

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

September 4, 2020

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: September 10, 2020, “The Need for Financial Aid to America’s States and Territories During the Pandemic: Supporting First Responders, Assisting Schools in Their Efforts to Safely Educate, and Preventing Mass Layoffs.”

The Committee on Financial Services will hold a virtual hearing entitled, “The Need for Financial Aid to America’s States and Territories During the Pandemic: Supporting First Responders, Assisting Schools in Their Efforts to Safely Educate, and Preventing Mass Layoffs” on Thursday, September 10, 2020 at 12:00 p.m. Eastern Daylight Time on the virtual meeting platform Cisco Webex. This hearing will have one panel with the following witnesses:

- **The Honorable Michelle Lujan Grisham**, Governor, State of New Mexico
- **The Honorable Tim Walz**, Governor, State of Minnesota
- **The Honorable Laura Kelly**, Governor, State of Kansas
- **The Honorable Lourdes “Lou” Leon Guerrero**, Governor, Territory of Guam
- **Douglas Holtz-Eakin**, President, American Action Forum

Overview

State governments have faced significant costs in fighting the COVID-19 pandemic. Since March, more than half of state legislatures have convened to pass emergency appropriations and approved over \$3.5 billion in unanticipated expenditures to support testing, prevention, the purchase of scarce medical supplies, and other public health costs related to containing the virus.¹ Overall state spending needs are expected to increase considerably, especially in health care and education, as schools take steps to adapt to distance learning.² Meanwhile, the economic recession caused by COVID-19 has led to a sharp decline in sales tax and other critical sources of state government revenue. Based on the Congressional Budget Office’s forecasts for economic outlook in 2021, the total budget shortfall for state and local governments next year is projected to approach \$1 trillion.³ According to the Center on Budget and Policy Priorities, state budget shortfalls are estimated to total \$500 billion before 2022, which is nearly double state government shortfalls in the first two years of the Great Recession.⁴

¹ “State Fiscal Responses to COVID-19,” *National Conference of State Legislatures*, (June 30, 2020), <https://www.ncsl.org/research/fiscal-policy/state-fiscal-responses-to-covid-19.aspx>

² “COVID-19 and State and Local Governments: Background, Available Evidence, and New Programs,” *Congressional Research Service (CRS)*, August 28, 2020. Also see CRS Report R46382, “Fiscal Federalism: Theory and Practice,” *CRS*, June 3, 2020, <https://www.crs.gov/Reports/R46382>, and “State and Local Fiscal Conditions and Economic Shocks,” *CRS*, June 10, 2020, <https://www.crs.gov/Reports/IN11258>.

³ “An updated proposal for timely, responsive federal aid to state and local governments during the pandemic recession,” *W.E. Upjohn Institute for Employment Research* (May 22, 2020), <https://www.upjohn.org/research-highlights/updated-proposal-timely-responsive-federal-aid-state-and-local-governments-during-pandemic-recession>

⁴ “States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession,” *Center on Budget and Policy Priorities*, (April 14, 2020), <https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep>

On March 27, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law, which included \$150 billion in assistance to help local governments respond to the COVID-19 emergency. While the latest jobs report showed that 300,000 government jobs were restored in July, the total number of government employees was still 1.1 million lower than it was in February.⁵ On April 11, the National Governors Association issued a bipartisan statement calling for Congress to pass \$500 billion in additional assistance.⁶ On May 15, the House of Representatives passed H.R. 6800, the Heroes Act, which would extend at least \$915 billion in aid to state and local governments within one year.⁷

Lessons from the Great Recession

State government spending during economic downturns tends to have a “pro-cyclical” effect. When the economy enters recession, states lose revenue they would normally collect from revenue sources like sales, income, and hotel occupancy taxes. To account for these revenue declines, state governments cut their budgets and raise taxes, which leads to public sector job loss and saps economic growth. According to the Hutchins Center, “cuts in state-financed spending lowered real GDP growth about 1.2 percentage points between 2009 and 2012.”⁸ Testifying before the Financial Services Committee on June 17, Federal Reserve Chair Jerome Powell affirmed economic research indicating that cuts by state governments prolonged the Great Recession.⁹ A 2012 paper published by the International Monetary Fund found that state budget shortfalls in the immediate aftermath of the 2008 financial crisis grew as high as \$174 billion in 2010, and that federal expenditures made through the American Recovery and Reinvestment Act (ARRA) were inadequate to fill the gap from lost tax revenue.¹⁰

