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Despite Improved State Fiscal Conditions, Serious Challenges Remain, Including for Localities, Tribal Nations, and Territories

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State fiscal conditions have improved since last fall but states still face unprecedented costs to address the immediate crisis, limit the long-term harm caused by the pandemic, and address longstanding inequities that greatly worsened the pandemic's impact. Further, many cities and counties continue to face especially serious fiscal challenges, with revenues down even as costs have soared, and most localities have received *no* federal aid to date. Tribal nations and U.S. territories also face particularly difficult fiscal conditions. Hence, even though state revenues have improved, additional federal aid for states, localities, tribal nations, and territories is needed.

Over the last few weeks, governors have begun releasing their budget proposals for fiscal year 2022, which include updated revenue forecasts for the current, 2021 fiscal year. In many cases these are the first official forecast updates for several months, giving us the first comprehensive look at how forecasts have changed since the early days of the pandemic, when the fiscal situation appeared much more dire.

Most states (34) still project lower revenues for the current fiscal year than they expected before the pandemic struck, our analysis of these data indicates. In some cases, the forecasts are *much* lower. In four states — Alaska, Nevada, New York, and Texas — forecasts are more than 10 percent below pre-COVID-19 projections. In 20 states they are more than 4 percent below. (See Table 1.)

That said, states' revenue outlooks for this year have improved markedly in the last few months. A survey by the National Association of State Budget Officers conducted last fall found state general fund revenue forecasts for the current fiscal year down 10.8 percent compared to pre-COVID-19 projections. By contrast, our corresponding analysis of governors' recent budget proposals finds forecasts down an aggregate of 3.3 percent for fiscal year 2021. (The decline is 4.3 percent if one adjusts for the fact that 18 states shifted some $10 billion in revenue from fiscal 2020 to fiscal 2021 when they pushed the income tax filing deadline from April 2020 to July 2020.[1]) In some states, revenue losses in the current fiscal year will be covered by federal aid provided last year.

To be clear, these revenue losses are for the current fiscal year only. States also absorbed revenue losses in the previous fiscal year, and a sizeable number are already projecting shortfalls for the next fiscal year, which starts July 1 in 46 states. For example, Hawai'i forecasts massive shortfalls of $1.4 billion in each of the next two fiscal years[2] and West Virginia forecasts sizeable shortfalls next year and beyond.[3]

Other analysts have also documented improvements in state revenues, primarily using preliminary data on individual state tax collections now available through December,[4] proprietary economic models,[5] or aggregate national data from the Bureau of Economic Analysis that draw on historical data and will be significantly revised in the future.[6] While these methods can be helpful, our analysis is based on states' most recent revenue forecasts for the current full fiscal year — a method in line with how states actually budget. Indeed, states will write their budgets based on these very figures (or updated ones they produce in the coming weeks).

An improved state revenue picture means that *state* governments will not need as much federal fiscal aid to close their aggregate revenue shortfalls as previously thought, but all states will need support to cover the ongoing costs of fighting COVID-19, help struggling people and businesses, and address inequities that worsened the pandemic's impact. Targeted additional support for states whose revenues have been particularly hard hit remains important. Policymakers determining how much federal aid to provide should keep the following in mind:

- **Fiscal aid is not only for revenue loss.** The pandemic has imposed massive additional costs to fight the virus, deliver services during a pandemic, and help struggling people and businesses. These substantial, unexpected costs will continue in the months ahead even if the pandemic is ultimately contained. Many millions of people, particularly low-income people and people of color, are struggling with hunger, have large unpaid rent bills, face mental health

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[1] The other states with income taxes collected the revenue in July but accrued it back into the prior fiscal year. See National Association of State Budget Officers, "Fiscal Survey of the States, Fall 2020," Table 21, p. 72, https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal Survey/NASBO_Fall_2020_Fiscal_Survey_of_States_S.pdf.

[2] Hawai'i Governor's Office, "News Release: Governor Ige's Biennium Budget 2021-23 Reflects Sudden, Sharp Reductions," December 21, 2020, https://governor.hawaii.gov/newsroom/governors-office-news-release-governor-iges-biennium-budget-2021-23-reflects-sudden-sharp-reductions/.

[3] Phil Kabler, "Governor's Budget Report missing key element: No six-year budget forecast," *Herald-Dispatch,* February 17, 2021, https://www.herald-dispatch.com/news/governors-budget-report-missing-key-element-no-six-year-budget-forecast/article_e8dea586-f82c-508c-a668-ee3dacfa84c9.html.

[4] Lucy Dadayan and Kim S. Rueben, "Why States and Localities Need More Federal Aid," Tax Policy Center, February 22, 2021, https://www.taxpolicycenter.org/taxvox/why-states-and-localities-need-more-federal-aid.

[5] Dan White, Emily Mandel, and Colin Seitz, "Stress-Testing States: COVID-19, A Year Later," Moody's Analytics, February 19, 2021.

[6] Chris Edwards, "More Federal Aid to States Not Needed," CATO Institute, February 12, 2021, https://www.cato.org/blog/more-federal-aid-states-not-needed.

challenges as a result of the pandemic, or are enduring other forms of extreme hardship.[7] Millions of children have effectively lost a year of schooling. Households, as well as millions of struggling small businesses, will require unprecedented levels of support to make it through the pandemic and to recover from the harm done. While other forms of federal support provide important direct assistance, states and local governments will also need to deliver a wide range of localized supports and services and to sustain them over a long period of time.

Further, our goal should be not only to restore pre-COVID-19 conditions but to address near-term challenges in ways that help undo longstanding structural inequities. After all, the hardships people have experienced in the last year were greatly exacerbated by these longstanding inequities; as such, repairing the pandemic's damage requires addressing them. That will necessitate more robust investments in people and communities in the short term but pay off with a more prosperous future for all of us.

