

Updated 11-13-08

**ECONOMIC RECOVERY:**  
**A Federal-State Partnership**

**National Governors Association**  
**2008**

## **Executive Summary**

The U.S economy recently has weakened and is likely to fall into recession for at least the next several quarters. It is unclear whether this will be a mild downturn or a more serious one similar to what was experienced in the early 1980s. To help stabilize the economy, Congress is considering passing an economic recovery package during a lame duck session this year or at the beginning of the 111<sup>th</sup> Congress.

One of the most efficient set of mechanisms the federal government can use to speed a national recovery is investments in existing federal-state programs. These mechanisms are effective because the programs are on-going and because state-by-state funding allocations, administrative procedures and staffs already are in place to quickly distribute any additional funds.<sup>1</sup>

The federal-state programs with the greatest potential to assist with recovery efforts fall into three categories:

- Benefit programs for individuals in need (e.g., Medicaid, food stamps, welfare and unemployment insurance);
- Infrastructure programs with ready-to-go projects that will create new jobs; and
- Countercyclical programs where the federal government can help offset proposed budget cuts by increasing the federal share of key federal-state programs such as Medicaid and special education.

In October, the National Governors Association (NGA) called on Congress to help stimulate the economy and encourage economic recovery by providing additional funding for Medicaid and infrastructure. This paper provides additional detail on those programs and identifies several other federal-state programs that, if properly funded, could strengthen the economy.

These programs are summarized in Table 1, Potential Recovery Programs. The countercyclical programs total \$61.7 billion, job creation programs total \$57.4 billion and targeted benefits programs total \$7.0 billion, for a total of \$126.1 billion. However, the mix of these programs is optional and NGA is not necessarily recommending that all programs be enacted.

This paper also summarizes the current fiscal situation of states and provides historical information on state spending and rainy day funds over the last two economic downturns. The current shortfall for states for 2009 is more than \$26 billion, but is expected to grow to about \$60 billion for that fiscal year and \$80 billion in fiscal year 2010. A review of state spending and budget cuts over the last two downturns also illustrates a critical point for state and federal lawmakers: A recession's greatest impact on state budgets takes place the year after the recession is over. This is primarily because Medicaid growth occurs late in the cycle and employment growth, the primary generator of state revenue, lags economic recovery.

---

<sup>1</sup> Unless otherwise specified, "states" refers to the 50 states, District of Columbia and the Commonwealths and territories.

Table 1  
Potential Recovery Programs

Program Function	Program	Characteristics	Funding Level	Special Considerations
Countercyclical	Medicaid FMAP	<ul style="list-style-type: none"> <li>▪ Temporary increase in FMAP for 24 months</li> <li>▪ Hold harmless to prevent scheduled FMAP decreases</li> </ul>	At least \$20.0 billion per year for 2 years	<ul style="list-style-type: none"> <li>▪ Two options for determining FMAP methodology</li> <li>▪ Provide state-like treatment to Commonwealths and Territories</li> <li>▪ Give the Secretary of HHS authority to temporarily increase a state's FMAP in case of a natural disaster or emergency</li> </ul>
	Transitional Medical Assistance	<ul style="list-style-type: none"> <li>▪ Extend authorization for transitional medical assistance (TMA) under Medicaid for low-income working families</li> </ul>	\$2.7 billion (over 18 months)	
	Special Education	<ul style="list-style-type: none"> <li>▪ Attain federal commitment to fully fund glide path to 40 percent of the cost to educate students with disabilities</li> </ul>	\$19.0 billion (over 2 years)	
Job Creation	Highways	<ul style="list-style-type: none"> <li>▪ Ready-to-go projects (&lt;3,000) under contract within 90 days</li> <li>▪ 68 percent is spent in 2 years</li> </ul>	\$18.9 billion	<ul style="list-style-type: none"> <li>▪ Temporarily eliminate non-federal match</li> </ul>
	Transit	<ul style="list-style-type: none"> <li>▪ Ready-to-go projects implemented within 90 days</li> <li>▪ 45 percent is spent in 2 years</li> </ul>	\$8.0 billion	<ul style="list-style-type: none"> <li>▪ Temporarily eliminate non-federal match</li> </ul>
	Highway Trust Fund	<ul style="list-style-type: none"> <li>▪ Ensure HTF solvency through fiscal year 2010</li> </ul>	\$9.0 billion	
	Airports and Airways	<ul style="list-style-type: none"> <li>▪ Increase funding for airport construction projects</li> <li>▪ 61 percent is spent in 2 years</li> </ul>	\$1.0 billion	<ul style="list-style-type: none"> <li>• Temporarily eliminate non-federal match</li> </ul>

