
Special Series: Economic Recovery Watch

May 26, 2009

FEDERAL FISCAL RELIEF IS WORKING AS INTENDED: THE CASES OF NEW YORK AND VIRGINIA

By Phil Oliff, Jon Shure, and Nicholas Johnson¹

The examples of New York and Virginia — two major (but very different) states, both facing significant budgetary challenges — suggest that the state fiscal assistance in the economic recovery legislation is having its intended effect. It is enabling states to balance their budgets with fewer cuts in public services that would harm residents and further slow the economy.

The actions by these two states, as well as evidence from other states, show that:

- **The federal aid is enough to close roughly 30-40 percent of state budget shortfalls.** The \$787 billion American Recovery and Reinvestment Act (ARRA) included approximately \$135 billion to \$140 billion for states to maintain current programs, which are being squeezed between rising demand for services and sharply declining tax revenues. These ARRA dollars closed 31 percent of New York's budget gap and 37 percent of Virginia's. (Other states, such as Utah, Washington, Georgia, and Maryland, report similar outcomes.) States are closing the remaining gaps with a mix of spending cuts, revenue increases, withdrawals from reserve funds, and other measures.
- **The federal aid is arriving at a crucial time; New York and Virginia were seriously considering severe cuts in services like health care, education, and public safety and very likely would have enacted those cuts in the absence of the federal aid.** Virginia is using the fiscal assistance to keep open three facilities serving persons with mental health needs, reverse a planned cut in Medicaid payments to hospitals, lessen a reduction in aid to universities that almost certainly would have led to large tuition increases, avoid a major education budget cut, and avoid a funding cut that would have resulted in the loss of an estimated 310 deputy sheriffs' positions. The governor had proposed these cuts before the federal funds became available.

¹ Frank Mauro of the Fiscal Policy Institute in New York and Michael Cassidy of the Commonwealth Institute in Virginia provided extensive research and analytic assistance for this report.

New York is using recovery-act assistance to sustain state-funded pharmaceutical coverage for seniors on fixed incomes; maintain aid to hospitals and nursing homes; avert a proposed reduction in payments to low-income residents who are elderly, blind, or have disabilities; undo a proposed \$1.1 billion cut in K-12 funding; reduce a proposed funding cut for community colleges; maintain programs that provide professional development for teachers; and avoid cuts in college tuition assistance for low- and moderate-income students. The aid also allowed New York to avoid shifting special education costs to local school districts, which would have had to cut services or raise property taxes more than they already are. As in Virginia, all of these cuts had been proposed by the governor prior to ARRA.

In addition, the federal aid undoubtedly is averting other, unspecified cuts in Virginia and New York. In both states, the governor's proposed spending reductions prior to ARRA would have been insufficient to balance the budget as the revenue situation worsened.

- **The flexibility afforded by ARRA dollars is important.** ARRA's state fiscal assistance consisted primarily of \$87 billion in increased Medicaid funding and a new \$50 billion State Fiscal Stabilization Fund administered by the federal Department of Education. (See the text box on page 3.) As ARRA requires, states are using most of these dollars for health care and education. However, the availability of the federal funds allows states to use available state funds to protect other important programs *not* specifically supported through ARRA.

For example, New York is using some of its savings resulting from the additional federal Medicaid funding to restore aid for New York City, while Virginia is using ARRA Medicaid savings to help address an \$820 million revenue shortfall that otherwise would have resulted in deeper cuts in a range of areas. States also are receiving money for criminal justice, human services, family assistance, child care, and other areas that they can, under some circumstances, use to pay for programs that otherwise would have been cut.

- **Federal aid will continue to play an important role as states — and the national economy — recover.** New York and Virginia, like most other states, expect budget problems to continue at least through 2011, and both states are planning to time the use of federal dollars so that some of the funds will be available for that year (which the federal law allows). This gradual expenditure also will allow the states to adapt to unforeseen circumstances as the economy recovers.

New York and Virginia Using Recovery Funds to Help Close Budget Gaps

New York and Virginia provide useful case studies of the recovery act's impact on state budgets, for several reasons. Their projected budget shortfalls in the latter part of 2008 and early 2009 were very large relative to the size of their budgets. (New York's was one of the nation's largest.) Their governors' proposed budgets, issued *before* Congress enacted ARRA, provide a useful snapshot of what the states might have done in the absence of the recovery act dollars. And, they were among the first states to enact new budgets in the spring of 2009. (A substantial number of states have yet to enact budgets for the upcoming fiscal year.) In both Virginia and New York, recovery act funding is important to closing budget gaps, but it is only part of the solution.

