

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The text is centered within the hourglass.

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States and Proposed Economic Recovery Plans

Robert Jay Dilger, Senior Specialist in American National Government

January 16, 2009

Abstract. This report examines arguments presented by the National Conference of State Legislatures (NCSL) and the National Governors Association (NGA) to include state fiscal assistance in an economic recovery plan, several arguments to exclude state assistance from such a plan, and the implications the proposals presented by NCSL and NGA might have for the economy. It also examines issues related to the targeting of state fiscal assistance and arguments for and against including infrastructure construction projects in an economic recovery plan, and presents key provisions in proposed economic recovery plans that directly affect state and local governments.

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States and Proposed Economic Recovery Plans

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Summary

On November 15, 2008, President-elect Barack Obama announced during his weekly radio address that the nation was facing "...the greatest economic challenge of our time" and that he would work with Congress to design a two-year economic recovery plan with the goal of creating 2 million jobs "...rebuilding our crumbling roads, bridges, and schools." As negotiations progressed, national unemployment figures jumped to a fifteen-year high of 6.7%, and the stock market plunged, with the Dow Jones Industrial Stock Index falling below 7,400 on November 21, 2008. In light of the poor economic news, President-elect Obama increased his economic recovery plan's job creation goal, first to 2.5 million jobs over two years and later to 3 million jobs. According to media reports, President-elect Obama presented congressional Democrats a proposal in mid-December to dedicate \$675 billion to \$775 billion over the next two years to middle-class tax cuts, aid to state governments and investments in infrastructure, health-care technology, and education.

This report examines the arguments presented by the National Conference of State Legislatures (NCSL) and the National Governors Association (NGA) to include state fiscal assistance in an economic recovery plan, several arguments to exclude state assistance from such a plan, and the implications the proposals presented by NCSL and NGA might have for the economy. It also examines issues related to the targeting of state fiscal assistance and arguments for and against including infrastructure construction projects in an economic recovery plan.

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On November 15, 2008, President-elect Barack Obama announced during his weekly radio address that the nation was facing "...the greatest economic challenge of our time" and that he would work with Congress to design a two-year economic recovery plan with the goal of creating 2 million jobs "...rebuilding our crumbling roads, bridges, and schools."¹ As negotiations progressed, national unemployment figures jumped to a fifteen-year high of 6.7%, and the stock market plunged, with the Dow Jones Industrial Stock Index falling below 7,400 on November 21, 2008. In light of the poor economic news, President-elect Obama increased his economic recovery plan's job creation goal, first to 2.5 million jobs over two years and later to 3 million jobs, and asked Congress to adopt an economic recovery plan by January 20, 2009, inauguration day.² According to media reports, President-elect Obama presented congressional Democrats a proposal in mid-December to dedicate \$675 billion to \$775 billion, with the possibility of reaching \$850 billion, over the next two years to middle-class tax cuts, aid to state governments and investments in infrastructure, health-care technology, and education.³

This report examines the arguments presented by the National Conference of State Legislatures (NCSL) and the National Governors Association (NGA) to include state fiscal assistance in an economic recovery plan, several arguments to exclude state assistance from such a plan, and the implications the proposals presented by NCSL and NGA might have for the economy. It also examines issues related to the targeting of state fiscal assistance and arguments for and against including infrastructure construction projects in an economic recovery plan.

NCSL's Arguments for Including State Assistance in an Economic Recovery Plan

On November 12, 2008, State Representative Joe Hackney, President of the National Conference of State Legislatures (NCSL), sent a letter to President-elect Obama on behalf of NCSL arguing that the federal government should include fiscal assistance to state governments in his economic recovery plan because "...49 of the 50 states have requirements to balance their budgets each year" and that "...during uncertain economic times, the decisions that state legislatures and governors make to keep their budgets balanced – cutting spending, raising taxes or both – can

¹ Barack Obama, "Remarks of President-Elect Barack Obama (as delivered), Democratic Radio Address, November, 15, 2008," http://change.gov/newsroom/entry/your_weekly_address_from_the_president_elect/.

