

Iowa will need more fiscal relief than Congress has given

Reserves, existing federal aid will not cover projected revenue shortfalls

By Peter Fisher

As we noted earlier,¹ the combined effect of the looming recession and the health emergency triggered by the COVID-19 pandemic will have a devastating effect on state and local budgets. Preliminary estimates released by Moody's Analytics suggested that Iowa will face a tax revenue shortfall of \$895 million to \$1.14 billion over the rest of this fiscal year and next fiscal year.² More recent estimates predict that state budgets collectively will suffer losses more severe than during the great recession of 2009-10: a \$350 billion shortfall predicted for next fiscal year, compared to \$230 billion in the worst year of the Great Recession.³ This and other recent data suggest that even the higher estimate provided by Moody's may well be too low.

The four major pieces of legislation passed by Congress to address the crisis include assistance to state and local governments. But more will be needed if the state is to avoid drastic cuts in funding for education, health care, public safety and other crucial public services as they struggle to balance budgets in the face of increasing need and plummeting revenues. Moreover, the impending recession could be both deep and long; the fiscal aid thus far is tied to the health emergency, or is slated to end within the year. It needs to be extended for the duration of the economic crisis.

Congress must provide more to states and local governments — for the duration of the economic crisis — for them to avoid drastic cuts in education and other crucial public services.

State revenue losses likely to be 15 percent or more

Moody's reports fiscal estimates under two scenarios: a baseline and a severe recession, both covering the remainder of the current fiscal year, which ends June 30, 2020, and all of the next fiscal year, which ends June 30, 2021. In the baseline scenario, Iowa general fund revenue falls 11.4 percent, or \$895 million; in the severe scenario revenue falls 14.5 percent, or \$1.14 billion

Other estimates of the total revenue losses to the states are even higher than those presented by Moody's. These revenue estimates are based on the latest projection by the Congressional Budget Office (CBO), which shows unemployment peaking at almost 16 percent this year. This compares to a peak unemployment rate of 10 percent during the Great Recession. According to the CBO, the rate will then fall but will still be 8.6 percent at the end of 2021.⁴

These more recent estimates suggest that the state fiscal shortfalls in fiscal year 2021 will be 60 percent larger than during fiscal 2010, the worst year of the great recession. Iowa general fund revenues in fiscal 2010 were 9 percent below the pre-recession level (FY2008). Losses 60 percent higher would put the revenue decline at 14.5 percent, in line with Moody's "severe" scenario.

The fiscal cliff could well be considerably higher. Goldman Sachs has projected a peak national unemployment rate of 25 percent, rather than 16 percent.⁵ Iowa, meanwhile, has seen 313,000 new applications for unemployment benefits since mid-March, a number equal to more than 18 percent of the state's nonfarm workforce. Iowa's unemployment rate peaked at 7.3 percent during the Great Recession, which indicates that Iowa — where already the unemployment rate hit 10.2 percent in April — will be facing an unemployment rate this year at least double the Great Recession peak. All of this suggests a decline in revenues much greater than 14.5 percent.

The revenue losses for the current fiscal year will fall in the final quarter of the year — April, May and June. If we assume Moody's severe scenario the revenue losses in that quarter would be one-fifth of the total (Moody's estimated revenue losses cover five quarters), and would amount to \$228 million. That decline in revenue would reduce the ending surplus, most recently projected at \$539 million, to \$311 million, without taking into account additional expenditures.

We will probably not have reliable estimates of the effect of the COVID crisis on the state general fund until August. A recent analysis by the Legislative Services Agency compared state tax revenues from March 19, 2020, through May 21, 2020, with revenues for the same period a year ago.⁶ (March 19 was the date that the Iowa Department of Revenue issued an order extending the deadline for filing corporate and individual income taxes to July 31, and initiated the process allowing businesses a 60-day delay in remitting income tax withholding and sales taxes collected, while two days earlier the Governor had issued the proclamation closing selected businesses.) While general fund net taxes were down a whopping 33 percent from a year ago, most of that decline is likely due to delays in payment rather than the economic downturn itself. Some of the 12.4 percent reduction in individual income tax estimated payments may be due to lowered income expectations, and the 18.6 percent reduction in vehicle sales tax may be due to a decline in vehicle purchases as a result of the emergency. The \$50.9 million reduction in gaming revenue, which does not go into the general fund, was clearly due to the closing of casinos. Sales tax revenues have decreased by 6.7 percent; some of that is no doubt due to the sales tax remittance deferral program.

