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THE CENTER FOR STATE POLICY ANALYSIS

MAKING THE MOST OF THE AMERICAN RESCUE PLAN

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EXECUTIVE SUMMARY

Massachusetts is about to get a massive infusion of federal dollars from the American Rescue Plan (ARP), the broad coronavirus relief package advanced by President Biden and approved by Congress in March.

Together, cities, towns, and the state itself are expected to receive nearly $8 billion in direct aid — along with billions more in targeted funds for areas like education, transit, and affordable housing.

It's a once-in-a-generation opportunity to make vital investments in infrastructure, public health, and economic revitalization, but lawmakers will have to decide — relatively quickly — what areas to prioritize and how to ensure a fair and efficient process.

The possibilities are legion. While ARP funds will come with some spending guidelines and explicit restrictions, state legislators and municipal officials will have a lot of latitude — particularly if they are creative about shifting money around.

In this report, we focus on the choices facing state government, though many of the core principles apply to cities and towns as well. We find that:

- Because ARP provides one-time money, it is best suited for one-time investments in things like broadband networks, school building upgrades, transportation maintenance, state IT systems, and public health infrastructure.

- There may be creative ways to use one-time ARP funding to support longer-term needs, for instance by covering large startup costs or establishing endowments and loan programs.

- Another option is to use one-time ARP money to introduce new programs, like universal pre-K, which would then by supported by other revenue streams. The viability of this approach depends on the continuing strength of state tax revenues or future tax increases such as the proposed millionaires tax.

- The legislature will have control over spending decisions, unless it cedes that authority to the governor. For efficacy, it may be necessary to establish a separate budget process that fits better with ARP's multiyear timeframe and investment-oriented focus.

- Given the different funding streams associated with ARP, some central oversight or information-sharing may be essential. This would ensure transparent use of public money and keep state and local decision-makers from working at cross-purposes.

In the sections that follow, we describe the official rules for ARP spending, lay out core principles for sound investment, and consider some potential political impediments to effective decision-making.

OFFICIAL GUIDELINES FOR ARP SPENDING

Before making detailed spending decisions, states are awaiting fuller guidance from the Treasury Department, which is expected in May.

In advance of that, states and municipalities can start identifying priorities. Especially as ARP money is expected to be disbursed relatively quickly.

Cities and towns are likely to receive the first half of their funds later this spring, with the rest in 12 months. State money may come slightly later, either in one batch or two. And regardless of when it arrives, this money is supposed to be spent by Dec. 31, 2024.

Some of the money is targeted for use in specific areas like education, transit, and affordable housing. However, a large block will come in the form of state and local aid, which has fewer strings.

The ARP law itself lists four broad uses for this pot of state and local aid: 1) responding to the ongoing public health emergency; 2) boosting pay for essential workers; 3) compensating for Covid-related revenue shortfalls; and 4) investing in infrastructure, notably "water, sewer, or broadband."

ARP also includes some clear prohibitions. In particular, ARP money can't be used to pay for tax cuts or fund state pension programs (though already these restrictions are getting some pushback.)

Judging from public comments, it doesn't seem like the rules around ARP spending will be rigidly policed. Treasury secretary Janet Yellen has said explicitly and repeatedly that she believes the law gives states a lot of flexibility. And Bharat Ramamurti, deputy director of the White House National Economic Council, told Massachusetts lawmakers: "We want to make sure the money is available for the broadest variety of uses possible."

It would seem, then, that states and municipalities will have a fair amount of freedom to make the investments they deem most valuable — provided they can articulate how those investments fit within the general framework of rescue and recovery laid out in ARP.

PRINCIPLES AND OPPORTUNITIES

Even with a federal program as generous as ARP, there are still trade-offs. Every dollar spent on public health is a dollar that can't be spent on water systems, just as any effort to address the digital divide requires funds that can't also fill holes in a municipal budget.

Difficult decisions like these depend on all manner of concrete considerations: local needs, expected benefits, equitable impacts, and political will. But there are core principles that can help guide the process and ensure the best possible use of ARP funds across Massachusetts.

One-time dollars, one-time spending

ARP provides a one-time infusion of money, not an ongoing commitment from the federal government. And that is vital to understand, because it shapes how Massachusetts can rightly spend.

Most important, one-time money isn't generally appropriate for long-term needs. It'll run out, after which you'll be stuck with a program you might not be able to afford. The fact that ARP dollars can be spent over several years may exacerbate this risk, as it means states will be able to use this money over several budget cycles, giving a false sense of permanence.

Fortunately, there are a lot of useful, one-time ways for the state to use this one-time money. This includes, but is not limited to, the following areas:

- **Temporary budget gaps**. While state finances have held up relatively well under Covid, some cities and towns face more serious budget pressures. Filling these Covid-wrought gaps is a core goal of ARP and a sensible fiscal approach, as programs that seemed affordable before

Covid are likely to look affordable again once the economy improves.

