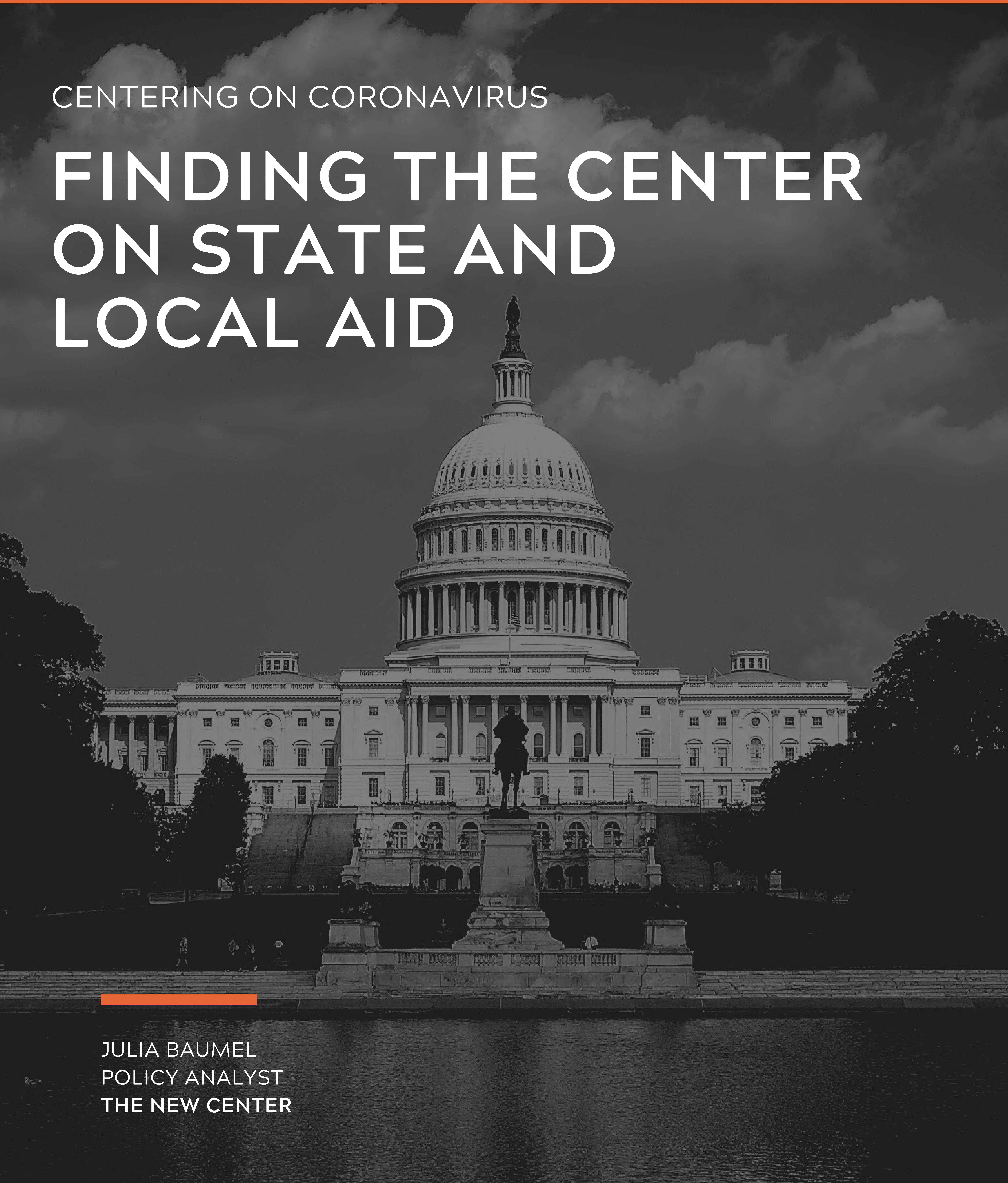
CENTERING ON CORONAVIRUS

FINDING THE CENTER ON STATE AND LOCAL AID



JULIA BAUMEL
POLICY ANALYST
THE NEW CENTER

In times of economic crisis, states