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WEBINAR

HOW CAN CONGRESS BEST HELP STATE AND LOCAL GOVERNMENTS?

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PROCEEDINGS

MR. REEVES: Hello. Thank you for joining us. My name is Richard Reeves. I'm a senior fellow at the Brookings Institution where I run the Future of the Middle Class Initiative and Center on Children and Families. I'm really grateful that you've all joined us today and hope that you're all keeping safe and healthy in these trying times.

Approximately nine months ago, the economic equivalent of an asteroid hit the U.S. economy an exogenous shock in the form of the pandemic, which along with the loss of human life and the self-isolation that has been imposed and the public health concerns, obviously a dramatic shock for the U.S. economy and indeed to the global economy. One of the consequences, of course, has been some impact in the revenue of various branches of government, not least state and local government. Early predictions of a catastrophe in terms of the balance sheets and revenues of state and local governments were not, thankfully, realized.

Nonetheless, as you'll hear from the panel who are about to be introduced to you, there has been a negative impact. That impact has varied between different places and, in many cases, may be more important than in other downturns, not least because of the impact on education. As we think about the long run impact of the pandemic and the associated economic costs for the nation, the loss of learning that we're seeing, particularly for those from less advantaged backgrounds, is significant. And, of course, that is an area where support will be helpful.

So, what has happened is that we've seen an accentuation of a permanent question, which is how best do federal governments support state and local governments, not only in times of crisis such as the one we're in now, but more generally? This is a question of and a question of policy and a question of economics, and it's one that's in the headlines right now, but also one that is subject of ongoing policy concern. And we're going to hear from the leading scholars in this field about the different ways we should think about helping states and localities and the different approaches that we should take.

But I will say at the very beginning that one way to help state and local governments is purportedly to remove the cap on the state and local tax deduction which was introduced in the Tax Cuts and Jobs Act. That is a bad way in my view and I think in the view of most people who've looked at this and the experts you're going to hear from. That's a bad approach, although it is one that's been suggested by leading politicians, including Chuck Schumer, who's set to be, of course, senate majority leader. And that is not to say that that isn't the right question how best should we be helping state and local governments? It's just that that's not the right answer.

And so the purpose of today's event is to come up with some better answers, more sustainable answers, and fairer answers, answers that are better grounded in fairness and in economic efficiency. And so as we're going hear from, they'll be some publications associated with some of these presentations, as well, and an ongoing debate here at Brookings. Please forward any questions using the hashtag #SALTdeductions as a kind of reminder of the place not to go for the kind of reform or using the usual email, events@brookings.edu.

And with that introduction, it's my great pleasure now to hand it over to my colleague, Bill Gale, who runs the Tax Policy Center, who's a senior fellow in Economic Studies and that runs the Tax Policy Center, which is a joint center between Brookings and the Urban Institute, to moderate our panel today and lead us through this discussion. Bill.

MR. GALE: All right. Thank you, Richard. Welcome, everybody. Thank you for joining us. We're aware that there are some other things going on this afternoon that might be of tangential interest to some people, but we're here to talk about state and local governments and the federal government and the relation between the two of them.

We have four excellent presentations lined up. I'm going to introduce the speakers real quickly now and then ask people to simply move through their presentations.

Our first talk will be by Louise Sheiner. She's my colleague here at the Brookings Institution. She's the Robert S. Kerr senior fellow in Economic Studies and the policy director for the Hutchins Center on Fiscal and Monetary Policy. Before joining Brookings she had a long career at the Federal Reserve Board. She served as deputy assistant secretary for economic policy in the Treasury Department. And she worked at the Council of Economic Advisors and the Joint Committee on Taxation. So, she will talk about the situation facing state and local governments and some aspects of their recent actions.

Our second speaker will be Josh Bivens. He's the head of research at the Economic Policy Institute. He's appeared widely in print media and television and radio. And in the past, he's served as assistant professor of economics at Roosevelt University.

Tracy Gordon is our third speaker. She's a senior fellow at the Urban Institute and the Tax Policy Center. She formerly worked at the Brookings Institution, at CEA, and the Public Policy Institute of California.

Our last speaker is Josh McCabe. He's at the Niskanen Center. He's also assistant professor of sociology and assistant dean for social sciences at Endicott College.

I am eager to get to the talk, so I'll sum up here and turn it over to Louise. And then after the conversations, after the talks, we'll have a general discussion and take questions from the audience.

MS. SHEINER: Okay, thank you. Can you see my screen?

MR. GALE: Yes.

MS. SHEINER: Great. Okay. Well, thanks for having me. So, today I'm going to talk about the fiscal effects of COVID-19 on state and local budgets.

So, why should we worry about state and local revenues in the first place? So I'm thinking about it really with respect to COVID. So balanced budget requirements mean that when revenues fall you need to either cut spending or increase taxes, unlike the federal government who can just borrow.

So, that is bad for a number of reasons. One, it's bad for people in the state. What you really want to do when you're hit with a shock is smooth through it by borrowing. State and local governments can't do that.

It's also bad for the economy. And the state and local governments are a very big player in the economy. They account for 13% of employment. The extremely slow recovery in the state and local sector following the Great Recession really was a major factor slowing the overall economic recovery.

So, one thing that you learn, though, is that this recession is really different. So, last spring, many people were warning about absolutely monumentally huge revenue losses given the surge in unemployment that we saw and that CBO forecast for continued high unemployment. And it turns out the losses have been quite a bit smaller than anticipated.

One reason is unemployment fell faster than CBO had thought. But I think maybe even more important is that the relationship between unemployment and revenues are just very different this recession than in the past.

