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## **Analyzing The Fiscal Impact Of Federal Economic Stimulus Package On California**

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### **Introduction**

The Legislative Analyst’s Office and the California Budget Project have just released reports on how the federal economic stimulus legislation will impact California. By April 1 the Department of Finance and the State Treasurer must decide whether or not the federal funding reaches the \$10 billion “trigger” included in the February state budget package so the state can avoid additional budget cuts and tax increases.

Preliminary analyses by the Department of Finance and LAO have determined that the federal funding will not be sufficient to meet this \$10 billion threshold, however, an analysis by the California Budget Project found that the state will in fact meet this threshold.

Budget watchers are focused on the federal stimulus because it is estimated to bring in more than \$31 billion for the state of California over the next three budget years—which represents nearly a third of annual General Fund spending. Much of this money can be used to balance the state budget by backing out General Fund dollars.

The American Recovery and Reinvestment Act of 2009 (“Stimulus Bill”) was signed into law by President Barack Obama on February 17, 2009. The Act, which spends a total of \$787 billion nationwide, is intended to provide a stimulus to the U.S. economy in the wake of the economic downturn created by the subprime mortgage crisis and resulting credit crunch.

The Act includes a variety of provisions including federal tax cuts, expansion of unemployment benefits, and domestic spending and aid to the states in the areas of education, welfare, health care, infrastructure, and the energy sector. The package is much larger than the Economic Stimulus Act of 2008, which consisted primarily of tax rebate checks.

The Act did not garner a single Republican vote in the U.S. House of Representatives and only obtained three Republican votes in the U.S. Senate.

Republicans charged that the Act was being billed as a “stimulus package” but was just another big government spending bill that provided welfare checks to the states, among other things. Many Republicans believe that the Act only serves to grow the size of government and will do little or nothing to stimulate the economy.

This report illustrates that much of the spending is for government programs but it does include significant funding for Republican “stimulus” priorities, namely infrastructure projects and tax cuts.

Economists such as Martin Feldstein, Daron Acemoglu, National Economic Council director Larry Summers and Nobel Memorial Prize in Economic Sciences winners Joseph Stiglitz and Paul Krugman favor a large federal economic stimulus package to counter the economic downturn. Some economists, such as Stiglitz and Krugman, say this Act was not large enough and call for a much larger economic stimulus package.

Economists, as well as the U.S. Congress, were divided on what should go into the stimulus, which is why the stimulus ended up spending money in an array of different program areas.

In a February 11 letter, Congressional Budget Office (CBO) director Douglas Elmendorf, noted that there was disagreement among economists about the effectiveness of the stimulus, with some skeptical of any significant effects while others expecting very large effects. Elmendorf said the CBO expected short term increases in gross domestic product (GDP) and employment but in the long term the CBO expects the legislation to reduce

output slightly by increasing the nation's debt and crowding out private investment, states the letter.

On the other hand, other factors such as improvements to roads and highways and increased spending for basic research and education may offset the decrease in output and that crowding out was not an issue in the short term because private investment was already decreasing in response to decreased demand.

The CBO estimates that the Act will increase employment by 0.8 million to 2.3 million by the end of 2009, an increase of 1.2 million to 3.6 million by the end of 2010, and an increase of 0.6 million to 1.9 million by the end of 2011, and declining increases in subsequent years as the U.S. labor market reaches nearly full employment.

With that said, in the longer term it is important for California examine the larger policy questions:

- Does the stimulus bring economic growth and new jobs to California?
- What is the impact of this package on our states in terms of new jobs and what is the expected multiplier effect on the California economy?
- How will the stimulus not only help the public sector out of a deep budget crisis but how will it help the state economy?
- What sectors of the economy will benefit most?
- What areas of the state will be in the best position to draw down the various grant funds included in the stimulus?
- Who are the expected winners in this package and what should the state be doing to maximize the positive effect of the stimulus on the California economy, not just benefit the public sector?

This impact analysis is beyond the scope of this first overview but KC Fiscal Focus will be examining these questions in future issues and stands ready to help our subscribers examine how to maximize the potential and beneficial impact of this new federal legislation on California communities.

