Georgia Public Policy Foundation

GeorgiaPolicy.org

ISSUE ANALYSIS

Fiscal Policy Considerations in COVID-19's Wake

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Introduction

The widespread business closures state and local governments have ordered to contain the COVID-19 pandemic have resulted in financial losses for many private budgets. Public budgets will not escape this financial pain, either. Many economists project the economic downturn now under way will end up being much deeper than the recession of 2007-2009, although they also forecast it will end sooner and be followed by an uptick that is also historically large.

In between, budgets for Georgia's cities, counties and state government are expected to lose billions of dollars in tax revenue as workers are idled and retailers shuttered. Federal funding is available but, as we explain below, Georgia's appropriators cannot necessarily count on using it to fill the entire budget hole. Tax increases should remain off the table; Georgia families and businesses have already suffered an enormous economic shock. Spending cuts will be necessary to ensure the state is able to balance its budget, as is constitutionally required.

Key factors will inform lawmakers' actions, among them:

Reserves

Georgia prudently built up reserves of $2.8 billion[1] during the decade-long economic expansion that followed the recession of 2007-2009, but these funds may not go as far as one might expect. Already, the General Assembly has appropriated $100 million from these reserves as initial funding for the state's COVID-19 response. The remaining $2.7 billion represents about 11.5% of the state's general-fund budget for fiscal year 2020[2] (FY20), or about six weeks' worth of spending. Looking at all state spending, including dedicated funds, the reserves would cover less than 10% of spending, or about five weeks' worth.

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[1] https://opb.georgia.gov/document/governors-budget-reports/afy-2020-and-fy-2021-governors-budget-report/download page 29

[2] https://opb.georgia.gov/document/document/hb-792-amended-fy-2020-appropriations-bill/download

In FY19, the state recorded about $6.75 billion in general-fund receipts over the final three months of the budget year (April[3], May[4], June[5]). The state's $2.7 billion in reserves would offset a 40% decline in receipts over the final three months of FY20.

Timing

Complicating matters, the Kemp administration's decision to mirror federal policy and push back the deadline for filing 2019 income taxes to July 15 – while understandable – means the reserves may be largely depleted simply to cover delayed tax payments. April and June, two of the most important months of the year for income-tax collections, not only fall before the new filing deadline for 2019 but are likely to take a hit as quarterly estimated payments for 2020 decline due to the economic shutdown.

The later filing deadline is not the only unfortunate aspect. In recent years, the timing of income-tax payments to the state has shifted.

- In FY12, the state received almost 52.9% of its income-tax revenues (individual and corporate) in the first half of the budget year (July through December). The remaining 47.1% arrived in the back half of the budget year (January through June).
- By FY19, only 49.4% of income-tax revenues came in the first half, with a slight majority arriving in the second half.

Although revenues for FY20 have been reported only through March, that trend appeared to be holding up. Revenue growth was largely sluggish in the first half of the budget year, but healthier in January, February and March. The stage was set for a substantial influx in April, May and June; now, that almost certainly will not materialize. If this trend was indeed continuing this year, the shortfall for FY20 could be more pronounced than it would have been if the economic shock had come in a different quarter. On the other hand, the timing may be more beneficial with regard to FY21 should the recovery begin before the second half of that budget year.

Federal Funding

One significant difference between the recession of 2007-2009 and the current downturn is the amount of emergency funding Congress is appropriating. Many Americans were upset by the size of the 2009 American Recovery and Reinvestment Act (ARRA), but its $836 billion cost[6] was less than half the estimated $1.7 trillion[7] cost for the Coronavirus Aid, Relief and Economic Security (CARES) Act alone – the third bill enacted in response to the present pandemic. It is unlikely to be the last; in fact, Congress has already amended the CARES Act to add some $480 billion[8] in funding.