Many states never fully recovered from the Great Recession. A 2019 study found that nearly half of states were spending less than they had prior to the Great Recession: support for higher education had been cut by 13%; infrastructure spending was at a 50-year low; and there were 132,000 fewer noneducation state government jobs than there had been in 2008.¹¹ Reduced spending by state and local governments, especially after spending from ARRA funding was exhausted and Congress reduced federal expenditures through the Budget Control Act of 2011, may partially explain why the recovery from the Great Recession was slower than previous recessions.¹²

Coronavirus Relief Fund and Need for More Direct Aid

⁵ “The Employment Situation—July 2020,” *Bureau of Labor Statistics* (August 7, 2020), <https://www.bls.gov/news.release/pdf/empsit.pdf>

⁶ “National Governors Association Outlines Need for ‘Additional and Immediate’ Fiscal Assistance to States,” *National Governors Association*, (April 11, 2020), <https://www.nga.org/news/press-releases/national-governors-association-outlines-need-for-additional-and-immediate-fiscal-assistance-to-states/>

⁷ “State and Local Fiscal Conditions and COVID-19: Lessons from the Great Recession and Current Projections,” *Congressional Research Service*, (May 18, 2020)

⁸ “How will the coronavirus affect state and local government budgets?,” *Brookings Institution*, (March 23, 2020), <https://www.brookings.edu/blog/up-front/2020/03/23/how-will-the-coronavirus-affect-state-and-local-government-budgets/>.

⁹ “Monetary Policy and the State of the Economy,” *House Financial Services Committee*, (June 17, 2020), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=406614>.

¹⁰ “Great Recession and Fiscal Squeeze at U.S. Subnational Government Level,” *IMF Working Paper*, (July 2012), <https://www.imf.org/external/pubs/ft/wp/2012/wp12184.pdf>

¹¹ “Lost Decade Casts a Post Recession Shadow on State Finances,” *Pew Trusts*, (June 4, 2019), <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2019/06/lost-decade-casts-a-post-recession-shadow-on-state-finances>

¹² “Why is recovery taking so long—and who is to blame?,” *Economic Policy Institute*, (August 11, 2016), <https://www.epi.org/publication/why-is-recovery-taking-so-long-and-who-is-to-blame/>

Title V of the CARES Act directs Treasury to administer the \$150 billion Coronavirus Relief Fund and distribute funds directly to governments in states, territories, and tribal areas.¹³ \$139 billion is allocated to state governments, with allocations based on population size and with no state receiving less than \$1.25 billion. \$8 billion is set aside for governments in tribal areas. \$3 billion is allotted to governments in territories, including the District of Columbia and Puerto Rico. As of August 20, \$149.5 billion has been allocated by the Treasury.

The CARES Act funds, however, are insufficient to address the challenges state and local governments face. According to the National League of Cities, more than one-third of cities with greater than 50,000 people anticipate permanent layoffs in the coming year,¹⁴ and an estimated 5.3 million public sector jobs could be lost by the end of 2021 if Congress does not pass additional federal aid.¹⁵ These layoffs are not expected to be felt evenly. Black workers are disproportionately represented in the public sector, and the Center for Economic and Policy Research projects that “workers who lose their jobs as a result of layoffs in the public sector are 20 percent more likely to be Black than workers who lose their jobs in the private sector.”¹⁶ The Heroes Act would provide more than \$915 billion in new direct assistance to state and local governments. A total of \$540 billion would go to a newly established Coronavirus State Fiscal Relief Fund, which would allocate money to state governments, territorial governments and tribal governments. An additional \$375 billion would be provided to a newly created Coronavirus Local Fiscal Relief Fund, which would allocate money to county governments, city and town governments that receive federal funding through the Community Development Block Grant, and other local governments.

