MARYLAND
BUDGET & TAX
POLICY INSTITUTE

*Analysis of state policy choices with particular attention to their impacts on low- and moderate-income Marylanders*

# SPECIAL REPORT

Special Report
February 27, 2009

**Maryland Budget & Tax Policy Institute**
190 W. Ostend Street
Suite 201
Baltimore, MD 21230

410-727-6367
fax 410-727-1914
www.marylandpolicy.org

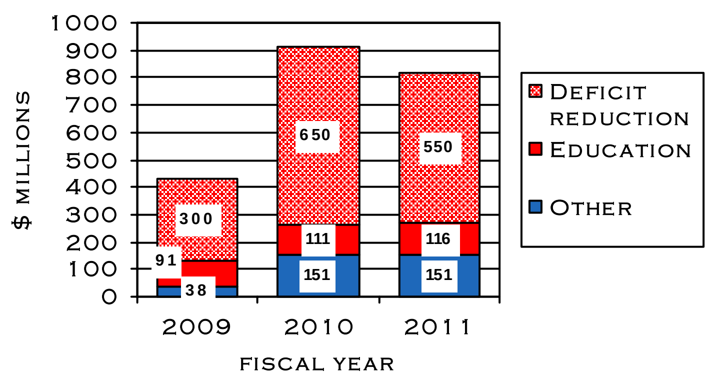
*a project of the*
***Maryland Association of Nonprofit Organizations***



## Maryland Budget Update

***The Governor's Plan for Stimulus Dollars***

- **Governor Martin O'Malley has proposed a plan to use flexible federal stimulus aid to restore cuts and eliminate projected state deficits over three fiscal years.**
- **Of $2.1 billion in flexible aid projected, $800 million will offset anticipated revenue write-downs, so as to eliminate the need for further budget cuts.**
- **$700 million was already anticipated in the Governor's existing spending plan.**
- **Over half of the remainder: $340 million will restore budget cuts for local schools or provide funding increases.**
- **Another $318 million will go for Medicaid, energy assistance, and other state-funded programs and will eliminate the need to lay off current state workers.**



## The Governor's Stimulus Plan

Within a month of the new president's inauguration, Congress passed a $787 billion economic stimulus bill. The bill is designed to restore demand for goods and service to the economy. Since households and businesses are buying less, government needs to step in to prop up the economy. This would put unemployed people back to work and re-start idle productive capacity.

It turns out that many of the programs that provide the best economic stimulus "bang for the buck" run through state and local governments. These include food stamps and unemployment insurance, health and education services, and infrastructure construction in transportation, water quality and housing.

So the stimulus bill, formally titled the American Recovery and Reinvestment Act (ARRA), includes over $300 billion in grants for state and local governments. $223 billion will be distributed through formulas (like Medicaid and education funding). The rest will be awarded competitively (like $200 million to help dislocated workers and $8 billion for high-speed rail).

Maryland's estimated share of the formula portions alone totals $3.8 billion (and the numbers are still changing as analysts puzzle through this 1100-page bill).

Some of this funding – like money for roads, transit, and water treatment – comes with a new cost. These pieces will be helpful to the economy, and they'll spin off some extra tax revenue in the future, but they don't provide the opportunity to restore state budget cuts right now.

But at least $2.1 billion is flexible aid for health, education, or general public purposes. This funding may be used to restore planed budget cuts or to provide additional public services.

Maryland Governor Martin O'Malley has announced his proposal for the use of this funding. It is summarized in Chart 1.

Funding comes from two sources: an increased federal share of Medicaid, and State Stabilization funds.

### Temporary Increase in Federal Share of Medicaid

The economic recovery bill provides a temporary increase in the share of the Medicaid program paid by the federal government (known as the Federal Medical Assistance Percentage or "FMAP"). The provisions will take effect immediately and provide Maryland with approximately $1.3 billion in assistance over nine calendar quarters (October 1, 2008 through December 31, 2010).