[3] https://dor.georgia.gov/press-releases/2019-05-06/april-net-tax-revenues-242
[4] https://dor.georgia.gov/press-releases/2019-06-07/may-net-tax-revenue-01
[5] https://dor.georgia.gov/press-releases/2019-07-08/june-net-tax-revenues-74
[6] https://www.cbo.gov/publication/49958
[7] https://www.cbo.gov/publication/56334
[8] https://www.cbo.gov/publication/56338

As with the ARRA, Congress is distributing funding to state and local governments and agencies – but, again, the present funding is on a far greater scale. Among the federal funds available to public agencies in the states are:

- $150 billion in direct payments to state and local governments;
- $31 billion in education funding;
- $25 billion for mass transit agencies; and
- an additional 6.2% match for states' Medicaid spending.

Other federal aid goes directly to entities such as hospitals and other public-health agencies, as well as supplemental funding for unemployment insurance. In addition, the Federal Reserve has established a short-term lending facility totaling $500 billion for state and large municipal governments.

Partial estimates of the federal funding available in Georgia are as follows:

- the Congressional Research Service (CRS) projects Georgia's state government will receive $4.117 billion in direct aid from the CARES Act, of which $614 million may go to cities and counties with at least 500,000 residents[9];
- the CRS also projects Georgia will receive $105.448 million from the Governor's Emergency Education Relief Fund, $457.17 million from the Elementary and Secondary School Emergency Relief Fund, and $403.172 million from the Higher Education Emergency Relief Fund, for a total of more than $965 million[10];
- the Federal Transit Administration says Atlanta will receive more than $370.9 million in emergency transit funding, while Augusta will receive almost $6.5 million, northwest Georgia will receive $2.3 million, Columbus almost $7 million, Savannah almost $10.8 million, 11 smaller metro areas will split more than $49.7 million, and about $75 million will go to rural areas – for a total of more than $522 million[11];
- using an estimate by health policy expert Brian Blase[12], modified to account for the 6.2% federal medical-assistance percentage (FMAP) increase all states will ultimately receive, Georgia will receive $713 million in enhanced Medicaid funding from the federal government.

Those four funding areas alone should total more than $6 billion in new federal funding for Georgia's state and local governments. It is unclear, however, how much of this funding may be used to offset revenue losses due to the economic downturn.

Federal guidance issued April 23, for example, indicates the $3.503 billion in direct state aid ($4.117 billion less $614 million for local governments) must be used for only certain expenses

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[9] https://crsreports.congress.gov/product/pdf/R/R46298
[10] https://secureservercdn.net/198.71.233.138/m01.813.myftpupload.com/wp-content/uploads/2020/04/Ed-Stabilitation-Fund-CRS-Estimates.pdf?time=1588285610
[11] https://www.transit.dot.gov/cares-act-apportionments
[12] https://www.nationalreview.com/2020/03/a-smarter-approach-to-offering-states-federal-covid-19-relief-funds/

and not to offset revenue losses[13]. Namely, these are expenses that 1) are necessary because of the public health emergency, 2) were not included in the state's budget prior to March 27, and 3) will have been incurred between March 27 and December 30. That would seem to preclude use for normal state expenditures. However, it is possible some broad categories of spending already projected for inclusion in the FY21 budget, which the General Assembly has not yet passed, might qualify.

There is little to indicate the $965 million in education funding and $713 million in additional Medicaid funding could not be used to offset revenue losses. That does not, however, mean all of those funds will be available to offset losses.

While the state will receive $403.172 million from the Higher Education Emergency Relief Fund, the University System of Georgia is already projecting a shortfall of approximately $350 million[14] due to refunds of student expenses, among other costs. Furthermore, while k-12 education is due to receive almost $563 million in emergency funding, it is also clear that school districts will face large expenses associated with remediating students who lost valuable months of instruction this spring and with enhancing remote-learning capabilities in the likely event that the novel coronavirus will disrupt classes in the 2020-21 school year as well. Some of these expenses could, and should, be offset by reduced spending in other areas, such as lower utilities in school buildings that were closed and reduced fuel usage due to buses not running.

