Iowa will need more fiscal relief than Congress has given

*State, cities, counties and schools struggle to maintain essential services*

By Peter Fisher

The combined effect of the recession and the health emergency triggered by the COVID-19 pandemic is having a devastating effect on state and local budgets across the country. Recent estimates predict that the average state will experience budget shortfalls this year and next 37 percent greater than during the worst year of the Great Recession.¹

Legislation passed thus far by Congress to address the crisis includes some badly needed assistance to state and local governments. But much more must be forthcoming if states, cities, counties, and school districts are to avoid drastic cuts in funding for education, health care, public safety and other crucial public services as they struggle to balance budgets in the face of increasing need and plummeting revenues.

The key findings discussed in this report can be summarized:

- **The balanced state budget for fiscal year 2021 passed in June by the Iowa Legislature is almost certainly a mirage.** National estimates of the impact of the recession on revenues, the high level of unemployment in Iowa, and the recent revenue forecasts from surrounding states all suggest much lower revenues in the coming year than were projected by the Revenue Estimating Conference (REC).

- **In late April, Iowa’s public universities were projecting a net loss of $170 million due to lost tuition and increased expenses resulting from the pandemic.** That figure will likely prove far too low as the universities deal with the enormous challenges of safely reopening in the fall.

- **Iowa’s school districts received $64.4 million from the CARES Act.** But that represents less than 1 percent of school district budgets. As public schools deal with partial re-openings and online learning this fall, their costs undoubtedly will far exceed that amount.

- **Iowa’s cities and counties face declining revenues across the board — sales taxes, hotel-motel taxes, utility and park fees, road-use tax funds, even property taxes.** And they face additional costs of everything from public safety overtime and emergency management, to public health services and elections. The Governor has promised $125 million in state assistance to cities and counties from the Coronavirus Relief Fund (CRF), but that represents just 1.8 percent of total city and county revenue; fiscal impacts are likely to be several hundred million.

Additional federal assistance is essential not only to support the low-paid essential workers struggling to make ends meet, the small businesses barely keeping afloat, and the millions of newly unemployed, but to bolster the economy in the face of an unprecedented shutdown of major sectors and the prospect of a worldwide recession lasting well into next year. Consumer spending is the mainstay of the economy, and shoring up that spending requires maintaining jobs wherever possible, including the jobs of teachers, police officers, firefighters, construction crews, nurses, and all the other essential public employees. Already, public sector employment in Iowa has fallen dramatically, by 31,000 jobs from March to May.² A recent estimate forecasts public sector job losses reaching 57,000 in Iowa by the end of this year, including 21,000 in education, if additional federal aid is not forthcoming.³ The lost income and lost spending from those jobs will ripple through the Iowa economy, adding to devastation already felt in the private sector.

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Budget shortfall likely much larger than state predicted

The FY2021 budget passed by the Iowa General Assembly on June 14 was based on the special May 29 report of the REC, which projected $360 million less revenue for FY2021 than they had estimated earlier. That left next year’s revenues just slightly below the current year’s figure, a decline of 0.6 percent from the largely pre-recession FY2020 to the recession year FY2021.

How do these estimates compare with Iowa’s actual experience during the Great Recession? Iowa general fund revenues in fiscal 2010 were 9 percent below the pre-recession level (FY2008). If the current recession produces average losses 37 percent higher than during the Great Recession, Iowa’s revenue would decline next fiscal year would be 12 percent, not 0.6 percent. Based on national projections, in other words, the REC estimates appear to be unduly optimistic. It is worth noting that one member of the three-person committee dissented from the estimate, arguing that it should probably be substantially lower.

This conclusion is supported by economic conditions in the state. Iowa’s unemployment rate peaked at 7.3 percent during the Great Recession, but hit 10.2 percent in April and declined only slightly to 10.0 percent in May. Economists anticipate a long, slow recovery, with the national unemployment rate remaining high through the end of 2021, when it will still be at 6.5 percent.

Other states in the upper Midwest are projecting higher revenue losses for FY2021 from the recession. While Iowa adjusted its revenue estimate downward by 4 percent, the Kansas estimate fell 6 percent, Minnesota 7 percent, Missouri and Wisconsin 10 percent, and Illinois 19 percent.