Program Function	Program	Characteristics	Funding Level	Special Considerations
	Passenger Rail	<ul style="list-style-type: none"> <li>▪ Ready-to-go projects for state improvements in corridor development projects (e.g., track purchase; new rail sidings; update switches/signaling)</li> </ul>	\$.35 - .50 billion	<ul style="list-style-type: none"> <li>• Temporarily eliminate non-federal match</li> </ul>
	Wastewater	<ul style="list-style-type: none"> <li>▪ Ready-to-go wastewater infrastructure projects</li> <li>▪ 54 percent is spent in 3 years</li> </ul>	\$9.2 billion	<ul style="list-style-type: none"> <li>▪ Temporarily eliminate non-federal match</li> </ul>
	Drinking Water	<ul style="list-style-type: none"> <li>▪ Ready-to-go drinking water infrastructure projects</li> <li>▪ 54 percent is spent in 3 years</li> </ul>	\$6.0 billion	<ul style="list-style-type: none"> <li>▪ Temporarily eliminate non-federal match</li> </ul>
	Affordable Housing	<ul style="list-style-type: none"> <li>▪ Fund backlog of capital maintenance and operating needs including carpentry, plumbing, painting, elevator, and HVAC maintenance</li> </ul>	\$4.8 billion	
Targeted Benefits	Pell Grants	<ul style="list-style-type: none"> <li>▪ Fund the Pell Grant shortfall</li> </ul>	\$3.5+ billion	
	Unemployment Compensation	<ul style="list-style-type: none"> <li>▪ Extend unemployment benefits in all states</li> </ul>	\$2.0 billion	<ul style="list-style-type: none"> <li>▪ 13 week benefit extension</li> </ul>
	Workforce Investment Act Title 1B Programs	<ul style="list-style-type: none"> <li>▪ Help up-skill workers and provide employment services and supports through the Adult, Dislocated Worker and Youth Programs and the Wagner-Peyser Act</li> </ul>	\$1.5 billion	<ul style="list-style-type: none"> <li>▪ Remove sequence of service requirements in the Workforce Investment Act of 1998; repeal Section 191(A) of WIA</li> </ul>

## Economic Recovery: A Federal-State Partnership

On October 24, 2008, NGA called on Congress to invest in states as part of any national recovery strategy by providing additional funding for Medicaid and investing in ready-to-go infrastructure.

One of the most efficient set of mechanisms the federal government has to speed up a national recovery is existing federal-state programs. These programs, which can provide benefits to individuals in need, administer ready-to-go infrastructure projects and act as a major anti-cyclical force. This mechanism is effective because the programs are on-going and state-by-state funding allocation and administrative procedures are already in place to quickly distribute funds.

This paper provides additional information regarding the fiscal condition of states, the role states play in lifting the national economy from an economic downturn and specific policy guidance for developing an economic recovery package. The focus of the paper is primarily on Medicaid and infrastructure, but it also discusses other federal-state programs that already exist, are administered by states and could help spur the nation's economic recovery.

### The Economic Downturn

Most state and local governments are experiencing the negative effects of the economic slowdown. Downturns in the national economy show up first in fewer purchases by consumers, followed by falling sales and corporate profits tax revenues and rising unemployment. Increasing unemployment likewise affects state revenues in the form of reduced income tax revenues and rising state expenditures to meet demand for services like unemployment benefits and Medicaid. Declining home values and increased foreclosures also have a profound effect on local finances, which depend on property taxes. Local government revenue declines often translate into increased expenditures by states to stabilize local economies.

### The State Role During Economic Declines

During any economic downturn, states are key players from three major perspectives. First, they administer most of the safety net programs in the United States. The four major programs that can both help stabilize the economy and provide benefits to individuals in need are 1) Medicaid, 2) welfare benefits, 3) unemployment compensation and 4) food stamps. All of these are federal-state programs that receive major federal funding. Second, states can quickly create jobs in the short-run through infrastructure investment such as highways, transit projects and water and sewer system modernization. States are able to do this quickly because states administer many infrastructure programs and have detailed information regarding unmet needs. Third, because of balanced budget requirements<sup>2</sup>, states typically react to downturns by cutting spending and raising taxes, which make the downturn more severe. Direct federal government payments to

