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[Workers' Comp]

COVID-19-Related State Budget Shortfalls and Resulting Impacts to Workers' Comp

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6 MIN READ

The economic impacts associated with COVID-19 have been far-reaching and headline-grabbing: "Record levels of unemployment", "Shuttered businesses", "Idled and furloughed workers". Economists have struggled to predict "What's next?" (both short and long-term) amid an ever-shifting backdrop of varying virus case numbers, differing public policy/governmental responses, and unsettled consumer demand. State and local governments are facing unprecedented budget shortfalls, with the Center on Budget and Policy Priorities predicting a cumulative $615 billion shortfall over the current[1] and next two fiscal years in state government budgets alone.[2] In this two-part series, we will explore the driving forces behind these state budgetary shortages, state responses, and resulting impacts to Workers' Compensation agencies associated with the shortfalls.

Key Takeaways

- Predicting the short and long-term economic impacts associated with COVID-19 vary due to many unpredictable factors.
- Loss of state and local revenue from taxes and rising expenditures associated with COVID-19 are responsible for most budgetary shortfalls.
- State and local governments have multiple alternatives to address budgetary shortfalls, including cuts in spending, tapping into reserves, accounting adjustments and revenue enhancements.

What's causing the shortfalls?

Revenue Reductions The underlying causes behind the budget shortages vary in type and degree by state. For example, many states rely heavily upon personal income taxes to fill state coffers – taxes that historically drop significantly during a recession. In California, for example, personal income taxes account for 67% of the state's overall revenue.[3] The personal income tax losses during COVID-19 are attributable not only to lay-offs and wage reductions, but also due to larger claimed capital losses.[4] Also significant to the states' "bottom lines" are the losses seen in corporate income tax revenues, as businesses report significant drops in net income that can often continue long after "the recovery" is underway.[5,6] Compounding these losses are significant drops in sales taxes, which are generally less volatile during a recession.[7] During COVID-19, however, sales taxes have plummeted, fueled by the drastic reduction in consumer demand associated with the stay-at-home orders and mandatory closures of non-essential businesses.[8] Those few business areas that have seen spikes in demand, such as groceries and home entertainment, are also less likely to carry sales tax, further widening the divide.[9] Excise taxes – defined as taxes paid on specific goods (such as gasoline) or activities (such as gambling)[10] – have also seen steep declines. Reductions in travel coupled with increased telework equate to reduced excise tax revenue from gasoline sales.[11] For example, the state of Tennessee saw a 39.88% drop in gas taxes in the month of May 2020 alone, contributing to an overall decline of 15.8% seen in tax collections for the state compared to 2019.[12] Less tourism also results in reduced excise tax revenues from hotel stays, car rentals, etc., in addition to reductions in "sin taxes" associated with casinos, bars, and other similar establishments.[13] Lastly, many well-meaning states have postponed state income tax filing/payment deadlines from April 15 to July 15, to correspond with the federal filing date extension, in an attempt to aid their citizens during the [anticipated] short-term income crunch, as well as to help with logistical constraints such as difficulty obtaining receipts/documents. This has resulted in a corresponding short-term "income crunch" for state budgets also, adding to overall state budget woes. ***Rising Expenses*** In addition to the drops in revenue streams outlined above, states have been faced with sudden, unexpected, and drastic expenditures associated with COVID-19. In California, for example, expenditures related to public health, housing and other measures to combat the spread of the virus were projected to total to $7 billion through June 30, 2020.[14] Expenditure types have, of course, included healthcare-related expenses (e.g., expanding hospital capacity, paid sick/medical leaves, acquisition/distribution of medical supplies/PPE, disinfecting public spaces, etc.), but have also included many other expenditure types such as educational funding to support the shift to distance learning for public school students, food delivery to vulnerable populations, and expenditures related to the provision of grants to small businesses to reimburse the costs of business interruption caused by required closures.[15]

How have states responded?