It is likely, then, that the next session of the Legislature will be forced to make significant mid-year budget cuts to accommodate revenues well below projections. The budgetary shortfall is compounded by the additional expenses necessitated by the health crisis. Federal legislation to date has provided substantial assistance to states to cover these costs; Iowa’s share of these funds, including the $1.25 billion in the CRF, has been detailed elsewhere. But these funds are to cover emergency expenses; Congress has yet to pass general fiscal support to cover state or local revenue government losses, akin to the substantial aid provided during the Great Recession.

Further aggravating the fiscal situation, the Governor needlessly transferred about 40 percent of Iowa’s $1.25 billion to the unemployment insurance trust fund. Any shortfall in the fund could have been met with a routine loan from the federal government, interest free for the next two years. That makes $490 million no longer available to cover state and local costs in pandemic response, needs that will continue for at least the next several months as schools and universities try to meet the challenge of safe schooling during the continuing health emergency. Instead it will serve only to prevent a possible increase in unemployment insurance rates on employers.

CARES Act offsets only a portion of the losses to universities, public schools

The CARES Act provided some assistance directly to public colleges and universities. However, that funding would offset only about 12 percent of the losses projected by Iowa’s three regents’ institutions, as shown below. The universities have estimated their losses in tuition revenue and residence hall refunds, as well as additional spending necessitated by the health crisis, totaling $193 million. While the CARES Act will send about $45 million to the three institutions, half of that

### Significant mid-year budget cuts are likely to accommodate revenues well below projections.

<table>
<thead>
<tr>
<th>Revenue Losses at Iowa’s Public Universities ($ millions)</th>
<th>Estimated Losses</th>
<th>CARES Act</th>
<th>Net Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>University of Iowa</td>
<td>$76.0</td>
<td>$8.1</td>
<td>$67.9</td>
</tr>
<tr>
<td>Iowa State University</td>
<td>$89.0</td>
<td>$10.8</td>
<td>$78.2</td>
</tr>
<tr>
<td>Univ. of Northern Iowa</td>
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<td>$3.8</td>
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<tr>
<td>TOTAL</td>
<td>$193.0</td>
<td>$22.7</td>
<td>$170.3</td>
</tr>
</tbody>
</table>

*Half of the total funding provided is available for general fiscal relief. The other half must be used for student financial assistance.*

must be used for student financial assistance. The remaining funds will cover only $22.7 million of the losses for the three universities. Meanwhile, the state budget for next fiscal year included a cut to the regents institutions, worsening their deficit, and the Governor plans no aid to the universities from the CRF.

The CARES Act also provided $64.4 million to Iowa from the Elementary and Secondary Schools Emergency Relief (ESSER) Fund for distribution to public and non-public school districts throughout the state. The $64.4 million represents less than 1 percent of total public school district budgets; Iowa's K-12 schools spent $6.7 billion in 2017. Iowa is also eligible for $26.2 million from the Governor's Education Relief Fund, and has received $7.2 million from ESSER for grants and statewide emergency expenses.

Districts will experience loss of revenue due to increased property tax delinquency, and a decline in the school infrastructure sales tax and the income tax surcharge revenue. In addition, school districts face additional costs for things such as on-line technology, sanitizing facilities, staff training, and compensating for the special needs of lower income children, English language learners, racial and ethnic minorities, and those with disabilities. Those revenue losses and additional expenses may add up to well over 1 percent of school budgets. If additional direct federal support is not forthcoming, the state could have distributed part of the CRF to public school districts to cover their additional costs necessitated by the emergency, but that money is now fully committed.

**Cities and counties need more help**

The Iowa League of Cities has outlined the ways in which the health crisis and recession will impact city revenues and expenses. Significant reductions are expected in Local Option Sales Tax and Hotel/Motel tax receipts as a result of reduced consumer spending and travel, and some reduction or delay in property tax revenue is expected as well. The Iowa Department of Transportation has forecast a roughly 20 percent drop in state Road Use Tax Funds distributed to cities and counties. Some decline is expected in other sources of revenue as well, including parking fees, public transit fares, and city utility revenue.

Meanwhile, expenses are rising as cities respond to the COVID-19 emergency. This includes technology costs incurred due to employees working remotely, cleaning expenses, public safety staff overtime, and emergency management.

