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The Fiscal Impact of COVID-19: A Study of Five States

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Abstract: Reporting on the budget and fiscal policy the actions taken by five states to manage the fiscal impact of COVID-19, this study reviews these actions in relation to recommended policy and practice responses that were included in the Volcker Alliance study of state budget practices. My research suggests that amidst periods of fiscal stress, Volcker's recommended policy and practices may not prove as valuable for state budget authorities.

Executive Summary

The COVID-19 pandemic has taken its toll on states' coffers due to declining revenues and in response state budget authorities have taken action to adjust budgets in order to maintain proper financial balance. At the end of fiscal year 2020 on June 30, 2020, budget authorities in 46 states likely found themselves straining to make sure their state's bottom line was not grossly negative. That strain has since continued into fiscal year 2021, which started the day after. As revenues appear to be on the rise again and the financial hardships lessened, an evaluation of the responses to the pandemic's fiscal stress is now possible.

This paper provides a detailed assessment of the budget and fiscal policy actions taken by Arkansas, Kentucky, Louisiana, Oklahoma, and Tennessee to manage the fiscal impact of COVID-19. In addition to reporting on the actions taken by these states, the study reviews their actions relative to recommended policy and practice responses as prescribed in the Volcker Alliance study of state budget practices. Altogether, it establishes a compelling narrative of state budget and fiscal policy actions as the country continues to combat the largest public health crisis it has faced in more than a century.

Using publicly available documents, I compared the budget and fiscal policy actions of each state to the rest of the cohort and discovered that budget authorities employed a wide array of strategies. These strategies included extensive use of federal relief and personal state reserve funds, enactment of budget reductions, and revisions to revenue forecasts. When reviewed through the lens of the Volcker study's best practices, states the Volcker study had designated as not following best practice fared well among the cohort while others struggled. These findings offer new considerations to what may truly define "best" in terms of best practice for state budget processes.

Introduction

On July 1, 2019, 46 states began their fiscal years with expectations for increased revenues and the greater sense of prosperity that comes with it. Despite the COVID-19 pandemic being declared a national public health emergency on January 27, 2020, nationwide, state economies rolled on. Soon though, as the third quarter of fiscal year 2020 (FY20) came to a close, it all came screeching to a halt. Almost immediately the pandemic began taking a toll on states' coffers with expectations for increased revenues replaced by revenue shortfalls. To help mitigate the fiscal strains faced by states, the federal government has taken action on three separate occasions. Beginning with the $2.2 trillion Coronavirus Aid, Relief and Economic Security Act (C.A.R.E.S Act) passed in March 2020, followed by $900 billion for COVID-19-related spending in the Consolidated Appropriations Act passed in December, and the most recent $1.9 trillion American Rescue Plan Act of March 2021, states and their citizens have received major influxes of federal funds to help combat the pandemic's fiscal impact. Accordingly, state leaders have been forced to take financial action and adjust budgets, both present and future. The budgetary actions taken by state budget authorities will go on to further impact their state's ability to address future economic crises.

Background

The following issue is being studied as part of the Martin School's ongoing work with the Volcker Alliance, a national nonprofit dedicated to driving research on effective government. First released in 2015, the Volcker Alliance has issued a series of reports titled *Truth and Integrity in State Budgeting* focusing on state budget practices. Their studies highlight five principal categories of state budgeting: budget forecasting, budget maneuvers, legacy costs, reserve funds, and budget transparency.[1] In order to compare states to each other, the organization compiles a list of research questions for each of the principal categories and assigns grades to each state according to how their budget practices answered the research question.[2] Information gathering on each state was conducted via partner universities who documented assigned states' use of these practices. The Volcker Alliance recently published the fourth iteration of its series on state budgeting practices on March 31, 2021, titled *Truth and Integrity in State Budgeting: Preparing for the Storm*. The study assigns grades to states from fiscal year 2015 through 2019 based on their performance in the five principal categories.

Ultimately, although there exists a plethora of public finance literature as it relates to state budget practices, this paper is directly grounded in the work previously completed by the Volcker Alliance.

Literature Review

I am not alone in taking an interest in the fiscal policies employed by states to manage the impact of COVID-19. A pair of national organizations have made an effort to track them. The National Conference on State Legislatures (NCSL) held a webinar on the subject as early as March of 2020, outlining state actions taken to date and discussing the challenges that state governments would come to encounter. Since then, NCSL has established databases to provide an overview of state actions to cover budget shortfalls, their use of federal relief funds, and revisions to revenue projections among other more extraneous subjects. In addition to the work done by NCSL, the National Association of State Budget Offices (NASBO) conducted its annual financial survey of its members in Fall 2020, presenting aggregate and individual data on the states' general fund expenditures, revenues, spending, and revenue actions, and balances. Together, the published

[1] Definitions for each of these terms, per the Volcker Alliance grading system, can be found in Appendix A.
[2] A complete list of the Volcker study's research questions can be found in Appendix B.

resources of these two organizations provided a foundation from which I was able to investigate the aforementioned five states more thoroughly.

My use of the Volcker study as a groundwork from which to develop further research follows in the footsteps of Hendrick and Hu (2020). They employ various socio-economic variables aggregated on the state level and utilize regression analysis to determin their effects on a state's use of Volcker-defined budget maneuvers. Their findings suggest that a state’s financial condition has one of the strongest effects on whether it utilizes such maneuvers. This and their additional conclusions supply important context for my research as financial conditions amid the pandemic have proven to be quite volatile.

