

## **Balancing Iowa's Budget and Maintaining Essential Services Using Federal Stimulus Funding Over 2010 and 2011**

Iowa lawmakers have been accorded extraordinary responsibility under the American Recovery and Reinvestment Act (ARRA), as the federal stimulus package is called. ARRA sends billions of dollars directly to state governments as part of its goal to arrest economic decline and help to restart the national economy. Although piecing together the various funding streams included in ARRA is an unprecedented task for state lawmakers, it is crucial to ensuring that federal money is put to work quickly and fulfills its twofold intent – helping the economy stay on its feet and helping the state meet its ongoing and increased obligations to hard-pressed families. This policy brief outlines the federal funding available to Iowa through ARRA and how it can support Iowa's budget during FY2010-11.

The March 20 report of the Iowa Revenue Estimating Conference (REC) also presented Iowa lawmakers with new challenges to balancing the state budget. With dramatically lowered estimates from the December revenue estimates upon which the Governor's initial budget was based, the stimulus funds become even more important to shoring up the budget and, to the extent possible, avoiding cuts and layoffs that could deepen the recession in Iowa.

The ARRA, signed by President Obama on February 17, 2009, provides substantial funding to Iowa that can be used to make restorations to some previously proposed budget cuts and, over the next two years, largely maintain higher education spending at 2009 levels and honor school-aid formula commitments. The ARRA funds also enable Iowa to continue to provide Medicaid services for children and adults who are eligible. Even after these actions, there still will be additional ARRA funding to address a portion of other revenue shortfalls in the budget.

In addition, however, Iowa lawmakers will have to look at both the revenue and spending sides of the state budget to minimize the inevitable harm caused by deep cuts to essential state programs.

This policy brief delineates the estimated federal funding available to Iowa through ARRA and how it can be used to eliminate or reduce the need for state spending cuts. This analysis assumes:

- There will be no more changes made to programs and funding for the 2009 budget. The cuts already made will stay in place. ARRA funding will be used to ensure that Iowa's budget stays in the black, meeting the additional shortfall in the 2009 budget identified by the REC.
- Although the General Assembly adopts annual budgets, the ARRA funding available after any amount used to keep the 2009 budget in the black will be spread over the next two fiscal years, 2010 and 2011, to produce a balanced budget throughout this period.
- The Governor's 2010 budget is the starting place for an analysis of the extent to which ARRA funding can adjust that budget, based both on ARRA funds and the REC estimates.

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## ***Iowa's Share of the American Recovery and Reinvestment Act Funds***

To simplify, the ARRA provides three different types of funding to states, communities and residents:

- Funding specifically designed for state fiscal relief to reduce the need for budget cuts, service reductions, and layoffs;
- Funding directed through state and local governments to stimulate the economy through increased economic activity; and
- Funding directly to individuals and providers to address needs and boost consumer demand.

Table 1 shows estimates of the overall funding for Iowa in the first two areas of stimulus spending.

<b><i>State Fiscal Relief</i></b>	
FMAP Increase	\$ 335.2 million <sup>1</sup>
Fiscal Stabilization Education Block grant	\$ 386.9 million
Fiscal Stabilization Flexible Block grant	\$ 86.0 million
<b>Total</b>	<b>\$ 808.1 million</b>
<b><i>Funding to Stimulate Economy</i></b>	
Highway and transit funding	\$ 394.6 million
Drinking and clean water funding	\$ 77.7 million
Public housing, homelessness, and HOME funding	\$ 43.4 million
Special education, Title I and technology funding to local education agencies (school districts)	\$ 192.8 million
Dislocated worker, adult and youth, and vocational rehabilitation grants	\$ 18.5 million
Child care block grant and Head Start funding	\$ 23.7 million
Community services block grant funding	\$ 10.8 million
Law enforcement and victim assistance grants	\$ 23.4 million
<b>Total</b>	<b>\$ 785.3 million</b>

In general, the funding through government programs to stimulate the economy is designed to “supplement and not supplant” existing state and community programs, e.g. to be in addition to current expenditure levels in order to increase employment and economic activity. Therefore, it is not discussed in relation to Iowa budget deliberations.

