

# The Moody Report

## The 2020 Economic Downturn

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#### Free Content

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#### Strange Times

In the past week your author received calls and texts that inquired, “What is going to happen to government and the economy?” As we write on March 25, 2020, we are in very strange times. Government and the economy have come to almost a standstill, as Governor Parson has closed the State Capitol and also has shut down Missouri governmental offices. The lack of economic activity will quickly have a dramatic impact on both state and local government revenues, which will impact Missouri’s ability to provide basic governmental services.

Here are our thoughts on the current recessionary times, and how they will impact Missouri and its governmental entities. This overview is our view on March 25, 2020 and events will surely change quickly. To our readers stay safe and healthy –**Jim Moody**

#### State Cash Reserves

While the State originally projected to end Fiscal Year 2020 (the current fiscal year) with a cash and anticipated lapse of over \$500 million, that beginning balance was budgeted by Governor Parson in the Fiscal Year 2021 budget. Budgeting the cash balance and the lapse is a pretty standard budgeting technique, and we are not being critical of that action. But that cash that was anticipated will likely not even be in the bank on June 30, 2020.

The deteriorating economic picture makes the anticipated cash balance and potential lapse unrealistic. One should assume that the presumed cash balance and normal spending lapses will not occur. Therefore, available cash to operate Missouri government is going to be tight.

Our current view is that any ending cash balance on June 30, 2020, will be small, and that there may be spending restrictions applied in FY 2020 in order to create some operating cash. A first infusion of the federal money we discuss below will need to get here quickly, or the State may not be able to pay bills when the Budget Reserve Fund is repaid.

#### The Budget

Governor Parson and legislative leaders have focused their attention (rightfully so) on passing the FY 2020 Supplemental Budget. The Supplemental Budget bill (House Bill 2014) will evolve as a new spending plan for the enhanced federal funding that should be forthcoming, and also to reflect the declining state General Fund.

There is plenty of time for the General assembly to pass the FY 2021 operating budget bills, which are poised to be debated in the Missouri House. FY 2021 will not begin until July 1, 2020, and in the normal course of state business the Governor does not sign the appropriations bills until the latter part of June. We are confident that the General Assembly and the Governor will find a way to get the FY 2021 budget in place in a timely manner.

### **The Budget Reserve Fund**

The constitutionally established Budget Reserve Fund in Missouri has two purposes. First, it can be used in an emergency, but must be repaid within three years with interest. This stringent repayment schedule has made the emergency use of the fund almost non-existent.

The second purpose of the Fund is for cash flow purposes. The key provision of the use of the fund for cash flow purposes is that the Fund must be repaid, with interest, by May 15 of each fiscal year, meaning that the Fund cannot be utilized to cover a budget problem. The Fund cannot be used as a cash flow Fund from May 16 through June 30 of a fiscal year.

The paradox of the Fund is that if it is being used for an emergency, the same money cannot be utilized for cash flow purposes. The counter is also true. If the Fund is being used for cash flow, the same money cannot be used for an emergency.

Thus, the Budget Reserve Fund is a very good idea for Missouri state government, but the Fund offers limited flexibility to address unusual circumstances such as the current COVID-19 crisis. As we are approaching April 2020, the use of the Fund to address COVID-19 in May and June 2020 will likely be very limited.

The State can access the Budget Reserve Fund again on July 1, 2020 through May 15, 2021 for cash flow purposes. We are assuming that the State will need the Fund for cash flow, and thus it will not be available for an emergency. In summary, the Budget Reserve Fund is a nice and good idea, but it is not the solution to all of the State's upcoming financial problems.

### **Enhanced Medicaid Funding**

The Congress has passed the first Emergency Stimulus program and President Trump has signed that bill. One of its provisions is an increase in the Federal Medical Assistance Percentage (FMAP) for the State Medicaid program by 6.2%. The normal basic Medicaid program match is about 36% state match, and 64% federal. This provision would increase the basic match to about 70%, and the increased match would provide an estimated \$690 million in federal funds for Medicaid in calendar 2020, which would then decrease the State match by a similar amount. Missouri will not get all of this new federal money upfront. It will be tied to the ongoing payment of Medicaid claims.

Our first take from a week ago was that for a recession similar to 2001-2002, the \$690 million would go a long way to bridging the revenue shortfall created by the recession. We now think that initial analysis was wrong. We think the economic downturn in Missouri will far outpace this level of federal assistance.

