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2009-10 Budget Analysis Series

Federal Economic Stimulus Package: Fiscal Effect on California

CONTENTS

SUMMARY

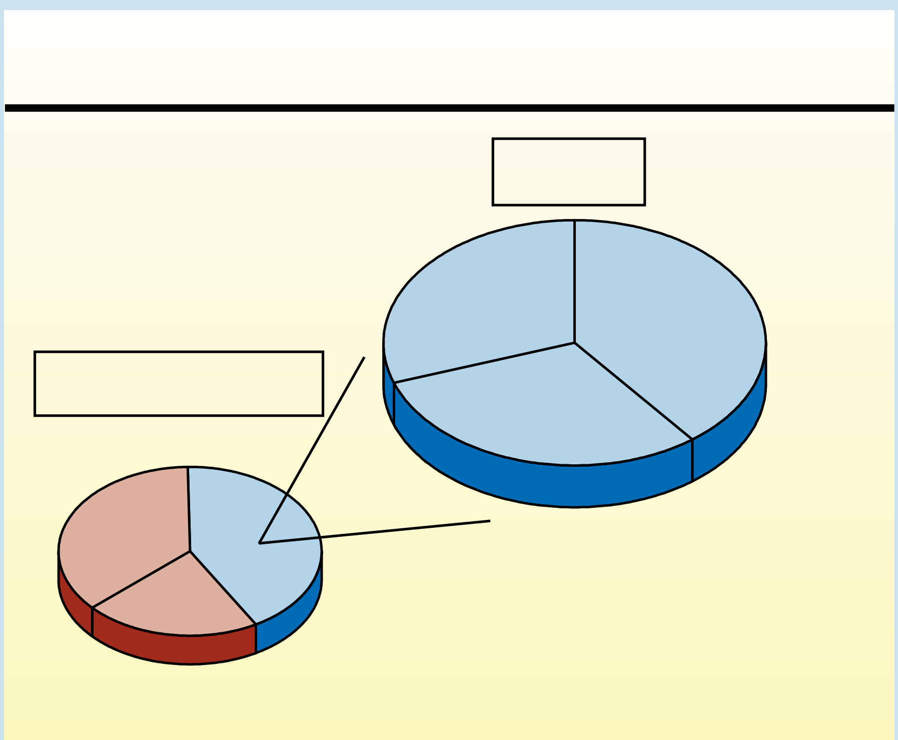
The recently enacted federal economic stimulus package—titled the American Recovery and Reinvestment Act (ARRA)—commits a total of $787 billion nationwide. As reflected in the figure below, this funding provides: (1) $330 billion in aid to the states, (2) about $170 billion for various federal projects and assistance for other non-state programs, and (3) $287 billion for tax relief.

This report focuses on the state aid component of the stimulus package, as it consists of the federal dollars with which the Legislature will be most involved. As the figure shows, the state aid "pie" also consists of three pieces: (1) federal dollars that can be used to address budget shortfalls, (2) funds that supplement existing state spending, and (3) competitive grants. We estimate that California will receive over $31 billion from the first two components (see table on next page) and billions more in competitive grants.

The State "Trigger"

A significant portion of the $31 billion in aid to California will be available to address the state's budgetary problems. We estimate that, based on the enacted state 2009-10 budget, California can use $10.4 billion in new federal dollars for this purpose over the life of ARRA. Of that amount, $8 billion would be available in 2008-09 and 2009-10. The Director of Finance and State Treasurer will determine their own estimate of the latter amount by April 1 of this year. If the amount is less than $10 billion, then annual state program reductions of nearly $1 billion and revenue increases of about $1.8 billion adopted as part of the 2009-10 budget package will go into effect.

Given the state's continuing economic struggles, however, it is possible that state revenues (and the Proposition 98 minimum funding level) may continue to fall. In that case, it may be possible to use additional federal education dollars for budgetary relief.



Key Considerations for the Legislature

The Legislature will need to take many actions in the coming months to ensure that the funds are used in ways that meet its priorities and preferences. To assist in this process, we offer the following considerations in making decisions regarding these new federal funds:

- ***Maximize the Benefit of Federal Funds to the General Fund Budget.*** In this report, we make specific recommendations about how to help the state's budgetary situation under different scenarios.
- ***Recognize the Short-Term Nature of New Federal Funds.*** Most of the state aid coming to California is intended to *supplement* current state spending. There is the risk, however, that the higher levels of service provided by the federal dollars will create ongoing expectations of state support once the funding expires. We offer strategies to address this risk.
- ***Act Quickly in a Handful of Cases.*** In certain instances, the state will need to act rapidly to ensure it receives the maximum amount of relief or to use the funds in the most effective way possible. Addressing a Medi-Cal eligibility issue and providing direction on the use of transportation funds are two such examples.
- ***Use Next Few Months to Oversee Implementation of New Federal Spending.*** For most of the new federal dollars and programs, the Legislature will have more time to take necessary actions. For example, the Legislature can use its budget process to monitor the state's revenue picture and take whatever actions are needed to use federal dollars to keep the 2009-10 budget in balance. Similarly, the Legislature can use policy and budget subcommittee hearings to craft needed legislation, specify its wishes as to how new dollars are to be spent and oversee the administration's plans with regards to the new funds.

California Will Receive Over $31 Billion in State Aid

(In Millions)

Program Area	Federal Fiscal Year 2008-09	2009-10	2010-11	Totals
Health	$3,986	$4,026	$1,024	$9,036
Education	—	7,973	—	7,973
Labor and workforce development	3,498	2,420	79	5,997
Social Services	1,500	1,441	577	3,518
Transportation	1,302	1,302	—	2,604
General purpose fiscal stabilization	—	1,100	—	1,100
Resources/environmental	597	—	—	597
Housing programs	381	—	—	381
Criminal justice	264	—	—	264
Other	27	—	—	27
Totals[a]	**$11,555**	**$18,262**	**$1,680**	**$31,497**

[a] Does not include significant additional federal funds the state is likely to receive from competitive grants.

OVERVIEW OF THE AMERICAN RECOVERY AND REINVESTMENT ACT

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act (ARRA) of 2009, H.R. 1. The spending and tax-cut plan is intended to help stabilize state budgets and spur economic growth. The stimulus package commits a total of $787 billion nationwide, and it will have a significant fiscal impact on California.

One-Third of the Federal Funding Is for State Aid

Figure 1 shows how ARRA funding falls into three main categories. The stimulus package provides about $330 billion in federal funds in aid to states. A variety of tax provisions intended to boost the economy will cost the U.S. Treasury $287 billion more. Finally, about $170 billion is available to be spent by federal agencies on federal projects or for other non-state programs, such as direct grants to local entities.

State Aid Comes in a Variety of Forms

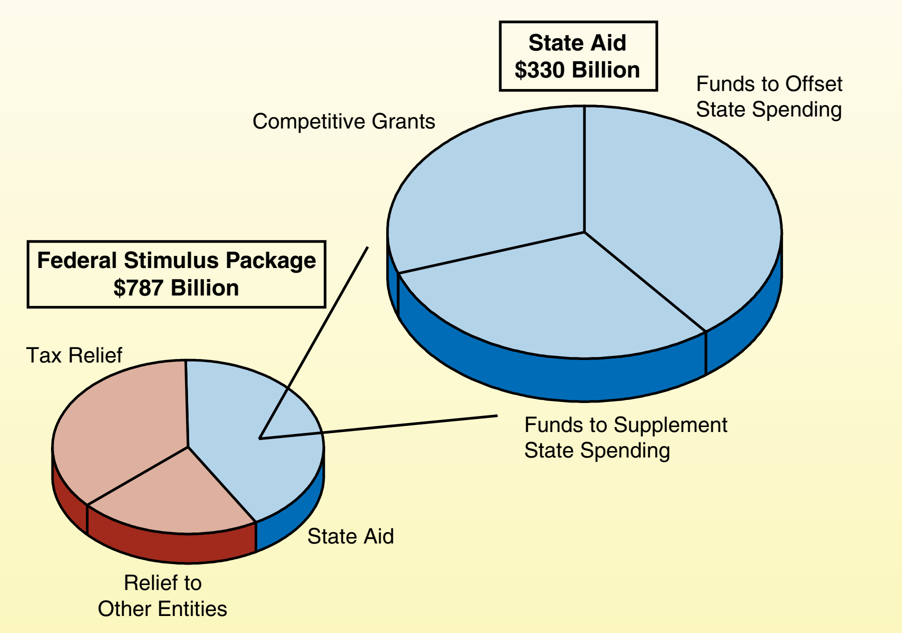
Of the roughly $330 billion in aid available nationwide for states:

- Almost $100 billion is available to supplant or offset states' general fund spending.
- As much as $130 billion will be available to states to supplement or increase state spending on a wide variety of programs.
- States and other entities (such as local governments) will also be able to apply for up to $100 billion in competitive or discretionary grants.

All of the funding for state relief is provided on a temporary basis and generally will be only available for the next few years.

Figure 1

Federal Economic Stimulus Package Provides Significant Aid for States



California Will Receive a Significant Amount of Additional Federal Funds

Of the $330 billion available under ARRA nationwide for state aid, we estimate that California will receive approximately $31 billion in additional federal funds during the current and the next two federal fiscal years (FFYs). As Figure 2 shows, the state's health programs will receive the largest share of these federal funds, about $9 billion, and education-related programs will receive nearly $8 billion in additional federal funds. These programs are followed by labor and workforce development and social services programs, which will receive about $6 billion and $3.5 billion, respectively.

In some of the program areas, the year-by-year flows of funds are estimates and may occur differently than depicted in Figure 2. In addition, this figure does not capture the unknown, but potentially significant additional federal funds that the state is likely to receive when it applies for competitive grant funding included in ARRA. Finally, given the complexity of this legislation, our estimates of the state's allocations included in this report should be considered preliminary and subject to revision as more information becomes available.

Figure 2

California Will Receive Over $31 Billion in State Aid

(In Millions)

Program Area	Federal Fiscal Year 2008-09	2009-10	2010-11	Totals
Health	$3,986	$4,026	$1,024	$9,036
Education	—	7,973	—	7,973
Labor and workforce development	3,498	2,420	79	5,997
Social Services	1,500	1,441	577	3,518
Transportation	1,302	1,302	—	2,604
General purpose fiscal stabilization	—	1,100	—	1,100
Resources/environmental	597	—	—	597
Housing programs	381	—	—	381
Criminal justice	264	—	—	264
Other	27	—	—	27
Totals[a]	**$11,555**	**$18,262**	**$1,680**	**$31,497**

[a] Does not include significant additional federal funds the state is likely to receive from competitive grants.

Some Federal Funds Are Available To Offset General Fund Spending

2009-10 Budget Package Is Linked to Federal Fiscal Relief. The Governor signed the *2009-10 Budget Act* and related legislation on February 20, 2009, to address the state's projected $40 billion shortfall. Based on the administration's estimates, the act assumes that the state will receive $8 billion in federal stimulus funds to offset General Fund expenditures. The Governor vetoed an additional $510 million from the universities' budgets in anticipation that even more fiscal relief would be available to backfill that reduction.

LAO Estimates of Offsets Under Budget Package. Our estimates of federal funds that can offset General Fund costs under the 2009-10 budget package are similar to the administration's. As Figure 3 shows, we project that state spending would be reduced by almost $8 billion through 2009-10, with an additional $2.4 billion in offsets in 2010-11.

These amounts capture offsets in General Fund expenditures that occur "on the natural" or with the state making relatively minimal changes to existing programs to receive the funds. For example, the single greatest source of relief comes from the increase in the percentage of program costs funded by the federal government for the state's Medicaid program, known as Medi-Cal in California. This source of funding and the others shown in Figure 3 are discussed in more detail later in this report.

Federal Stimulus and the State Trigger

The budget package requires the State Treasurer and the Director of Finance to determine by April 1, 2009 if ARRA makes available by June 30, 2010 additional federal funds that may be used to offset at least $10 billion in General Fund expenditures. If they determine that federal fiscal relief reaches that $10 billion threshold, then nearly $1 billion in cuts to various programs and a 0.125 percentage point increase in personal income tax rates included in the budget package would trigger off—that is, not go into effect.

Language Open to Interpretation. The language in the *2009-10 Budget Act* describing what needs to happen in order for the trigger to be reached is somewhat open to interpretation. For example, the language states that the federal legislation must "make available" by June 30, 2010, federal funds "that may be used" to offset $10 billion in General Fund expenditures. This wording raises such questions as whether $10 billion must actually be used to offset state General Fund costs, or whether this requirement would be satisfied if funds of this amount were identified that theoretically could be used in this way.

Our estimate of $8 billion in federal funds being available to offset General Fund expenditures, shown in Figure 3, excludes offsets

Figure 3

Stimulus Funds Potentially Available to Offset General Fund Expenditures

Based on Enacted Budget Package
(In Millions)

Program Area/Provision	State Fiscal Year 2008-09	2009-10	2010-11	2008-09 and 2009-10 Combined	All Years
General Purpose					
State Fiscal Stabilization Fund	—	$1,100	—	$1,100	$1,100
Health					
Medi-Cal-related programs	$2,631	$3,740	$1,957	$6,371	$8,328
Early Start program	—	53	—	53	53
Labor and Workforce Development					
Workforce Investment Act discretionary funds	—	$37	$37	$37	$74
Unemployment Insurance—interest relief	—	30	209	30	239
Social Services					
CalWORKs Emergency Fund	$40	$200	$190	$240	$430
Foster Care and Adoption Assistance programs	33	45	24	78	102
Department of Child Support Services	22	30	7	52	59
Totals[a]	**$2,726**	**$5,235**	**$2,424**	**$7,961**	**$10,385**

[a] The General Fund impact of the education American Recovery and Reinvestment Act funds is addressed later in this report.

the state might achieve from education-related federal funds. This is because our estimate is based on the level of state revenues assumed in the *2009-10 Budget Act* and the corresponding level of support provided for state education programs. The state's continuing economic struggles, however, suggest that revenues (and the Proposition 98 minimum guarantee) may continue to fall. Under such a scenario, it may be possible to use additional federal education funding to offset a greater amount of General Fund spending for state education programs, as we discuss in the "Education" section of this report. Ultimately, the interpretation of this provision of statute is a matter for the Director of Finance and the State Treasurer to decide. The administration has indicated that its preliminary conclusion is that the available federal funds will be insufficient to avoid the tax increase and cuts contained in the February budget package.

