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New Jersey, California Dodge Worst of Tax Crisis in ‘Weird Recession’

- **Revenue starting to rebound as nation emerges from lockdown**
- **Yet states still expect big shortfalls with Congress stalling**

State tax revenues in some parts of the U.S. are rebounding as the economy emerges from the coronavirus lockdown, a positive sign for governors and mayors who had been bracing for the biggest fiscal crisis in decades.

August sales-tax receipts in hard-hit New Jersey rose 3% from a year earlier and non-partisan legislative analysts are forecasting that revenue will exceed Governor Phil Murphy's projections by \$1.4 billion for the fiscal year. California's revenue is exceeding forecasts, Georgia's collections are on the rise and Ohio's Cuyahoga County — home to Cleveland — dodged almost all of the devastating blow it once predicted.

The figures are an early sign that the worst economic collapse since World War II may not decimate governments' revenues as badly as some feared, potentially reducing the scale of budget cuts and tax increases that would exert a drag on the nation's recovery. It's also providing comfort to investors in the \$3.9 trillion municipal-bond market who had anticipated that Congress would come through with hundreds of billions of dollars in aid, a prospect that is seen as increasingly unlikely until at least after the November election.

"There is no impending existential fiscal crisis that states are facing," said Ty Schoback, a senior municipal analyst at Columbia Threadneedle Investments. "That being said, we know from past recessions, states and locals experience a lagged effect on their tax revenues. So it's not to say they're in the clear as budget challenges will certainly persist."

States and cities are still contending with large budget shortfalls and government officials caution that the good news may be fleeting, given that the disappearance of enhanced unemployment benefits or a resurgence in the coronavirus outbreak could deal another setback to the economy. And because of the lag with which income taxes are collected, states have historically continued to face big deficits well after recessions end.

Beating Expectations

But so far, some are seeing that their tax base didn't erode as much as feared. California's revenue exceeded its estimates by \$3.4 billion in July and August, giving the government 9% more than the budget reflected. Georgia's personal income-tax revenue rose 10% in August from a year earlier. And Cuyahoga County, which projected a 20% decline in sales-tax revenue, has seen collections fall just 1.6% through June.

"The numbers are coming in way better than we anticipated," said Walter Parfejewiec, the budget director for the county. "We were assuming the numbers would be down the remainder of the year."

Preliminary figures from 40 states show total state tax revenues were down by about \$28 billion, or 7.5%, from March through July, the first five months of the pandemic, compared with the same period a year earlier, according to the Urban Institute. In fiscal year 2009, in the midst of the Great Recession, state tax revenue declined 8%, according to the National Association of State Budget Officers.

Look Ahead

Yet that doesn't mean the toll is behind states, since full income-tax payments for 2020 income won't be made until next year, said Brian Sigriz, director of state fiscal studies for the budget officers group.

"The expectation is still that the worst is yet to come," Sigriz said.

The severity of the revenue drop so far has been lessened by the \$2.2 trillion stimulus plan enacted in March that provided payroll support to small businesses, direct payments to families, and larger unemployment checks to millions of out of work Americans. The rescue package also gave the Federal Reserve the ability to intervene in the municipal market if needed.

But unique elements of the pandemic have also played a role. Income-tax payments haven't dropped as much as anticipated because job losses have disproportionately affected lower-paid workers in the restaurant, retail and tourism sector. Higher paid white-collar workers who could work from home have kept earning and spending, unlike during the recession set off by the housing market collapse, when many high-paid finance and real estate workers lost jobs.

"This is a very weird recession," said Jeffrey Dorfman, Georgia's fiscal economist. "Nobody has data that fits this. Nobody's statistical model can predict what's going on."

Lost Revenue

Still, the impact has been significant. The Urban Institute estimates that states will see a \$125 billion revenue shortfall in fiscal 2021, with those particularly hard hit by the pandemic especially affected. On Monday, Moody's Analytics lowered its forecast of the shortfalls facing states and cities and said that \$200 to \$400 billion in aid for them is more "practicable" for Congress. In April, the National Governors Association called on Congress to provide at least \$500 billion to offset their lost revenue.

Despite the positive sales-tax bump, New Jersey's income-tax revenue fell 5.3% in August from a year earlier. New York's sales-tax revenue declined \$1.3 billion, or 20%, for the first five months of the fiscal year, as a prolonged lockdown dashed tourism and shuttered restaurants and shops. Income tax withheld from paychecks has declined just 1.2% compared with the prior year, but estimated payments on capital gains and from small business owners and partnerships are lower by \$1.3 billion, or 14%.

New York says it will have to cut \$8 billion in aid to cities and schools without more federal help. New York City may be forced to cut 22,000 jobs, Mayor Bill de Blasio said.

Not everywhere is the outlook so dire. In Idaho, a rural state far less affected by the pandemic, the government's revenue exceeded forecasts during July and August, leaving it expecting that its surplus could grow from \$186 million at the start of the fiscal year to over \$500 million by next June, said Alex Adams, administrator for the Idaho Division of Financial Management.

"We feel optimistic," he said. "But cautiously optimistic."

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