U.S. Municipal Bond Market

A Non-Fiction Look at State Government Revenues One Year After COVID-19

- U.S. state tax revenues were just higher (+0.01%) for the 12 months between March 2020 and February 2021. In other words, cumulative state tax receipts passed a key COVID-19 recovery indicator, their pre-pandemic level.
- Results differ state-to-state. We do see 19 states where revenues have not recovered. Receipts were the worst in Alaska (-49.2%), Hawaii (-17.4%), North Dakota (-10.9%), Nevada (-10.8%), and Texas (-10.3%).
- We address the Wall Street Journal's cynical, "The Great State Budget Con." The assessment does not appreciate the nuance inherent in state governments nationwide.

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The State Government Revenue Reality One Year After COVID-19

This is the non-fiction version of the U.S. state government revenue reality a little over one year after COVID-19 shutdowns began. There are two key reasons we are writing about this topic now. One is because a key marker was reached in February. The year-over-year cumulative change of state tax revenue receipts just turned positive (+0.01%), as you can see in the bar and line chart. This is an important "recovery milestone" as Pew's report reinforces. For the second reason, it is important to clarify misunderstandings about this very nuanced subject so that observers, investors, and especially policymakers understand the status of revenues not only on an aggregate basis but also the noteworthy differences state-to-state.

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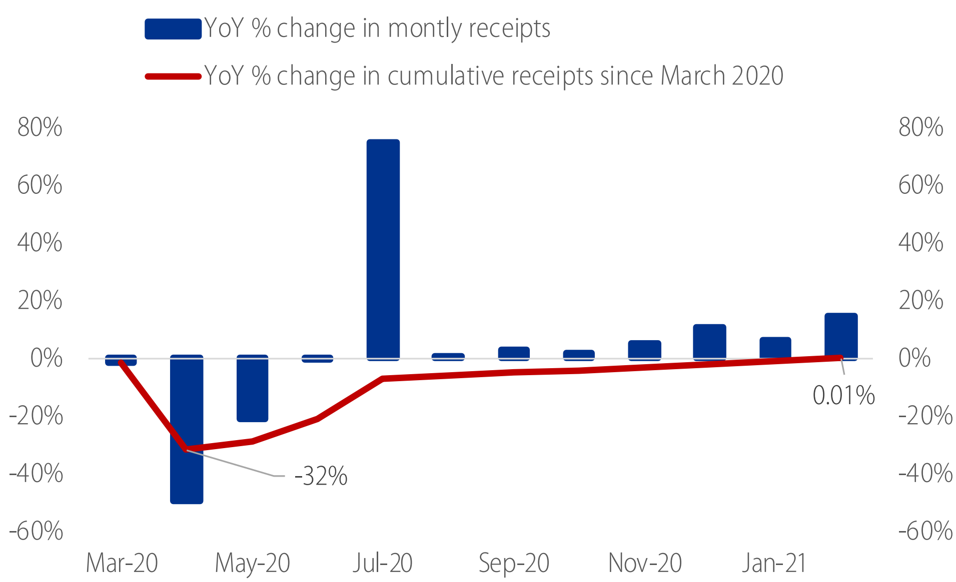
U.S. State Tax Revenues Shake Early Pandemic Losses on Way to Recovery



Source: Urban Institute, Pew Trusts, and HilltopSecurities.

Cumulative State Tax Revenues Pass a Key COVID-19 Recovery Milestone

The Urban Institute reported that state government revenues were only -1.8% from April to December 2020. Even though the numbers were still in the red to end the calendar year, state revenue forecasts in the summer of 2020 projected a much, much worse result. Over the first few months of 2021, the data continued to trend in favor of recovery. Just a few months later, the revenue picture improved ever more so slightly.

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More recent Urban Institute data utilized in Pew's May 7, 2021 article, State Tax Revenue Passes a Recovery Milestone, show an even better scenario than we saw at the end of last year. U.S. state tax revenues were +0.01% higher for the 12 months between March 2020 and February 2021. In other words, cumulative state tax receipts passed a key COVID-19 recovery indicator: their pre-pandemic level.