KEY CONSIDERATIONS FOR THE LEGISLATURE

As noted earlier, the federal economic stimulus package will provide about $31 billion in additional federal dollars directly to the state for a wide array of programs. In response, the Legislature will need to take many actions in the coming months to ensure that the funds are used in ways that meet its priorities and preferences. To assist in that process, we discuss below some key considerations in making decisions regarding these new federal funds.

Maximize the Benefit of Federal Funds on the General Fund Budget. Given both the deteriorating economic situation and the gloomy out-year state budget forecast, we believe the Legislature must maximize the use of stimulus dollars to offset General Fund expenditures. In this report, we make specific recommendations about how to do so. Some federal dollars may only be available for General Fund relief in certain situations (such as certain education funds if state revenues decline further).

Recognize the Short-Term Nature of New Federal Funds. Most of the state aid coming to California is intended to *supplement* current state spending. There is the risk, however, that the higher levels of service provided by the federal dollars will create ongoing expectations of state support once the funding expires. There are ways to limit this risk:

- The Legislature should dedicate this limited-term federal assistance as much as possible to limited-term purposes. For instance, we recommend using some of the education funds to pay for one-time mandate costs and data systems development.
- For ongoing programs receiving supplemental funding, the Legislature could spread out dollars over three years (instead of one or two), thereby reducing the level of new spending. In addition, the Legislature could make explicit that the supplemental funding is in effect only for the duration of the added federal funds.
- The Legislature could also use the near term to explore and implement program reforms that often take several years to achieve savings. For example, the Legislature could expand "pay for performance" programs that provide fiscal incentives

for Medi-Cal providers that could ultimately save tens of millions of dollars annually. By starting now, the state would be more likely to have in place programmatic savings that could offset the loss of supplemental federal funds in the out-years.

Act Quickly in a Handful of Cases. In certain instances, the state will need to act rapidly to ensure it receives the maximum amount of relief or to use the funds in the most effective way possible. We have identified the following situations where quick action is needed:

- ➢ To receive major new federal funding for the Medi-Cal Program, California must make a change in state law regarding eligibility by July 1, 2009.
- ➢ The Legislature should provide direction on its preferred approach to distributing new federal dollars for transportation and input on the federal government's plans regarding the allocation of high-speed rail funds.
- ➢ To fully access state clean waters monies, legislation must authorize specific types of financial assistance.

Use Next Few Months to Oversee Implementation of New Federal Spending. For most of the new federal dollars and programs, the Legislature will have more time to take necessary actions. For example, the Legislature can use its budgetary process to monitor the state's revenue picture and take whatever actions are needed to use federal dollars in keeping the 2009-10 budget in balance. Similarly, the Legislature can use policy and budget subcommittee hearings to:

- ➢ Address any needed legislation related to the use of new federal dollars.
- ➢ Oversee departments' plans and efforts in applying for competitive grants and spending supplemental funds.
- ➢ Ensure that the use of federal stimulus dollars is consistent with existing state policies.
- ➢ Provide any needed assistance to local governments regarding their use of new federal dollars.

Below, we describe by program the additional federal funding the state will be receiving and major issues for legislative consideration.

EDUCATION

As Figure 4 (see next page) shows, ARRA will provide California with almost $8 billion in state-administered education funding. The ARRA also allows the state to apply directly for billions of dollars in additional grants and subsidized bonds. In addition, ARRA offers the potential for California to benefit indirectly from billions more in competitive grants, tax credits, and subsidies to individuals, colleges, and local educational agencies (LEAs).

Major Provisions

State Fiscal Stabilization Fund

Nationwide, ARRA provides $54 billion for state fiscal stabilization. Funding allocations are based on states' school-age and total populations. The majority of stabilization funding will support education (82 percent), with the remainder set aside for other government services.

California Will Receive Almost $5 Billion to Support K-12 and Higher Education. According to the most recent U.S. Department of Education (USED) estimates, California will receive $4.9 billion in fiscal stabilization funds for K-12 and higher education. States must follow specific rules for distributing this funding between K-12 and higher education, as well as allocating funding within those sectors.

California Will Receive Additional $1 Billion for Other Government Services. The state also

Figure 4

California to Receive Large Boost in Federal Funding for Education

(In Millions)

Program	Funding	Description
State Fiscal Stabilization Fund		
Education	$4,875[a]	Generally mitigates K-12 and higher education cuts.
State Incentive Grants	—[b]	Competitive program supports states that demonstrate need in certain education areas (including teacher quality, student data systems, and assessment systems) and presents innovative ways to address those needs.
Subtotal	($4,875)	
K-12 Education		
Title I	$1,511[c]	Supplemental services for low-income students and support for low-performing schools.
Individuals With Disabilities Education Act	1,268	Supplemental services for special education students.
Child Care and Development Block Grant	220	Approximately $28 million is earmarked for specific activities. The rest must supplement state funding for child care for low-income families.
Enhancing Education Through Technology	71	Classroom use of technology. Funds may be used for hardware, software, infrastructure improvement, and professional development.
McKinney-Vento Homeless Assistance	18	School districts' efforts to educate homeless youth.
Child Nutrition	10	Assistance to high-need districts in purchasing meal-related equipment.
Institute of Education Sciences Grant	—[b]	Competitive program to help state develop/expand a statewide longitudinal student database.
School Construction Subsidies	—[b]	Tax credit bonds for public school construction or repair.
Qualified Zone Academy Bonds	—[b]	Interest-free tax credit bonds for qualified infrastructure efforts.
Impact Aid	—[b]	Facility cost funding for districts with high percentages of students living on federal land.
Title V Innovation and Improvement	—[b]	Competitive program to help districts and states develop performance-based compensation systems for teachers and administrators. Funds do not pass through state.
Subtotal	($3,098)	
Total Education Funding	**$7,973**	

[a] An additional $1.1 billion is provided for other government services.

[b] Total benefit for California is unknown at this time.

[c] Consists of $1.1 billion in basic grants, $45 million in Program Improvement Grants, and $383 million in School Improvement Grants.

will receive almost $1.1 billion for "public safety and other government services." This funding is relatively free of federal constraints. While funding does not need to be used for K-12 or higher education, the law specifically permits such uses, including school building modernization, renovation, and repair. The 2009-10 budget package assumes that these funds will be used to offset General Fund costs.

California Could Receive More Education Funding Through Competitive Grants. Of the $54 billion in ARRA stabilization funding nationwide, the act sets aside $5 billion for K-12 education incentive grants. The USED is to award these grants on a competitive basis. While LEAs will apply directly for some of these grants ($650 million nationwide), states will apply for the remainder ($4.4 billion nationwide). The portion going to states will be distributed according to their identified fiscal and program needs. At least 50 percent of the state money must be distributed to LEAs based on their Title 1 counts (number of low-income students).

Law Establishes Minimum Level of State Spending on Education. To receive fiscal stabilization funds, the state must maintain at least the same level of state support for K-12 and higher education as in 2005-06. If the state were to experience a "precipitous" decline in financial resources that threatens its ability to maintain sufficient state support, however, the U.S. Secretary of Education can waive or modify this requirement.

Funding Must First Be Used to Mitigate State Funding Cuts. Fiscal stabilization funds must first be used to mitigate state funding cuts for K-12 and higher education in 2009, 2010, and 2011. Funds for K-12 education must be allocated based on existing funding formulas, whereas states have discretion in how they allocate funds for higher education. If a federal award is greater than needed to reach 2008 or 2009 state funding levels (whichever is higher), then remaining funds are to be allocated to K-12 education based on schools' Title I counts. If a federal award is less than needed to restore education funding to 2008 or 2009 levels, then funds must be allocated in proportion to the relative shortfalls that exist for K-12 and higher education.

K-12 Education

As Figure 4 shows, ARRA funds 11 targeted K-12 programs—with California expected to receive at least $3.1 billion, plus the opportunity to apply for various competitive grants The majority of available monies provide supplemental funding on top of existing base federal grants. The ARRA funding typically is intended to be used consistent with existing program rules. It also funds several one-time opportunities for state or local improvements to K-12 infrastructure and systems.

Title I. The ARRA provides California with a $1.5 billion augmentation to the existing Title I program to support supplemental services for low-income students. As a condition of receiving these funds, the California Department of Education (CDE) must provide the USED with information on the current per-pupil distribution of state and local funds.

- ***Formula Grants.*** The bulk of the Title I money ($1.1 billion) is to be allocated using certain formulas that are based largely on LEAs' concentration of low-income students. Schools must use funds to target services to low-income students who are not meeting or are in danger of not meeting academic proficiency standards. If more than 40 percent of students at a school are low-income, then the school may run a "schoolwide" program, in which funding may be used for the benefit of all students rather than targeting only specific at-risk students. Of the $1.1 billion, the state must set-aside 4 percent, or $45 million, to support LEAs and schools in Program Improvement or PI. (LEAs and schools enter PI when they have failed to meet federal performance targets for two consecutive years.) Funding may be used for general LEA and school improvement activities.

- ***School Improvement Grant (SIG).*** The remaining funds ($383 million) would be provided through a SIG, which is somewhat more restrictive. The SIG funding can only fund LEAs with schools in PI for specific school-level improvement activities. The SIG rules also specify minimum and maximum grants of $50,000 and $500,000, respectively, per PI school, but states can decide how to prioritize SIG funding among PI schools.

Special Education Funding. The ARRA provides a $1.3 billion augmentation in Individuals with Disabilities Education Act (IDEA) funding for special education. Of this amount, $1.2 billion is for K-12 education and $41 million is for preschool. Consistent with IDEA, funding must be used to ensure that special education students receive a free and appropriate education as determined by their individualized education programs. Also consistent with IDEA, LEAs may use up to 50 percent of any year-over-year increase in IDEA monies to reduce their local maintenance-of-effort (MOE) requirement. Local savings resulting from a MOE reduction must be used for federal education priorities.

Child Care and Development Block Grant (CCDBG). The ARRA provides California $220 million to supplement state funding for child care for low-income families. These CCDBG funds are intended to allow the state to provide care to more children than otherwise would have been possible. Allowable uses include funding more child care slots, reducing family fees for child care, supplementing provider fees, lowering eligibility requirements to enable more families to use services, and professional development and recruitment of providers. Funds may not be used to construct facilities. Of the total funding, we estimate about $28 million must be used to improve the quality and availability of child care, including $10 million to improve the quality of infant and toddler care.

Enhancing Education Through Technology (EETT). The ARRA provides California $71 million for supplemental support of the existing EETT program. Generally, EETT funds are intended to improve the use of technology in the classroom. Funds may be used to purchase hardware or software, undertake professional development, and support instructional technology staff and services at the local level.

McKinney-Vento Homeless Assistance. The ARRA provides California $18 million for supplemental support of the existing McKinney-Vento Homeless Assistance program. Generally, these funds are intended to help districts improve the enrollment, attendance, and success in school of homeless children.

Child Nutrition Equipment. The ARRA provides California $9.7 million for National School Lunch Program equipment assistance (a new one-time funding grant). The CDE is required to allocate these funds to LEAs through a competitive process based upon need for equipment assistance. Priority is to be given to schools with at least 50 percent of the student population eligible for free or reduced price meals.

Student Longitudinal Data System Grants. The ARRA includes $250 million nationwide for competitive grants from the Institute of Education Sciences (IES) to support the development of statewide student longitudinal data systems that include postsecondary education and workforce information. Up to $5 million of the funds nationally may be used for state data coordinators and for awards to public or private organizations to improve data coordination. Presumably, these grants will be similar to previous IES grants such as the one California used for the development of the California Longitudinal Pupil Achievement Data System (CALPADS).

New Subsidized School Construction Bonds. The ARRA includes $22 billion nationwide for a new type of subsidy for school construction bonds issued in calendar years 2009 and 2010. These bonds may be issued by state or local governments for (1) construction, rehabilitation, or repair of public school facilities; or (2) the acquisition of land on which a public school will be constructed. The amount of new bonds that states (including local governments within the state) can issue is based upon the number of children living below the poverty line in each state. Based on this criterion, California could issue about $3 billion in subsidized bonds. (A portion of this amount is reserved for large school districts to issue bonds directly.)

Qualified Zone Academy Bond. The ARRA provides a $1.4 billion augmentation nationwide to the existing Qualified Zone Academy Bonds (QZAB) program. These subsidized bonds can be used to improve facilities or provide teacher training for school districts in certain high poverty areas. To participate, school districts must partner with a local business and develop an academic program that better prepares students for college or the workforce.

Impact Aid. The ARRA provides $100 million nationwide for supplemental support of the existing Impact Aid program. The ARRA requires that 40 percent of this funding be distributed via formula grants directly to eligible districts and 60 percent be available for competitive grants. Impact Aid monies are intended to fund facility costs for districts with high percentages of students living on military bases and Native American reservations.

New Teacher Performance-Based Compensation Grants. The ARRA provides $200 million nationwide for competitive grants intended to promote the development and implementation of performance-based compensation systems for teachers and administrators. States or districts with innovative program ideas in this area may apply for the grants.

Higher Education

The federal stimulus package funds five targeted higher education programs, which will provide benefits directly to California colleges or students. None of these programs require state administration.

Higher Education Tax Credits. Under current law, the federal Hope tax credit reimburses eligible students for the enrollment fees they pay for college. The stimulus package replaces the Hope credit with the American Opportunity tax credit, which is larger and available to more students. Figure 5 (see next page) summarizes these added features.

Pell Grants. The federal Pell Grant program provides grants to low-income undergraduate students to help them with the costs of attending college. The ARRA increases the maximum Pell Grant from $4,731 in 2008-09 to $5,350 in 2009-10, and expands eligibility for the program. We anticipate that students at California public colleges and universities, including community colleges, will receive about $500 million in additional Pell Grant funds in 2009-10.

