



State and Local Fiscal Conditions and COVID-19: Lessons from the Great Recession and Current Projections

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Federal assistance to state and local governments has been a central part of the fiscal policy discussion surrounding the COVID-19 pandemic. Economic downturns tend to depress the tax bases of federal, state, and local governments and increase demands for certain spending programs. Unlike at the federal level, however, most states and localities have statutory requirements to balance their budgets every one or two years. Absent other measures, these balanced budget requirements can necessitate tax rate increases or spending cuts that could exacerbate economic distress.

Evidence from the Great Recession

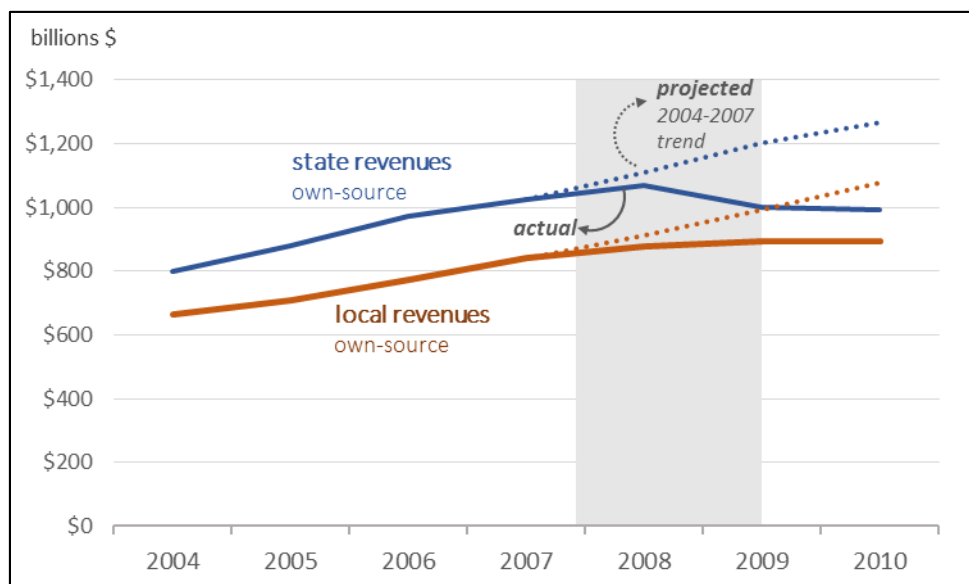
The Great Recession, which lasted from December 2007 to June 2009 as [measured](#) by the National Bureau of Economic Research (NBER), was considered the largest U.S. economic shock since the Great Depression, as significant disruption in the housing and financial markets generated adverse conditions throughout the economy. At its peak, quarterly real gross domestic product (GDP) declined by 8.4% (in the [second quarter of 2008](#)), and federal deficits averaged 9.0% of GDP from FY2009 through FY2011, their largest values since World War II.

Trends in revenues, the portion of the budget typically [most affected](#) by recessions, may offer some perspective on the Great Recession's effect on state and local budgets. **Figure 1** shows the actual state and local own-source revenues in FY2008-FY2010 relative to levels consistent with FY2004-FY2007 growth trends. Relative to FY2004-FY2007 revenue trends, the cumulative combined state and local revenue gap from FY2008 to FY2010 was \$838 billion.

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Figure 1. Actual and Projected State and Local Own-Source Revenues, 2004-2010

Source: U.S. Census Bureau, Annual Survey of State & Local Finances, 2004-2010.

Notes: State and local revenues are own-source revenues, which exclude transfers from other governments. Shaded area indicates recession as measured by the [NBER](#).

Cumulative declines in revenues from trend levels were larger for state governments (\$520 billion, 62% of the total) than for local governments (\$319 billion, 38% of the total). This effect was partly due to larger state budgets prior to the Great Recession. But it was also due to declines in consumption taxes—a major source of revenue for many states—that are more sensitive to economic downturns than local property taxes, which are the primary sources of revenue for local governments.

Projections of Effects from COVID-19

The [Federation of Tax Administrators](#) estimated a near-term decline in state revenues of \$152 billion through the remainder of the fiscal year (generally ending June 30, 2020) and \$91 billion adjusting for delayed tax filing. The largest source of shortfalls was from individual income taxes (\$83 billion), followed by \$38 billion in sales tax revenue, \$24 billion in corporate revenue, and \$5 billion in motor fuel taxes. The study estimates states have about \$90 billion in rainy day funds.

[Moody's Analytics](#) estimated shortfalls for states through FY2021 (ending June 30, 2021) from revenue declines and increased Medicaid payments of \$158 billion to \$203 billion (17.9% to 23.0% of general fund budgets), with the majority (14.8% to 19.5% of general fund budgets) due to revenue shortfalls. States with the largest projected shortfalls have more volatile revenue sources (e.g., oil severance taxes or progressive income taxes) or more affected industries (e.g., tourism, finance, and energy). The states with the largest shortfalls as a share of their budgets were Alaska, Louisiana, and North Dakota. States are generally well prepared with rainy day funds but not to address a crisis of the current magnitude. States with the largest relative shortfalls net of reserves are Louisiana, New Jersey, and New York. States will also increase direct spending due to the demands of COVID-19 (estimated at \$150 billion in the analysis), offset by funds from already enacted federal legislation—\$35 billion from the Families First Coronavirus Response Act (P.L. 116-127) and \$110 billion from the [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#) (P.L. 116-136).

The [Center on Budget Policies and Priorities](#) estimated effects for states through FY2022 at \$500 billion, with \$360 billion remaining after rainy day funds and federal aid. The [National League of Cities](#) projected a revenue shortfall of \$134 billion for 2020 and \$360 billion for 2020-2022 for local governments. The [Upjohn Institute](#) projected a revenue shortfall for the second quarter of calendar year 2020 of \$127 billion for state governments and \$62 billion for local governments; through end of calendar year 2021, these amounts are \$644 billion and \$315 billion. The [Urban Institute](#) estimated a revenue loss for the states of \$200 billion through FY2021 (generally ending on June 30, 2021).

A recent [American Enterprise Institute study](#) indicates a general consensus estimate of a revenue shortfall of around \$200 billion for FY2021.

Recent Federal Activity

The federal government has already enacted some measures to address state and local fiscal conditions. The Coronavirus Relief Fund, established by the CARES Act, enacted on March 27, 2020, provided \$150 billion in payments to state and local governments, with [roughly](#) 20% distributed to large local governments and the remaining 80% to state governments. The CARES Act also created a Municipal Lending Facility that can provide up to \$500 billion in direct financing for state and local debt. The Heroes Act (H.R. 6800), which passed the House on October 1, would direct \$436 billion in payments within one year of enactment (\$257 billion to states, territories, and tribes, and \$179 billion to localities).

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