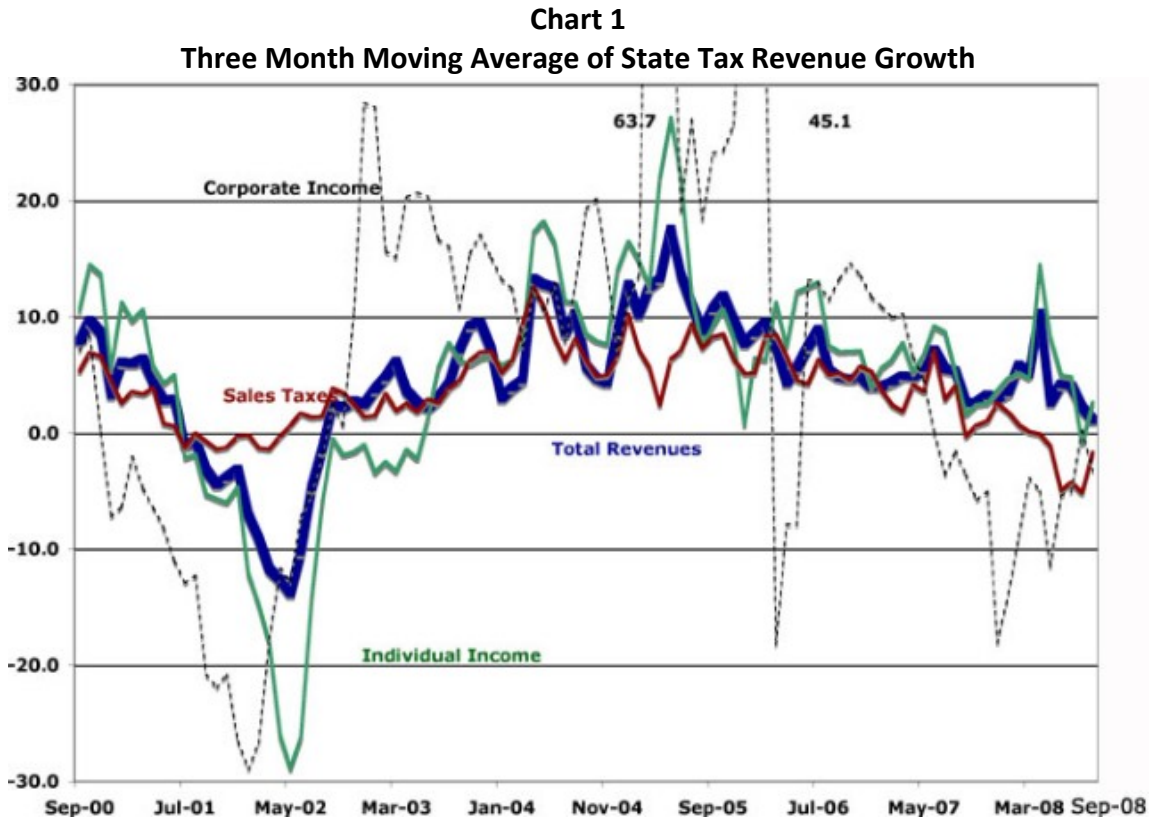
---

<sup>2</sup> All but one state has a balance budget requirement.

states to help offset these actions is therefore one of the most powerful countercyclical actions the federal government can take.

States' Fiscal Condition

A recent survey of state fiscal conditions found twenty-seven states currently projecting shortfalls in FY 2009 totaling \$26 billion. In addition, tax collections are trending downward. Already sales tax growth compared with last year has gone negative along with corporate business tax revenues. Personal income tax collections remain slightly higher than last year, but have trended negative over the past three months. These revenues will be further depressed by the lack of capital gain tax revenues resulting from the selloff in the stock market. Income tax revenues are likely to dip most after unemployment peaks, which could be well into 2009. Similar trends were evident just before the last recession in 2001, although the current decline in sales tax revenues—one of the larger sources of state revenues—is greater than in 2001. (See Chart 1, Three Month Moving Average of State Tax Revenue Growth.)



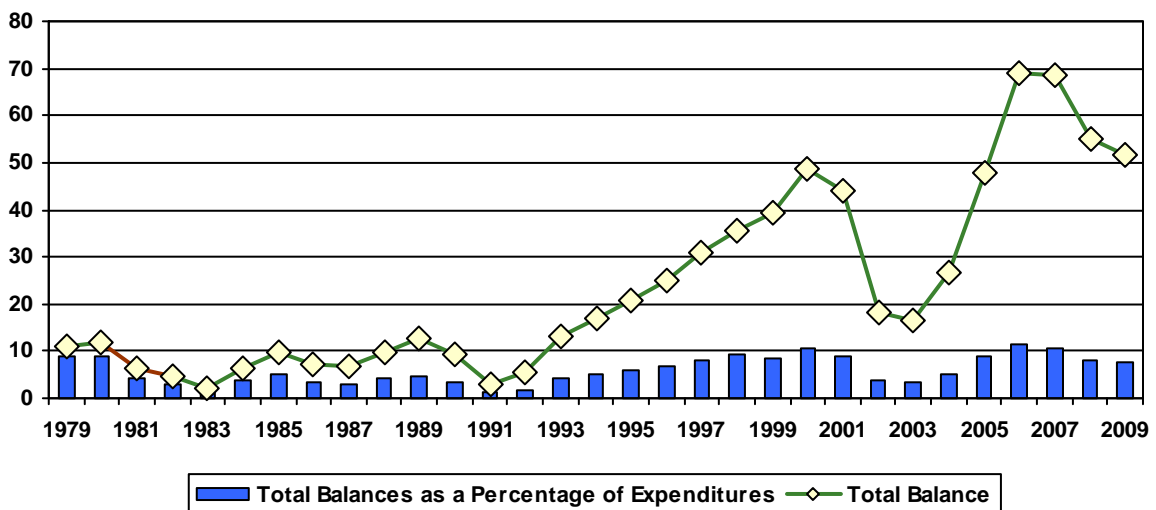
As the economy continues to deteriorate, it is likely that 2009 state budget shortfalls will reach \$60 billion, more than double the current estimate. And fiscal year 2010 is likely to be worse, with shortfalls reaching more than \$80 billion. Even the 8-10 states with budget surpluses last

year—mostly energy and farm states—are witnessing significant erosion in their surpluses as the price of oil and commodities has plunged in recent months.