State Fiscal Assistance Intended to Support Public Services and State Economies

Congress included state fiscal assistance in ARRA for two reasons. One reason was that Congress heard extensive evidence from economists and others that helping states close their shortfalls was one of the best ways the federal government could strengthen the economy. Each dollar of federal aid to states, according to Moody's Economy.com, produces \$1.36 in increased economic output — a far bigger “bang-for-the-buck” than most other forms of economic stimulus under consideration, including tax cuts.

The reason is straightforward. When states trim spending, they lay off employees, cancel contracts with vendors, reduce payments to businesses and nonprofits that provide services, and cut benefit payments to individuals. *All* of these steps lower aggregate demand in the economy, which worsens a downturn.

Another reason was the mounting evidence that cuts in important services are harming residents and communities. Massive state budget shortfalls — almost certainly the largest since the Great Depression — already have led roughly three-fourths of the states to cut back on health care, assistance for seniors and people with disabilities, K-12 and higher education, and other services. With the economy worsening, revenues continuing to fall, and more Americans turning to local and state agencies for help, these shortfalls clearly were having dramatic human impacts.

ARRA's two main streams of operating funds to states are:

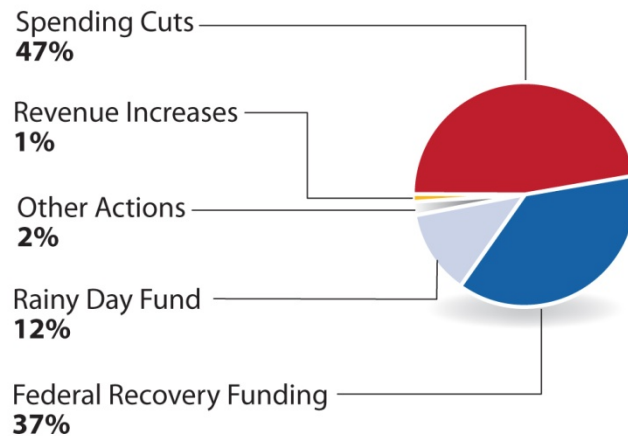
- *An estimated \$87 billion in federal Medicaid funding.* Under the recovery act, the federal government is paying a larger-than-normal share of the Medicaid expenses that states incur from the fourth quarter of 2008 through the end of 2010. The primary purpose of these funds is to address the rising Medicaid costs that come as more people lose employer-provided coverage and qualify for Medicaid.
- *A new \$48 billion State Fiscal Stabilization Fund* administered by the federal Department of Education. Of this amount, \$39.5 billion is to be used for ongoing operating support to public schools, colleges, and universities, mostly replacing state aid that otherwise would likely be cut due to insufficient revenues. The remaining \$8.8 billion is in a flexible block grant that states can use to support general government services.

The recovery act also contains smaller funding sources for states — some of which can help solve their budget problems. Examples include Byrne Grant law enforcement block grants, child care block grants, and grants through the Temporary Assistance to Needy Families program. Under some circumstances, states may use these funds to pay for services they otherwise would have cut, helping address their budget shortfalls.

Other major streams of funding in the recovery act that flow through state governments *cannot* be used to address state operating budget shortfalls. Some are specifically targeted for programs that generally lie outside of the operating budget, such as transportation and unemployment insurance. Others are designed to be passed on to local governments.

FIGURE 1

Federal Recovery Funding Is Closing Almost 40 Percent of Virginia's FY2010 Budget Deficit.



Virginia: Recovery Funds Closing 37 Percent of Budget Shortfall

The recession opened a wide hole in Virginia's budget by shrinking state revenues. When enacted in June 2008, the budget for the 2009-10 biennium (i.e., the two-year period ending June 30, 2010) was in balance. But subsequent estimates showed that the state was unlikely to collect enough revenue to cover budgeted spending. By February 2009, the gap between projected revenues and expenditures had risen to \$4 billion. At roughly 13 percent of the budget, the shortfall was somewhat below the national average but still sizable and difficult to close.