<sup>1</sup> These figures are taken from the Legislative Service Agency’s (LSA) analysis, available at: <http://www.legis.state.ia.us/lsadocs/FedEconomicStimulus/2009/ESDPW016.PDF> and, for Medicaid, from more recently revised estimates. Estimates prepared by the Government Accountability Office (GAO) show that Iowa is projected to receive \$550 million in FMAP funding (see Center on Budget and Policy Priorities analysis of GAO estimates at <http://www.cbpp.org/2-13-09sfp.pdf>). The LSA’s analysis of stimulus funding available through the FMAP increase differs because it does not include FMAP funding going directly to counties or other non-state Medicaid programs or funding that could become available when Iowa’s unemployment rate rises above a federal trigger. This unemployment trigger, which starts when the quarterly unemployment rate is 1.5 percentage points higher than a 2006 baseline, is 5.2 percent for Iowa. With a current unemployment rate for January of 4.8 percent, it is possible that Iowa will reach this trigger by the end of the second quarter of 2009 or sooner. If the trigger occurs starting in July, IFP estimates that Iowa’s FMAP increase will total \$490.3 million, based upon the federal formula (which increases Iowa’s FMAP rate by an additional 2.4 percent) being in effect through the rest of the period and Medicaid expenditures increasing by 10 percent in 2011 over 2010).

## State Fiscal Relief Provisions and their Potential Use in Iowa

The ARRA provides two major pools of funding specifically designed to help states avoid making large cuts in their state budgets: assistance with Medicaid costs (boosting the Federal Medical Assistance Percentage, or FMAP) and the State Fiscal Stabilization Fund, which includes both an education block grant and flexible block grant. Together, these funds address the two largest expenditure areas by state governments — health and education.

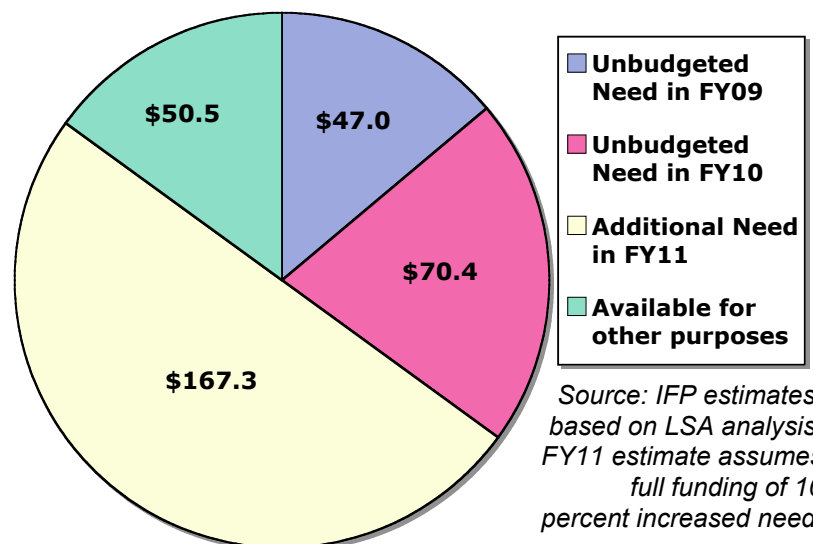
This funding was specifically designated for state governments because of the critical role of state budgets in supporting the national economy. In addition to providing essential services, states employ workers, contract for services from the private sector, and contribute to economic activity. Unlike the federal government, states have limited options to respond to fiscal strains, since they are statutorily barred from deficit spending. If states cut spending in order to balance their budgets, they further damage state and national economies by shrinking aggregate demand just when it needs to be stimulated. The ARRA provides funding specifically so that states, facing declining revenues as a result of the recession, do not deepen or prolong the recession by making further cutbacks of their own.

**FMAP Increase.** The FMAP increase applies to the state Medicaid program and increases the federal matching rate over the period from October 1, 2008, through December 31, 2010, provided that states do not restrict their eligibility levels for Medicaid or impose stricter enrollment standards. Essentially, this FMAP increase can be used over three state fiscal years, the current FY2009 and the upcoming FY2010 and FY2011 years.

According to the Legislative Services Agency, there is currently a \$47 million Medicaid shortfall in the FY2009 budget caused by costs that go above FY2009 appropriations for Medicaid. In addition, the Governor budgeted \$908 million for the Medicaid program in his 2010 budget, but the most recent forecast for Medicaid expenditures in 2010 is \$969 million, a shortfall of an additional \$60.3 million. Even if Medicaid costs grow by 10 percent in 2011 (need is projected to grow by just under 5 percent between FY2009 and FY2010, so a 10 percent increase for FY2011 produces high-end estimates of state cost), the additional cost in the 2011 budget for Medicaid over the Governor's 2010 budget would be \$167.3 million. Added together, additional Medicaid costs due to increased need and under-budgeting total \$284.7 million from FY2009 through FY2011.