So, for one reason this recession is an especially low-income recession. All recessions hit low-income people worst, but this one is especially so, meaning that the loss of tax revenues is smaller. So, it's terrible for inequality this K-shaped recovery, but it helps on tax revenue.

Similarly, the CARES Act expanded unemployment benefits much more than had ever been done in a previous recession. And in most states, unemployment benefits are taxable, so even though unemployment was high, taxable income didn't fall commensurately.

Third, unlike other recessions the stock market has done quite well and the housing market has done well, as well. What does that mean? It means that capital gains taxes and property taxes are robust whereas in previous recessions they have been not. So, all those things are reasons why income tax revenues, although they have been affected, have been affected much less than in the past.

On the other hand, there have been much larger declines in sales taxes and other taxes, like excise taxes, as consumption has fallen. And particularly, there's a lot of tax revenue that state and localities get from transportation: gas taxes, airport taxes, things like that, parking. And that's just been decimated. Right? So, it's a really -- so, the managers and different and the composition is way different than in previous recessions.

But when you add it all up, what is the condition of state and local budgets? Well, that's hard to know. I have done some work. I did work with a BPEA paper with Bill Gale, Alan Auerbach, and Byron Lutz. And I've kind of recently done some back-of-the-envelope re-estimates. And I think a reasonable estimate is that state and local revenue losses will be about $300 billion over 3 years starting in 2020. Now, state and local governments have received about $400 billion in federal aid, so they've received more in aid than they've lost in general revenue losses, but that aid wasn't meant to cover general revenue losses. It's not perfectly flexible, but probably it's relatively flexible, and there's a lot of uncertainty about that.

The other thing is it's unclear how much expenses have increased because COVID clearly also created some new expenses. Right? So it may be that they got enough aid to cover their revenue losses, but not enough to cover their revenues losses and their expenses.

And then finally, this is from the nation as a whole. Clearly, some states, particularly those depends on tourism and energy, are much harder hit. And even within a state you might say the state as a whole is doing okay, but localities may not be doing it or transit authorities may not be doing okay. It's not clear that the money flows around in the way to sort of -- in the way that you might expect.

One thing that's interesting is that if you think about the Great Recession revenue losses and this recession, the revenue losses were just much -- they're much smaller this time. So, I estimate that sort of inflation-adjusted own-source revenue will be about 3.25% last year's, in 2020, about 3.25% 2019 levels, and then be about back to 2019 by 2021; lower than they would have expected pre-recession, but just in terms of the level. In the Great Recession real revenues fell about 8 % and stayed below that level for years. So, in terms of revenue losses, this is clearly much smaller than the Great Recession.

What's so interesting is that the employment declines are much bigger this time around. So, let me just quickly tell you. So, these are state employment on the left, local employment on the right; solid lines are this recession, dotted lines are the Great Recession; green is education and blue is non-education.

So, what you see is, first of all, the solid lines are on the bottom for both education and non-education, state and local. So, employment declines have just been much larger however you look at it. And education at the state level has fallen really dramatically, and sort of non-education and education have fallen a lot. So, compared to the Great Recession, that top line, the declines in employment are much larger and much swifter. Right? It took a long time last time for unemployment to climb. Why is that?

So, I think one of the main reasons is really about social distancing. So, schools go virtual, they don't need bus drivers, they don't need cafeteria workers. Parks were closed, DMV is operating about half capacity. There's just less need for employees. And so I think that's part of the reason.

There is some evidence -- not next slide; I changed my slides; this slide, sorry -- that tight budgets affect local education employment. So, if I look at -- so, these two slides, on the left is local education employment changes since the beginning of the year and revenue losses that we projected as a share of own-source revenues. And so the states that have larger revenue losses do have larger reductions in local education employment.

And if you look at how about states that got more aid, the more aid you got, the less you cut local education employment. If I do this for other kinds of employment, state employment of any kind, local, non-education employment, it doesn't work. I only see this on local education employment.

So, does that mean that like more aid wouldn't help increase spending? No, I don't think so. More aid would likely help increase spending substantially. So, one, as I said, local education is clearly affected by aid, so more aid would help increased spending on education.

And as Richard mentioned, I think one of the worst aspects of this recession is the impact on poorer kids of this going virtual. You know, they have lost a year of schooling. There's widening inequality of how much learning's going on by income. This will require, particularly once we're not virtual anymore, a lot of money to remediate, as well as some creativity. And I really think that's the biggest place where we need to focus on.

You know, and the fact that it's hard to find an empirical relationship between spending on unemployment and other kinds of employment besides local education doesn't mean that it's not about money. Right? States are all different. They're making different choices. They were really, really scarred by the Great Recession and how difficult it was and how long revenues were low. And I think they're just very nervous and, you know, the outlook is really unclear. We have a vaccine now. How long is it going to take to get vaccinated? Will there be another series of lockdowns? Will the vaccine work long-term?

So, I think that they are just being very, very cautious. And more money would help reassure them that it's okay to start spending again. And them, as I said before, some state and local governments are clearly in financial distress and more money would help.

Okay. Thank you very much. I'll stop sharing my screen and I'll pass it over to Josh Bivens.

MR. BIVENS: Thank you. Can everyone hear me? I think I've taken myself off. I'll try to be relatively quick.

I'd say I think this is a really timely discussion. I think I agree that allowing unlimited deductibility of state and local taxes from federal income taxes is not the most efficient and progressive way, but I would try to transfer fiscal resources to states from the federal government. And I do think unless policymakers hear of more efficient, direct ways to do that transfer, they're going to be really tempted to go back to uncapping that. So, I'm happy to be a part of this discussion.

