



TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION

The state of state budgets during COVID-19

Prepared for the Governor's Council on Tax Reform

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Takeaways

- State budgets were in good shape before COVID-19
- State fiscal problems are deep and widespread but the severity varies
 - Depends on the state's economy, tax system, and virus cases
 - Congress's assistance has helped but is expiring
- States took substantial budget actions in FY 2020, but deficits and budget cuts likely will be larger in FY 2021
 - Uncertainty is huge and persistent problem
- Kansas can look to other states for revenue options

What states budgets looked like before COVID-19

States were generally in good fiscal shape

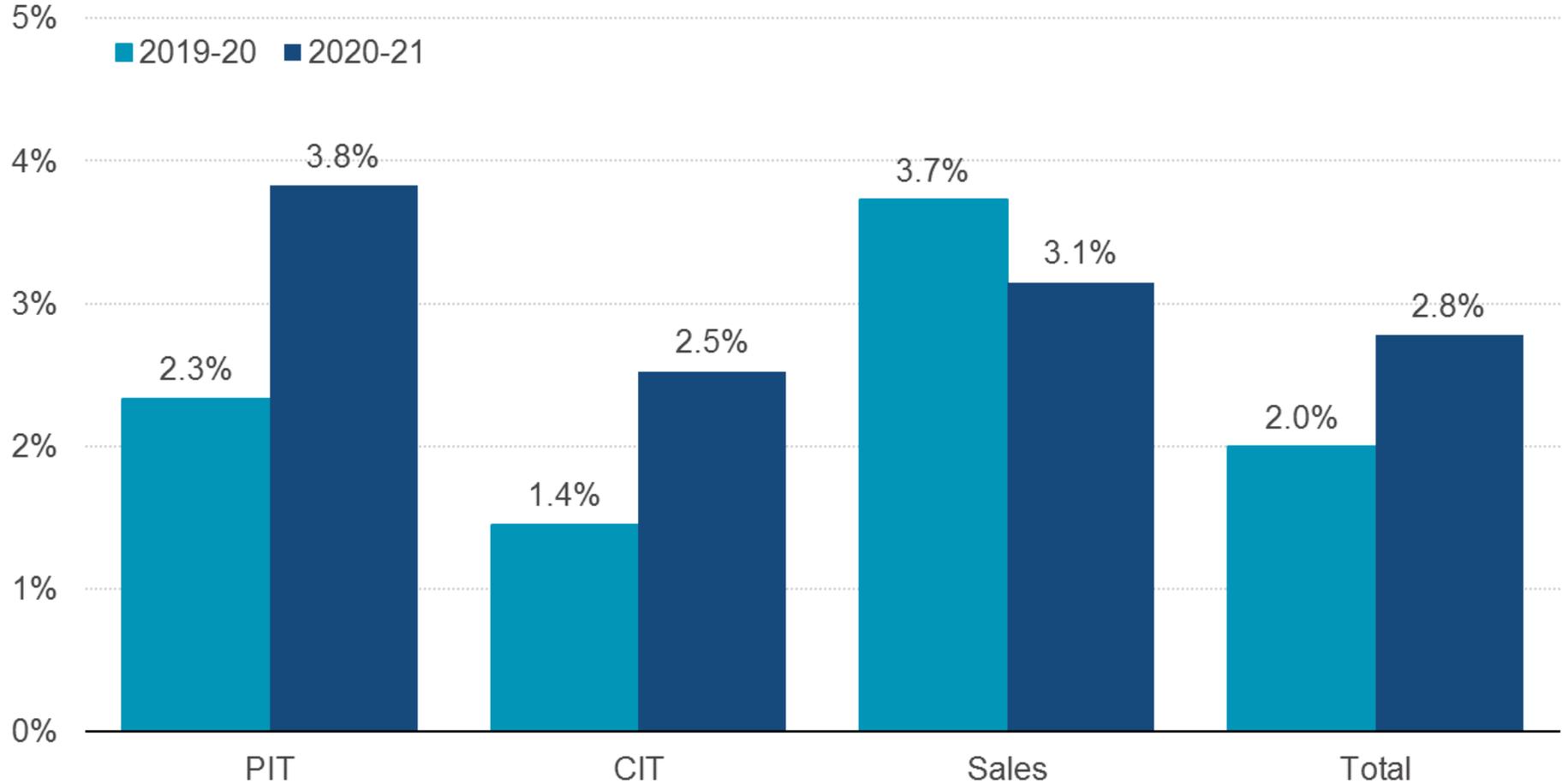
- State revenues were on track for a 10th consecutive year of growth
- No state was forced to make a mid-year budget cut in FY 2019
- NASBO: Median rainy day fund was 7.6% of expenditures in FY 2019—a record high
 - Kansas established its rainy day fund in 2016 and was set to make its first deposit in FY 2020