Other Programs. Under ARRA, California universities are eligible for hundreds of millions of dollars in competitive grants for scientific research. Public and private colleges and universities in the state will receive an estimated $21 million in additional federal work-study funds in 2009-10. Changes to the rules for Section 529 college savings plans will allow students to count computer equipment and technology and services, including Internet access, as qualified higher education expenses in 2009 and 2010. Additional teacher quality grants and Public Health Service Corps training funds for health care providers will benefit California higher education students and institutions. As we discuss in the "Labor and Workforce Development" section of this report, the federal economic stimulus package directs funds to workforce investment boards for job training purposes. It is likely that community colleges and adult education programs will receive a portion of these funds to carry out such activities.

Issues for Legislative Consideration

In this section, we discuss various opportunities the state has for using federal education funds to achieve General Fund relief. We also describe several other opportunities the state has for maximizing the benefit of these funds—for example, by using them to restore reductions made in the *2009-10 Budget Act*, mitigate deeper reductions in 2010-11 or 2011-12, or bolster existing state education initiatives.

Using Federal Funds to Offset State Education Expenditures

The 2009-10 budget package was premised on the use of only $510 million of education federal stimulus funds to offset state costs. If the Proposition 98 minimum guarantee were to drop

Figure 5

New Federal Tax Credit Expands Hope Credit

Hope Credit (2008 Tax Year)	American Opportunity Credit (2009, 2010)
• Directly reduces tax bill.	• Directly reduces tax bill and/or provides partial tax refund to students without sufficient income tax liability.
• Covers 100 percent of the first $1,200 in tuition payments. Covers 50 percent of the second $1,200 (for maximum tax credit of $1,800).	• Covers 100 percent of the first $2,000 in tuition payments and textbook costs. Covers 25 percent of the second $2,000 (for maximum tax credit of $2,500).
• Designed for students who: —Are in first or second year of college. —Attend at least half time. —Are attempting to transfer or acquire a certificate or degree.	• Designed for students who: —Are in first through fourth year of college. —Attend at least half time. —Are attempting to transfer or acquire a certificate or degree.
• Provides full benefits at adjusted income of up to $96,000 for married filers ($48,000 for single filers) and provides partial benefit at adjusted income of up to $116,000 ($58,000 for single filers).	• Provides full benefits at adjusted income of up to $160,000 for married filers ($80,000 for single filers) and provides partial benefit at adjusted income of up to $180,000 ($90,000 for single filers).

from the enacted level due to declining revenues, however, the state could be in the position to use billions more in federal funds for budgetary solutions. This is due to the way that the stabilization requirements are structured. As shown in Figure 6, we identify almost $7 billion in potential offsets to state education spending across the next three years assuming more pessimistic state revenues. Of this amount, approximately $3.5 billion could be achieved in 2009-10 (or $3 billion more than the current budget). In addition to the options listed in the figure, the state has an opportunity to reduce significantly its existing special education mandate obligations.

Use Education Stabilization Funding to Maximize General Fund Relief. California appears to have options for using most, if not all, education stabilization funding for state General Fund relief. The exact timing of such relief, however, would depend on several factors, including the interpretation of various formulas in the federal law and the final determination of the 2009-10 Proposition 98 minimum guarantee. For example, if revenues fell substantially below the level assumed in the budget, California could use more than $3 billion in federal stabilization funding to offset 2009-10 state education expenditures and avoid having to make deeper cuts to education programs. In this case, approximately $1.5 billion in stabilization funding would remain available to aid the state in 2010-11.

Options for Using Other Federal Funds. If revenues were to deteriorate further, the state has additional options to achieve state General Fund relief by substituting federal funds for General Fund spending. Under this approach, programs would receive the same total amount of funding envisioned in the enacted 2009-10 budget, but more federal and less state funding would be used. These options include:

- ***Title I/Economic Impact Aid (EIA).*** The state EIA program provides funding for supplemental services for educationally disadvantaged students and English Learners (EL). Because EIA is partly based on Title I counts (and Title I counts overlap significantly with EL counts, the other EIA factor), EIA is a natural candidate for such a funding swap. This option would result in up to $1.1 billion in General Fund (Proposition 98) savings spread across the next few years.

- ***Title I/Quality Education Investment Act (QEIA).*** The state QEIA provides funding to 487 schools for school improvement efforts. Given that the vast majority of

Figure 6

Potential Federal Offsets to State General Fund Education Expenditures

(In Millions)

Program	State Fiscal Year 2009-10	2010-11	2011-12	Totals
Education Stabilization Funds	$3,321	$1,554	—	$4,875
Title I, Basic Grants	—	946	$182	1,128
Title I, School Improvement Grants	—	192	192	383
Individuals with Disabilities Education Act (IDEA), state special schools	85	85	85	256
IDEA, residential placements	59	65	72	196
Totals	**$3,466**	**$2,842**	**$531**	**$6,838**

these schools are in federal PI and are implementing specific school-level improvement strategies consistent with SIG rules, SIG funding could be used to fund QEIA. This option would provide the state with up to $383 million in General Fund (non-Proposition 98) savings spread across the next few years.

- ***IDEA/State Special Schools.*** The CDE operates three state special schools (the Fremont School for the Blind, the Fremont School for the Deaf, and the Riverside school for the Deaf) and three regional diagnostic centers (North, Central, and South). The state special schools and diagnostic centers are funded with Proposition 98 ($47 million) and non-Proposition 98 ($39 million) General Fund monies. The state could use IDEA funds to cover these costs over the next three years—resulting in total General Fund savings of $256 million ($140 million Proposition 98 and $116 million non-Proposition 98).
- ***IDEA/Residential Placement.*** The Department of Social Services covers residential costs for special education students who have been diagnosed with serious emotional disorders and require residential placement. The state covers a share of these costs. The state could use IDEA funds to cover these costs over the next three years—resulting in total General Fund savings of $196 million (non-Proposition 98).

Use IDEA Funding to Pay Retroactive Special Education Mandate Claims. In 1994, three school districts filed a claim with the Commission on State Mandates arguing that Chapter 959, Statutes of 1990 (AB 2586, Hughes), constituted a reimbursable mandate by regulating the types of behavioral interventions that could be used for special education students. The administration recently negotiated a settlement with districts. Under the terms of the settlement, districts would receive $520 million to cover retroactive claims. (Of this amount, $10 million would be paid in 2009-10, with the remainder paid in $85 million increments over the course of six years, beginning in the 2011-12 fiscal year.) We instead recommend using IDEA funding provided under ARRA to reimburse districts in 2009-10 for these retroactive claims in one lump sum. Under this approach, a dollar-for-dollar reduction in the state's outstanding mandate obligations would be achieved.

Other Opportunities for Maximizing Benefit of Federal Education Funds

Several other opportunities exist for the state to maximize the benefit of federal education funds.

Apply for State Incentive Grant, Use to Support Certain Education Programs. As described above, the state will need to apply if it is to benefit from any of the $5 billion available nationwide for education incentive grants. While relatively little is known about the criteria that the U.S. Secretary of Education will use to evaluate grant proposals, federal law suggests grants must be used to improve academic achievement, especially at low-performing LEAs. Given this requirement, the state could use grant funds to restore some funding for certain education programs that were reduced in the *2009-10 Budget Act*. For example, the budget reduces funding for alternative high schools, supplemental instruction related to failing the high school exit exam, EL programs, Foster Youth programs, state assessments, and an alternative teacher-training program. Incentive funding also might be reserved to mitigate future cuts in these areas.

Use Title I Set-Aside Funding to Benefit All Schools Serving Low-Income Students. Federal funding available to help low-income schools in need of academic improvement has exceeded identified program costs in recent years. As a result, the state has built up substantial carry-over funding. Thus, we recommend using the additional $45 million in ARRA Title I set-aside funding to benefit all low-income students. To this end, we recommend allocating the additional funds using the basic Title I formulas, which would ensure funds are spread broadly across Title I schools. Title I regulations allow states to distribute set-aside funds in this manner when such funds are found to exceed PI needs.

Child Care and Development Block Grant. Due to the state budget situation, the *2009-10 Budget Act* made various reductions to child care and development programs. The one-time increase in federal CCDBG funding comes with relatively restrictive rules requiring states to spend above existing levels. The funds, however, could be used to backfill cuts already made. Specifically, provider reimbursement rates, family fee rates, and/or the number of child care slots could be partly restored to prior-year levels. The $220 million in available CCDBG funding would be sufficient to sustain some of these restorations through 2010-11. The restorations could be specifically linked to the duration of the availability of the federal funds.

Enhancing Education Through Technology. In recent years, the Legislature has considered various proposals to provide funding to LEAs to prepare for implementation of CALPADS. The Legislature has recognized that while CALPADS will be of benefit both to the state and LEAs, the new system will require much work at the local level to collect and maintain reliable data. The limited-term federal EETT funding is an ideal source of funding for these activities. The EETT funding can be used for efforts to improve local infrastructure in preparation for CALPADS, train local staff on education data quality, and conduct various other related activities that generally will help prepare educators to use data and technology more effectively at the school-site level. In short, this one-time federal funding could offset the need for the state to provide additional funding for LEAs and/or allow for faster implementation of CALPADS.

Statewide Education Database Grant. California used a $3.2 million IES grant to help fund the development of CALPADS, which will be fully implemented in the 2009-10 school year. While CALPADS will significantly improve the state's longitudinal student data system, it does not yet meet all of the federal criteria delineated for such systems. For example, recently enacted federal legislation requires such systems to include data from preschool through postsecondary education. CALPADS, however, currently is designed only to include K-12 student information. We recommend the state pursue additional IES funding to begin a CALPADS improvement project that would meet these federal requirements. (Such a project also could address California-specific issues highlighted in a recently released report, *Framework for A Comprehensive Education Data System.* This report, developed by McKinsey and Company at the request of CDE and the Governor, recommends a multiphased approach for expanding CALPADS to include preschool and postsecondary data as well as undertaking additional improvements to maximize security and data quality.)

Leverage Federal Tax Credits to Increase College Funding. In the *2009-10 Budget Analysis Series: Higher Education*, we noted that additional revenue could be raised through California Community Colleges (CCC) fees with minimal net effect on student costs. This is because financially needy students are exempt from fees, and most other students would be fully or partly reimbursed through federal tax credits. Because ARRA expands the size and availability of these tax credits, middle- and upper-income students would be even better protected from the effect of CCC fee increases. The Legislature, thus, could increase revenue received by community colleges through fees, while having only a minimal effect on college affordability. In effect, raising fees would be an effective strategy for leveraging more federal money for higher education.

In addition, the Legislature may wish to consider modifying the community college fee waiver program into a no-interest loan program for needy students who could fully repay the loan with federal tax reimbursements. This action would add hundreds of millions of dollars in CCC revenues each year—without affecting affordability.

Adjust Campus Financial Aid Funding for Increases in Pell Grants. Both University of California (UC) and California State University (CSU) employ campus-based financial aid grant programs to help their students pay their education costs. In general, the campus-based aid programs seek to cover those costs that the student is unable to meet through family contributions, loans, and grants (such as Cal Grants and the Pell Grant). Because the size of Pell Grants will be increasing under ARRA, this will reduce the amount of aid to be covered by campuses. As noted by the Governor, this has the effect of providing fiscal relief to the campuses. The Legislature may wish to take this fiscal relief into consideration as it determines the level of state funding needed to cover university operations.

HEALTH

One of the largest portions of federal fiscal relief to states will come in the form of an increased federal share of costs for state Medicaid programs (known as Medi-Cal in California). Below, we summarize and discuss the increased federal share and other key health-related components of ARRA.

Increased Federal Share of Funding for Medi-Cal

The federal government pays a certain percentage of the cost of each state's Medicaid program. This percentage is known as the federal medical assistance percentage or FMAP. The ARRA temporarily increases the FMAP for all states retroactively to October 2008 and continuing through December 2010, subject to certain requirements and restrictions, which we discuss below. The ARRA provides a base FMAP increase of 6.2 percentage points for all states, plus additional increases determined by a formula that incorporates each state's unemployment rate and current federal share.

Significant Funding for California. Based on recent employment data, California likely would qualify initially for the highest unemployment-based FMAP increase available under ARRA. Thus, our preliminary estimate is that Medi-Cal will receive an FMAP increase of 11.6 percentage points, equivalent to $10.1 billion in additional federal funds for the state through December 31, 2010. This amount will be distributed among several state departments that administer portions of the Medi-Cal Program, as well as to local governments, who also share in the cost of some Medi-Cal services. Figure 7 summarizes our estimates of state and local savings. The state portion of the federal funds, $8.3 billion, will reduce state General Fund costs over the period.

Requirements and Restrictions. In order to receive the enhanced FMAP, states must comply with certain requirements and restrictions. The most significant of these are the following:

- ***Eligibility.*** States may not receive the FMAP increase after July 1, 2009, unless they maintain eligibility levels and procedures that were in place as of July 1, 2008. The FMAP increase is not available for Medicaid eligibility expansions enacted after July 1, 2008 or for certain health programs that already receive enhanced federal matching funds.

- ***"Prompt Pay."*** As of June 1, 2009, states are not eligible for the enhanced FMAP for days during which they do not meet federal prompt pay requirements. These requirements specify, among other provisions, that state Medicaid programs pay 90 percent of noninstitutional medical claims within 30 days. The ARRA would apply these provisions to nursing homes and hospitals as well.

- ***"Rainy Day Funds."*** States may not use funds attributable to the increased FMAP as deposits into a rainy day fund or reserve.

Figure 7

State and Local Savings From Increase in Federal Share of Medi-Cal Costs

(In Millions)

	2008-09	2009-10	2010-11	Total
State Departments				
Health care services	$1,973	$2,838	$1,482	$6,293
Social services (IHSS)	282	389	206	876
Developmental services	234	313	163	710
Other departments	143	200	106	449
Subtotals	($2,631)	($3,740)	($1,957)	($8,327)
Other Entities				
Local government	$305	$408	$203	$916
Public hospitals[a]	293	361	179	833
Subtotals	($598)	($769)	($382)	($1,749)
Total Federal Fund Relief	**$3,229**	**$4,508**	**$2,339**	**$10,077**

[a] Includes University of California hospitals.
IHSS = In-Home Supportive Services.

