June 25, 2020

State Fiscal Outlook: Pre- & Post-COVID-19

Today, NASBO released its Spring 2020 Fiscal Survey of States. In a typical year, this report reflects the fiscal health of state governments based on governors’ budget proposals for the upcoming fiscal year, and these proposals usually align closely with the expenditure and revenue plans ultimately adopted by states. However, this is not a typical year.

The Spring 2020 Fiscal Survey reflects state fiscal conditions before the COVID-19 pandemic and its economic fallout, and therefore does not capture the current fiscal state of the states. The survey shows state fiscal conditions were strong before the onset of COVID-19, following a decade of revenue growth and building reserves.

Most governors proposed their budgets in December or January, with the earliest coming out in November and the latest released in early March. These budget proposals reflect another era, before “coronavirus” and “COVID-19” were household words, when unemployment was at a 50-year low of 3.5 percent, state revenues were on track to grow for a 10th consecutive year, and budget reserves were at an all-time high. Just a few months later, resulting from public health measures to control the spread of a novel coronavirus, the nation was (and likely still is) facing the worst economic crisis since the Great Depression. Unemployment in April reached 14.7 percent – the highest level on record since data began being tracked in 1967, travel and tourism ground to a halt, retail sales plummeted, and gross domestic product was on track to have its worst quarterly decline in the post-World War II period.

NASBO expects the data in the Spring 2020 Fiscal Survey will serve as a historical baseline for comparison to post-COVID fiscal conditions, as states release revised revenue projections, and make budget adjustments for fiscal 2020 and fiscal 2021.
State Efforts to Balance Budgets in the Post-COVID-19 Era

In the new, post-COVID-19 fiscal environment, states face tough decisions, including cutting spending, instituting layoffs and furloughs, and weighing when to use the reserves they built in recent years. These actions are rapidly evolving in the states as more data become available.

All states expect revenue loss and the need to adjust their budgets, as states are required by law to balance their budgets. However, the timing and nature of state budget actions vary depending on differences in reserve levels, revenue forecasting processes, executive authority to reduce the budget, and other variations in state budget processes. States are also waiting to see whether additional aid will come from the federal government, and where possible, delaying budget reductions until more certainty at the federal level is provided.

The remainder of this post will briefly discuss examples of how states are updating their revenue forecasts and managing their budgets in response to the COVID-19 pandemic and economic crisis. NASBO is also monitoring and tracking state budget actions in response to the COVID-19 pandemic and economic crisis in a new resource, which will be updated periodically as more information becomes available. The actions documented in this resource, and examples discussed below, are not meant to be exhaustive, but rather illustrative of the tools states are turning to in response to this crisis.

Forecasting the Impacts of COVID-19 on State Revenues

The COVID-19 pandemic and ensuing recession have dramatically altered state fiscal conditions in record time. States rely on personal income taxes and sales taxes combined for roughly 75 percent of their general fund revenue. These revenue sources have been hit hard in light of stay-at-home orders, business closures, and rising unemployment claims. States have begun to release updated revenue forecasts that project the impacts of the COVID-19 recession over the next one to two years. A number of states have already announced multi-billion-dollar budget shortfalls and revenue losses, as others are preparing to release updated projections in the coming weeks and months. Further complicating the forecasting process, most states followed the federal government in shifting their state tax deadline to July 15, 2020, causing a sharp drop in personal income
tax payments in April. States are hopeful that they will receive most of the delayed payments in July. However, some of the deferred taxes may not be collected in July as taxpayers’ financial outlooks worsen, creating additional uncertainty for state revenue forecasters. NASBO will continue to track updated revenue forecasts as they are released.

