States should say 'no thanks' to a federal bailout

BY JONATHAN WILLIAMS AND LEE SCHALK — 04/20/20 06:30 PM EDT

A growing chorus of governors is calling on Congress to “bail out” state governments. Maryland Governor Larry Hogan and New York Governor Andrew Cuomo released a joint statement over the weekend requesting an additional $500 billion in federal funds for the states.

“We must be allowed to use any state stabilization funds for replacement of lost revenue, and these funds should not be tied to only COVID-19 related expenses,” the governors wrote.

Their plea comes on the heels of the $2 trillion CARES Act, which included a general $150 billion COVID-19 relief fund, a $30 billion education costs fund, a $45 billion disaster relief fund and more for state and local governments. Yet, economic conditions throughout the country remain dire due to government mandated closures. States seeking even more cash from Congress should think twice.

History suggests that federal bailouts are not a "free lunch" for states. They decrease state sovereignty, incentivize future fiscal irresponsibility and create a moral hazard problem. Bailouts reward fiscally reckless states at the expense of fiscally responsible ones. Academic research from the Mercatus Center at George Mason University shows that federal bailouts could even lead to higher state level taxes. According to their research, every dollar of federal aid to states drives state taxes higher by 33 to 42 cents.

During the 2009 debate on the Obama-era American Recovery and Reinvestment Act (ARRA), states were warned that the strings attached to federal dollars, like maintenance of effort requirements, would be far costlier than the "shovel ready projects." At the time, the national debt was roughly $10 trillion. Now, having just surpassed $24 trillion, it is essential to examine the sustainability of additional bailouts.

With those threats in mind, states like Utah and Idaho have wisely implemented Financial Ready policies. These policies require state agencies to track dependency on federal dollars, develop a contingency plan in case federal funds are diminished and examine the harmful strings attached to the federal aid.

But who are the big government politicians really fooling here? Whenever you send one group a bailout, another group must foot the bill. In this case, those groups are actually one and the same: State taxpayers are also federal taxpayers. In short, bailing out states with federal tax dollars is akin to using your American Express card to pay off your Visa.

Make no mistake: State and local governments do not lack revenue. They lack spending restraint. Over the past 40 years, after fully accounting for increases in population and inflation, state and local direct general spending has grown by 88 percent. Despite one of the longest economic booms in American history, states have also continued accumulating debt and unfunded public pension obligations.

ALEC Center for State Fiscal Reform research reveals bonded debt for the 50 states totaled nearly $1.16 trillion in 2019, unfunded public pension liabilities totaled nearly $5 trillion, while other post-employment benefit (OPEB) liabilities for retired public employees added an additional $1 trillion in unfunded liabilities. This is all future spending that has been promised but not funded.

Hundreds of billions of dollars in federal aid would let states continue this cycle of debt and spending. It would also send the wrong message to states that have made difficult spending choices and practiced fiscal discipline.

For instance, North Carolina dramatically lowered its personal and corporate income tax rates and built an empty rainy day fund to $1.17 billion as the economy thrived over the past decade. Additionally, the economic growth produced while cutting tax rates allowed North Carolina lawmakers to accumulate a balance of $3.9 billion in the Unemployment Trust Fund, after repaying more than $3 billion in debt. On the other end of the spectrum, Illinois' rainy day fund would only keep the state running for about 15 minutes. Illinois state debt totals over $486 billion ($38,000 per resident) — equal to 56 percent of the state's GDP.

Rather than request a $500 billion bailout from Congress, adopting spending reforms like priority-based budgeting – which eliminates redundancy and increases accountability to taxpayers – is key.

In 2002, Washington state took this approach and closed a $2.5 billion budget gap without raising taxes under the leadership of Democratic Governor Gary Locke and a bipartisan group of legislators. They did this by identifying the core functions of government and ranking agency and program spending needs from top to bottom until they spent available revenue.

This level of fiscal discipline is not easy to achieve, but it is exactly what taxpayers deserve. As American families and businesses make their own financial sacrifices to survive the COVID-19 economy, state policymakers must reprioritize spending and avoid the temptation of falling into a cycle of federal dependency.

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