Counties are experiencing similar challenges, with the loss of local option sales taxes hitting counties particularly hard, along with declining road use tax distributions, sharp declines in fee revenue from parks and recreation facilities, and loss of gaming revenue. Counties are also experiencing additional expenditures for technology, public health, emergency management, and elections. A survey of 11 diverse counties with a total population of 960,000 (about 30 percent of the state total) produced estimates of $5.8 million in additional expenditures and $10.4 million in lost revenue for the group as a whole just over the period from March through early May. This suggests fiscal losses for all counties over calendar 2020 in the hundreds of millions of dollars.

The federal government left it up to the states to decide if they would allocate a portion of the state CRF funding to local governments, and the Iowa Legislature left the allocation of that $1.25 billion entirely up to the Governor. On May 29, the Governor announced plans for the next $700 million from that fund, including $125 million for Iowa cities and counties. To date, none of that has been allocated, though we assume that it will be. No additional money will be provided from that fund apparently, because nearly all of the $1.25 billion has been committed. Cities and counties in Iowa together collect over $7 billion in revenue each year. The $125 million allocated from the CRF represents just 1.8 percent of combined revenue, or less; this will clearly cover only a small share of the revenue losses and cost increases of cities and counties.

**Much more federal fiscal assistance needed**

Most analysts agree that federal fiscal assistance to states provided in the CARES Act will prove woefully inadequate. As noted above, the funds are for emergency related purposes beyond what the state budget
normally covers. But the substantial drop in state revenues that is likely for next fiscal year means that all general state funding — K-12 school aid, support of regents institutions and community colleges, public safety, infrastructure, and general operations of state agencies — will have to be slashed below current budget levels unless federal funds replace lost revenue. Not only are state general fund revenues falling dramatically, but regents’ institutions, public schools, and cities and counties will need financial help well beyond what the CARES Act provides as their own revenue sources shrink and expenditures rise. The state will have no ability to offset those revenue losses and costs given the state’s own bleak fiscal outlook.

Such broader fiscal support may be forthcoming in a fifth piece of federal legislation dealing with the COVID-19 emergency: the HEROES Act. The bill passed the House on May 15 and included nearly $1 trillion in additional aid to state and local governments. That would include $5.8 billion to the state of Iowa, $3.5 billion to Iowa local governments, $516 million to public schools, and $238 million to public colleges and universities, all over a two-year period.\textsuperscript{11} The bill would also provide an additional $980 million in Medicaid funding to cover the state’s cost of an estimated 28 percent increase in Medicaid caseloads.\textsuperscript{12}

While that bill is unlikely to pass the Senate in its current form, it is important that some version of the bill be enacted in the next few months. That support must be extended beyond December of this year, and should be tied to the length of the economic recession, not the health crisis that triggered that recession and that may well have largely ended long before the economy recovers. Without further assistance, public services will shrink and additional private sector job losses and business closures will devastate the Iowa economy.

\textsuperscript{1} It is estimated that the states collectively will suffer losses more severe than during the Great Recession of 2009-10: $315 billion in shortfalls predicted for next fiscal year, compared to $230 billion in fiscal year 2010. Michael Leachman. New CBO Projections Suggest Even Bigger State Shortfalls. Center on Budget and Policy Priorities, April 29, 2020. \url{https://www.cbpp.org/blog/new-cbo-projections-suggest-even-bigger-state-shortfalls}
\textsuperscript{2} U.S. Bureau of Labor Statistics, employees on nonfarm payrolls, seasonally adjusted. \url{https://www.bls.gov/news.release/laus.t03.htm}
\textsuperscript{4} A listing of the various components can be found in: Legislative Services Agency, May 14, 2020. “State of Iowa Financial Update: Revenue and Budget Implications of COVID-19.”
\textsuperscript{6} U.S. Bureau of the Census, 2017 Census of Governments. Total K-12 school expenditure, from all sources, including own revenues and state aid.
\textsuperscript{8} Iowa League of Cities. “COVID-19 Impacts on Local Finance.” \url{https://www.iowaleague.org/Pages/COVID-19-Impacts-on-Local-Finance.aspx}
\textsuperscript{10} U.S. Census of Governments: general revenue from own sources, Iowa cities and counties, 2017.

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