Iowa has \$767 million in reserve funds to help it weather the economic downturn — \$588 million in the cash reserve fund and \$179 million in the Economic Emergency Fund (EEF).⁷ The Iowa Legislature, in their emergency bill (SF2408) passed as they adjourned in March, granted the Governor authority to spend up to 10 percent of the EEF and authorized the Legislative Council to approve amounts beyond that, up to the full amount in the EEF. It is too early to tell whether the ending surplus combined with the EEF will be sufficient to offset both the revenue shortfalls and the additional spending necessitated by the COVID-19 crisis in the fourth quarter. If it is not, legislative action would be required to draw on the Cash Reserve Fund.

Federal assistance aimed at emergency spending, not revenue shortfalls

The four federal acts dealing with the health and economic emergency provide a number of assistance programs to states and localities. These include grants directly to state governments, educational institutions, health care providers, and transportation systems.⁸ Here we focus on the major components of these acts that provide funding to the state and to public schools and colleges; no general relief funds have been provided to cities or counties.

Moody's Analytics has estimated that Iowa will need an additional \$205 to \$236 million to cover increased Medicaid claims over the remainder of this year, and next year. The Families First Coronavirus Response Act, enacted on March 18, provides additional federal Medicaid funds for

each quarter in which the national emergency caused by COVID-19 remains in effect, with Iowa's share estimated at \$64 million per quarter.⁹ That would appear to be sufficient to cover the additional Medicaid costs if the emergency were to stay in effect through March of 2021 (four quarters, starting in April of this year). But given the administration's eagerness to end the economic shutdown, the declaration of emergency could end much sooner than that. The federal act requires as a condition of the increased aid that states not disenroll anyone currently on Medicaid or hawk-i, which is part of the reason for the projected increase in claims.

The state will also have additional spending needs necessitated by the state response to COVID-19 and increased demand on safety net programs. This additional spending, however, may be covered by the third piece of federal legislation, the Coronavirus Aid, Relief and Economic Security Act (CARES Act). Under that legislation, a Coronavirus Relief Fund (CRF) was created to funnel \$139 billion to the states for expenditures related to the COVID-19 public health emergency. Iowa's share will be \$1.25 billion.

The CRF money must go for COVID-19 related expenditures not accounted for in the state budget most recently passed, which would be for the current fiscal year, and only for such expenditures through December 30, 2020.¹⁰ Congress has made it explicit that these funds are not for regular general fund programs seeing a shortfall in revenue due to the economic crisis.¹¹ This differentiates the CARES Act from the state fiscal relief that during the Great Recession was intended to allow states to maintain services at current levels. The guidance published by the Office of Management and Budget makes this quite explicit: "Although a broad range of uses is allowed, revenue replacement is not a permissible use of Fund payments."¹² Importantly, the guidance also stated that the CRF cannot be used to cover the state's share of Medicaid; thus if the increase in Medicaid funding in the Families First Act proves inadequate, the state will have to make up the shortfall from its own revenue sources.

Eligible expenditures necessitated by the coronavirus emergency include not only direct expenses for public health needs but also expenses "incurred to respond to second order effects of the emergency, such as providing economic support to those suffering from employment or business interruptions due to COVID-19 related business closures."¹³ The kinds of expenses that are allowable from Iowa's CRF allocation include the following, according to recent guidance from the federal government:¹⁴

- Payroll for "public safety, public health, health care, human services, and similar employees whose services are substantially dedicated to mitigating or responding to the COVID-19 public health emergency." A state or local government "may presume that payroll costs for public health and public safety employees are payments for services substantially dedicated" to the emergency. This could include the payroll costs that had been included in the most recent budget for employees who "have been diverted to substantially different functions" as a result of the emergency, such as diverting education staff to the development of online learning, or redeploying police to enforce stay-at-home orders, or corrections staff to perform sanitation of facilities.
- Funding of a program to provide assistance to individuals enrolling in a government benefit program who have been laid off and lost health insurance as a result of COVID-19.
- Payments to the state's unemployment insurance trust fund to maintain solvency in the face of COVID-19 related increases in benefit claims.
- Transfers to local governments for expenditures related to the health emergency.
- Payments to public and private hospitals to cover expenses related to the public health emergency.