Additionally, data from the Department of Labor indicates that 22 state Unemployment Insurance Trust Funds have fallen below the minimum adequate balance and are at risk of insolvency. Curing this problem will either require additional federal funds or an increase in business taxes to meet increased demand.

**Rainy Day Funds** - Rainy day funds are used by states to fill budget gaps when revenues drop dramatically. Prior to the last downturn in 2001 and 2002, states built large rainy day funds totaling \$49 billion, or 10.4 percent of general fund spending. In 2007, once state economies began to recover, states again built rainy day funds totaling \$69 billion, or 11.5 percent of general fund spending, heading into the current downturn. This means that states have acted responsibly in that they have built large surpluses in good economic times for use in economic downturns. (See Chart 2, Total Year-End Balances.) States also averaged only 4.5 percent growth in spending over the past eight years, well below the historical average of 6.5 percent.

Chart 2  
Total Year-End Balances and Total Year-End Balances as a Percentage of Expenditures, Fiscal 1979-Fiscal 2009 (Recommended)



**Credit Problem** – The current credit crisis has negatively affected states, which access credit markets for short- and long-term borrowing. While most states issue long-term bonds for capital infrastructure and other projects, some states also engage in short-term borrowing. For example, some states rely on short-term borrowing, using mechanisms called Revenue Anticipation Notes (RANs) or Tax Anticipation Notes (TANs), to reconcile the uneven flow of revenues versus expenditures during a fiscal year. The inability to obtain these funds in the market leaves states that use these instruments with an immediate concern: If they cannot gain access to short-term funds, they cannot pay their bills and make payroll. Although states have recently succeeded in selling debt, they are concerned that a tight credit market may limit their ability to issue long-term

bonds or short-term borrowing instruments or require them to offer higher interest rates to attract buyers.

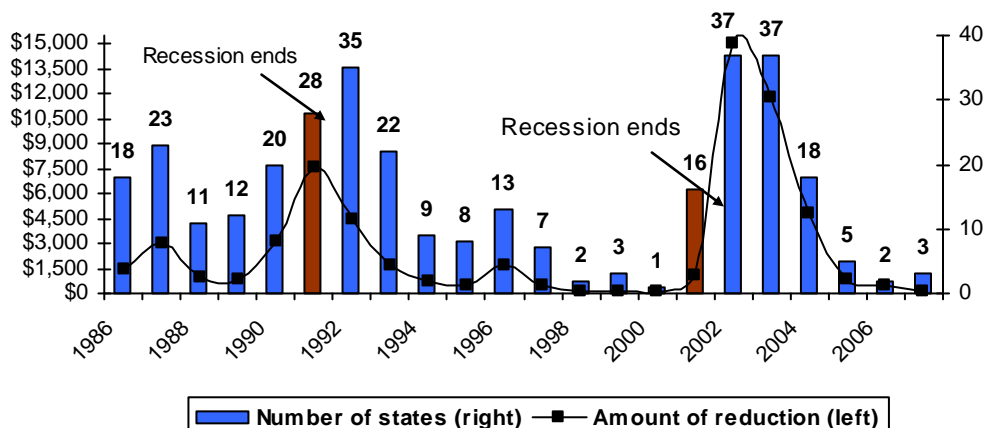
**State Impacts Lag the Downturn** – The state fiscal picture will continue to deteriorate over the next two years. When the economy slows, state sales tax revenues decline first because reductions in personal consumption often lead downturns. Rising unemployment is the next sign, which in turn leads to declines in state personal and corporate income tax revenues. The increase in unemployment also often leads to increases in the demand for food stamps, unemployment benefits and especially Medicaid payments, which is currently about 23 percent of state budgets. Medicaid growth from women and children coming onto the rolls tends to occur very late in the cycle and constitutes a significant state expense.

During the last economic downturn, between 2000 and 2003, growth in Medicaid spending averaged 10.2 percent per year and was primarily driven by enrollment growth, as opposed to benefit expansions, reflecting the economic downturn. Medicaid enrollment between 2000 and 2002 increased 11 percent and another 7 percent in 2003. Even in FY 2004, the rate remained 7.9 percent.

Before the liquidity crisis hit in September and October 2008, states estimated Medicaid enrollment would increase by 3.5 percent in FY 2009. Anecdotal evidence is emerging that the faltering economy is at least partially contributing to increases in state Medicaid program enrollments beyond initial projections.

The lag effect on states was evident in each of the last two recessions. The recession that ended in 1991 resulted in 28 states cutting budgets that year. States, however, continued to experience the recession’s impact and in 1992, 35 states cut budgets. Similarly in 2001, when the most recent recession ended, 16 states cut budgets. However, 37 states cut budgets in each of the next two years—2002 and 2003. (See Chart 3, Budget Cuts Made After the Budget Passed). If the current downturn continues and follows the path of past recessions, 35 to 40 states will face budget shortfalls in 2009 and 2010.