² Barack Obama, "Remarks of President-Elect Barack Obama (as delivered), Democratic Radio Address, November, 15, 2008," http://change.gov/newsroom/entry/2_5_million_jobs/; CNN Money.com, "Dow Jones Industrial Average Stock Charts," <http://money.cnn.com/quote/chart/charts.popup.html?ClientID=44711&symb=djia&sid=1643&pg=ch&time=2mo&freq=1dy&maval=60&lf=1&type=2&mocktick=1&symbtype=0&country=US&rtsid=1000001643&style=2108&size=3>; and Lori Montgomery, "Obama Expands Stimulus Goals As Economic Outlook Grows More Dire, Early Target for Job Growth Is Bolstered," *Washington Post*, December 21, 2008, p. A1.

³ Lori Montgomery, "Obama Expands Stimulus Goals As Economic Outlook Grows More Dire, Early Target for Job Growth Is Bolstered," *Washington Post*, December 21, 2008, p. A1.

have the pro-cyclical affect of deepening and prolonging any slump.”⁴ Representative Hackney attached to the letter NCSL’s recommendations for the President-elect’s economic recovery plan:

- a temporary increase in the Federal Medical Assistance Percentage (FMAP) to assist people who lose health care coverage during the economic downturn and complement support – an extension of unemployment benefits – provided in the previously passed spending bill;⁵
- increased funding for broad, ready-to-go transportation, clean water and drinking water projects to stimulate job creation;⁶
- a temporary extension of unemployment benefits to eligible individuals who have exhausted their state benefits;⁷
- a temporary increase in food stamp benefits to assist the increasing number of families struggling with rising food costs;⁸
- provide discretionary grants to state governments with the flexibility to address fiscal concerns through one-time state grant assistance;⁹
- rescind the provision in the Deficit Reduction Act (P.L. 109-171) that prohibits states from using incentive payments to draw down federal funds to assist states with collections of child support payments and provide immediate assistance to working families;¹⁰
- grant states that have complied with the Streamlined Sales and Use Tax Agreement the authority to require collections of sales tax on remote sales and provide equity for all retailers, providing as much as \$30 billion in fiscal relief to the states at no expense to the federal government;¹¹ and

⁴ Representative Joe Hackney, President of the National Conference of State Legislatures (NCSL), “Letter to The Honorable Barack Obama concerning the Economic Stimulus Package,” November 12, 2008, http://www.ncsl.org/print/statedef/Transition_Stim111308.pdf. Note: Vermont does not require a balanced state budget; balanced budget requirements apply to state operating budgets only; and all states have a deficit for capital expenditures, primarily for land, highways and public buildings.

⁵ For further program analysis see CRS Report RL32950, *Medicaid: The Federal Medical Assistance Percentage (FMAP)*, by April Grady; and CRS Report RS22849, *Medicaid Financing*, by April Grady.

⁶ For further program analysis see CRS Report R40053, *Surface Transportation Program Reauthorization Issues for the 111th Congress*, coordinated by John W. Fischer; CRS Report RL34675, *Surface Transportation Reauthorization: Selected Highway and Transit Issues in Brief*, by Robert S. Kirk; and CRS Report RL34171, *Public Transit Program Issues in Surface Transportation Reauthorization*, by William J. Mallett.

⁷ For further program analysis see CRS Report RL34340, *Extending Unemployment Compensation Benefits During Recessions*, by Julie M. Whittaker.

⁸ For further program analysis see CRS Report RL33829, *Domestic Food Assistance: The Farm Bill and Other Legislation in the 110th Congress*, by Joe Richardson.

⁹ For further program analysis see CRS Report RL31936, *General Revenue Sharing: Background and Analysis*, by Steven Maguire.

¹⁰ For further program analysis see CRS Report RL34203, *Child Support Enforcement Program Incentive Payments: Background and Policy Issues*, by Carmen Solomon-Fears.

¹¹ For further program analysis see CRS Report RL34211, *State and Local Taxes and the Streamlined Sales and Use Tax Agreement*, by Steven Maguire and CRS Report RL33261, *Internet Taxation: Issues and Legislation*, by Steven Maguire and Nonna A. Noto.