Finally, the enhanced Medicaid match may not offset the additional state spending required for new enrollees as Georgians lose their jobs and become eligible for the program. This funding problem is exacerbated by the fact that the CARES Act included supplemental funding for unemployment insurance of up to $600 per week then exempted that supplemental funding for the purposes of calculating Medicaid eligibility. This combination will have the perverse effect of encouraging laid-off workers to remain unemployed even after their employers resume operations. It may also mean that workers who move from full-time to part-time will shift from their employer-sponsored insurance to Medicaid –transferring these expenses onto taxpayers.

While the $600 weekly payout offered through the Federal Pandemic Unemployment Assistance (PUA) program does not factor into Medicaid eligibility, it will have a prolonged impact on state finances through the end of July, and possibly longer as unemployment numbers continue to rise. PUA benefits are taxable (as income) and will negate some of the losses in state revenues, but the net losses will remain significant as state unemployment payouts increase. If the state were to reach 20% unemployment, there could be roughly 1 million workers eventually filing for unemployment. With current state unemployment payments reaching up to $365/week per worker, the state could face payouts of up to $10 billion over 26 weeks. Unfortunately, the longer the pandemic stalls businesses, the worse those numbers, and the likelihood of increased unemployment premiums in the future will rise for Georgia employers. The Georgia

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[13] https://home.treasury.gov/system/files/136/Coronavirus-Relief-Fund-Guidance-for-State-Territorial-Local-and-Tribal-Governments.pdf

[14] https://www.onlineathens.com/news/20200414/georgia-public-colleges-could-take-350-million-hit-from-virus

Unemployment Trust Fund began 2020 with approximately $2.5 billion in reserves[15]. Once current premiums being paid out are factored in, these reserves will last the state for roughly two months.

In summary, although some new federal funding flowing into Georgia could offset revenue losses, it remains to be seen how much will remain available after additional expenses are covered.

Magnitude of Revenue Losses

As of publication, Georgia had not yet reported a full month of revenues since the economic shutdown began and was not likely to do so until almost mid-May. But if history is any guide, the losses will be substantial.

The recession of 2007-2009 caused state revenues to plummet by almost $1.97 billion (9.9%) between FY08 and FY09, and a further $1.58 billion (8.9%) between FY09 and FY10. These losses stemmed from a 2.5% contraction in real U.S. GDP during FY09 and growth of only 0.4% during FY10[16]. The economic contraction was sharper in Georgia: losses of 4.7% in FY09 and 0.9% in FY10.

In contrast, a series of forecasts are projecting a much sharper economic contraction in 2020 (calendar year, not fiscal year) due to the pandemic. The government's initial estimate for first-quarter U.S. GDP showed a decrease of 4.8%[17]. On April 22, Fitch Ratings projected the U.S. economy will shrink by 5.6% over the full year[18], in line with other private-sector forecasts. If the forecasts prove correct, this recession will be twice as deep as the previous one – although most projections also show a rapid and sharp rebound afterward.

Unlike the recession of 2007-2009, however, Georgia's economy may be better-positioned than other states' to weather the storm. A report by WalletHub ranked Georgia's economy as the "least exposed to coronavirus" because industries at high risk of disruption due to the pandemic make up a relatively smaller share of the economy[19].

Analysis more academic in nature also points in a hopeful direction. The Fiscal Research Center at Georgia State University analyzed the potential loss of sales and use tax revenue for the state government, examining similarly at-risk industries. The report estimated losses ranging from $360 million to $406 million in FY20 and $52 million to $313 million in FY21[20].