Chart 3  
Budget Cuts Made After the Budget Passed,  
Fiscal 1986-Fiscal 2007 (\$ millions)



## Countercyclical Programs

The following programs are high priorities for countercyclical programs because they allow states to defer planned program cuts.

**Medicaid** – The Federal Medical Assistance Percentage (FMAP) is the share of the Medicaid program paid for by the federal government. FMAPs are recalculated each year, and the new FMAP is applied at the start of the federal fiscal year. Small changes in a state’s FMAP can have a significant impact on state budgets, and any reduction will force states to spend more than they otherwise would have.

In federal FY 2009, which began October 1, 2008, 17 states experienced FMAP declines over their federal FY 2008 FMAPs. Twelve of these states had also experienced FMAP declines in the previous fiscal year. Fourteen states are projected to have FMAP decreases in federal FY 2010, beginning October 1, 2009.

The FMAP formula is based on a three-year rolling average that reflects economic conditions from several years ago, and as a result, can exacerbate problems states have financing Medicaid during fiscal downturns.

During the 2001-02 recession, states faced high unemployment and weak tax revenues, which when combined with unexpected Medicaid growth, forced almost every state to seek serious cutbacks in Medicaid costs.

In response, Congress approved \$10 billion to temporarily enhance FMAPs for every state by 2.95 percentage points for five fiscal quarters in 2003 and 2004. Spending caps for the territories (which face unique financing challenges) were raised by 5.9 percentage points for the last two quarters of FY 2003 and first three quarters of FY 2004.

For the economic recovery package being considered by Congress, there are essentially two options.

**Option 1** – Enact an across-the-board FMAP increase for all states that is similar to the provision in the 2003 legislation. As the national downturn proceeds, an increasing number of states will face budget shortfalls and the differential impact of this economic downturn will lessen over time. A uniform FMAP increase is a relatively straightforward policy which could provide the greatest certainty in predicting Medicaid program expenditures for both the federal and state governments.

**Option 2** – Combine an across-the-board FMAP increase with a more targeted approach. All states would receive a temporary baseline FMAP increase, as in option 1. Then, Congress would develop a comprehensive and balanced set of economic indicators (for example, changes in employment or unemployment, mortgage defaults, index of relative

decrease in the value of housing, Medicaid caseload growth or similar measures) that would trigger individual states' eligibility for additional FMAP increases.

Each month the triggers would be updated to determine whether new states would become eligible for additional FMAP increases. Once a state became eligible, it would remain eligible for the FMAP increase for a minimum of one year and potentially longer if those economic conditions continue. In no case would these FMAP increases be available outside the 24-month window of opportunity.

In addition, for FY 2003 and FY 2004 Congress implemented a hold harmless provision to prevent scheduled FMAP decreases for the same period. Both provisions were contingent on a state maintenance of effort (MOE) on eligibility criteria. Studies conducted by the Government Accountability Office (GAO) and other experts found that temporarily increasing all states' FMAP levels provided immediate fiscal relief to states by alleviating Medicaid obligations and preventing cuts to programs important to residents during fiscal downturns.

Since each economic downturn is different, and has differential impacts on states, it may be necessary to tailor this policy to the nature of the economic contraction. For example, if the downturn is widespread (i.e., national in scope) then option 1, which includes all states would be the appropriate option. On the other hand, if the downturn primarily affects selected states or a region of the country, then the more targeted option 2 may be most appropriate. Any increase in FMAP should be temporary; however, the specific time period should reflect the nature and depth of the currently projected downturn. An enhanced FMAP is most effective as a countercyclical measure if implemented at the onset of an economic downturn and for a period of time that allows states to meet anticipated increases in Medicaid costs for the duration of the economic downturn.

FMAP increases can provide some much-needed counter-cyclical assistance to states. To achieve the maximum effect, the funding should be at least \$20 billion per year over the next two years. At this level it would offset about one-third of the estimated \$60 billion state shortfall for 2009 and one-fourth of the \$80 billion state shortfall in 2010. It is critical that the funding be for 24 months, which includes the year after the recession is over, to cover the lag on the state impacts. *Recalculating* the triggers each month allows FMAP increases to be targeted to states based on the most recent economic indicators, whereas an across-the-board increase provides greater certainty for budgeting purposes. Given current shortfall projections, anything less than \$20 billion per year for two years would limit the countercyclical effect, while substantially more could limit the pressure on states to streamline state government, consolidate agencies and continue to make state government more efficient. If, however, shortfalls significantly exceed projections for 2009 and 2010, Congress should consider funding beyond the \$20 billion per year level.

**Emergency Medicaid FMAP Designation** – A final measure could be considered as part of a permanent reform to the Medicaid program. Title XIX could be changed to give the Secretary of HHS the clear authority to temporarily increase any individual state's (or group of states') FMAP in

case of a natural disaster, such as a hurricane or flood, or other similar emergency. Such an increase should be limited in both time (15 to 18 months) and in scope (2 to 3 percentage points).

