPP, “How Much Would Each State Receive Through the Coronavirus State Fiscal Relief Fund in the Heroes Act?” updated May 28, 2020, <https://www.cbpp.org/research/state-budget-and-tax/how-much-would-each-state-receive-through-the-coronavirus-state-fiscal>.