- pursue any federal personal and corporate tax relief through tax credits, such as accelerating the scheduled increase in the child tax credit, and other changes in federal tax liability, rather than through exclusions or deductions.¹²

On December 22, 2008, NCSL sent a letter to congressional leaders urging them to include state assistance in an economic recovery plan, arguing that:

...As of today, states are facing a cumulative budget shortfall of nearly \$100 billion, after already closing a \$53 billion gap. To make matters worse, state finances will continue to deteriorate in the coming months, perhaps years. Because of state balanced budget requirements, state lawmakers are being compelled to cut spending, increase revenues and delay important infrastructure projects - actions that will prolong and deepen the effects of the economic downturn. The state fiscal situation is so critical that it threatens the viability of essential state programs and services, particularly those assisting vulnerable populations most disadvantaged by the recession.¹³

The letter included a list of recommendations for an economic recovery plan that was similar to the list submitted to President-elect Obama earlier. Some of the differences included the addition of public university facilities to the list of suggested infrastructure projects, a request for a temporary waiver of state matching requirements for infrastructure projects to "...ensure that these projects get started quickly," and "...to temper the pressure that unfunded federal mandates place on state budgets, the nation's legislative leaders urge you to appropriate the promised 40 percent of costs for special education."¹⁴

NGA's Arguments for Including State Assistance in an Economic Recovery Plan

On October 27, 2008, NGA sent a letter to congressional leaders urging them to include state fiscal assistance as part of any proposed economic stimulus package. The letter echoed NCSL's argument that state fiscal conditions were deteriorating and that state balanced budget requirements would force states to either reduce spending, raise taxes, or both, actions that could prolong the economic downturn and counter federal efforts to stimulate the economy.¹⁵ NGA

12 NCSL, "NCSL Recommendations for an Economic Stimulus Package," November 12, 2008, <http://www.ncsl.org/print/statefed/FiscalRecs111308.pdf>. For further program analysis see CRS Report RL34715, *The Child Tax Credit*, by Maxim Shvedov, and CRS Report RL32682, *Children in Poverty: Profile, Trends, and Issues*, by Vee Burke, Thomas Gabe, and Gene Falk.

13 National Conference of State Legislatures, "Letter to Senators Harry Reid and Mitch McConnell and Representatives Nancy Pelosi and John Boehner concerning the Economic Stimulus Package, December 22, 2008, <http://www.ncsl.org/statefed/FederalStimulusLTR122208.htm>.

14 Ibid. For further program analysis see CRS Report RL32085, *Individuals with Disabilities Education Act (IDEA): Current Funding Trends*, by Ann Lordeman.

15 Governors Edward G. Rendell and James H. Douglas, on behalf of the National Governors Association, "Letter to Senators Harry Reid and Mitch McConnell and Representatives Nancy Pelosi and John Boehner concerning a proposed Economic Recovery Package," October 22, 2008, <http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=147053975ef2d110VgnVCM1000001a01010aRCRD>.

argued that "...one of the most effective sets of mechanisms the federal government can use to speed recovery is investments in existing federal-state programs because these programs are on-going and therefore the funds can be obligated quickly and expedited efficiently."¹⁶ Specifically, NGA recommended that Congress:

- temporarily enhance the Federal Medical Assistance Percentage (FMAP) for at least two years because funding for FMAP is a particularly effective countercyclical tool that immediately allows Governors to eliminate planned budget cuts required to meet balanced budget requirements and continue services for those with the greatest need;
- invest in ready-to-go infrastructure projects that are a cost effective creator of high paying jobs. These investments should include a broad array of infrastructure projects including airports, highways, transit systems, clean water, sewers and broadband; and
- change the tax code to spur economic growth and avoid policies that preempt state authority, shift costs to states or impose new unfunded mandates.¹⁷

As negotiations on President-elect Obama's economic recovery plan got underway, NGA issued a more detailed proposal for economic recovery, entitled "Economic Recovery: A Federal State Partnership."¹⁸ The report, issued on November 13, 2008, reiterated NGA's earlier argument that "...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."¹⁹ The report argued that the programs with the greatest potential to hasten the recovery include:

- countercyclical programs where federal government funding can help prevent proposed budget cuts that states would be forced to make because of their balanced budget requirements;
- infrastructure investments that create jobs; and
- safety net programs that assist people in the greatest need (unemployment insurance, Medicaid).²⁰

Specifically, NGA recommended that an economic recovery plan include \$126.1 billion for states: \$61.7 billion for three countercyclical programs, \$57.4 billion for eight job creation programs, and \$7 billion for three targeted benefits programs.²¹

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ National Governors Association, "Economic Recovery: A Federal-State Partnership," November 13, 2008, <http://www.nga.org/Files/pdf/0811ECONOMICRECOVERY.PDF>.

