Tufts UNIVERSITY | Jonathan M. Tisch College of Civic Life

THE CENTER FOR STATE POLICY ANALYSIS

TESTIMONY

October 2020

# cSPA testimony at the Economic Roundtable, October 7, 2020

I want to thank you for inviting me to testify today, and for giving me this opportunity to help address the difficult revenue and spending questions still shadowing the current fiscal year.

My name is Evan Horowitz and I'm the executive Director of the Center for State Policy Analysis, abbreviated as cSPA and pronounced "sea-spa."

cSPA is a relatively new initiative at Tufts University, housed at the Tisch College of Civic Life. We provide timely, relevant research on live legislative topics — in a strictly non-partisan way. Since launching in February, we've done work not just on state revenue but also on creative approaches to economic aid, voting under Covid, police reform, ranked-choice voting, and beyond.

I'll start with our central projection and then step back to give a sense for how we arrived there and the main sources of uncertainty moving forward.

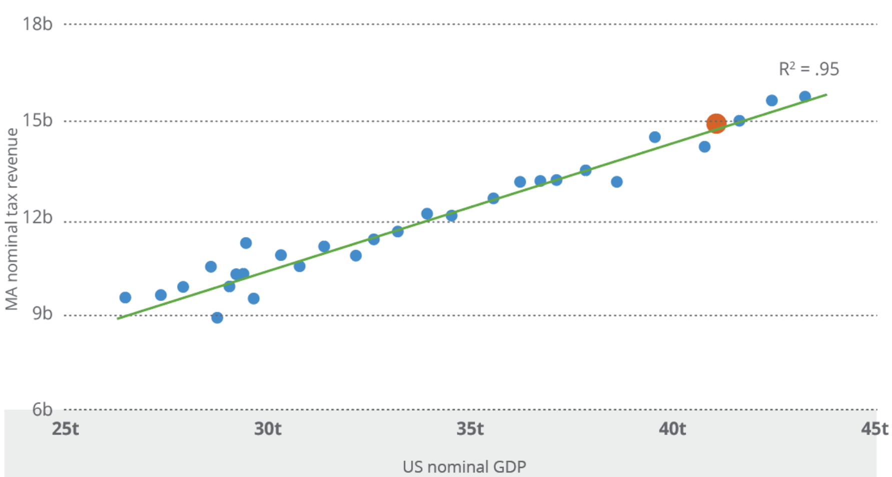
**For FY21, we estimate that state tax revenues will amount to roughly $29.6b, $1.6b below the consensus revenue estimate from January and in line with final revenues for FY20.**

Our estimate is based on a predictive model that uses US GDP to gauge likely state tax revenues. It works because GDP reflects exactly the kinds of things that the state tends to tax: income and spending. Year in and year out, there is basically a 1:1 correlation between national GDP and Massachusetts tax revenues.

To give a sense for the strength of this connection, I'd like to share the same chart that I showed in April — with one update.

**US GDP strongly correlated with MA tax revenues**

Comparing US GDP against Massachusetts tax revenues, every half-year since FY 2006




**SOURCE:** Bureau of Economic Analysis. Massachusetts Comptroller. Both datasets seasonally adjusted.

The blue dots represent the key data on which this model is built; they show that if you know the level of GDP, you have the information you need to predict state tax revenue: it is going to be very close to that green line.

The orange dot is what happened from January-June. And the fact that it lands right on the line shows that even in this moment of unprecedented uncertainty, with the largest economic contraction since WW2, the relationship between US GDP and state tax revenues has continued to hold.

Building off this relationship, we can project state tax revenues using existing estimates of US GDP, which are produced by a range of reputable private and public organizations, including the Conference Board, the Congressional Budget Office, the Federal Reserve, and various investment banks.

Gathering those together, we find a general consensus that the US economy will grow rapidly in this quarter and continue growing — though much more slowly — through the end of the fiscal year.

Given this consensus, we can plot the next dot on the chart I showed, using GDP to establish the likely amount of state tax revenue, which we calculate to fall between $29 and $30 billion, with a central estimate of $29.6 billion, which is roughly $1.6 billion below the original consensus and in line with the final tax revenues from FY20.

If actual tax collections do match these estimates — as they have at least through September — it does not seem like the FY21 budget will require dramatic actions on either side of the ledger, be it spending cuts or tax increases.

Obviously, such moves could be pursued on their own merits, but they're not necessary for deficit-fighting as a gap of this size could comfortably be filled with money from the state stabilization fund. Especially given that we were able to close FY20 without a drawdown.

I understand the desire not to deplete the fund, for fear of facing a future crisis with limited reserves. However, the prime rationale for the stabilization fund is to help fill temporary budget gaps from sudden economic downturns — precisely today's situation. And I would add two points:

1) *It's important not to cause real harm now, in an attempt to avoid potential harm tomorrow*. The reason you may want to hold substantial reserves is to avoid painful cuts in future years. But if the cost of that prudence is painful cuts today, you're actually ensuring the bad outcome you're trying to avoid.

2) *Concerns about FY22 seem overstated*. I know there are worries about the fiscal landscape of FY22, but we see no basis for this assessment. To the contrary, the fiscal prospects for FY22 look relatively bright, with ample opportunity for catch up growth in a world where some kind of effective vaccine or therapeutic is likely to be widely available. There's no particular reason to expect a large deficit that year and therefore no reason to be particularly fearful about maintaining large reserves.

Having summarized our findings, and what they mean for the work of deficit-closing, I'd like to talk about some of the uncertainty behind our estimate, especially as the shortfall we project is smaller than the multi-billion-dollar estimates from other quarters.

Our model assumes about an 80 percent chance of additional fiscal stimulus from the federal government. Federal support, including the expanded unemployment insurance program, has helped to keep families and businesses afloat, providing much-needed supplementary income that has also translated into stronger economic activity and higher state tax revenues.

Following other forecasters, we find it likely — but not certain — that additional stimulus will be forthcoming. And the decisive factor may be the election.

In a scenario where Democrats regain control of the Senate, substantial fiscal stimulus is highly likely, which would reduce uncertainty in our budget estimates.

Otherwise, if Donald Trump remains president or Republicans hold the Senate, federal aid is still possible but far from guaranteed and likely smaller. That would reduce our estimate of state tax revenues by roughly $1 billion.

Given the dramatic impact of this one event, we recommend that budget writers consider deferring some decisions until after election day (unless federal stimulus is passed before then.)

At least under our estimates, the availability of additional federal stimulus means the difference between a budget gap that can be readily filled via the rainy day fund and one which might require additional activity in the form of higher taxes or reduced spending.

It’s worth noting, however, that FY21 is not entirely beset by downside risks; there is also some upside potential in the form of improved therapeutics and the remarkable progress towards a vaccine — which at one point seemed like a prospect for late 2021 but which could actually arrive much sooner.

At this point, I’d like to thank you for your time. I'm happy to answer any questions you may have. And more generally I'd like to say that cSPA is ready to provide research on any topic or issue that you think could be useful.