To receive the increased FMAP, a state must satisfy two requirements. First, a state's Medicaid eligibility levels may not be restrictive than those in effect on July 1, 2008. Second, a state must ensure that it is promptly paying physicians, hospitals, and nursing homes that provide Medicaid services. This means that Maryland's recent expansion of Medicaid coverage to parents up to 116% of the Federal poverty level must remain in place for Maryland to receive the increased match.

Maryland may extend coverage further, but expansion beyond existing eligibility will not get the advantage of the increased match.

## State Fiscal Stabilization Fund

ARRA also creates a "State Fiscal Stabilization Fund" to help state and local governments avert budget cuts amid the growing state fiscal crisis. The Stabilization Fund provides two block grants for states — a $39.5-billion grant earmarked for education and an $8.8-billion grant to help fund other key services. Together, these provisions provide about $48.3 billion in fiscal relief for state and local governments. (The Stabilization Fund also includes about $5 billion for incentive grants to address academic achievement gaps and other purposes, for a total of $53.6 billion.)

The $48 billion in block grants is allocated among states through a combination of two population measures. Sixty-one percent of the funds are allocated by each state's population aged 5 to 24. The remaining 39 percent of funds are allocated based on total state population. Out of each state's allocation based on these measures, 81.8 percent is reserved for the education block grant, and 18.2 percent is considered the "flexible" grant.

The $39.5 billion in education grants would support K-12 and higher education during state fiscal years 2009, 2010, and 2011. A portion of the funds would be dedicated to helping *states* maintain K-12 and higher education funding; the remainder would flow directly to *local* school districts. The funds must first be used to restore state education funding up to the greater of the FY08 and FY09 level, or, if higher, up to existing state formula levels. Maryland's share of the education stabilization grant is $721 million.

States can use the $8.8 billion in flexible block grants to avert budget cuts in education or in other basic state services, such as public safety and law enforcement, services for the elderly and people with disabilities, or child care. The funds are available to states immediately, and must be spent within two years of receipt of the grant. Maryland's share of the flexible stabilization fund is $160 million.

To receive the block grants, states are required to fund both K-12 and higher education at no less than the fiscal year 2006 level in fiscal years 2009, 2010, and 2011, though the Secretary of Education would have some discretion to loosen this requirement. States must also satisfy other requirements, including requirements for data collection, educational assessment, and equitable distribution of teachers among schools.

Chart 1

**Governor O'Malley's Funding Plan**

**$ million**

| | FY 09 | FY 10 | FY 11 | Total |
|---|---|---|---|---|
| **SOURCES:** | | | | |
| Medicaid Match | 420 | 560 | 300 | 1,280 |
| Education Stabilization* | | 296 | 425 | 721 |
| Flexible Stabilization | | 80 | 80 | 160 |
| **Subtotal** | 420 | 936 | 805 | 2,161 |
| | | | | |
| **LESS DEFICIT REDUCTION:** | | | | |
| Estimated revenue write-down | (300) | (300) | (200) | (800) |
| Stimulus assumed in original budget | | (350) | (350) | (700) |
| **Subtotal** | (300) | (650) | (550) | (1,500) |
| **NET SOURCES** | 120 | 286 | 255 | 661 |
| | | | | |
| **USES** | | | | |
| **Education** | | | | |
| GCEI | 38 | 88 | 88 | 214 |
| Supplemental Grant | | 15 | 15 | 30 |
| Non-Public Special Ed | | 48 | 48 | 96 |
| **Subtotal*** | 38 | 151 | 151 | 340 |
| **Other** | | | | |
| Medicaid | 50 | 30 | 30 | 110 |
| Energy Asst. | 21 | 21 | 21 | 63 |
| Community Colleges | 10 | 20 | 22 | 52 |
| Local Health | 10 | 10 | 10 | 30 |
| State Employee Positions | | 30 | 31 | 61 |
| DPSCS/DJS/DHMH/MSP/DHR | | 50 | 52 | 102 |
| LESS: Legislative cuts | | (50) | (50) | (100) |
| **Subtotal** | 91 | 111 | 116 | 318 |
| **Total USES** | 129 | 262 | 267 | 658 |
| **Excess of sources over uses** | (9) | 24 | (12) | 3 |