Solid revenue growth was forecast before COVID-19



Revenue forecasts prior to COVID-19 in 48 states

Percent change



What state budgets look like after COVID-19

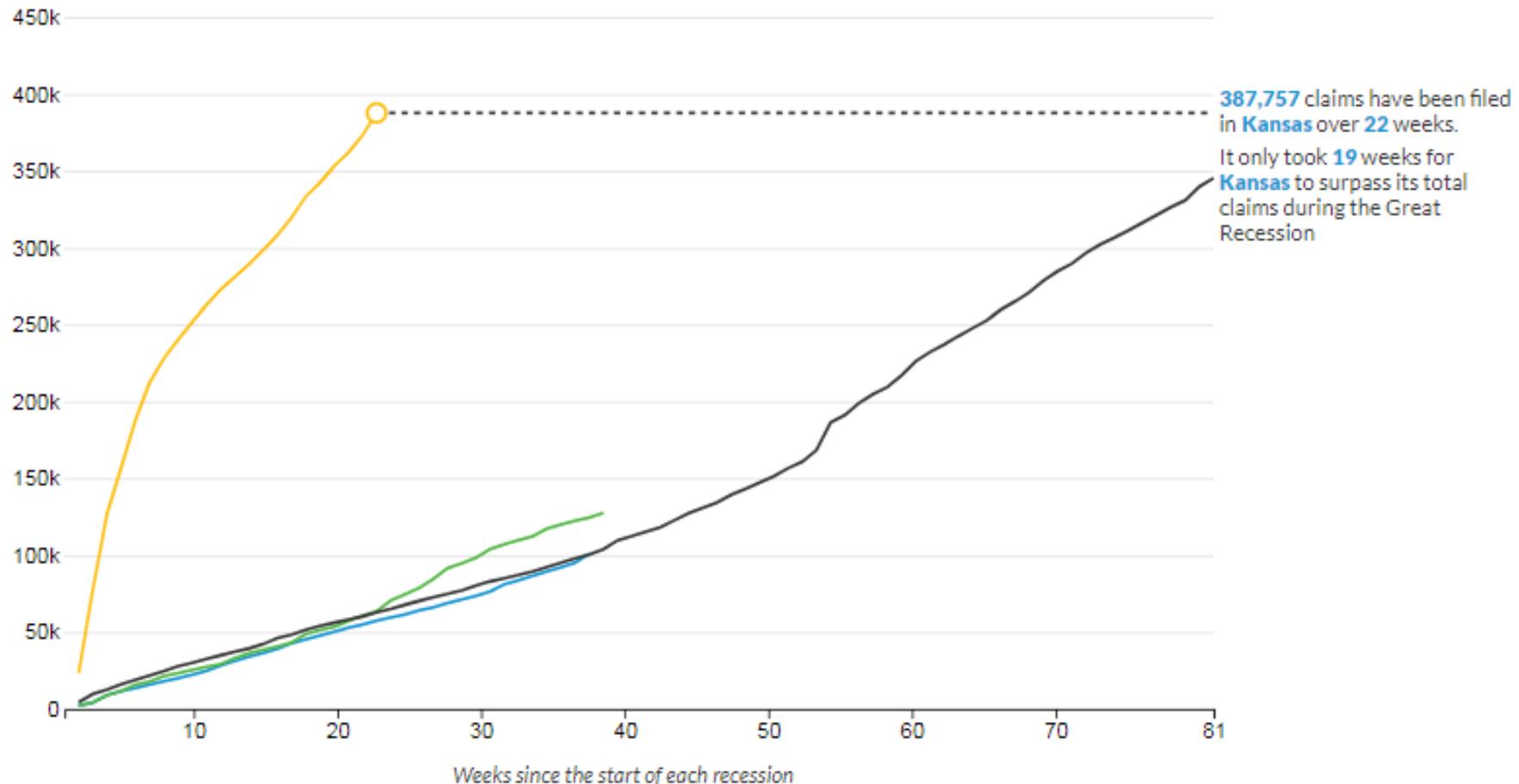
The COVID-19 recession is not a normal recession



Kansas Unemployment Insurance Claims as of August 20, 2020

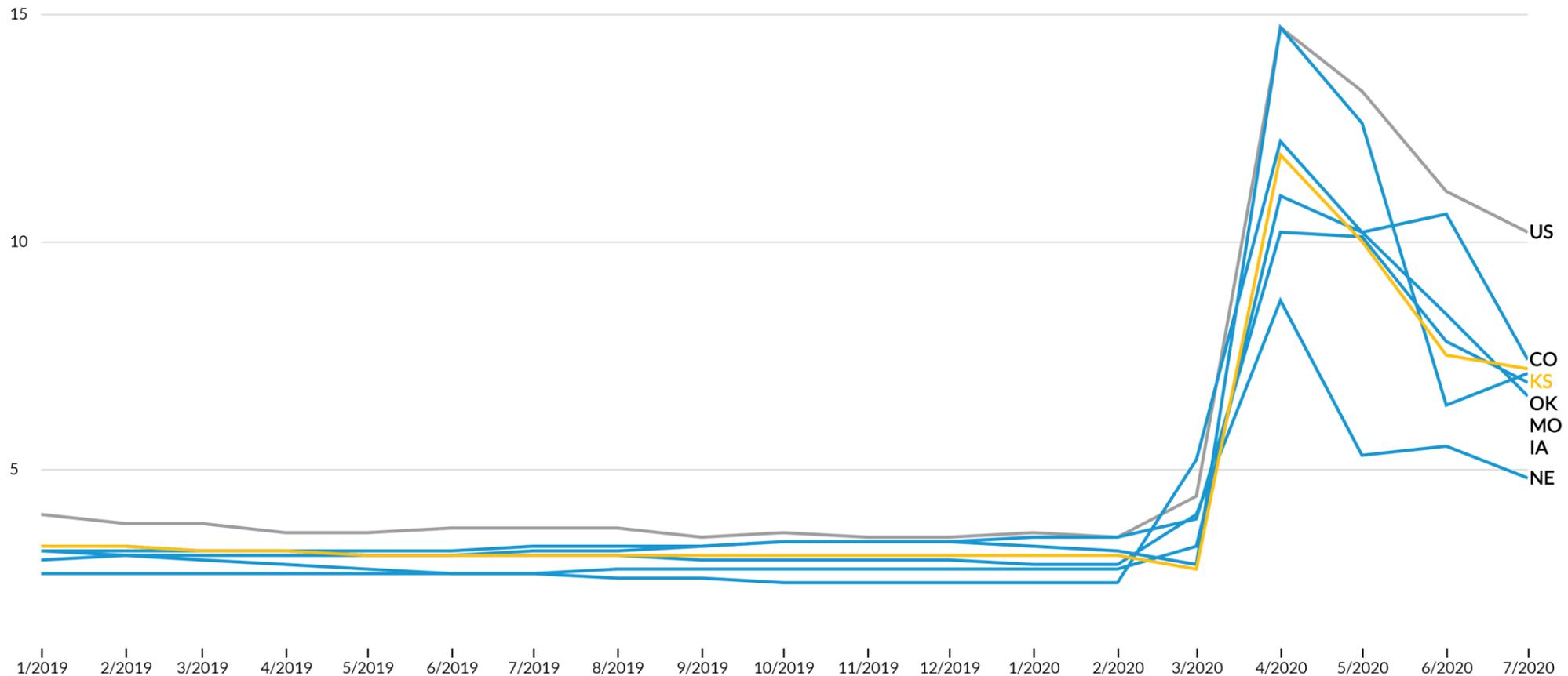
— 1990 recession Beginning 7/14/1990 — 2001 recession Beginning 3/17/2001 — Great Recession Beginning 12/15/2007 — COVID-19 pandemic Beginning 3/14/2020

