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Using SALT Revenues to Help State and Local Governments Prepare for a Rainy Day

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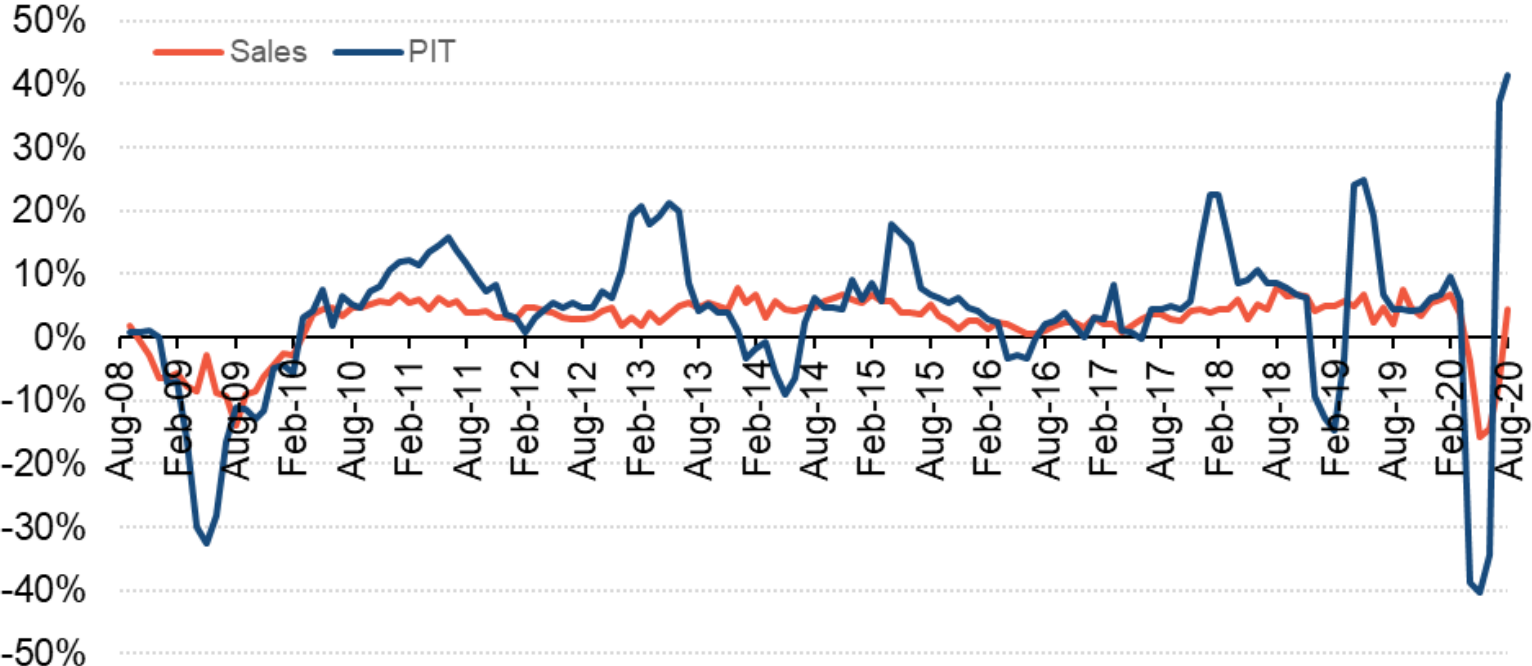
How can Congress best help state and local governments?