I'll just say a couple of things. I do think there is some -- you know, it's really bad timing for the unlimited deductibility of state and local taxes was not a great way to transfer fiscal resources to states. To take it away just as that need became ever greater is really bad timing for state and local governments, so I think we should try to deliver something quickly.

I would say the two things I'm just going to talk about in my time is that since 2008, it's become really clear that this federal aid to subnational governments, one, there should be triggers. It should be automatic. It should not depend on ad hoc decisions by Congress. I think that's just an obvious, clear lesson.

I'd also argue, though, that the sort of post-2008 experience should also make us think that the federal government should take on more of the nation's overall fiscal burden going forward, even in normal times. And so those are going to be sort of two of things I argue about.

So, the easier argument first, using state aid as an automatic stabilizer, not being dependent on sort of ad hoc congressional decisions, you know, we know from the very high-quality empirical work looking at provisions in the American Recovery and Reinvestment Act that federal aid to state and local governments, it works really well when it flows. You know, I think you could see it in some of Louise's slides. Like you actually see state and local employment hold up pretty well during the actual recession. And it even holds up pretty well until sort of mid-2010.

Then as the ARRA provisions that provided aid to state and local governments dry up, you start to see the state and local sector become a very big drag on growth. In fact, if you look at how long it took to regain pre-recession levels of unemployment, and you compare growth in state and local spending per capita in the recovery from the Great Recession, with other recessions, say from the 1980s on, you can basically say that this sort of state and local spending austerity by itself probably delayed recovery by about three or four years relative to what would have happened if we had just followed sort of historic norms and how quickly state and local spending usually grows following a recession. So, it was a very big deal.

You know, the evidence that this needs to be automatic is just the experience of the Great Recession. As soon as the discretionary air of ARRA went away, it became a big drag on growth. And honestly, you know, I would even say so far in sort of the COVID-inspired recession, or I don't know if we're in -- anyway, since the COVID crisis began, there's been no general state aid. Louise points out that there's been lots of sort of the targeted state and local aid that might even add up to cover the revenue losses. I think her point that there are spending needs that have probably increased a lot given COVID is really well taken.

I mean, the flip side of the fact that this was a low-wage recession, meaning revenues fell less, I think it also means the human needs were greater because of the recession. Because you're talking about an affected population that was much less likely to have a buffer stock of savings and the fact that COVID has just been such a disaster for education and it's required all sorts of rejuggling of how we actually try to educate kids, especially kids who have the highest needs. I think just looking at revenue losses would be understating the fiscal distress that this has put on states. And I think that was a really good point that you made. So, I think, you know, we really want triggers going forward if you want aid to be -- at least some good tranche of aid to be delivered more automatically.

And then finally, I'll just say I do think the growing literature on sort of chronic demand shortfalls facing the U.S. economy, whether you call that secular stagnation, the falling mutual interest rate, I think it needs to be taken pretty seriously when you talk about sort of overall fiscal policy, sort of a combination of federal, state, and local. I think basically what this means is we're going to need a more flexible approach to how we think about overall national fiscal balance over the business cycle.

And we likely should be willing to tolerate larger deficits during normal times than we may have been comfortable with in the past. I think budgeting rules along with some real economic constraints mean that state and local sectors are going to have a hard time tolerating larger deficits during normal times. That's really going to be a job for the federal government. They could just do it themselves without running resources through state and local governments, but if you think the services provided by state and local governments are valuable, and I do, I think it just makes natural sense to increase sort of a baseline level of federal aid there.

I would say I think there's two other reasons. These are maybe more political, less economic why the federal government is better poised to take on more of the fiscal burden going forward. First, between state variance and the quality of services delivered by state and local governments is starting to look like a real problem. Maybe it's always been a real problem, but, you know, the state heterogeneity in dealing with the crush of unemployment benefit-seekers over this crisis, it was really hard to see. I mean, if you were in a state with a really low-performing unemployment insurance system, you waited months and months to get the aid you were entitled to. That seems pretty unacceptable to me.

Second, even if we get back to an era -- and so, if the federal government can provide resources across all states, maybe you can reduce or at least bring up some of the low-performing states. Second, even if we get back to an era where I think all -- you know, most public spending, all public spending should be tax-financed rather than debt-financed in normal times, if we think there is a value to having taxes be progressive, I think the federal government faces far fewer constraints in raising significant amounts of revenue progressively than state and local governments do.

You know, I think claims of millionaire migration due to high tax rates in a given state are way overblown. Again, it just seems obvious to me that this is going to become a risk at the state level far before it becomes a risk at the federal level.

I'm mostly stop there. I will say in terms of how we construct automatic triggers for aid to state and local governments, how we increase the baseline level of federal aid to those governments, I'm pretty ecumenical. I think there's tons of good levers out there that could be used. I've got some opinions on what they precisely should be, but to me the bigger issue is just the overall sort of view that this needs to happen, that we need better automatic stabilizers. The state and local sector is an obvious way to do it. And we need a larger part of the nation's fiscal burden borne by the federal government going forward.

And so I will wrap up there. And I'm going to pass it over to Tracy Gordon.

MS. GORDON: Hi there. Okay. I'm going to share some slide very quickly. I think my comments are going to be very complementary to what you've already heard from Louise and Josh. This is a joint work with Len Burman and Nikhita Airi. And we should have blog summarizing some of these thoughts coming up soon, as well as similar work in this area.

So, as Louise mentioned, economic shocks can be very harmful to state budgets. These are some data that my colleague Lucy Dadayan collected from state revenue estimators, so these are monthly data providing some of the most timely and accurate information that's available on state revenues. And she basically found that the initial shocks from this downturn were greater than in the Great Recession. Personal income taxes fell by about 40 % initially. Sales taxes fell by about 15% compared to about 30% and 14% in the Great Recession.