Total Unemployment Insurance claims



Kansas's unemployment rate is lower than nation's, but roughly equal to its peak during the Great Recession

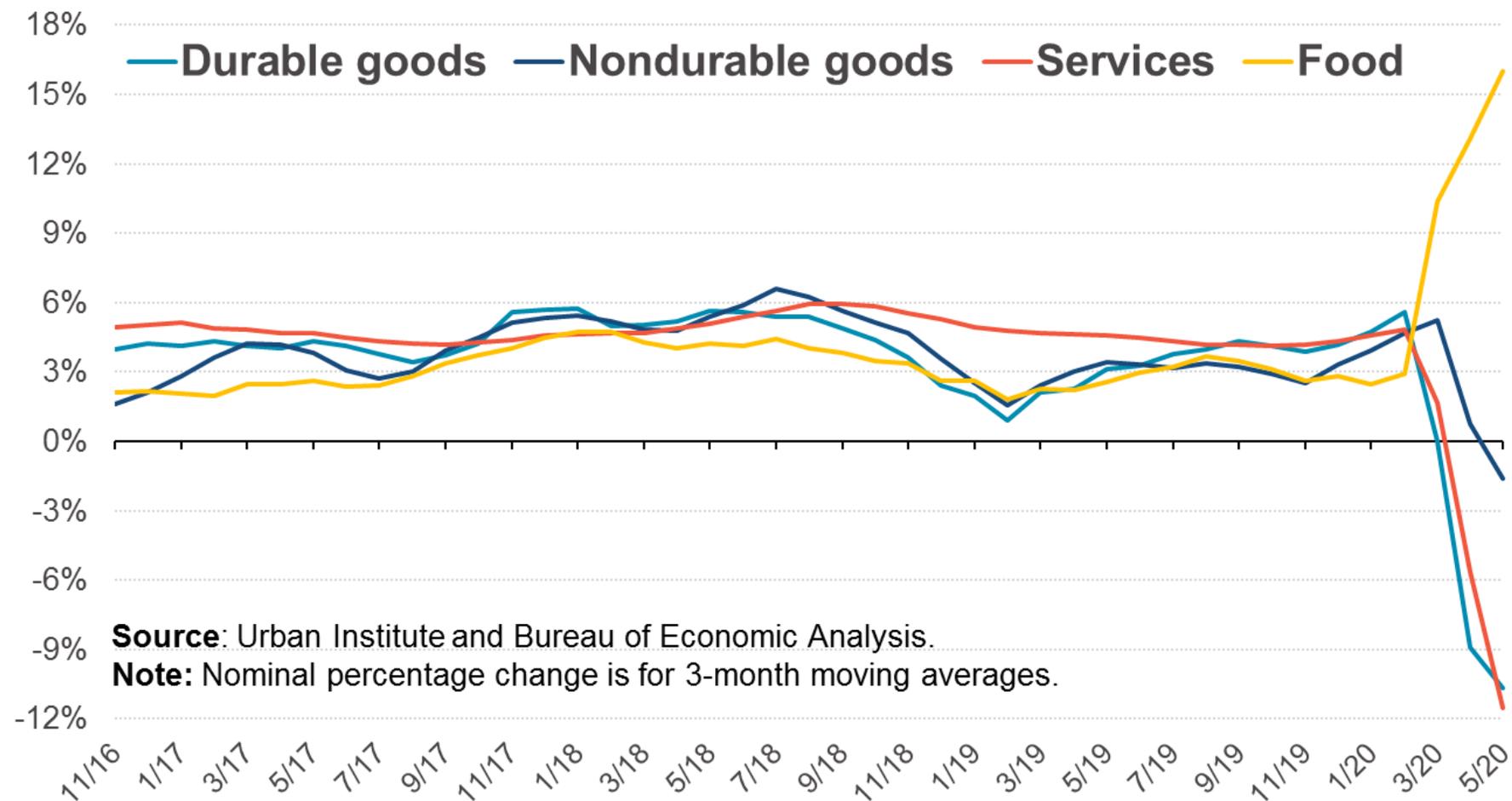
Unemployment rate *(percent, seasonally adjusted)*