- **Many cities and counties badly need support**. Though fiscal strains among cities and counties also vary, they are widespread. First, most cities and counties have received *no* direct federal aid since the pandemic started. Second, certain revenue sources that cities and counties depend upon — hotel and restaurant charges, business licenses, and parking fees, for example — have been hit much harder than in a normal recession. Sales tax collections — another major revenue source — are generally still down. Property taxes, also a major revenue source, are holding up for now partly due to low interest rates, but the impact of recessions on property values tends to lag the general economy and commercial property values are still falling.[8] While hard data on local government revenue needs are difficult to come by, a National League of Cities survey from late November found cities averaging a roughly 13 percent revenue decline,[9] even as costs have soared. Revenue losses among counties are likely roughly similar.
- **States and localities have lost 1.3 million jobs.** They'll need to hire back teachers, health care workers, and others to support a robust recovery. Restoring that level of job loss will require some $40-50 billion alone.
- **Tribal nations and U.S. territories also face serious fiscal challenges.** Tribal nations are especially vulnerable to COVID-19's health risks and the effects of the recession, due largely to the federal government's failure to uphold its trust responsibilities and treaty obligations to tribes.[10] And the pandemic has stretched tribal nations' finances and health systems to the

[7] CBPP, "Tracking the COVID-19 Recession's Effects on Food, Housing, and Employment Hardships," updated February 24, 2021, https://www.cbpp.org/research/poverty-and-inequality/tracking-the-covid-19-recessions-effects-on-food-housing-and.

[8] Noah Buhayar, John Gittlesohn, and Jackie Gu, "Commercial Real Estate's Pandemic Pain Is Only Just Beginning," Bloomberg, December 22, 2020, https://www.bloomberg.com/graphics/2020-commercial-real-estate/.

[9] 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/.

[10] Joshuah Marshall, "Tribal Nations More Vulnerable to COVID-19 Impacts, Need Additional Fiscal Aid," CBPP, August 5, 2020, https://www.cbpp.org/blog/tribal-nations-more-vulnerable-to-covid-19-impacts-need-additional-fiscal-aid; 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.

breaking point. Puerto Rico and other U.S. territories also face particularly concerning fiscal and economic conditions.[11]

- **Unintended consequences of the year-end relief package's Paycheck Protection Program (PPP) provisions will cost states billions this year.** Contrary to the normal tax treatment of forgiven debt, the CARES Act provided that businesses don't have to count forgiven PPP loans as income. Consistent with other provisions of federal tax law, however, the IRS decreed shortly thereafter that businesses can't deduct the expenses they cover with PPP loans from their taxable income — analogous to an individual being unable to deduct an otherwise eligible medical expense if their insurance company reimburses it. But in the December COVID-19 relief legislation, the President and Congress overruled the IRS and provided that businesses can deduct those expenses, thereby layering a tax break on top of PPP's federal wage reimbursement.

  Many states could face new, unanticipated revenue losses of hundreds of millions of dollars if they don't decouple from the new federal tax break,[12] a politically challenging task. In about half the states, that new federal tax break will automatically create the same tax break under state personal and corporate income taxes because the state and federal tax codes are linked — unless the state enacts a law to "decouple" from it. In the other half of the states, the tax break will take effect when (or if) the state updates its tax laws to incorporate it. In aggregate, we estimate states could lose at least $20 billion.

TABLE 1

Fiscal Year 2021 Revenues Below Pre-COVID Projections in Many States

State	Change in General Fund Revenues Compared to Pre-Pandemic Estimates
Alabama	-2.7%
Alaska	-37.0%
Arizona	4.6%
Arkansas	-3.5%
California	3.0%
Colorado	-9.8%
Connecticut	-2.9%
Delaware	1.7%
Florida	-5.5%
Georgia	-6.7%
Hawai'i	-6.4%
Idaho	3.3%
Illinois	-4.8%
Indiana	-2.4%

[11] Javier Balmaceda, "Long in Recession, Puerto Rico Needs More Than Just COVID-19 Relief to Overcome Its Crises," CBPP, May 7, 2020, https://www.cbpp.org/research/economy/long-in-recession-puerto-rico-needs-more-than-just-covid-19-relief-to-overcome-its.

[12] Michael Mazerov, "States Should Decouple From New Federal Tax Break for PPP Loans," CBPP, February 3, 2021, https://www.cbpp.org/blog/states-should-decouple-from-new-federal-tax-break-for-ppp-loans.

TABLE 1

Fiscal Year 2021 Revenues Below Pre-COVID Projections in Many States

State	Change in General Fund Revenues Compared to Pre-Pandemic Estimates
Iowa	-3.2%
Kansas	-1.1%
Kentucky	0.1%
Louisiana	-5.9%
Maine	-6.3%
Maryland	-3.1%
Massachusetts	-6.6%
Michigan	-4.9%
Minnesota	-4.8%
Mississippi	-4.6%
Missouri	2.2%
Montana	-3.9%
Nebraska	2.6%
Nevada	-12.7%
New Hampshire	1.7%
New Jersey	-9.6%
New Mexico	-8.7%
New York	-10.2%
North Carolina	6.0%
North Dakota (biennial)	2.9%
Ohio	-1.3%
Oklahoma	-8.6%
Oregon (biennial)	2.6%
Pennsylvania	0.5%
Rhode Island	-4.4%
South Carolina	-7.3%
South Dakota	4.7%
Tennessee	-2.9%
Texas	-11.1%
Utah	6.5%
Vermont	-1.4%
Virginia	-1.3%
Washington	-2.6%
West Virginia	-0.2%
Wisconsin	0.1%
Wyoming	4.1%
DC	-9.2%

Source: CBPP analysis of state budget documents.