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What the CBO's Latest Predictions Mean for States and Localities.

The Congressional Budget Office expects the economy to grow at an even slower rate than it has in the past.

For those who have wondered whether we've reached a "new normal," or whether these years of slow economic growth are just a blip on the radar, the Congressional Budget Office (CBO) has officially called it. Its new economic and budget outlook contains a sobering prognosis: Get comfortable because the nation's economic output won't pick up any time soon.

This week's CBO report anticipates that output will grow slower than it has in the past, to a little more than 2 percent each year thanks in part to slow growth in the labor market. The predicted long-term growth rate reflects a 1 percent drop from the CBO's last projection in August when forecasters still thought that the economy had not rebounded to its full potential, said CBO Director Douglas Elmendorf. "For some time, that seemed like a reasonable expectation because productivity usually falls when the economy is weak," Elmendorf said at a briefing Monday. "It's hard to know how much of what's been going on over these half-dozen years is just because the economy is weak or how much of it is the underlying structural conditions we face. The persistent slow growth in a growing economy suggests more of that is due to a structural versus cyclical [weakness]."

State budgets have reflected that weakness. Accounting for inflation, this fiscal year's total general fund spending of $748 billion is still 2 percent below the pre-recession peak, according to the National Association of State Budget Officers (NASBO). Even not accounting for inflation, this year's 3.1 percent spending increase over 2014 is far below the 5.5 percent year-over-year average recorded over the 37 years NASBO has been conducting its budget survey.

On the national level, federal revenues are expected to match this weakness and not keep pace with expenditures. The CBO has lowered its revenue estimates for future years, and forecasters say it will take less than 25 years for the federal debt burden to equal the nation's annual GDP. The last time federal debt soared to those levels was just after World War II. But rather than dealing with the one-time spending spike of paying for a war, this era's spending spree has a more permanent flavor with Social Security and Medicare payments being among the biggest cost drivers as baby boomers retire. Spending on those two programs is expected to nearly double over the next decade. Meanwhile non-defense discretionary spending, which goes to state needs like law enforcement, transportation, education grants, veterans' health care and environmental protection, is expected to only inch along by comparison, growing 18 percent by 2025.

So what does all this mean for state and local governments as the 114th session of Congress kicks off? It places a higher priority than ever on states to ensure their own financial sustainability. "Clearly the federal government will be less responsible for things at the state and local level," said Matt Fabian, a partner at the research firm Municipal Market Analytics. "The policy stage is shifting toward the states and that's where the meaningful work gets done."

That said, Capitol Hill observers believe Congress could take action in a few key areas, including the Marketplace Fairness Act (MFA). The bill, which taxes Internet sales, passed the Senate last session but died in the House of Representatives. It's expected to get another hearing this session. House Speaker John Boehner is pushing an alternate idea that would tax Internet purchases at the sales tax rate in the seller's home state instead of the buyer's, as the MFA does. The National Conference of State Legislatures has already fired off a blistery letter to the Speaker, panning the idea as "unclear, unconstitutional [and] riddled with loopholes." But at a minimum, the idea of taxing Internet sales will get far more airtime in the House this session.

A second area where progress is expected is in infrastructure bonds. In his State of the Union speech, President Obama proposed so-called qualified public infrastructure bonds, which are essentially a new type of tax-exempt municipal bond that would help finance public-private infrastructure projects. The idea to use tax incentives as a way of encouraging more private investment is popular with market participants and Republicans, who now control both houses on Capitol Hill. More private investment in public infrastructure projects means that governments would be sharing the financial risk of those projects, an appealing notion in times of fiscal austerity.

Sadly for state and local governments, the federal government's growing financial inflexibility also means that calls for so-called flexible federalism, the idea that the federal government shouldn't fix its own problems on the backs of the states, will likely go unheeded. The flexible federalism agenda is a perennial one from the National Governors Association and includes requests like reauthorizing the federal Workforce Investment Act and restoring the 15 percent set-aside dedicated to state workforce innovation. In fact, says Municipal Market Analytics' Fabian, quite the opposite is in store unless Congress makes a policy shift. "Look for an increase in unfunded mandates. States will have to look at ways to raise more money because, increasingly, they're on their own. That's the message."

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