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MTF Bulletin

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Fiscal Principles for Fiscal Recovery Funds

Over the next three years, Massachusetts will appropriate $4.9 billion in remaining Fiscal Recovery Funds (FRFs) provided through the American Recue Plan (ARPA).[1] The use of these funds will be pivotal in determining the strength, sustainability and equity of the Commonwealth's recovery from the COVID-19 pandemic and future economic growth. At a recent hearing on the use of FRF resources, MTF identified four broad priorities areas for use of ARPA funds:

- Economic recovery;
- Workforce;
- Barriers to prosperity; and
- Infrastructure improvements.

This bulletin outlines five critical fiscal principles that policymakers must adhere to in order to maximize the impact of the FRF in each of these priority areas.

Principles in Brief

- **S**ustainability of investments;
- **P**rioritization and organization;
- **E**vidence, evaluation, forecasting and monitoring;
- **C**oordination of state and local priorities; and
- **S**trategic use of FRF and other resources.

These SPECS principles will protect our fiscal future, while forging ahead with vital investments to improve economic opportunity for all residents and regions in a changing world.

Sustainability of Investments

Sustainable investments are those that are temporary in nature or that can reasonably be supported after FRF resources are gone. Massachusetts received $5.3 billion in Fiscal Recovery Funds, of which $4.9 billion remain unobligated. These funds are available for use for the next five years,

[1] The state FRF award is $5.3 billion of which $4.9 billion is subject to appropriation. The remaining amount (approximately $394 million) is being used to supplement ARPA awards to four communities, support a COVID paid leave program and to provide the Baker Administration with $200 million for discretionary use.

after which time they and all other American Rescue Plan resources are likely to go away.[2] The temporary, but extended, window in which these funds can be used creates a fiscal planning opportunity. The resources are significant enough and the timeline is long enough to allow for transformative investments, but their temporary nature means that investments must be chose carefully to prevent a fiscal cliff.

The danger of a fiscal cliff is not theoretical in Massachusetts; a look back to our experience with the Great Recession and the American Recovery and Reinvestment Act (ARRA) demonstrates the danger of tying ongoing spending obligations to temporary federal funds. Massachusetts used more than $4.3 billion in temporary federal funding to support ongoing costs over a five year period. Between 2009 and 2013, Massachusetts relied on $3.4 billion in enhanced federal Medicaid reimbursements to balance the budget and a further $944 million in federal education funding to prevent cuts to K-12 spending.

Figure 1. Massachusetts' Use of ARRA to Balance the Budget

	Enhanced Medicaid	K-12 Stabilization /EduJobs	Total
FY 2009	$870	$412	$1,282
FY 2010	$1,280	$174	$1,454
FY 2011	$1,240	$221	$1,461
FY 2012	$0	$131	$131
FY 2012	$0	$7	$7
Total	$3,390	$945	$4,335
$ in millions			

This decision was defensible: the impact of the Great Recession on tax revenues was catastrophic and large cuts were still necessary despite the use of ARRA funds. In addition, a large increase to the sales tax was adopted, and the Rainy Day Fund was depleted. The pitfalls of using temporary funds for ongoing costs became apparent as the state emerged from the Great Recession. Between FY 2011 and FY 2015 the state budget continued in a vicious cycle of cuts, 9C reductions and use of one-time resources that prevented new investments and contributed to a credit rating downgrade in 2017.

At present, the commonwealth is in a much stronger fiscal position than it was during the Great Recession and does not need to choose between sustainable use of FRF and drastic budget cuts. The recently completed FY 2022 General Appropriations Act (GAA) does not use any ARPA funds or a draw from the Rainy Day Fund, while still increasing spending by more than four percent. This is a great start, and policymakers must continue along this path by not using FRF resources in a way that does not contribute to future budget challenges.

[2] Fiscal Recovery Funds must be obligated (planned for expenditure) by the end of 2024 and fully expended by 12/31/2026

FRF use is sustainable if it is dedicated to one-time costs or for expenses that can reasonably supported by future ongoing revenues or savings.

FRF spending and one-time costs

Non-recurring costs are expenditures that provide a material benefit without a long-term obligation. Examples include pay-as-you-go capital construction or rehabilitation, temporary grants to people, businesses and communities, and allowable FRF uses like Unemployment Insurance fund replenishment or premium pay for essential workers. An allowable use of FRF resources would be to make capital improvements to the state's water infrastructure. Such an investment will help address a long-standing concern by accelerating a number of projects that would otherwise have to wait years to begin. When federal resources are no longer available, the state can return to pre-ARPA levels of capital spending. The state will need to ensure that ongoing maintenance and upkeep costs can be met, but these costs can more easily fit into the existing capital budget.

