Extending the State Fiscal Relief Provisions of the American Recovery and Reinvestment Act (ARRA)

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During recessions the federal government tries to stimulate the economy (i.e., "prime the pump") by increasing spending and cutting taxes. This requires deficit spending. But state governments have to balance their budgets in both good times and bad. So, to balance their budgets during recessions, states almost always end up cutting spending and/or increasing taxes, thus putting more drag on the economy rather than less.

Since the federal government is responsible for overall macroeconomic management, it makes sense for the federal government to provide fiscal relief to the states during recessions to reduce the amount of budget cutting and tax increasing necessary at the state level. If the federal government doesn't help the states during recessions, then state budget-balancing actions will cancel out a greater portion of the positive impact of federal stimulus efforts.

The "state fiscal relief" that was included in the American Recovery and Reinvestment Act (ARRA) played a major role in allowing New York and the other states to balance their 2009-10 with fewer budget cuts and fewer tax increases than would have been necessary otherwise. **This "state fiscal relief" should be extended so that its phase-out dovetails more closely with the recovery of the 50 states' economies and finances.**

The two major forms of "state fiscal relief" included in the ARRA were a temporary increase in the federal share of state Medicaid costs (called the Federal Medicaid Assistance Percentage or FMAP) and the State Fiscal Stabilization Fund which provided funds to avoid state and local layoffs particularly in the education. A 6-month extension of the enhanced FMAP has been passed by the House of Representatives on several occasions in the past year and, on March 10, 2010, by the Senate. But to date, no single bill with the 6-month extension of the enhanced FMAP has passed both houses of Congress. This week the Senate is considering a jobs and tax "extenders" bill in which it previously included the FMAP extension and has the opportunity to do so again.

Using an economic impact model (IMPLAN), FPI estimates that if the lost federal fiscal relief (from a failure to enact the 6-month FMAP extension) were absorbed over a 12-month period by state and local government layoffs, that the direct government employment loss would be around 48,000 and that the indirect and induced employment effects, which would be mostly in the private sector, would be almost 29,000. FPI thus estimates that the total job reduction statewide (direct, indirect and induced) would be about 77,000.

The federal government and state budgets during recessions generally

The federal government is responsible for the overall macroeconomic management of the U.S. economy. This is why, during recessions (which, by definition, are periods during which consumer and business spending is low, thus slowing the economy and creating a downward economic spiral) the federal government works to stimulate the economy by increasing spending and cutting taxes. This requires deficit spending, which the federal government can, does and should engage in during recessions.

State governments, on the other hand, have to balance their budgets in both good times and bad. To balance their budgets during recessions, states have to cut spending and/or increase taxes, thus putting more drag on the economy. This means that states, left to their own devices, have to do things during recessions that cancel out some of the positive effects of the actions that the federal government is taking to get the economy moving.

Given that the federal government is responsible for overall macroeconomic management, it makes sense for the federal government to provide greater fiscal relief to the states during recessions than it provides during good times. By providing enhanced fiscal relief to the states during economic downturns, the federal government is able to reduce the amount of budget cutting and tax increasing that the states have to do to balance their budgets. If the federal government doesn't help the states during recessions, then state budget-balancing actions will cancel out a greater portion of the positive impact of federal stimulus efforts than would otherwise be necessary.

The federal government and state budgets during the Great Recession

During the Great Recession that began in 2008, the American economy experienced the deepest and most prolonged decline since the Great Depression. As part of this Great Recession, state government revenues plummeted – literally falling off a cliff. This in turn has created large gaps between state revenues and expenditures.

Fortunately, the federal government responded strongly and in a relatively timely fashion. On February 17, 2009, less than a month after taking office, President Obama signed the American Recovery and Reinvestment Act (ARRA) into law. The bulk of this package's total estimated multi-year cost of $787 billion took the form of tax cuts (such as the Making Work Pay Tax Credit) and transfer payment increases (like increased and extended Unemployment Insurance benefits) designed to increase aggregate demand and to kick start the economic recovery.

The ARRA also included $135 billion that was explicitly for state fiscal relief. This aid came in the form of two funding streams that were explicitly intended to help the states to maintain essential public services in the face of sharply declining tax revenues:

- An estimated $87 billion in the form of a temporary increase (until December 31, 2010) in the federal government's share of state Medicaid costs (referred to as the Federal Medicaid Assistance Percentage or FMAP), and

- A new $48 billion State Fiscal Stabilization Fund consisting of $39.5 billion for public schools, colleges, and universities, and $8.8 billion that the states could use to support government services generally including education.