and their localities are uniquely vulnerable

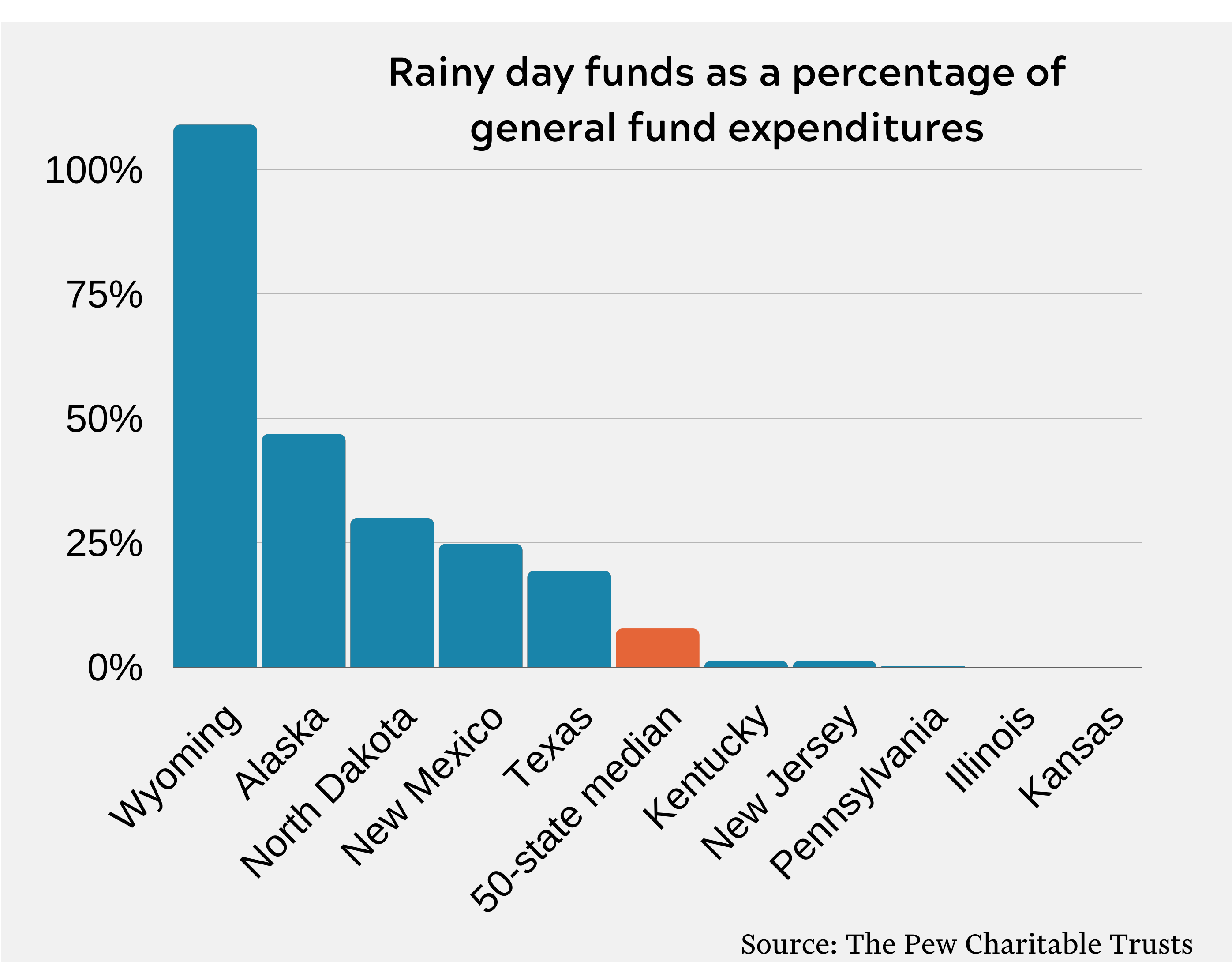
As a result of the COVID-19 outbreak, many state and local governments are in desperate financial straits.