* Education Stabilization funds would also be used for teacher pension payments and formula aid, currently budgeted in state general funds

SOURCE: Martin O'Malley, Impact of American Recovery and Reinvestment Act and Fully Funding Maryland Schools, February 2009.

## Deficit Reduction

Before allocating funds to restore cuts or enhance programs, the Governor had to allocate $1.5 billion of the funding for deficit reduction.

$800 million was needed to offset further reductions in revenue estimates. The Board of Revenue Estimates reported its latest official estimates of state revenue in December. Since then, the national and state economies have continued to deteriorate. Since economic factors affect the state's revenues – particularly income and sales taxes – the Board will almost certainly reduce its projections when it revises the estimates in March. In addition, disappointing bids from potential slot machine operators mean the state will receive less licensing and operating revenue from slot machines in 2009 and 2010.

The Governor has anticipated that the Board will write revenues down by $300 million each for fiscal years 2009 and 2010. Although the Board does not re-estimate revenues beyond the budget year (fiscal year 2010) in its March report, the Governor has also taken the precaution of assuming 2011 revenues will be $200 million under the December projection.

Another $700 million must be deducted from the available stimulus funding because it was already assumed in the state's budget and financial forecast. The budget submitted by the Governor in January assumed $350 million in additional federal Medicaid funding would be available in fiscal year 2010. The financial forecast assumed a like amount in fiscal year 2011.

These deductions leave $661 million available for restoring budget cuts or supplementing programs.

## Education

The Governor proposes to use the education stabilization fund to restore education funding to the levels provided in state formulas, and to free up state general funds for other purposes.

The Governor proposes to restore planned reductions to the "Geographic Cost of Education Index, special education funding, and "supplemental grants" that assure each school system a minimum 1% increase in state aid. These measures total $340 million over the three years.

The Governor would also use federal education stabilization dollars in fiscal years 2010 and 2011 to pay part of the state's expenses for teachers' retirement contributions and increases in formula funding reflecting enrollment increases. These federal funds will replace the state general fund dollars that would otherwise be used for these expenses. The state general fund dollars, in turn, become available to reduce the deficit and to support other state programs.

In addition to the flexible education aid allocated by the state, local school systems will also receive nearly $400 million in federal stimulus aid directly over the two years fiscal year 2010 and 2011. Most of this aid will support services for economically disadvantaged students ("Title 1") and students with disabilities.

## Other Programs

The Governor's plan provides $318 million in funding for programs other than education.

- Medicaid: The plan includes $110 million over three years to fund caseload increases in the Medicaid program and avoid deficiencies in that program. The Governor's proposal does not fund any expansion in Medicaid eligibility.

- Energy Assistance: The plan provides $21 million per year – for a total of $63 million over three years – to meet demands for low-income energy assistance.
- Community Colleges: The plan eliminates proposed cuts in community college funding in the current fiscal year and provides 5% increase in fiscal years 2010 and 2011. The three-year total is $52 million.
- Local Health: The plan restores proposed cuts to local heath department funding, at $10 million per year for three years.
- State Employee Positions: The plan restores a $30 million funding cut in fiscal year 2010 in state employment. The Governor characterized this cut as potentially requiring lay-offs of 700 state employees. Another $32 million is restored in fiscal year 2011 reflecting the next year's cost of these positions. The budget still eliminates 1000 vacant positions and 435 specifically identified state positions.
- "DPSCS/DJS/DHMH/MSP/DHR": The plan sets aside $50 million in fiscal year 2010 and $52 million in fiscal year 2001 to "adequately fund" the departments of Public Safety and Correctional Services, Juvenile Services, Health and Mental Hygiene, State Police and Human Resources. The specific uses of this funding are not available at the time of this writing. The fiscal year 2010 installment will likely be included in a supplemental budget the Governor submits to the General Assembly. Given the enormous demands on these five agencies, the Maryland Budget and Tax Policy Institute does not believe that $50 million per year will constitute "adequate funding." However, this funding may be able to address a few critical needs.