Source: Bureau of Labor Statistics via the State Economic Monitor

Sharp decline in most (but not all) spending

Year-over-year percent change in personal consumption spending

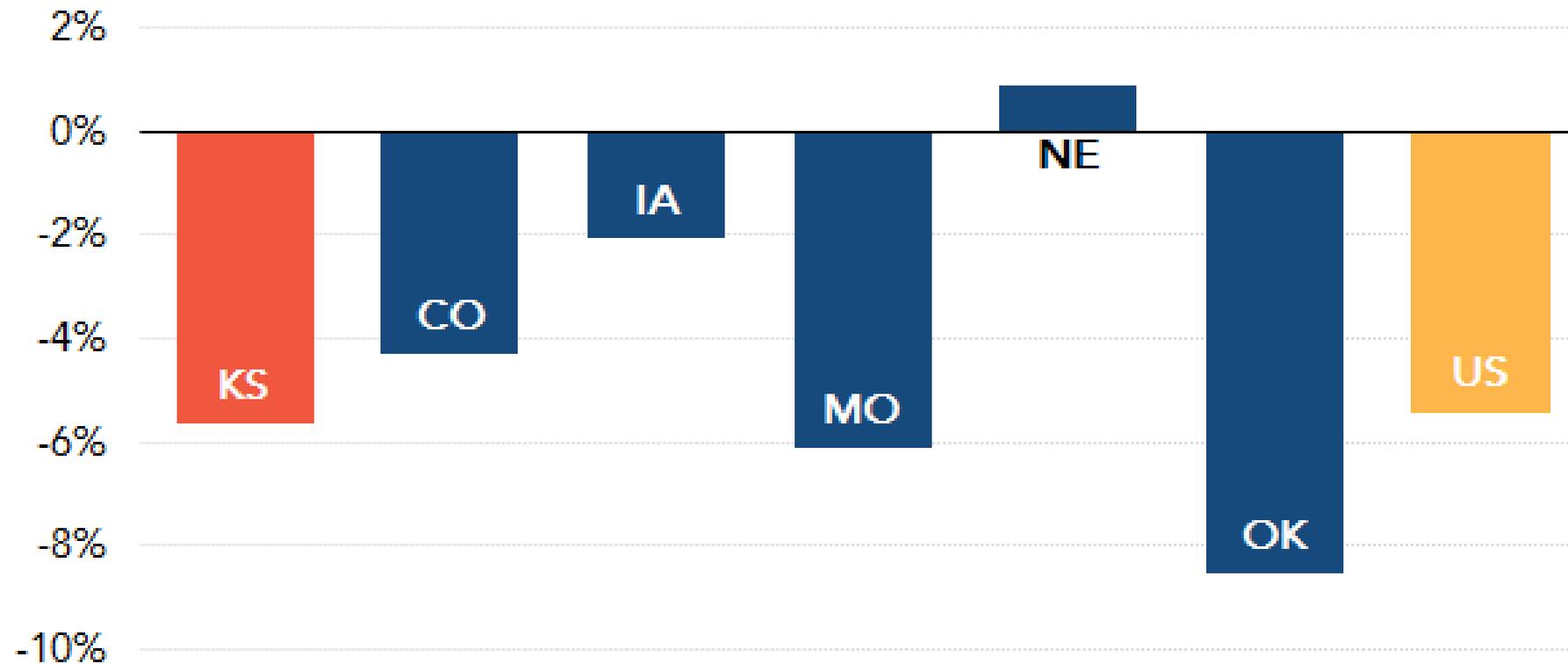


Source: Urban Institute and Bureau of Economic Analysis.

Note: Nominal percentage change is for 3-month moving averages.