State Currently Does Not Qualify for Enhanced FMAP. Based on our review of the ARRA provisions affecting Medicaid, California currently does not qualify for the FMAP increase due to a procedural change to Medi-Cal Program eligibility rules the state enacted as part of the *2008-09 Budget*

Act. This change required children to submit a midyear status report to confirm their continuing eligibility for Medi-Cal every six months, along with their parents, who were already required to submit this report. In order to receive the new federal funds, the state would need to reverse this policy prior to July 1, 2009. This reversal would result in additional General Fund costs to the state of $70 million in 2009-10 (as estimated at the enhanced FMAP rate). Based on our review and our discussions with the state Department of Health Care Services (DHCS), which administers Medi-Cal, the state currently meets all other ARRA requirements.

State Policy Change Needed to Access Increased Federal Funds. The federal government made increased FMAP funding available as of February 25, 2009 for six months of prior expenses. The department indicated in discussions that it will be ready to begin drawing down the additional funds as soon as mid-March. However, DHCS also reported that it must certify to the federal government that California has reversed its new midyear status report requirement before the state can access these funds. Therefore, we recommend that the Legislature enact legislation as soon as possible to reverse the children's midyear reporting requirement.

Other Medicaid Provisions

In addition to the FMAP enhancement, the federal economic stimulus package includes other funding for state Medicaid programs that we discuss below. We summarize the major provisions in Figure 8. None of these provisions are likely to offset General Fund expenditures in the Medi-Cal Program, but some may increase state costs.

Health Information Technology (HIT). The ARRA provides an estimated $15 billion nationwide over nine years to pay most of the costs to implement and administer electronic health records for qualifying Medicaid providers, such as children's hospitals and physicians who serve a minimum percentage of Medicaid enrollees in their practice. Only technologies that meet

Figure 8

Other Key Medicaid Provisions in Federal Economic Stimulus Package

Provision	Fiscal Effects	
	Nationwide	California
Health information technology	$2 billion appropriated for grants, $15 billion estimated spending for Medicaid incentive payments, and $22 billion for Medicare incentives.	Unknown.
Disproportionate Share Hospital (DSH) funding	Estimated $548 million.	Direct increase of $54 million in federal DSH funds for public hospitals. Also results in increase of $9 million (General Fund) for other hospitals.
Transitional Medi-Cal expansion	Estimated $1.3 billion.	Costs of $59 million (General Fund) if California implements optional expansion.
Delay in various Medicaid regulations	Potential savings.	Potential savings.

certain standards will be eligible for funding, and the state would need to administer a HIT oversight program to ensure that providers receiving federal funds adhere to ARRA's specified criteria.

The ARRA provides an estimated $22 billion nationwide over nine years for similar incentives in the federal Medicare program, and $2 billion for a variety of grants and other assistance to promote various health information technologies. The grant and other assistance programs require varying levels of nonfederal funding to draw down this federal assistance—in some cases as little as $1 of nonfederal funding for every $10 received from the federal government. These nonfederal shares could be provided by states or potentially by local governments or other entities. The federal grants will be awarded based on a competitive application process, and the details of the distribution are not yet established.

In our recent report, the *2009-10 Budget Analysis Series: Health* (see page HE-15), we discuss how increasing the adoption of HIT among health care providers holds the potential to reduce the costs and increase the quality of health care in California. We recommend that the state seek to identify nonstate sources of funding from private health care organizations or provider organizations in order to participate in the proposed HIT programs to the extent possible. We further recommend that the state Office of Health Information Integrity be directed to take the lead in these efforts.

Disproportionate Share Hospital (DSH) Payment Increase. Under the federal DSH program, the federal government provides a pool of funds each year to supplement Medicaid reimbursements to hospitals that serve a disproportionate number of Medicaid or other low-income patients. The ARRA increases DSH funding by 2.5 percent a year for two years. We estimate this will result in additional federal payments of $54 million over that period to public hospitals in the state, including hospitals operated by the UC. The nonfederal share needed to access these DSH funds is provided by the public hospitals themselves in the form of costs they incur to deliver services. The federal DSH increase will result in automatic increases in payments to certain other hospitals by an estimated $9 million in General Fund costs ($24 million total funds) over the next two years due to current provisions in California law.

Transitional Medi-Cal. Current federal law requires states to provide an additional 12 months of coverage to families enrolled in Medi-Cal who increase employment income beyond a certain level. Under the ARRA, for a two-year period ending December 31, 2010, states could elect to (1) loosen restrictions on retaining this Medi-Cal coverage by automatically enrolling these families in 12 months of coverage and (2) waive the minimum enrollment period now needed to qualify for transitional coverage. We estimate that the state would incur General Fund costs of $59 million (assuming the enhanced FMAP provided in the ARRA) over two years to automatically provide the additional coverage for the approximately 150,000 current transitional enrollees. The state also would incur unknown costs as a result of waiving the minimum enrollment period requirements, as it is unclear how many enrollees might become eligible to receive the extended period of benefits. Given the state's severe fiscal problems, we would recommend that the Legislature not expand this program.

Delay of Certain Medicaid Regulations. The ARRA extends through June 30, 2009, the current moratoria on certain federal regulations that could otherwise increase state and local costs for the Medi-Cal Program. For example, one regulation would limit the opportunity for the state to use so-called provider taxes to fund rate increases and achieve General Fund savings. It also imposes a new moratorium through June 30, 2009, on a regulation regarding outpatient hospital facility services. Lastly, ARRA expresses Congress' intent that certain pending federal regulations should not be issued. If these federal regulations were in effect, the state and local agencies and health care providers would face potentially significant adverse fiscal impacts.

Other Health Provisions

In addition to the Medicaid provisions described above, the federal economic stimulus package includes additional funding for other health-related provisions. We summarize the most significant of these in Figure 9, and discuss them further below.

Grant Money for Public Health Centers. The ARRA provides $2 billion in grant money nationwide to qualified health centers, including federally qualified health centers. Of the $2 billion, $1.5 billion is for construction and renovation of facilities, and the purchase of HIT. The remaining $500 million is available to support new or existing health center sites or service areas and to provide supplemental payments for spikes in uninsured populations. At the time this report was prepared, the federal government had not established how it would distribute these funds.

Figure 9

Other Major Health-Related Provisions in Federal Economic Stimulus Package

Provision	Fiscal Effects		Available to Offset General Fund Spending?
	Nationwide	California	
Grant money for public health centers	$2 billion for construction, certain technology, and general purposes.	Unknown.	No
Health workforce funding	$500 million for health workforce development.	Unknown.	No
Additional federal grants for Early Start program	$500 million for the federal Individuals with Disabilities Education Act Part C grants.	About $50 million for the Early Start Program.	Yes
Prevention and Wellness Fund	$1 billion for various prevention and wellness programs.	$34 million for vaccinations. Unknown for other programs.	Unknown
Supplemental funding for Women, Infants, and Children	$500 million for nutrition assistance programs, including $100 million for information systems.	Unknown.	No
Safe Drinking Water State Revolving Fund	$2 billion.	$160 million to the state for drinking water projects that can begin construction before February 17, 2010.	No
Continuing employer-sponsored health coverage (COBRA)	Unknown.	Unknown.	No

COBRA = Consolidated Omnibus Budget Reconciliation Act.

Health Workforce Funding. The ARRA provides $500 million nationwide to support health care workforce development programs. Included in this amount is $300 million for the federal National Health Service Corps, which provides medical education scholarships and loan replacement funds as well as grants to medical training programs. The Office of Statewide Health Planning and Development currently administers various health care workforce development programs, including medical education support funded in part through $1 million annually from the National Health Service Corps. At the time this report was prepared, information was unavailable regarding how these funds will be distributed or how much California might receive.

Additional Federal Grant Funds for Early Start Program. The ARRA provides about $50 million in grant funding in FFY 2009-10 for the federal IDEA Part C early intervention programs, known in California as the Early Start program. This funding can likely be used to offset General Fund support of Early Start, which is administered by the state Department of Developmental Services. Some IDEA Part C funds support Early Start requirements in other departments including CDE and the Office of Administrative Hearings. At the time this analysis was prepared, it was unclear what process the federal government will follow to distribute these funds.

Prevention and Wellness Fund. The ARRA provides $1 billion nationwide for prevention and wellness efforts, including: (1) $50 million to prevent heath care-associated infections, (2) $300 million in grants to state and local health departments to vaccinate certain eligible children and adults, and (3) $650 million for clinical and community-based strategies that are proven to reduce chronic disease rates. The state is expected to receive $34 million of the $300 million for the vaccination program. A federal spending plan has not yet been announced for the remaining $700 million. Some funds will likely be distributed through grants, with guidelines for such grants announced by May 2009.

Supplemental Funding for Women, Infants, and Children (WIC). The ARRA provides supplemental funding of $500 million for the WIC nutrition assistance program, including $100 million for information systems. Although the state-by-state allocation of these funds has not been announced, it is likely that California will receive a portion of this supplemental funding in order meet the increasing demand for WIC services in the state.

Safe Drinking Water State Revolving Fund (SDWSRF). The ARRA provides an estimated $160 million to the state for "shovel-ready" drinking water projects that can begin construction before February 17, 2010. The state Department of Public Health (DPH) has already begun to solicit applicants and proposals for this funding and anticipates posting a list of eligible projects by April 2009. The DPH anticipates that, once the list is posted, it will begin awarding funding to eligible projects on a first-come, first-served basis until all funds are allocated.

Provisions to Continue Employer-Sponsored Health Insurance. The federal Consolidated Omnibus Budget Reconciliation Act (COBRA) allows employees and/or their family members to temporarily extend their coverage in a group health plan when coverage would be lost due to certain events, such as loss of a job. This program can provide coverage up to 36 months. An individual must pay the entire monthly premium.

Under ARRA, persons who lost employer-based health coverage between September 1, 2008 and January 1, 2010 due to job loss would be eligible for a federal subsidy. The subsidy would last for nine months and would cover 65 percent of the premium, with the individual responsible for the remaining 35 percent. The subsidy would be phased out for higher-income persons.

LABOR AND WORKFORCE DEVELOPMENT

Below, we discuss how ARRA impacts workforce development programs and the unemployment insurance system in California.

Workforce Investment Act (WIA)

The federal WIA provides funding for a range of workforce development activities through statewide and local agencies. The WIA has separate funding streams for youth, adults, and dislocated workers. Pursuant to federal law, 85 percent of the state's total WIA funds (an estimated $427 million in 2009-10) is allocated to local Workforce Investment Boards (WIBs). The remaining 15 percent ($64 million in 2009-10) is available for state discretionary purposes such as administration, statewide initiatives, and competitive grants for employment and training programs.

Additional WIA Funds. As shown in Figure 10, ARRA provides additional WIA funds of about $494 million for California. We estimate that about $420 million will be allocated to local WIBs to administer local workforce development activities, while an estimated $74 million will be available for state discretionary purposes. These additional WIA funds would be available for expenditure over the 2009-10 and 2010-11 state fiscal years.

Competitive Grants for WIA Funds. The ARRA also includes the following WIA discretionary grants for state, local WIBs, and other providers and agencies:

- $200 million available nationally for additional dislocated worker assistance.
- $50 million available nationally for YouthBuild activities, specifically targeting individuals who have dropped out of high school and re-enrolled in an alternative school.
- $750 million available nationally for competitive grants for worker training and placement in high growth and emerging industry sectors, including $500 million targeted for preparing workers for careers in energy efficiency and renewable energy.

Use WIA Funds for General Fund Relief. In the past, the Legislature has used the 15 percent state discretionary funds for new initiatives and to achieve budget solutions by offsetting General Fund costs for employment and training

Figure 10

Additional WIA Funds for California

(In Millions)

Category	Estimated Allocation
Adult	$81
Youth	188
Dislocated workers	225
Total	**$494**

WIA = Workforce Investment Act.

programs in other state departments. Given the state's fiscal situation, we recommend that the Legislature direct all of the additional $74 million in discretionary funds to offset employment and training program General Fund costs in either the California Department of Corrections and Rehabilitation or the California Conservation Corps.

Other New Employment And Training Funds

Currently, the state receives about $80 million in Wagner-Peyser Act (WPA) to support employment services to individuals and employers at "one-stop" locations throughout the state. In addition, California receives about $10 million for Trade Adjustment Assistance (TAA), which targets training services to workers who have lost employment as a result of increased imports.

New Employment and Training Funds. The ARRA provides an additional $45.5 million in WPA funds to California for state employment services. The ARRA specifies that about $28 million be used to provide reemployment services for Unemployment Insurance (UI) claimants. We expect these additional WPA funds to be available in FFY 2008-09. The ARRA also provides additional TAA training funds through December 2010. Specifically, we estimate that California will receive an additional $17.3 million in FFY 2008-09, $17.3 million in FFY 2009-10, and $4.3 million in FFY 2010-11.

Unemployment Insurance

The UI program is a federal-state program that provides weekly UI payments to eligible workers who lose their jobs through no fault of their own. To be eligible for benefits, a claimant must be able to work, be seeking work, and be willing to accept a suitable job. Regular UI benefits can be paid for a maximum of 26 weeks, while federally funded extended benefits may be available to workers who have exhausted regular UI benefits during periods of high unemployment. The regular UI program is financed by unemployment tax contributions paid by employers for each covered worker.

As we discussed in the *2009-10 Budget Analysis Series: General Government* (see page GG-25), the UI fund is currently insolvent. The Governor has introduced a proposal to restore solvency to the UI fund, which remains under consideration by the Legislature. We find that the Governor's plan has merit in that it restores solvency to the UI fund. The Employment Development Department, which administers the UI program, has already obtained a federal loan to cover projected fund deficits, which means there will be no interruption in benefit payments.

Figure 11 summarizes the major impacts of ARRA on the UI program. As the figure shows, we estimate that California could receive approximately $5.4 bil-

Figure 11

Unemployment Insurance (UI)—Major Fiscal Impacts

(Through 2011-12, in Millions)

Provision	Amount
Extended UI benefits now available through 2009	$3,200
Temporary increase of $25 in weekly benefits through 2009	1,000
Incentive payment if the state implements UI eligibility changes	844
Temporary relief of state interest payments for UI federal loans	314
Additional funds for UI administration	60
Total	**$5,418**

lion, with most funds going directly to recipients of unemployment benefits.