With sales, restaurant, and hotel tax revenues collapsing, some localities have already started to cut essential services and furlough frontline workers like police officers, firefighters, sanitation workers, and medical personnel.

In the ten weeks since the beginning of the economic downturn sparked by COVID-19, 40.8 million people have filed for unemployment, which amounts to about one in four people who were previously employed as recently as February. This is nearly four times higher than the number of unemployment filings during the Great Recession between December 2007 and December 2009, and it has created a vicious cycle: People have less money to spend, so state and local governments collect less tax revenue. At the same time, demand soars for government safety net programs like Medicaid and unemployment insurance (UI).

Both of these programs are jointly funded by the federal government and the states, with cost-sharing breakdowns that vary from state to state. During times of recession, the federal government covers about 60% of the costs of Medicaid and unemployment insurance while the states cover the rest. (The contribution breakdown for Medicaid is typically constant, while the federal government's share of UI financing automatically increases during an economic downturn.)

In response to the outbreak, several states have tapped into reserve funds, and many others are in the process of doing the same. Some states entered this crisis in good fiscal condition while others were facing chronic budget shortfalls even before the economic downturn began. Illinois, for example, is down to just $818,000 in rainy day funds, and as of last year, its pension plans were underfunded by $138 billion. But even in the best-prepared states, rainy day funds are unlikely to be sufficient to get them through an economic crisis of this magnitude.



States and localities can, of course, borrow money, but the amount is limited by balanced budget requirements included in most state constitutions. That's why Washington must step up with a common-sense bipartisan compromise that keeps states and localities afloat and frontline workers on the job for now, while encouraging more fiscal responsibility and preparedness in the future.

Federal government assistance has been insufficient

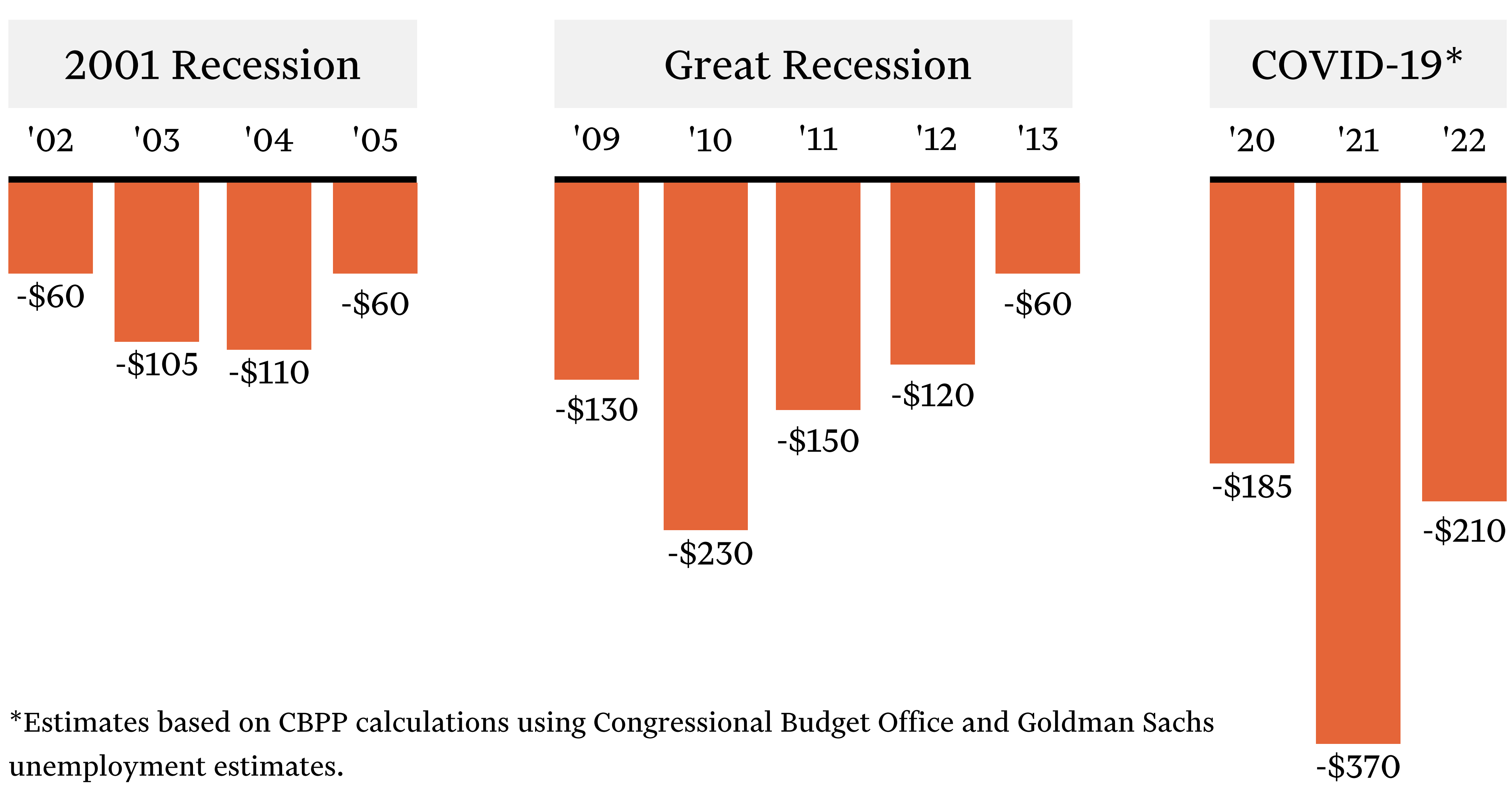
Federal assistance through the Families First Coronavirus Response Act (FFCRA) and the Coronavirus Aid, Relief, and Economic Security (CARES) Act has included funding for state and local governments to assist with their public health responses as well as increased funding for unemployment insurance and Medicaid/CHIP. However, these provisions fall short. The allocated amounts are insufficient, and each funding allocation comes with an arbitrary expiration date.

