As they grapple with public health crisis, state leaders have limited budget-balancing options

Tim Anderson

As most states in the Midwest entered a new fiscal year in July, the unknowns about FY 2021, and beyond, far outweighed the knowns. Will more federal assistance be made available to help close budget shortfalls? How big will those shortfalls be? Will the economic effects of the COVID-19 pandemic be felt the entire fiscal year?

“It’s been very hard for states to forecast given the uncertainty of the public health emergency,” Shelby Kerns, executive director of the National Association of State Budget Officers, said during a July webinar of The Council of State Governments’ Midwestern Legislative Conference.

But she told legislators of one unmistakable fiscal reality: “States will be grappling with the impact of COVID-19 for years to come.”

The options to fix out-of-balance budgets fall into three broad categories: cut spending, raise more revenue or tap into savings. But some of the specific strategies traditionally used by legislators may not be available this time around.

“What’s different about this fiscal crisis is the public health emergency, which can limit or change some of the options,” Kerns said. “In addition to increased spending being required to respond to the pandemic, some cuts may be impossible, or least unwise.”

During the Great Recession, many states cut reimbursement rates for Medicaid providers and reduced aid to local governments, which employ many first-responders and other frontline workers. Would such cuts be wise, or even possible, now?

Similarly, Kerns noted that during the two fiscal years of the Great Recession, state spending on K-12 education fell by nearly 8 percent. Some kind of cuts in this area would seem likely in FY 2021, simply because the funding of elementary and secondary schools takes up such a large portion of spending (more than one-third of expenditures in state general funds). Yet there will be pressures to spend more on education, due to concerns about the impact of this spring’s school closures on academic achievement and the push to boost student access to broadband and e-learning devices.

Paths to balanced budgets

According to Kerns, most governors were asking state agencies to plan for cuts of 4 percent, 10 percent or 15 percent in FY 2021. Projected declines in revenue for the fiscal year have ranged widely in different states, anywhere from 4 percent to 40 percent — a sign of how uncertain this fiscal period is. Also unclear is the extent to which states will get help from Washington, D.C.; during the Great Recession, federal aid helped offset many state budget cuts.

“To date, that aid has been more focused on helping with increased expenditures from the public health crisis and not on assisting states with revenue loss,” Kerns said.

When the pandemic hit, state rainy day funds (both nationally and in some Midwestern states) were at an all-time high. Tapping into these funds will be one budget-balancing strategy for FY 2021. However, rainy day funds alone won’t be enough to fill the large shortfalls in FY 2021, and Kerns added that it’s best not to deplete these savings in a
single year.

What about raising taxes?

Kansas Sen. Carolyn McGinn said that option is out of the question in her home state due to concerns about the economic effects. “We have small businesses that are just trying to survive,” she told fellow legislators on the webinar.

**View from the Canadian provinces**

Also on the webinar, lawmakers learned about the economic slowdown occurring in Canada. In Ontario, in the months of March, April and May, one in three workers either lost their jobs or had their hours cut in some way. Ontario’s year-over-year economic GDP is expected to decline by 9 percent in 2020.

But that province’s government has one option not available to the states: Run a deficit. (Every state in the Midwest has a statutory or constitutional requirement to enact balanced budgets.) Ontario’s deficit is projected to be $41 billion, or 5 percent of GDP, David West, chief economist and deputy officer of the Financial Accountability Office of Ontario, told webinar participants.

Provincial law does require the government to have a multi-year plan to balance the budget.
RECENT FISCAL DATA AND ESTIMATES FROM THE MIDWEST

ILLINOIS
Revenue collections for FY 2020 were $1.1 billion below last year's levels. And for FY 2021, budget forecasters in May scaled revenue estimates for the state general fund downward by a total of $4.2 billion — a drop of 10.4 percent compared to March estimates.

INDIANA
As of May, revenue collections in FY 2020 were 5.4 percent below collections at the same period in FY 2019. One indicator of the impact of COVID-19: Prior to the pandemic, forecasters expected $550 million in revenue in May from casino/arcade activity; instead, Indiana got 30.

IOWA
In May, state forecasters revised their estimates for fiscal years 2020 and 2021 — both in a downward direction. They were still predicting higher year-over-year revenues between FY 2019 and 2020 (1.0 percent), but an actual drop between FY 2020 and 2021 (0.8 percent).

KANSAS
In April, revenue estimates for FY 2020 and FY 2021 were decreased by a combined $3.3 billion (10.6% and 5.6% in 2020 and 2021, respectively). For this calendar year, Kansas forecasters were predicting a 4.7 percent drop in gross state product.

MICHIGAN
Compared to the January 2020 forecast for revenue collections for the current fiscal year (which ends Sept. 30), estimates in May were down 12 percent in the two largest funds (general fund and school aid). Michigan expects to collect $3.8 billion less than previously anticipated.

MINNESOTA
In early May, a budget deficit of $2.4 billion was being projected for the current biennium, which ends June 30, 2021. In July, Minnesota did report general fund revenue for FY 2020 as being slightly higher (0.8 percent) than that May forecast.

NEBRASKA
As of March 2020, actual revenue collections in the state general fund for FY 2020 were 6.8 percent higher than projections. But by the end of May, actual collections for FY 2020 were running slightly below previous projections (-0.1 percent).

NORTH DAKOTA
General fund revenue was down 24 percent in May compared to previous projections for that month. However, actual collections for the current biennium were still outpacing by 2 percent the numbers that legislators used last year in crafting North Dakota’s budget.

OHIO
Ohio ended the fiscal year for 2020 with a balanced budget, despite tax revenue collections falling $1.1 billion below estimates. A mix of cost containment measures and fiscal controls were implemented in March to help balance the budget.

SASKATCHEWAN
The province closed the fiscal year in 2020 with a budget deficit of $3.1 billion, the result of a steep revenue decline related to the COVID-19 pandemic. In the final three months of the fiscal year, Saskatchewan’s revenues declined by $409 million.

SOUTH DAKOTA
General fund collections in May were 19.1 percent below what had been forecast a year earlier. However, for the fiscal year ending in June, South Dakota was expected to have a budget that was either balanced or had only a small shortfall.

WISCONSIN
In June, revenue collections for the state general fund were $370 million lower (-21.6 percent) than those in June 2019. State fiscal analysts cite two reasons why: the impact of the COVID-19 pandemic and the delayed filing date for income and franchise tax payments.
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