

## State Trends Policy Brief

### The Impact of COVID-19 on State Budgets

#### Background

The COVID-19 pandemic, first impacting the U.S. on a large scale in March 2020, continues to sweep the country roughly nine months later with only mixed potential for virus eradication, and a return to normal business, educational and social operations in sight.

As federal and state governments rushed to address the urgent medical needs of the crisis, it was initially unclear how sizeable the virus' impact would be on the U.S. economy. We now know that the economic impacts have been some of the greatest in our country's history, with job losses and furloughs exceeding one million, surpassing that of the recent Great Recession.<sup>1</sup>

Virtually no sector of the U.S. has remained unimpacted by the pandemic, including higher education, and the disastrous impact the faltering economy has had on state budgets will almost certainly result in future budget cuts for higher education. While the overall effect on state revenues this spring and fall were smaller than initially anticipated,<sup>2</sup> economists warn that not only will state budgets take years to return to a pre-pandemic state, but a number of factors could actually make the coming fiscal years even worse than the last one.

#### Federal Response

In response to the outbreak of the COVID-19 pandemic, the federal government quickly passed several packages of relief legislation. The largest and most impactful of these packages was the \$2 trillion Coronavirus Aid, Relief and Economic Security (CARES) Act that was enacted at the end of March. Notably, Title V of the CARES Act established the Coronavirus Relief Fund (CRF), which contained \$150 billion in funding for state and local governments with populations over 500,000. The CRF is the largest measure of direct financial support that Congress has provided to states thus far, although an earlier bill, the Families First Coronavirus Response Act, raised the federal share of Medicaid spending, which provided some relief to state budgets. The CARES Act also provided funds directly to some traditionally public services like public transit, K-12 and higher education, and hospitals and healthcare providers, which indirectly benefited most state governments as well.

While state lawmakers praised the initial relief provided by the CRF, specific conditions regarding use of the funds also have made them less impactful than they could potentially be. CRF funds must be used for expenditures incurred due to the COVID-19 public health emergency—not including any lost revenue expenses—and no expenditures are permitted for items that had been accounted for in state budgets most recently approved as of March 27 (the date of CARES passage). CRF funds must be utilized by the end of the 2020 calendar year.

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<sup>1</sup> Michael Leachman and Elizabeth McNichol, "[Pandemics Impact on State Revenues Less Than Earlier Expected But Still Severe](#)," Center on Budget and Policy Priorities, October 30, 2020.

<sup>2</sup> Id.

A survey by the Government Finance Officers Association (GFOA) of CRF prime recipients found that 75 percent of respondents cited the restrictions on the use of CRF funds as the biggest challenge in utilizing the aid, and that specifically the prohibition on using the funds for lost revenue, and the requirement to use them by December 30, 2020, were the largest hurdles to effective use.<sup>3</sup> While 82 percent of those polled did state that their government anticipated spending their full allocation by the due date, many state lawmakers also have said the due date is forcing expenditures where they otherwise might have chosen to save. That is to say, state lawmakers would mostly prefer to budget some of their CRF allocations for the next calendar year given the indefinite duration of the COVID-19 pandemic but are instead spending the entirety of their allocation now as a result of the federal government’s somewhat arbitrary use date.

Further, halting and unclear guidance from the Treasury Department (Treasury) on permissible expenditures and reporting requirements has made it more burdensome for states to utilize their funds. The GFOA survey discovered that only 5 percent interpreted Treasury’s guidance as “very clear,” while 51 percent found it to be either “somewhat unclear” or “very unclear.”<sup>4</sup> One respondent noted that “[t]he piecemeal approach to updating guidance seems at odds with the urgency to spend CRF funds.”<sup>5</sup>

Finally, many state lawmakers are wary about the potential for federal lawmakers to pass additional COVID-19 relief packages containing more state aid. In response to the GFOA survey, 91 percent of respondents indicated that their governments would benefit from additional federal aid, but 60 percent said they were not at all confident that the federal pandemic response would continue to be responsive to the needs of state and local governments.<sup>6</sup> Indeed, much of Summer and Fall 2020 was characterized by failed attempts by federal lawmakers to successfully negotiate any further pandemic relief packages, much less ones containing a sizeable amount of flexible state aid. While late fall and early winter Congressional negotiations following the 2020 election cycle have seemingly moved federal lawmakers closer to an agreement on future aid packages, the final amount allotted to states, the expediency of related guidance, and the flexibility of fund use will continue to impact the actual effect this aid may have on state budgets.

