NGA Conference Recommendations for the American Recovery and Reinvestment Act
Date: February 10, 2009

Governors strongly support the objectives of the *American Recovery and Reinvestment Act* (ARRA) to stimulate private investment, create jobs and speed recovery. Governors also appreciate the inclusion of several key elements of the bill critical to states -- increased federal support for Medicaid and K-12 and higher education; investment in the nation's infrastructure; and tax provisions to spur investment. Finally, Governors support the bill's transparency and accountability provisions to protect the American taxpayer and look forward to working with Congress and the Administration to speed economic recovery and put people back to work.

States are facing fiscal conditions not seen since the Great Depression. The National Governors Association's most recent information indicates that states already closed shortfalls of $29.6 billion in fiscal year 2009, and will have to address a remaining shortfall of $46.4 billion this fiscal year. States expect shortfalls for fiscal year 2010 to be $98.9 billion. These totals anticipate some level of federal assistance in both 2009 and 2010, which means if a recovery bill is not passed, shortfalls could be higher.

To maximize the economic benefits of the ARRA, the bill should adhere to several principles.

- **Federal funds to states should be made available as soon as possible.**
  In general, funds should be allocated within 30 days of passage of the bill.
- **Funds should payout over the duration of the downturn.**
  We know from previous downturns that the largest impact on state budgets from a recession is the year after the national economy begins to recover. Economist generally agree that the current recession is likely to last until the end of 2010, which means states will feel the effects of increased unemployment and Medicaid roles well into fiscal year 2011.
- **The bill should limit restrictions on the use of funds and provide states ample flexibility to manage funds, maximize their economic benefit and stabilize state programs.**

The following sections detail NGA's recommended changes to the ARRA to enhance its effectiveness and maximize its impact on the economy.

EDUCATION AND WORKFORCE

State Stabilization Fund – (House Title XIII – Senate Title XIV)

The State Stabilization Fund is critical for allowing state and local governments to maintain education spending during the economic downturn. In fiscal year 2008, states spent over $424 billion on elementary, secondary, and higher education. In fact, elementary, secondary, and higher education represents almost 40% of total state spending and comprises the first, second, or third largest spending categories for almost all states. While governors made every effort to protect education, given the severity and depth of the current state fiscal crisis all spending categories, including education are subject to cuts. In addition, growing school age populations and pressures on higher education to accommodate students with growing financial needs and greater numbers of students choosing education as a viable alternative to unemployment, have placed immense pressures on education systems during this downturn.

Attached is a chart outlining the proposed House and Senate State Stabilization Fund. The chart includes NGA's alternative to improve he State Stabilization Fund. The NGA proposal is designed to do three things:

1. Provide immediate relief to states facing cuts to education funding this fiscal year;
2. Ensure the fund does not penalize states that have protected education programs during the downturn and provide for continued growth in education spending to accommodate needs;
3. Preserve governors' flexibility to use federal funds to mitigate or avoid cuts to core state services including education.

Recommendation: Adopt NGA proposed language for State Stabilization Fund (see attached).

Title I and Individuals with Disabilities Education (IDEA) Act
(House Title IX, Subtitle C; Senate Title VIII, Department of Education Subtitle)

Timeline and Disbursement Dates

The House bill would make the first installment of federal IDEA and Title I funds available to states and schools on July 1, 2009, and the second installment would be available on July 1, 2010. The Senate bill would make one payment available through September 20, 2010. State and local governments are in the midst of making budget decisions for the fiscal year 2010. Between now and July 1, 2009, states and schools will make significant cuts in education and enact corresponding layoffs. Additionally, states and schools will need funds in state fiscal year 2011. As written, the federal funds would arrive too late to avoid these layoffs and cuts, thus drastically reducing the effectiveness of the bill.