### **Overview Of Stimulus Package**

On February 17, 2009 President Barack Obama signed the American Recovery and Reinvestment Act (ARRA)—which commits a total of \$787 billion nationwide. In general terms, this money is allocated as follows:

- \$330 billion in aid to the states
- \$170 billion for various federal projects and assistance for other non-state programs
- \$287 billion for tax relief

(Source: Legislative Analysts' Office, LAO)

The portion allocated for state aid to California consists of three pieces:

Federal dollars that can be used to address state budget shortfalls  
 Funds that supplement existing state spending  
 Competitive Grants

The LAO finds that approximately \$10.4 billion of the \$31 billion in aid to California will be available to address the state’s budgetary problems over the life of ARRA. Some \$8 billion would be available in the current year, 2008-09 and budget year 2009-10.

The Director of Finance and State Treasurer will make their own estimates by April 1 of this year to determine if the “trigger” included in the 2009-10 budget agreement is pulled. According to this “trigger,” if the amount is less than \$10 billion, then annual state program reductions of nearly \$1 billion and revenues increases of about \$1.8 billion will go into effect.

Refer to the following pages for the significant aspects of the ARRA by program area.

### Summary of California Aid By Program Area

California Will Receive Over \$31 Billion in State Aid				
<i>(In Millions)</i>				
Program Area	Federal Fiscal Year			Totals
	2008-09	2009-10	2010-11	
Health	\$3,986	\$4,026	\$1,024	\$9,036
Education	—	7,973	—	7,973
Labor and workforce development	3,498	2,420	79	5,997
Social Services	1,500	1,441	577	3,518
Transportation	1,302	1,302	—	2,604
General purpose fiscal stabilization	—	1,100	—	1,100
Resources/environmental	597	—	—	597
Housing programs	381	—	—	381
Criminal justice	264	—	—	264
Other	27	—	—	27
<b>Totals<sup>a</sup></b>	<b>\$11,555</b>	<b>\$18,262</b>	<b>\$1,680</b>	<b>\$31,497</b>

<sup>a</sup> Does not include significant additional federal funds the state is likely to receive from competitive grants.

Source: LAO

### LAO Urges Legislature to Act Quickly In Some Cases To Secure Federal Dollars

In a March 10 analysis, the LAO states that the Legislature will need to take many actions in the coming month to ensure that it maximizes the state’s share of federal funding and to ensure that the funds are used in ways that meet its priorities.

**Medi-Cal Law Changes Required:** “In order to claim the full amount of additional federal funding for Medicaid—Medi-Cal in California—policymakers must reinstate annual eligibility renewals for children in Medi-Cal and ensure that this change takes effect before July 1, 2000,” states a brief by the California Budget Project. The state would lose an estimated \$3.7 billion if it misses this deadline and even more federal funding for each quarter that it delays, states the brief.

**List of “Shovel-Ready” Drinking Water Projects Needed:** To access the \$160 million in federal funding available to the state for the Safe Drinking Water State Revolving Fund (SDWSRF), the state must produce a list of “shovel-ready” drinking water projects that can begin construction before February 17, 2010. The state Department of Public Health (DPH) is currently working on complying with this, according to the LAO report.

**Spend It Or Lose It Transportation Dollars:** The ARRA allocates \$1.7 billion to the State Department of Transportation (Caltrans) for state transportation programs and projects but the state must be ready to obligate at least half of this money by July 2009. All of this funding must be obligated within one year—March 2010. If Caltrans fails to meet this requirement, one-half of the funds will be taken back and redistributed to other states who have met this deadline.

**Maximizing State’s High-Speed Rail Dollars:** The state could increase its chances of getting a portion of the \$8 billion in federal funding to support the development of its High-Speed Rail line if it weighs in on the development a strategic plan which is currently being developed by the U.S. Transportation Secretary. The money will be allocated through a competitive process and the state has two specific advantages that could be used to tilt the process in our favor, namely California’s system calls for trains that can reach speeds of more than 200 miles an hour—a faster speed than systems proposed in other states. Second, with the passage of Prop. 1A in 2008, the state has substantial state funding to match federal funding, which other states may not be able to provide. The LAO report suggests lobbying the U.S. Transportation Secretary’s office to give preference to these two project characteristics to increase the funding allocated to California.

Given the deteriorating economic situation, the LAO recommends that the Legislature take action to maximize the use of stimulus dollars to offset General Fund expenditures. It cautions that the funding is temporary and should only be expected to pay for programs on a one-time or temporary basis.

## **Education**

California will receive almost \$5 billion to support K-12 and higher education. This money will be primarily used to mitigate K-12 and higher education cuts. The state must follow specific rules for allocating this funding.

