Austerity Isn't the Answer: How State and Local Budget Cuts Will Harm Our Recovery

The COVID-19 pandemic has exposed the fragility and inequality of our economy and plunged our states and local governments into a severe budget crisis. The extraordinary need for public health and safety net programs, combined with precipitous drops in tax revenue, has produced stark budget shortfalls. Because of balanced budget requirements and a cramped view of state taxation, governors and legislatures are likely to slash public sector employment and services unless they receive fiscal relief.

Cuts to state and local budgets would have dire macroeconomic consequences. In *Four Priorities for Pandemic Relief Efforts*, Roosevelt Institute Chief Economist Joseph Stiglitz warns that austerity budgets as responses to revenue shortfalls could send our economy into a deeper recession, making a robust and timely recovery all but impossible.

Cuts to State and Local Spending Could Induce a Significant Contraction in GDP

- According to Stiglitz, states could face a shortfall of up to $300 billion in 2021. A spending cut of this magnitude, in a recession, would have a large multiplier effect: As states cut spending, they cancel contracts with vendors, reduce payments to businesses and nonprofits, and cut benefit payments to individuals. As individuals see income drops, they pull back on their consumption spending, which removes demand from the economy.
- The ripple effects of these cuts are substantial; assuming a fiscal multiplier of 1.5 (meaning every dollar cut from the budget leads to $1.50 less in consumer spending), the impact on GDP could be between $240 billion and $450 billion. In short, contraction of state and local spending could, by itself, induce a significant contraction in GDP.

Cuts to State and Local Spending Could Spur Significant Long-Term Job Loss

- Stiglitz estimates that state budget cuts could translate into a total increase in unemployment of 2.25 percentage points, or another 3.7 million jobs lost. But because the labor intensity of state and local government is high, the unemployment effect could be even larger, with estimates of up to 5.5 million jobs lost.
- The effects of this job loss would likely persist. The Great Recession, for example, saw steep declines in state and local employment, which never recovered to pre-crisis levels.

Without State Fiscal Relief from the Federal Government, Recovery Efforts Will Likely Stall

- Failure to provide sufficient state and local funding will stall our recovery. During the Great Recession, states enacted unprecedented budget cuts even as the federal government provided other forms of fiscal stimulus. These broad cuts undermined the stimulus provided at the federal level, leading to a needlessly slow and anemic recovery.

For more information, see *Four Priorities for Pandemic Relief Efforts*.