Recommendation: The first installment of IDEA and Title I funds should be made available January 1, 2009 to September 30, 2010 for use in state and local fiscal years 2009 and 2010; and the second installment of funds should be made available January 1, 2010 to September 30, 2011 for use in state and local fiscal years 2010, 2011, and 2012. Additional consideration should also be given to length of time to obligate funds to comport with state and local government budget cycles and fiscal years.

Individuals with Disabilities Education (IDEA) Act – (House Title IX; Senate Title VIII)

Maintenance of Effort Requirements for States

Neither the House nor Senate bill addresses the current IDEA maintenance of effort (MOE) requirement for states. IDEA requires states to maintain state spending on special education at the same level as the preceding fiscal year. IDEA also penalizes states unable to maintain special education spending by reducing federal funds in future years. Given the unprecedented state fiscal crisis, states will struggle, and some will fail, to maintain state funding levels on special education.

Recommendation: Amend the IDEA state MOE requirement for federal fiscal year 2010 and 2011 to provide states with similar flexibility as provided to local school districts. Specifically, IDEA currently allows local schools to count up to 50% of their federal increase in IDEA Part B toward the local maintenance of effort requirement.

Title I – (House Title IX; Senate Title VIII)

Coordination with State Early Education Programs

The Senate bill appropriately clarifies that local school districts shall reserve not less than 15% of funds for early childhood education services and programming provided by federally funded programs. However, the bill does not require schools to collaborate or coordinate with children served by state funded early childhood, preschool programs, or even state-funded educational child care quality rating and improvement programs. Without a specific reference to state programs, the legislation will by-pass and undercut state efforts to create a sound, efficient, and effective continuum of early educational programs for the nation's youngest children.

Recommendation: Add the following clause:

> "That each local educational agency receiving funds available under this paragraph for sections 1125 and 1125A shall use not less than 15 percent of such funds for activities serving children who are eligible pursuant to section 1115(b)(1)(A)(ii) and programs in section 1112(b)(1)(K) *and where applicable, state funded preschool, state funded early childhood education programs, or state-funded preschool child care educational programs operating under a quality rating improvement system."*

Unemployment Insurance – (Title II, Subtitle A)

Weeks of Benefits

The House and Senate bills include a temporary extension of Unemployment Insurance benefits for up to 20 weeks for workers who have exhausted their state UI benefits. Both bills also include an additional 13 weeks of benefits in States with a high rate of unemployment (3 month seasonally adjusted average UI rate of at least 6 percent). Unemployment benefits are paid to individuals, not to states; therefore no distinction in benefits should be made with regard to the rates of unemployment in certain states versus others. The additional 13 weeks of benefits should be available to every qualifying American, regardless of what state they reside or the state's unemployment rate.

Recommendation: Support the Senate and House bills to provide a 20 week temporary extension of Unemployment Insurance benefits and amend the additional 13 weeks of temporary benefits to include ALL qualifying workers in ALL states.

LABOR – (Title IX, Subtitle A)

Employment and Training Administration Training and Employment Services

Funding Levels

The House bill calls for $4 billion for activities under the Workforce Investment Act of 1998; the Senate bill calls for $3.25 billion.

Recommendation: Adopt House funding level.

Department of Labor -- Title VIII

State Unemployment Insurance Trust Fund Insolvency

The Senate bill includes a provision for "*Temporary Assistance for States with Advances."* The provision waives interest accrual and interest payments on state loans from the Federal Unemployment Account (FUA) used to pay state Unemployment Insurance benefits. The measure would be in effect from the date of enactment to 12/31/10. There is no similar provision in the House bill.

Neither the Senate nor the House bill provides relief for businesses who will experience a reduction in their Federal Unemployment Tax Act (FUTA) tax credit in states that borrow FUA funds. The loss of tax credit essentially increases the FUTA tax rate by 0.3 percent per year, with an additional 0.3 percent increase each year thereafter up to the maximum tax of 6 percent, as long as there is an outstanding balance. The increased tax is applied against any outstanding balance of the loan. The loss of the tax credit essentially penalizes businesses for paying their FUTA taxes in full and on time, and will limit the number of employees businesses can afford to hire during the recession and in the recovery years.