This means, as shown in Figure 1, that **in addition to addressing any shortfall in the Medicaid budget over the biennium of FY2010-11 and covering the projected Medicaid shortfall in 2009, the FMAP increase provides approximately \$50.5 million in additional federal support to the state to address other budget issues.** This also represents federal funding available to address the REC's March downward estimates of revenues for FY2009.

**Figure 1. \$335.2 Million in FMAP Funds Can Address Several Budget Areas**



In addition, it should be noted that these estimates assume that Iowa’s unemployment rate does not increase from its February 2009 level of 4.9 percent to the 5.2 percent level that would trigger additional federal FMAP funds at any time during the two years. If unemployment does rise to 5.2 percent by the end of June 2009, Iowa will receive more Medicaid matching funds through the federal FMAP provisions. Rising unemployment would also produce increases in Medicaid enrollment, but the calculations above already factor in a 10 percent growth in Medicaid for the FY2011 year. If this trigger is reached and Iowa receives elevated FMAP from July 2009 on – and Medicaid costs do not increase beyond this 10 percent growth factor – Iowa will receive over \$150 million in additional FMAP above the \$332.5 million figure, which could be used to address other budget needs. This \$150 million also would cover substantial Medicaid growth over and above the 10 percent used in the estimates, if that should occur.

**State Fiscal Stabilization Fund – Education Block Grant.** The State Fiscal Stabilization Fund provides two sources of funding to states to avert state and local budget cuts. First, State Fiscal Stabilization funding for Iowa includes \$386.9 million in an education block grant that must go to K-12 education, the Regents universities and community colleges. In addition, the fund provides \$86 million in more flexible funding that can be used to prevent cuts in other areas of the budget.

Iowa can use the education block grant to restore state education funding to the higher of 2008 or 2009 funding levels or to existing state formula levels for the FY2009, FY2010 and FY2011 years. Any funding remaining after that used by the state to restore funds flows directly to local school districts.

Table 2 shows the proposed cuts in the FY2010 Governor’s budget from the original 2009 appropriations or allowable growth factor. The FY2010 column includes estimates of the funding necessary to provide 2 percent allowable growth for K-12 education and fund community colleges and the Regents institutions at the same level as in FY2010.

		<b>Subtotal (\$ millions)</b>
<b>Available stimulus funding</b>		<b>\$386</b>
<b>K-12 Education</b>		
	FY10 cuts restored	-\$92.4
	FY11 2% allowable growth	-\$123.3
		<b>\$171</b>
<b>Community Colleges</b>		
	FY10 cuts restored	-\$13.1
	FY11 funding	-\$13.1
		<b>\$145</b>
<b>Regents Institutions</b>		
	FY10 cuts restored	-\$61.4
	FY11 funding	-\$61.4
		<b>\$ 22</b>
<b>Remaining stimulus funding</b>		<b>\$ 22</b>

*Source: IFP estimates based on Legislative Services Agency analysis.*

**As Table 2 shows, the \$386.4 million from the State Fiscal Stabilization Fund for education provides sufficient funding in the education block grant to restore the 2010 and 2011 higher education budgets to 2009 levels and maintain allowable growth commitments for K-12 education in 2010 and 2011.** These adjustments leave Iowa with \$22.1 million in additional federal stimulus funding for education. If these funds are not applied elsewhere at the state level, they flow directly to local school districts.

In addition, Iowa school districts will receive \$193 million in direct federal funding for special education, Title I and technology over the two budget years through other parts of the ARRA, equivalent to an additional 3 percent increase in both 2010 and 2011 of the approximately \$3.5 billion in K-12 education spending per year.

**State Fiscal Stabilization Fund – Flexible Block Grant.** In addition to the education block grant, Iowa also will receive \$86.0 million in the flexible block grant, which can be used to avert budget cuts in education and other basic services. **These funds can and are intended to be used to address some of the additional revenue shortfalls identified by the March REC in FY2009 and onward.**

### ***The Governor's 2010 Budget and the March REC***

As described earlier, the flexible block grant funding of \$86.0 million, combined with the available FMAP funding of at least \$50.5 million, provides \$136.5 million in federal state fiscal stabilization funding over and above the amount needed to maintain the state Medicaid program through the biennium of FY2010-11, bring higher education budgets to 2009 appropriations levels, and fund allowable growth for the K-12 school system.