Methodology

Following the completion of the fiscal 2019 study, the Volcker research team at the University of Kentucky Martin School (UK), led by Dr. Merl Hackbart and Dr. Rhonda Trautman, elected to pursue a course of study that grounded itself in the Volcker method while going beyond it to understand how states were reacting to the ongoing pandemic. In order to observe this phenomenon, I, along with Dr. Hackbart and Dr. Trautman, created a research template modeled after the Volcker study’s five categories with particular focus on budget maneuvers as it relates to budget reductions, budget forecasting and the use of reserve funds. Using this template, I compiled information on the five states that UK had been assigned as part of their work for the Volcker Alliance: Arkansas, Kentucky, Louisiana, Oklahoma, and Tennessee.[3]

These survey questions are descriptive in nature, collecting primary data on state budgetary actions in response to the pandemic. The answers to these questions are not intended to critique a state’s ability to address this crisis financially but rather to establish a foundation

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[3] A blank version of the research template created by UK’s research team can be found in Appendix C.

from which I can draw comparisons between the observed states and develop further analysis. They cover the extent to which budgetary maneuvers have been taken and the necessary context to understand why these decisions were made and what they mean.

Moving forward from the descriptive analysis the study reviews state actions relative to recommended policy and practice responses to state fiscal stress. Drawing further from the Volcker study, the review highlights their five principal categories of state budgeting. While I aim to comment on all five of the Volcker categories, I will highlight the areas of budget forecasting, budget maneuvers, and reserve funds as these best encapsulate the fiscal actions taken during the pandemic period.

Data

The core of the financial data from fiscal years 2020 and 2021 was gathered via primary budget documents. Oftentimes these documents are made available to the public through the designated state budget office, but it may differ according to each state. As FY2021 officially began on July 1, 2020 in each of the five states, the responsible state offices have since posted these budgets and they are available to the public. Additional documents such as comprehensive annual financial reports and public legislative records may be utilized in order to provide additional context on the enacted fiscal 2021 budgets. As comprehensive annual financial reports are not often released until well into the next fiscal year and legislative sessions differ across the sample, the information provided by them will be used only when available. Any amendments to enacted fiscal 2021 budgets will be accounted for as time permits.

In addition to primary documents, I will be utilizing the Volcker Alliance's most recent report and the grades assigned therein. The report is available via online publication and contains an overview of each state's budget and fiscal policy actions taken in the previous five fiscal years.[4]

Survey Findings:

Overview of State Budgets and Budget Processes

Although operating on different budget preparation cycles, each of the five states have fiscal years starting July 1 and ending on June 30 of the following year. Louisiana, Tennessee, and Oklahoma compose their budgets on an annual basis while Kentucky and Arkansas compose theirs biannually. Biennial budgets are enacted in even-numbered years in Kentucky and odd-numbered years in Arkansas.[5]

Governors in each state are required to present a balanced budget to the state legislature. In Arkansans, the governor submits their budget proposal to the state legislature during the month of November prior to the legislature convening the following year. Elsewhere, the governors submit their budget proposals in the same calendar year relative to the legislature convening. Except for Arkansas, the state legislatures must also enact a balanced budget.

The general fund budget for each of the observed states may serve as a key indicator of state government's fiscal status but with different states come different financial structuring. For instance, in Arkansas, the general fund only accounted for 16 percent of the state's entire budget while in Oklahoma the general fund accounted for 40 percent of its entire budget. Further, how states allocate their money depends on a myriad of factors including a state's population, their

[4] *Truth and Integrity in State Budgeting: Preparing for the Storm* may be found at: volckeralliance.org/publications

[5] Arkansas Amendment 86 reduced the period for which appropriation bills are valid from two fiscal years to one, requiring the General Assembly to meet in a limited fiscal session during even-numbered years to consider appropriation bills. Budget recommendations for most agencies are only presented to the legislature during regular sessions and are submitted the fall prior. These recommendations are then pre-filed as bills ahead of fiscal sessions. Only six entities are allowed to present their budgets during fiscal sessions: The Public School Fund, Department of Correction, Department of Community Correction, Department of Human Services, Department of Health, and the Institutions of Higher Education.

needs, the amount of federal funds provided, and a state's spending priorities. Drawing further on the comparison between Arkansas and Oklahoma, in Arkansas, a state with just over three million people, approximately 83 percent of the $5.7 billion in enacted allocations went to the education and health care fields while in Oklahoma, with nearly a million more people than Arkansas, the proportion was closer to 71 percent out of its $8.1 billion budget.

To provide a basis for how states entered FY20, totals for general fund expenditures are reported in Table 1. Kentucky officially enacted its FY20 budget in April 2018 following an override of a gubernatorial veto. All other states enacted their FY20 budgets in the first six months of the following year.[6] Beginning fund balances of rainy day funds are also included in Table 1.

