State fiscal relief: How much is needed, and how to deliver it?

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Anatomy of the State Fiscal Crisis

Three sources of fiscal pressure:

- Direct COVID-19 costs
- Collapsing revenues
- Higher demand on Medicaid, other programs

Balanced budget req’s + limited reserves mean states must cut spending/increase taxes. Results:

- Loss of valuable state services
- Deeper downturn and slower recovery
Figure 1: Changes in Real per Capita State Tax Revenues and Changes in the National Unemployment Rate, 1985–2018

Source: Fiedler, Furman, and Powell (2019)
Putting It All Together

Per point unemployment rises:

$41$ billion in revenue loss

+ higher demand on Medicaid, other programs

= $45$ billion in total fiscal pressure
Two Unemployment Projections Through 2023

- Congressional Budget Office (CBO)
- CBO extrapolated
- Goldman Sachs

Source: Congressional Budget Office; Goldman Sachs; author's calculations
Note: Quarterly estimates have been interpolated for time periods where forecasters provided only annual estimates.
Implied State Budget Shortfalls Through FY23

$923 billion

$392B

$253B

$157B

$291B

$121B

$102B

$121B

$57B

Billions of dollars

2020

2021

2022

2023

CBO (extrapolated)

Goldman Sachs

Source: Congressional Budget Office; Goldman Sachs; Fiedler and Powell (2020); author's calculations.

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## What Has Congress Done So Far?

<table>
<thead>
<tr>
<th>Panel A: Families First Coronavirus Response Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in federal Medicaid matching rate</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: CARES Act Funding Available for Direct COVID-19 Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coronavirus Relief Fund</td>
</tr>
<tr>
<td>FEMA Disaster Relief Fund</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel C: Other CARES Act Funding to States, Localities, and Local Agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education Stabilization Fund</td>
</tr>
<tr>
<td>Transit Infrastructure Grants</td>
</tr>
<tr>
<td>Airport Improvement Grants</td>
</tr>
<tr>
<td>Community Development Block Grant</td>
</tr>
<tr>
<td>Homeless Assistance Grants</td>
</tr>
<tr>
<td>Child Care and Development Block Grant</td>
</tr>
<tr>
<td>Election Security Grants</td>
</tr>
</tbody>
</table>
Implied State Budget Shortfalls Through FY23

- $923 billion
- $571 billion

Source: Congressional Budget Office; Goldman Sachs; Fiedler and Powell (2020); author's calculations.

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Three Principles for State Fiscal Relief

Federal aid to states should:

(1) Match the size of the problem
(2) Adjust based on length/duration of downturn
(3) Encourage states to protect Medicaid
One Potential Approach

Increase share of a state’s Medicaid program financed by fed gov’t based on the state’s unemployment rate.

Increase in federal matching rate equals product of:

- Number of percentage points unemployment rate exceeds a “threshold” level; and
- [7] percentage points.

Threshold level is state’s 20th percentile unemployment rate over prior 15 years, plus 1 p.p.
Conclusion

- States certain to face large budget shortfalls, likely >$500b through FY23, perhaps >$900b
- At best, aid to date offsets <$200b, likely less
- A well-designed aid package should be large, adjust with the economy, and protect Medicaid
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