Extended and Increased UI Benefits. The ARRA extends the Temporary Emergency Unemployment Compensation (TEUC) program through the end of calendar year 2009. Eligible workers in California can receive up to 33 weeks of extended benefits under TEUC, which had been scheduled to terminate in March 2009. Our preliminary estimates indicate that the extension of TEUC will result in about $2.2 billion of extended benefit payments for eligible claimants in FFY 2008-09 and about $1 billion in FFY 2009-10.

The ARRA increases regular and extended benefits by $25 per week for claims filed by December 31, 2009. The federal government would fund this additional temporary benefit increase. Our preliminary estimates indicate that this temporary benefit increase will result in about $700 million in additional benefit payments for eligible claimants in FFY 2008-09 and about $300 million in FFY 2009-10.

Temporary Relief of UI Interest Costs for Federal Loan. As discussed above, states may receive federal loans to cover UI benefit payments when their funds are insolvent. Short-term federal loans are generally interest-free, but longer-term loans must be repaid with interest. While the principal amount of borrowed funds is repaid automatically from the UI fund whenever the fund has a positive balance, any interest charges must be paid with other state funds (usually the General Fund). The ARRA includes temporary relief of these interest payments for states with federal UI loans through December 31, 2010.

Additional Funds for UI Administration. The ARRA includes additional funds for state UI administration. We estimate that California will receive about $60 million of these funds in FFY 2008-09. These additional funds can only be used for certain UI administration purposes, including expenses for implementing federal options for UI modernization discussed below.

Our preliminary estimates indicate that ARRA's provision to temporarily waive UI federal loan interest costs will result in General Fund savings of $30 million, $209 million, and $75 million in state fiscal years 2009-10 through 2011-12, respectively. We note that these interest amounts depend on the nature of any corrective action to address the UI fund insolvency and/or the economy.

Incentive Payments Tied to Significant UI Program Changes. The ARRA includes incentive payments for states that choose to "modernize" their UI programs by expanding eligibility. These changes would essentially allow more low-wage, part-time, or other unemployed workers to be eligible for UI benefits. States can receive the first one-third of the incentive payment by adopting an alternative base period (ABP) for individuals who otherwise would not earn enough money to qualify for UI benefits using the existing base period. States can receive the remaining two-thirds of the incentive payment by adopting the ABP, as well as at least two of four provisions related to part-time workers, individuals who separated from their job for compelling family reasons, individuals enrolled in training programs, and dependent allowances. California's estimated share of the incentive payment is about $844 million.

Potential State Fiscal Impacts. California currently provides part-time worker coverage and extended UI benefits for individuals in training programs, thus meeting two of the four requirements related to the two-thirds portion of the UI incentive payment discussed above. To receive any of the incentive payment, however, the state would have to adopt legislation implementing the ABP for determining UI eligibility.

Preliminary estimates indicate that the additional payments for individuals qualifying for UI benefits under the ABP would total about $70 million per year. In addition to the cost of these new benefit payments, implementing the ABP could be a timely and/or labor-intensive process, as it would require changes to the existing UI automated database. These one-time automation costs could be between $30 million and $40 million, but the state could use the additional UI administrative grant discussed above to cover these costs.

If the state implements an ABP in accordance with the federal requirements and receives an incentive payment of about $844 million, there could be several potential state fiscal impacts. It is our understanding that if a state's UI fund is insolvent, it must use the incentive funds to pay UI benefits. This could result in a reduction in future General Fund costs if the fund continues to be insolvent past December 2010. This is because the incentive funds would reduce the state's UI fund deficit, resulting in interest savings once the interest forgiveness period ends.

Conversely, if the UI fund were solvent, the incentive payment funds may be available for other purposes. These could include paying for administrative or capital expenditure costs (including automation) in the UI program or state employment services. Some of these actions could result in state General Fund savings.

When considering the ABP and the new federal incentive payments, we recommend that the Legislature examine these issues within the broader context of addressing the UI insolvency.

SOCIAL SERVICES

For social services programs and beneficiaries, ARRA provides an estimated $5.3 billion in federal funding for California from FFY 2008-09 through FFY 2010-11, as shown in Figure 12 (see next page). About $2.8 billion is in the form of direct payments to individuals—mostly recipients of Supplemental Security Income (SSI), Social Security, and/or food stamps. With respect to state- and county-funded social services programs, ARRA provides about $2.2 billion in additional funding, much of which can be used to offset General Fund costs. Finally, ARRA provides about $300 million in additional funds to existing programs which have no state General Fund participation. Below, we describe how ARRA affects various social services programs.

California Work Opportunity and Responsibility to Kids (CalWORKs)

The CalWORKs program provides cash grants and welfare-to-work services to low-income families with children. The CalWORKs program is primarily supported by state General Fund and the federal Temporary Assistance for Needy Families block grant.

Significant New Funding. For FFY 2008-09 and FFY 2009-10, ARRA creates a new federal funding stream which provides 80 percent federal financial participation in costs for ongoing basic assistance (cash grants), non-recurring short-term assistance, and subsidized employment which exceed the corresponding costs during FFY 2006-07. State and county funds cover the remaining 20 percent of these costs. On a cash flow basis, California will begin to receive these funds in the April to June quarter of 2009. We estimate that this provision will provide California with a total of about $450 million in additional federal funds, including a 2.5 percent share for counties.

Automatic General Fund Relief. This new federal stream results in General Fund savings

Figure 12

Social Services—Summary of Impacts in California

(In Millions)

Programs/Provisions	Amount	Description
Payments to Individuals		
One-time retiree payment	$1,500	A one-time $250 payment to recipients of Social Security, Railroad Retirement, and certain veterans benefits.
One-time SSI payment	320	A one-time $250 payment to about one million SSI recipients.
Food stamps benefits	970	A 13.6 percent increase in food stamps benefits.
Subtotal	($2,790)	
State Programs With General Fund Costs		
IHSS, ADHC, and MSSP	$1,356[a]	FMAP relief of 11.6 percent applies to these programs.
CalWORKs	450	New 80 percent federal financial participation for increased benefit costs since 2007.
Child support enforcement	175	Federal incentive funds eligible for 66 percent federal match.
Adoption Assistance Program	97	FMAP relief of 6.2 percent for state/county costs.
Foster Care	72	FMAP relief of 6.2 percent for state/county costs.
DOR—Vocational Rehabilitation	57	Additional funds to assist disabled individuals obtain and retain employment.
DOR—Independent living services	7	Additional funds for independent living centers and blind services.
Food stamps administration	22	Additional funds for state/county food stamps administration.
CDA—Nutrition	13	Additional funds for home-delivered and congregate meals.
Subtotal	($2,249)	
State Programs With No General Fund Costs		
DCSD—Weatherization	$192	Grants to local agencies to assist low-income individuals with weatherization projects to reduce utility costs.
DCSD—Local block grant	89	Formula grants to localities to assist low-income individuals in becoming self-sufficient.
CDA—Employment	10	Additional funds for senior community service employment programs.
TEFAP	12	Additional funds for commodities distribution.
Subtotal	($303)	
Total	**$5,342**	

[a] These amounts are also reflected in Figure 7, which itemizes FMAP relief.
ADHC = Adult Day Health Care; MSSP = Multipurpose Senior Services Program; FMAP = Federal Medicaid Assistance Percentages; DOR = Department of Rehabilitation; CDA = California Department of Aging; DCSD = Department of Community Services and Development; IHSS = In-Home Supportive Services; SSI = Supplemental Security Income; CalWORKs = California Work Opportunity and Responsibility to Kids; TEFAP = The Emergency Food Assistance Program.

of $40 million, $200 million, and $190 million for state fiscal years 2008-09 through 2010-11, respectively. We note that the *2009-10 Budget Act* scores General Fund savings of $147 million from a 4 percent grant reduction (which could be triggered off if sufficient federal fiscal relief is identified). Due to this new federal funding stream, the net savings from this grant reduction is only $29 million during 2009-10.

Food Programs

The federal Food Stamps Program provides monthly benefits to low-income households and individuals to assist them with food purchases. The cost of the benefits is borne entirely by the federal government. The associated administrative costs are shared among the federal government (50 percent), the state (35 percent), and the counties (15 percent). In addition to the federal program, the California Food Assistance Program (CFAP) provides state-only funded food stamp benefits to legal noncitizen adults under age 64 who would otherwise be eligible for federal food stamps once they have resided in the United States for five years.

Food Stamps Benefit and Administrative Funding Increase. The ARRA increases the monthly maximum food stamps benefit by 13.6 percent effective April 1, 2009. (We note that future federal inflationary adjustments to food stamps benefits are suspended until such time as their combined impacts would exceed this 13.6 percent increase.) We estimate that this provision will provide Californians with just under $1 billion in additional food stamps benefits from FFY 2008-09 through FFY 2010-11. The state also will receive about $11 million in additional federal funding over the same time period for the administration of the food stamps program.

Increased State Costs for Food Stamps Benefits. Because CFAP benefits are statutorily linked to federal benefit levels, this 13.6 percent increase will raise General Fund CFAP costs by $1 million, $3.5 million, and $2.5 million for state fiscal years 2008-09 through 2010-11 respectively.

State Could Achieve General Fund Savings by Reducing Administrative Support. Due to the availability of additional federal funds, the Legislature could achieve General Fund savings by reducing state and county support for food stamps administration. Specifically, we estimate that this additional funding could allow the state to achieve General Fund savings of $3.8 million in 2009-10 and $2.9 million in 2010-11. Counties also could achieve some savings.

Federal Funds Available for Distribution of Commodities. The ARRA increases funding for The Emergency Food Assistance Program by $150 million. California is estimated to receive about $6 million in FFY 2008-09 and $6 million in FFY 2009-10 from this provision. These funds are used for the distribution of food commodities to food banks.

Foster Care and Adoption Assistance Program (AAP)

The Foster Care program provides monthly cash grants to individual and group home providers for the care and supervision of children who have been removed from their homes for health and safety reasons. The AAP provides monthly cash grants to parents who adopt foster children. The federal government pays a share of the costs for eligible Foster Care and AAP cases based on the state's Federal Medicaid Assistance Percentages (FMAP) rate of 50 percent.

General Fund Relief From Temporary Increase in FMAP Rate. As further discussed in the

"Health" section of this report, ARRA temporarily increases the FMAP rate for states by a base amount of 6.2 percent, plus additional increases for high unemployment rates. The ARRA provides the base FMAP increase of 6.2 percent for the Foster Care and AAP programs retroactively to October 2008 and continuing through December 2010. We estimate that this provision will provide California (the state and counties) with $32.9 million in FFY 2008-09, $30.9 million in FFY 2009-10, and $7.7 million in FFY 2009-10 in additional federal funds for the Foster Care program. In addition, we estimate $41.1 million in FFY 2008-09, $44.1 million in FFY 2009-10, and $11.5 million in FFY 2010-11 in additional federal funds for AAP. We estimate that the temporary FMAP increase for Foster Care and AAP will result in combined General Fund savings of $32.8 million in 2008-09, $45 million in 2009-10, and $23.5 million in 2010-11.

The ARRA also potentially allows for a reduction in General Fund expenditures for certain Foster Care children who are designated as seriously emotionally disturbed (SED). Please see the "Education" section of this report for an option to use additional IDEA federal funds in lieu of General Fund to support residential costs for SED children.

In-Home Supportive Services (IHSS)

The IHSS program provides various services to eligible aged, blind, and disabled persons who are unable to remain safely in their homes without such assistance. The IHSS program is funded by a combination of federal, state, and local funds. The IHSS program is eligible for the enhanced FMAP funding described in the "Health" section of this report. As shown in Figure 7, we estimate a General Fund savings in IHSS of $282 million in 2008-09, $389 million in 2009-10, and $206 million in 2010-11.

Economic Recovery Payments

The ARRA provides a one-time additional $250 payment to SSI recipients (except those residing in an institution), Social Security recipients, Railroad Retirement recipients, and veterans receiving disability or pension benefits. The total federal funds received as a result of this proposal are estimated to be $1.8 billion ($320 million to SSI recipients, $1.4 billion to Social Security recipients, $9 million to Railroad Retirement recipients, and $88 million to veterans). The payments are required to be made within 120 days of the enactment of ARRA.

Child Support

The child support enforcement program helps custodial parents obtain child support from noncustodial parents. The program is supported 66 percent by federal funds and 34 percent by state funds. States compete for federal incentive funds based on the performance of their child support enforcement system. Prior to October 2007, states could count the federal incentive funds towards the states' 34 percent match.

Restores Ability to Receive Federal Match for Incentive Funds. The federal Deficit Reduction Act eliminated the states' ability to use federal incentive funds to draw down a federal match. In order to hold child support enforcement harmless, the Legislature appropriated sufficient General Fund dollars to backfill the lost federal funds. The ARRA temporarily (from October 2008 to September 2010) restores states' ability to use federal incentive funds to draw down federal matching funds. Based on the incentive funds in 2008-09 and 2009-10, we estimate that this provision could provide California with about $175 million in additional federal funds. However, the amount of federal funds drawn down as a result of this proposal will depend on the amount of incentive funds California ultimately receives.

Remove General Fund Backfill to Achieve State Relief. Because ARRA temporarily rescinds the federal law prohibiting the use of federal incentive funds to draw down federal matching funds, we recommend the Legislature remove the existing General Fund backfill without reducing total funding for Department of Child Support Services. Based on the amount of General Fund backfill in 2008-09 and 2009-10, we recommend that the Legislature achieve General Fund savings of about $22 million in 2008-09, $30 million in 2009-10, and $7.5 million in 2010-11. The actual level of savings achieved will depend upon the final amount of incentives earned.

California Department of Aging (CDA)

The CDA administers California's Senior Community Employment and Nutrition programs. These programs are provided at the local level through Area Agencies on Aging (AAAs). The Senior Community Employment Program (SCEP) provides part-time, subsidized training and employment for low-income individuals age 55 or older. The Nutrition program provides several services including home delivered and congregate meals to individuals age 60 and older. The SCEP is funded with a combination of federal and local matching funds, while the Nutrition program is funded through a combination of federal funds with state and local matching funds.