Table 1: Overview of State Budgets and Reserve Fund Balances

State	General Fund Expenditures	Rainy Day Fund Balance (as of 7/1/19)
Arkansas	$5,750,205,755	$153,000,000
Kentucky	$11,781,864,300	$129,077,800
Louisiana	$9,724,350,000	$405,000,000
Oklahoma	$8,130,075,680	$854,000,000
Tennessee	$15,952,310,850	$875,000,000

With an understanding of how much states are appropriating through their general fund budget, it is then important to shift the discussion to how they generate the revenue to support these endeavors. Table 2 provides an overview of each state's general revenue structure

[6] While Arkansas considers and passes its appropriation bills on a biennial basis, the legislature enacts an omnibus budget prioritization bill on an annual basis known as the "Revenue Stabilization Law." The legislation officially allows lawmakers to transfer tax revenues into budget coffers to fund the state's budget. Under it, legislators prioritize all state agency spending requests dividing them into "A," "B," and "C" categories. The "A" category is often fully funded while the other two categories are funded as revenues permit.

according to their collection totals from fiscal year 2019. While each state relies heavily to some extent on income taxes paid by individuals and businesses as well as sales and use taxes, the differences are stark. In Arkansas, such taxes comprised over 90 percent of the state's revenue. Meanwhile in Tennessee, which imposes no income tax on personal wages, only on income earned from interest and dividends, the state is heavily reliant on consumers and the companies that serve them to generate tax revenue. States with relevant gas and oil production, like Oklahoma, rely on their severance taxes, a source more prone to market volatility than others. Kentucky, while still a relevant coal producing state, has become more reliant on other sources, with over 80 percent coming from income, sales, and use taxes as well as property and lottery taxes (listed under Misc.) which make up 8 percent of the remaining total. Louisiana presents itself as the most diversified structure with only 65 percent of their revenue coming from income, sales, and use taxes and the remaining 35 percent spread out across various sectors.

Table 2: Revenue Structure According to Fiscal 2019 Actual Totals

Source	**Arkansas**	**Kentucky**	**Louisiana**	**Oklahoma**	**Tennessee**
Individual Income Tax	49.82%	39.89%	29.43%	30.96%	1.31%
Sales & Use Tax	34.66%	34.56%	30.93%	33.27%	61.20%
Corporate Income Tax	7.99%	6.69%	4.99%	4.08%	19.10%
Severance Tax	0.14%	1.12%	4.15%	10.07%	0.01%
Tobacco Products Tax	2.93%	3.30%	2.25%	2.65%	1.56%
Misc. Taxes, Fees, Dept. Revenues	4.47%	14.43%	28.25%	18.97%	16.82%

State Revenues for FY20

With the exception of Oklahoma, every other state exhibited revenue growth heading into March 2020. As we now know, revenue growth soon became revenue decay as state economies were forced to shut down. With shutdowns came revised revenue forecasts, all of which projected revenue shortfalls. Despite the pessimistic outlooks, all but Oklahoma exceeded their estimated revenue totals. Table 3 reports the total gross receipts for each state as compared to their latest forecasted estimates.[7]

Table 3: General Revenue in Fiscal 2020 ($ million)

Tax Source	Arkansas		Kentucky		Louisiana		Oklahoma		Tennessee	
	Est.	**Actual**	**Est.**	**Actual**	**Est.**	**Actual**	**Est.**	**Actual**	**Est.**	**Actual**
Individual Income	3,242.7	3,418.6	4,526.0	4,765.2	3,730.0	3,778.2	2,291.8	2,511.4	103.2	150.7
Sales & Use	2,514.6	2,543.7	3,931.6	4,070.9	3,321.0	3,309.0	2,135.2	2,019.9	9,612.6	9,708.8
Corporate Income	434.0	482.1	488.4	639.2	468.1	562.7	256.9	238.2	2,828.3	3,074.6
Severance	7.4	7.6	62.7[8]	58.8	415.0	430.1	481.9	469.7	0.8	0.76
Tobacco Products	205.0	220.4	352.0	355.0	279.9	277.9	-	-	240.8	241.4
Misc. Taxes, Fees, Dept. Revenues	291.5	287.7	1,630.8	1,677.6	1,379.0	1,473.5[9]	1,062.8	1,033.9	2,633.9	2,612.5
Total	**6,695.2**	**6,960.1**	**10.991.5**	**11,566.7**	**9,593.0**	**9,782.9**	**6,669.6**	**6,273.1**	**15,419.6**	**15,788.8**
Over (Below)	-	272.5	-	575.2	-	238.6	-	(396.5)	-	369.2

[7] States officially adopted revised revenue forecasts on the following dates: Arkansas – 6/30/20; Kentucky – 5/22/20; Louisiana – 5/11/20; Oklahoma – 4/20/20. Tennessee's State Funding Board did not officially revise their estimate for FY20, thus their estimated total reflects that which was budgeted by the state legislature in their amended FY20 budget.

[8] Only reflects coal severance

[9] Reflects difference between the sum of listed tax revenues & total tax revenues minus dedications (labeled "State General Fund Revenue"

Across the board, income taxes, both individual and corporate, came in over predicted totals. It appears that the extension of the federal tax deadline, which each of the states replicated on the state level, did not impact state coffers as heavily. Tennessee, who accounts on an accrual basis, making July 2020 the last month of FY20, certainly was able to recoup any expected drop-offs. By contrast, sales and use taxes fluctuated across the board with states like Kentucky and Tennessee surpassing their predicted totals while Louisiana and Oklahoma fell short of their already lowered expectations. The tobacco product tax, severance tax, and miscellaneous revenues similarly varied across the five states.

