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*Special Series:* **Economic Recovery Watch**

February 4, 2009

# RECOVERY BILL'S "FISCAL STABILIZATION FUND" IS IMPORTANT TO PROTECTING EDUCATION AND AVERTING STATE AND LOCAL BUDGET CUTS THAT WOULD FURTHER WEAKEN THE ECONOMY

By Jason Levitis and Joan Huffer

The Senate economic recovery bill includes a $79-billion "State Fiscal Stabilization Fund" to help state and local governments fund education and other key services. The economic downturn has opened budget deficits in *46 states*, forcing large spending cuts and layoffs, with more expected. These actions remove demand from the economy, which deepens the downturn.

The Stabilization Fund would provide funds to partially close state and local budget shortfalls and allow states to avoid some of the most harmful actions they otherwise would have to take to meet their balanced budget requirements. In particular, it would help avert damaging cuts in state aid to education at a time when school districts are reeling from declines in property taxes caused by sinking property values. The economic recovery bill that the House passed includes a similar provision.

The Fiscal Stabilization Fund and the Medicaid assistance also provided in the bill together would fill less than half of projected state deficits for the next 2½ years. Diminution of the proposed funding would increase the extent to which states must take budgetary actions that are likely to undercut efforts to stimulate the economy.

**States are Facing Massive Deficits and Cutting Vital Programs.** States are facing their worst fiscal crisis since the Second World War. The recession has reduced state revenues, while increasing the need for state services such as Medicaid. Forty-six states face budget deficits in the 2009 and/or 2010 state fiscal year, and state deficits are expected to total $350 billion through state fiscal year 2011.[1]

The state fiscal crisis is a direct result of the economic downturn. Before the downturn, states had amassed reserves totaling 11.5 percent of state spending. Moreover, total state spending, which fell sharply relative to the economy during the 2001 recession, remains below its fiscal year 2001 level as a share of the economy.

[1] Elizabeth McNichol and Iris J. Lav, "State Budget Troubles Worsen," CBPP, *Updated* Jan. 29, 2009. www.cbpp.org/9-8-08sfp.htm.

Because most states are required to balance their operating budgets, states with deficits are forced to cut spending and/or increase taxes. At least 39 states have enacted or proposed spending reductions.[2]

Among the budget cuts, 34 states have cut funding for elementary, secondary, and/or higher education or have proposed such cuts.

- At least 20 states have implements cuts to K-12 and early education, and other five have proposed such cuts.

- At least 27 states have implemented cuts in funding for public colleges and universities, and another three have proposed such cuts. The result is reductions in faculty and staff and tuition increases of 4 percent to 15 percent.[3] Tuition increases and cutbacks in faculty and enrollment reduce access to higher education for many low- and middle-income students.

When states cut spending, they lay off employees, cancel contracts with vendors, reduce payments to businesses and nonprofits that provide services, and cut benefit payments to individuals. All of these steps remove demand from the economy and compound the economic slowdown, counteracting the effects of the recovery bill. If states raise taxes to balance their budgets, the effects on demand are similar. The Stabilization Fund would help prevent further cuts to K-12 and higher education, as well as other critical state and local services.

**How the Stabilization Fund Would Work.** The State Fiscal Stabilization Fund creates two block grants. The larger block grant would provide $38.8 billion, be earmarked for education, and be allocated by each state's population of individuals between the ages of 5 and 24. A portion of the funds would be dedicated to helping *states* maintain their education funding commitments; the remainder would flow directly to *local* school districts. The smaller block grant would provide $24.8 billion, allocated based on each state's total population, to support other basic state services, such as public safety and law enforcement, services for the elderly and people with serious disabilities, child care, and the like.

**The $39-billion block grant would provide vital protection for education funding.** To receive either block grant, states would be required to fund both K-12 and higher education at no less than their fiscal year 2006 level. States could use the funds to help fulfill their commitments under their regular school funding formulas, which in most states would include increases in state funding to compensate for declining property values and property taxes on which most local school districts rely for funding.[4] In combination, these provisions would help to protect school districts and public colleges against the steep budgets cuts they otherwise would face.

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[2] Nicholas Johnson, Phil Oliff and Jeremy Koulish, Facing Deficits, "At Least 39 States Are Imposing Or Planning Cuts that Hurt Vulnerable Residents," CBPP, *Updated* Jan. 29, 2007. www.cbpp.org/3-13-08sfp.htm.

[3] Nicholas Johnson, Phil Oliff, and Jeremy Koulish, "Most States Are Cutting Education," CBPP, Revised Jan 29., 2009. www.cbpp.org/12-17-08sfp.htm.

[4] If a state's block grant exceeded permissible uses of the funding for K-12 and higher education, the remainder would be allocated to local school districts based on the Title I formula.

**The $25-billion block grant provides vital protection for other key services.** Most of the assistance for states in the recovery bill is dedicated to either Medicaid or education. The sole piece not so dedicated is the smaller, $25-billion Stabilization block grant. States provide a wide range of other vital services that also are threatened by budget deficits, including public safety, corrections, and services for the elderly and disabled. State budget cuts in these areas, as well, reduce demand and increase unemployment, thereby deepening the recession.

- At least 22 states plus the District of Columbia are cutting, or proposing cuts to, medical, rehabilitative, home care, or other services needed by low-income people who are elderly or have disabilities, or significantly increasing the cost of these services.[5]

- Cuts in other states are reducing funding for law enforcement, programs to prevent child abuse, funding for homeless shelters, and the like.

- Many states are cutting state aid to localities, which will reduce funding for local programs including police and fire protection, meals for the elderly, hospice care, and seniors' services.

- At least 36 states and the District of Columbia have made, or have proposed making, cuts affecting their state workforces, including layoffs.

The $25-billion grant can help to reduce the depth of the cuts states and localities will otherwise have to make, preserving essential services and jobs and sustaining economic demand.

**Total fiscal assistance for states in the recovery bill will cover less than half of state deficits.** The direct budget assistance to states in the recovery bill will cover less than half of the $350 billion in combined deficits that states are likely to face over the next two and a half years.[6] Besides the two Stabilization Fund grants totaling $64 billion, the bill includes an estimated $87 billion in Medicaid funding, which would help pay for Medicaid costs and avert Medicaid cuts. Together, these pieces add up to about $151 billion, or about 43 percent of expected state deficits. (States will also receive funding for infrastructure, but that is not fiscal relief that helps close holes in state *operating* budgets, which are the budgets that states must balance each year. States fund most infrastructure projects out of their *capital* budgets, which are separate.)

**States would be required to spend the funds quickly.** The Senate bill includes a provision requiring states that fail to spend any portion of a Stabilization grant *within one year* to return the unspent portion, which would then be redistributed to the other states. And while the bill allows grants to be made through September 30, 2010, states are likely to request their grants much earlier than that in order to address immediate budget needs. Some 43 states face mid-year deficits in the current fiscal year, which ends June 30, 2009 in most states, and a comparable number of states face deficits for the next fiscal year, which generally runs from July 1, 2009 to June 30, 2010. As a result, a large portion of the grants is likely to be spent within a year and a half of the bill's passage.

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[5] Johnson, Oliff, and Koulish, "At least 39 States Are Imposing Or Planning Cuts that Hurt Vulnerable Residents."

[6] See Iris J. Lav and Nicholas Johnson, "Funding for States in Senate Economic Recovery Package Would Close Less Than Half of Projected State Deficits," CBPP, Jan. 29., 2008. www.cbpp.org/1-29-09sfp.htm.