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Stimulus Solves Most - But Not All - State and Local Budget Problems.

Billions in new federal funding come with some strings attached. Nevertheless, the sheer amount will be enough to erase budget shortfalls in states and cities across the country.

Pittsburgh ran through $120 million in reserve funds last year and yet still faces a shortfall. The city has been planning to lay off 633 workers at the start of its fiscal year in July, or more than one out of six of its employees.

But suddenly, those workers no longer have to worry about their jobs. Pittsburgh stands to receive more than $300 million in direct federal aid, as part of the $1.9 trillion stimulus package President Biden signed yesterday.

"These funds will help us avoid layoffs and will also allow us to fill the revenue gaps the pandemic created last year and this year," says Kevin Pawlos, Pittsburgh's budget director. "It will also allow us to restore vacant positions and programs that were removed from our 2021 budget."

Similar stories are now being told all over the country. Almost overnight, budget shortfalls accumulated over the past year are being eliminated, thanks to the federal largesse. The stimulus includes $350 billion in direct aid to states and localities — $195 billion for states and $130 billion for local governments, with the rest going to territories and tribal governments.

"It allows us to offset some of our major revenue losses in a way that the CARES Act did not," says Jeff Aluotto, the county administrator in Hamilton County, Ohio, referring to the first major federal stimulus package enacted a year ago. "It will permit us to provide ongoing support to those areas of the community most devastated by the pandemic."

State and local officials begged Washington most of last year for fiscal help, to little avail. By now, however, their revenues have rebounded much faster than expected, particularly at the state level, leading some to wonder whether this isn't a case of too much, too late. For some states, the windfall will equal more than 20 percent of their 2020 operating revenues.

The "worst since the Depression" cash crisis in states that was predicted last year ultimately did not materialize. Overall, state revenues fell by less than 2 percent between April and December, compared with the same period in 2019, according to the Urban-Brookings Tax Policy Center.

Expenses shot up due to the pandemic and unemployment, so states and localities did get a real fiscal shock. But once previous rounds of federal aid are factored in, they ended up only $56 billion in the hole from fiscal 2020 to fiscal 2022, according to a recent estimate by Moody's Analytics.

"You're talking roughly $300 billion more than necessary to keep the lights on and not lay people off," says Dan White, director of government consulting and public finance research at Moody's Analytics. "It's definitely big enough. It's probably more than big enough."

The intent wasn't just to make states and localities whole, however. As with the rest of the package, the hope is that the sudden gusher of federal funds will help stimulate the broader economy. "This is going to be an injection, a shot in the arm that's very good for states," says David Brunori, a public finance expert at George Washington University. He thinks the amount was probably excessive. That said, he notes that "the money will be welcome and will be spent and will be a boost to the economy."

State and local officials still have to be careful about how they spend the money. It's more than enough to fill general fund budget holes in most cases, but lawmakers can't get giddy and take on ongoing expenses they won't be able to afford once the federal dollars run out. Few people would bet on another round of relief of this magnitude.

"This is not by any means a silver bullet to solve our budgetary problems long-term," says Chris Cate, who chairs the San Diego city council's budget committee. "The fear that I have is that if we use this money now, without addressing any structural issues that we have, next year we won't be in the same financial position in terms of federal help, so we're still facing deficits."

Tourism and Energy States Hit Hard

Although state revenues have recovered pretty well in general, there are plenty of states still struggling, including major states without income taxes such as Texas and Florida. Particularly hard hit are those that rely heavily on tourism, such as Nevada and Hawaii, or on energy, such as Alaska and North Dakota. Or both, as in the case of Louisiana.

"We saw tourism fall out from under us," says Della Au Belatti, majority leader of the Hawaii House. "We cannot have a vibrant economy here without some form of tourism."

There are also continuing worries at the local level. "There is a chance that business districts or large sporting events may not be as well attended as before," says Pawlos of Pittsburgh. "It will affect some of our major revenue sources moving forward if that occurs."