¹⁹ Ibid., p. 1.

²⁰ Ibid.

²¹ Ibid.

NGA recommended including the following three countercyclical programs in an economic recovery plan: a temporary increase in the Federal Medical Assistance Percentage (FMAP) for at least two years (costing an estimated \$20 billion each year), extend authorization for transitional medical assistance under Medicaid for low-income working families (\$2.7 billion over 18 months), and commit to fully fund a glide path to 40% of the cost to educate students with disabilities (\$19 billion over two years).

NGA recommended including the following eight job creation programs: \$18.9 billion for highway projects, with 68% spent in two years and temporarily eliminate the non-federal matching requirement; \$8 billion for mass transit projects, with 45% spent in two years and temporarily eliminate the non-federal matching requirement; \$9 billion to ensure the solvency of the Highway Trust Fund, \$1 billion for airport construction projects, with 61% spent in two years and temporarily eliminate the non-federal matching requirement; \$350 million to \$500 million for ready-to-go passenger rail projects and temporarily eliminate the non-federal matching requirement; \$9.2 billion for ready-to-go wastewater infrastructure projects and temporarily eliminate the non-federal matching requirement; \$6 billion for ready-to-go drinking water infrastructure projects and temporarily eliminate the non-federal matching requirement; and \$4.8 billion for affordable housing projects.

NGA also recommended including the following three targeted benefit programs: \$3.5 billion for Pell Grants, \$2 billion for a 13-week benefit extension for unemployment compensation, and \$1.5 billion to remove sequence-of-service requirements in the Workforce Investment Act of 1998 (repeal of Section 191(A)).²²

On December 2, 2008, President-elect Obama met with 40 current and newly elected governors at Philadelphia's Independence Hall to discuss his economic recovery plan. Media reports indicated that the governors requested \$176 billion in state assistance at the meeting - \$136 billion for infrastructure projects and \$40 billion for Medicaid.²³

On December 15, 2008, NGA and the National Association of State Budget Officers released its semi-annual report on state fiscal conditions, *The Fiscal Survey of States*. The report indicated that in FY 2008 most states' fiscal conditions weakened and have continued to deteriorate; nominal general fund expenditures and revenue collections increased for many states, but more than half of the states experienced negative growth in general fund expenditures and revenue collections after accounting for inflation; and fiscal conditions varied widely across states, as some states (e.g., Alaska and Texas) prospered due to increases in commodity prices, while other states were more exposed to the economic downturn.²⁴ For FY 2009, the report indicated that enacted state budgets reflected a 0.1% decrease in state expenditures compared to a 5.3% increase

²² Ibid., pp. 2, 3. For further program analysis see CRS Report RL31129, *Higher Education Tax Credits and Deduction: An Overview of the Benefits and Their Relationship to Traditional Student Aid*, by Linda Levine and Charmaine Mercer; CRS Report RL31668, *Federal Pell Grant Program of the Higher Education Act: Background and Reauthorization*, by Charmaine Mercer; and CRS Report RL34251, *Federal Programs Available to Unemployed Workers*, by Julie M. Whittaker and Blake Alan Naughton.

²³ Ceci Connolly, "States Want \$176 Billion Slice of Stimulus," *Washington Post*, December 2, 2008, D1.

²⁴ National Governors Association and National Association of State Budget Officers, *The Fiscal Survey of States* (Washington, DC: National Association of State Budget Officers, December 2008), p. 1, <http://www.nasbo.org/Publications/PDFs/Fall2008FiscalSurvey.pdf>.

in FY 2008 (the 31-year average is +6.3%). The report also noted that since state budget enactments economic conditions in most states had deteriorated and, as of November 2008, 22 states had reduced state spending totaling \$12.1 billion, and 31 states reported budget gaps totally \$29.7 billion. The report also indicated that "...states are forecasting declining economic growth and expect to make significant budget cuts in the coming fiscal years."²⁵