Additional Federal Funds for Senior Employment and Nutrition Programs. California is eligible to receive federal ARRA funds of up to $9.5 million for SCEP and up to $13 million for the Nutrition program. At this time, it is our understanding that the actual amount of federal dollars California will receive from these provisions will depend on the ability to secure local matching funds to draw down these additional federal funds. Because it is difficult to estimate the amount of matching funds the local AAAs will be able to provide, the actual amount of additional SCEP and Nutrition funds California will receive is unknown at this time.

Potential General Fund Offset. Because the Nutrition program is partially supported by the General Fund, there may be an opportunity to replace some General Fund dollars with the additional federal funds. However, whether these savings could be achieved would depend on the ability to identify the required matching funds.

Department of Community Services And Development (DCSD)

The DCSD administers California's Weatherization and Community Services Block Grant (CSBG) programs. The Weatherization Assistance Program (WAP) reduces the cost of heating and cooling for low-income families by improving the energy efficiency of their homes through attic insulation, heating system repair, and other conservation measures. The CSBG program provides a range of services, such as job training and tax preparation guidance, to assist low-income people in attaining the skills, knowledge, and motivation necessary to achieve self-sufficiency. Both programs are supported by federal funds that are allocated to local community action agencies pursuant to an existing funding formula.

Additional Federal Funds for WAP and CSBG Programs. The ARRA provides increased federal funds of $192 million for WAP and $89 million for the CSBG program. In addition to increasing funding for these programs, ARRA makes some program policy changes that may expand program eligibility, increase maximum benefits, and set aside a higher percentage of funds for training and technical assistance. At this time, it is unclear whether state legislation is needed to implement these changes.

Rehabilitation Services

The Department of Rehabilitation (DOR) provides programs and services to assist individuals with disabilities in obtaining and retaining employment, as well as maximizing their ability to live independently in their communities. The DOR's two major programs are (1) Vocational Rehabilitation (VR), which provides training, education, and other services to prepare disabled individuals for employment; and (2) Independent Living Services (ILS), which assists disabled individuals to live independently. The DOR programs are supported with federal and state funds.

Additional VR and ILS Funds. The ARRA provides an additional $56.5 million in VR funds and about $7 million in ILS funds. The ARRA targets about half of the ILS funds to independent living centers, while the remaining half of ILS funds are to be used for services for older blind individuals.

TRANSPORTATION

Figure 13 shows the amount of funding provided by ARRA for transportation programs. As shown in the figure, California will receive about $3.6 billion in additional federal funds from formula-based highway and transit programs. None of these additional funds will offset General Fund expenditures. In addition, the state, local governments, and transit agencies can apply for additional funding that will be provided on a discretionary basis.

Major Provisions

Highway Funds. California is expected to receive about $2.6 billion in federal economic stimulus funds for highway and road projects. Of this amount, ARRA allows 67 percent of the funds (about $1.7 billion) to be used by the state Department of Transportation (Caltrans) for state transportation programs and projects. The federal act requires that 30 percent (about $770 million) be allocated to regional transportation agencies for projects selected by them. The other 3 percent of funds (about $77 million) must be used for transportation enhancement projects, such as bicycle and pedestrian paths and landscaping. In addition, the federal act requires the timely use of funds through a series of "use it or lose it" deadlines. These timelines for the use of funds are as follows:

- At least one-half of the Caltrans' share of the funds must be obligated within 120 days. (Funds are obligated for a transportation project when a project is fully designed and is ready to advertise for construction.) This requirement means that the state must obligate about $900 million of the highway and road funds by July 2009. If Caltrans fails to meet this requirement, one-half of the funds will be taken back and redistributed to other states that have been able to meet this deadline.

- All of the funding for highways and roads must be obligated within one year (by March 2010). Any funds that have not been obligated by this deadline will be taken back and redistributed to states that have been able to meet this deadline.

- Funding that is provided to the states through the redistribution of funds after March 2010 must be obligated by September 20, 2010. After this deadline, ARRA funds for highways and roads will no longer be available.

Transit Funding Distributed Directly to Regions. Of the $7.55 billion available nationwide, California's share of the formula-based transit funds is just over $1 billion. This includes $968 million for larger metropolitan areas for bus, rail and related capital assistance, and $66 million for light and commuter rail systems. This funding will be provided directly to the regions and local operators, which means the state is not involved in the distribution or accountability of these funds. Another $34 million is provided for the nonurbanized areas in the state. This funding is administered by Caltrans.

Similar to highway funds, the federal act requires the timely use of these transit funds through a series of deadlines:

- At least 50 percent of these formula-based funds must be obligated within 180 days. This means that each local agency must obligate one-half of its funds by no later than early September 2009. The federal government will withdraw one-half of the funds originally apportioned from any recipient that fails to meet this requirement and redistribute the money to other states or agencies that have been able to meet this deadline.

- All of the funding must be obligated within one year (by March 2010). The federal government will withdraw any funds that have not been obligated by this deadline and redistribute the money to states or agencies that have missed both deadlines.

The State Could Additionally Benefit From Discretionary Programs. Beyond the formula-

Figure 13

Transportation Component of the American Recovery and Reinvestment Act

(In Millions)

Program	Nationwide Total	California's Share
Formula-Based Funding		
Highways and roads	$27,500	$2,570
Transit	7,550	1,068
Discretionary Funding		
High-speed and intercity rail	$8,000	—[a]
Supplemental discretionary grants	1,500	—[a]
Aviation infrastructure	1,300	—[a]
Other transit grants	850	—[a]
Totals	**$46,700**	**$3,638**

[a] The amount is unknown as it will depend on receipt of discretionary grants.

based funds, other competitive grant programs could provide additional benefits to California.

- First, the California High-Speed Rail Authority could receive a substantial amount of capital funding, as ARRA provides $8 billion to support the development of intercity high-speed rail service nationwide. This money will be allocated through a competitive process based on the U.S. Transportation Secretary's strategic plan, which will be developed no later than April 18, 2009.

- Second, $1.5 billion is available nationwide to be awarded on a competitive basis for projects that will have a significant impact on the nation, a metropolitan area, or a region. States, local governments, and transit agencies are all eligible to apply for this funding; however, no state can receive more than $300 million. Caltrans has indicated that it will work with local governments or transit agencies to guarantee that the state maximizes the amount of funding it receives from this program.

- Finally, there are other discretionary grant programs that could benefit the state. These include $1.3 billion in discretionary grants for airport facilities and equipment and $850 million for transit projects. The federal government may also spend a portion of the $1.3 billion in California for Amtrak to make track, equipment, and security improvements.

Maintenance of Effort and Reporting Requirements. The federal act requires the Governor to certify by mid-March that California will maintain its efforts with regard to state funding for the types of transportation projects that use federal economic stimulus dollars. If that level of state funding is not maintained, California would not be eligible to receive any federal highway funds that are redistributed in August 2011. In addition, ARRA requires a number of periodic reports on the use of federal economic stimulus funds for transportation.

Issues for Legislative Consideration

State Law Sets Process to Allocate Federal Funds. Current state law sets up a process to allocate federal funds available to the state for highway purposes. Specifically, the California Transportation Commission (CTC), working with Caltrans, determines the amount of funding to set aside for highway rehabilitation and repair projects in the State Highway Operation and Protection Program (SHOPP), and the remaining amount that would be made available to regions and Caltrans for highway expansion projects in the State Transportation Improvement Program. Current state law also specifies that highway rehabilitation and safety improvements (that is, SHOPP projects) have priority over highway expansion projects. As of February 2009, Caltrans indicated that it has about $1.5 billion in SHOPP projects that could begin construction within 180 days. This means that the state could comply with the federal deadlines for these ARRA funds. Thus, under current law, nearly all of the state's federal economic stimulus highway funds ($1.7 billion) could be made available for SHOPP projects. At the time this analysis was prepared, CTC had not yet decided on the amount to use for SHOPP. However, it has set a minimum target (or floor) to provide at least $500 million for these projects.

Administration Proposes Different Allocation of Funds. Instead of allocating the federal stimulus funds using the process set up by current law, the administration is proposing legislation to allocate the $2.6 billion in total state and local ARRA funds in a different manner. Under the administration's proposal, about $1.6 billion (or 62.5 percent) of the highway funds would go to the regions to be used at their discretion, and $964 million would be provided to the state for SHOPP and other state projects. Thus, the proposal would result in less funding being available for SHOPP projects compared to the amount that would be available under current law. In fact, Caltrans indicates that it would likely use about half of the $964 million (about $500 million) for SHOPP projects and the other half for Proposition 1B projects.

Use Federal Funds to Maximize Highway Rehabilitation. As we have noted in past analyses, the limited availability of funding for highway maintenance and rehabilitation means that there is a significant volume of highway rehabilitation work that cannot move forward on a timely basis. (See, for example, the *Analysis of the 2008-09 Budget Bill*, page A-30.) While Proposition 1B, passed by voters in 2006, provided a one-time infusion of $500 million for SHOPP projects, this has only made a relatively small reduction in the overall backlog of highway repair work.

In our December 2008 report, *Advancing Transportation Projects to Stimulate the Economy: An Alternative Approach*, we found that advancing highway repair projects would have a number of benefits to the state. This approach could:

- ***Maximize Savings From Competitive Construction Prices.*** Caltrans is currently awarding construction contracts for an average of 20 percent less than the estimated cost of the project. While this competitive environment would likely result in lower construction prices for any projects funded with federal stimulus money, small- and mid-sized projects in particular are likely better able to capture cost savings because they typically receive more bids than larger projects.

- ***Avoid the Cost of More Expensive Future Repairs.*** Making needed highway repairs now would result in cost savings by avoiding higher future costs that would occur if repairs were delayed.

- ***Benefit All Regions.*** Because SHOPP projects are located throughout the state, funding these projects would provide transportation benefits and construction-sector jobs in every region of the state. In addition, ARRA requires the state to give funding priority to projects located in "economically distressed" areas as defined in federal law. Funding SHOPP projects throughout the state would help the state meet this requirement.

In light of the benefits and the backlog of needed repair work, we recommend that the Legislature direct Caltrans and CTC to use $1.5 billion (out of the $1.7 billion the state would receive under current law) for SHOPP projects that are ready for construction. Furthermore, given the short deadlines on the use of the federal funds, we recommend that the Legislature provide this direction to CTC expeditiously. (The Legislature can do so through various means, including the adoption of legislation.) If the Legislature were to adopt the administration's proposal to change the way these funds are allocated, we recommend that the Legislature direct CTC to dedicate the state's entire share of funding (about $964 million) for SHOPP projects.

Federal Funds Could Provide Cash Flow for Proposition 1B Bond Projects. While we recommend using the federal stimulus funds ultimately for SHOPP projects, these same funds could be used to provide interim financing for some Proposition 1B bond projects. The state has a number of projects that have been scheduled to go to construction by mid-2009 using Proposition 1B bond money. However, due to the state's recent inability to issue bonds, many of these projects are delayed. In order to prevent further delays to high-priority Proposition 1B projects, we recommend that the Legislature consider using ARRA funds to provide cash-flow loans for Proposition 1B projects. This would be similar to the state's current process of providing short-term loans for bond projects from the Pooled Money Investment Account. Once the state is able to issue Proposition 1B bonds, these funds would then be available for SHOPP projects. This approach would allow the state to meet its commitment to high-priority Proposition 1B projects, while providing substantial funding for needed highway repairs (although at a later time than if the federal funds were used immediately for SHOPP projects).

Input Into High-Speed Rail Strategic Plan Could Increase State's Share of Funding. Before the $8 billion in federal stimulus money would be available for any high-speed rail systems, the U.S. Secretary of Transportation must submit to Congress by April 18 a strategic plan with guidelines for the allocation of funds. California could potentially increase its share of the high-speed rail funding by providing input to that strategic plan. There are two specific advantages that the state may have over other proposed high-speed rail systems in the country. First, the state's system calls for a train that can reach sustained speeds of over 200 miles per hour, a faster speed than many systems proposed in other states. Therefore, California would benefit from a plan that gives preference to higher-speed trains. Second, with the passage of Proposition 1A in 2008, the state has substantial state funding to match the federal funds that other proposed systems may not be able to provide. The state could receive more of the federal set-aside for high-speed rail development if the ability to match funds is given preference in the strategic plan.

HOUSING PROGRAMS

The ARRA provides approximately $13.5 billion nationwide for various housing-related programs, including funds for affordable housing development, homelessness prevention, rental assistance, and emergency assistance for the redevelopment of abandoned and foreclosed homes. Of this amount, about $10 billion will be allocated to state and local housing agencies based on funding formulas used to make the 2008 grant awards. The remaining $3.5 billion will be competitively awarded.

Major Provisions

California to Get Between $1.1 Billion and $1.3 Billion for Housing Programs. Preliminary estimates of California's share of the housing monies range from about $1.1 billion to $1.3 billion. (The actual amount will largely depend on how well California's state and local governments, and nonprofit entities fare in receiving competitive grants.) Of that amount, California state housing agencies—namely the Department of Housing and Community Development (HCD) and the Tax Credit Allocation Committee (TCAC)—are expected to receive about $400 million in formula-based grants, as well as some unknown amount in competitive grants. Some, if not all, of this funding could be allocated to the state during the current state fiscal year. However, given the timing, it is not likely that the state would begin making awards for housing and community development projects until 2009-10. In general, these funds will not provide any state General Fund relief, since the affected housing programs are supported almost entirely by federal funds. (The relatively small amount of General Fund spending is needed to meet federal match requirements.)

Housing Money Must Be Spent Rapidly. The ARRA places an emphasis on rapid distribution of the housing stimulus funds. For example, in the case of the Community Development Block Grant program, the act requires state and local recipients to give priority to projects that are ready to go ("shovel ready") within 120 days from the date funds are made available to the recipient. Depending on the program, grant recipient agencies are required to spend between 50 percent and 75 percent of the funds within two years, and all of the funds within three years. Failure to meet these time frames could result in reallocation of the funds to other states or local governments.