However, not all news is positive, because in most cases even flat revenue growth is not enough to keep up with rising expenditure demand. On top of that, many states are still below pre-COVID levels.

The results state-to-state are still important. Although the cumulative number is just higher, and a majority of states saw their revenues pass pre-COVID-19 levels, there are still at least 18 states that have not overcome their losses. Receipts through February 2021 are the worst in Alaska (-49.2%), Hawaii (-17.4%), North Dakota (-10.9%), Nevada (-10.8%), and Texas (-10.3%), according to Pew's state-by-state highlights.

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We did assign a "Stable" credit outlook to the state sector at the end of March, but the greatest influence to our outlook was really the significant federal relief promised to state, local, and tribal governments included in the $1.9 trillion American Rescue Plan Act of 2021 signed into law on March 11. It is important to remember there was an unprecedented level of state sector credit deterioration between the Great Recession and the COVID-19 crisis. Several state governments were experiencing multi-year structural fiscal imbalances, and it is possible this status is recaptured after this 'Golden Age' of public finance.

This is Not "The Great State Budget Con," as the Wall Street Journal Suggests

The second reason we addressed the state revenue situation is due to a misunderstanding of a very nuanced situation nationally and state-by-state. *We are highlighting this because of the level of respect we possess for the Wall Street Journal, its Editorial Board, and we full well understand its reach.*

The Wall Street Journal Editorial Board's, The Great State Budget Con, May 15, 2021 piece is at issue. In this piece, the Wall Street Journal accused Treasury Secretary Janet Yellen of spinning fiction as it related to the need of state government fiscal aid. We addressed and noted that we agreed with Secretary Yellen's statement about the relief in our May 11 report, Treasury Issues Relief Guidance for State, Local, and Tribal Governments.

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The $1.9 trillion American Rescue Plan Act of 2021 (Rescue Plan) was the sixth phase of federal relief to COVID-19. The Rescue Plan included $350 billion for state, local, and tribal governments. State and local governments have been impacted significantly. We talked about the revenue situation above. Expenditure demand is also higher than usual because of the emergency circumstances. State and local government employment is still 1.2 million below its pre-pandemic peak. This is a much more complicated situation and one that differs place-to-place than what cynical headlines or assessments can encapsulate.

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Again, cumulatively, state government revenues have recovered. But, there could be a bumpy ride going forward. We are not certain this pace is sustainable for state revenues. Also, what the post-pandemic normal looks like is still far from certain. Changes like remote work or other potential structural changes may shift. There is just too much nuance here, generally, and state-to-state.

Let's hit two of the items specifically mentioned by the Wall Street Journal.

California Budget Surplus

California is expecting a healthy surplus this budget cycle, which was factually stated in the 'Budget Con' piece. The bipartisan California Legislative Analyst's Office (LAO) characterized California state tax collections over the last year as, "Extraordinary" in a recent (May 17) analysis. The California LAO's tempered expectations at the end of 2020 when the state's surplus was building in With New Deficits Looming, California Will Weigh its Options for Allocating a Large Revenue Windfall, Dec.1, 2020. The office warned, "Looking ahead, however, we also identify the emergence of a new ongoing deficit beginning in the budget year 2021-22. This fiscal gap persists and widens through the remainder of our outlook period (2024-25)."

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While the LAO is acknowledging the "windfall," they are not describing it as a situation where they expect an ongoing surplus. An ongoing surplus situation might imply a circumstance where lawmakers would be able to add to spending line-items or even include new commitments. In fact, the LAO warns that the structural deficit grows to "around $17.5 billion by 2024-25, and warrants legislative attention."

New Jersey and its Recent Full Pension Payment

New Jersey Governor Phil Murphy proposed spending more this fiscal year in his budget, and more specifically, he has proposed to make the full actuarial public pension payment. This full pension payment is not being prioritized because of a sound, structurally balanced fiscal situation, but rather the pension assets are under threat of depletion. Please see our Feb. 24, 2021 report, Pension Funding Not Improving From Stabilizing Fiscal Conditions, NJ Proposing Full Payment to Avoid Asset Depletion, for more on this situation.

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