A NCSL study of state budget forecasts, released on December 4, 2008, reported similar findings. It reported that 38 states faced projected budget gaps totaling more than \$31 billion in FY 2009 and \$65 billion in FY 2010. As shown on **Table 1**, NCSL reported that California had the largest projected FY 2009 budget gap (\$8.4 billion, 8% of its General Fund Account), followed by Illinois (\$2.3 billion), Florida (\$2.142 billion), Georgia (\$2.1 billion) and Pennsylvania (\$2 billion). It also reported that six states had projected FY 2009 budget gaps equaling 10% or more of its General Fund Account (Arizona, Georgia, New Hampshire, Nevada, Rhode Island, and South Carolina). Twelve states (Alaska, Arkansas, Indiana, Louisiana, Michigan, Missouri, Montana, North Dakota, Oklahoma, Texas, West Virginia and Wyoming) did not have a projected budget gap in FY 2009.²⁶ NCSL also reported that 15 states anticipated budget gaps of at least 10% of their General Fund Account in FY 2010, including Arizona (24.2%), New York (20%), California (18%), Wisconsin (17.2%), Minnesota (14.7%) and Kansas (14.5%).²⁷

Table 1. Projected State Budget Gaps, FY 2009

| State | Projected Budget Gap | Gap as a Percent of General Fund Account |
|--------------------|----------------------|--|
| 1. California | \$8,400,000,000 | 8.0% |
| 2. Illinois | 2,300,000,000 | 7.7 |
| 3. Florida | 2,142,000,000 | 8.6 |
| 4. Georgia | 2,100,000,000 | 10.4 |
| 5. Pennsylvania | 2,000,000,000 | 7.1 |
| 6. New York | 1,475,000,000 | 2.6 |
| 7. Arizona | 1,235,000,000 | 12.3 |
| 8. Massachusetts | 1,200,000,000 | 4.3 |
| 9. North Carolina | 1,200,000,000 | 5.0 |
| 10. Ohio | 1,180,000,000 | 6.1 |
| 11. Virginia | 973,600,000 | 5.7 |
| 12. Tennessee | 800,000,000 | 7.0 |
| 13. South Carolina | 724,400,000 | 10.0 |
| 14. Kentucky | 456,100,000 | 5.1 |

²⁵ Ibid.

²⁶ NCSL, *State Budget Update: November 2008* (Washington, DC: NCSL, November 2008), <http://www.ncsl.org/summit/budgetmap.htm>.

²⁷ Ibid.

| State | Projected Budget Gap | Gap as a Percent of General Fund Account |
|-------------------|----------------------|--|
| 15. Massachusetts | 426,000,000 | 1.2 |
| 16. Washington | 413,000,000 | 2.7 |
| 17. New Jersey | 400,000,000 | 1.2 |
| 18. Connecticut | 391,800,000 | 2.3 |
| 19. Utah | 354,000,000 | 6.4 |
| 20. Rhode Island | 350,000,000 | 10.4 |
| 21. Nevada | 337,000,000 | 10.5 |
| 22. Michigan | 281,000,000 | 2.0 |
| 23. New Mexico | 253,000,000 | 4.2 |
| 24. New Hampshire | 250,000,000 | 10.0 |
| 25. Hawaii | 220,000,000 | 3.8 |
| 26. Oregon | 142,000,000 | 1.0 |
| 27. Maine | 140,300,000 | 4.5 |
| 28. Maryland | 138,000,000 | 0.9 |
| 29. Kansas | 136,800,000 | 2.1 |
| 30. Delaware | 128,700,000 | 3.6 |
| 31. Alabama | 123,500,000 | 6.0 |
| 32. Colorado | 99,700,000 | 1.3 |
| 33. Vermont | 88,000,000 | 8.0 |
| 34. Mississippi | 85,500,000 | 1.7 |
| 35. Iowa | 35,000,000 | 0.5 |
| 36. Idaho | 27,000,000 | 1.0 |
| 37. South Dakota | 7,000,000 | 0.6 |
| 38. Nebraska | 5,300,000 | 0.2 |
| Total | 31,012,600,000 | |

Source: NCSL, *State Budget Update: November 2008* (Washington, DC: NCSL, November 2008), <http://www.ncsl.org/summit/budgetmap.htm>.

Notes: Alaska, Arkansas, Indiana, Louisiana, Michigan, Missouri, Montana, North Dakota, Oklahoma, Texas, West Virginia and Wyoming did not report a projected budget gap for FY 2009.