Now, as Louise points out, a lot of these revenues came back. Some of them were mechanical, basically caused by the filing deadline extensions that the federal government implemented and then states soon followed. But it's hard to overstate the enormous uncertainty that existed in the second quarter of 2020 and how states really had to adjust very quickly to an abrupt and very deep revenue loss.

As Louise points out and Josh pointed out, states are constrained by the Fed's balanced budget rules, and so their actions, either cutting spending or raising taxes, can harm the overall economy. We see this right now where state and local governments have detracted about 0.4 percentage points from GDP growth over the last two quarters. During the Great Recession, from the middle of 2009 all the way through 2013, their contribution to GDP growth was either negative or zero.

And building adequate reserves or insulating themselves against budget shocks is difficult at the state level. So, states and cities both went into this downturn with record high savings in their rainy day fund. However, there was a lot of variation around that average. So, Wyoming famously has reserves that are above its budget because of revenues from severance taxes. Illinois was closer to zero.

And there are well-known reasons why it's difficult to amass savings at the state level. There are political inhibitions against having too much surplus around, pressures to rebate those savings; or on the converse, you can see governors basically having pressure to spend money to help secure reelection and they're supporting academic literature for that. So, there are structural features that could improve the design of rainy day funds, but it's hard for states to get the political wherewithal to implement those changes. So, things like uncapping rainy day funds or establishing clearer rules around deposits and withdrawals.

It's also not straightforward economically how you should exercise that option value to use your rainy day funds. Basically, if you use your rainy day fund this year, then you don't have it around next year. And so I think some of the sort of psychological scarring that Louise mentioned can come into play here, and it's just not a straightforward question.

Also difficult is timing and targeting discretionary federal assistance. After the federal government acted very swiftly and decisively in March and April enacting $2.6 trillion worth of total aid, about $240 billion of that was geared towards state and local governments, although not all of it unrestricted, which is the biggest bang for the buck, as COB and other analysts have found. That assistance meant a lot, but then nothing happened for eight months and that, again, led to enormous uncertainty at the state and local level as they had to develop their budgets without knowing whether more assistance would be forthcoming.

Work by Jeff Clemens, Ippolito, and Veuger showed that it's also difficult to time the assistance. So, we now have an increase in federal reimbursement for Medicaid costs that's tied to the declaration of a public health emergency. As soon as the public health emergency is over, that aid will also be over and it's hard to know if that will be timed correctly with state fiscal conditions. So, right now, that's acting as unrestricted aid. States are getting enough money to cover both the enrollment increased costs by the economic downturn and to have funds that they can then use to support what they otherwise would have spent, so they can redirect their funds to other purposes. But, again, the timing is difficult. It's not necessarily tied to the fiscal condition of the states.

So, we propose an alternative. We would like to direct funds from the tax expenditure of the foregone federal revenues from either the full or parties SALT deduction, and that amounts to about $80 billion to $100 billion a year to a State Macroeconomic Insurance Fund, or the SMIF. And the SMIF would be governed by the SMIC, the State Macroeconomic Insurance Council. And basically would make automatic payments to states in recession based on a formula that's tied to economic conditions, not revenue forecasts, not deviations from revenue forecasts, but something that's objective and not politically manipulatable.

Importantly for federal budget treatment it would be considered a non-budgetary account or a deposit fund. So, the contributions to the fund would be considered outlays when they're made, not when those payments are actually disbursed. And any additional revenues, for example if states paid premiums, would be recorded with offsetting outlays. So, this is similar to the federal budgetary treatment of loan guarantees, and basically would ensure that federal policymakers could not raid the fund as with Social Security, for example.

So, the SALT tax expenditure is quite large and that would be enough for a robust countercyclical fiscal assistance program, but you could make it more like insurance if you wanted states to pay a premium that was tied either to their utilization of the und or projected utilization or if you wanted to have it somehow related to fiscal capacity on a declining or sliding scale. We would want the fund to pay out only for large emergencies, so a condition of participation would be that states maintain some minimum reserves. And this could be a way of harmonizing the rules around rainy day accounts, as well. And that would function similarly to a deductible in the insurance market. You could also require that states contribute some amount to solving their budget crises, and that would be similar to coinsurance in an insurance model.

A frequent concern with insurance is moral hazard. And that often comes up with so-called bailouts of the state and local sector. I would point out there's two kinds of moral hazard: ex ante and ex post. So the ex-ante moral hazard is that states would expect federal assistance and, therefore, not take precautionary measures. If we have conditions that are tied to -- if we have a formula that's based on economic conditions and not revenues, there's less of a danger of that. And also, the deductible and coinsurance would limit overutilization of the fund.

If we're concerned about adverse selection or only states that would actually use the fund signing up to participate, then we could make it universal or required to participate.

So, there are obviously all kinds of tradeoffs with setting up a program like this. I think our motivation is that these so-called hundred-year events or hundred-year floods seem to be happening more and more frequently. The Great Recession and COVID are both things that we thought would be, you know, never seen in our lifetimes and now we have two in a decade.

There's also some evidence that Medicaid enrollments and taxes are also growing more volatile with respect to the economy. And that puts states that are not necessarily built to absorb risk in a position where they're absorbing a lot of fiscal risk with repercussions for the larger economy, as the two previous speakers have mentioned.