Revenue declines in fiscal year 2020

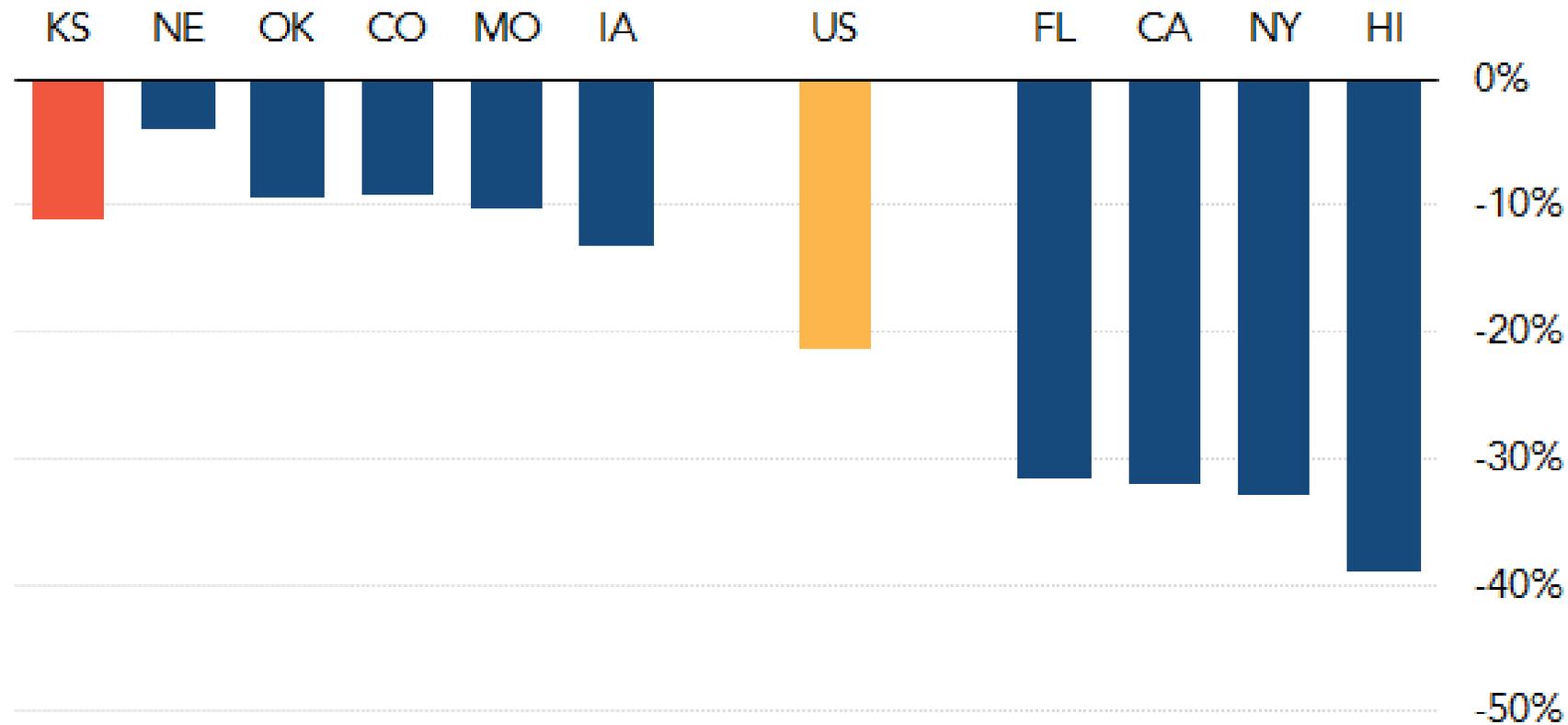
Percent change in total state tax revenue FY 2019 vs. FY 2020



Source: State fiscal agencies

Decline in sales tax revenue, May 2019 vs. May 2020

Percent change, year-over-year

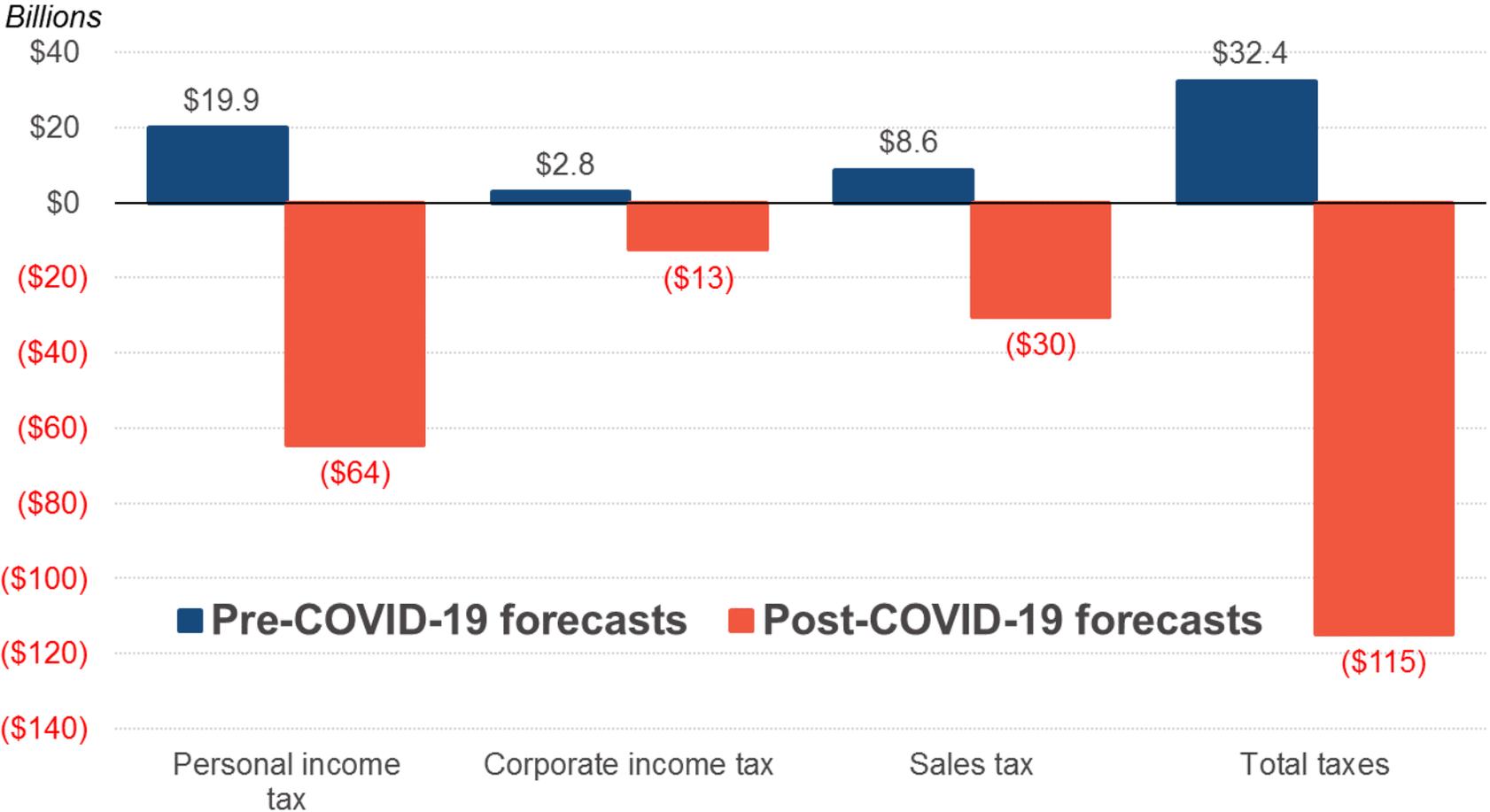


Source: State data collected by the Tax Policy Center.