Every state in the US requires a balanced budget with the singular exception of Vermont, although the extent to which those budgets must remain balanced after passage varies by state.[16] As of June 22, 2020, 35 states had enacted budgets for fiscal year 2021, 16 of which were biennial budgets enacted during the 2019 legislative sessions.[17] For those states that have yet to enact budgets for fiscal year 2021, several have adopted "stop gap" measures to avert shut-downs in the event that their budgets are not in place by the start of the fiscal year, including implementation of "base budgets" and continuing resolutions.[18] States have multiple alternatives to address budgetary shortfalls, including cuts in spending, tapping into reserves, accounting adjustments and revenue enhancements.[19] Labor reductions in state governments as a response to budgetary shortfalls from COVID-19 have been swift. Despite marginally improving unemployment figures released by the Department of Labor showing a reduction in the US unemployment rate from 14.7% in April of 2020 down to 13.3% in May[20] , state and local governments have furloughed or laid off more than 1.5 million workers in just three months, twice as many as the Great Recession[21], and 2021 is poised to present a larger cumulative state budgetary shortfall than any of the years during the Great Recession[22]. These drastic reductions in state workforces are expected to create a "spillover" drag on US economic recovery as a whole, as state and local government spending alone accounts for 11% of the US Gross Domestic Product (GDP), and employs about 1 out of every 8 American workers.[23] In part 2 of this series, we will explore state budget balancing tactics in more detail, as well as anticipated impacts on Workers' Compensation state agencies. Author: Lisa Anne Bickford, Director, Government Relations, Coventry

[1]Current fiscal year for most states ends June 30th. 46 states have new fiscal years that begin on July 1st, according to the Nat'l Council of State Legislatures. [2]States Continue to Face Large Shortfalls Due to COVID-19 Effects, June 15, 2020, Center on Budget and Policy Priorities, at https://www.cbpp.org/research/state-budget-and-tax/states-continue-to-face-large-shortfalls-due-to-covid-19-effects [3]Fiscal Impacts of COVID-19 and California's Economy, May 14, 2020, UC Berkeley Labor Center at http://laborcenter.berkeley.edu/fiscal-impacts-of-covid-19-and-californias-economy/ [4]State Strategies for Closing FY 2020 with a Balanced Budget, Tax Foundation.ORG at https://taxfoundation.org/fy-2020-state-budgets-fy-2021-state-budgets/ [5]Ibid. [6]

The CARES Act of March 2020 contains changes to the federal tax code that will "…[loosen}… limitations on the use of net operating loss carryovers and carrybacks…and excess business losses". The practical impact of this will be lowered levels of "net income" for taxation purposes in future filing years. See Income Tax Relief Under COVID-19 Legislation, April 15, 2020, The New York Law Journal at https://www.law.com/newyorklawjournal/2020/04/15/income-tax-relief-under-covid-19-legislation/ [7]Ibid. [8]Ibid. [9]Ibid. [10]IRS – "Excise Tax" definition at https://www.irs.gov/businesses/small-businesses-self-employed/excise-tax#:~:text=Excise%20taxes%20are%20taxes%20paid,excise%20program%20is%20motor%20fuel. [11]State Strategies", supra. [12]Tennessee tax collections take 15.83% hit during May, June 9, 2020, Chattanooga Times Free Press at https://www.timesfreepress.com/news/business/aroundregion/story/2020/jun/09/tennessee-tax-collections/524906/ [13]State Strategies", supra. [14]Fiscal Impacts of COVID-19 and California's Economy, supra. [15]Coronavirus Relief Fund, Guidance for State, Territorial, Local and Tribal Governments, US Dept of the Treasury, April 22, 2020 at https://home.treasury.gov/system/files/136/Coronavirus-Relief-Fund-Guidance-for-State-Territorial-Local-and-Tribal-Governments.pdf [16]State Strategies for Closing FY 2020 with a Balanced Budget, Tax Foundation.ORG at https://taxfoundation.org/fy-2020-state-budgets-fy-2021-state-budgets/ [17]National Council of State Legislatures at https://www.ncsl.org/research/fiscal-policy/fy-2021-state-budget-status.aspx [18]Ibid. [19]"State Strategies", supra. [20]The Employment Situation – May 2020, June 5, 2020, Bureau of Labor Statistics, at https://www.bls.gov/news.release/pdf/empsit.pdf [21] Ibid. from States to Continue to Face Large Shortfalls, citing the Bureau of Labor Statistics report supra. [22]Ibid. [23]State and Local Budget Woes Create Drag for Economic Recovery Prospects, May 24, 2020, The Wall Street Journal at https://www.wsj.com/articles/state-and-local-budget-woes-create-drag-for-economic-recovery-prospects-11590312600

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