With an eye towards the pessimistic outlooks provided, state leaders were prompted to take action to mitigate the damage. The following sections detail how leaders in each state responded to these projected shortfalls in an attempt to close out FY20 budgets, their decisions on how to use federal funds, and their actions to address the then upcoming FY21. Table 5 provides a summary of these actions and may be found in the subsequent section.

State Narrative: Arkansas

On March 23, 2020 the Arkansas Department of Finance and Administration cut the net general revenue budget for fiscal 2020 by $353.1 million, to $5.38 billion. Per the state's revenue stabilization law, which prioritizes spending to prevent deficits, the cut resulted in a $236 million across-the-board reduction in the Category A allocations. Categories B and C, totaling $115.6 million and $14.7 million respectively, were cut immediately.[10] Updated forecasts from June 30, 2020 called for 100 percent funding of Category A and 3.64 percent of Category B.[i] With the updated forecast, Category A budgets were restored to their respective pre-cut totals, but over $100 million worth of budget items were left unfunded.[ii]

[10] See footnote 6 for an overview of what these spending categories are.

That same week in March, the state legislature convened in a special session to create a pandemic-specific rainy day fund totaling $173.6 million in previous budget surpluses. The fund was created with the intent to “offset general revenue reductions, [and address] funding needs and unanticipated needs created by the COVID-19 crises.”[iii] The fund distributed more than $90.6 million to various state entities, $45.8 million of which was returned. The fund was closed at the end of the fiscal year and the remaining balance was transferred back to the General Revenue Allotment Reserve Fund, the original source.[iv]

Arkansas received $1.25 billion in the original CARES Act, passed March 27, 2020. Three days later, Arkansas Governor Asa Hutchinson established the CARES Act Steering Committee with a mission to make recommendations to the Governor on best uses of the CARES Act funds. Proposals for funding were approved as early April 15, the first totaling $80 million to the Department for Health and Human Services. As of March 15, 2021, the committee has accepted funding proposals totaling up to $1.2 billion, leaving only $40 million left to be distributed. With the federal deadline to use these funds extended to December 2021 under he Consolidated Appropriations Act, the committee voted in January 2021 to extend the state deadline for use of previously allocated funds to March 15, 2021.[v] Some exceptions were made and given deadlines of June 15, 2021.

In the April 2020 fiscal session, the Arkansas General Assembly approved a $5.89 billion general revenue budget for fiscal 2021.[vi] Given its revenue stabilization tactics, the state allocated funds in excess of its revenue forecast, with the specific deficit amount fully encompassed in Category D. In a November 2020 letter to the state legislature, the Finance and Administration Secretary Larry Walther stated that the net available forecast for FY 2021 is unchanged from the Official General Revenue Forecast of April 2, 2020.[vii] As of March, net available revenues were up $529 million above that forecast.[viii]

State Narrative: Kentucky

Despite Kentucky's declaration of a state of emergency on March 6, 2020, the state's consensus forecasting group did not officially revise their revenue estimate until May 22. Earlier unofficial estimates, prepared on behalf of the legislature who were crafting the state budget at the time, predicted a General Fund revenue shortfall ranging from $318.7 to $495.7 million. In response, Kentucky Governor Andy Beshear utilized budget reduction authorities vested in the executive branch, putting in place hiring restrictions and imposing limits on discretionary spending unrelated to the COVID-19 response. The Governor also asked state agencies for preliminary spending reduction plans, targeting 12.5 percent of remaining budgets.[ix] Interestingly, although the state legislature includes a budget reduction plan as part of its budgets, the plan was never activated.

Ultimately, the cuts made by the governor totaled $48.5 million with an additional $23.2 million in expenses replaced through CARES relief funds. While important in the moment, they proved unnecessary as the state ended FY 2020 with a General Fund surplus of $177.5 million. This surplus was then divided into two funds with $15.0 million deposited into FY21 reserves for necessary government expenses and the remaining $162.5 million transferred into the state's rainy day fund.

Kentucky received $1.6 billion in March 2020 from the federal government for the Coronavirus Relief Fund. As of September 4, 2020 the state had spent or committed 52 percent of those funds, leaving a balance of $769 million.[x] In a letter sent five days later to Kentucky's Legislative Research Commission, State Budget Director John Hicks mentioned that he "recommended to the Governor to be mindful of possible Congressional action in the near term and to reserve a portion of the Fund."[xi] Two months later, in a presentation to the General Assembly's Interim Joint Committee on Appropriations & Revenue, Director Hicks testified that that the Governor had announced that all $1.6 billion had been committed or allocated.[xii] He further noted that Kentucky would use all the funds provided, this being said ahead of the deadline extension provided in December. Notable among the use of CARES Act funds is $300 million allocated to cities and counties for COVID-19 response and a minimum allotment of $200 million reserved to repay the unemployment insurance trust fund's federal borrowing.