Finally, the Governor's plan assumes that the legislature will cut $50 million from the base budget request in its regular budget review process. This would be a fairly modest level of cuts compared with recent legislative sessions. The plan assumes these cuts will carry forward to fiscal year 2011.

### Categorical and Competitive Grants

As indicated earlier, the Governor's funding plan does not include Maryland's share of categorical formula and competitive grants. As part of the stimulus bill, Maryland can also expect:

- Infrastructure funding of $781 million, covering transportation, water quality, and housing projects.
- Other formula funding of $780 million including the local education funds cited above and a variety of other programs. Many of these are outlined in the Maryland Budget & Tax Policy Institute's earlier report, Federal *Stimulus and Maryland* (http://www.marylandpolicy.org/documents/federalstimulus.pdf).
- Finally, Maryland state agencies and local governments will be able to compete for a share of over $19 billion nationally in competitive grants included in the bill.

### Assessment – Governor's Plan Follows ARRA's Goals

Governor O'Malley's proposal is faithful to the purposes of the American Recovery and Reinvestment Act. It would expend the funds promptly so as to actually stimulate Maryland's economy. It focuses resources on education and programs that help low-income and newly unemployed Marylanders. It provides a sound plan for using the funds over the three fiscal years covered by the bill.

The Maryland Budget & Tax Policy Institute continues to observe that staffing in state social services offices and other operations that administer benefits is at crisis levels. As a result, eligibility determinations and assistance programs are needlessly delayed, causing undue hardships and suffering. The Institute urges the Governor and General Assembly to dedicate a portion of the $50 million for agency operations and funding in categorical programs to staffing these operations at the level needed to meet the demand for services.

**About the Maryland Budget & Tax Policy Institute**

The Maryland Budget and Tax Policy Institute is a nonpartisan research organization that provides timely, accurate and accessible analysis of state budget and tax issues. In addition to general budget and tax research and analysis, the Institute examines issues affecting low-income Marylanders and other vulnerable populations and the important community programs that serve them. For additional information, to be added to our e-mail list, or to make a tax-deductable contribution, please visit our website at www.marylandpolicy.org.

The Maryland Budget and Tax Policy Institute gratefully acknowledges the Ford Foundation, which provides financial support for the Institute under its State Fiscal Analysis Initiative. Additional general support for the Maryland Budget and Tax Policy Institute is provided by the Aaron Straus and Lillie Straus Foundation, AFSCME-Maryland, the Eugene and Agnes E. Meyer Foundation, the Fund for Change, the Moriah Fund, the Maryland State Teachers Association, the Open Society Institute-Baltimore, and generous individual donors.

The Institute is a project of Maryland Nonprofits, www.mdnonprofits.org.

## Sources:

Center on Budget and Policy Priorities. *American Recovery and Reinvestment Act of 2009: State-by-State Estimates of Key Provisions Affecting Low- and Moderate-Income Individuals, February 25, 2009. http://www.cbpp.org/1-22-09bud.htm*

Department of Legislative Services, American Recovery and Reinvestment Act: Impact on Maryland Governments, February 2009. http://mlis.state.md.us/2009RS/misc/AmericanRecoveryReinvestmentAct.pd

Federal Funds Information for States, *Information brief 09-04 The American Recovery and Reinvestment Act Becomes law, February 23, 2009.*

Martin O'Malley, Impact of American Recovery and Reinvestment Act and Fully Funding Maryland Schools, February 2009.