The CARES Act also included a $260 billion expansion of unemployment benefits. While a portion of this will ease the burden on state unemployment trust funds, most of the funds will cover new programs, such as the additional $600 in weekly unemployment benefits. This supplementary benefit is set to expire on July 31 unless it is extended with the passage of the next stimulus bill. According to the Tax Foundation, given the trajectory of new unemployment claims, many states' UI trust funds are likely to be depleted in just a matter of weeks.

The CARES Act did include an allocation of $150 billion to state and local governments. But the legislation specified that this funding could only be used to cover costs directly related to fighting the pandemic that were not previously accounted for in approved budgets. And, even without these usage restrictions, this amount is likely to fall short given the record-breaking damage our economy has incurred and the grim projections of what might be still to come. Using data from the Congressional Budget Office and Goldman Sachs, the Center on Budget and Policy Priorities estimates that state budget shortfalls alone will total about $765 billion over the course of three years in the wake of the pandemic. This figure does not include the additional shortfalls projected for towns, cities, territories, and tribes.

COVID-19 State Budget Shortfalls Could Be Largest on Record

Total state budget shortfall in each fiscal year, in billions of 2020 dollars



*Estimates based on CBPP calculations using Congressional Budget Office and Goldman Sachs unemployment estimates.

Source: CBPP survey of state budget offices (pre 2014); CBPP calculations (2020-2022)

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The UI system does include a program intended to ease economic burdens that automatically triggers federal aid in times of high unemployment. But this program, known as the Extended Benefits (EB) component of the UI system, has some design flaws that make it ill-suited for the current moment. While it triggers federal dollars for several extra weeks of benefits in states experiencing high unemployment, the federal government only covers half of this extension while the states are responsible for the other 50%. While providing aid, it also imposes new burdens on already strained state budgets. Additionally, the metric used to determine eligibility is the "insured unemployment rate"— the number of people receiving unemployment insurance as a percentage of the labor force. This measure is an imprecise indicator of need, especially at a time when unprecedented demand has kept many qualified individuals from receiving benefits.