- **Physical infrastructure**. The ARP law lists water, sewer, and broadband as potential infrastructure investments, but there are plentiful options, starting with deferred maintenance across buildings, transit, bridges, and roadways. Improvements in the air-quality and ventilation systems of public buildings — like schools and libraries — would also seem well-positioned to meet ARP's twin focus on Covid recovery and local investment.

- **State capacity**. The pandemic exposed limitations in technology, data collection, and oversight across a range of state agencies. As examples, upgrades to the state's Unemployment Insurance system could smooth operations and improve fraud detection. And the dearth of data about eviction patterns speaks to the potential benefits of improving records management in the courts.

- **Public health infrastructure**. Much of the response to Covid was coordinated in an emergency, ad hoc manner; better preparation for future pandemics could save future lives. This includes plans for identifying pathogens, tracking cases, supporting research, delivering treatment, and generally enabling smoother coordination between state authorities and local boards of health.

- **Climate investment**. The future resilience of the Commonwealth depends on our ability to address climate change, and ARP money could enable investments in new energy sources, electric vehicle charging, flood planning, and beyond.

- **Covid trauma**. The experience of the last year is likely to leave a lot of scar tissue, including a potential near-term uptick in mental health and substance abuse issues. A surge approach, including hazard pay for health workers and conversion of facilities, could help those who are struggling and potentially curb the ongoing overdose epidemic.

Turning one-time dollars into long-term revenue

It is sometimes possible to use one-time dollars for longer-term state needs, but it requires a careful approach.

One possibility is for ARP funds to cover startup or transition costs in programs that need a big investment upfront but far less later on.

Consider an income-based repayment system for public colleges. In this approach, tuition is deferred until students start earning paychecks. Then, a small, consistent share of their income is devoted to repayment. There's a timing problem, however, as colleges have to wait years before receiving repayments from their first crop of students. An infusion of money from ARP could potentially fill this hole.

At the local level, there are also some "smart city" initiatives that work like this, where the setup is costly but the maintenance and management is more affordable.

A whole different approach for spinning long-term proposals out of one-time ARP money involves endowments and loan programs, where you set aside a block of funds today so that you can spend the interest over time or use the cache to backstop future lending.

As yet, it's unclear whether this approach will be permissible under final ARP rules, but if so it could provide some unique opportunities.

Additional capital from ARP could be added to programs that already exist, like the Mass Housing Partnership and MassDevelopment — thereby expanding support for affordable housing and economic development.

Alternatively, the state could establish a public bank, capitalized using ARP funds and structured to provide loans that advance core public priorities like racial equity in business ownership or environmental infrastructure.

Thinking smaller, a targeted endowment could allow for the creation of a legislative research service — like the Congressional Budget Office but for Massachusetts. Having a dedicated endowment would guard against political influence, while allowing researchers to provide the best data and evidence about public policy.

Bridging to the millionaires tax

Next year, Massachusetts voters could see a ballot measure known as the millionaires tax (also the "Fair Share Amendment") that would impose a surtax on people earning over $1 million a year.

If passed, the tax would raise an estimated $2 billion annually for the state. Unlike the one-time ARP money, that is, the millionaires tax would provide ongoing revenue.

By thinking of these two funding sources as a pair, the state might be able to leverage ARP money to introduce programs that would later be sustained by the millionaires tax.

A prime example is the Student Opportunity Act, which expands state support for K-12 schools and has already been passed into law. Funding for the program is expected to ramp up over time, and ARP money might support that initial ramp-up — with the expectation that the millionaires tax would provide long-term support.

Early education and child care is another area that might conceivably benefit from linking ARP with the millionaires tax. In this case, ARP funds could drive a major expansion — or set of pilot programs — that would then form the basis of a new, long-term approach.

There are some significant risks, though. One is that the millionaires tax may not pass, or might be offset by tax cuts.

This has happened before. An earlier version of the millionaires tax was slated to be on the ballot in 2018 before being blocked in court, and some new impediment might arise this time — or voters may turn against it.

Without a careful accounting, there's also a risk of overcommitting money from the millionaires tax, using ARP to introduce a variety of programs whose total costs greatly exceed likely tax collections.

Given that the millionaires tax is expected to appear on the 2022 ballot, and ARP funds can be spent through 2024, the most prudent approach may be to await the voters' verdict before embarking on any program that relies on this uncertain revenue.

Focusing on fairness

The ARP legislation passed very quickly — barely two months after Biden took office — and consequently it has elements that weren't thoroughly vetted.

One glaring inequity has already emerged here in Massachusetts, where some poorer, Covid-wracked communities like Chelsea and Methuen are slated to receive far less aid than some wealthier, less-afflicted places like Newton, the result of a poorly-targeted funding formula.

Governor Baker quickly pledged to rectify this problem, but lawmakers should be alert to other equity issues. In particular, any aid distributed via a funding formula should be checked to ensure fairness across racial, ethnic, and geographic lines.

