Iowa Fiscal Partnership

POLICY BRIEF

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Iowa will need more fiscal relief than Congress has given

Reserves, existing federal aid will not cover projected revenue shortfalls

By Peter Fisher

As we noted earlier,[1] the combined effect of the looming recession and the health emergency triggered by the COVID-19 pandemic will have a devastating effect on state and local budgets. Preliminary estimates recently released by Moody's Analytics suggest that Iowa will face a tax revenue shortfall of $895 million to $1.14 billion over the rest of this fiscal year and next fiscal year.[2] More recent estimates predict that state budgets collectively will suffer losses more severe than during the great recession of 2009-10: a $350 billion shortfall predicted for next fiscal year, compared to $230 billion in the worst year of the Great Recession.[3] This suggests that the higher estimate provided by Moody's is more likely.

The four major pieces of legislation passed by Congress to address the crisis include assistance to state and local governments. But more will be needed if the state is to avoid drastic cuts in funding for education, health care, public safety and other crucial public services as they struggle to balance budgets in the face of increasing need and plummeting revenues. Moreover, the impending recession could be both deep and long; the fiscal aid thus far is tied to the health emergency, or is slated to end within the year. It needs to be extended for the duration of the economic crisis.

> *Congress must provide more to states and local governments — for the duration of the economic crisis — for them to avoid drastic cuts in education and other crucial public services.*

Moody's reports fiscal estimates under two scenarios: a baseline and a severe recession, both covering the remainder of the current fiscal year, which ends June 30, 2020, and all of the next fiscal year, which ends June 30, 2021. In the baseline scenario, Iowa general fund revenue falls 11.4 percent, or $895 million; in the severe scenario revenue falls 14.5 percent, or $1.14 billion

Other estimates of the total revenue losses to the states are even higher than those presented by Moody's. These revenue estimates are based on the latest projection by the Congressional Budget Office (CBO), which shows unemployment averaging 15 percent for the next six months of this year. This compares to a peak unemployment rate of 10 percent during the Great Recession. According to the CBO, the rate will then fall but will still be 9.5 percent at the end of 2021.[4]

These more recent estimates suggest that the state fiscal shortfalls in fiscal year 2021 will be 52 percent larger than during fiscal 2010, the worst year of the great recession. Iowa general fund revenues in fiscal 2010 were 9 percent below the pre-recession level (FY2008). Losses 52 percent higher would put the revenue decline at about 14 percent, in line with Moody's "severe" scenario.

The revenue losses for the current fiscal year will fall in the final quarter of the year — April, May and June. If we assume Moody's severe scenario the revenue losses in that quarter would be one-fifth of the total (Moody's estimated revenue losses cover five quarters), and would amount to $228 million. That decline in revenue would reduce the ending surplus, most recently projected at $539 million, to $311 million, without taking into account additional expenditures.

We will probably not have reliable estimates of the effect of the COVID crisis on the state general fund until August. A recent analysis by the Legislative Services Agency compared state tax revenues from March 19, 2020, through April 24, 2020, with revenues for the same period a year ago.[5] (March 19 was the date that the Iowa Department of Revenue issued an order extending the deadline for filing corporate and individual income taxes to July 31, and initiated the process allowing businesses a 60-day delay in remitting income tax withholding and sales taxes collected, while two days earlier the Governor had issued the proclamation closing selected businesses.) While general fund net taxes were down a whopping 56.7 percent from a year ago, almost all of that decline is likely due to delays in payment rather than the economic downturn itself. The only revenue loss clearly due to business decline was the $26.7 million reduction in gaming revenue, which does not go into the general fund.

Iowa has $784 million in reserve funds to help it weather the economic downturn — $588 million in the cash reserve fund and $196 million in the Economic Emergency Fund (EEF).[6] The Iowa Legislature, in their emergency bill (SF 2408) passed as they adjourned in March, granted the governor authority to spend up to 10 percent of the EEF and authorized the Legislative Council to approve amounts beyond that, up to the full amount in the EEF. It is too early to tell whether the ending surplus combined with the EEF will be sufficient to offset both the revenue shortfalls and the additional spending necessitated by the COVID-19 crisis in the fourth quarter. If it is not, legislative action would be required to draw on the Cash Reserve Fund.

