Bond Case Briefs

Municipal Finance Law Since 1971

Why Federal Aid Remains a Tough Sell for States and Localities.

President Trump remains opposed to a bailout for “poorly run states.” The administration may end up agreeing to help, but warnings about dire spending cuts have not yet prompted action.

President Trump is not sold on the idea of helping states, cities and counties. In recent days, administration officials negotiating with congressional Democrats have apparently agreed to offer as much as $150 billion in state and local aid as part of the next coronavirus relief bill, but the president himself says it would be a bad idea to bail out “poorly run states.”

“We can’t go along with the bailout money,” Trump said during a White House news conference on Wednesday. “We’re not going to go along with that, especially since it’s not COVID-related.”

Since the pandemic began, Republicans have been skeptical about federal aid for states and localities. In April, Senate Majority Leader Mitch McConnell floated the idea of letting states go bankrupt instead. The American Legislative Exchange Council has organized a letter-writing campaign among hundreds of legislators concerned about the federal deficit and other potential harms from a bailout.

The bipartisan associations that represent state and local officials assume that this has all been political posturing. Federal-level Republicans may not agree to the $1 trillion in aid sought by congressional Democrats, but the expectation ever since the spring has been that eventually the two sides would meet halfway. That’s still not a bad bet.

Estimates vary, but states and localities may end up collectively falling about $500 billion short of revenue projections over the next couple of fiscal years. A half-trillion dollars – the midpoint between the Democrats’ $1 trillion and the GOP’s zero – would stave off major economic damage, says Dan White, director of government consulting at Moody’s Analytics, an economic research group.

“$500 billion is not a bad place,” White says. “Quite frankly, I would be shocked if we don’t end up somewhere around this point.”

Economists almost universally agree that direct aid to states and localities is one of the best tools the federal government has at its disposal to avoid a weak recovery or a dip back into recession. States and localities employ about one out of seven American workers. Every federal dollar sent their way contributes at least $1.30 to the economy.

“Federal aid to state and local governments has not been in question in prior recessions,” says Chris Hoene, executive director of the California Budget & Policy Center, a nonprofit watchdog group. “The surprise here is that there’s even a debate about whether there should be additional aid to state and local governments when there’s so clearly a need.”

States and localities have failed to convince their colleagues in Washington that they represent not just a good but necessary investment. Politically, they've presented a less sympathetic face than others seeking assistance, including schools, small businesses and unemployed individuals. Some of this may be due to "anti-government feeling," says Laura Curran, the Nassau County, N.Y., executive.

"Numbers are important, but behind the numbers are actual people and actual services being provided to people," she says. "What's lost is the human element – the contact tracing and the ambulances and the medics and the EMTs and all of the first responders."

Curran says she "shudders to think" what kind of cuts she'll have to make if federal aid is ultimately denied. The longer the negotiations in Washington drag out, the more nervous state and local officials are getting. They know that their revenue pictures are only going to grow worse.

On Wednesday, Maine Gov. Janet Mills directed state agencies to come up with 10 percent budget reduction plans. That's a lower percentage drop than some other governors are imposing.

"We're expecting states to have to go back and make adjustments to their fiscal 2021 budgets," says Brian Sigritz, director of state fiscal studies at the National Association of State Budget Officers. "We're hearing that fiscal 2022 is likely to be as difficult, or more difficult, than 2021."

Why Resistance Remains Strong

An earlier aid package enacted in March, the CARES Act, provided $150 billion for state and local governments. McConnell and some other officials are unhappy that states and localities are asking for more money when they haven't spent all of the CARES funding yet.

The Treasury Department has given states and localities some wiggle room, but there are still issues with how freely the CARES money can be spent. It was originally intended for expenses directly related to the coronavirus, not backfilling budget holes. For the most part, unspent sums are being held for anticipated expenses.

"That money is already spoken for," says Tracy Gordon, a public finance expert at the Urban Institute. "You can't spend the same dollar twice."

There's also a boy who cried wolf complaint. State and local revenues have yet to take a beating that's been as serious as their initial fears. To a large extent, that's because as late as July 15, they were still collecting taxes based on pre-pandemic income from 2019. Property taxes, of course, have not taken the kind of immediate hit that sales taxes have.

That doesn't mean things won't get worse. Tax revenues are always a lagging indicator, taking time to be affected as the economy slows. "I think the real pain you're going to see in a lot of states is at the end of this year and the start of 2021, when you start seeing the income earned in 2020 reflected," says White, the Moody's analyst.