Examples of Budget Actions & Adjustments Post-COVID-19

**Fiscal 2020 Close Out**
In response to the COVID-19 recession and updated revenue projections, a number of states have taken immediate steps through executive authority to rein in spending and balance their budgets for fiscal 2020, such as implementing hiring freezes, restricting contracts, and freezing discretionary spending. Arkansas, Colorado, Idaho, Indiana, Missouri, Ohio, and Wisconsin are among the states where governors exercised their authority to reduce the budget through across-the-board or targeted cuts in response to revenue shortfalls for fiscal 2020 (and fiscal 2021 in Indiana). In Maryland, the Board of Public Works, consisting of the governor, comptroller and treasurer, approved general fund cuts for fiscal 2020, while Nevada’s governor proposed state agency budget cuts for the current fiscal year that were subsequently approved by the legislature’s Interim Finance Committee. Given the severity of projected revenue losses, several states have already instituted employee furloughs and/or layoffs. Others are considering or proposing similar personnel actions for fiscal 2021.

Given that the effects of COVID-19 hit state revenues primarily in the last quarter of the fiscal year for most states,¹ it is more difficult to achieve budget balance through spending cuts alone with relatively little time left in the fiscal year. States are also relying on other budget management tools, such as tapping their rainy day funds and using other one-time fiscal measures, to close budget gaps for fiscal 2020.

**Fiscal 2021 Budgets**
States are forecasting even larger revenue losses due to the COVID-19 recession in fiscal year 2021. In response to these projected revenue shortfalls, some states already enacted

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¹ Generally, 46 states begin their fiscal years on July 1. New York starts its fiscal year on April 1; Texas starts on September 1 start date; and Alabama and Michigan start their fiscal years on October 1. [For fiscal 2020 only, New Jersey extended its fiscal year so that fiscal 2021 will begin on October 1, 2020 and end on June 30, 2021.]
cuts to their budgets for fiscal 2021. For example, Tennessee approved a fiscal 2021 budget in March that was nearly $900 million below the governor’s originally proposed budget, and since that time, Tennessee’s governor proposed additional spending reductions for the legislature’s consideration. Washington State’s governor vetoed 147 line items in the state’s supplemental budget in early April, cutting general fund spending by $445 million over the next three years. Other states have also taken initial steps to slow spending for fiscal 2021 by cancelling planned pay increases, program expansions and other new spending initiatives.

Most states are still in the planning phase for how they will make the necessary adjustments to their fiscal 2021 budgets. Facing steep revenue declines, and with continued uncertainty about additional federal aid to states, many governors and their administrations have directed agencies to develop contingency plans to reduce their budgets, primarily for fiscal year 2021, by as much as 15 percent or 20 percent. Cuts at these levels would be devastating to essential services, at a time when demand for such services is on the rise due to the public health crisis and economic downturn. Such cuts would also lead to large job losses; as of May 2020, state and local governments had already shed 1.5 million jobs, mostly in education.

**Looking Back and Charting a Path Forward**

During the Great Recession, states relied on a number of tools, led by spending reductions, to manage their budgets, but the effects of these cuts, particularly on core services such as education and health care, were mitigated by federal aid to replace lost revenues under the American Recovery and Reinvestment Act (ARRA). State revenue losses resulting from the COVID-19 recession are expected to well exceed the 11.6 percent drop states experienced during the Great Recession, with some states anticipating declines of more than 20 percent. The worst is likely still to come for state tax revenues, as enhanced unemployment benefits expire, as more Americans restrict their spending, and the full economic impacts of the pandemic are felt. Though not expected to eliminate the need for spending reductions, additional federal aid to states will be necessary to avoid more drastic and painful cuts to essential services that will hurt state residents and significantly dampen the nation’s economic recovery.
Additional Resources

Compilation: State Budget Actions in Response to COVID-19
Compilation: State Revenue Forecasts
Report: Spring 2020 Fiscal Survey of States (June 2020)
Report: Budget Processes in the States (Spring 2015)
Report: Lessons Learned from the Economic Downturn (Summer 2013)
Issue Brief: Summaries of Fiscal Year 2021 Proposed Budgets (April 2020)
Budget Blog: State Budget Basics During an Economic Downturn (May 2020)
Budget Blog: April Tax Collections Plummet from Tax Deadline Shift (May 2020)
Budget Blog: States Saving for a Rainy Day (January 2019)