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FUNDING FOR STATES IN ECONOMIC RECOVERY PACKAGE WILL CLOSE LESS THAN HALF OF STATE DEFICITS

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The state fiscal situation is dire. Revenues are declining, and the need for services such as Medicaid is rising as people lose income and jobs. Before passage of the economic stimulus package, state deficits were projected to equal $350 billion over the next 30 months. Because nearly all states are required to balance their budgets, states have begun to cut expenditures and raise taxes — both of which create a drag on the economy and threaten to counteract part of the intended federal economic stimulus.

The American Recovery and Reinvestment Act recognizes this fact and includes substantial assistance for states. The amount of funding that will go to states to help them maintain current activities is approximately $135 billion to $140 billion — or about 40 percent of projected state deficits. Most of this money is in the form of increased Medicaid funding and a "State Fiscal Stabilization Fund." This funding will reduce the depth of state budget cuts and moderate state tax and fee increases. There are also other streams of funding in the economic recovery bill that will flow through states, but — for reasons described below — those funds will not address state operating budget shortfalls.

Federal Assistance to Close State Deficits

Projected state budget deficits represent the difference between projected revenues and the projected cost of maintaining the current level of services, given changes in factors such as population and inflation and in the number of people who qualify for programs like Medicaid that expand in recessions when need increases. The economic recovery package provides $135 billion to $140 billion that states can use to reduce the magnitude of their budget gaps, including the following provisions:

- **An estimated $87 billion in federal Medicaid funding**, which will help pay for increased Medicaid costs that states face as a result of the recession and will also help make up for reduced state revenues, thereby mitigating Medicaid cuts.

- **Most of the $54 billion "Fiscal Stabilization Fund**." The Senate provides $53.6 billion in a Fiscal Stabilization Fund. Some $5 billion of that amount is designated for incentive grants. Most of the incentive grants will be for new education reform initiatives, rather than being available to support ongoing state obligations to fund education, and at least half of these funds will have to be passed through to local school districts. That leaves about $48.3 billion. Of this amount, $39.5 billion is to be used to help states and localities pay for ongoing K-12 and higher education costs, with states likely to use the lion's share. The remaining $8.8 billion is in a flexible block grant that states can use to support other key services.

- **A small portion of some of the other funding streams that states may be able to pass through to local jurisdictions.** Examples include funding for local law enforcement, the Individuals with Disabilities Education Act, and Title I funding for schools with high proportions of disadvantaged students. While important to struggling local governments and school districts, this type of funding typically will not play a large role in closing state deficits, as discussed below.

If one counts the $87 billion in Medicaid assistance and the $48.3 billion for education in the stabilization fund, the total is $135 billion. If one assumes that some of the funding for other programs could substitute for state funding that otherwise would be devoted to that program, there may be an additional $5 billion in state fiscal relief, for a total of approximately $135 billion to $140 billion or about 40 percent of projected state deficits.

Other Funding for States in the Economic Recovery Bill

The economic recovery package includes substantial additional funding that will be administered by states. Although this funding will provide important services and create jobs, states will not be able to apply it to the $350 billion in estimated budget shortfalls. Because of the way the provisions were designed, some of the funding will need to be passed along to local governments. (The $350 billion figure represents the gap in *state* operating budgets; it does not include *local* government shortfalls.) Some of the funding is specifically for infrastructure — which typically is part of state *capital* budgets rather than state *operating* budgets — or specific new initiatives. The only way such funding could address state budget gaps would be if states were able to use this federal funding to substitute for state funding that otherwise would be devoted to these program areas, which may be possible in some programs, but not in others.[1]

Funding to maintain local government services is warranted; local governments throughout the country are experiencing large deficits because of declining local tax revenue — especially property and sales tax revenue — and rising needs for local services. (Since there is no reliable figure for how large those local deficits are, no such figure is included in the $350 billion estimated *state* budget shortfall.) Similarly, there are extensive unmet infrastructure needs. The point is simply that aiding local government and providing funds for infrastructure do not help close states' operating budget shortfalls.

[1] In the case of infrastructure, in some limited cases, states' operating budgets may receive some benefit from the federal infrastructure funds, either because funds for infrastructure reduce the need for capital borrowing, which reduces debt service paid from operating budgets, or because capital projects would otherwise be funded directly with operating funds. However, most of the infrastructure spending in the bill will fund projects that would not otherwise be undertaken in the next two years because the amount of infrastructure expenditures, particularly on-budget expenditures, tends to vary from year to year depending on available funding. Little would be done under current economic conditions, so there will be little replacement of operating costs that would otherwise be incurred in the near future. In the case of specific programmatic spending, the funding is typically for additional activity that a state would be required to undertake beyond what it would normally have planned to do. Examples include teacher quality enhancement grants to help states change certification and training procedures and vocational rehabilitation grants to allow states to serve more people. While these grants will help states improve services, they will not help fill state deficits because these new costs were not included in the calculation of the deficits. Deficits measure shortfalls relative to the funding needed to maintain existing services.