State and local officials are worried about the economy continuing to stall, or even reverse. The general economy has been propped up by the $2 trillion CARES Act, but its extra money for unemployment benefits and small business aid has run dry.

"There's this coming economic cliff that could have a huge impact on future revenue projections," Hoene says.

Not Just Partisan Opposition

The question of aid for state and local governments has become a partisan question, with Democrats and Republicans by and large lined up on opposite sides. But there are other forms of political resistance making federal relief uncertain.

During the debate over stimulus back in 2009, members of Congress were reluctant to send money out to other levels of government to spend. It's just human nature. No one likes handing over their checkbook for other people to spend money. "Members of Congress push back," Gordon says. "We raise the revenue and governors get to spend it."

In the end, state and local spending under the 2009 American Recovery and Reinvestment Act was closely monitored by the federal government. The feds set up a reporting system, with each state designating an official who participated in weekly calls with the Office of Management and Budget. President Barack Obama called Joe Biden, then his vice president and about to be anointed the Democratic nominee against Trump, as "the sheriff" overseeing the effort.

It may be more difficult to imagine such a cooperative effort taking place now. There have been moments of overt hostility between Trump and various Democratic governors recently, with constant friction over the years – including numerous lawsuits – between blue states and the administration.

But if federal policymakers don't trust states and localities to spend the money wisely, they could send out money based on formulas – such as an increase in the Medicaid matching rate – while also demanding longer-term looks at issues such as pensions and "guardrails" against frivolous spending.

Counties are looking for help for the coronavirus response, not money to build new courthouses, says Boone County, Ky., Judge-Executive Gary Moore, the new president of the National Association of Counties (NACo).

"We hear the stories that local governments might actually increase their revenues over last year's budget," he says. "We're not advocating for that. We're advocating for oversight."

A Drag on the Economy

Rather than spending more, states and localities are looking at places they can cut. Most states had to draft budgets for the fiscal year that started July 1 without knowing what their 2019 income tax collections would look like or whether federal aid would be forthcoming. "Many are placeholder budgets, that explicitly say there's too much uncertainty, so we're going to pass a continuing resolution or include magic asterisks," says Gordon, of the Urban Institute.

The most prominent example of the latter is California. Its budget includes dramatic cuts that will occur automatically if $14 billion in flexible federal aid is not forthcoming by Oct. 15. It's not clear what the cuts will look like if there's less federal aid than hoped for, but the scheduled cuts include $7 billion from K-12 and higher education and $2 billion from employee compensation, with smaller cuts to courts and the like.

California began the year expecting to run a $7 billion surplus. Instead, it ended up facing a $54 billion shortfall. In contrast to the president's complaints about mismanagement, the state entered the pandemic in sound financial shape. Its enacted budget includes $9 billion drawn from reserves. "I would say that we certainly went into this recession, even as surprising and rapid as it came about, much better prepared than in prior recessions, particularly the Great Recession," Hoene says.

California's budget illustrates the kinds of cuts that will occur if federal aid is not provided to states and localities. Two-thirds of state and local budgets are spent on education, health and social services. To achieve substantial savings, that's what they'll have to cut.

Many of those programs are, in fact, federal programs that the states and localities carry out. The fact that governments act in many ways as pass-throughs makes them less sympathetic, politically, than stand-alone entities such as schools and hospitals. “People can visualize what it means, not having a teacher or not having police,” Gordon says. “It’s tangible. But state and local governments, they’re just something in the background.”

Sending aid to states and localities is a way to send money into every corner of the country. Failure to do so will not only hurt those governments, but the larger economy. The capital projects being put on hold all over mean vendors aren’t being hired. “Yes, counties have their own employees, but typically private sector contractors are doing the job for us,” says Matt Chase, NACo’s executive director.

States and localities have shed 1.2 million jobs since February. Friday’s job report showed some improvement, but absent federal aid, it could take years to recover those lost workers.

It’s the lesson from the last recession that’s potentially being forgotten, when state and local governments acted as a drag on the economy. Balanced budget requirements mean those governments, absent outside revenues, have to cut spending or increase taxes just at the time the economy is already hurting.

“They’re actually amplifying the business cycle and making it worse,” White says. “It’s one of the significant reasons why the Great Recession was followed by the not-so-great recovery.”

GOVERNING.COM

ALAN GREENBLATT, SENIOR STAFF WRITER | AUGUST 7, 2020