The Daily Dish

Beware Feds Bearing Gifts

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Eakinomics: Beware Feds Bearing Gifts

One big headline in the American Rescue Plan (ARP) is that it provides $362.05 billion in fiscal assistance for state, local, municipal, tribal, and territorial governments. There are some predictable controversies that have arisen over this assistance, notably whether it is the right amount to compensate for pandemic-related revenue losses and unforeseen spending. In his review of the issues, Gordon Gray notes that "the subnational funding in the ARP is excessive – as much as 116 times the needs by one measure. The $362 billion pot of funding is somewhat of a policy in search of problem." As it turns out, this is just the beginning of the problems.

The error metastasizes in handing out the cash. ARP establishes the Coronavirus State Fiscal Recovery Fund and provides $219.8 billion for states, territories, and tribal governments. It also establishes the Coronavirus Local Fiscal Recovery Fund and provides $130.2 billion for cities, counties, and other local governments. These are the pots into which the U.S. Treasury can pour the money.

But at the other end of the deal, a state or locality cannot take money out of the pot for just any old reason. The Funds come with "allowable uses" of the money, notably (1) to respond to the public health emergency, including assistance to households, businesses, and affected industries; (2) provide premium pay to eligible workers; (3) fund "the provision of government services to the extent of the reduction in revenue" experienced by the governmental entity; and (4) investments in water, sewer, or broadband. You can be sure that Treasury and some governments will not see eye-to-eye on the use of funds. See you in court.

But the real kicker is what a government cannot do with the funds: "…either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase."

That's right. If you touch the money you cannot cut taxes. One can understand the motivation for this provision. There will be states whose revenue is at or above where it was budgeted, and it would be tempting to keep spending untouched and shift the revenue burden away from the state to the federal taxpayer. That is not ok.

But as Gray notes, "The restriction on funds being used to 'indirectly' offset a reduction in revenues through any number of legislative or administrative state actions is somewhat more puzzling and heavy-handed." And the policy means that federal government can make $10,200 of unemployment insurance benefits tax free, but a state cannot. The federal government can use tax credits to provide relieve to households and business, but a state or locality cannot.

This has the makings of an administrative mess, and probably more than one lawsuit over Treasury disallowing a subnational policy. But the real problem is the excessive largesse provided by ARP. If there were no excesses, there would be no need for complex rules on how to use them.