Although the amount of federal money may exceed what's necessary for a lot of states, politically it would have been impossible to target funds only where help was needed most. Biden and Congress erred on the side of being generous, says Kim Rueben of the Urban Institute, to ensure other levels of government can do whatever's necessary to address the pandemic and the economy.

There's also an emphasis on speed. As vice president in 2009, Biden oversaw state and local spending included in that year's package. Transparency and watching out for wasted funds were public commitments from the Obama administration, with Biden acting as "sheriff," as President Barack Obama called him.

The current stimulus will certainly require reporting, but given that most of the funding is undirected, the feds shouldn't be looking over state and local shoulders as much. They want states, cities and counties to avoid cuts and keep spending. Those with long memories will recall that state and local spending and job cuts slowed the nation's overall recovery following the Great Recession.

"I think President Biden is aware of some of the lessons we learned in the last recession," Rueben says. "For example, having too many restrictions on how the money could be spent and having to report back in ways that led to delays in spending the money."

In addition to the $350 billion in direct aid, the new stimulus includes lots of other money that should help take pressure off state and local budgets. There's $40 billion more for higher education, $30 billion for mass transit and more than $30 billion for housing and rental assistance programs.

States and localities will have until the end of 2024 to spend the direct aid. In the case of local funds, half the funding will be made available within 60 days, with the second half provided 12 months later. “Given the 2024 end date, it will give us the opportunity to be more strategic in using these dollars to promote the long-term recovery and resiliency of our community,” says Hamilton County’s Aluotto.

Terms and Conditions Do Apply

There are some restrictions on how direct aid can be spent. Most notably, federal money can’t be used to shore up pension funds and can’t go toward tax cuts.

That’s going to cause some problems for states. The stimulus law itself exempts the first $10,200 worth of unemployment benefits from income taxes, retroactive to last year. States that want to change their laws to match that relief may not be able to do so, without facing a potential clawback of federal funds. “There have been a lot of proposals to provide relief for unemployment benefits,” says Belatti, the Hawaii legislator. “That is now off the table.”

Other tax cuts may come under question. In Hawaii, the state’s earned-income tax credit will sunset this year. It would almost certainly have been extended, but now its fate is uncertain. “The way we’re reading it, the states cannot pass anything that provides a tax cut or tax relief,” Belatti says.

There are bound to be some unexpected pitfalls as well. The bigger question facing state and local officials, however, is how they’ll choose to spend all the money now coming their way. They shouldn’t bake too much additional spending into their budgets, warns White, the Moody’s Analytics director. Since they’re getting what amounts to a one-time influx of funds, it might make sense to pay for one-time expenses, he suggests, such as infrastructure projects, including broadband.

But with shortfalls suddenly erased, there will be a lot of demand to spend money for ongoing expenses, notably salaries. “We’re in the middle of negotiations with our six employee unions,” says Cate, the San Diego council member. “We have to be very careful and tread lightly.”

The stimulus package includes hefty incentives to try to convince the 12 states that haven’t expanded Medicaid under the Obama-era Affordable Care Act that it’s finally time to do so. Leaders of those states have long argued that expanding Medicaid will expose them to increased costs. The new law makes that argument harder to sustain. “If all 12 non-expansion states accept the incentives, each will net an estimated nearly $10 billion, after their new Medicaid costs,” according to Moody’s Investors Service.

No congressional Republican supported the stimulus package. A good number of state-level Republicans were opposed also, finding its price tag excessive. Still, it’s unlikely that any GOP governors will turn down the federal money, as some talked about doing after the 2009 stimulus passed. Even some legislators who opposed the stimulus recognize that it will make their jobs easier.

“Today, our reserve funds are full and we’ve got a projected ending balance of $433 million for fiscal year 2021,” says Tim Kraayenbrink, who chairs the Iowa Senate Appropriations Committee.

That doesn’t mean Iowa will reject federal aid.

“While I’m not sure we need the additional federal money being sent to us by Congress,” Kraayenbrink says, “we will certainly put it to good use helping Iowa families as we all work to recover from this global pandemic.”

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