So, the debate, as Richard said at the beginning, about the SALT cap appear is really an opportunity to rethink the whole federal, state, and local relationship. And I understand that, you know, there are winners and losers under any proposal to the states that benefit a lot from the SALT deduction. A bird in the hand rather than some hypothetical program is worth more to them right now. But I do think that the value of risk protection is going to become more and more important and greater than the cost of setting up something like this.

So, thanks very much. And I will turn it over to the other Josh.

MR. McCABE: Thanks, Tracy. All right. So, I'm going to be a bit less about rainy days and more about some everyday problems with our current set of fiscal federalism.

So, my starting point is this idea that COVID-revealed states were just not equipped to deal with increased unemployment and the need of income support to keep people afloat. So, we have had some innovative pledges, like the unemployment top-off, the relief checks, but I don't think they're a really good substitute for state administrative infrastructures that can be activated pretty quickly.

So, some people will note that we have programs like TANF and some states have general assistance programs. So, it's worth examining why they didn't really help in this case. So, I'm going to focus on two issues here.

The first one is this idea that federal support is in adequate and leaves states bearing too much of the fiscal burden. It's been a theme today. But also, I want to focus on this idea that existing allocation is enormously inequitable. So, you're going to see a lot of maps from me. I love maps. My daughter loves Dora the Explorer, so I think that tells a lot of the story.

So, the first problem is inadequate federal support. So, a lot of people know the story of AFDC as a matching grant, which converted to a block grant in 1996. And at the time, states received about 16-1/2 billion based on spending circa 1996. The program -- or the value of that block grant is not automatically adjusted for inflation and population growth. So, it was 16.5 billion in the '90s and it's 16.5 billion today. If it had been properly adjusted to keep pace with inflation and population growth, it'd be closer to about 27 billion today. So, that amounts to a 42% decline in the real value of the grant for states.

So, this is only for families with children. If we think about this recession and all the folks who are employed who are able-bodied adults with dependents, the story's even worse. So, the U.S. had never had any federal support for general assistance programs, so, needless to say, that's even more inadequate than what we see with the TANF.

The second issue is the allocation across states. So, rather than base funding on fiscal capacity or population, the TANF block grant formula as it exists today is an anachronism of the old system that replaced it. The previous system used the FMAP matching formula, which for a lot of reasons I can get into later ended up favoring wealthy states for poor states. So, when it was converted into a block grant, policymakers simply froze the existing federal funding allocation, and this had the effect of locking in previously existing inequities.

So, this was exacerbated by differential growth in the population under 18 across states because TANF block grant is allocated on a per state rather than per capita basis. So, we'll see states like Nevada have seen a lot more children, have states like Vermont have seen the number of children actually decline. So, that's going to increase or exacerbate these inequalities.

Furthermore, we actually see the opposite of what you might expect from a progressive federal system. The way that it locked in these existing inequities, New York, which is a very wealthy state, receives almost five times as much per child as Mississippi, which is a very, very poor state. So, this is extremely regressive. It exacerbates income and racial inequality. In a good system we would actually see the opposite here. So, we want to see them inversely correlated; we see them positively correlated.

So, the problem is that you can imagine it's worse for general assistance programs. Some support is better than no support, but with general assistance there's no support at all. so, you can imagine Mississippi is going to have a lot more trouble funding a system of general support than New York without any federal assistance.

So, the question is, is this an inevitable outcome of block granting programs? So, this is -- I'm a sociologist. This is common sense that if you block grant a program something bad will happen. I'm a comparativist by training, so the first thing I always do is look to Canada, which I think tells us a whole lot about what's going on. I think Canada's experience suggest that the answer is no, this isn't something that's inevitable.

So, most people don't realize that Canada had similar social assistance matching grants into the 1990s. And in 1996, Canada block granted their social assistance federal funding. But they did so very, very, very differently.

So, in the U.S., some of the things we've talked about, we only cover families with children, allocated to states based on spending in the 1990s, not indexed for inflation. And what we've seen is a declining reach in benefit levels. So, TANF, some people would declare it dead. I think it's still alive a little, but it's clearly declined a lot over the past 25 years.

Canada looks very, very, very different. Right? So, families with children are eligible, but also able-bodied adults without dependents. It's allocated to provinces on a per capita basis. And they've legislated an automatic 3% increase, which has been higher than the inflation rate.

So, what we've seen in Canada, right, even though they block granted at the same time, is these programs have been relatively stable in terms of their reach and their benefit levels. They're doing what they're supposed to be doing.

And the other big thing, this is -- I love pointing this out that we can talk about the SALT deduction and U.S. federalism as it's sort of given. But the reality is most or pretty much as far as I know all other federal countries don't have a SALT deduction. They've never had a SALT deduction. So, this idea that if we take away the SALT deduction you won't have any spending on a subnational level, I think Canada, Australia, Germany, all the other countries that have never had this deduction show that's just really not the case.

So, what can we do about it? It's a pretty simple plan: we just talk to Canada. It's not original, but I think it's really useful.

So, what does that entail? First we could eliminate the SALT deduction. These are just back-of-the-envelope numbers. Use social revenues to increase total funding for state social assistance programs. We could then expand federal support to general assistance for able-bodied adults without dependents. This is something we've never done. Canada has done this since 1966. I think we should join that club, as well.

So, we could take all of that funding, close to $36 billion, and allocate it on an equal per capita basis for those under 65. So, anyone who might potentially be eligible -- SSI covers the elderly, so we wouldn't need to include them -- and index after inflation to make sure that it doesn't erode again in the future. And we would see some pretty significant shifts over time if we did that.

So, this would be about 130 per capita under 65 to each state. So, this would be deficit-neutral. It would actually make the system a lot more progressive. Right? So, the SALT deduction we know is pretty regressive. It goes primarily to high-income people. Social assistance primarily goes to low-income people. So, we would see progressive in terms of income, but also progressive in terms of giving that money better towards states with lower fiscal capacity.