The Families First Coronavirus Response Act included a temporary increase in the federal medical assistance percentage (FMAP)—the match rate that determines the federal government's contribution to state Medicaid/CHIP programs—to 6.2%. But the expiration date on this increase corresponds with the end of the national public health emergency as determined by the U.S. Department of Health and Human Services, regardless of economic conditions at that time. Further, according to economists at Brookings and Harvard Kennedy School, this FMAP increase would not be enough to cover the losses associated with even a one percentage point increase in unemployment. According to the U.S. Bureau of Labor Statistics, the unemployment rate skyrocketed from 4.4% to 14.7% between the end of March and the end of April, and this number will undoubtedly be higher in the next report, which is scheduled to be released on June 5.

Following the FMAP increase to 6.2% that took effect with the passage of the Families First Coronavirus Response Act on March 18, National Governors Association (NGA) Chair Maryland Governor Larry Hogan and NGA Vice Chair New York Governor Andrew Cuomo wrote a letter to congressional leadership urging them to include in the next stimulus bill an additional increase of the FMAP to at least 12%—a match rate several states received in the Recovery Act of 2009 by meeting certain economic conditions in the wake of the Great Recession. Notably absent from the CARES Act, passed on March 27, was any further increase to the FMAP.

After the passage of the CARES Act, NGA leadership released another statement requesting $500 billion in additional fiscal assistance for states and more flexibility for the use of funds already allocated in the legislation. This time, Senators Bob Menendez (D-NJ) and Bill Cassidy (R-LA) responded to the governors' plea with the introduction of the State and Municipal Aid for Recovery and Transition (SMART) Act. If passed, this bipartisan legislation would allocate the $500 billion requested by Hogan and Cuomo to states and localities in three equal tranches in an effort to distribute funds to the places with the greatest need:

- One-third would be proportionally allocated based on population
- One-third would be proportionally allocated based on the number of COVID-19 cases recorded
- One-third would be proportionally allocated based on revenue loss due to shutdowns

Notably, the funding may not be deposited in state pension funds. In the House of Representatives, a companion SMART Act has been introduced by a bipartisan group that includes Problem Solvers Caucus co-chairs Tom Reed (R-NY) and Josh Gottheimer (D-NJ).

Suggested solutions

In the short term, Congress should enact the bipartisan, bicameral SMART Act to help states and localities weather the COVID-19 pandemic and avoid further budget cuts to essential services. But the coronavirus crisis has also revealed a more fundamental problem with how Washington responds to unexpected crises.

Instead of requiring Congress to piece together $500 billion relief packages in a matter of days in the middle of a crisis, shouldn't there be a more orderly and predictable response planned in advance? Fortunately, some federal government programs are already structured this way. These types of programs are called "automatic stabilizers."

WHAT IS AN AUTOMATIC STABILIZER?

An automatic stabilizer is a policy mechanism intended to ease the burden of worsening economic conditions by providing automatic relief (to individuals and households or states and localities) in the form of increased government spending. Bypassing the legislative process, relief is triggered when a certain economic indicator is met and is only switched off when that indicator returns to a certain pre-set level. For example:

- Eligibility for unemployment insurance is triggered when an individual loses a job. Additionally, when a state reaches a certain level of unemployment, the Extended Benefits (EB) program kicks in to extend the duration of benefits for recipients.
- Eligibility for Medicaid is triggered when a household or individual drops below a certain income level.

Rather than continuing to provide one-off emergency assistance through the legislative process—a huge investment of time that states and localities cannot afford to lose in this crisis—the federal government might consider one-time legislation to automatically trigger fiscal relief to the states in an economic downturn, with the amount determined by the duration and magnitude of the crisis.

An automatic stabilizer would allow states and localities in need of assistance to receive it as soon as they reached a certain threshold of need as opposed to enacting damaging budget cuts while waiting for Congress to take action. The need threshold would be measured by some economic indicator (e.g., the unemployment rate dipping below a certain number), and a return to normal economic conditions would automatically deactivate the program. Funding could come in the form of general aid to be used at the recipient's discretion—something similar in structure to the SMART Act—or it could be built into current automatic stabilizer programs (like unemployment insurance and Medicaid) in need of strengthening.