Forecasts anticipate further declines into FY 2021



State revenue forecasts for FY 2020 and FY2021 in 27 states

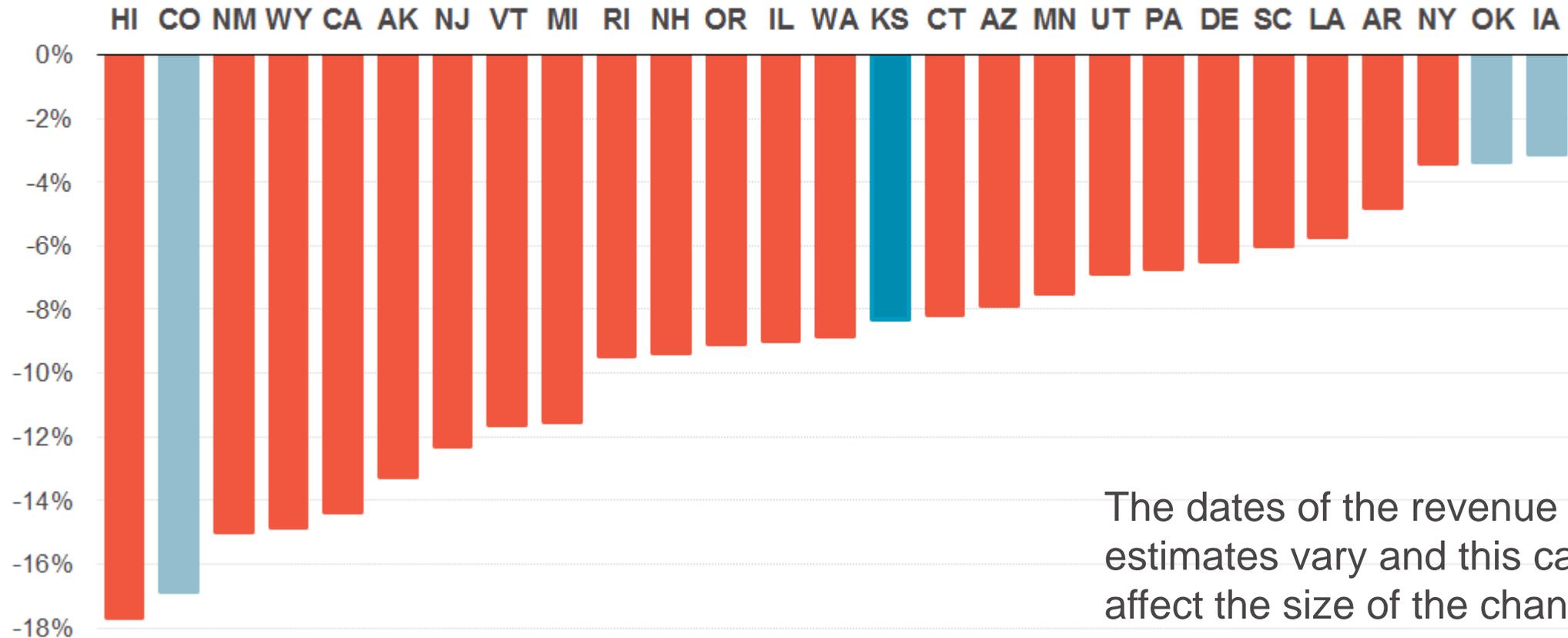


Extrapolated to 50 states:

Combined \$200 billion shortfall in FY20 & FY21

The economic and revenue pain is not equal, though

Percent change in revenue estimates compared to pre-COVID-19 estimates



The dates of the revenue estimates vary and this can affect the size of the change.

Additional pressures on the spending side

- Public health emergency
 - Testing, PPE, hospitals, etc.
- Medicaid
 - Urban Institute estimates non-elderly Medicaid enrollment will increase by 8 million to 26 million people (16% to 53%) during the COVID-19 recession
- Education
 - Preparing for in-person and online learning, simultaneously, is challenging and possibly costly for both K-12 education and higher education
 - Lots of uncertainty

Federal assistance to states and localities so far

- \$1 billion for the public health response (Phase 1)
- \$40 billion in additional Medicaid funds (Phase 2)

CARES Act

- \$150 billion for a Coronavirus Relief Fund dedicated to state and local governments
 - For costs related to COVID-19 not otherwise accounted for and limited to CY 2020
- \$30 billion for an Education Stabilization Fund (half K-12; half higher education)
- \$25 billion for mass transit agencies
- \$5 billion in Community Development Block Grants
- \$3.5 billion for Child Care Development Block Grants

Enhanced unemployment insurance payments

- \$600 increase in UI payments expired on July 31
- Executive order created \$300 supplemental benefit
 - So far, only Arizona has paid out the \$300
 - 13 additional states have been approved for the enhanced payment
 - FEMA: enhanced payments will last only three weeks
- Enhanced UI payments helped prop up withholding (taxable in all but six states) and consumer spending