Federal Reserve’s Municipal Liquidity Facility (MLF)

State and local governments issue bonds for a variety of purposes, including infrastructure construction. In early March, the municipal bond market experienced unprecedented disruption,¹⁷ and the CARES Act included language instructing the Federal Reserve (Fed) and Treasury to establish a facility to assist state, local, and territorial governments. On April 9, the Fed announced the MLF to support up to \$500 billion in lending to states and cities.¹⁸ On May 11, the Fed unveiled the MLF’s terms, which include penalty rates that some critics believe have made the MLF an unattractive alternative to the private market for all but the lowest investment grade issuers.¹⁹ Since the MLF became operational, the Fed has denied access to territorial governments, but it has taken several steps to increase the number of eligible issuers by: lowering the population threshold for eligible issuers, allowing multi-state agencies to participate, and allowing states to designate two eligible cities and counties with fewer than 250,000 residents.²⁰

Following criticism that the MLF was “functionally unusable” for the vast majority of eligible borrowers, the Fed announced on August 10 that it would reduce the penalty rates by 50 basis points across the

¹³ “The Coronavirus Relief Fund (CARES Act, Title V): Background and State and Local Data,” *CRS* (Aug. 25, 2020), <https://www.crs.gov/Reports/R46298>.

¹⁴ “The Economy and Cities: What America’s Local Leaders Are Seeing,” *National League of Cities* (April 2020), https://www.nlc.org/sites/default/files/users/user57221/NLC-USCM-Survey-Data-Infographic.pdf?_ga=2.143650544.438213199.1589334831-934507068.1589334831

¹⁵ “Without federal aid to state and local governments, 5.3 million workers will lose their jobs by the end of 2021,” *Economic Policy Institute*, (June 10, 2020), <http://www.epi.org/blog/without-federal-aid-to-state-and-local-governments-5-3-million-workers-will-likely-lose-their-jobs-by-the-end-of-2021-see-estimated-job-losses-by-state/>

¹⁶ “Cutting State and Local Budgets is an attack on the country’s black workers,” *Center for Economic and Policy Research*, (June 16, 2020), <https://cepr.net/cutting-state-and-local-budgets-is-an-attack-on-the-countrys-black-workers/>

¹⁷ “Unprecedented conditions stagger municipal market,” *Bond Buyer*, (March 12, 2020), <https://www.bondbuyer.com/news/unprecedented-conditions-stagger-municipal-market>

¹⁸ “Municipal liquidity facility,” Board of Governors of the Federal Reserve System, (April 9, 2020), <https://www.federalreserve.gov/monetarypolicy/muni.htm>.

¹⁹ *Ibid.*

²⁰ *Ibid.*

board.²¹ Even with these reductions, MLF rates remain “substantially higher than market rates.”²² Only two entities have utilized the MLF since it became operational in May: Illinois sold a \$1.2 billion bond to the MLF in June, and the New York Metropolitan Transportation Authority sold \$450 million in notes to the MLF in August.²³ Federal Reserve Bank of New York analysts have acknowledged that “improvements in muni debt markets are not necessarily sufficient to induce willingness to spend at the local level,”²⁴ and without more federal government assistance to state and local governments, pressure on the Fed to “unleash” the MLF will likely grow.²⁵ The Heroes Act included provisions to further expand the MLF by reducing the interest rate paid on bonds purchased to the federal funds rate, among other provisions.

Housing security and state eviction moratoria

State governments have responded in varying degrees to help millions of renters who struggle to pay their rent as the pandemic continues. The Urban Institute estimates that at least 20% of renter households nationwide have experienced at least one job loss,²⁶ and Mark Zandi of Moody’s Analytics estimates that renters already owed nearly \$25 billion at the beginning of August.²⁷ The CARES Act established a 120-day moratorium on evictions for individuals living in federally assisted rental housing and properties with federally backed mortgages, which expired on July 25.²⁸ The Federal Reserve Bank of Atlanta estimates that the CARES Act moratorium only covers between 28 percent and 45 percent of occupied rental homes nationally.²⁹ States have put in place their own moratoriums, but many have already expired. According to the National Low Income Housing Coalition, there are currently 21 states and Washington, D.C. that have some form of an eviction moratorium in place, although several are set to expire in September.³⁰ Additionally, at least 31 states have initiated a program providing some form of rental assistance.³¹ The Heroes Act would extend this moratorium to cover all rental properties through March 27, 2021, and also would provide \$100 billion in rental assistance.