Accountability as a prerequisite for aid

Congressional Democrats have expressed support for new automatic stabilizer policies to assist states and their localities, but their proposals haven't included measures to encourage more accountability for fiscally mismanaged states. A bipartisan solution should include preconditions that states must meet to become eligible for funding from these automatic stabilizers. The stipulation in the SMART Act that states may not deposit funding into their pension funds is one potential solution, but a slightly different option might be more effective in getting to the root of the problem.

The USA Today Editorial Board suggests the requirement that states enact reforms to their pension systems in order to receive future fiscal aid. Required reforms could include "reductions in payouts, mandated increases in state contributions, some loss of state control over pension finances, and spinning off public employee pensions as free-standing entities so they don't take down governments when they fail." With prerequisites like these to encourage fiscal responsibility, the federal government could:

Increase the federal share of unemployment insurance funding

In times of need, the federal government could automatically take on a greater proportion of funding for state UI programs for states that have been fiscally responsible. In March, Senator Michael Bennet (D-CO) has released an unemployment insurance reform proposal, which includes the expansion and improvement of the Extended Benefits portion of the program. Under the proposal, the EB program would be fully funded by the federal government. Additionally, Extended Benefits would be triggered by a spike in unemployment or the total unemployment rate reaching 6.5%. The addition of some type of fiscal responsibility requirement could make a proposal like this favorable to both parties.

Increase the federal share of Medicaid/CHIP funding

The federal government could increase the FMAP automatically when states reach elevated unemployment rates. In March, House Democrats introduced the Take Responsibility for Workers and Families Act, which includes a provision that would increase a state's FMAP by 4.8 percentage points each time its unemployment rate exceeded some baseline threshold by one percentage point.

If enacted, this would deliver about $32 billion in additional funds to state governments. Again, fiscal responsibility prerequisites would strengthen the proposal and invite bipartisan support.

If Congress were to enact these automatic stabilizers now, along with the accompanying measures to promote greater fiscal responsibility at the state level, they could help America effectively navigate not only the current economic crisis, but also future crises to come.

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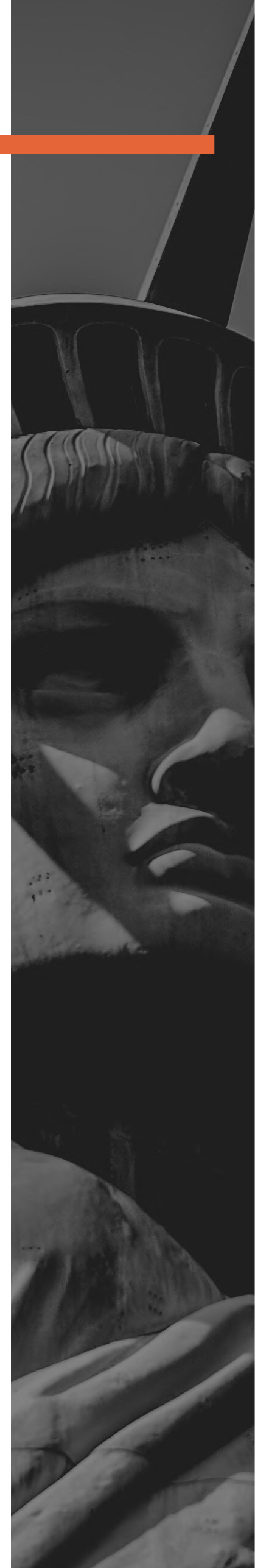

AUTHOR

Julia Baumel
Policy Analyst
julia@newcenter.org

ABOUT CENTERING ON CORONAVIRUS

Centering on Coronavirus is a new policy series from The New Center that provides insights and analyses of how coronavirus is progressing, how it is impacting our health system, economy and workers, and the extraordinary human, policy, and technological resources that are being mobilized to fight it.

ABOUT THE NEW CENTER

American politics is broken, with the far left and far right making it increasingly impossible to govern. This will not change until a vibrant center emerges with an agenda that appeals to the vast majority of the American people. This is the mission of The New Center, which aims to establish the ideas and the community to create a powerful political center in today's America.

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1808 I Street NW, Fl. 5
Washington, D.C. 20006
www.newcenter.org