**Transitional Medical Assistance (TMA) under Medicaid** – States are required to temporarily continue Medicaid benefits for certain low-income families who would otherwise lose coverage because of changes in their income. This continuation is known as transitional medical assistance (TMA). It is an important program for parents because income eligibility limits for Medicaid coverage of adults who are not pregnant, disabled or elderly are quite low in some states and because private health insurance may be unavailable or unaffordable. States report that TMA strengthens incentives for TANF recipients to go to work and remain employed without losing health insurance coverage.

Federal law requires four months of TMA for families who lose Medicaid eligibility because of increased child or spousal support collections, as well as those who lose eligibility because of an increase in earned income or hours of employment. In 1988, Congress expanded work-related TMA, requiring states to provide TMA to families who lose Medicaid for work-related reasons for at least six, and up to 12, months. Since 2001, TMA requirements have been funded by a series of short-term extensions, with the most recent running until June 30, 2009.

To qualify for work-related TMA, a family must have received Medicaid in at least three of the six months preceding the month in which eligibility is lost and have a dependent child in the home. During the first six months of TMA, states must provide the same benefits the family was receiving. An additional six months of TMA (for a total of up to 12 months) is available for families who continue to have a dependent child in the home, who meet reporting requirements, and whose average gross monthly earnings (less work-related child care costs) are below 185 percent of the federal poverty line. A 2008 report by the Congressional Research Service (CRS) estimated there were two million TMA enrollees in June 2006.

Since low-income individuals are more likely to be without health insurance than those with higher incomes, extension of the TMA coverage could provide financial certainty to states in budgeting for continuation of this program and in turn play an important role in supporting working families.

**Fully Fund the Federal Share of Special Education Costs** – For many years, states, local government and schools have significantly subsidized the federal government's share of the Individuals with Disabilities Education Act (IDEA). This long-term federal funding shortfall is straining state and school budgets and diverting resources from other critical programs. As a result of the subprime meltdown, the steady decline in housing values and the rising costs of health care for employees, state and local education budgets are under siege to cover basic operation costs, such as teacher salaries, transportation and educational programming. The federal government made a commitment to fully fund 40 percent of the cost to educate students with disabilities. Congress could renew that federal commitment and appropriate sufficient resources for special education.

Congressman Chris Van Hollen (D-MD) and Senator Chuck Hagel (R-NE) have similar proposals to create a new glide path to attain the 40 percent federal commitment. Both cost about \$19 billion over two years. This funding would go a long way to protecting elementary and secondary education from planned cuts over the next two years.

### Promoting Job Growth Through Infrastructure Investments

Infrastructure spending is an effective mechanism to create jobs in a slowing economy, especially when projections for economic weakness stretch into years, not months. These are generally high-paying domestic jobs because there is very little international leakage in terms of imports from this type of spending. Federal investments that allow states to initiate ready-to-go infrastructure projects can therefore spur demand for labor and increase productive capital.

Physical infrastructure provides the necessary foundation for our nation's production and delivery systems. Investment in new and existing infrastructure, particularly in "ready-to-go" projects where work could begin within 120 days, would create jobs in the short-term, thereby stimulating the economy. Projects could comprise highways, bridges, airports, passenger rail, drinking water systems, public transportation, flood control and water reclamation. Long-term infrastructure investments strengthen U.S. economic competitiveness, reduce congestion, improve safety, achieve environmental sustainability and improve overall quality of life. The estimates below are for projects that qualify as ready-to-go.

**Highways and Transit** – Every \$1 billion in transportation infrastructure spending generates approximately 35,000 jobs and \$5.7 billion in additional economic activity. According to research compiled by the American Association of State Highway and Transportation Officials, more than 3,000 ready-to-go highway projects totaling \$18.9 billion could be under contract within the next 30-to-90 days if additional federal funds, above the 2008 funding levels, are made available. Similarly, the American Public Transportation Association's research shows that transit agencies have \$3.6 billion in ready-to-go projects for implementation within 90 days with additional federal funding, and could initiate as much as \$32.4 billion in projects over the next 24 months. Projects should include not only new construction but also maintenance and upgrades to existing infrastructure such as bridges and tunnels. According to the Federal Highway Administration and the Congressional Budget Office, about 68 percent of highway and 45 percent of transit obligations spend-out over the first two years of a project. An infusion of additional money, however, would not help states that either do not have or cannot reallocate sufficient revenue to meet state-match requirements. Therefore, Congress should also temporarily eliminate match requirements for any additional funds to maximize their use.

The recent \$8 billion infusion by Congress into the federal Highway Trust Fund (HTF) represents a commitment to cash flow stability. However, changed economic conditions and uncertainty surrounding whether Congress will reauthorize federal surface transportation laws before they expire in August 2009 raise pragmatic concerns regarding the HTF's ability to sustain spending on infrastructure projects over the next several years. States will be reluctant to start new projects in

FY 2009 when projections show that they will not receive prompt reimbursement in FY 2010 or FY 2011. Consequently, Congress also should consider injecting an additional \$9 billion funds into the HTF to ensure its solvency for the next two years.