State legislative leaders were pessimistic about the state's budget heading into FY2021, breaking from tradition and only passing a single-year budget with appropriations decreasing by $130 million.[xiii] State Budget Director Hicks requested state agencies and postsecondary institutions to submit tentative plans for an 8 percent spending reduction on the first day of the fiscal year.[xiv] Contrasting his own pessimism, Director Hicks later reported in his November testimony that Kentucky was on track to exceed revenue expectations and with added federal relief fund flexibility may avoid making further budget cuts.[xv] Further, the state's consensus forecasting group reported in December 2020 that their pessimistic economic outlook only amounted to a $41.2 million revenue shortfall.[xvi] The Quarterly Economic Report on Kentucky's Q2 outcomes projected FY21 General Fund revenue surplus of $126.5 million relative to the official revenue estimate of $11.73 billion, a 2.5 percent increase over the FY20 annual total.[xvii]

State Narrative: Louisiana

Similar to the previous two states, despite late forecasts of revenue declines the state of Louisiana was able to avoid a revenue shortfall for FY2020 and as a result did not take any official actions to cut budgets. The state's Revenue Estimating Conference met in May 2020 and adopted a forecast that predicted a $131.9 million revenue shortfall.[xviii] However, at the close of the fiscal year, Louisiana found itself with a $190 million surplus. No decision was reached on how to spend this surplus. Rather, state leaders were busy handling how to spend the $535 million surplus from FY2019 in which they were constitutionally mandated to use $53 million to pay down retirement debt and to place $134 million in the state's rainy day fund. $241.5 million of the remaining surplus was spent on designated capital projects, and the last $105.9 million went in a newly created fund for a later decision.[xix]

Louisiana's CARES Act funds totaled $1.8 billion.[xx] Of that total, $511 million was used to create the Coronavirus Local Recovery Program for local government units. An additional $300 million was dedicated to providing economic support to eligible Louisiana businesses. Only $41.5 million remained in the Local Recovery Program fund as of December 2020 but with $431 million remaining in eligible expenditures and new relief funds coming, the program may seek to make further allocations.[xxi] That same month, a reported $693 million had been dispersed to various state agencies between FY20 and FY21 to help fill budget gaps.[xxii]

In June 2020, the Louisiana state legislature convened in special session to pass the state's FY21 budget. In order to account for an expected revenue shortfall, they allocated $90 million from the state's rainy day fund and further relied upon federal funds. Ultimately, their budget exceeded FY20's by nearly $3 billion.[xxiii] On July 8, 2020 the Louisiana Governor John Bel Edwards issued a press release stating that he intended to sequester 10 percent of cabinet agencies' budgets in order to prepare for possible mid-year cuts and issue an executive order to freeze hiring of state employees[xxiv]. Neither the cuts nor the cuts have been issued to date. This is likely the result of the Revenue Estimating Conference having revised its FY21 revenue forecast upwards of $300 million, citing higher than expected oil prices, corporate income tax revenues, and gambling tax revenues[xxv].

State Narrative: Oklahoma

The state of Oklahoma elected to take a different approach than the prior states. After the state's revenue forecasting group certified a revenue shortfall of $416 million for the 2020 fiscal year[xxvi], Republican and Democratic legislative leaders expressed opposition to cutting state agency budgets during the COVID-19 crisis.[xxvii] Despite Governor Kevin Stitt's request otherwise, no cuts were made during FY2020. Rather, funds were appropriated from the rainy day fund to the General Revenue Fund and Revenue Stabilization Fund to offset the shortfall, the sole approach taken. Ultimately, the shortfall totaled $366.6 million.

Originally given $1.5 billion in CARES funds, Oklahoma elected to only use $84 million of its CARES Act Funds in FY2020 with $64 million going to the Department of Health and the remaining going to the Department of Education, state postsecondary institutions, and other sources. The Governor has said that Oklahoma will use all the federal coronavirus relief funds allocated to the state. As of March 29, 2021 it had allocated nearly $1.4 billion out of the $1.5 billion it was originally given.[xxviii] The state issued $361 million in grants to city and county governments, the Oklahoma Department of Health was provided an additional $232 million, $100 million was dedicated to the Oklahoma Business Relief Program, and the Department of Education received an additional $93 million.

Pessimistic revenue projections by the State Board of Equalization made in April 2020 predicted a $1.3 billion shortfall for FY2021 compared to February 2020 predictions. Accordingly, the legislature enacted a budget which implemented across the board budget cuts where most Oklahoma state agencies received budgets cuts of 3.5 to 4 percent while education faced a 2.5 precent cut. In addition to making budget cuts, Oklahoma legislators overrode the governor's veto to lower the statutory contribution rate for its public retirement plans.[xxix] They also used fund transfers from the rainy day fund to help craft the budget, bringing the state's reserves down nearly $800 million across the FY20 and FY21. As of February 2021, general revenue funds were $11.1 million above the estimate.

State Narrative: Tennessee

Unlike the other states, Tennessee's State Funding Board, the group charged with certifying the state's revenue forecasts, never officially declared a revenue shortfall. While they met in May 2020 where they heard presentations from various economic advisors[xxx], a new revenue forecast was not formally adopted.[xxxi] Instead, on March 19, 2020, the Legislature passed a preliminary budget for FY21, including amendments to FY20 which accounted for potential revenue shortfalls.[xxxii] In a June 2020 presentation to the legislature, the State Department of Finance and Administration Commissioner Butch Eley highlighted the use of hiring and purchasing freezes, non-tax revenues, agency savings, and reserves to help close the state's revenue shortfall. Ultimately though, when accounting for changes adopted during the 2020 legislative session, total general fund revenues were $484.9 million more than the revised estimate. To that extent, like Kentucky, some of those cuts may have proven unnecessary, but the surplus serves as non-recurring revenue for FY21.