So, you can see states like Texas or Mississippi would see a huge increase in the amount of support they get from the federal government. Based on these numbers we would have two states that are doing pretty well for themselves. New York is one and the District of Columbia is another one. So, we could make sure that they don't actually lose money from this. But under this scheme they wouldn't actually get any new funding. But most states would see five or six times what they're getting now.

So, this would also have the benefit of bringing the U.S. in align with other rich democracies in regard to fiscal federalism. So, no other countries have a SALT deduction. Most will have a broad either proportional or progressive set of federal support for social assistance. And this would do both of those.

So, it wouldn't help with any of the rainy day issues we're talking about. It's really just fixing what I think is one of the major, major flaws in American federalism by simply looking at what the rest of the world is doing and bringing us in line with them.

So, I will leave it there and I will turn it over to Bill.

MR. GALE: Okay. Thank you all very much for four stimulating talks. I have a few questions and there are some questions that people have sent in. I guess the first thing I'd like to start with is I was going to ask this anyway and I was intrigued by Josh's graphs at the end. We tend to talk about states as if they're a monolithic sector and, in fact, there's huge variation. I'm just wondering, maybe this is for Louise, in the current environment how would you characterize, you know, states that are doing badly versus states that are doing well? How many fall into one category, you know, or another? I mean, I can imagine if like New York and California and Texas are doing badly that's going to influence the aggregates, even if lots of other states are doing well. What can you tell us about that and the current downturn?

MS. SHEINER: Well, I haven't looked exactly at how many states are doing well economically versus not, but one of the things I can say is, well, first of all, we know California actually is doing pretty well, much better than they expected. The tech sector's done very well in this recession and, therefore, their revenues are quite high. That wasn't included in any of my estimates, like, oh, well, tech is going to do great. So, that's one big state that's doing well.

In terms of the states that are not doing well are states, as I said, very heavily dependent on tourism or oil revenues. But the other thing is that the way the aid was disbursed, you know, and this relates to what Josh was talking about, the $150 billion coronavirus relief fund had a minimum of $1.5 billion per state. That was just a huge amount of money for the small states. If you looked at what they got, they got like 20% of their own-source revenues in aid just from that. And so there was a really big difference in how generous aid was.

So, a lot of smaller states I'm just not that worried about because their aid was quite large. And if they manage to use it, there's no way their expenses went up as much as their aid, I don't think. So, if they manage to use it, which I think they have, then I think they're in decent shape.

So, some of the big states, you know, I don't -- off the top of my head I can't tell you how Texas did, but the small states are fine. I know California's done pretty well. Tracy probably has a better sense. You can (inaudible), Tracy.

MS. GORDON: I thought they had taken this out of my hands. Okay. So, in our data the average decline from March to October for all states is about 5%. For states like Texas and Florida, it was greater than that. I think it was more like 10% for Texas. It was like 15% of Hawaii and a couple of other states. And then you had states that did better, like Idaho, and that could be -- well, that's their own revenues, but revenues were helped enormously by the federal assistance for individuals and businesses. And so I think that's another important difference between this recession and previous recessions. And again, why having these automatic formulas either pegged to something like unemployment or personal income, if you think that's a better metric, is so important.

MR. GALE: All right. Well, let's turn to these automatic formulas. I understand the economic logic of them. I'm wondering a little bit about the politics. There's a -- you know, politicians want to get credit for things that they do. There's a quote that I think someone told me Senator Russell Long said, but I've never been able to track it down. But it's to the effect that a politician should never solve a constituent's problems until he knows he has one. (Laughter)

And so the automatic stuff, I mean, I get the economic logic. How do you assess the political possibilities of something like that? And this is for anybody. Anybody who will unmute.

MS. GORDON: Yeah, I'll jump in since I managed to unmute myself. So, I actually had a project that I was planning in February/March of this year looking at barriers to enacting automatic stabilizers because it seemed like going into this crisis, you know, all the economists and sort of thinkers on this issue were aligned on doing something on automatic stabilizers. And yet, it seemed like there was just no political prospect for that happening. So, I think part of it is what you said, that legislators like to legislate. I think it's also demonstrating to a larger set of actors the importance of certainty and creating some kind of confidence the federal government will act and act quickly and reasonably.

So, I think showing those tradeoffs is very important, as well as if the counterfactual is not no action, but poor fiscal stimulus, you know, fiscal stimulus that's designed by the seat of your pants. And so I think there might be structural improvements to things, like CBO scoring of automatic stabilizers, that could really help make them look more attractive.

MR. GALE: All right. Josh?

MR. BIVENS: Yeah, just, I mean, quickly. And the politics are hard and I'm probably wrong about this. But, I mean, part of it is convincing them that it's probably not in any incumbent's interest to be sitting on top of an economy that is really bad. And so these are things that will keep economy from getting really bad, and if you think that helps you as an incumbent. I mean, you know, to be really blunt about it, talking to sort of especially Democrats on the Hill right now and urging them to go too large rather than too small on COVID relief, like the 2010 midterms were a disaster for them I think at least in part because the economy was so bad and people did not think anything had been done to help them, and so this sort of solves that problem.

And then, too, I would say, you know, just because they're automatic doesn't mean you can't take credit for them every time they trigger. I mean, if you're someone who wants to talk about federal dollars going to your state, you can point to it. You're like we passed this thing a couple years ago and it led to this much money coming to our state this year.

So, yeah, I think the idea that someone's going to point out that that was three years ago and maybe you weren't on the committee that did that, I mean, just take credit for it.