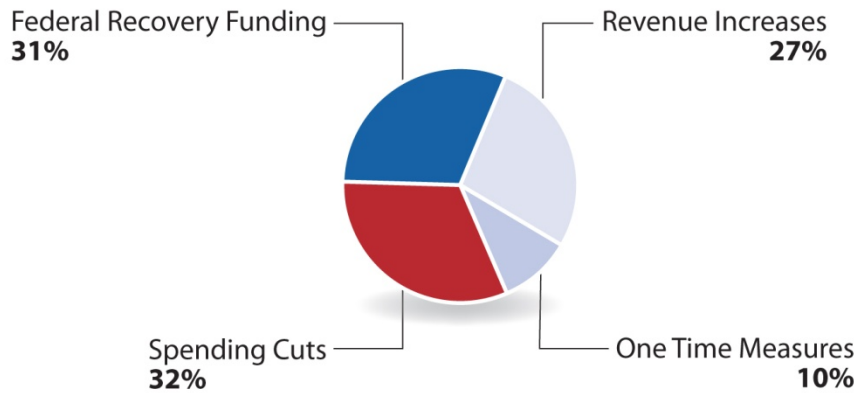
Virginia enacted a revised budget for 2009-10 just a few weeks after passage of the federal recovery act. The updated plan reflects the state's decision to use \$962 million in new federal Medicaid funding, \$491 million from the education portion of the State Fiscal Stabilization Fund, and \$24 million in Byrne Grant funds for law enforcement.

Virginia is closing the remainder of its budget gap with a combination of spending reductions, small revenue increases, and drawing down the state's reserve fund (see Figure 1). Even with the recovery act funding, the state has cut spending substantially: the revised budget is 8 percent below the original budget for 2009-2010 and approximately 7.6 percent below the budget for 2007-2008, despite rising costs and caseloads.

Virginia plans to use approximately 71 percent of the federal Medicaid funding it expects to receive over the lifetime of the recovery act, as well as 50 percent of the education stabilization funding and about 60 percent of its Byrne Grant funding, during the 2009-2010 biennium. Most likely it will use the remainder of the recovery act funds in the next budget period (which begins July 1, 2010), although the state could use some of these funds sooner if budget conditions deteriorate further.

FIGURE 2

Federal Recovery Funding Is Closing Almost One-Third of New York's Budget Deficit for Fiscal Years 2009 and 2010.



New York: Recovery Funds Closing 31 Percent of Budget Shortfall

Prior to ARRA's enactment, New York faced an even more precarious fiscal situation than Virginia. The crisis in the nation's financial services industry — highly important to the state's revenue base — and the broader economic downturn led revenues to decline sharply. New York predicted that without changes to its revenue structure or spending programs, available funds in fiscal year 2010 (the 12-month period beginning April 1, 2009) would fall about \$17.9 billion or 26 percent short of what was needed to balance the budget. In addition, New York's FY2009 budget was projected to be short \$2.2 billion due to declining revenues and rising costs.²

The federal recovery law is providing New York \$6.2 billion in federal funding that it is using to help close its budget gap. This includes \$5 billion in additional federal Medicaid funding, \$876 million in education-related State Fiscal Stabilization Fund money, and \$274 million from the "government services" component of the State Fiscal Stabilization Fund.

To put these numbers in perspective, across two fiscal years (2009 and 2010) federal recovery assistance is closing roughly 31 percent of New York's budget hole. A major tax increase will cover about 27 percent of the shortfall, spending reductions another 32 percent, and such one-time budget maneuvers as fund transfers the remaining 10 percent (see Figure 2).³

² The state budget is defined here as the state's general fund plus funding for the health care reform act, which is a separate component of the state's budget. These figures exclude federal aid.

³ CBPP analysis of New York State Division of Budget data. The budget gap that existed prior to the federal recovery legislation and prior to enactment of the budget bill reflects the gap between projected revenues and the cost of providing current-law services. The cost of services thus reflects such items as rising need for state-financed health care programs and other rising cost factors.

As in Virginia, New York is not planning to use all of its available recovery act funding by the end of fiscal year 2010, instead reserving some for 2011 as the law allows. The state plans to use approximately 60 percent of its increased Medicaid funding, 36 percent of education stabilization funding, and 50 percent of government services stabilization funding in fiscal years 2009 and 2010.