Before the March REC, the Child and Family Policy Center had estimated that there are \$20 million in budget cuts to essential child and family programs in the Governor's 2010 budget – in health, education and human services. This \$20 million in cuts may affect as many as 500 community jobs in providing child care, parenting education and home visiting, and other community health, education and social services. **Restoring funds cut from these child and family services over the biennium could be achieved with \$40 million from either FMAP or state fiscal stabilization funds** (see appendix for detail). In addition, there are approximately \$60 million in other appropriations cuts in the 2010 budget below the 2009 budget that could be considered for restoration. As this analysis suggests, the \$136.5 million in available federal stimulus funding would have been sufficient to cover these restorations over the two years, particularly when considering that these calculations do not account for any budget growth in 2011. They do assume, however, that other aspects of the Governor's budget, including the use of emergency funds and the adoption of tax expenditure provisions, occur.

The March REC, however, dramatically lowered the projections of state revenue for FY2009 and FY2010 (the REC does not provide biennial revenue projections). Compared with the December estimates upon which the Governor's budget was based, the REC estimated that total state revenues would be \$5,970.3 million in FY2009 and \$5,755.9 million in FY2010. These figures represent a reduction below December estimates of \$81.7 million for FY2009 and \$279.9 million for FY2010. The new REC estimate for FY2010 for state revenue is 5.4 percent below the actual revenue received in FY2008, indicating the severity of the recession in Iowa.

The federal stimulus funds through FMAP and the flexible grant can more than cover the FY2009 shortfall but can only begin to address the FY2010 additional shortfall. Even using the higher \$200 million figure for FMAP, \$280 million in additional federal stimulus funding leaves only \$100 million for each of the two years to address the additional shortfalls. The Governor's budget, in order to be in balance, must find \$180 million in additional spending cuts or revenue increases than he proposed in January for FY2010 – and find these mostly outside the education and Medicaid budget areas, which represent the majority of the state budget.

### ***Conclusion***

The depth of the recession and Iowa's fiscal crisis require concerted action. Integrating the ARRA funds into Iowa's budget development process is needed, and this represents a complex undertaking for state lawmakers. The deepened Iowa recession since December and its impact upon state revenues pose an even greater challenge to lawmakers in developing the budget.

This policy brief shows that the federal fiscal relief for education and Medicaid to Iowa is likely to be sufficient, if used over the the next two budget years, to stabilize higher education spending at 2009 appropriation levels, while maintaining commitments to school foundation allowable growth and

medical assistance services through Medicaid. The ARRA also provides some help in other areas of the budget, but this help falls far short of restoring overall spending to 2009 levels.

This still means very substantial belt-tightening for most state programs and likely will result in layoffs and loss of essential services to some Iowans.

In particular at this time, it is essential that Iowa lawmakers look at both the revenue and the expenditure side of the budget in responding to the recession. As previous IFP resource briefs have indicated, closing tax loopholes, taking tax incentives off automatic pilot, and making tax incentives and credits accountable to achieving public goals are needed reforms to provide for a balanced state budget over the long term and avoid cliff effects when federal money expires. IFP has identified upward of \$100 million in very questionable state tax expenditures that need to be part of the deliberations over how to balance the state budget.

While the federal stimulus package is meant to be spent over the next two fiscal years in order to stimulate the economy, increased state revenues as a result of this growth will be needed to sustain programs. Some of this should occur through the ensuing economic recovery; but some of this also must be achieved through a tax system that is fair and not laced with exemptions and loopholes.

Maintaining a balanced Iowa budget during and beyond the recession ultimately requires a fair and equitable tax system. Actions are needed on both revenues and expenditures to produce a sustainable state budget. As actions are taken on the expenditure side to stabilize spending through judicious use of federal stimulus funds, actions are needed on the revenue side as well.

