AFTER THE FACT >

After the Fact | State Budgets and COVID-19

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TRANSCRIPT

Dan LeDuc, host: $75 billion.

When was the last time you thought that might not be enough money for, well, almost anything?

[Music break]

For The Pew Charitable Trusts, I'm Dan LeDuc and this is "After the Fact." We hope this finds you safe and healthy. That $75 billion is our data point for this episode and it's the combined total of money the states had set aside this year for a rainy day in order to protect critical services for the public, like health care and aid to education, in case of a downturn. Of course, this is more than a rainy day—the coronavirus is more like a deluge and it's lasting for months.

And it's taken most of the last decade, since the end of the Great Recession, for states to save that money and stabilize their economies. The federal stimulus package Congress passed at the end of March tops $200 billion to help states and localities, and that includes a $150 billion coronavirus relief fund. But will it be enough?

For more, we turn to Josh Goodman, a senior officer on Pew's state fiscal health team, on how COVID-19 is affecting the states.

Dan LeDuc: Josh Goodman joins us. He's a senior officer on Pew's state fiscal health team. Josh, we hope this finds you well and your family doing OK.

Josh Goodman, senior officer on The Pew Charitable Trusts' state fiscal health team: Yeah, definitely. Thank you so much for having me on.

Dan LeDuc: We're talking, of course, about the importance of state budgets. Let's remind listeners just why they're important. What happens at the state level?

Josh Goodman: State governments are just central to the lives of every single American. Primarily, what states fund is education, health care, transportation, and public safety. And so if you're someone that drives on the state highway, states are paying for that road. If you or your family are on Medicaid, states are contributing to that funding. If you send your children to public schools, that's dependent on state funding.

And additionally, everyone that pays taxes, when you go buy almost anything and pay the sales tax on it, when you have personal income taxes withheld from your paycheck, that's linked to state decisions. And so if state governments aren't healthy, if their budgets are struggling, that means they'll have less money to provide all of those critical services. It also means that your taxes may be going up in a variety of different ways. Beyond that, state governments are also important for the national economy.

One thing that economists saw coming out of the Great Recession is that even as the federal government was making efforts to stimulate the economy, states were delaying our economic recovery because they were raising taxes or cutting spending, either of which take money out of the U.S. economy. States played this role of limiting the recovery, slowing it down, and so having healthy state budgets matters for all of us.

Dan LeDuc: We're going to talk about what all of this means for the states and their budgets, which are going to have a huge impact, economic impact. The data point for our episode is $75 billion, which sounds like a lot of money, because that's what the states have sort of stockpiled as of the end of this past fiscal year to sort of get ready for tough times. But, Josh, did they anticipate tough times this tough?

Josh Goodman: I don't think anyone anticipated a situation quite like this. States always do need to plan for difficult budget situations. One way that states are different than the federal government is they have generally constitutional requirements that forbid them from engaging in deficit spending, and so states really do have to balance their budgets each year or each two years.

And one way they do that, knowing that the money they bring in in good times will be a lot more than it is in bad times, is they build up these reserves. And so by saving in their rainy day funds, as they're known, states can have money to get them through tougher times. But even states that have done a really good job saving didn't expect something to happen this quickly and this dramatically that would affect their budgets.

Dan LeDuc: Josh, break down where state revenue comes from and why volatility poses such an issue for state budgets?

Josh Goodman: State governments get most of their tax dollars from personal income taxes and sales taxes. And so if people are spending less money in the economy, sales tax revenue will decline. If people are working fewer hours, if there are layoffs, then personal income taxes will also go down.

States have pretty limited options to deal with those problems. They really depend heavily on their reserves to get them through these difficult times, but also they rely on the federal government. During the Great Recession, the federal government offered substantial aid to states. States really need a lot of help, but they're also making difficult choices for themselves as their budget situations deteriorate.

Dan LeDuc: And for some context here, Congress and the president have created a $2.2 trillion stimulus package for the nation, but how much of that is targeted towards state and local governments?

Josh Goodman: One of the biggest parts of that for state governments is a new $150 billion fund that's designed to help states pay for their responses to coronavirus and all the public health costs that go along with that. And in addition to that money, though, there's a variety of other funding streams that are intended to help both state governments and local governments.

One thing Congress has done, for example, is increase the amount of money that the federal government is paying for Medicaid. Medicaid is a jointly funded program by the federal government and states. And so to help states out to get through these difficult budget times, Congress is increasing what the federal government will pay.

Dan LeDuc: We're coming out of the aftermath of the Great Recession, and it offered, I'm sure, a lot of lessons to state policymakers on how to deal with calamities. What are some of those lessons?