Issues for Legislative Consideration

Providing Funds to Existing Programs Minimizes Implementation Issues. The act does not create new affordable housing programs. This should help to accelerate the process of getting the funds to providers. Based on our initial review, it does not appear as though state legislation would be required to draw down the federal funds. Under the act, most of the housing money is to be allocated based on existing funding formulas. It is likely that only minimal administrative actions will be required to obtain formula-based grants. At the time this analysis was prepared, the U.S. Department of Housing and Urban Development (HUD) was still developing some of the details regarding the use of these monies. The state, however, would need to apply to HUD to receive any of the competitive grants available under the federal Neighborhood Stabilization Program. This program, with total national funding of $2 billion, provides grants for emergency assistance to redevelop abandoned and foreclosed homes.

Tax Credit Allocation Agency May Not Be Best Suited to Administer Loans. The federal Low-Income Housing Tax Credit Program offers tax credits to investors as a means to attract private capital into new construction, acquisition, and rehabilitation of affordable rental housing. In California, TCAC administers the program. Because of the downturn in the housing market and the overall economy, the value of tax credits to investors has declined, making it difficult for affordable housing project sponsors to raise the capital required to finance housing projects.

In recognition of this problem, ARRA provides one-time, formula-based grants to state housing tax credit agencies to make up for the lost value of the tax credits. California is estimated to receive about $325 million. Under the act, the tax credit agencies will use the grant funding to make loans (on a competitive basis) to affordable housing projects previously and newly approved to receive tax credits. In addition to these formula-based grants, the act also authorizes a state housing tax credit agency to exchange up to 40 percent of its 2009 federal tax credit allocation for a cash grant. This would provide up to an additional approximately $300 million for loans to affordable housing projects.

The TCAC historically has not administered loan programs. Traditionally, HCD and the California Housing Finance Agency (CalHFA) have administered such programs. It is unlikely that TCAC has sufficient staff and internal program expertise to administer the funds and comply with related federal requirements, particularly given the short time frames for allocation of the funds. Moreover, since the funds are being provided on a one-time basis, we do not think it would be prudent to establish within TCAC the resources to administer the program. For this reason, we think it would be more efficient and effective to have the grant program administered by either HCD or CalHFA. Both of these agencies have experience making competitive project awards, and more staff resources and expertise than TCAC to handle the anticipated high volume of applications. Accordingly, we recommend that the Legislature direct TCAC to contract with either HCD or CalHFA for administration of the tax credit supplement funds.

RESOURCES AND ENVIRONMENTAL PROTECTION

The ARRA includes several resources and environmental protection-related provisions that will have a fiscal impact on California. All of these additional federal funds supplement spending on resources and environmental protection-related programs and do not benefit the state's General Fund. We will discuss these provisions in the following four broad categories.

- Funds that flow directly to the state.
- Competitive or discretionary grants.
- Funds that will be spent directly by federal agencies on federal projects and programs in the state or administered directly by federal agencies to individual grantees in the state.
- Industry-specific tax credits and other financial incentives.

Figure 14 summarizes the federal funding provided in ARRA in the resources and environmental protection areas under each of these four categories.

Funds Flowing to the State by Formula

Clean Water State Revolving Fund (SRF)—State Water Resources Control Board (SWRCB). The ARRA includes about $283 million provided directly to the state in grant and loan funding (including for loan forgiveness and "negative-interest rate" loans) for wastewater infrastructure, through the existing Clean Water SRF. (Negative-interest rate loans have a zero interest rate and some degree of forgiveness of the loan principal, effectively making the interest rate negative.) The funds will all be made available in FFY 2008-09. The SWRCB administers the program on behalf of the state in cooperation with the U.S. Environmental Protection Agency (U.S. EPA).

The ARRA changes the state's existing program in two ways. First, the current state matching fund requirement is waived as a condition of receiving the federal economic stimulus monies. Second, the federal authorization expressly includes three forms of financial assistance—grants, loan forgiveness, and negative-interest

Figure 14

Stimulus Funding for California Resources and Environmental Protection Programs

(In Millions)

Program	Funding	Description
Funding Flowing Directly to State, by Formula		
Clean Water State Revolving Fund	$283	Existing program, largely for wastewater treatment upgrades.
State Energy Programs	239	Focus on energy efficiency and renewable energy programs.
Energy Efficiency and Conservation	56[a]	Block grants to be used to reduce total energy usage, improve overall energy efficiency, and reduce fossil fuel emissions.
Subtotal	($578)	
Competitive or Discretionary Grants		
Leaking Underground Storage Tank	$17	Financial assistance for cleanup of leaking tanks.
Diesel Emission Reduction	2[b]	On- and off-road diesel emission projects; $210 million nationwide.
Wildland fire management	—[b]	Hazardous fuels reduction, forest health, and ecosystem improvements on state and private lands; $250 million allocated nationally.
Brownfields remediation	—[b]	$100 million nationwide.
Defense environmental cleanup	—[b]	$5.1 billion nationwide for environmental cleanup at former military installations.
Wireless and broadband access	—[b]	$4.4 billion nationwide for broadband deployment in unserved and underserved areas.
Subtotal	($19)	
Funding Spent Directly by Federal Agencies[c]		
Smart (Electricity) Grid	—[b]	$4.5 million nationwide in competitive grants for electricity transmission infrastructure modernization.
Non-defense environmental cleanup	—[b]	$438 million to Department of Energy for environmental cleanup at non-defense federal sites nationwide.
Army Corps—Flood control	—[b]	$4.6 billion for construction and operations of various civil works projects nationwide (such projects are mainly for flood control in California).
Department of Interior—Water programs	—[b]	$1 billion for federal water-related programs nationwide, which potentially includes federal Central Valley and Colorado River Projects in California.
Hazardous Substance Superfund	—[b]	$600 million for cleanup at abandoned hazardous waste sites nationwide under the federal Superfund program.
Federal land and resource management	—[b]	At least $1.7 billion for federal land and resource management activities nationwide.
Subtotal	(—)	
Tax/Financial Incentives in Energy Area		
Various tax incentives	—[b]	For energy efficiency and renewable energy, including personal income tax, investment, and production tax credits.
Renewable energy tax credit bonds and loan guarantees	—[b]	
Subtotal	(—)	
Total Funding	**$597**	

a In addition, the state is potentially eligible for an unknown portion of $400 million of competitive grants to be allocated nationwide.

b Total benefit to California unknown at this time.

c Includes funding administered directly by federal agencies to individual grantees.

rate loans—that are expressly prohibited under state law for the Clean Water SRF program. We recommend urgency legislation to authorize the board to include these categories of financial assistance under the state's program so as to maximize the federal funding allocated to the state.

State Energy Programs—Energy Commission. The ARRA includes $3.1 billion for State Energy Programs under the existing Energy Policy and Conservation Act, of which $239 million will come to California. The ARRA directs states to focus on funding energy efficiency programs (such as energy efficient retrofits of buildings and industrial facilities) and renewable energy programs, and in particular to expand those programs already approved by the state. States are also directed to prioritize joint projects between states. All funds must be obligated by September 30, 2010.

To access these funds, the Governor must provide various assurances to the U.S. Secretary of Energy. These include assurances that (1) the use of the funds will be prioritized to the two program areas referenced above, (2) the state will adopt a policy that ensures that utilities' financial incentives are aligned with helping their customers use energy more efficiently, and (3) the state will have a plan for exceeding the international energy code for residential buildings within eight years of enactment of the ARRA.

Energy Efficiency and Conservation Block Grants—Energy Commission. The ARRA includes $2.8 billion for Energy Efficiency and Conservation Block Grants (EECBG), of which $784 million is to be allocated nationwide directly to the states. (The majority of the remainder will be allocated to local jurisdictions, with a small amount for tribes and other entities.) Of the allocation to the states, California will receive a total of $56 million, with $22 million available for state use and $34 million to be passed through to small cities. An additional $400 million is available nationally in the form of competitive grants, although there is currently no information available on how these grants are to be awarded.

The purpose of the EECBG program is for the grant recipients to reduce total energy usage, improve overall energy efficiency, and reduce fossil fuel emissions. The EECBG is a program that, while authorized in the Energy Independence and Security Act of 2007, has not been funded prior to the ARRA. Statutory changes will be required in order for the Energy Commission to be able to spend the funds within the schedule that the federal government has set. The funds have to be obligated by September 30, 2010.

Competitive or Discretionary Grants

Leaking Underground Storage Tank Fund Program. The ARRA appropriates $200 million nationally to the U.S. EPA for the Leaking Underground Storage Tank Fund Program. The state is expected to receive between $15 million and $17 million in the first year of funding and may be eligible to receive an additional $5 million in the second year should other states be unable to fully utilize their grants. It is likely that the state will require minor legislative changes to allow federal funds to be deposited specifically into the Underground Storage Tank Petroleum Contamination Orphan Site Cleanup Fund in addition to other funds annually made available in the state budget. The state matching requirements for this program are waived for the ARRA funds.

Diesel Emission Reduction. The ARRA appropriates $300 million to U.S. EPA for grants and loans awarded nationally for on- and off-road diesel emission reduction projects, including for diesel engine retrofit and replacement. Of this total, $90 million is allocated directly to states (of which the Air Resources Board [ARB] expects the state to receive at least $1.8 million). The remaining balance—$210 million—is to be awarded directly by U.S. EPA as competitive grants. As U.S. EPA's grant guidelines have yet to be developed, it is not known what amount of grant funds that the state could potentially access directly. Therefore, it is unknown whether the state could use these funds, for example, to offset state agency costs (proposed by the Governor to be funded from the General Fund and special funds) to comply with ARB's recently enacted diesel regulations. We think that this latter opportunity should be considered once the federal grant guidelines have been finalized.

Wildland Fire Management. The ARRA appropriates $250 million to the U.S. Forest Service for state and private forestry activities, including hazardous fuels reduction, forest health, and ecosystem improvement activities on state and private lands. While the U.S. Forest Service has yet to determine how this funding will be delivered to the state, it is likely that a significant portion of the funding coming to the state would be administered by the California Department of Forestry and Fire Protection. The department has already submitted a $176 million list of potential projects to the U.S. Forest Service. The ARRA prohibits a state from having a cost-share requirement if funds are passed through to other entities. Since state law currently has such a requirement, a statutory change would be needed to allow such pass-throughs.

Brownfields Remediation. The ARRA appropriates $100 million nationally for projects to be awarded by competitive grants under the Comprehensive Environmental Response, Compensation, and Liability Act. There is no cost-share requirement in order to receive the money. While there is no allocation specific to California, projects in California may be eligible for grant funds. The Department of Toxic Substances Control (DTSC) would be the state's applicant agency.

Department of Defense Environmental Cleanup. The ARRA appropriates $5.1 billion to the Department of Defense for environmental cleanup activities. There are several former military installations in California that could be eligible for these funds. The DTSC administers the cleanup of some of these sites with federal reimbursement through the state budget.

Wireless and Broadband Access. The ARRA appropriates $4.4 billion to the National Telecommunications and Information Administration (under the Department of Commerce) for competitive grants awarded nationally to increase the deployment of broadband services in "unserved and underserved areas." While there is a 20 percent state matching requirement (which can be waived), the ARRA gives priority to states with a source of matching funds. California has recently enacted legislation that could provide a source for these matching funds—Chapter 393, Statutes of 2008 (SB 1193, Padilla). Chapter 393 created the ratepayer-supported California Advanced Services Fund under the California Public Utilities Commission (CPUC) to help promote the deployment of broadband infrastructure in unserved and underserved areas. As the amount of the allocation of the ARRA competitive grants to California is unknown, is it uncertain whether the current level of revenues supporting the California Advanced Services Fund would allow the state to leverage the maximum amount of federal funding potentially allocated to the state.

In order to access these grant funds, the ARRA requires that there be a single centralized entity from within a state that applies for all of the grant funds on behalf of all eligible grant recipients in a state (which would include, for example, cable providers, wireless carriers, and community-based organizations). The ARRA does not specify who the state representative should be, nor does it require that this entity be a state agency. Since the Legislature has made broadband access a funding priority, we recommend that the Legislature enact legislation designating the CPUC as the state entity to access these funds. This would improve the Legislature's oversight of the state's access to and use of these funds to ensure that the state is maximizing funding for which it is eligible and that the expenditure of the funds is consistent with legislative priorities.

In addition to the new broadband deployment grant program discussed here, the ARRA also provides $2.5 billion to the Rural Utilities Service under the U.S. Department of Agriculture for an existing program awarding competitive loans, grants, and loan guarantees for broadband infrastructure projects that primarily serve rural areas. It is expected that these funds would flow directly to the rural telecommunications carriers.

Funds Spent Directly by Federal Agencies

Department of Energy (DOE)—Smart (Electricity) Grid Investment Program. The ARRA appropriates $4.5 billion to DOE for the Smart Grid Investment Program. This funding—likely to be administered by a competitive grant process—is for electricity transmission infrastructure investments that make the transmission grid "smarter" by improving the flow of information from both the energy generator and the energy user so that better choices can be made about how energy is produced, delivered, and consumed. In particular, these investments are seen as necessary to move renewable energy resources onto the grid cost-effectively. What portion of this funding the state might be eligible for is uncertain. The CPUC assumes that the funding would not flow through the state, but would flow directly to the applicants—entities making capital investments for some part of the electric transmission grid, such as utilities that own transmission and/or distribution systems.

DOE—Non-Defense Environmental Cleanup. The ARRA appropriates $438 million to DOE for environmental cleanup of nonmilitary sites. Previous appropriations for this fund have been used for the cleanup of civilian energy research sites. The allocation of these funds has yet to be determined.

Army Corps of Engineers—Flood Control. The ARRA appropriates $4.6 billion to the Army Corps of Engineers for investigations, construction, and operations and maintenance of various civil works projects (which, in California, are mostly for flood control). While there are no direct appropriations to the state, the Corps is a partner with the state on federally authorized flood control projects for which costs are shared among federal, state, and local governments. These include projects in the State Plan of Flood Control, modifications to Folsom Dam, and other projects in Central and Southern California. In some cases, the state Department of Water Resources (DWR) has "fronted" the federal share of funding, mainly through bonds (Proposition 1E), in order to expedite the projects. These latter cost-sharing agreements were made with the expectation that when federal funds became available, the federal government would in some way compensate the state for the funds it fronted, such as by providing matching funds for ongoing flood control projects. We recommend that the Legislature and DWR urge the federal government to provide such compensation to the state.