The ARPA specifically identifies water and broadband as two eligible infrastructure categories for FRF use, but other types of capital spending is allowed. Subsequent treasury guidance makes clear that pay-as-you-go capital projects (projects supported with available cash on hand and not through debt financing) can be paid for with 'revenue replacement' FRF resources. Paying for critical capital needs provides a sustainable and impactful use of FRF resources.

One-time costs are not limited to capital projects. A number of other spending areas responsive to the recovery qualify as well:

- Recapitalization of the state's Unemployment Insurance Trust Fund, or grants to employers to offset steep increases in UI assessments;
- Job training support for workers affected by the pandemic;
- Recovery grants for business, non-profits and cultural organizations that face one-time costs as they reopen;
- Educational programs to mitigate learning loss in students;
- Programs or financial support for essential workers;
- Mental health, substance use, public health programs that address acute needs related to the pandemic.

FRF spending supported by future revenue or savings

Policymakers should also identify spending areas that require initial investments but will result in future revenue growth or savings. Our year-to-year budgeting process does not incent long-term fiscal planning. This means that short-term investments with longer term returns are often not considered and seldom prioritized. The FRF presents a unique opportunity to make investments now that will results in savings or additional revenue in the future.

Regionalization and data-systems improvements are examples of this type of investment. Small communities often do not pursue regionalization plans, even though long-term benefits are clear, because the start-up costs are too high. FRF could enable regional approaches to public safety, public health or education that have long been considered by covering the initial outlay necessary to implement such initiatives.

Improving state data and oversight systems would have clear long-term fiscal benefits that include improved program integrity and smarter policy choices. One example of how improved oversight could save multiple millions of dollars is the UI system. During the pandemic, the inability of this system to detect fraud contributed to the pay out of more than $1 billion in overpayments, claims that employers are now being asked to cover. [3] Fraud is only one of the drawbacks of system limitations. Antiquated or siloed data systems can prevent or delay important policy changes and data collection limitations makes it difficult to distinguish programs that work from those that are ineffective.

Programs with an evidence-based track record of return on investment are a smart use of FRF. For example, the average cost to the state of keeping someone in prison is more than $70,000 per year. Programs that effectively divert at-risk youth from the criminal justice system or connect former inmates to the workforce are sound investments for the Commonwealth. Supporting programs that are proven to result in long-term savings or provide net new revenue are a sustainable and sound use of FRF resources.

Prioritization and Organization

The task of spending approximately close to $5 billion in one-time federal funds efficiently and effectively over a five year time period is a daunting task. There are many competing worthwhile investments that expose the underlying tension between quick action and big ideas. The executive and legislative branches can meet this daunting challenge and resolve that underlying tension by agreeing on priority areas for spending, establishing a timeline for action, and developing some guiding principles for investment as initial first steps.

The first step for the legislature and Governor is to designate several key priority areas for ARPA investment. Colorado provides an example of a 'bucketing' approach to prioritization that Massachusetts should employ. Colorado divided its $3.8 billion FRF award into five programmatic categories (economic relief, mental health, workforce, housing, and transportation) while setting aside $1 billion for unexpected future needs and $300 million for the Administration to use flexibly.

Setting aside FRF resources for critical areas like these, while retaining a portion of the award for unexpected future needs, will focus our efforts around shared priorities and lends itself well to an approach that builds on existing programs in the short-term, while developing innovative ideas for the coming years. Massachusetts will likely differ from Colorado in the specific priority areas chosen, but the approach is straightforward, thoughtful and adaptable.

As priorities are established, it is vital to also create a timeline for action to determine the balance in using FRF resources to use for immediate needs while setting aside funds for future use. Initial

[3] The estimate of more than $1 billion is based on a National Conference of State Legislatures report on UI fraud which states that 2020 improper UI payments cost state systems $63 billion and the US Department of Labor's 2020 Payment Accuracy Report.

funds are best used to make immediate impact by expanding existing, effective programs. For example, Massachusetts already operates programs to improve water infrastructure, develop mental health workforce capacity, improve education attainment, or accomplish any number of other recovery goals. Policymakers should quickly identify effective, evidence-based programs that can be quickly scaled up or expanded to increase their impact immediately.