On January 2, 2009, the five Democratic governors from New York, New Jersey, Massachusetts, Ohio and Wisconsin held a joint press conference urging Congress to adopt a \$1 trillion economic stimulus package, with \$350 billion for infrastructure, \$250 billion for anti-poverty programs, \$250 billion in flexible education spending for programs from pre-kindergarten to higher

education, and \$150 million for middle-class tax cuts.²⁸ Referring to their proposal, New Jersey Governor Jon S. Corzine reportedly said that “The scope of it needs to be substantial” and it needs to “... include this education piece.”²⁹ Wisconsin Governor Jim Doyle reportedly argued that without the added assistance for education, “We will see quality fall off in our schools. ... We will see a great restriction of university education, or such soaring tuition that ordinary, hard-working families will be unable to afford it.”³⁰ Ohio Governor Ted Strickland reportedly said that “We aren’t crying wolf; these are real circumstances, unprecedented situations we are facing. ... Looking forward, if I were simply to flat-fund the operations of this government, I would end up with \$7.3 billion in deficit. To get a balanced budget, I would have to fund current operations at 75 percent.”³¹

Arguments Against Including State Assistance in an Economic Recovery Plan

Media reports indicated that during the governors’ December 2, 2008 meeting with President-elect Obama in Philadelphia that Governor Mark Sanford (R-SC) opposed the President-elect’s economic stimulus plan because “... we are just putting off the day of reckoning. A problem created as a consequence of too much debt probably will not be solved by issuing more debt.”³² In a letter to the editor published in the *Washington Post* on September 26, 2008, Governor Sanford opposed federal government intervention in the financial crisis:

An ever-expanding scope of federal commitment and power is not what made this country great. Expanded power in one place comes at a cost in other places. American cornerstones such as individual initiative and an entrepreneurial spirit—born in free and open societies with private property rights and the rule of law—have never fit particularly well within the context of an ever-growing federal government.³³

He also called on taxpayers to “admonish those in Washington to get their own financial house in order. Washington is the master of creative and unsustainable finance, with \$50 trillion in unfunded promises.”³⁴

Although Governor Sanford’s arguments were presented in opposition to federal intervention in the marketplace, they could be applied to the provision of federal assistance to state governments. Those who advocate restraint in government intervention in the marketplace typically advocate restraint by all levels of government, including state government. As a result, one possible ideological objection to providing financial assistance to states in an economic recovery plan is

²⁸ Robin Shulman, “Governors Call for \$1 Trillion Stimulus to Offset Budget Cuts,” *Washington Post*, January 3, 2009, p. A2.

²⁹ Ibid.

³⁰ Ibid.

³¹ Ibid.

³² Ceci Connolly, “States Want \$176 Billion Slice of Stimulus,” *Washington Post*, December 2, 2008, D1.

³³ Governor Mark Sanford, “A Bailout for All Our Bad Decisions?” *Washington Post*, September 26, 2008, A23.

³⁴ Ibid.

that, depending on how it is structured, it could increase the size and scope of state government. According to this view, state governments have, by their own choice through their state constitutions or by statute, designed their state policymaking process to force themselves to make budgetary tradeoffs when state revenue fails to meet expectations. It could be argued that because states purposively devised these systems to operate in this fashion, the federal government should not interfere. Depending on one's ideological viewpoint, what one views as a state fiscal crisis that needs to be fixed could be viewed by another as states adjusting to changed economic circumstances and living within their means.

Another possible argument against providing fiscal assistance for states in an economic recovery plan is that most states have accumulated "rainy day" funds for times of economic distress. The NGA and the National Association of State Budget Officers' study of state fiscal conditions reported that states had \$50.8 billion in total year-end balances at the end of FY 2008, and \$48 billion set aside for FY2009.³⁵ It could be argued that these funds should be exhausted before any federal assistance is provided to states. It could also be argued that states that failed to accumulate enough in their rainy day funds to cope with the current economic downturn should suffer the consequences of their actions. Others might argue that states could not have foreseen the extent of the current economic downturn and its impact on state revenue. Also, the amount states have set aside for FY 2009 varies, with Alaska (\$8.9 billion) and Texas (\$12 billion), accounting for 43% of the FY 2009 total. Ten states (Alabama, Arkansas, Florida, Kansas, Illinois, Massachusetts, Michigan, Nevada, New Jersey, and Wisconsin) reported in November 2008 that they had FY 2009 budget balances below 2% of state expenditures and seven more (Arizona, California, Hawaii, Kentucky, Minnesota, Pennsylvania, and Rhode Island) reported balances below 3%.³⁶