Nationwide, the ARRA provides \$54 billion for state fiscal stabilization and allocates the money based on states’ school-age and total population. Some 82% of this funding will

go to support education with the remaining set aside for other government services, according to the LAO.

Summary of ARRA's significant education funding for California:

- \$4.9 billion to mitigate K-12 and higher education cuts
- \$1.5 billion in Title I funding for supplemental services for low-income students and support for low-performing schools
- \$1.27 billion for supplemental services for special education students
- \$220 million for child care and development block grant for child care for low-income families
- \$18 million for school districts' efforts to educate homeless youth
- \$10 million for assistance to high-need districts in purchasing meal-related equipment to improve child nutrition

**Higher Education:** The federal stimulus package replaces the Hope higher education tax credit with the American Opportunity tax credit, which is larger and available to more students. The federal Hope tax credit reimburses eligible students for the enrollment fees they pay for college.

The ARRA also increases the maximum Pell Grant from \$4,731 in 2008-09 to \$5,350 in 2009-10 and expands eligibility for the program. The federal Pell Grant program provides grants to low-income undergraduate students to help them with the costs of attending college. The LAO estimates that California public colleges and universities will receive an additional \$500 million in additional Pell Grant funding in 2009-10.

## Health

The LAO notes that one of the largest portions of federal fiscal relief to the states will come in the form of an increased federal share of costs for state Medicaid programs, known as Medi-Cal in California.

The ARRA temporarily increases the percentage of federal dollars which supplement state Medicaid programs for all states retroactively to October 2008 and continuously through December 2010, provided certain conditions are met. This percentage is known as the federal medical assistance percentage (FMAP).

The LAO estimates that Medi-Cal will receive an FMAP increase of 11.6 percentage points, which is equal to an additional \$10.1 billion in additional federal funds for the state through December 31, 2010. As mentioned previously, in order to receive this money the state must reverse a policy requiring children and their parents to submit an eligibility report every six months by July 1, 2009.

Other significant health funding included in ARRA for California include:

Potentially more than \$3 billion annually to improve health information exchange

- infrastructure and incentive payments for the adoption of electronic health records, chronic disease management systems, and other technologies, according to the CBP.
- \$54 million in federal disproportionate share hospital funding (DSH) for California public hospitals
- \$50 million in additional federal grants for the Early Start Program to help individuals with disabilities
- \$160 million to the state for safe drinking water projects that can begin construction before February 17, 2010.
- Persons who lost employer-based health coverage between Sept. 1, 2008 and January 1, 2010 due to job loss would be eligible for a federal subsidy to help pay for their COBRA health coverage. The subsidy would last for 9 months and would cover 65% of the premium for eligible workers (the subsidy is phased out for higher-income persons). The CBP estimates that more than 800,000 Californians could maintain health care coverage under this provision.
- \$34.2 million for immunization services to fight preventable diseases, according to the CBP.

## **Labor and Workforce Development**

The ARRA provides an additional \$494 million for Workforce Investment Act (WIA) programs in California. The LAO estimates that about \$420 million will be allocated to local WIA boards to administer local workforce development activities, while an estimated \$74 million will be available for state discretionary purposes.

The ARRA specifies that about \$28 million be used to provide reemployment services for Unemployment Insurance (UI) claimants.

The California Unemployment Insurance (UI) fund is currently insolvent. The Governor has introduced a proposal to restore solvency but the proposal is currently being considered by the Legislature.

The ARRA is estimated to provide approximately \$5.4 billion to the state's UI program, which would help extend UI benefits through 2009, provide a temporary increase of \$25 in weekly benefits through 2009, provide incentive payments if the state implements UI eligibility changes, provide temporary relief of state interest payments for UI federal loans and provide additional funds for UI administration.

The CBP estimates that approximately 2.4 million unemployed Californians could receive increased benefits and 506,000 unemployed Californians could receive benefit extensions.

## **Social Services**

The ARRA provides an estimated \$5.3 billion in federal funding for California social service programs from 2008-09 through 2010-11, states the LAO analysis. Roughly \$2.8

billion is in the form of direct payments to individuals, primarily recipients of supplemental security income (SSI), Social Security, and/or food stamps.

The ARRA would provide \$1.5 billion to California for increased food stamp benefits by increasing the maximum benefits by 13.6% (\$80 for a family of four) and providing the state with additional money to help respond to rising caseloads, according to the CBP. This increased funding will be available until 2013 and help an estimated 2.5 million low-income Californians each year, according to the CBP.