The State of Iowa has received the \$1.25 billion allocation from the CRF, but to date has spent only \$70 million of it, all of that going to the Small Business Relief Program.¹⁵ The Iowa Economic Development Authority anticipates using an additional \$30 million from the CRF for this program, which has so far awarded \$74.4 million to 3,946 businesses.¹⁶

The CARES Act also includes \$31.9 million in additional Child Care and Development Block Grant funds (CCDBG), \$10.7 million under the Community Services Block Grant, and \$14.6 million to the state under the Community Development Block Grant. The Iowa Department of Human Services has prepared a plan for the additional CCDBG funds that would use most of the CCDBG funds to assist child care providers under the state’s Child Care Assistance Program.¹⁷ The Iowa Fiscal Partnership has recommended that a substantial share of these funds be directed towards expanding eligibility to better serve lower wage workers during this economic crisis, and suspending eligibility redetermination.¹⁸

The other major funding programs in the CARES Act include \$691 million in “provider relief funds” to Iowa health care providers, \$107.2 million to transit agencies in Iowa and \$79 million to airports.¹⁹

CARES Act offsets some of the losses to universities, public schools

The CARES Act provided some fiscal relief directly to public colleges and universities. However, that funding would offset only about 12 percent of the losses projected by Iowa’s three regents’ institutions, as shown below. The universities have estimated their losses in tuition revenue and residence hall refunds, as well as additional spending necessitated by the health crisis, totaling \$193 million. While the CARES Act will send about \$45 million to the three institutions, half of that must be used for student financial assistance. The remaining funds will cover only \$22.7 million of the losses for the three

universities. If tuition is not to be raised, the state must increase state funding to the regents institutions to avoid substantial cuts. Covering the entire net loss would represent a 30 percent increase over the \$576.4 million state appropriation for FY 2020.

	Estimated Losses	CARES Act*	Net Loss
University of Iowa	\$ 76.0	\$ 8.1	\$ 67.9
Iowa State University	89.0	10.8	78.2
University of Northern Iowa	28.0	3.8	24.2
TOTAL	\$ 193.0	\$ 22.7	\$ 170.3

**Half of the total funding provided that is available for general fiscal relief. The other half must be used for student financial assistance.*

Source: Legislative Services Agency, Fiscal Updates: "Higher Education Funding, Final Distribution," April 10; and "Covid-19 Impact On University Revenue And Expenses," May 4.

The CARES Act has also provided \$64.4 million to Iowa from the Elementary and Secondary Schools Emergency Relief (ESSER) Fund

that will be distributed to public and non-public school districts throughout the state.²⁰ The \$64.4 million represents less than 1 percent of total public school district budgets; Iowa’s K-12 schools spent \$6.7 billion in 2017.²¹ Iowa is also eligible for \$26.2 million from the Governor’s Education Relief Fund, and has received \$7.2 million from ESSER for grants and statewide emergency expenses.²²

Districts will experience loss of revenue due to increased property tax delinquency, and a decline in the school infrastructure sales tax and the income tax surcharge revenue. In addition, school districts face additional costs for things such as on-line technology, sanitizing facilities, staff training, and compensating for the special needs of lower income children, English language

learners, racial and ethnic minorities, and those with disabilities. Those revenue losses and additional expenses may add up to well over 1 percent of school budgets. If additional direct federal support is not forthcoming, the state could distribute part of the CRF to public school districts to cover their additional costs necessitated by the emergency.

Much more federal fiscal assistance needed

Most analysts agree that federal fiscal assistance to states provided in the CARES Act will prove woefully inadequate. As noted above, the funds are for emergency related purposes beyond what the state budget normally covers. But the substantial drop in state revenues expected for next fiscal year means that all general state funding — K-12 school aid, support of regents institutions and community colleges, public safety, infrastructure, and general operations of state agencies — will have to be slashed below current budget levels unless federal funds replace lost revenue. Not only are state general fund revenues falling dramatically, but regents' institutions, public schools, and cities and counties will need financial help well beyond what the CARES Act provides as their own revenue sources shrink and expenditures rise. The state will have no ability to offset those revenue losses and costs given the state's own bleak fiscal outlook.

Such broader fiscal support may eventually be forthcoming in a fifth piece of federal legislation dealing with the COVID-19 emergency. The bill that passed the House on May 15 included nearly \$1 trillion in additional aid to state and local governments. While that bill is unlikely to get a serious look in the Senate, some further stimulus package may be viable in the next few months. That support must be extended beyond December of this year, and should be tied to the length of the economic recession, not the health crisis that triggered that recession and that may well have largely ended long before the economy recovers.

Additional aid is essential not only to support the low-paid essential workers struggling to make ends meet, the small businesses barely keeping afloat, and the millions of newly unemployed, but to bolster the economy in the face of an unprecedented shutdown of major sectors and the prospect of a worldwide recession lasting well into next year. Consumer spending is the mainstay of the economy, and shoring up that spending requires maintaining jobs wherever possible, including the jobs of teachers, police officers, firefighters, construction crews, nurses, and all the other essential public employees.