If in fact federal lawmakers do fail to provide any future pandemic relief to state and local governments, this functionally means that states will have received federal pandemic support that could only be used for expenses incurred at the very end of one fiscal year, and in half of another, based on the June 30 fiscal year end date used by the majority of states. As the 2021 and 2022 calendar years proceed, states undoubtedly will continue to incur lost revenues and additional expenses related to the pandemic—even under the most ideal vaccine and social distancing conditions— and the impact of this on state budgets in the absence of additional federal aid would almost certainly surpass the damaging effects we’ve already seen over the last nine months.

## State Impacts

When examining immediate revenue impacts of the pandemic on state budgets, initial revenue shortfalls for the FY20 were better than initially projected. A Center on Budget and Policy Priorities

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<sup>3</sup> Mehreen Haroon, “[CARES Act Coronavirus Relief Funds: The Prime Recipient Perspective](#),” Government Finance Officers Association, October 2020.

<sup>4</sup> Id.

<sup>5</sup> Id.

<sup>6</sup> Id.

analysis of census data and state tax collections found that revenues generally fell only about 2 percent below states' pre-pandemic projections.<sup>7</sup> Notably, however, 46 states have June 30 fiscal year end dates, so the majority of FY20 (which for most started on July 1, 2019, and ended June 30, 2020) was not during the time period impacted by the pandemic. Similarly, CARES Act CRF aid was available in relatively short order after the legislation's passage in March 2020, meaning that many states started utilizing the funds to ease FY20 emergency expenditures before the fiscal year's end.

In the absence of additional federal support, those shortfalls are projected to increase to 11 percent in FY21 and 10 percent in FY22.<sup>8</sup> While the pandemic has thus far had a smaller-than-expected impact on income tax revenues, primarily because of its extreme concentration of job loss on lower-income earners, states also have seen larger-than-expected impacts on sales tax revenues as individuals spent more time at home and delayed larger purchases in light of economic uncertainty. Likewise, state expenditures on Medicaid and other social service programs have predictably risen significantly as more individuals find themselves in need of state-provided support.

Another concern, emerging in Fall 2020, about the potential for a "double-dip" recession could also potentially impact future state shortfalls well beyond current estimates. The term, coined by Moody's Analytics Chief Economist Mark Zandi, refers to the potential for the country to sink back into another recession, as it did immediately after the initial virus outbreak, due to a rise of infections in the cold-weather months, and the deepening impact that would have on the economy.<sup>9</sup> Such a recession would be exacerbated by the absence of further federal relief, according to Zandi.

As we see state governments respond to current and future budget shortfalls, higher education almost certainly will continue to be hugely impacted as well. Many states already have passed spending cuts for public colleges and universities. California, for example, has already cut higher education funding by roughly \$1 billion for the 2020-21 academic year.<sup>10</sup> Colorado public higher education institutions are facing a 5 percent decrease in their appropriations for the next fiscal year after previously expecting a spending increase,<sup>11</sup> and Ohio public higher education saw a 3.8 percent state funding cut in just the few remaining months of FY20 following the pandemic's outbreak.<sup>12</sup> In Oregon, which operates on a two-year budget cycle, state higher education officials were told to anticipate a total of 17 percent in cuts and Georgia school officials have been asked to prepare for a 14 percent cut.<sup>13</sup> Missouri lawmakers have drafted a 10 percent cut for higher education but are putting it temporarily on hold as the state waits to see if further federal aid develops.<sup>14</sup>

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<sup>7</sup> Michael Leachman and Elizabeth McNichol, "[Pandemics Impact on State Revenues Less Than Earlier Expected But Still Severe](#)," Center on Budget and Policy Priorities, October 30, 2020.

<sup>8</sup> Id.

<sup>9</sup> Mark Zandi, "[Odds favor a double-dip recession, Moody's Mark Zandi says. Which presidential candidate has the best plan?](#)" The Philadelphia Inquirer, October 23, 2020.

<sup>10</sup> California Budget & Policy Center, "[First Look: State Budget Manages COVID-19 Challenges But Fails to Use All Options to Invest Now in Californians](#)," July 2020.

<sup>11</sup> Victoria Yuen, "[Mounting Peril for Public Higher Education During the Coronavirus Pandemic](#)," Center for American Progress, June 11, 2020.

<sup>12</sup> Kery Murakami, "[State Cuts Grow Deep](#)," Inside Higher Ed, May 15, 2020.

<sup>13</sup> Id.

<sup>14</sup> Id.

## Conclusion

In summation, state budgets already have been significantly impacted by the outbreak of the COVID-19 pandemic, and those impacts are only anticipated to grow in the absence of future federal relief that features clear regulatory guidance and flexible allowable expenditures. The potential for a worsening economy if virus outbreaks continue to rise in the coming months will further heighten this economic pressure.

While higher education received some targeted federal relief in the CARES Act, it has not kept pace with revenue loss and additional expenses at most institutions, and public higher education is facing an even more severe funding crisis as state lawmakers move to cut higher education funding across the country.