Recovery Act Averting Cuts in Important Services

Virginia: Reversing Proposed Cuts in Health, Education and Public Safety

When Governor Kaine proposed a revised budget for 2009 and 2010, he did not take federal recovery act funding into account because the legislation was far from certain. Instead, he proposed deep spending cuts. A comparison of the governor's proposal with the budget he eventually signed in March 2009 — which *did* reflect the recovery act — suggests the kinds of cuts the legislation allowed the state to avoid. The federal funds:

- *Enabled the state to retain its funding for some 13,000 non-teaching school personnel — such as janitors, psychologists, and administrative assistants — that the governor had proposed eliminating.* The proposed \$341 million cut for local school districts (relative to previously budgeted levels) would have placed additional stress on already strained school district budgets.⁴
- *Allowed the state to reduce its planned cut to state colleges and universities from \$296 million to approximately \$169 million (not taking into account other smaller changes enacted by the legislature), lessening the need for tuition increases.* For example, following release of the governor's budget proposal, the president of Virginia Tech said the university would need to raise tuition by 9 percent, on top of an 11 percent increase implemented in the fall of 2008.⁵ Ultimately, with the help of federal stimulus aid, Virginia Tech held its tuition increase for the coming academic year to 5 percent.⁶
- *Prevented closure of three hospitals and treatment centers serving persons with mental health needs.* Closing these facilities would have entirely eliminated Virginia's public inpatient psychiatric services for children. This raised concerns that the 844 children and adolescents served there might have trouble finding alternative sources of treatment. Opponents of the closures feared that private hospitals might be unable or unwilling to care for the patients with the most severe disabilities. They also raised concerns that some of these patients might end up in juvenile detention facilities for lack of available alternatives.
- *Enabled the state to provide 200 mentally disabled individuals with care outside of an institutional setting.* This funding, which was eliminated in the governor's proposed budget revisions, means that recipients can reside outside of a mental health institution while receiving intensive treatment (such as skilled nursing services) that they would not otherwise be able to afford. More than

⁴ Specifically, the governor proposed cutting a state program that reimburses school districts for a substantial share of the cost of employing key non-teaching personnel. Given Virginia school districts' own budget problems, it is likely that all or most of those positions would be eliminated without the state funds.

⁵ Warren Fiske, "College Presidents: Tuition Will Increase With State Cuts," *The Virginian-Pilot*, January 22, 2009

⁶ Larry Hincker, "Board of Visitors Sets Tuition and Fees for 2009-10," *Virginia Tech News*, April 23, 2009.

4,200 people are on a waiting list for this funding, according to the Department of Mental Health.

- *Prevented a 3 percent cut in inpatient hospital reimbursement rates relative to previously budgeted levels.* The proposed cut would have reduced revenue to the state's nonprofit hospitals at a time when many are likely to face budget problems of their own — potentially leading to staff layoffs or cutbacks in patient care.
- *Averted a proposed cut in aid to local sheriffs' departments.* The Virginia Sheriffs' Association had warned that the cut would have forced the elimination of 310 deputy sheriffs' positions.

The legislature likely would have approved the governor's proposed cuts had recovery act funding not been available. In fact, there is good reason to think it would have gone even further. Between December 2008 (when the governor outlined his proposals) and March 2009, the Virginia revenue forecast was revised downward even further by over \$800 million. The legislature also rejected the governor's proposal to raise the cigarette tax. Thus, the federal recovery funding helped to avert not only the governor's proposed cuts, but also the additional cuts that would have resulted from the further decline in the revenue forecast and the legislature's decision not to raise the cigarette tax.

New York: Reversing Proposed Cuts to Education, Other Core Services

Governor Paterson, like his counterpart in Virginia, issued his budget proposal in December 2008, before the recovery act was enacted, so it did not reflect the additional federal dollars. As in Virginia, a comparison of the proposed December budget with the final budget signed in March suggests the impact of the recovery act funds. The funds:

- *Contributed \$750 million to pay for anticipated increases in Medicaid costs in fiscal years 2009 and 2010.* The state's Medicaid enrollment is projected to grow by 3.7 percent between fiscal years 2008 and 2009 and 7.9 percent between 2009 and 2010. (Medicaid is a countercyclical program, designed so rolls can increase when people lose jobs, health insurance, and income.) The state had not anticipated such levels of increase at the time the governor submitted his original budget.
- *Averted \$1 billion in planned health care cuts.* The governor had proposed deep cuts to state reimbursements for hospitals and nursing homes that serve Medicaid patients. He also had proposed eliminating state funding to help seniors with limited incomes to purchase drugs that Medicare Part D does not cover.
- *Allowed the state to reduce its share of spending on health care relative to the federal share and use the resulting savings to fill holes in other areas of the budget.* By this means, New York reduced by \$1.3 billion the revenue increases the governor had advocated for fiscal year 2010. These included proposed taxes on non-diet soft drinks and digital downloads, as well as the imposition of sales taxes on an array of items.
- *Prevented several proposed cuts to human services, mental health, and other programs.* Using \$164 million of the added federal Medicaid funds, New York is cancelling several proposed reductions in human services and related areas. These included planned cuts of between \$16 and \$28 in

monthly Supplementary Security Income (SSI) payments to low-income residents who are elderly, blind, or have disabilities.