U.S. Department of the Interior—Water Programs. The ARRA allocates about $1 billion to water-related programs under the Department of the Interior, which includes the Bureau of Reclamation. Included in this amount is up to $50 million that may be transferred for programs and activities under the California Bay-Delta Restoration Act. Additional funding is appropriated for canal inspections, development of rural water treatment facilities, water reclamation and reuse projects, and for other construction and maintenance projects. Traditionally, a majority of funding for the Bureau of Reclamation, which only operates in western states, has been allocated to California-related projects, including the federal Central Valley Project and the Colorado River Project.

U.S. EPA—Hazardous Substance Superfund Program. The ARRA appropriates $600 million for the federal Superfund program administered by U.S. EPA that cleans up abandoned hazardous waste sites. There are a number of existing federal Superfund sites in California receiving funding for cleanup from the federal Superfund. Additional funds may therefore come to California for the cleanup of these sites.

Miscellaneous Funding for Federal Land and Resource Management. In addition to the above, the ARRA includes funding for the land and resource management activities of a number of federal resources agencies, potentially for activities in the state. This funding, to be spent nationally, includes $320 million for construction and land management activities on Bureau of Land Management lands, $280 million for construction and resource management activities of the U.S. Fish and Wildlife Service, $750 million for construction and deferred maintenance activities in the National Park Service, and $900 million to the U.S. Forest Service for capital improvements and maintenance projects ($650 million) and for wildland fire management on federal forest lands ($250 million).

Energy-Related Tax and Financial Incentives

The ARRA extends and expands the scope of a number of energy efficiency and renewable energy tax incentives. For example, the personal income tax provisions extend a tax credit for energy efficiency upgrades to existing homes to 2009 and 2010, also increasing the cap on these incentives from $500 to $1,500. The bulk of the tax incentives pertain to the development of renewable energy. For example, project developers of a broader group of renewable energy sources are now eligible for the 30 percent federal investment tax credit. The production tax credit for renewable energy facilities has been extended to the end of 2012 or 2013, depending on the type of facility. Renewable energy facilities may also now apply to the Department of the Treasury for grant funding in lieu of the investment/production tax credits.

The ARRA also includes provisions providing renewable energy-related loan guarantees and tax credit bonds. Specifically, the ARRA provides $6 billion nationwide for a loan guarantee program to be administered by DOE for renewable energy power generation and transmission projects. The ARRA also authorizes an additional $1.6 billion nationwide of new clean renewable energy tax credit bonds, up to one-third of which is to be made available for qualifying projects of state, local, and tribal governments. Finally, the ARRA authorizes an additional $2.4 billion nationwide of qualified energy conservation tax credit bonds to finance state, local, and tribal programs designed to reduce greenhouse gas emissions. Legislation may be required to facilitate the state's issuance of these bonds.

CRIMINAL JUSTICE AND OTHER PROGRAMS

The federal economic stimulus package also provides additional funds for a variety of criminal justice programs and other programs run by the state. Below, we describe the likely increases in federal funds to the state from ARRA. These increases in federal funds generally would not result in an offset of General Fund expenditures.

Additional Funding for Public Safety Grants. Under the Edward Byrne Memorial Justice Assistance grant, Violence Against Women Act, and Victims of Crime Act, the federal government provides grant funds to help support local public safety programs. In California, these grant funds are administered by the California Emergency Management Agency, which receives the funds from the federal government and distributes them to eligible sub-grantees. The federal economic stimulus package includes a one-time increase of about $250 million nationwide in federal funds for these three programs. As part of the conditions for acceptance of federal funds, the state must agree not to supplant existing state funding with any federal funds.

Increased Funding for Crime Victims Compensation. Under the Victims of Crime Act, the federal government provides grant funds to help support state victim compensation and assistance programs. In California, these funds partially support the Victim Compensation Program (VCP), which is operated by the Victim Compensation and Government Claims Board and helps pay for certain unreimbursed expenses incurred by victims of crime and their families. (The state's Restitution Fund—fines and penalties collected from criminal offenders—is the primary source of funding for the program.) The federal economic stimulus package includes a one-time increase of about $8 million in federal funds for VCP in California.

Competitive Grants Provide Funds to Hire Additional Sworn Officers. Currently, the federal Community-Oriented Policing Services (COPS) office distributes funding through a wide range of programs to assist law enforcement agencies. In the past, many local law enforcement agencies, as well as some state-level agencies, in California have received federal grants from various COPS programs. The federal economic stimulus package includes $1 billion for a new COPS Hiring Recovery Program (CHRP) to provide competitive grants for law enforcement agencies to hire additional full-time sworn officers. The CHRP grants are intended to support the full cost of additional officers for three years, based upon approved entry-level salaries and benefits. Although there is no funding match requirement, grant recipients must retain all of the additional positions awarded under the grant with state or local funds after the three-year period. Grant applications are scheduled to be available at the end of March. The Legislature should direct the various state-level law enforcement agencies (such as the California Highway Patrol) to report at budget hearings regarding their intention to apply for CHRP grant funding and the longer-run fiscal impact on the state once federal funding expires.

Potential Additional Patrols at Southern California Border. The federal economic stimulus package provides $30 million nationally to local law enforcement for patrolling the United States-Mexico border. This new program targets southwest border states and designated high-intensity drug trafficking areas. An additional $10 million is available to support efforts to stem firearms trafficking through Project Gunrunner—a cooperative program between the United States and Mexico. California may benefit from a portion of these funds.

California National Guard to Receive Funding for Building Construction and Renovation. A total of $26.5 million is expected to be provided to the California National Guard for various deferred maintenance construction and renovation projects. While the list of eligible projects is still being developed by the federal government, it is possible that some of the federal funds provided to the California National Guard may help the state avoid future General Fund costs for the same purposes.

Transit and Port Security Projects to Receive Federal Grants. The ARRA makes available nationally $150 million for public transportation and railroad security assistance and $150 million for port security grants. The stated preference is for projects that can be started and completed quickly. It is unclear what amount, if any, the state would receive because the grants are competitive. Moreover, it is uncertain what the state's need would be for these funds given recent expenditures of Proposition 1B bond funds for security projects.

TAX CHANGES IN THE FEDERAL ECONOMIC STIMULUS PACKAGE

The ARRA contains a variety of tax provisions that are designed to provide a boost to the economy. Nationally, the act provides $287 billion in federal tax relief, mainly over the next three years. We estimate that Californians would receive between $30 billion and $35 billion of this relief. Figure 15 (see next page) displays the major elements of the tax package and their estimated cost over the next ten years. Two provisions—the "making work pay" credit and alternative minimum tax provision—comprise two-thirds of the total relief provided. Figure 15 also shows that the federal economic stimulus legislation contains $53 billion nationwide in other types of tax provisions that affect a variety of program areas. For instance, it includes $18 billion in tax subsidies for a variety of fiscal incentives to encourage "green" energy production and conservation. Some of the tax provisions listed in Figure 15 are discussed in their respective program areas earlier in this report.

Major Personal Income Tax Changes

Below, we review selected personal income tax changes that are part of the stimulus legislation. Estimates are available on the national impact of the personal income tax provisions from the federal Joint Committee on Taxation (JCT). In some cases, additional data on state-level effects of existing provisions that are modified by the stimulus bill are available. As a result, we can make rough estimates of the amount of the federal benefits that would be coming to California from several of these provisions.

New Making Work Pay Tax Credit. This new tax credit is equal to 6.2 percent of earned

Figure 15

Tax Relief Provisions Included in the 2009 Federal Stimulus Legislation

(In Billions)

Provision	Description	National Total[a]
Personal Income Tax		
"Making work pay" credit	Creates a new credit of up to $800 in 2009 and 2010 based on annual income.	$116.2
Alternative minimum tax (AMT) threshold	Raises income levels subject to the AMT in 2009.	69.8
Child tax credit	Reduces the annual wage threshold for eligibility in 2009 and 2010 from $12,600 to $3,000.	14.8
Education tax credit	Expands the existing "Hope" credit for higher education costs in 2009 and 2010.	13.9
New homeowner tax credit	Converts an existing incentive into a refundable credit for first-time homebuyers who purchase a home in 2009.	6.6
Taxation of unemployment benefits	Exempts up to $2,400 in benefits received in 2009.	4.7
Earned income tax credit	Increases benefits and raises the income threshold for eligibility in 2009 and 2010.	4.7
Energy improvement tax credit	Increases tax benefits in 2009 and 2010 from increasing the energy efficiency of existing homes.	2.0
Automobile sale tax deduction	Creates a new deduction of sales taxes paid on the purchase of a new car over the next 12 months.	1.7
Subtotal, Personal Income Tax		($234.4)
Other Tax Provisions		
Renewable energy incentives	Extends or increases a variety of tax subsidies for "green" energy production and conservation.	$18.0
School construction bonds	Increases federal subsidies for school construction and repair projects.	10.9
Recovery Zone Bonds	Authorizes $25 billion in federally subsidized bonds for projects that encourage growth in depressed areas.	5.4
Extension of bonus depreciation	Allows rapid depreciation of equipment purchases in 2009.	5.1
Build America Bonds	Establishes a new type of federally subsidized bond that would be available to state and local governments.	4.3
Deferral of income on the repurchase of debt	Permits companies to repurchase their own debt in 2009 and 2010 and defer taxes on any reduction in the value of that debt.	1.6
Other		7.2
Subtotal, Other Tax Provisions		($52.5)
Total		**$286.9**

[a] Expected costs over the period from 2009 to 2019, as estimated by the federal Joint Committee on Taxation.

income in tax years 2009 and 2010, up to a maximum of $400 for an individual or $800 for a married couple that files a joint return. The required annual earnings to reach the maximum $400 credit is just $6,451, so most workers will qualify for the maximum credit. The federal law also phases out the credit for high-income earners. Specifically, the credit is reduced for individuals who earn more than $75,000 and eliminated entirely for individuals earning above $95,000. For married couples, the credit phases out between $150,000 and $190,000. The JCT estimates the national cost of this provision at $116.2 billion. The state has about 11 percent of the nation's total employment, so the income gain to state taxpayers should be roughly 11 percent of $116.2 billion, or $12.8 billion.

Increase in Existing Earned Income Tax Credit (EITC). The existing federal EITC provides taxpayers with a credit for up to 40 percent of earnings up to a maximum credit of $5,028 for a household with two or more dependents. The amount that couples can claim under the EITC peaks at an income of $19,540 and gradually phases out up to an income of $43,415. The stimulus bill makes several changes for tax years 2009 and 2010. For households with three or more dependents, the credit percentage increases from 40 percent to 45 percent of earnings and the maximum credit increases to $5,657. In addition, for couples with dependents the credit amount will peak at $21,420 of income and phase out up to $45,295. The estimated national ten-year cost of this change is $4.7 billion. According to the Internal Revenue Service (IRS), 10.6 percent of all EITC payments went to California. Therefore, the state impact of the new provision over that period would be about $500 million.

Increase in Child Tax Credit Refundability. Current federal law provides a tax credit of up to $1,000 per child. This credit is partially refundable. Refundable credits allow taxpayers to claim the difference between the credit and tax liability as a tax refund if the credit exceeds the amount owed by the taxpayer. For nonrefundable credits, if the amount of the credit exceeds liability, the taxpayer can only claim the amount of credit needed to eliminate a tax payment. The child tax credit allowed taxpayers to claim a refundable credit equal to 15 percent of earned income above $12,550. The stimulus legislation reduces the threshold for claiming a refund to $3,000 for tax years 2009 and 2010. This change would have two effects. First, it would increase the number of low-income households that would be able to claim a partial refund of the credit. In addition, the change would increase the amount of the credit that would be refundable for households with an income over $12,550.

The estimated national ten-year cost is $14.8 billion. According to the IRS, 11.1 percent of all child tax credit payments went to California. As a result, Californians would receive roughly $1.6 billion in tax relief from this provision.

Expansion of the Hope Education Tax Credit. As discussed in the "Education" section of this report, the federal government significantly expanded the Hope Education tax credit. The estimated national cost is $13.9 billion over ten years. Data on California's share of these tax benefits are not available. Because the state's community college fees are about 75 percent below the national average, however, California is likely to receive a smaller share of these funds than its 11 percent share of the other tax credits.

Extension of Credit for First-Time Homebuyers. The current credit for first-time homebuyers is equal to 10 percent of the purchase price up to a maximum of $7,500. This credit, however, was scheduled to expire on June 30, 2009. The stimulus bill extends the credit to November 30, 2009, and increases the maximum credit amount to $8,000. The estimated national cost is $6.6 billion over ten years. No data are available on the estimated state impact. If the state received 11 percent of these funds, it would reduce Californians' federal tax liabilities by about $700 million.

Sales Tax Deduction for New Car Purchases. Under the stimulus bill, taxpayers will be allowed to deduct the sales tax on new car purchases from taxable income until February 2010, and will be able to take the deduction even if they take the standard deduction instead of itemizing. The limit on the cost of the vehicle is $49,500 and the limits on the taxpayer's income are $135,000 for a single taxpayer or $260,000 for a couple. The estimated national cost is $1.7 billion. Past sales data show California accounting for about 12 percent of new car sales nationally. California's share of this credit likely would tend to be higher because its average sales tax rate is high compared to other states, but lower, because the economic downturn is adversely affecting California more than other states.

Issues for Legislative Consideration

State Conformity Issues. Most of these new federal tax provisions are administered through the federal tax system and do not require state actions. In addition, according to the Franchise Tax Board, the changes to federal tax law will not automatically alter the state's tax laws—and, thus, the new provisions will not reduce state tax collections. Because of the state's fiscal situation, we do not recommend that the state conform its tax policies to any of the federal personal or corporate income tax reductions included in the stimulus act.

Bond Program Administration. Some of the bond-related tax credits in the stimulus bill may need to be administered by the state. At the present time, it is not clear whether federal or state agencies will administer these programs and allocation processes. If the federal government decides to give states this responsibility, the Legislature may need to choose a state agency to administer the funds. For example, the State Treasurer administers several existing bond and tax credit allocation programs, however, other state agencies also are involved. The Legislature also may need to determine how best to use the federal subsidies available for bonds to supplement existing state programs.

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This report was coordinated by Farra Bracht, with input from all sections in the office.

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