Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

Special Series: Economic Recovery Watch

July 9, 2009

MYTHS AND REALITIES ABOUT HOW STATES ARE USING ECONOMIC RECOVERY ACT FUNDS

by Nicholas Johnson and Phil Oliff

Two major misconceptions about how state governments are using funds from the economic recovery law that President Obama and Congress enacted early this year are contributing to a broader misunderstanding about whether the law is, in fact, helping the U.S. economy.

Evidence that includes a major new report from the Government Accountability Office (GAO) shows that — contrary to these myths — states are using the funds as intended. These funds will help the economy recover over time from what will be the nation's deepest recession in decades.

Myth 1: States are using the money improperly by applying it to their budget shortfalls.

Reality: The law was specifically designed to help states close their budget shortfalls.

To quote the legislation, "The purposes of this Act include the following: … To stabilize State and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases."[1]

By working toward this purpose, states are helping the economy.

- State revenues have fallen sharply due to the recession. As a result, states face a combined $350 billion in projected budget gaps over the next two years. Because states also face legal requirements to balance their budgets, most are enacting program cuts and tax increases to close their budget gaps. Such measures, however, reduce demand for goods and services, making a weak economy even weaker. Without federal funds, states would have to take even more dramatic measures that, by reducing demand, would result in lost jobs and make the recession worse.

  The recovery law is giving states roughly $140 billion over the next two years in Medicaid and education funding, reducing the $350 billion shortfall by that amount, helping states avoid some of the largest program cuts they were contemplating, and reducing the negative impact of their budget-balancing steps on the economy. Virginia, for example, reversed plans to end funding

[1] Section 3, American Recovery and Reinvestment Act of 2009.

for hundreds of sheriffs' deputies, thousands of school personnel, and three mental health facilities. New York reversed a major proposed cut to senior citizens' prescription drug benefits and another major cut to school funding.[2]

- Other states are responding similarly, according to the new report from GAO. In at least eight states (out of 16 states studied), GAO found, increased education funding was helping local school districts keep teachers on the payroll who would have been laid off. "Overall, states reported using Recovery Act funds to stabilize state budgets and to cope with fiscal stresses," GAO concluded. "The funds helped them maintain staffing for existing programs and minimize or avoid tax increases as well as reductions in services."[3]

Myth 2: States should not be using recovery law funds for short-term projects or temporary support for ongoing programs.

Reality: Short-term projects and support for ongoing programs are entirely appropriate uses of the funds.

- In the recovery law, Congress required that states put their additional federal funds to work as quickly as possible, which in many cases means investing in existing projects and programs rather than major new initiatives. That helps to achieve the goal of saving or creating as many jobs as possible, as quickly as possible. In contrast, using the funds for new initiatives that require significant start up time would be less effective as economic stimulus and would save or create fewer jobs in the short run.

- In infrastructure spending, GAO found that many states are using recovery law funds for paving improvements and other projects that were "shovel ready" and would create jobs relatively quickly. Longer-term projects could require years of planning and would not create jobs as quickly.

- In education spending, GAO found that many states and school districts are using the money to avert elementary and secondary school layoffs, minimize tuition increases at colleges and universities, avoid class cancellations, and address other immediate needs. Preventing a teacher's job loss is just as helpful to the economy as hiring a new staff person to implement a new program; in either case, a job exists that otherwise would not.

Such criticisms of how states are using economic recovery funds reflect a serious misunderstanding of how the law was intended to work and what it is supposed to do.

---

[2] See Phil Oliff, Jon Shure and Nicholas Johnson, "Federal Fiscal Relief is Working as Intended," Center on Budget and Policy Priorities, updated June 29, 2009.
[3] GAO, "Recovery Act: States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stresses," July 8, 2009.