Another possible objection to the inclusion of financial assistance to state governments in an economic recovery plan is that while many states are experiencing fiscal difficulty, so is the federal government. It could be argued that with a debt now estimated at over \$10.6 trillion the federal government is not in a position to subsidize states. For example, Nick Ayers, the Republican Governors Association's Executive Director, reportedly advocates including state assistance in an economic recovery plan but was quoted as saying that the five Democratic governors' recommendation to increase the plan's cost to \$1 trillion went too far, calling it "essentially a bail out of these states' general funds" and that "Now is the time to focus on finding cost-effective ways to provide essential services without burdening future generations with ever greater debt."³⁷ Also, House Minority Leader John Boehner reportedly met with President-elect Obama on January 5, 2009 to discuss options for an economic recovery plan and expressed concern "about wasteful spending that might be attached to tax relief. Simply put, we should not bury future generations under mountains of debt."³⁸ Others might argue that, depending on how the federal assistance was structured, that the federal government is not subsidizing states, but, as

³⁵ National Governors Association and National Association of State Budget Officers, *The Fiscal Survey of States* (Washington, DC: National Association of State Budget Officers, December 2008), p. 24, <http://www.nasbo.org/Publications/PDFs/Fall2008FiscalSurvey.pdf>.

³⁶ *Ibid.*, p. 66.

³⁷ Robin Shulman, "Governors Call for \$1 Trillion Stimulus to Offset Budget Cuts," *Washington Post*, January 3, 2009, p. A2.

³⁸ Paul Kane, Lori Montgomery and Shailagh, "Obama Pitches Stimulus Plan: GOP Asked to Help Design Bill; \$300 Billion in Tax Cuts Sought," *Washington Post*, January 6, 2009, p. A1.

NGA has argued, merely taking advantage of existing administrative arrangements to get assistance to those found to both need and deserve assistance in an expeditious manner.

Other Issues of Possible Congressional Interest

Another issue of possible congressional interest relates to the manner in which federal assistance might be allocated among states if Congress decided to include federal assistance to states in any economic recovery plan. Should Congress target federal assistance to states that are anticipating budgetary gaps in the next few years, or should it not concern itself with how federal resources are allocated among states? If federal assistance is to be targeted to states with greatest need, what criteria should be used to measure that need? For example, West Virginia, based on per capita income, is a relatively poor state, yet it is not anticipating a state budget gap in the next two fiscal years. California is a relatively rich state, yet it is anticipating budgetary shortfalls both this fiscal year and next. Should California receive a proportionally greater share of federal assistance under the economic recovery plan than West Virginia?

GAO has made several recommendations on federal-state allocation issues. During the last recession, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27) provided states \$20 billion in temporary federal fiscal assistance, \$10 billion in unrestricted federal assistance and \$10 billion in additional Medicaid payments. Congress asked GAO to study the program's impact on states. GAO reported that the funds were intended to provide antirecession fiscal stimulus to the national economy and to help close state budget shortfalls due to the recession that began in March 2001. GAO focused its analysis on the \$10 billion in unrestricted federal assistance and concluded that the unrestricted funds were not targeted to take into account "...differences among states in the impact of the recession, fiscal capacity, and cost of expenditure responsibilities. Rather, the funds were allocated to the states on a per capita basis, adjusted to provide for minimum payment amounts to smaller states."³⁹ It argued that "...because recessions affect states unevenly, targeting unrestricted funds to states most affected and with less available resources could yield better results."⁴⁰ It recommended that in the future Congress use change in state unemployment rates as a proxy for the recession's impact on the state and change in gross state product as a proxy for state fiscal capacity when allocating federal resources to provide states fiscal relief during economic downturns.⁴¹

GAO also reported in its analysis of Jobs and Growth Tax Relief Reconciliation Act of 2003 that providing states fiscal assistance during economic downturns raised the question of "moral hazard."