Embracing fungibility

If you get a $5 coffee shop gift card — say, in a raffle — that doesn't actually mean you'll spend an extra $5 on coffee. Perhaps you already planned to get a morning latte, using a $5 bill that you keep in your wallet. Well, now you can use the gift card for coffee and spend your $5 bill at the hardware store next door.

In this scenario, the raffle actually increases spending at the hardware store — not at the coffee shop, even though that was the express purpose.

In the same way, Massachusetts might be able to spend ARP money on all manner of things, just by shifting dollars around. For instance, if we devote ARP money to water and sewer systems, that would free up tax dollars we were otherwise planning to spend on water and sewer — tax dollars we could now use for a variety of investments not contemplated under ARP.

This process is sometimes referred to as fungibility, building off the basic idea that a dollar is a dollar is a dollar — whether it comes through ARP, or tax revenue, or a raffle.

To be sure, there's a limit to what can be accomplished through creative fungibility. Efforts to get around ARP's explicit prohibition on tax cuts and pension funding might draw serious scrutiny from the federal government, possibly resulting in penalties. And cutting existing programs in order to support new ARP priorities may also be viewed suspiciously.

But provided that lawmakers stay within the spirit of the law — making investments to address Covid harms and promote recovery — some shifting of dollars could expand the universe of spending possibilities and amplify the impact of ARP.

Following events in Washington

At least in part, ARP is an infrastructure bill, providing money that states can use to fix water systems, expand broadband access, invest in transit, repair schools, and improve IT.

Yet it's possible the federal government will pass an even larger infrastructure bill later this year, which creates a sequencing problem. Waiting on this uncertain, future infrastructure bill wastes time, but it's a waste of money to use ARP dollars on efforts that may get dedicated support in the near future.

Faced with this kind of uncertainty, lawmakers need to keep one eye on unfolding events in DC, spacing out ARP commitments in a way that allows for changes, if additional funding becomes available.

In a similar way, city and town leaders will have to keep an eye on Beacon Hill, lest they commit precious local resources to priorities ultimately eligible for state support.

Such an approach should be possible, given that ARP allows states to spend money over the course of several years. With proper phasing, initial efforts could be focused on the urgent needs of Covid recovery, while investments that require extensive planning or greater coordination could be spread over time.

WHO MAKES, OVERSEES SPENDING DECISIONS

Legislators generally set spending priorities for the Commonwealth, but Covid has scrambled that norm. This past year, it was the governor who largely oversaw the distribution of money from the federal Cares Act of 2020, an arrangement that could conceivably extend to ARP.

Leaving spending decisions to the governor has some advantages, including speed and a unifying vision. But it also means less open debate and discussion, as decisions are made inside agencies rather than among elected officials.

In the case of ARP, legislative leaders seem committed to a more robust, legislature-led process, but the time constraints are real and a lot depends on finding a workable approach.

The normal state budget process, which is already well underway for fiscal year 2022, isn't perfectly suited for these spending decisions.

ARP money is substantial enough, and the spending restrictions unique enough, that a separate budget process may be required, with a different set of deadlines and a multiyear purview extending through the 2024 culmination of ARP spending.

A fractal version of this problem will then play out across our 351 separate municipalities, where the timing of ARP may not quite align with existing budget processes and where there is no ready mechanism for information-sharing or regional coordination.

There's a real risk that the state won't know what towns are doing; also, that towns won't know what the state is doing — or what neighboring towns are doing — on a timeframe that's relevant to planning and decision-making.

Add to this potential interactions between targeted funds (like those that must be used for education) and general aid (some of which we might want to spend on education) and you can start to see the multidimensional complexity.

Some kind of oversight seems essential to avoid unnecessary duplication and ensure that cities, towns, and the state are working in mutually reinforcing ways.

One approach would be a portal for tracking ARP spending across all levels of government and the various ARP funding streams. Alternatively, an oversight panel could be setup, with an ambit to ensure the transparent and efficient use of all ARP funds by collecting information, sharing data, and issuing regular reports.

Separately, local governments might look to existing nonprofits to help set regional priorities. Between chambers of commerce and conduits like our regional community foundations, Massachusetts has a skeletal system for regional thinking.

CONCLUSION

The American Rescue Plan presents Massachusetts with a rare investment opportunity — far bigger than the CARES Act, far more flexible than what we got after the Great Recession of 2007-2009.

Seizing this opportunity, however, requires a difficult mix of quick and thoughtful action. State lawmakers and city officials have several years to make final spending decisions, but that doesn't leave a lot of time to debate, decide, and oversee the use of federal dollars — much less to coordinate between regions and optimize across different lines of funding.

We hope that this report offers some guidance on how to think about key choices and trade-offs. Looking ahead, the Center for State Policy Analysis is ready to provide follow-up research on any aspect of this topic.

Contributors

In assembling this report, the Center for State Policy Analysis was aided by a number of experts in public finance and elsewhere. However, the final contents reflect our best judgment and are not necessarily endorsed by reviewers.

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