Future of the Middle Class Initiative at Brookings

January 13, 2021

Economic Shocks Can Be Very Harmful to State Budgets

Nominal year-over-year percent change in state tax revenues



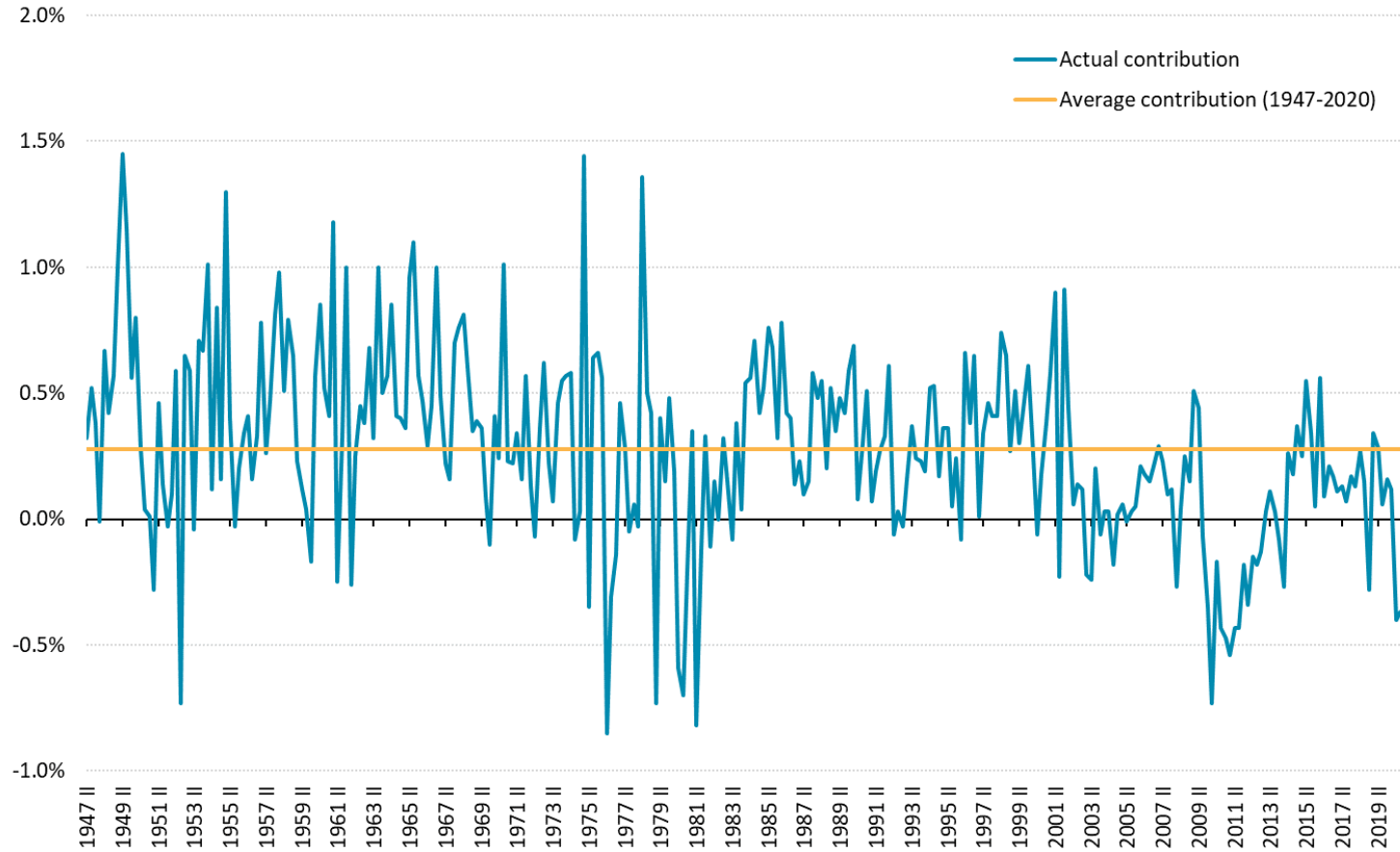
Note: Percentage change is for 3-month moving averages.