¹ Peter Fisher, *COVID-19 poses threats to Iowa state and local services*, Iowa Fiscal Partnership, April 16, 2020. <http://www.iowafiscal.org/covid-19-threatens-state-local-services/>

² Dan White, Sarah Crane, and Colin Seitz. *Stress-Testing States: COVID-19*. April 14, 2020. Moody's Analytics. <https://www.economy.com/economicview/analysis/379097/StressTesting-States-COVID19>

³ Michael Leachman. *New CBO Projections Suggest Even Bigger State Shortfalls*. Center on Budget and Policy Priorities, April 29, 2020. <https://www.cbpp.org/blog/new-cbo-projections-suggest-even-bigger-state-shortfalls>

⁴ Michael Leachman. "Projected State Shortfalls Grow as Economic Forecasts Worsen" Center on Budget and Policy Priorities, May 20, 2020. <https://www.cbpp.org/blog/projected-state-shortfalls-grow-as-economic-forecasts-worsen>. See also Elizabeth McNichol, Michael Leachman. And Joshua Marshall. *States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession*. Center on Budget and Policy Priorities, April 14, 2020. <https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep> and NGA: "National Governors Association Outlines Need for 'Additional and Immediate' Fiscal Assistance to States." <https://www.nga.org/news/press-releases/national-governors-association-outlines-need-for-additional-and-immediate-fiscal-assistance-to-states/>

⁵ Michael Leachman. "Projected State Shortfalls Grow as Economic Forecasts Worsen" Center on Budget and Policy Priorities, May 20, 2020. <https://www.cbpp.org/blog/projected-state-shortfalls-grow-as-economic-forecasts-worsen>

⁶ Legislative Services Agency, Fiscal Update, May 22, 2020. "State Tax Revenue Update — COVID-19 Impact."

⁷ Legislative Services Agency, May 14, 2020. "State of Iowa Financial Update: Revenue and Budget Implications of COVID-19." The balance in the EEF is after a \$17 million transfer to the Small Business Disaster Assistance Program.

⁸ A listing of the various components can be found in: Legislative Services Agency, May 14, 2020. "State of Iowa Financial Update: Revenue and Budget Implications of COVID-19."

⁹ Legislative Services Agency, Fiscal Update, March 20, 2020, "Covid-19 Economic Stimulus Package — Medicaid," And Legislative Services Agency, May 14, 2020. "State of Iowa Financial Update: Revenue and Budget Implications of COVID-19." The additional funding is provided by raising the FMAP – the percentage of Medicaid expenses covered by the Federal government rather than the state. The additional match covers regular Medicaid and the Hawki program, but not the Iowa Health and Wellness Program (the expansion program for those from 100 to 138 percent of poverty).

¹⁰ Legislative Services Agency, Fiscal Update, March 31, 2020. "H.R. 748 Coronavirus Aid, Relief, And Economic Security Act Appropriations."

¹¹ The CARES Act states: "Coronavirus Relief Fund payments may not be used to directly account for revenue shortfalls related to the COVID-19 outbreak."

¹² Coronavirus Relief Fund Guidance for State, Territorial, Local, and Tribal Governments, April 22, 2020.

¹³ Legislative Services Agency, Fiscal Update, May 15, 2020, "COVID-19 – Iowa Coronavirus Relief Fund."

¹⁴ U.S. Department of the Treasury: "Coronavirus Relief Fund: Frequently Asked Questions," updated as of May 4, 2020.

¹⁵ Legislative Services Agency, Fiscal Update, May 15, 2020, "COVID-19 – Iowa Coronavirus Relief Fund"

¹⁶ Legislative Services Agency, Fiscal Update, May 22, 2020, "COVID-19 – Iowa Small Business Relief Program Update"

¹⁷ Legislative Services Agency, May 14, 2020. "State of Iowa Financial Update: Revenue and Budget Implications of COVID-19."

¹⁸ Iowa Fiscal Partnership: COVID-19: Stabilizing child care. May 8, 2020. <http://www.iowafiscal.org/covid-19-stabilizing-child-care/>

¹⁹ Legislative Services Agency, May 14, 2020. "State of Iowa Financial Update: Revenue and Budget Implications of COVID-19."

²⁰ Legislative Services Agency, Fiscal Update, May 7, 2020, "Elementary and Secondary School Emergency Relief Funding for COVID-19."

²¹ U.S. Bureau of the Census, 2017 Census of Governments. Total K-12 school expenditure, from all sources, including own revenues and state aid.

²² Legislative Services Agency, May 14, 2020. "State of Iowa Financial Update: Revenue and Budget Implications of COVID-19."

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Iowa Fiscal Partnership

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