The expansion of existing programs should occur in conjunction with planning for more transformative investments. Funds should be set aside for investments beginning in 2022 after a transparent process soliciting input from stakeholders. Issue specific working groups should be formed to be comprised of experts, government officials and civic leaders, to develop recommendations for long-term impact. These groups can also be used to ensure coordination between FRF spending and other streams of funds, as referenced above. Harnessing expertise that exists in and out of government has been critical in the past for state action on health care, education finance and criminal justice reform and will be necessary again as we move forward in a changing environment. Creating a multi-year plan for ARPA spending requires the same approach.

Evidence, Evaluation, Forecasting & Monitoring

Massachusetts does not employ consistent, rigorous and transparent methods to use evidence to make decisions, evaluate program outcomes or forecast its fiscal future, in contrast to a number of other states. Building capacity in each of these areas will improve the budgeting process more generally and be critical to effective and sustainable use of FRF resources and must be prioritized. Thankfully, Massachusetts can learn from best practices in other states to create fiscal evaluation and oversight systems that will provide benefits long after ARPA funds are gone.

Fiscal forecasting

Long-term fiscal forecasts enable states to understand how near-term spending and revenue decisions fit into their financial future. This type of modeling is particularly important when assessing if current spending is sustainable going forward. The State Fiscal Project at the Pew Charitable Trusts highlights financial forecasting as a key best practice for state financial management.

Massachusetts uses a consensus process to project tax revenues for each upcoming fiscal year, but does not employ a consistent process to look at how spending and revenue trends are likely to play out over the next few years or economic cycle. Decisions on when and how to deploy ARPA funds as well as surplus tax revenues must be made with a long-term view and must be adaptable to different economic scenarios. Long-range fiscal forecasting enables this type of budget and scenario planning.

States like Utah, Minnesota and Washington, among others, provide examples of high-quality fiscal forecasting that is incorporated in budget decision-making. Utah's fiscal forecasting work includes "stress-tests" that use macroeconomic projections to assess how the state's budget would respond to economic downturns. Minnesota releases two fiscal forecasts each year that project spending and revenue, as well as economic factors for the next four to five years. Washington has an independent Economic and Revenue Forecast Council that produces quarterly reports with revenue estimates for the current year and projections for future years.

Our consensus revenue process does a good job of creating a shared fiscal framework on which to build the annual budget. Expanding that work to look at future scenarios for revenue and spending will improve FRF decision-making and help the Commonwealth prepare for future challenges.

Evidence & Evaluation

Effective use of FRF resources requires that we prioritize spending that has demonstrated results or put in place the means to evaluate impact. This premise is stressed by US Treasury guidance on FRF compliance and oversight which requires that Massachusetts, and all other recipients report on whether FRF funds are being used for evidence-based interventions or being rigorously evaluated. Massachusetts lags behind a number of other states when it comes to rigorous and consistent use of evidence and evaluation, but the ARPA provides a great opportunity for Massachusetts to catch up by creating a permanent evidence and evaluation unit.

Massachusetts does not have an entity dedicated to assessing the evidence used to support spending decisions or evaluate program success. These activities do occur in some agencies or for some programs, but there is no consistent or streamlined approach to making sure we understand whether or not programs are likely to work or assessing whether or not they do. Creation of a centralized unit to undertake or coordinate use of evidence and evaluation in decision-making that is readily available to lawmakers will maximize the impact of FRF resources, improve oversight and provide greater transparency for spending decisions.

As with fiscal forecasting, other states provide a host of examples of how an evidence and evaluation unit could work in Massachusetts. Some states have evaluation units within the executive branch, some in the legislative branch and some are independent. Irrespective of where the unit is housed, the consistent elements of this work is the use of evidence clearinghouses to assess likely program impact and an emphasis on experimental or quasi-experimental design in program evaluation.

Evidence-based decision making and program evaluation results in improved outcomes for state investment. When the impact of programs can be quantified, it allows policymakers, advocates and the public to make more informed decisions about how to pursue shared policy goals. Understanding the impact of various policy options is particularly relevant to the FRF because funding is limited and knowledge about what did and did not work will be essential in charting our fiscal course once ARPA resources are gone.

Monitoring

The ARPA requires states, as well as cities, towns and some counties, to meet strict reporting and compliance requirements for all FRF expenditures. Massachusetts, Boston and Plymouth, Norfolk and Bristol Counties are also required to provide the federal government with detailed Recovery Plans for how recipients plan to use resources, the intended impact, demographic distribution of benefits and process for incorporating evidence and evaluation in decision-making.