Recommendation: Adopt Senate provision to waive interest accrual and interest payments on state FUA loans. Add a provision to waive the FUTA business tax credit reduction in states borrowing and with an outstanding FUA balance through 12/31/2012.

Unemployment Insurance Modernization (Title II, Subtitle A, SEC. 2003) -
Both the Senate and House bills provide $700 million in incentive payments to states with modernization laws. One-third of the maximum incentive payment is available to states whose state law provides for the use of an "alternative base period" when calculating state UI benefit eligibility. The remaining two-thirds of the maximum incentive payment is available for states with provisions to carry out at least two of the following: cover part-time workers, cover workers separated from employment for compelling family reasons, cover workers who have exhausted state UI benefits and are in job training, or provide a weekly dependents allowance of at least $15 per dependent.

19 states currently have law that provides for the use of an alternative base period when calculating state UI benefits. Of the 19 states that cover part-time workers, 4 of those states also include two of the other provisions necessary to qualify the state for the remaining two-thirds incentive payment. 31 states will have to significantly change their state laws to receive any funds under this section.

Recommendation: Address this matter with your governor.

ENERGY AND NATURAL RESOURCES

House Title VIII/Senate Title VII – Interior and Environment

Wildland Fire Management
The House bill provides $850 million while the Senate bill provides $485 million. Of these amounts, states will be able to use approximately $550 million or approximately $260 million respectively through the USDA Forest Service State and Private Forestry (S&PF) programs.

The House bill gives states the flexibility to use stimulus funds distributed through S&PF programs for hazardous fuels reduction grants, volunteer fire assistance, forest health projects, city forest enhancements, and wood to energy grants on state and private lands. The Senate bill does not extend this flexibility to states, allocating funding only for hazardous fuels reduction and hazard mitigation activities in areas at high risk of catastrophic wildfire. Allowing broad authority to spend allocated funds gives states the opportunity to support a multitude of "shovel-ready" activities on non-federal forests and create jobs where they are needed.

Under S&PF, statutory cost share requirements often accompany funding received through cooperative programs, and in most cases states are required to match federal funds on a 50/50 basis. Budget shortfalls in many states will limit their financial ability to meet these match requirements that accompany the anticipated rapid increase in spending.

Recommendations:

- Adopt the House funding level of $850 million.
- Adopt House language allowing for flexibility in spending within S&PF programs.

- Insert "except that such funds shall not be subject to the State matching requirements."

<u>House Title VII / Senate Title VII – Interior and Environment; Environmental Protection Agency</u>

Clean Water and Safe Drinking Water Revolving Loan Funds

State and Tribal Assistance Grants

Each bill mandates how states can spend a percentage of the money:

- The House requires 50 percent of the money be given out in the form of grants. Unfortunately, most state water loan programs do not have grant making authority requiring legislative action in some states. This will make it difficult for these states to adhere to the first deadline of 50 percent of the money in one year.
- The Senate requires states to spend 15 percent of the loans on green infrastructure, water efficiency and projects. While many of these types of projects are already funded through the SRF, the decision to fund them should be left to each state based on its individual needs. Additionally, trying to meet the 15 percent threshold will slow the delivery of funds to local communities. The Senate further requires that all funds be under obligation to projects that are ready to proceed to construction within 180 days of receipt.