The ARRA also contained some smaller funding streams that also helped the states to pay for services that would have otherwise been cut but the other major streams of ARRA that are passing through the state's treasuries (and frequently through their appropriations and budgets cannot be used to address state operating budget shortfalls. For example, the infrastructure funds made available by the ARRA were intended to increase the level of capital construction going on in the country, not to replace state funding.

New York and the Recovery Act's state fiscal relief

Like virtually all of the other states in the United States, New York continues to face its greatest revenue shortfalls since the Great Depression of the 1930s. State government revenues have literally fallen off a cliff. In January 2008, for example, the New York State Division of the Budget (DOB) was projecting that state income tax revenues during the 2010-2011 state fiscal year would be an estimated $44.5 billion. In the Governor's January 19, 2010, Executive Budget, DOB's projection of income tax revenues for the 2010-2011 state fiscal year had fallen by $7.3 billion to $37.1 billion. But $4.8 billion of that January 2010 projection was attributed by DOB to the temporary Personal Income Tax (PIT) rate increases that New York State had enacted in April 2009 for single individuals with taxable income above $200,000 and married couples filing joint returns with taxable incomes over $300,000. In other words, if it were not for the revenue from the temporary increases in the top PIT rates, projected income tax revenues for 2010-11 would have fallen from $44.5 billion, just two years ago, to $32.3 billion – a falloff of $12.2 billion.

The state fiscal relief provisions of the American Recovery and Reinvestment Act (ARRA), as signed into law by President Obama on February 17, 2009, played a major role in allowing New York to accommodate these steep revenue declines with fewer service cuts and fewer tax increases than would have been necessary otherwise.

In a study of the impact of the ARRA on the states' 2009-10 budgets, the Center on Budget and Policy Priorities (CBPP) found that the ARRA's state fiscal relief was enough to close roughly 30 to 40 percent of state budget shortfalls. For New York, these ARRA dollars closed 31 percent of New York's 2009-10 budget gap. CBPP found that the states closed their remaining 2009-10 budget gaps with a mix of spending cuts, revenue increases, withdrawals from reserve funds, and other measures. While New York did not tap any of its official reserve funds, it did close ten percent of its budget gap with one-time resources. The rest of New York's gap was closed with revenue increases (27%) and spending cuts (32%).

A good example of New York's use of ARRA state fiscal relief to reduce reductions in services occurred in its 2009-10 budget for state aid to public school districts. About $1.2 billion of ARRA state fiscal relief funds (from the education portion of the State Fiscal Stabilization Fund created by the ARRA) were used to avoid Governor Paterson's proposed reduction in state aid by that amount, which he referred to as a Deficit Reduction Assessment. But even with that federal relief, Foundation Aid, which represents about 80% of all state aid to education and which is weighted towards the state's neediest school districts, was frozen at its 2009-10 level.

This year (for the 2010-11 school year), the Governor has proposed continuing the freeze on Foundation Aid and implementing a $2.138 billion Gap Elimination Assessment (GEA) which would operate very much like the Deficit Reduction Assessment that he proposed last year. He has also proposed using New York's remaining State Fiscal Stabilization Fund moneys ($726 million) to reduce every district's GEA by just under 34% thus providing for a net GEA of $1.4 billion, i.e., the gross $2.138 GEA reduced by the $726 million in federal stimulus funds.

A new round of federal education aid (like last year's State Fiscal Stabilization Fund) has been proposed by President Obama, but has not yet been acted upon by Congress. Without such additional aid, NYS, like other states around the country, is going to experience a large number of teacher lay offs and a diminution of the quality of the educational programs particularly in the high need districts which depend the most on state aid and which were supposed to received the most help under the 2007 reforms.

A 6-month extension of the enhanced Federal Medicaid Assistance Percentage (FMAP)

A 6-month extension of the enhanced FMAP rates would provide the New York State government itself with an estimated $1.06 billion in fiscal relief during its current state fiscal year which ends on March 31, 2011; and an estimated $1.06 billion in fiscal relief for the state fiscal year that begins on April 1, 2011.

Because New York State requires New York City and the county governments outside New York City to pay for a portion of the non-federal share of Medicaid costs, federal law requires NYS to share its FMAP relief with these local governments.