MR. GALE: Great. Let's talk about state unemployment insurance systems. In the pandemic, unemployment insurance last summer they ended up just tacking on $600 because -- they did other things, too, but rather than making it proportional or dependent on anything else they just tacked on $600. Allegedly because the unemployment insurance systems were so antiquated that they couldn’t make those changes, that -- and then there’s this sort of background issue that some states want to make it hard to get unemployment insurance and some less hard.

So, the question is, given the key role of that as an automatic stabilizer and kind of a humanitarian policy, should we make that federal? Should we offer federal money to bolster the administration of state unemployment systems? I mean, that seemed like kind of a disaster to me last summer and I just -- you know, what are your opinions about that?

MS. SHEINER: I mean, I think there’s a good argument for making it federal. I mean, if you look at the adequacy of benefits across the states, some states are reasonable. Forget about just the administrative stuff. And some states are just completely unreasonable. They’re not providing adequate unemployment insurance. So, that either says, you know, change the rules, which then politically you can’t get through, or federalize it and make sure every state has adequate unemployment insurance that’s related to their wages, but the replacement rate shouldn’t vary so dramatically across states and the number of weeks that you can get shouldn’t vary so dramatically across states.

MR. GALE: Josh?

MR. BIVENS: I mean, I definitely support that. I do think federalizing it would solve a lot of problems. I think that the ones Louise just mentioned are the really key ones.

I mean, obviously, I think it just makes the whole system less fudgy to have one sort of unified system of sort of minimum benefits, as well as the financing. I mean, the UI financing system is pretty byzantine with all of the state trust funds and they borrow from the federal government and how that -- it’s just -- there is a chance to have real economies of scale and how all of this is constructed, along with making sure you’re at least providing sort of a baseline level of adequacy.

So, I think that should be the goal. Whether or not we get there, there’s lots of things you could do without full federalization. But, boy, this seems like that should at least be the target at the outset.

MR. GALE: Okay, great. Are there -- oh, sorry, Tracy.

MS. GORDON: No, no, go ahead.

MR. McCABE: I was going to say two advantages in Canada, you have a federal unemployment insurance system, and the two advantages there are, one, that it's a bit more redistributive because seasonal unemployment or places with higher unemployment tend to be -- have less fiscal capacity. So, you see a lot of redistribution from like Ontario to the poorer Atlantic provinces.

But also, it helps with the provinces in terms of most people have access to unemployment insurance before they have access to social assistance. So, you would go on UI. If your benefits ran out, that's when the province would step in. So, that helps with provincial finances, as well.

MS. GORDON: I was just going to say that, you know, everyone has noted rightly the problem with IT at the state level and that they're relying on these very old systems, and that's part of the reason for the backlogs and so proposed just more funding for IT and that as a solution. The only problem is that you're sort of layering that onto the existing systems at the state level where, you know, I think as other shave already pointed out there are different politics.

Already there are differences in maximum relief benefits. And there's some very good work basically showing that, you know, modernization is not only not a panacea, but can actually make things worse in terms of recipiency rates for people who are unemployed. It's a way of sort of aggressively keeping people off the rolls rather than finding people who need assistance and providing it to them.

MR. GALE: All right, great. Thank you. Josh McCabe, I want to come back to you. You mentioned Canada a couple of times as a constructive example. One of the things that is playing out in the U.S., of course, is issues of racial equity. And if you look around you can sort of find it everywhere. So, I'm wondering what your thoughts are and the differences in racial composition of Canada or the U.S., and how that might play into what policymakers are willing to do in terms of assistance.

MR. McCABE: Yeah. So, we have sort of weird politics in the U.S. And so far as we -- I think now we often talk about redistribution from blue states to red states, but, you know, one of the things that I look at when I see those maps is that we have wealthy blue states that are disproportionately White and poor red states that are also disproportionately Black. Right? And so if you look at the Black Belt in the South, it's really a matter I think of racial justice of getting more money to those states. Right?

And I think one of the issues we have is this competition between ideology and interests, right? So, it's in Democrats' ideological interest to funnel more money to Mississippi and Georgia, but it's also against their state interest. Right? You want to send that money to Massachusetts, California, and New York. Inversely, you know, Republicans have an issue with more federal spending even though it would probably aid their state more than any other state. So, I think it's open question of what kind of coalition could you put together so that Republicans follow their interests and Democrats follow their ideology?

MR. GALE: Great. Anybody else want to pitch in on that? No? Okay.

There are a variety of issues like climate change and infrastructure that get talked about at the federal level, but I think would largely be implemented through the states. And I'm wondering if there are particularly auspicious options you see there, particularly difficult obstacles. Is there a policy that has to be done at the federal level versus one that would be better done at the state level? How should we think about these other policies in the context of federal-state relations?

MS. GORDON: Well, state and local governments already pay for about 80 % of infrastructure. So, like it or not, you know, any solutions to climate change and resilience are going to have to happen at that level. I think there are issues with project selection and delivery in infrastructure, so, you know, you frequently hear people in Washington sort of inveigh against states why aren't they borrowing more given that interest rates are so low? You know, it really would help the economy for some of the statistics that we've been talking about, if they would have sort of juiced up their purchases right after the Great Recession. And I think that it's not clear where that marginal dollar spent on infrastructure will go.

And so we really need to think about the funding formulas and incentivizing the right kinds of projects in the right kinds of places. You know, all the econometric studies that show that infrastructure has a big bang for the buck are, you know, sort of predicated on this idea of sort of well-chosen projects and often involving projects that were built decades ago and not necessarily the ones that we would be building now, which would be things like sea walls or large infrastructure projects built to a different standard to withstand things like rising sea levels.