<u>Recommendations</u>:

- Funding: Recede to the House funding levels of $6 billion for the CW SRF and $2 billion for the DW SRF.
- Timing: Use the House provision. States will have one year from receipt of funds to enter into binding obligations for 50 percent of the funds and two years to enter into agreements on the remaining 50 percent
- Disadvantaged Assistance: As is done in the Senate, allow states to use in the grants, principal forgiveness and negative interest loans in Clean Water Program. Due to both various states' statutory and Constitutional issues, all three terms must be used. In both programs allow them to use these tools for up to 100 percent of their stimulus funds. Priority should be given to those projects on a state's priority list.
- Green Infrastructure: Strike the Senate requirement that states provide 15% of the SRF in the form of loans and replace with "States may also fund green infrastructure, water efficiency, energy efficiency, and stormwater mitigation projects."
- Drinking Water – waive the drinking water set asides in Section 1452(g)(2).

Hazardous Substances Superfund

The House and Senate bills maintain the state match for the Superfund programs. Many states will be financially unable to meet the match requirements that will accompany the anticipated rapid increase in Superfund spending. Similar state matching requirements, including those for LUST program funding, are already waived in the bill.

<u>Recommendation:</u> Waive state matching requirement for Superfund funds under the bill and recede to the House funding level of $800 million.

Title V / Senate Title IV - Energy and Water – Department of Energy Subtitle

State Energy Program

The House bill provides $3.4 billion for SEP while the Senate provides $500 million. SEPs are mature programs run that have a history of making effective and efficiency investments; they already manage more than $3 billion of their own states' nonfederal funds. For every $1 in federal money invested in SEP, over $7 is saved in energy costs. Further, $10 of funds are leveraged for every $1 in federal funds. State energy offices have identified more than $8 billion of shovel-ready projects nationwide.

Recommendation: Adopt House funding level of $3.4 billion and the House timeline for use of the funds.

Weatherization
The House bill provides $6.2 billion while the Senate provides $2.9 billion. Weatherization funding can help millions o flow-income families save money on their monthly energy bills enabling them to spend that money elsewhere. Further, increased funding will put thousands of people to work from those who staff Weatherization offices to those who supply parts and tools for the weatherization.

Recommendation: Adopt House funding level of $6.2 billion the House timeline for use of the funds.

Energy Efficiency and Conservation Block Grant
The House bill provides $3.5 billion while the Senate provides $4.2 billion. Of these amounts, states will be able to keep approximately $420 million or approximately $504 million respectively for their State Energy Programs.

Recommendation: Adopt Senate funding level of $4.2 billion.

HEALTH AND HUMAN SERVICES

Medicaid FMAP Requirements/Restrictions for States *(Title V, Sec. 5001 House & Senate)*
The House and Senate include temporary increases in each state's FMAP, retroactive to October 1, 2008 and continuing until December 31, 2010 through three separate mechanisms: a hold harmless provision, an across-the-board increase, and an increase for states with significant changes in unemployment rates. The state's receipt of the enhanced FMAP has restrictions and is contingent upon the state meeting certain requirements. The U.S. Secretary of Health and Human Services is prohibited from waiving any of these requirements. The requirements include:

- Maintenance of state eligibility standards, methods and procedures in place as of July 1, 2008;
- Prohibits the state from increasing the proportion of the non-federal share made by local governments;
- Prohibits federal FMAP funds from being deposited into any reserve/rainy day funds; and
- Prohibits the Secretary from waiving any of the requirements.

The Senate approved several additional requirements for the enhanced FMAP that are not in the House bill, including:

- Requires states to comply with and report on all prompt pay requirements in order to be eligible and applies prompt payment requirements to nursing facilities.
- Prohibits enhanced FMAP payments for individuals who become eligible due to an expansion of the state' income eligibility policies as of July 1, 2008. The state would still receive its regular FMAP for such individuals; and
- Requires states report on the use of the additional federal funds by September 30, 2011.

Recommendation: Oppose expanding the MOE to include benefit packages, cost-sharing levels, and provider reimbursement rates. Also oppose efforts to prohibit the HHS Secretary from waiving certain requirements.

Health Information Technology ***(Title IV, Section 4301 of House-passed and Senate bills)***
The House and Senate both include funding to invest in developing and implementing utilization of health information technology (HIT) infrastructure and incentives to promote adoption by doctors, hospitals and providers.