Although either end of the range for FY20 would represent a very sharp decrease for essentially three months, both years' estimates compare favorably with the recession of 2007-2009. State

[15] https://oui.doleta.gov/unemploy/docs/trustFundSolvReport2020.pdf
[16] While we are referring to U.S. GDP, we are keeping the timeframe of Georgia's fiscal year. The federal fiscal year begins on October 1, vs. July 1 for Georgia.
[17] https://www.bea.gov/news/2020/gross-domestic-product-1st-quarter-2020-advance-estimate
[18] https://www.fitchratings.com/research/sovereigns/unparalleled-global-recession-underway-22-04-2020
[19] https://wallethub.com/edu/state-economies-most-exposed-to-coronavirus/72631/
[20] https://frc.gsu.edu/download/covid-19-impact-report/?wpdmdl=5505&refresh=5e964506a370e1586906374

sales and use tax revenues fell by more than $490 million in FY09 and by almost $442 million in FY10, both from smaller (although not dramatically so) bases.

Existing economic trends are also likely to be exacerbated during this time. The anticipated substantial declines in sales tax revenues will affect both the state budget and municipalities across Georgia. One factor is that online sales have replaced a large percentage of the local retail sales decimated by the prolonged closure of these stores. Exemptions on some necessities will also have an impact: For example, consumers have decreased their traditional spending in restaurants and retail (which is taxable) and shifted towards increased grocery expenditures (which are exempt for the state portion of sales tax). The overall effect on local sales tax receipts is uncertain, and it is possible the decline in revenues could be more severe than what the state experienced during the recession of 2007-2009.

Projecting revenue losses based on past downturns is difficult for a variety of factors. This economic downturn is projected to be much deeper than the recession of 2007-2009, and income-tax revenue is more volatile than revenue from sales and use tax. On the other hand, there is more federal fiscal aid to shuttered businesses and laid-off workers this time. The recovery – when it comes – is expected to be swifter this time because the economy was stronger when the pandemic hit, and the shutdown appears unlikely at this point to spark a more serious banking crisis, as in 2007-09. Among the current unknowns is how widespread a "second wave" of the virus, or even a third, may be should it hit this fall or winter, and how lengthy the accompanying economic disruption might be.

Possible Budget Savings

Whatever deficit remains after reserves and federal funding are exhausted should be closed with spending cuts. While blunt, across-the-board cuts such as employee furloughs may be necessary, more targeted cuts could not only close immediate budget deficits but lay the groundwork for a smarter state budget after the crisis.

Highest on the list should be reforming the State Health Benefits Plan. Georgia spends almost $3.75 billion each year to insure more than 660,000 employees, teachers, retirees and dependents. Private-sector professionals estimate the state could save hundreds of millions of dollars per year through competitive bidding and modernized plan designs. The changes would also likely produce out-of-pocket savings for plan members, making it a win-win for state employees and state taxpayers. This reform should be a top priority of state policymakers as revenues begin falling.

An additional option for policymakers to consider is borrowing within the state's constitutionally mandated limits, which allows for up to $1.3 billion to meet any budgetary shortfalls. Historically low interest rates, coupled with the prospect of inflation in the future, would make it easier for Georgia to pay back these loans later. Although this would delay the ability to replenish the rainy-day fund in the near term, it provides the state with a path forward that does not include raising taxes.

Conclusion

The early indicators for the present downturn suggest sharp decreases in economic activity, and thus state tax revenues, followed by sharp increases once the public health threat dissipates. Georgia is relatively well-positioned to absorb a short-lived, if deep, recession thanks to prudent fiscal management over the past decade. Reserves are available to offset losses during the remainder of FY20, and wise use of federal funding should cushion much of the blow in FY21.

Some trimming of state spending would be prudent, and lawmakers should seize the opportunity to reform programs that would have benefitted from changes even in better times. Calls for tax increases are, at a minimum, premature. We do not yet know the scope of the revenue downturn, or the final size and availability of all federally appropriated relief funds. Nor do we know enough yet about which sectors of the economy will sustain the worst, longest-lasting damage from the shutdown, which means new taxes affecting those sectors and Georgia's taxpaying families could make the revenue situation worse, not better. Raising new revenue would in most cases be counter-productive as the economy attempts to regain its footing. Good fiscal stewardship has served Georgians well for years. Now is no time for the state to reverse course.

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