- *Averted the proposed elimination of \$328 million in aid for New York City.* New York City is facing its own considerable fiscal challenges, and Mayor Bloomberg recently released an austere budget proposal that includes more than 3,700 layoffs.⁷ The elimination of state municipal aid would likely have resulted in further layoffs and program cuts.
- *Reversed a sweeping cut to K-12 education aid for the 2009-2010 school year.* Governor Paterson had called for a \$1.1 billion reduction in state K-12 education aid. Faced with declining state revenues and growing expenses, school districts would have had little choice but to cut positions, salaries, and programs or raise property taxes more than they already are. The federal recovery funds allowed New York to undo the proposed cut.⁸
- *Averted proposed cuts to community college funding.* New York used \$39 million in education stabilization aid to avoid the cuts, reducing the need for tuition increases and program and staff cuts.
- *Helped the state avoid a number of the governor's other proposed cuts, primarily in K-12 and higher education.* The "government services" stabilization funding in the recovery act enabled the state to avoid proposals to shift some pre-school special education costs to local school districts and to cut professional development resources for teachers.
- *Averted proposed eligibility restrictions for a college tuition assistance program for low- and moderate-income New York residents.* The program helps these students afford in-state colleges or universities.

As in Virginia, most or all of the governor's proposed cuts would likely have become law had it not been for the federal funding. Like Virginia, New York received new revenue estimates in early 2009 indicating the 2009 and 2010 budget gaps were even worse than the governor's budget had assumed, meaning that the governor's proposals — severe as they were — would have been insufficient to balance the budget. The federal recovery funds thus helped to avert not only many of the governor's proposed cuts, but also likely additional cuts.

Other States Making Similar Use of Federal Recovery Funds

Other states, as well, have used ARRA funds to help close their budget shortfalls, significantly reducing the extent of cuts to state services. Available data suggest that these other states, like Virginia and New York, are using federal stimulus funding to close 30 to 40 percent of their budget gaps for the current fiscal year, the coming fiscal year, or both. These states include Connecticut (where the federal aid is closing about one-third of the projected shortfall for fiscal year 2009, and is likely to help close shortfall in 2010 as well), Georgia (40 percent of the gap in fiscal year 2010),

⁷ New York City Office of Management and Budget.

⁸ The federal aid was insufficient, however, for the state to fully fund its foundation education formula which had been enacted in 2007 to address a court decision that the state had failed to meet its legal obligation to ensure adequate education funding for all children.

Maryland (38 percent of the combined 2009 and 2010 gap), Utah (39 percent of the 2010 gap), and Washington (33 percent of the combined 2009-2011 gap).⁹

In addition, anecdotal evidence from other states suggests that they, like New York and Virginia, are using the federal aid to avert planned cuts in public services. For example:

- **Arizona** used \$20 million in stimulus money to reverse cuts to child care subsidies for low-income families. The cuts were scheduled to take effect this spring and ultimately would have affected 20,000 children.
- **Georgia** reversed scheduled cuts in funding to school districts.
- **Maryland** reversed a number of proposed cuts to K-12 schools and community colleges, avoided 700 proposed layoffs, and funded anticipated cost growth in the state's Medicaid and energy assistance programs, among other measures.
- **South Carolina**, in order to qualify for the federal Medicaid assistance under ARRA, reversed cuts it had made to restrict eligibility and access to Medicaid services.¹⁰ Most notably, the state is reversing tighter income requirements that would have caused an estimated 3,700 elderly and disabled people to lose coverage.
- **Utah** mitigated planned cuts to K-12 and higher education, among other areas.

Conclusion

Just a few months after enactment of the American Recovery and Reinvestment Act, federal fiscal assistance for state governments has begun to have its intended impacts. It has enabled states to close their large budget shortfalls with smaller cuts in education, health care, and other important services than would have occurred had the federal government not provided this assistance. This, in turn, has helped preserve many key programs that serve states' most vulnerable residents. It also has lessened the damage to state economies that comes when states sharply reduce spending in a recession. In short, federal assistance has helped change the state budget equation for the better.

⁹ These figures come from legislative fiscal analyses and independent budget experts in each of the states.

¹⁰ To receive the added federal Medicaid funding under ARRA, states must (among other things) not have Medicaid eligibility levels that are more restrictive than were in effect on July 1, 2008.