The ARRA also provides \$2.2 billion in additional funding to state- and county-funded social service programs, much of which can be used to offset General Fund costs, states the LAO analysis.

Specifically, the ARRA provides a one-time \$250 payment to recipients of Social Security, SSI, Railroad Retirement and certain veterans benefits (\$1.5 billion). Approximately 5.5 million Californians will receive payments, according to the CBP.

The ARRA would provide more than \$400 million in additional federal funding in 2009 and 2010 to assist the state in paying its share of the temporary assistance for needy families (TANF), according to the California Budget Project (CBP). In general, states must increase their own TANF-related spending and experience caseload increases relative to a base year to qualify for the federal funds, states the CBP analysis.

According to the CBP analysis, the ARRA would also provide California with:

- \$158.5 million in additional federal funds for foster care and adoption assistance payments between October 2008 and December 2010
- \$220.8 million to provide child care for children in low-income working families through September 30, 2010
- \$154.5 million to temporarily suspend a provision in the Deficit Reduction Act of 2005 that reduced federal child support funding by 20 percent
- \$89.2 million to local communities to help alleviate poverty by providing a range of services that address employment, education, housing, nutrition, and other issues
- \$189.1 million to prevent homelessness and help those who are homeless by providing short-term rental assistance and help with security deposits. Roughly 25,000 Californians could receive assistance, according to the CBP.
- \$13.2 million to local agencies that provide food and shelter to homeless individuals and/or help prevent homelessness (under McKinney-Vento Homeless Assistance Act)
- \$13 million for nutrition services for seniors including support for meals on wheels
- \$11.8 million to buy commodity foods for food banks, soup kitchens, food pantries and for administrative costs.

## **Transportation**

California will receive about \$3.6 billion in additional federal funds from formula-based highway and transit programs. None of these funds will offset General Fund expenditures, according to the LAO.

The state is expected to receive \$2.6 billion in federal economic stimulus funds for highway and road projects, of which 67% or \$1.7 billion, would be used by Caltrans for state transportation programs and projects.

The ARRA requires that 30% (roughly \$770 million) be allocated to regional transportation agencies for projects selected by those agencies. The remaining 3% or \$77 million must be used for transportation enhancement projects such as bicycle and pedestrian walkways and landscaping.

As mentioned previously, there are certain timelines by which the transportation funding must be spent. The state will also receive \$1 billion in formula-based transit funding for bus, rail and related capital assistance and \$66 million for light and commuter rail systems.

## **Housing**

The state is estimated to get between \$1.1 billion and \$1.3 billion for housing programs. Of that amount, the Department of Housing and Community Development (HCD) and the Tax Credit Allocation Committee (TCAC) are expected to receive \$400 million in formula-based grants as well as some unknown amount in competitive grants, states the LAO analysis.

The ARRA places great emphasis on the rapid distribution of the housing stimulus. For example, in the case of the Community Development Block Grant program, the act requires state and local recipients to give priority to projects that are ready to go (“shovel ready”) within 120 days from the date the funds are made available to the recipient.

According to the CBP, the ARRA would provide California with the following funding:

- \$123.3 million to provide affordable housing and promote community development
- \$305 million to fund contract renewals under the Section 8 project-based rental assistance (PBRA) program, which provides rental subsidies for eligible tenant families
- \$326 million in grant funding for capital investment Low Income Housing Tax Credit (LIHTC) projects
- \$118 million to enable local public housing agencies to address a \$32 huge backlog in capital needs
- \$17.6 million for programs that identify, control, and prevent lead-based paint hazards and other housing-related health and safety hazards

\$2 billion in nationwide funding awarded on a competitive basis to purchase and rehabilitate foreclosed or vacant properties

## **Resources and Environmental Protection**

The ARRA includes several resource and environmental protection-related provisions that will have a fiscal impact on California but none of these federal funds will benefit the state's general fund, according to the LAO.

Summary of significant funding for California:

\$283 million in grant and loan funding for wastewater infrastructure through the Clean Water State Revolving Fund

\$239 million for state energy programs under the Energy Policy and Conservation Act to increase energy efficiency, fund renewable energy programs, and expand programs that have already been approved by the state

\$159 million to upgrade drinking water systems under the Drinking Water State Revolving Fund, according to the CBP.

