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FUNDING FOR STATES IN HOUSE ECONOMIC RECOVERY PACKAGE WOULD CLOSE LESS THAN HALF OF PROJECTED STATE DEFICITS

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The state fiscal situation is dire. Revenues are declining, and demand and need for services such as Medicaid is rising, as people lose income and jobs. State deficits are 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 House economic recovery package recognizes this fact and includes substantial assistance for states. The amount of funding that would go to states to help them maintain current activities is approximately $150 billion to $155 billion — or roughly 40 percent to 45 percent of projected state deficits. Most of this money is in the form of increased Medicaid funding plus portions of a "Fiscal Stabilization Fund." This funding would likely be sufficient to deter many states from making the most severe spending cuts and to moderate state tax and fee increases. But states would still have very large gaps to close on their own.

Some reports have suggested that the stimulus package would fill a much larger share of state budget gaps. The discrepancy stems from the fact that a substantial amount of funding in the House package beyond the $150 billion to $155 billion would flow through states or be administered by them. But states would not be allowed to apply these other funds to the $350 billion in estimated budget shortfalls, a figure that represents the gap in state operating budgets and does not include *local* government shortfalls. Under the House package, states would be required to spend these other funds on increased aid to local governments, on infrastructure — which typically is part of state *capital* budgets rather than state operating budgets — or on specific new initiatives.[1]

[1] In a number of cases, the funding is 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 would help states improve services, they would not help fill state deficits because these new costs were not included in the calculation of the deficits. Deficits measure the funding needed to maintain existing services.

Funding to maintain local government services, address infrastructure needs, and undertake certain initiatives may be 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.

Federal Assistance to Close State Deficits

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 $150 billion to $155 billion in the House recovery package that states could use to reduce the magnitude of their budget gaps include the following:

- **An estimated $88 billion in Medicaid funding**, which would help pay for Medicaid costs that states otherwise would incur and help to avert Medicaid cuts.

- **A substantial portion of a new $79 billion "Fiscal Stabilization Fund**." Some 39 percent of the "Fiscal Stabilization Fund" after set-asides — or approximately $25 billion — would be available as flexible fiscal relief that could be used to avert cuts in a wide range of programs. In addition, some portion of the other 61 percent of these funds — approximately $39 billion after set asides — could be considered state fiscal relief. States would be able to use those funds to restore state funding for schools to their fiscal year 2008 level. (Any funds beyond that would have to be passed to local school districts.) Finally, $7.5 billion would be set aside for state incentive grants; some of that would be for new initiatives, and at least half of these funds would have to be passed through to local school districts, but a modest amount of this could effectively serve as fiscal relief.

- **A small portion of some of the other funding streams that could pass through to local jurisdictions.** Examples include funding for COPS, Byrne law enforcement grants, 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 would not play a significant role in closing state deficits.[2]

If one counts the $88 billion in Medicaid assistance, the $25 billion flexible portion of the stabilization fund, and three-quarters of the $39 billion portion of the stabilization fund, the total is $142 billion. If one assumes that some of the funding for programs such as IDEA could substitute for state funding that otherwise would be devoted to that program, there may be an additional $10 billion to $15 billion in state fiscal relief, for a total of about $150 billion to $155 billion.

[2] 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 such as IDEA, but not in others.