We believe that the Medicaid match rate is the right tool to help States. Use of that match rate is a simple and efficient way of providing states with help during the recession. We think that the enhanced federal match rate will need to go higher, potentially much higher in order for States to deal with the economic downturn.

## **Revenue Shortfalls**

The revenue shortfalls that are beginning to occur will ripple through all aspects of government, both State and Local. The State of Missouri's second largest industry, Tourism, has come to a virtual halt in the past few weeks. The lodging and restaurant businesses in the State will suffer dramatically, and these businesses pay sales taxes, the second largest source of State General Revenue, and a very important revenue source for local governments.

Businesses in many industries are having to layoff massive numbers of employees. This will result in a very large decrease in the individual income tax receipts for Missouri, and that probably will reflect itself in April 2020 collections. Sales tax receipts will also massively suffer from the closing of businesses to commercial activity.

It is too early to make a reasonable estimate of how large the revenue shortfalls will be and how long they will last. But the 2009-2009 recession seems like a reasonable place to start when examining this issue. In Fiscal Year 2009 (July 2008 through June 2009) General Revenue receipts declined by 6.91%, or \$553.1 million. In the ensuing Fiscal Year 2010 (July 2009 through June 2010) General Revenue receipts declined by an additional 9.08%, or \$676.5 million.

The combined shortfall for the two fiscal years of the Great Recession was \$1.230 billion cumulatively for FY 2010 receipts below FY 2008 receipts. We think that Missouri policymakers will have to plan for this level of revenue reduction, or possibly worse. The questions are "how soon does the loss of state tax revenue happen," and "how long will the loss of revenue last." It is possible that the impact on state revenues might be deeper than the Great Recession, but for a shorter duration. We think it is possible to have a billion-dollar shortfall in General Revenue for Fiscal Year 2021, but a shorter duration of the downturn than during the Great Recession.

This picture in the short term does not look good. An economic shutdown of three to four months will be devastating to the State budget.

## **Local Government Impacts**

Missouri generally does not provide direct financial assistance to City and County governments. Rather, the Missouri Constitution and state statutes allow local governments to levy property taxes and sales taxes to provide for local governmental services.

Sales taxes are likely to plummet for local governments due to the cessation of many business activities. Sales taxes will also be impacted by the massive loss of jobs that will be occurring. People cannot make purchases with money that they don't have. Hopefully the second Federal Stimulus plan will allow those displaced workers to have some federal financial assistance while their jobs are lost.

We think that the loss of sales tax revenues will be very deep. We also believe that the Missouri State government will not be in a position to provide any relief for local governments.

We also believe that many businesses will react to the economic downturn by attempting to lower the amount of property taxes that they must pay. If your business is a lodging establishment, as an example, and the business is forced to close because no one is checking in to stay overnight, we think that the lodging establishment will believe that their property is not correctly assessed, and those businesses will want to pay less in property taxes.

Combined with the loss of sales tax, the combination of potentially lower property tax receipts and rapidly declining sales taxes could provide a devastating double whammy for local governments.

### **K-12 Schools Impact**

Local K-12 schools are funded by a combination of local property taxes, State of Missouri school formula and earmarked funds, and federal funds. For purposes of this discussion, we believe that federal funds will be stable, and might possibly increase. However, those federal funds tend to be supporting categorical programs, and are tied to existing federal programs.

As noted above in the discussion of local property taxes, we believe that K-12 funding will be susceptible to businesses that must, at least temporarily, close, and who also may think that their property tax assessment levels are too high. That process may take some time to play out, but we believe that it is a realistic risk about which property tax dependent governmental entities must be concerned.

The school foundation formula for K-12 schools relies on a formula that includes the average daily attendance pupil count for the school district as a driving factor. When schools have to close, due to COVID-19 fears, there is no accurate pupil count to drive the school foundation formula, since the pupils are not in school. It now appears possible that there will be no further school at many school districts through May and June 2020.

We believe that Governor Parson and the State Board of Education will find some rational basis for providing schools their state aid through the use of some interim or prior pupil ADA pupil count. We believe that it is less likely that the State steps in if there are massive property tax assessment appeals, which we believe may be an ongoing risk for school districts.