So, I do know that, you know, credit rating agencies are looking into this a lot more and it's something that's being taken into account. And actually, you know, to the extent that state and local governments do start building this stuff could be a real boost to the economy in the next couple of years.

MS. SHEINER: And I think the other thing to think about, I'm not an expert on this, but when you think about some of the policies, like any kind of regulatory policy, that, you know, some states have tried to do it on their own. But then you worry about, you know, just having jobs leave and factories leave. And so when you think about a carbon tax or any kind of, you know, cap and trade, like the national solution is clearly better. And you're not going to get states to decide, well, I'm going to just make it impossible for people to do business here, if that's the -- what would happen, so.

MR. BIVENS: I would say, as well, on financing front, like especially in the climate context, like investments that really do mitigate greenhouse gas emissions, like the primary beneficiaries of that are future generations. If you're trying to think of a mechanism that borrows from the future to make investments today, you know, that's deficit finance. That's something state and local governments just have much more limited capacity to do that the federal government. So, the degree you think that kind of thinking should be part of how we finance infrastructure investments aimed at climate change mitigation, I think that argues for a bigger federal role using debt to finance some of those.

MS. SHEINER: Can I make my standard little spiel? Which is I agree with all that, but when I think -- when we're thinking about investing in the future and this sort of whole question that we have to remember just there's so much evidence in recent years about how investing in poor families has these huge returns in the future. It's the same issue, which is a state doesn't know whose kids -- you know, the kids may not live in your state and so they are wonderful opportunity for investing to help the future that involves deficit financing investment, and it has to be done at the federal level.

MR. GALE: Right. In the sense the federal government can capture the externality that the state government wouldn't if the kid grew up and then moved. Yeah, exactly.

All right. So, let's turn to the legislative front. Are we going to get another stimulus/relief package? Is it going to have state and local assistance in it? Are the people who have been pushing on reinstating the state and local deduction likely to get anywhere?

MR. McCABE: Yeah. No, I think there's two countervailing forces. One makes me optimistic, one makes me pessimistic.

You know, I think we all look at Georgia and we see Georgia tends to be a lower fiscal capacity state. And now we have Democrats in control of the Senate who now represent Georgia. And I think we have a bit more Southern Democrats than we did before.

On the flip side, you know, leadership represents to the wealthiest states in the country, New York and California, right, and there's going to be a pressure to sort of bring home the bacon to those states, which I think they need it less. So, it'll remain to be seen are we going to follow sort of a progressive agenda that helps poorer states or are we going to do a progressive agenda that helps all states, but, you know, New York and California just a little bit more?

MS. GORDON: You know, I mean, CBO found in its analysis of the aid that was provided in the COVID downturn that unrestricted state and local relief had the biggest bang for the buck. And yet, you know, that was dropped at the 11th hour in the $908 billion bill that was passed last year. So, I think the most important thing at that point in time was to get more aid to individuals and businesses for whom assistance was about to run out. But I still am just surprised that that happened. You know, the bill that was passed included a lot for K-12 education and for transportation. And as Louise pointed out, that is beneficial for state and local governments that have to balance their budget. I think we can probably expect more of the same in the next bill. And that's because of this murky picture that some states are actually doing better than -- not only better than expected, but better than they did in the previous year. California has a windfall of $15 billion. On the other hand, Nevada, you know, the governor has instructed its agencies to prepare for cuts of 12% across the board. So, there's just enormous uncertainty.

You know, we have a new strain of the COVID virus, rising hospitalizations. And state and local governments are in this safety net provider role where they have to absorb that risk. You know, we've talked about ways to reallocate risk, but that's the status quo right now.

So, you know, I would like to see unrestricted aid in the bill, but I can understand the reasons that it might not be. I think providing something for the major spending categories that state and local governments are responsible for would be a next best solution.

MR. GALE: Great. Go, Josh, please.

MR. BIVENS: Yeah. I mean, I know what I read in The New York Times the same way everyone else does. I mean, I guess I'm -- I agree with all that. I am strangely optimistic that there will be another bill before too long that will have some awfully flexible, it's not completely unrestricted, but awfully flexible state and local aid. I think precisely because it's well known that it was the last thing to hit the cutting room floor before the $900 billion, as well as a big chunk of that $900 billion bill was sort of a re-up of the Payroll Protection Program. I'm going to bet that's not going to be a big part of any new thing that rolls out in the next couple of months because the thought will be we did that. That'll get us through. So, I think in the very short run I'm optimistic on that. I would bet, as well, that the entire like next bill that happens on COVID relief and recovery will probably be debt-financed, so there'll probably be no tax -- well, there'll be -- aside from things like refundable tax credits, there will be very little in the tax base, so I think we will not see an uncapping of the SALT deduction in that. I do think keeping that cap going forward, I would not bet a ton on that. That's going to be a tougher one.

MS. SHEINER: I think there will be unrestricted aid, too, but probably not as much as -- definitely not as much as they had talked about before, but I bet there will be some. And I think it's -- you know, when we start talking about the expiration of the TJ -- whatever, the Tax and Jobs Act, that's when I think the whole -- that's when we'll see what happens with it, the cap, not as part of Biden's first year I don't think.

MR. GALE: All right. That's excellent. Thank you to all the panelists for a really interesting conversation. I confess that I learned a lot. Thank you, Richard Reeves, for organizing it and for Anna, Dan, and Carl for their work behind the scenes. And thank you to everyone for attending.

So, that concludes our event and we will reconnect soon. Thanks.

MS. SHEINER: Thank you very much.

MS. GORDON: Take care, everyone.

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