The potential availability of countercyclical federal funds could discourage state actions to prepare for the fiscal pressures associated with a recession. States can prepare their finances for fiscal stress and budget uncertainty, primarily through establishing budgetary reserves. Budgetary reserves (sometimes referred to as budget stabilization funds or "rainy day"

³⁹ GAO, *Federal Assistance: Temporary State Fiscal Relief*, GAO-04-736R (Washington, DC: USGPO, May 7, 2004), p. 2.

⁴⁰ *Ibid.*, p. 4.

⁴¹ *Ibid.*, p. 6.

funds) are available revenues set aside to provide a cushion that could be used in times of fiscal stress.⁴²

Another issue of possible congressional interest is the possible impact proposed state-run infrastructure construction projects might have on the timing of an economic recovery plan's fiscal stimulus.⁴³ GAO reported in its analysis of the Jobs and Growth Tax Relief Reconciliation Act of 2003 that the first distribution of fiscal relief funds to states occurred about 19 months after the end of the recession, limiting its effectiveness as a countercyclical program.⁴⁴ Much of the discussion concerning the role states might have in an economic recovery plan reportedly involves their role in overseeing infrastructure construction projects. NGA's recommendations, for example, included eight job creation programs, all involving infrastructure construction projects. One of the criticisms of infrastructure projects as a short-term means to stimulate economic activity is the relatively long timeline associated with moving infrastructure projects from planning to actual use. For example, the National Surface Transportation Policy and Revenue Study Commission reported in December 2008 that:

Federal funds are currently distributed to State and local transportation agencies along with many "procedural strings" that lead to excessive delays. Particularly for larger projects, the complex process of planning, evaluating environmental impacts, and arranging project funding can take as long as 15 years - an unacceptably long time in the face of immediate and growing transportation problems and in contrast to the ever-shortening cycle of private sector and entrepreneurial decision making.⁴⁵

It could be argued that the need for an immediate economic stimulus suggests that an economic recovery plan should focus on tax credits and other direct spending proposals that arguably could provide for a more immediate fiscal stimulus than infrastructure spending. States counter this argument by focusing on "ready-to-go" infrastructure projects. However, in recognition of the time it takes to move even smaller infrastructure construction projects from planning to construction, NGA's job creation proposals included targets requiring the expenditure of federal assistance within two years. For example, 68% of NGA's proposed \$18.9 billion for highway projects, 45% of its proposed \$8 billion for mass transit projects, and 61% of its proposed \$1 billion for airport construction projects was to be spent within two years. Others might argue that the nation's economic difficulties are so extensive that including infrastructure spending in an economic recovery plan is appropriate because even if its stimulative impact on the economy is delayed it will reinforce the more immediate fiscal stimulus provided by other programs in the plan. It could also be argued that the nation's infrastructure needs are so profound that infrastructure spending should be included in an economic recovery plan, even if that spending has a delayed stimulative impact on the economy. For example, the National Surface

⁴² Ibid., p. 5.

⁴³ For further program analysis see CRS Report R40080, *Job Loss and Infrastructure Job Creation During the Recession*, by Linda Levine.

⁴⁴ GAO, *Federal Assistance: Temporary State Fiscal Relief*, GAO-04-736R (Washington, DC: USGPO, May 7, 2004), p. 2.

⁴⁵ National Surface Transportation Policy and Revenue Study Commission, *Transportation for Tomorrow*, Washington, D.C.: National Surface Transportation Policy and Revenue Study Commission, December 2007, Volume 1, "Recommendations," p. 4, http://www.transportationfortomorrow.org/final_report/.

Transportation Policy and Revenue Study Commission reported in December 2008 that the transportation challenges facing the Nation “have reached crisis proportions,” with “underinvestment in all modes of transportation ... that cannot meet the scale of future projected demand.”⁴⁶ It recommended that funding for surface transportation programs be increased to at least \$225 billion annually from all sources for the next 50 years to upgrade the existing surface transportation system to a “state of good repair.”⁴⁷

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⁴⁶ National Surface Transportation Policy and Revenue Study Commission, *Transportation for Tomorrow*, Washington, D.C.: National Surface Transportation Policy and Revenue Study Commission, December 2007, Volume 1, “Recommendations,” pp. 3, 4, http://www.transportationfortomorrow.org/final_report/.

⁴⁷ *Ibid.*, Volume 1, p. 1.