Three weeks after then-President Trump signed the CARES Act, awarding Tennessee $2.65 billion in funds, Tennessee Governor Bill Lee announced the creation of the Stimulus Financial Accountability Group to ensure proper fiscal management of stimulus funds. $284.65 million was requested directly by the governments of Shelby County, the City of Memphis, and Metro-Nashville. As of February 2, 2021 the state had distributed nearly all its funds with nearly

$1 billion going to the state's unemployment trust fund, $325 million going to small businesses, $150 million going to nonprofits, $115 million going to local governments, and $76 million to the state's K-12 education system.[xxxiii]

Seeking to address the projected $1 billion revenue shortfall in FY21, the Tennessee legislature convened in June 2020 to finalize the preliminary budget it had passed in March. The budget heavily taps non-recurring revenues, borrowing, and federal funds in order maintain stability.[xxxiv] Specifically, it seeks to deploy a $500 million carry-forward from FY20, $60 million in non-tax sources, $62 million in budget reductions, $167 million in debt service, and $150 million in reserves. This follows the strategy outlined by Commissioner Eley, who in June 2020 highlighted the use of reductions and efficiencies and the utilization of reserve funds to cover budget shortfalls, with the rainy day fund as a last resort option.[xxxv] The search for greater budget efficiencies appeared to be on the horizon as early as November 2020 when the governor asked Tennessee state department heads to cut their 2021 budgets by 12 percent.[xxxvi] Such cuts are still to be determined though and may ultimately be unnecessary as the state's general fund recorded $1.2 billion more than the budgeted estimates as of February 2021.

Revisiting the Volcker Alliance Study

In light of these narratives, I want to transition to a discussion on these actions relative to how each state was graded by the Volcker Alliance in their most recent publication. This connection seeks to bridge the actions taken between states' recovery from the Great Recession to the recent financial stress. Table 4 reports each state's five-year grade average for each of the five principal categories organized alphabetically by state name. Before beginning, I want to note that the categories of legacy costs and transparency, while relevant in the context of the Volcker study, are less relevant to a discussion on state actions during the pandemic. Both subjects are difficult to consider in a single-year context, legacy costs even more so in a pandemic.[11]

Table 4: Volcker Alliance 5-Year Grade Average					
	Budget Forecasting	Budget Maneuvers	Legacy Costs	Reserve Funds	Budget Transparency
Arkansas	D	A	C	C	D
Kentucky	B	C	C	C	B
Louisiana	B	C	D	A	B
Oklahoma	B	B	A	A	B
Tennessee	C	A	B	A	A
US Average	C	B	C	B	B

At first glance, Oklahoma and Tennessee stand out in that they received average to above average grades across the five categories while Kentucky and Louisiana did so in three of the categories, and Arkansas did so in only one category. Interestingly though, these grades are noticeably reversed when considering how states faired in the pandemic. In observing Table 5 from left to right, one sees that Arkansas, the state graded the lowest among the cohort, was the only state that did not issue budget cuts nor use its reserve funds. Louisiana similarly did not issue any budget cuts but did draw from its rainy day fund to help structure its FY21 budget. Meanwhile, Kentucky did issue budget cuts but did not draw upon any reserves throughout the

[11]It is worth noting though that Oklahoma lawmakers overrode a gubernatorial veto to lower the statutory contribution rate for its public retirement plans

pandemic. Despite receiving the best grades among the cohort, both Oklahoma and Tennessee withdrew large sums from their reserves in both fiscal years and still issued budget cuts.[12]

Table 5: Summary of Fiscal Actions Taken

	AR	LA	KY	OK	TN
Officially revised its revenue forecast for FY20	✓	✓	✓	✓	
Use of reserve funds in FY20				✓	✓
Mid-year budget cuts in FY20			✓		✓
Officially revised its revenue forecast for FY21	✓	✓	✓	✓	✓
Use of reserve funds in FY21		✓		✓	✓
Mid-year budget cuts in FY21					

Breaking it down further, when observing budget maneuvers, specifically as it relates to budget reductions, Louisiana avoided making any all-together. Arkansas, thanks in part to its strict revenue stabilization law, only cut "extraneous" spending. Kentucky made only minimal spending cuts totaling $48.5 million. Meanwhile, Tennessee made significant cuts totaling nearly $250 million, balancing them out with better-than-expected revenues. Oklahoma, electing to not make cuts in FY20, was instead forced to heavily tap its reserves amid the state's poor revenue returns. It then proceeded to enact budget cuts within the FY21 budget.

Despite having the lowest average grade in budget forecasting across the five states observed, Arkansas was the first state to update its revenue forecasts as the national economy ground to a halt in March 2020. Oklahoma's Board of Equalization met three times during FY20

[12] Although not issued "mid-year", Oklahoma did enact budget cuts within its FY21 budget, more details can be found in the state's narrative above.

to discuss its revenue projections for the fiscal year. By the time it held its third meeting in April, the Board had predicted decreased revenues each time, with the third totaling a $760 million reduction from the budgeted projections made in June 2019. Kentucky and Louisiana were more delayed, taking official action in May 2020, though each provided unofficial estimates to help guide legislators as they constructed the state budget. Louisiana's revenue forecasting group has since met three different times to present new forecasts for FY21, Kentucky's has only met once. Tennessee, with the lowest grade among the 5 states, failed to ever officially adopt a revised forecast in FY20 but did so in FY21. Its State Funding Board called for a revenue shortfall in both years.