Moody's Analytics has also estimated that Iowa will need an additional $205 to $236 million to cover increased Medicaid claims over the remainder of this year, and next year. The Families First Coronavirus Response Act, enacted on March 18, provides additional federal Medicaid funds for each quarter in which the national emergency caused by COVID-19 remains in effect, with Iowa's share estimated at $62 million per quarter.[7] That would appear to be sufficient to cover the additional Medicaid costs if the emergency were to stay in effect through March of 2021 (four quarters, starting in April of this year). But given the administration's eagerness to end the economic shutdown, the declaration of emergency could end much sooner than that.

The state will also have additional spending needs necessitated by the state response to COVID-19 and increased demand on safety net programs. This additional spending, however, may be covered by the federal CARES Act. Under that legislation, a Coronavirus Relief Fund (CRF) was created to funnel $139 billion to the states for expenditures related to the COVID-19 public health emergency. Iowa's share will be $1.25 billion.

The CRF money must go for COVID-19 related expenditures not accounted for in the state budget most recently passed, which would be for the current fiscal year, and only for such expenditures through December 30, 2020.[8] Congress has made it explicit that these funds are not for regular general fund programs seeing a shortfall in revenue due to the economic crisis.[9] This differentiates the CARES Act from the state fiscal relief that during the Great Recession,was intended to allow states to maintain services at current levels. The guidance recently published by the Office of Management and Budget makes this quite explicit: "Although a broad range of uses is allowed, revenue replacement is not a permissible use of Fund payments."[10] Importantly, the guidance also stated that the CRF cannot be used to cover the state's share of Medicaid; thus if the increase in Medicaid funding in the Families First Act proves inadequate, the state will have to make up the shortfall from their own revenue sources.

Most analysts agree that federal fiscal assistance to states provided in the CARES Act will prove woefully inadequate. As noted above, the funds are for emergency related purposes beyond what the state budget normally covers. But the substantial drop in state revenues expected for next fiscal year means that all general state funding — K-12 school aid, support of regents institutions and community colleges, public safety, infrastructure, and general operations of state agencies — will have to be slashed below current budget levels unless federal funds replace lost revenue.

Such broader fiscal support may be forthcoming in a fifth piece of federal legislation dealing with the COVID-19 emergency. That support must be extended beyond December of this year, and should be tied to the length of the economic recession, not the health crisis that triggered that recession and that may well have largely ended long before the economy recovers.

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[1] Peter Fisher, *COVID-19 poses threats to Iowa state and local services*, Iowa Fiscal Partnership, April 16, 2020. http://www.iowafiscal.org/covid-19-threatens-state-local-services/

[2] Dan White, Sarah Crane, and Colin Seitz. *Stress-Testing States: COVID-19*. April 14, 2020. Moody's Analytics. https://www.economy.com/economicview/analysis/379097/StressTesting-States-COVID19

[3] Michael Leachman. *New CBO Projections Suggest Even Bigger State Shortfalls.* Center on Budget and Policy Priorities, April 29, 2020. https://www.cbpp.org/blog/new-cbo-projections-suggest-even-bigger-state-shortfalls

[4] Michael Leachman, *New CBO Projections..*,(see above). See also Elizabeth McNichol, Michael Leachman. And Joshuah Marshall. *States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession.* Center on Budget and Policy Priorities, April 14, 2020. https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep and NGA: "National Governors Association Outlines Need for 'Additional and Immediate' Fiscal Assistance to States." https://www.nga.org/news/press-releases/national-governors-association-outlines-need-for-additional-and-immediate-fiscal-assistance-to-states/

[5] Legislative Services Agency, Fiscal Update, April 27, 2020. "State Tax Revenue Update — April 24, 2020."

[6] Legislative Services Agency, Fiscal Update, March 13, 2020. "LSA General Fund Balance Sheet Update (March 2020)"

[7] Legislative Services Agency, Fiscal Update, March 20, 2020, "Covid-19 Economic Stimulus Package — Medicaid."

[8] Legislative Services Agency, Fiscal Update, March 31, 2020. "H.R. 748 Coronavirus Aid, Relief, And Economic Security Act Appropriations."

[9] The Cares act states: "Coronavirus Relief Fund payments may not be used to directly account for revenue shortfalls related to the COVID-19 outbreak."

[10] Coronavirus Relief Fund Guidance for State, Territorial, Local, and Tribal Governments, April 22, 2020.

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