The House included $2 billion to be used for existing programs and new grant and loan programs for states, with matching requirements beginning no later than fiscal year 2011.

The Senate adopted similar language but provided $3 billion for this investment.

Recommendation: Adopt Senate spending level of $3 billion. Maintain flexibility for states to determine which entities and providers are qualified and best positioned to support coordinated and certified HIT and HIE efforts. Support strong federal role in setting federal interoperability standards. Provide for state official representation on policy, standards and other applicable federal HIT-related committees or advisory bodies. Avoid preempting state privacy laws.

Medicaid Regulations ***(Title V, Section 5002,House)***
The House extends the moratoria on six Medicaid regulations from April 1, 2009 until July 1, 2009 and adds to the moratorium a final regulation impacting Medicaid outpatient hospital payments. The Senate did not include this language.

Recommendation: Adopt House provision.

Medicare Disability Claims ***(Title V, Section 5003, Senate)***
The Social Security Administration (SSA) is completing an effort to examine their process for determining the disability status of individuals filing for that status. They have discovered several hundred thousand cases where individuals were wrongly denied eligibility for Social Security Disability Insurance (SSDI) and therefore automatic Medicare eligibility as well. These individuals generally became eligible for Medicaid and states have wrongly incurred billions of dollars in health care costs for this population (and that should have been paid for by Medicare). Not only has CMS refused to develop a sensible and workable means for states to recover these costs from Medicare, but they have begun charging states retroactively for the payment of Medicare Part B premiums for these same individuals.

The Senate is considering a provision, including $3 billion for FY 2009, which would attempt to recoup the majority of these costs for all states. It includes $3 billion to resolve the liability. To be eligible, a state may not have filed or be a party to a lawsuit against the federal government – whether pending or previously decided in the state's favor – related to Medicare liability. The state also must agree not to seek further reimbursement for Medicare liability.

Recommendation: Adopt Senate provision.

Supplemental Nutrition Assistance Program

The House bill (H.R. 1, Title II, Sec. 2001) includes $20 billion, which results in a 13.6% benefit increase for fiscal year 2009 and 2010. The Senate version (S. 336, Title I, Sec. 102) provides $16.5 billion, which includes an 85% benefit increase for the first month, and a 12% benefit increase for the remainder of fiscal year 2009 and 2010. The Senate bill adds a maintenance-of-effort requirement (Sec 102 (c) paragraph 5) on specified state administrative expenditures in order for a state to receive the funds.

Changing the benefit amount so dramatically from one month to the other will have significant administrative implications for states in configuring their automated systems to handle this fluctuation, and further, is likely to cause great confusion for those receiving a certain allotment one month, and a substantially less amount the next

<u>Recommendation</u>: Adopt House provision.

Temporary Assistance for Needy Families.
Both the House and Senate bills include an emergency contingency fund for states experiencing an increase in caseload and/or expenditures associated with subsidized employment and non-recurring benefits, relative to a base year (2007 or 2008 respectively). The Senate version additionally includes an extension of the TANF supplemental grants and a provision allowing states to use carry-over funds on any TANF benefit or service, rather than on cash welfare only, as currently restricted.

<u>Recommendation</u>: Adopt Senate provision.

Justice Programs, State and Local Law Enforcement Assistance
The House and Senate bills would provide $4 billion and $3.5 billion respectively to support state and local law enforcement. The House bill provides funding through the Byrne Justice Assistance Grant program, which provides the greatest flexibility for states to target funds where they are needed most. The Senate bill divides nearly $1.3 billion of the funds into specific programs limiting state flexibility.

<u>Recommendation:</u> Adopt House provision.

Homeland Security Programs, Federal Emergency Management Agency Grant Programs –
The Senate bill provides over $1 billion in state and local grants to secure critical infrastructure and transportation systems, support the needs of firefighters, and construct emergency operations centers. The House bill does not include similar funding.