When considering the use of reserve funds, two of the three A recipients, Tennessee and Oklahoma, withdrew large sums from their reserves in both fiscal years.[13] Tennessee though managed to build upon its rainy day fund at the end of FY2020, with a deposit of $325 million and has consistently referenced its reluctance to tap the fund during the pandemic[xxxvii]. Additionally, according to Tennessee State Senate Bill 2932, the Governor was given authority to access certain reserve funds as needed during FY2021. Oklahoma meanwhile dipped heavily into its rainy day fund to help address budget shortfalls for its state agencies in FY20 and incorporated additional reserve funds into its FY21 budget. Its highest score among the five categories, Louisiana built up its reserves headed into FY21, using monies made available from previous surpluses. The state then proceeded to withdraw $90 million from the fund ahead of FY21 in order to help fund the budget. Ranking lowest among the states, both Kentucky and Arkansas avoided tapping into reserves to close out FY20. Arkansas elected to create a pandemic-specific fund with monies from the state's previous budget surpluses and the governor

[13] Tennessee used $600 million in reserve funds while Oklahoma used approximately $776 million.

has indicated he seeks to build up the state's reserves "from about $185 million now to about $420 million after the next two fiscal years."[xxxviii] Kentucky utilized a majority of its FY20 surplus to make a deposit into the fund, effectively doubling the total it had when the year began.

Concluding Remarks

The COVID-19 pandemic has effectively thrown down the gauntlet to state budget authorities everywhere. Facing drastic declines in tax revenue and a poor economic outlook, states have struggled to keep themselves afloat using any means necessary. To that end, by revisiting the grades assigned to each of these states, we can begin to see how the Volcker study is only able to capture "best practices" as it relates to state budget processes in "normal" times. As has been said several times throughout the pandemic, COVID-19 brought with it a "new normal". In this "new normal", it may be the case that "best practices" in state budget processes are simply those that help relieve fiscal stress in the moment without destabilizing future budget cycles. Showcasing this best is Arkansas, who ranked the lowest among the cohort but arguably "performed" the best throughout the pandemic. Perhaps their procedures do not satisfy certain criteria but through strict implementation of their budget processes they were able to avoid making any cuts to necessary services and were able to avoid draining their reserves, placing themselves in a good position as the economy begins to open back up. Is that not the most important outcome when it comes to assessing budget processes? This study is not nearly sufficient enough to offer an answer to that question but does suggest there may be an argument in favor of a state such as Arkansas being truly the "best" practitioners of state budget processes and therefore a revisitation of how to assess state budget practices may be in order.

Ultimately, budgeting is an art, not a science. State budget authorities were working up through June 30, 2020 to ensure budgets remained balanced at the end of the fiscal year. They have since continued to have to revisit their fiscal 2021 budgets once it began the following day. As the nation begins to move forward with vaccines rolling out, there is renewed optimism for how the economy will fare and these budget authorities may finally be seeing some light on the horizon. Still, the actions taken by these authorities in the last twelve months will affect their ability to respond to future crises that may very well appear on that bright horizon. To that end, it is important to continually assess these actions, holding authorities accountable for how they spend a state taxpayer’s dollars.

Appendix A

Budget Forecasting: was graded on a state’s using a consensus revenue forecast; having a reasonable rationale for revenue growth projections based on historical revenue and economic growth trends; producing multiyear revenue forecasts; and generating multiyear expenditure forecasts.

Budget Maneuvers: graded on a state's one-time actions to create short term budget fixes, often to the detriment of long-term budget sustainability. They may include transferring special funds, reserves, or windfalls from legal settlements into the general fund; bringing a future year’s revenue into the current period; or pushing the cost of current expenditures into the future.

Legacy Costs: graded on a state’s willingness to meet obligations for public employee pensions and other postemployment benefits

Reserve Funds: was graded on a state’s having a reserve fund disbursement policy; having a reserve fund replenishment policy; tying reserves to historic trends in revenue volatility; and having a positive reserve or general fund balance at the beginning of each fiscal year.

Budget Transparency: was graded on the extensiveness and usefulness of a state’s financial disclosure practices.