Source: Urban Institute State Tax and Economic Review Project

State Budget Balancing Actions Can Harm Economy

State and Local Government Contributions to Real GDP Growth

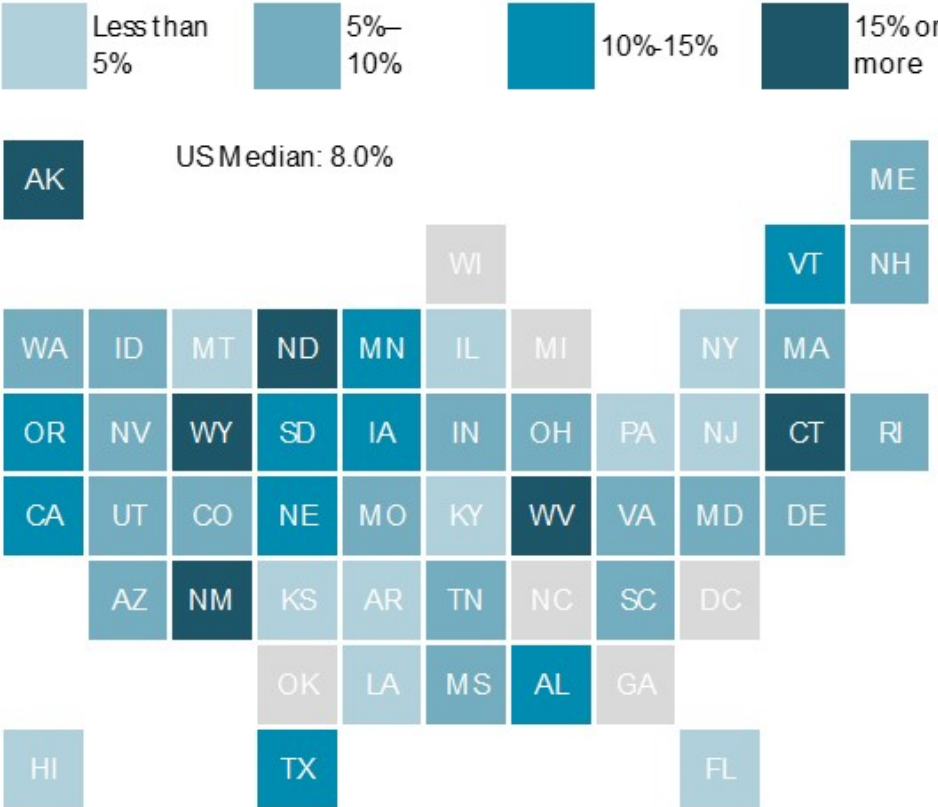
Percentage change (%)



Source: Bureau of Economic Analysis

Building Adequate Savings is Difficult

Rainy Day Balances by State, Fiscal Year 2020
Balances as share of general fund expenditures



Source: National Association of State Budget Officers
Note: Grey indicates data were unavailable or incomplete for fiscal year 2020.

As Is Timing Discretionary Federal Assistance

Table 2: Net State Medicaid and CHIP Costs Due to COVID-19 Pandemic

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2020-2030
Enrollment increase due to COVID-19 (millions)	3	9	7	4	2	2	2	-1	0	0	0	28
Potential state costs owing to enrollment increase (\$ billions)	\$4.4	\$19.9	\$17.8	\$13.5	\$9.8	\$9.8	\$9.8	-\$0.7	\$0	\$0	\$0	\$84.2
FMAP transfer (\$ billions)	-\$30.8	-\$38.9	-\$18.8	-\$1.5	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	-\$89.9
Net State Medicaid & CHIP Costs (\$ billions)	-\$26.4	-\$19.0	-\$1.0	\$12.0	\$9.8	\$9.8	\$9.8	-\$0.7	\$0.0	\$0.0	\$0.0	-\$5.8

Note: Enrollment estimates are taken from Tables A-1 and A-3 from CBO (2020d) and are inclusive of economic and legislative effects. State costs assume states would have paid their normal average portion of costs (40 percent). State costs owing to enrollment increase based on median total expenditures in 2018 among states that CMS deems to have a high level of data usability (CMS, 2020c). Value of FMAP transfer from CBO (2020d; 2020e) (see above text for discussion of calculation). Numbers within columns may not add due to rounding.

Source: Clemens, Ippolito, and Veuger, December 2020

We Propose an Alternative

- Redirect partial or full SALT deduction tax expenditure (\$80-\$100 billion/year) to a State Macroeconomic Insurance Fund (SMIF)
- SMIF makes automatic payments to states in a recession based on formula tied to state economic, not revenue conditions
- SMIF is a “non-budgetary account” or “deposit fund.” Contributions = outlays when they are made, not when state payments dispersed; any additional revenues are recorded with offsetting outlays
- SALT revenues would be enough for a robust countercyclical assistance program, but could make it more like insurance where states pay premiums tied to utilization or fiscal capacity
 - SMIF would pay out only for large emergencies, with minimum rainy day funds (RDFs) as condition of participation (i.e., a deductible)
 - States could also be required to contribute a certain percentage to budget solutions (i.e., coinsurance)
 - Formulas would help limit moral hazard, could also consider participation mandate to limit adverse selection

Tradeoffs

- 100-year flood type events seem to be occurring more frequently
- Debate over SALT cap repeal provides an opportunity to rethink federal-state-local relationship
- A “bird in the hand” has value, but so does risk protection