<u>Recommendation:</u> Adopt Senate provision.

INFRASTRUCTURE AND ECONOMIC DEVELOPMENT

<u>House - Secs. </u>12001; <u>Secs. 1605</u>

General Maintenance of Effort

For housing and transportation appropriations, the House bill requires that governors certify within 30 days of enactment that the state will maintain its planned investment as of October 1, 2008 through September 30, 2010, in those types of projects funded by the stimulus bill. If a governor is unable to certify for all or a portion of the apportioned funds, then the uncertified funds are recaptured. Portions of these federal funds are distributed either by competitive grant to recipients other than States or sub-allocated to units of local government; therefore, there would be no corresponding state funding against which governors could certify. Moreover, a certification period that is retroactive to October 1, 2008, punishes those states that have reduced spending because of budget constraints.

The Senate mark does not contain an equivalent maintenance of effort requirement, but instead requires governors to certify that, upon full review, infrastructure projects funded by federal dollars are an "appropriate use of taxpayer dollars."

Recommendation: Adopt Senate provision.

House Title XII.
Highway Funds – Project Selection Criteria
Priority selection criteria in the House bill include a criterion for projects located in "economically-distressed areas," defined at 42 U.S.C. §3161. This criterion narrows the pool of eligible projects for selection, which would lower the spend-out rate. The Senate mark does not include a similar criterion for priority project selection.

Recommendation: Delete this priority criterion.

Transportation and Housing – Generally (Title XII)
General Waiver Authority
Housing provisions in the Senate mark contain general waiver authority of federal statutory or regulatory provisions, excluding those governing fair housing, non-discrimination, labor standards, and the environment, necessary to facilitate timely use of stimulus funds. The House bill does not contain a similar waiver provision for either transportation or housing funds; the Senate mark does not extend it to transportation funds. Absent authority to waive or modify certain conditions, current eligibility rules could limit the scope of eligible projects and impede the ability of recipients to meet spend-out deadlines (e.g. preventive maintenance is an eligible use of federal-aid highway funds, but routine maintenance is not).

Recommendation: Apply Senate waiver provision for housing to all transportation and housing funds.

Transportation (Title XII).
Highway Funding - Generally
The House and Senate funding distribution formulas are significantly different. Total funding under the House bill is greater than the Senate ($30 billion versus $27 billion), and the House distribution formula is more favorable to States because it sub-allocates less money than the Senate version.

Recommendation: Adopt House provision.

TAX
Repeal of 3% Withholding (House Section 1541; Senate Section 1511)
The 3% withholding provision requires federal, state, and certain local governments withhold 3% from contracts and other payments, such as Medicare payments, grants, and farm payments. The requirement is scheduled to take effect January 1, 2011. States and business groups have long argued that the cost and complexity of implementing the provision far outweigh the revenues it

would generate for federal, state or local governments. The House proposes repealing the provision; the Senate bill would delay implementation for one year.

Recommendation: Adopt House repeal the 3% withholding requirement.

Deduction of interest on car loans and state sales and excise taxes for auto purchases
This Senate-approved amendment creates an above-the-line deduction for interest on auto loans and sales taxes paid on auto purchases. Unfortunately, because the deduction would lower individual's federal adjusted gross income (AGI), which is also used by all but four states with an individual income tax, the provision will also reduce state tax revenues.

Recommendation: If the provision is included in the final bill, place the deduction after the calculation of AGI to avoid state revenue losses.

CERTIFICATION

Additional Certification by Governor
The House bill includes language requiring a governor to certify within 45 days of enactment that the state will request and use funds provided under the ARRA. If a governor fails to so certify, the state legislature may request the funds, but funds received after a legislative request may only go to local governments or public entities within the state. In addition, by restricting the distribution of funds to local governments for failure of a governor to certify, the provision would severely hinder the countercyclical intent of several provisions of the bill.

Recommendation: Remove certification requirement.