Supporting Small Businesses through State and Territory Governments

State and territory governments have previously demonstrated an ability to effectively deploy federal funds to support small businesses. For example, Congress established the State Small Business Credit Initiative (SSBCI) in 2010 to provide \$1.5 billion in funding for state and territory programs that support access to credit for small businesses. This temporary program, which was administered by the Treasury

²¹ “Federal Reserve Lowers Pricing for Municipal Liquidity Facility,” *Yale Program on Financial Stability*, (August 19, 2020)

<https://som.yale.edu/blog/federal-reserve-lowers-pricing-for-municipal-liquidity-facility>

²² “The Fourth Report of the Congressional Oversight Commission,” *Congressional Oversight Commission*, (August 21, 2020),

https://coc.senate.gov/sites/default/files/2020-08/COC%204th%20Report_08.21.2020%20with%20Appendix.pdf

²³ “New York MTA rejects bids, head to the Fed,” *BondBuyer*, (August 18, 2020), <https://www.bondbuyer.com/news/new-york-mta-sells-second-large-deal-to-federal-reserve>

²⁴ “Municipal Debt Markets and the COVID-19 Pandemic,” *Liberty Street Economics*, (June 29, 2020),

<https://libertystreeteconomics.newyorkfed.org/2020/06/municipal-debt-markets-and-the-covid-19-pandemic.html>

²⁵ “The Fed May Have to Do More to Keep the Economy on Track. Here’s What Could Be Next,” *Barron’s*, (August 21, 2020),

<https://www.barrons.com/articles/the-fed-may-have-to-do-more-to-keep-the-economy-on-track-heres-what-could-come-next-51598036462>

²⁶ “How much Assistance is Needed to Support Renters through the COVID-19 Crisis,” *The Urban Institute*, (June 26, 2020),

https://www.urban.org/sites/default/files/2020/06/26/how_much_assistance_is_needed_to_support_renters_appendixes.pdf

²⁷ “Trump is Calling for another moratorium on evictions. Landlords are pushing back.,” *Washington Post*, (August 6, 2020),

<https://www.washingtonpost.com/business/2020/08/06/trump-eviction-moratorium/>

²⁸ “A federal eviction moratorium has ended. Here’s what renters should know,” *Washington Post*, (August 4, 2020),

<https://www.washingtonpost.com/business/2020/07/24/faq-federal-eviction-moratorium/>

²⁹ “Housing Policy Impact: Federal Eviction Protection Coverage and the Need for Better Data,” *Federal Reserve Bank of Atlanta*, (2020),

<https://www.frbatlanta.org/community-development/publications/partners-update/2020/covid-19-publications/200616-housing-policy-impact-federal-eviction-protection-coverage-and-the-need-for-better-data>

³⁰ “Eviction update,” *National Low-Income Housing Coalition*, (August 28, 2020), <https://nlihc.org/coronavirus-and-housing-homelessness/eviction-update>

³¹ “COVID-19 Rental Assistance,” *National Low-Income Housing Coalition*, <https://nlihc.org/rental-assistance>

Department and expired in 2017, leveraged the SSBCI funds to provide over \$8 billion in loans and investments in small businesses.³²

Legislation

- **H.R. 6800, the Heroes Act (Lowey)** would provide: nearly \$1 trillion to state, local, territorial and tribal governments; \$175 billion to support renters and homeowners; a second round of economic stimulus payments; an extension of unemployment benefits to January 2021; and an expansion of the MLF to support territories and more local governments, among other provisions.
- **H.R. 7717, the Uplifting Our Communities Act (Tlaib)** would extend the maturity of bonds purchased by the MLF to ten years, explicitly require the inclusion of territorial governments, cap the interest rate for the bonds purchased at the federal funds rate, and mandate the establishment of a facility to support long-term borrowing by eligible issuers.
- **H.R. ____, the State Small Business Credit Initiative Renewal Act (McAdams)** provides \$10 billion through a reauthorized State Small Business Credit Initiative (SSBCI) to support \$100 billion in small business financing through state and territory programs. These programs must include a plan to support access to credit to minority- and women-owned small businesses.

³² Treasury Department, “State Small Business Credit Initiative (SSBCI),” last accessed Jul. 6, 2020.