How states are addressing the budget crisis

Most states enacted FY 2021 budgets

- 43 states enacted FY 2021 budgets (16 enacted a biennial budget in 2019)
- Michigan's and New Jersey's FY begins on October 1
 - New Jersey delayed the start of its fiscal year by three months
- MA, PA, RI, SC, and VT all enacted some type of temporary or partial budget
- The timing budget actions vary, depending on reserve levels, revenue forecasting processes, executive authority to reduce the budget, and state budget rules
- States are also waiting for (and sometimes budgeting on the assumption of) additional federal relief measures

Widespread FY 2020 budget cuts

- **Colorado** cut \$3.3 billion from its general fund (including K-12)
- **Florida** governor vetoed \$1 billion in spending
- **Georgia** cut \$2.2 billion (including K-12)
- **Indiana** governor announced 15% cut to all state agencies
- **Missouri** cut spending by roughly \$600 million
- **Ohio** cut \$775 million (including \$300 million from K-12)
- **Tennessee** budget cut \$1 billion from governor's proposal
- **Washington** governor's vetoes removed \$445 million from budget

Rainy day funds drawn down

- **Arkansas:** \$173 million
- **California:** \$8.8 billion
- **Indiana:** \$900 million
- **Maryland:** \$50 million
- **Michigan:** \$350 million
- **Nebraska:** \$84 million
- **Nevada:** \$401 million
- **Utah:** \$680 million

Possibly larger cuts anticipated for FY 2021

- **California:** \$14 billion in cuts if no further federal assistance
- **Colorado:** 10% across-the-board cuts
- **Florida:** Agencies ordered to prepare budget with 6% cut
- **Georgia:** Agencies ordered to prepare budget with 14% cut
- **Kentucky:** 16% to 29% across-the-board cuts depending on federal assistance
- **Louisiana:** Budget cuts of at least 10%
- **North Dakota:** Forecast cuts of 5% to 15%
- **Tennessee:** Identify as much as 12% in cuts
- **Wyoming:** Up to 20% cut across-the-board cuts

State (and local) budget cuts are often job cuts

- Nationally, the number of state and local public employees has fallen by 1.2 million, or 6%, since February
 - Typically, public job losses lag private job losses; recent nadir was 2013

- **Layoffs:** MI, MO, NV, PA
- **Furloughs:** CA, MI, NV, WA, WY
- **Hiring freezes:** HA, IN, KS, KY, ME, MD, MI, MN, NV, NM, NY, OH, TN, VA, WA, WY
- **Canceled/delayed pay increases:** AL, AR, KY, NM, UT, WA

Few significant tax changes since COVID-19

- Some states (CO, GA, NC, NM, NY) decoupled from CARES Act changes
 - Kansas uses “rolling” conformity and adopted changes
- California suspended NOLs (taxpayers w/ \$1 million+) for 2020, 2021, and 2022—but extended carryover period for three years for anyone affected by the suspension
 - Also capped business tax incentive credits at \$5 million for 2020, 2021, and 2022
- Colorado curtailed some corporate tax expenditures

- Alternatively: Nebraska passed property tax relief, estimated to cost the state’s general fund \$95 million in fiscal 2021 and \$135 million in fiscal 2022

Options for revenue in Kansas

Note: None of these are policy recommendations

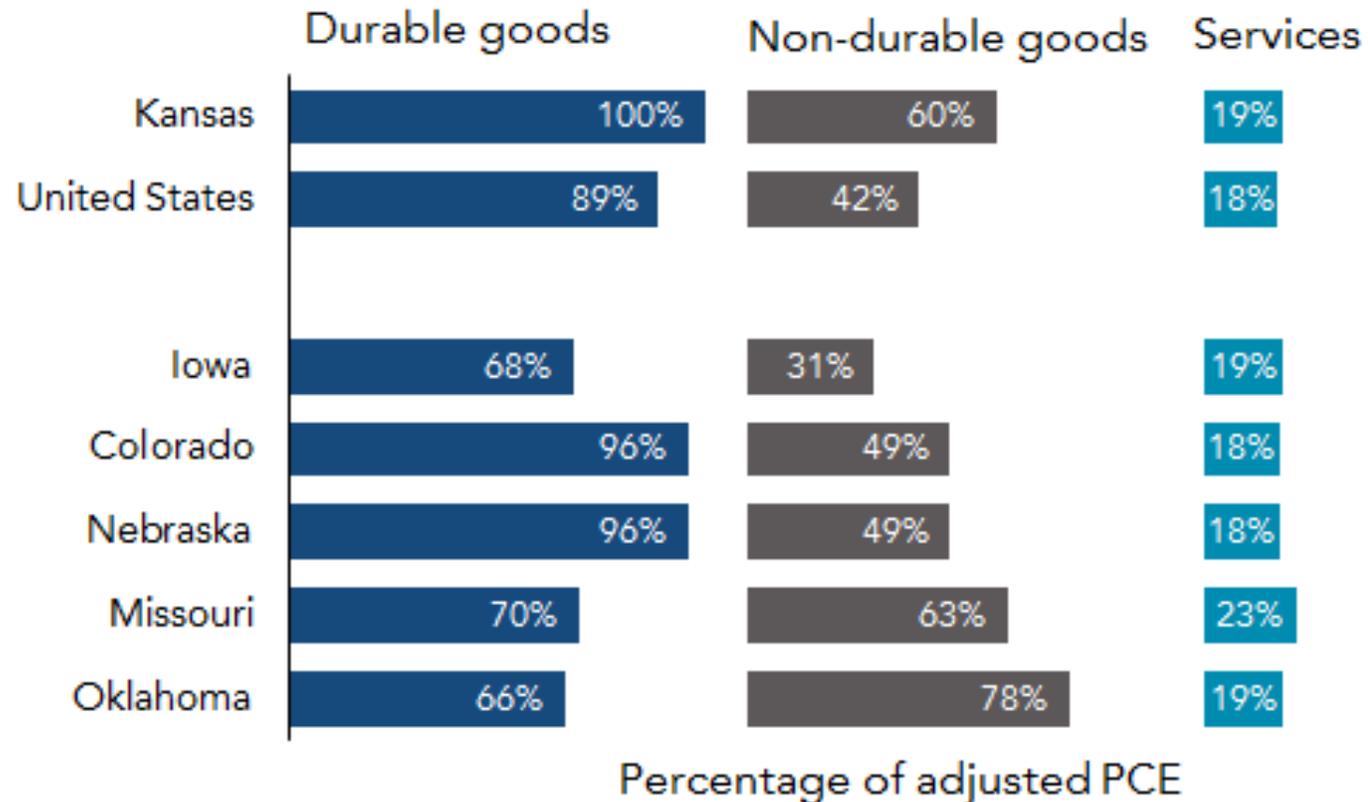
- The following tax policies are changes other states recently made to increase revenue (mostly before COVID-19)
- Every tax increase is politically challenging
- The Tax Policy Center does not make specific policy recommendations, but attempts to help policymakers better understand the tradeoffs involved in these decisions