Josh Goodman: We saw lots of sort of short-term thinking during the Great Recession. Some of that was just due to the degree of the crisis that states really didn't have great options. But states were doing things like saying, "hey, our education payment, what we're giving to school districts on June the 30th, if we just push that into the next fiscal year, which begins July the first, that saves us a lot of money this year." But of course, then that's more you have to have next year. And so it's those kinds of decisions that if states are really desperate they turn to, but they don't ultimately solve the underlying problem. And so saving money in good times to use in bad times is one of those key steps.

Dan LeDuc: So what have states been doing since the Great Recession to prepare for the next downturn?

Josh Goodman: One concept that came out of the Great Recession was the idea of stress testing state budgets. And the idea of a stress test is just sort of to analyze different scenarios of, if the economy declines by this amount, if personal income drops by this amount, if unemployment goes up by this amount, those kinds of things, what does that mean for our budget? And it's something that some states have begun to embrace and really use it to drive their decisions.

Dan LeDuc: And of course, that's also going to vary state by state, right? Each state has their own economy based on the natural resources, for example, that could be a huge part of their state's economy or the businesses that are located there. So there's no one size fits all.

Josh Goodman: We see a lot of variation in the volatility from state to state, which is linked to the state's economy as well as their tax structure. And that's really where stress testing can be such a useful approach. What states are doing is customizing their stress tests to their own budgets and circumstances. And so if you have an economy that's really linked to the price of oil, you're going to want to assess, well, if oil is $30 a barrel versus $45 a barrel versus $50 a barrel, what does that mean for our budget, and do we have enough savings if oil prices are depressed to make it through those times until we would expect to see things bounce back?

Every state has a different level of volatility in its revenue structure, and every state is maybe more sensitive as well to spending pressures that might occur during a downturn. Something like Medicaid, which is a means-tested program, if people are earning less money, more people qualify for Medicaid, and that costs state governments more money. So states really ought to be thinking about the revenue side, the tax revenue they bring in, as well as the spending side, what are going to be our spending pressures during challenging times.

Dan LeDuc: For listeners who want to follow this fiscal news and judge the impact on the state where they live, we're, of course, in the coming weeks going to be watching the public health numbers and people who are going to be contracting the virus and the outcomes of that. But what are the fiscal numbers we should be looking for to get a handle on how well things are happening there?

Josh Goodman: One thing to look at is states' revenue estimates. Every state has a process for estimating how much money they will bring in. Many states produce those numbers in January and February. And as you can imagine based on how the economy is changing right now, those numbers from January and February are not expected to remain accurate for very long. And so as states redo their revenue estimates, you can look and see whether in your state those numbers are going down, how much they're going down, and how large of a challenge that is posing for state budgets.

Many states coming after the Great Recession didn't stick to their regular revenue estimating schedule. They did special revenue estimates because conditions were changing so quickly, they knew the numbers weren't accurate. So as those revenue estimates change, that's what will shape what states have, how much money they have for their budgets, and that will translate into decisions about whether states need to tap their reserves, cut spending, rely on federal aid, or raise taxes.

Dan LeDuc: Is there anything different about the economic downturn being caused by the pandemic, say, compared to the Great Recession or sort of a large natural disaster? When there's a recession, we can look at factors that are going on broadly. Here, everything was just sort of put on hold, and it had dramatic impact. Is there any sense among policymakers that once the health threat begins to subside that the turnaround could be quicker than maybe we've seen in other economic issues and other economic hardships?

John Goodman: One thing that really does distinguish this particular situation is the abruptness of it all, that if you ask state officials in January how their budget situations were, there would have generally been optimism. State tax revenue was generally going up year over year. It was often coming in at or above expectations. In recent years, they'd been able to put more money in their reserves. The picture was pretty good.

And so then you just fast forward a few months later, and states really are facing substantial challenges and challenges that could last a long time. Certainly, no one's quite sure how the economy is going to bounce back, how long the restrictions will last, and those factors will play into states' recovery as well. In many ways, states experienced a lost decade coming out of the Great Recession. And so one of the questions now is, will there be another lost decade? Will states be able to make it through this crisis better than they did the last one? And that's very much an open question at this point.

Dan LeDuc: Josh Goodman, in these uncertain times, we appreciate you helping us sort it all out.

Josh Goodman: My pleasure.

[Transition music fades in]

Dan LeDuc: To learn more about how state governments are faring and what it could mean for public services during this time of uncertainty, visit pewtrusts.org/afterthefact.

In the coming weeks we'll be bringing you more data and stories behind those numbers that we hope will help you make some sense out of this unsettling time.

In the meantime, please stay safe. Let's all try to come out of this as healthy as when we started.

For The Pew Charitable Trusts, I'm Dan LeDuc.

[(Female voice over music) "After the Fact" is produced by The Pew Charitable Trusts.]