

How Much State Fiscal Relief is Enough?

By Stan Dorn

State fiscal relief is a centerpiece of the emerging economic recovery package – and for good reason. Almost every state is legally forbidden from running deficits, even during recession. As a result, the combination of falling revenue and rising caseloads for Medicaid and other need-based programs means that, without significant federal help, cutbacks and tax increases are inevitable. Laid-off workers are thus denied help precisely when they need it, and a struggling economy suffers further blows.

To prevent those results, how much does Congress need to spend? Recent Urban Institute research suggests that, between increased Medicaid caseloads, rising indigent care costs, and Medicaid's share of state revenue losses, an economic downturn over a two and a half year period will impose the following extra financial burdens on the 50 states:¹

- \$74 billion if unemployment reaches an average of 8 percent;
- \$96 billion if unemployment averages 9 percent; and
- \$118 billion with average unemployment at 10 percent.

So that's how much money Congress should provide in fiscal relief, right? Not necessarily.

If Congress gives every state exactly the amount it needs, these funds might suffice. But in 2003-2004, Congress passed fiscal relief legislation that increased the federal government's share of Medicaid costs by the same number of percentage points in each state, regardless of its financial circumstances. If Congress takes the same approach today, the above amounts will not come close to providing sufficient assistance to the states that experience the greatest fiscal harm. Distributed through a uniform increase in federal matching percentages, without any recognition of state variation, these funds might fully compensate the

average state. However, states in deep trouble would get nowhere near enough help, while states feeling relatively little economic pain might get more than they need.

If each state's level of relief is instead based on objective, economic indicators like the state's unemployment rate, the allotted funds could go much farther towards solving state fiscal woes, since a higher proportion of the money will benefit the states that most need help. Put differently, to wring the maximum amount of economic stimulus out of every new federal dollar, Congress should base federal allotments, as much as possible, on each state's economic conditions, measured as the recession unfolds.

Of course, even the best funding formula that bases state aid on ever-changing local economic indicators will match imperfectly with state economic circumstances. Formulas like those explored in earlier Urban Institute work² are based on experience with prior economic downturns, and each recession and its aftermath are unique in important ways. A good but imperfect formula is the best that policymakers can achieve.

The amount of fiscal relief matters. But equally important are the rules that decide how the money gets spent.

Notes

¹ John Holahan and A. Bowen Garret, *Rising Unemployment, Medicaid and the Uninsured*, prepared by the Urban Institute (UI) for the Kaiser Commission on Medicaid and the Uninsured (KCMU), January 2009.

² Stan Dorn, A. Bowen Garrett, John Holahan, and Aimee Williams, *Medicaid, SCHIP and Economic Downturn: Policy Challenges and Policy Responses*, prepared by UI for KCMU, April 2008.