**Airports and Passenger Rail** – According to Airports Council International, increasing funding by \$1 billion above current levels for ready-to-go airport construction projects would help stimulate the economy by creating approximately 35,000 high-paying jobs. Over two years nearly \$4 billion could be put to work to expedite the construction of critical safety, security and capacity infrastructure at airports around the country. According to CBO, about 19 percent of airport obligations spend-out in the first year and with another 42 percent spending-out in year two. Amtrak, in conjunction with the states and the freight rail industry, has identified \$350 to \$500 million in ready-to-go projects for state improvements in corridor development projects. These projects include purchasing track, adding rail sidings and updating switches or signaling.

**Water Infrastructure** – Construction of water and wastewater facilities creates similar economic benefits; therefore, Congress also should increase funding for both the clean water and drinking water state revolving loan funds. According to a survey conducted by the Association of State and Interstate Water Pollution Control Agencies and the Council of Infrastructure Financing Authorities, there are more than \$9 billion in ready-to-go wastewater infrastructure projects throughout the country. Additionally, according to the Association of State Drinking Water Administrators, there are nearly \$6 billion in ready-to-go drinking water infrastructure projects. However, similar to highway and transit programs, an infusion of additional money may not help states that either do not have or cannot reallocate sufficient revenue to meet the state-match requirement unless Congress temporarily modifies it as applied to those additional funds. According to CBO, about 24 percent of drinking water and wastewater obligations are expended over two years, and 54 percent over three years.

**Affordable Housing** – One of the largest sectors of affordable housing is public housing. The estimated annual capital investment necessary to maintain the existing stock is \$4.8 billion; however, there is a backlog of capital maintenance and operating needs. Additional federal investment would help the approximately 3,500 U.S. public housing authorities fund ready-to-go maintenance projects like carpentry, plumbing, painting, elevator and HVAC maintenance. According to a 2007 economic impact analysis of 10 metropolitan statistical areas touching one-quarter of the states directly, \$1.00 in capital and maintenance expenditures by public housing authorities generates \$2.12 in total regional spending.<sup>3</sup>

#### Targeted Benefits

As unemployment increases, the caseloads of state low-income programs also increase. Federal investments in targeted federal-state programs can quickly distribute funds to the neediest

---

<sup>3</sup> *Assessing the Economic Benefits of Public Housing – Final Report*, Econsult Corporation, Philadelphia, PA, on behalf of the Council of Large Public Housing Authorities, January 2007.

individuals and help avoid cuts to basic services. Although the federal government has already acted to bolster unemployment benefits and address concerns in the housing markets, policy changes and enhancements to the following programs could be particularly helpful to citizens and states.

**Foreclosure Mitigation Efforts** – The mortgage foreclosure crisis has battered many regions across the country. States have been the first responders to the crisis and have worked to put infrastructure in place to assist at-risk homeowners and help stabilize neighborhoods. Today, approximately 20 percent now operate some type of emergency mortgage assistance or refinancing program tailored to at-risk homeowners. More than half of all states have linked with the Homeownership Preservation Foundation to provide around-the-clock consumer counseling hotlines. While the threat of housing foreclosure has affected states to varying degrees, those most affected have executed response plans with a variety of policy tools to help mortgage holders in distress.

The federal response includes programs to assist at-risk homeowners directly with foreclosure counseling and refinancing opportunities and indirectly through the Troubled Asset Relief Program in the Emergency Economic Stabilization Act. Most recently, Congress appropriated \$3.92 billion in emergency assistance to states and local governments through the Neighborhood Stabilization Program (NSP). Qualified recipients may use this money to acquire and redevelop foreclosed and abandoned properties for rehabilitation, resale or redevelopment to help stabilize neighborhoods and stem property value declines. While this program targets property already foreclosed, Congress could consider a complementary program to the NSP that builds on state efforts and permits foreclosure mitigation efforts by states and local governments.

**Student Access to Higher Education** – The liquidity crunch and crisis on Wall Street has made it more difficult for families to qualify for student loans and access higher education. With the downturn in the economy, a large and growing number of people also are also going back to school as a way to increase their skills and earning potential. More than 786,000 applicants used the Pell Grant program than at the same point last year. As a result, the estimated Pell Grant shortfall is \$3.5 billion in FY09, even after Congress provided \$2.5 billion in the Continuing Resolution. At the current rate of increase, there will be 1.2 million more Pell Grant students. Congress could fund the Pell Grant shortfall and ensure adequate federal resources are available in the program for all eligible students at the maximum grant of \$4,800 proposed by President Bush.