<u>Appendix B</u>

Category	Question
Budget Forecasting	Does the state utilize a consensus revenue estimate for the forthcoming fiscal year or biennium in budget and planning documents?
Budget Forecasting	Does the state provide a reasonable, detailed rationale to support revenue growth projections at time of initial budget?
Budget Forecasting	Did the state successfully avoid having to make a material midyear negative budget adjustment?
Budget Forecasting	Does the state utilize multiyear revenue forecasts for at least 3 full fiscal years in budget and planning documents?
Budget Forecasting	Does the state utilize multiyear expenditure forecasts for at least 3 full fiscal years in budget and planning documents?
Budget Maneuvers	Did the state successfully avoid utilizing borrowing proceeds to pay for recurring expenditures?
Budget Maneuvers	Did the state successfully avoid utilizing "scoop and toss" refinancing to raise funds for any current expenditures, including debt service?
Budget Maneuvers	Did the state successfully avoid diverting bond premiums (or other upfront cash flows generated during sales of bonds or other financial transactions) into the general fund or other general revenue account?
Budget Maneuvers	Did the state successfully avoid utilizing pension bond proceeds to make the annual required or actuarially determined contribution to any pension?
Budget Maneuvers	Did the state successfully avoid utilizing upfront proceeds or deferral of upfront costs on financial transactions to fund recurring expenditures?
Budget Maneuvers	Did the state successfully avoid utilizing proceeds from material, nonrecurring asset sales (excluding routine disposals of surplus or outdated property) to fund recurring expenditures?
Budget Maneuvers	Did the state successfully avoid accelerating tax or other revenues from a future year into the current fiscal year to fund recurring expenditures?
Budget Maneuvers	Did the state successfully avoid deferring recurring expenditures, excluding those for capital projects, into future fiscal year(s) from the current year?
Budget Maneuvers	Did the state successfully avoid utilizing one-time transfers into the general fund from special funds to pay for recurring expenditures?
Budget Maneuvers	Did the state successfully avoid temporarily shifting costs (to counties, municipalities, school districts, or other governments or agencies), or upstreaming cash from any such entity to the state, that is not part of a regular agreement or process?
Budget Maneuvers	Did the state successfully avoid drawing down on the rainy day or other budget stabilization reserve funds to pay for recurring expenditures?
Budget Maneuvers	Did the state successfully avoid drawing down on the general fund reserve on a budgetary basis to pay for recurring expenditures?
Legacy Costs	Was the contribution to public-employee pension fund(s) effectively 100% of the actuarially required or determined amount?

Legacy Costs	Was the contribution to public-employee OPEB (postemployment benefits other than pensions) effectively 100% of the actuarially required or determined amount?
Reserve Funds	Does the state have and follow a policy (set by constitution, referendum, statute, or other formal rule) for the use of its rainy day funds?
Reserve Funds	Does the state have and follow a policy (set by constitution, referendum, statute, or other rule) for the replenishment of rainy day funds?
Reserve Funds	Is the state's targeted rainy day fund balance specifically tied to historical trend of revenue volatility?
Reserve Funds	Are deposits into the state's rainy day fund specifically tied to historical trend of revenue volatility?
Reserve Funds	Were state reserve funds greater than $0 on the first day of the fiscal year?
Transparency	Does the state have a consolidated website or set of related sites that provide budget and supplemental data?
Transparency	Does the state provide tables listing outstanding debt and debt-service costs, as well as provide information on any legal debt limits?
Transparency	Is the estimated cost of the deferred infrastructure maintenance liability for the state for all its capital assets disclosed in budget and planning documents?
Transparency	Does the state provide an annual or biennial tax expenditure budget (or similar description) of the cost of any tax exemptions, credits, and abatements?

Appendix C

Section 1: Background Information FY2020

1. State: _________
2. FY 2020 General Fund Budget (enacted) _________
3. Restricted Fund Budget (enacted) _________
4. Budget Stabilization Fund (start of FY2020) _________
5. Annual or Biannual Budget _________
6. State General Fund Tax Structure (example response)

Tax Source	% of G. Fund Revenue (as Enacted)
Individual Income	50.69%
Sales & Use	22.03%
Corp. Income & Ltd. Liability	17.07%
Property	5.60%
Other	4.61%

Section 2: 2020 Financial Summary Information

1. Tax and Revenue Data for FY 2020
   a. Original 2020 General Fund Estimate _________
   b. Original and Final Revenue by type (example response)

Tax Source	Enacted ($M)	Revised ($M)	Final Receipts ($M)
Individual Income	4,664.4	4,526.0	4,765.2
Sales & Use	4,129.8	3,931.6	4,070.9
Corp. Income & Ltd. Liability	581.1	488.4	639.2
Property	657.1	632.4	643.0
Other	757.8	736.0	763.2
Total	11,462.0	10.991.5	11,566.7
Surplus (Shortfall)	-	-	177.5

Section 3: Economic and Demographic Data as of July 1, 2019 (vs. July 1, 2020)

1. Population ________
1. Employment
    a. Civil Labor Force ________
    b. Labor Force Participation rate ________
2. Unemployment
    a. Seasonally-adjusted unemployment rate ________
    b. Initial unemployment insurance claims ________
    c. Continued claims ________

Section 4: Budget Impacts of the Pandemic

1. Shortfall actions (if any)
    a. Across the board cuts Yes/No (detail)
    b. Use of Stabilization fund Yes/No (detail)
    c. Use of Special Revenue Funds Yes/No (detail)
    d. Prioritized Expenditure Reductions (lapsed funds) Yes/No (detail)
        i. Cancel Capital Projects Yes/No (detail)
2. Other actions
    a. Use of CARES Act Funds in FY2020 (describe)
    b. Federal Stimulus in FY2020 (describe):
3. Surplus actions (if any, describe)

Section 5: Preliminary Observations for FY2021

1. Has the state revised its revenue forecast Yes/No
    a. If not, when will it be done
2. Does the state have a budget action plan Yes/No
    a. Possible actions
        i. Use of residual CARES funds (describe)
        ii. Across the Board Budget Cuts (describe)
        iii. Other (describe) --
    b. Response to revision (describe)
3. State Specific Insights (for example):
    a. Budget planning and stabilization funds (describe):
    b. Revenue forecasting (un)certainty (describe):
    c. Executive branch flexibility (describe):
    d. Other:

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