The federal government requires Recovery Plans to be made public, but does not have a similar requirement for state or local expenditure reports. Massachusetts should require that information from these reports for all FRF recipients in the state be made available online. Currently, ANF provides comprehensive state level expenditure data for a variety of CARES and ARPA funding programs. This data reporting should be expanded to include local spending in order to provide all residents with a one-stop shop to assess how federal funds are being used to catalyze the recovery.

During the Great Recession Massachusetts created a robust website to provide policymakers, researchers and the public with a wealth of information on the use of federal stimulus funding as well as related planning documents. The Baker Administration has created a similar website to track federal dollars dedicated to pandemic response and recovery. Expanding that website to provide recovery planning documents and information from the local level would increase transparency and improve decision-making and advocacy.

Coordination of State and Local Priorities

For Massachusetts to get the biggest return on FRF, it should align state and local priorities around several critical areas. For example, the American Society of Civil Engineers estimates that Massachusetts' drinking water system requires more than $10 billion in repairs and improvements over the next 20 years. Water infrastructure is an allowable use of FRF resources at the state and local level. By creating a state/local match program that builds on the already successful State Water Revolving Fund, we can maximize the impact of federal funds to address this long-standing infrastructure need.

Education improvement provides another example where a state/local matching partnership makes sense. The Student Opportunity Act, which will be fully phased in over the coming years, will provide large increases in state aid to low-income communities to address disparities in resources and outcomes. These same communities are receiving hundreds of millions of dollars in ESSER funding, to be expended by the start of the 2024-2025 school year. The ARPA, and earlier federal relief legislation, provides local school districts with $2.9 billion Elementary and Secondary School Emergency Relief (ESSER). Local communities will determine how to use these funds, in compliance with federal program guidelines, but the state should use a portion of its FRF award to create matching incentives for communities to invest in shared priorities.

This provides an opportunity to jump start educational programs proven to be effective while SOA implementation is still ongoing. The state should leverage FRF funds, the state's ESSER award and future SOA funding to give districts the assurance they need to invest in educational programs that work now.

Creating matching programs for state/local partnership over the next several years will make all of our dollars go farther and improve spending efficiency. The examples for water infrastructure or public education apply just as readily to housing, public health and workforce investments. Policymakers should create several matching pilot programs that amplify state and local investments.

Strategic use of FRF with Other Resources

FRF is the largest source of state funding from the ARPA, but it comprises less than half of all ARPA resources to be expended by the public entities in the state over the next several years. Many priorities for FRF resources – including child care, transportation, K-12, public health – will also benefit from targeted ARPA spending. These resources, coupled with the state's revenue surplus in FY 2021 and projected surplus in FY 2022, provide another potential financial resource to aid in recovery efforts. Coordinating the FRF with other federal programs and traditional state spending is critical to allow for the scaling of existing programs, the creation of innovative programs and the resources necessary to oversee both.

The variety of people, processes and requirements governing spending decisions require close coordination. The legislature will appropriate FRF funds, while the executive branch will determine the use of many of the dedicated programs. Therefore, it is imperative that the Administration and legislature work together to ensure that FRF and other funds complement each other and do not work at cross purposes. While this is not a new challenge, as many federal grants are expended outside of the appropriations process necessitating coordination through the annual budget submission process to ensure that state and federal spending works together, the scope of ARPA resources and the relatively short timeline speak for a more deliberate coordination process.

The Fiscal Recovery Fund hearings announced by House and Senate budget leaders are a good first step in promoting ongoing communication between legislative and executive branch officials with responsibility for different ARPA funding streams. Continuing to conduct these hearings on major priority topics – such as economic recovery, housing, education, childcare, transportation, public health and mental health – over the coming years will provide government officials, stakeholders and the public with ongoing information and an opportunity to coalesce around future expenditures.

Maine provides another possible approach to improved coordination. Soon after the passage of the CARES Act, Maine created an Economic Recovery Committee to gather information and make shared recommendations on the most effective investments and policies to support a strong recovery with representation from the executive branch, the legislature, the federal delegation and business and community leaders While this model was employed prior to the American Rescue Plan, it could easily be used in Massachusetts to gather and coordinate information and develop medium and long-term recommendations for the FRF funds.

The goals of coordination are to maximize impact and efficiency, advance common goals develop a shared sense of direction as we recover from the pandemic, work to address long-standing disparities and make once in a generation investments in critical areas. Creating structures that maintain the autonomy of public entities tasked with expending federal dollars while promoting shared planning and prioritizing is not only possible, but vital.