The New York City Office of Management and Budget estimates that New York City would receive $600 million over time if the 6-month extension of the enhanced FMAP. But because of the way that New York State estimates and reconciles the local Medicaid shares, the Executive Budget that was recently proposed by Mayor Bloomberg counts on $279 million in relief during the New York City fiscal year that begins on July 1, 2010. To date NYC has gotten about two-thirds of the FMAP relief for all local governments in New York. If that relationship holds true for the 6-month extension period, the 57 counties outside New York City, would have a total benefit of $300 million. A portion (probably 50 to 60%) of this fiscal relief would come during the counties' upcoming 2011 (January 1 to December 31) fiscal years

New York City and New York state are both facing large projected budget gaps for their 2010-11 fiscal years. The gap remaining to be closed at the state level is an estimated $8.464 billion. The Governor's proposed gap closing plan for 2010-11 and the Senate and Assembly's plans for balancing the state budget for 2010 11, all are counting on the estimated $1.06 billion in fiscal relief from the extension of the enhanced FMAP.

New York City's projected budget gap for FY 2011, which is partially attributable to the reductions in state aid that being proposed by the Governor as part of his plan to eliminate the state's budget gap, is $4.6 billion. Mayor Bloomberg proposes to close this gap by using an accumulated fund balance of $3.3 billion, and implementing a $1.3 billion gap closing plan that includes 10,997 layoffs. (including 6,414 public school teachers and 27 faculty members at the City University of New York). Last week, Mayor Bloomberg put forth a proposal to avoid the 6,414 public school teacher layoffs by freezing teachers' salaries for two years.

Because of the cut in state aid to education proposed by Governor Paterson for New York State's 2010-11 school year, New York City would lose $493 million in state aid for the operation of its public school system. In his Executive Budget, Mayor Bloomberg has proposed accommodating this $493 million revenue loss by laying off 6,414 teachers and 279 school support employees.

If New York City had to accommodate an additional loss of revenue during FY 2011 of $279 million (the amount of the fiscal relief that it is expecting from a 6-month extension of the enhanced FMAP), and it chose to do so by increasing the layoffs of non pedagogical employees, it would have to double the number of such layoffs from 4,556 to 9,110.

If on the other hand, New York City decided to lay off teachers and other school system employees (either in addition to the 6,693 layoffs proposed in the Mayor's Executive Budget or in addition to the wage freeze alternative proposed yesterday by Mayor Bloomberg) as a way to accommodate the loss of the projected $279 million in fiscal relief, it would require an estimated 3,788 layoffs in addition to either the 6,693 layoffs proposed in the Executive Budget, or in addition to the proposed wage freeze.

The situation could be much worse for New York City (and for other local governments throughout the state) if New York State accommodated the loss of its projected $1.06 billion in 2010-11 fiscal relief (from the 6-month extension of FMAP) by making even more cuts is state aid programs than what is currently being proposed by the Governor and in the Senate and Assembly budget resolutions. This, in turn, would result in staffing and service reductions at the local level. If, for example, New York City received 40% of the state aid cuts, it could mean an additional 5,756 school system layoffs with virtually all of those layoffs being of teachers. But, if these cuts in state aid were accommodated through additional cuts in the number of non-pedagogical employees from the same wide range of departments and agencies being hit by the current layoff proposal, it would require an additional 6,856 layoffs.

If the state decided to accommodate the loss of this fiscal relief by making further cuts in Medicaid's hospital and/or nursing home reimbursement rates, the result would be staffing reductions at these institutions which would mean, in turn, reductions in the quality of care available to hospital patients and nursing home residents.

If the state government decided to make further reductions in its own workforce as its way to further reduce state expenditures by $1.060 billion, the number of layoffs would be in the 15,000 to 16,000 range. These estimates are based on an average state employee salary is $64,000 and retirement system contributions are 7.2% for employees other than public safety officers. If state employees are laid off – rather than leaving voluntarily, the state is required to provide health insurance coverage for a transitional period meaning that these savings would not be available during the first year of a layoff. The other costs of layoffs have not been taken into consideration.

Overall, if Congress does not enact the 6-month extension of the enhanced FMAP rates, New York would lose about $3 billion in expected federal fiscal relief:

- $1.06 billion for the state government itself in 2010-11 and another $1.06 billion in 2012-13,
- an estimated $600 million for New York City over time, and
- $300 million for the counties outside New York City.

Using an economic impact model (IMPLAN), FPI estimates that if the full $3 billion in lost federal fiscal relief were absorbed over a 12-month period by state and local government layoffs at an average salary level of $54,000 with payroll tax and benefit contributions of 15%, that the direct government employment loss would be around 48,000 and that the indirect and induced employment effects, which would be mostly in the private sector, would be almost 29,000. FPI thus estimates that the total job reduction statewide (direct, indirect and induced) would be about 77,000.

The bottom line is that New York State would experience substantial job losses if the enhanced FMAP funding is not extended. The failure to extend this needed relief would be felt everywhere in the state and nation, and hinder the emerging economic recovery.