\$17 million in assistance for the cleanup of leaking underground storage tanks

Smaller amounts of money were allocated for an array of other state programs including diesel emission reduction, wildland fire management, brownfields remediation, defense environmental cleanup, wireless and broadband access, electricity grid modernization, flood control, water programs, hazardous substance superfund, federal land and resource management, green tax incentives, and renewable energy tax credit bonds and loan guarantees, states the LAO analysis.

## **Tax Changes in ARRA**

On a nationwide basis, the ARRA provides \$287 billion in federal tax relief, primarily over the next three years, according to the LAO. The LAO estimates that Californians will receive between \$30 billion and \$35 billion of this relief.

The "making work pay" credit and the reduction in the alternative minimum tax comprise two-thirds of the total relief provided. (see chart on next page for more information)

The new "making work pay" tax credit is equal to 6.2% of earned income in tax years 2009 and 2010. It is capped at a maximum of \$400 for an individual or \$800 for a married couple that files jointly. The required annual earnings to reach the maximum \$400 credit is just \$6,451, so most workers will qualify for the maximum credit. The federal law phases the credit out for high income earners (starting at \$75,000) and eliminates the credit for individuals earning more than \$95,000 a year.

For married couples, the credit phases out between \$150,000 and \$190,000. The state has about 11 percent of the nation's total employment, so the income gain to state taxpayers

should be roughly 11% of \$116.2 billion or \$12.8 billion.

Under the stimulus bill, taxpayers will be allowed to deduct the sales tax on new car purchases from taxable income until February 2010, and will be able to take the deduction even if they take the standard deduction instead of itemizing, states the LAO analysis. The limit on the cost of the vehicle is \$49,500 and the limits on the taxpayer's income are \$135,000 for a single taxpayer and \$260,000 for couples.

### Summary of Tax Relief Provisions Included in the 2009 Federal Stimulus

Figure 15

#### Tax Relief Provisions Included in the 2009 Federal Stimulus Legislation

(In Billions)

Provision	Description	National Total <sup>a</sup>
<b>Personal Income Tax</b>		
"Making work pay" credit	Creates a new credit of up to \$800 in 2009 and 2010 based on annual income.	\$116.2
Alternative minimum tax (AMT) threshold	Raises income levels subject to the AMT in 2009.	69.8
Child tax credit	Reduces the annual wage threshold for eligibility in 2009 and 2010 from \$12,600 to \$3,000.	14.8
Education tax credit	Expands the existing "Hope" credit for higher education costs in 2009 and 2010.	13.9
New homeowner tax credit	Converts an existing incentive into a refundable credit for first-time homebuyers who purchase a home in 2009.	6.6
Taxation of unemployment benefits	Exempts up to \$2,400 in benefits received in 2009.	4.7
Earned income tax credit	Increases benefits and raises the income threshold for eligibility in 2009 and 2010.	4.7
Energy improvement tax credit	Increases tax benefits in 2009 and 2010 from increasing the energy efficiency of existing homes.	2.0
Automobile sale tax deduction	Creates a new deduction of sales taxes paid on the purchase of a new car over the next 12 months.	1.7
Subtotal, Personal Income Tax		(\$234.4)
<b>Other Tax Provisions</b>		
Renewable energy incentives	Extends or increases a variety of tax subsidies for "green" energy production and conservation.	\$18.0
School construction bonds	Increases federal subsidies for school construction and repair projects.	10.9
Recovery Zone Bonds	Authorizes \$25 billion in federally subsidized bonds for projects that encourage growth in depressed areas.	5.4
Extension of bonus depreciation	Allows rapid depreciation of equipment purchases in 2009.	5.1
Build America Bonds	Establishes a new type of federally subsidized bond that would be available to state and local governments.	4.3
Deferral of income on the repurchase of debt	Permits companies to repurchase their own debt in 2009 and 2010 and defer taxes on any reduction in the value of that debt.	1.6
Other		7.2
Subtotal, Other Tax Provisions		(\$52.5)
<b>Total</b>		<b>\$286.9</b>

<sup>a</sup> Expected costs over the period from 2009 to 2019, as estimated by the federal Joint Committee on Taxation.

Source: LAO

### **Criminal Justice**

The ARRA also provides \$220 million to California and its local governments to prevent, fight, and prosecute crime under the Edward Byrne Memorial Justice Assistance Grant (JAG) Program, according to the CBP.

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*This brief was produced by David Kersten, with Kersten Communications. Kersten Communications specializes in public policy research and analysis.*