**Extend Unemployment Insurance** – The national unemployment rate has steadily risen from 4.7 percent a year ago to 6.5 percent in October of 2008. Possibly more significant, however, is the 21.1 percent of individuals who are unemployed for 27 weeks or longer as compared to approximately 11 percent at the beginning of the last recession in 2001. In June of this year, Congress passed legislation which provided up to 13 weeks of extended unemployment benefits in every state to workers exhausting the 26 weeks of regular unemployment benefits. Those extended benefits are running out. Extended unemployment benefits are effective in targeting

needy populations and putting cash into the economy because families on unemployment benefits spend them quickly to meet day-to-day expenses. With unemployment rising and long-term unemployment expected to continue escalating, Congress could immediately extend unemployment benefits to both help stimulate the economy and lessen the impact on those without jobs.

**Human Capital Investments** – The worker skills shortage is broad and deep, cutting across industry sectors and contributing to America’s lack of economic growth. To help stimulate our economy and get America back to work, workers must have access to training and education to secure family wage jobs in emerging and high-growth occupations. Congress could provide \$1.5 billion through the Adult, Dislocated Worker, and Youth Programs and Wagner-Peyser Act to help up-skill workers and provide employment services and supports that will increase worker employability and earning power. This countercyclical investment would immediately put training dollars into workforce systems, community and technical colleges and other training providers thereby lessening the need for institutional cut-backs and tax increases.

To ensure that enrollment in training is not impeded or delayed by rigid program eligibility criteria, Congress could remove sequence of service requirements in the Workforce Investment Act of 1998. Additionally, to ensure that federal funds are rapidly dispersed in states, Congress could repeal Section 191(A) of the Workforce Investment Act to give governors clear authority to quickly allocate federal funds as state economic conditions warrant. This would cost about \$1.5 billion.

#### State Issues Related to Federal Tax Proposals

Changes to federal tax policy are generally aimed at providing additional cash for individuals to spend or to encourage business to make investments they would otherwise delay during an economic downturn. When properly structured, tax changes can be very effective at getting cash into the economy quickly and nationwide.

State and federal tax systems are closely linked, meaning that changes in federal tax policy that reduce the federal tax base generally have the same effect at the state level. Any policy that would reduce both federal and state tax revenues violates the criteria of do no harm because losses at the state level have to be offset to meet balanced budget requirements. When considering tax changes for individuals or businesses to spur economic growth, Congress and the Administration should take into account the degree to which states conform their income tax base to the federal base and whether the stimulus provided by federal tax changes will be undermined by corresponding revenue losses for states.

**Changes to Personal Income Tax** – A review of past stimulus packages demonstrates that tax changes focused on individuals can generate immediate positive results for the economy. In particular, tax benefits aimed at putting cash in the hands of lower income households are most effective because such individuals tend to spend extra cash more rapidly than high-income individuals. Currently, 36 states plus the District of Columbia conform their individual income tax

base to the federal individual income tax base. Refundable tax credits distributed directly to individuals through checks would not affect the federal or state tax base; that is, they would not reduce state revenues, but would put additional cash in the hands of individuals and benefit all income levels. Likewise, nonrefundable tax rebates would not reduce state revenues but would exclude those portions of the populations that have no income tax liability, thus diminishing their stimulus effect. Furthermore, they will not reduce state revenues.

**Changes to Business Taxes** – Tax changes designed as incentives to encourage business to invest in equipment and structures are another popular form of tax stimulus. Studies of bonus depreciation policies enacted in 2002, however, indicate that such incentives are not as effective as measures aimed at individuals. They also reduce state revenues, thereby exacerbating economic conditions in states and undermining at least part of the effect of the federal stimulus.

Because most states conform to federal rules on depreciation in the calculation of their business income taxes, changes to federal depreciation calculations also affect state taxable income. In 2002, federal bonus depreciation provisions were projected to reduce revenues in 47 states by more than \$14.7 billion over three years. To counter these revenue losses, all but 13 states decoupled from the federal depreciation rules. Decoupling prevents immediate revenue losses at the state level, but it also increases complexity for states and taxpayers as businesses must conform to different depreciation schedules in different tax jurisdictions. Most states have once again coupled their depreciation rules with federal guidelines. If federal officials adopt temporary accelerated depreciation provisions as part of a stimulus package, states will either once again decouple from the federal system or be forced to raise revenues or cut spending to counter the loss in business income tax revenues.

Alternatively, investment tax credits can have the same stimulus effect on business investment without undermining state revenues. Tax credits are preferable for states because they do not reduce federal taxable income upon which state business taxable income is based. The credit still encourages business to make investments in equipment and structures in the near term but does not require states to undertake countervailing measures to protect revenues.

#### Final Comment

The scope of this paper is essentially limited to programs that are administered by states. While there may be tax cuts, rebates or tax credits that can be effective as part of a national recovery package, this paper comments only on the potential impact of these policies on states. In addition, most of the programs included in this report are existing programs, which have an advantage over new programs because additional funds can be obligated and spent quickly because state-by-state allocations and necessary federal guidelines are already in existence. Finally, any recovery package involving federal-state programs also should strive to remove existing unfunded federal mandates and avoid policies that preempt state authority, shift costs to states or impose new unfunded mandates.