Marketplace facilitator legislation

- Kansas is the only state that requires online sellers to collect its sales tax that does not also require marketplace facilitators (e.g., Amazon marketplace) to collect the tax
 - Florida and Missouri do not require any online sellers to collect the tax
- Revenue estimates for first year of marketplace enforcement (all before COVID-19):
 - Arkansas: \$32 million
 - Colorado: \$44 million
 - Idaho: \$30 million
 - Illinois: \$80 million
 - Indiana: \$67 million
 - Kentucky: \$17 million
- In each states this is roughly 1% of state general sales tax revenue

Expanding the sales tax base to services

Tax Base Utilization by Expenditure



Source: Bureau of Economic Analysis, Regional Accounts Table SAEXP1, Bureau of Economic Analysis, National Income and Product Accounts Table 2.4.5U, and state statutes accessed in Bloomberg BNA.

Note: Preliminary analysis.

Expanding the sales tax base, continued

- HB 2384: towing; security services; barber shops; beauty salons; pet care; parking
 - Fiscal note: \$40 million to \$50 million in new revenue
- Taxes on digital purchases (i.e., streaming services)
 - Typically generate tens of millions of dollars in revenue
- Federation of Tax Administrators survey useful for state comparisons
 - <https://www.taxadmin.org/sales-taxation-of-services>

Reforming tax expenditures

- Kansas provides nearly \$10 billion in tax expenditures (2018 report)
- Total is inflated as some are part of the tax system’s “normal structure”
 - Credits for income taxes paid in other states
 - Business-to-business sales exempted from the general sale tax
- Most expenditures are inherently politically popular
 - State income tax expenditures typically benefit lower-income filers, seniors, and businesses
- Still, there are opportunities to evaluate and reform to ensure expenditures are meeting their established goals (and raise revenue)
 - Colorado is currently going through this process

Adding a new tax bracket to the income tax

- Kansas's top individual income tax rate is relatively low (5.7%) and levied on a relatively low level of taxable income (\$30,000 single filers, \$60,000 joint filers)
- The state could add a new rate on a higher level of income and still keep its top rate below neighboring Iowa (8.53%) and Nebraska (6.84%)
 - The rates in Colorado (4.63%), Missouri (5.4%), and Oklahoma (5%) are lower
- Raising taxes in a recession is challenging; using a progressive income tax at least allows policymakers to levy the tax on residents who are at least relatively better off during the downturn

Increasing cigarette and alcohol taxes

- Kansas’s cigarette tax is \$1.29 per pack, 33rd highest the nation
 - Lower than in Iowa (\$1.36) and Oklahoma (\$2.06)
 - If passed, a ballot initiative in Colorado would eventually raise its tax to \$2.64
 - Cigarette taxes range from \$0.17 per pack in Missouri to \$4.50 per pack in the District of Columbia
- Kansas’s per gallon taxes on alcohol
 - Spirits: \$2.50 (range from \$1.50 in DC and Maryland to \$14.27 in Washington)
 - Wine: \$0.30 (range from \$0.20 in California and Texas to \$2.50 in Alaska)
 - Beer: \$0.18 (range from \$0.02 in Wyoming to \$1.29 in Tennessee)
 - Kansas does not collect revenue from state-owned liquor stores; 22 states do, making tax rate comparisons difficult
- Only 11 states have increased taxes on beer and wine since 2008

Legalizing and taxing marijuana

- Although prohibited under federal law, marijuana sales for recreational use are legal and taxed in nine states: AK, CA, CO, IL, MA, MI, NV, OR, WA
- Marijuana tax revenue accounts for roughly 0.5% of general revenue in these states
 - Examples: Oregon, \$94 million; Colorado, \$267 million; Washington, \$429 million (all FY 2018)
- Marijuana policy involves decisions and politics well outside of fiscal policy
- However, policymakers (or voters via ballot questions) in Arizona, Montana, New Mexico, New York, Pennsylvania, Vermont are considering legalization in large part because of the revenue opportunities

Thank you

- Contact information

- Richard Auxier: rauxier@urban.org
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- Resources online

- <https://www.taxpolicycenter.org/>
- <https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative>