
Will the Lack of Federal Financial Support Impact Municipal Financing?

In the run-up to the presidential election, BrandeisNOW asked faculty to provide analysis and insight into some of the most pressing issues facing the country. This is part of the series. Dan Bergstresser is an associate professor of finance at Brandeis International Business School.

The COVID-19 pandemic and resulting economic disruptions have cost the United States more than 200,000 lives and led to the steepest drop in gross domestic product (GDP) in history.

The effect of this crisis on state and local budgets has been particularly sharp and has come at a time during which the need for services provided by state and local governments is greater than ever.

In March 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act, also known as the "CARES Act." It included $150 billion in direct support to state and local governments, but it was still not sufficient to help states and localities avoid steep cuts in services.

An additional stimulus bill, the Health and Economic Recovery Omnibus Emergency Solutions Act (the "HEROES Act") has been introduced in the House of Representatives. It includes an additional $400 billion in assistance to state and local governments, but the chances of passage appear very cloudy at the moment.

Although the federal government will employ deficit spending to smooth the effect of temporary economic disruptions, states and localities generally do not employ deficit spending to cover cyclical gaps in operating budgets.

Without more federal support for states and localities job losses and cuts in services will be inevitable. These cuts will compound the economic disruption for people who depend on their services, in particular families with school-age children and especially lower-income families.

The extent to which states and localities have been affected by the pandemic and recession depends to some degree on how they generate revenues to fund their budgets.

Typically, about a third of state revenues come from the federal government. The rest mainly comes through state-imposed taxes on income, business and retail sales. At the local level, about a third of revenue comes from transfers from states to localities, with the bulk of the remainder coming from property taxes.

But there are differences across the states, with states like Oregon and New York being particularly reliant on income taxes for revenue, while Florida and Texas are particularly reliant on sales taxes.

These differences in revenue sources and the unusual nature of this pandemic-driven recession make their impact on state and local budgets different from place to place.

The impact on retail sales and sales taxes have so far been greater than the impact on personal income, so the effect of this recession on state and local budgets will be larger in places that are more dependent on sales taxes and in places where sales and income tax receipts have been more affected by the pandemic.

For example, the Colorado legislature is now forecasting a 20 percent decline in revenue in 2021, while in Idaho the state is now forecasting a 1 percent decline.

Investing in our families and school-age children is one of the most important and highest return investments that our society can make. Cuts to these services will affect our country for years to come.

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