**APPENDIX – Governor’s Proposed 2010 Budget and Child and Family Services**

<b>Department - Program</b>	<b>Actual FY 2008 Funding</b>	<b>Est. FY 2009 Funding</b>	<b>FY 2009 Funding with ATB Cuts</b>	<b>Dept. Proposed FY 2010 Funding</b>	<b>Governor Rec. FY 2010 Funding</b>	<b>\$ Difference (Gov. Rec. 2010 vs Est. 2009)</b>	<b>% Diff. (Gov. Rec. 2010 vs Est. 2009)</b>
<b>Education</b>							
Early Childhood-Community Empowerment	\$23,781,594	\$22,302,006	\$21,967,476		\$20,220,242	-\$2,081,764	-9.33%
Early Childhood- Early Care, Health, & Education (Comm. Empowerment)	\$10,000,000	\$10,000,000	\$9,850,000		\$8,523,624	-\$1,476,376	-14.76%
Early Childhood-Family Support & Parent Education (Comm. Empowerment)	\$5,000,000	\$5,000,000	\$4,925,000		\$4,604,875	-\$395,125	-7.90%
Community Empowerment - HITT	\$2,153,250	\$2,153,250	\$2,153,250		\$0	-\$2,153,250	-100.00%
Early Childhood-Special Ed Services Birth to 3	\$1,721,400	\$1,721,400	\$1,695,579		\$1,585,366	-\$136,034	-7.90%
Early Childhood-Voluntary Preschool	\$15,000,000	\$15,000,000	\$14,769,449		\$14,769,449	-\$230,551	-1.54%
Early Childhood- Early Head Start Projects	\$400,000	\$400,000	\$0		\$0	-\$400,000	-100.00%
Child Development (Standing) - CDCC, Shared Visions, AEAs, At-risk	\$12,606,196	\$12,606,196	\$12,417,103		\$11,609,991	-\$996,205	-7.90%
<b>Board of Regents</b>							
Center for Disabilities & Development	\$6,726,227	\$7,017,146	\$6,911,889		\$6,462,616	-\$554,530	-7.90%
Special Child Health Services	\$732,388	\$842,069	\$829,438		\$775,525	-\$66,544	-7.90%

**Department  
of Human  
Services**

FIP/JOBS	\$42,675,127	\$42,701,422	\$42,060,901	\$36,010,696	\$35,036,216	-\$7,665,206	-17.95%
Family Support Subsidy	\$1,936,434	\$1,936,434	\$1,907,312	\$1,936,434	\$1,783,337	-\$153,097	-7.91%
Child Care Assistance	\$37,875,701	\$41,345,381	\$40,483,732	\$45,848,033	\$40,452,289	-\$893,092	-2.16%
Child Welfare Provider Training				\$250,000	\$0		
Foster and Adoptive Family Peer Support				\$406,391	\$0		
Child Abuse Prevention (Standing)	\$232,575	\$240,000	\$232,911		\$217,772	-\$22,228	-9.26%
Medicaid/haw k-I Expansion Family Planning	\$0	\$4,800,000	\$4,728,000	\$14,800,000	\$4,420,680	-\$379,320	-7.90%
	\$0	\$750,000	\$738,750	\$750,000	\$690,731	-\$59,269	-7.90%

Child Support Recoveries	\$10,469,844	\$15,632,714	\$15,397,334	\$15,632,714	\$14,102,101	-\$1,530,613	-9.79%
DHS Field Operations	\$66,555,087	\$71,782,744	\$70,680,435	\$71,782,744	\$70,680,435	-\$1,102,309	-1.54%

**Department  
of Public  
Health**

DPH Comm. Capacity Pilot Projects - Family Planning	\$100,000	\$100,000	\$100,000		\$0	-\$100,000	-100.00%
DPH Comm. Capacity Pilot Projects - Maternal & Child Health	\$100,000	\$100,000	\$100,000		\$0	-\$100,000	-100.00%
Healthy Children & Families*	\$2,536,913	\$2,678,980	\$3,035,917	\$2,488,321	\$2,776,543	\$97,563	3.64%
Chronic Conditions**	\$1,842,840	\$2,249,026	\$2,215,291	\$2,988,374	\$3,750,280	\$1,501,254	66.75%
Child Vision Screening	\$100,000	\$100,000	\$100,000		\$0	-\$100,000	-100.00%
<b>TOTAL</b>	<b>\$237,865,823</b>	<b>\$256,230,762</b>	<b>\$251,748,559</b>		<b>\$235,935,249</b>	<b>-\$20,295,513</b>	<b>-7.92%</b>

\* Includes elimination of Mother's Milk Bank, Perinatal Program, Child Death Review to fund PHMA. Governor's Request includes \$562,340 increase from moving HCTF Healthy Children and Families line item to the General Fund.

\*\* Includes elimination of Iowa Stillbirth Evaluation Project, Epilepsy Education to fund PHMA. Governor's Request FY 2010 includes \$1,058,291 increase from moving HCTF Chronic Conditions line item to General Fund.