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Balancing the Budget: What Washington
Can Learn from the States

By Governor Terry E. Branstad



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Balancing the Budget: What Washington Can Learn From the States

The Honorable Terry E. Branstad

It is an honor for me to be with you today to address The Heritage Foundation. I commend Heritage and your leadership for the good work that you do. In my years of public service, you have always been a reliable and consistent voice for sound, conservative public policy at the state and national levels.

With Congress and the President reaching an apparent compromise on a balanced budget, there is a great deal of discussion throughout the country on the federal budget. After decades of excessive spending, fiscal irresponsibility, and steady growth in both the size and complexity of government, it seems as though we are finally on the course toward what we conservatives have been pursuing for a long time: a balanced budget.

Being governor of Iowa for over 14 years and having dealt firsthand with the issues of balancing a budget, I would like to share with you a little of what we did in Iowa to restore fiscal integrity, control spending and the growth of government, and put our state in an economic and a budgetary position to significantly reduce taxes this year. I believe what we did in Iowa bears an important message for Congress and the President in their work to balance the federal budget.

Like most states, Iowa had adopted many of the bad budgeting practices and big-spending habits of the 1970s. Automatic spending formulas, not using generally accepted accounting principles, operating on unrealistic revenue expectations, underestimating the costs of entitlement programs, and starting new programs without taking into account the long-term cost meant that our state budget was out of control. When I took office, we had a budget deficit camouflaged by a “smoke and mirrors” accounting system.

In addition, I had a legislature dominated by liberal Democrats. After ten years of budget battles, \$600 million in item vetoes, and defeating both the Majority Leader of the Senate and the Speaker of the House in gubernatorial elections, we still had a budget deficit of \$400 million.

To make things worse, in 1991 an arbitrator awarded state employees pay raises of 9 percent to 19 percent over my objections. Since there was no way the state could afford to pay that, I vetoed the pay raise and was taken to court by the state employees union. Despite the fact that the state had a deficit of hundreds of millions of dollars, the Supreme Court ruled that we had to pay the enormous award at a total cost of \$100 million.

After making the painful but necessary choice to lay off over 1,000 state employees, and fully realizing that state spending was spiraling out of control, I formed a citizens commission with

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the charge of taking a nonpartisan, comprehensive look at all state spending. Nothing was off the table, and there were to be no sacred cows.

Unquestionably, our greatest challenge was to control spending. Almost 60 percent of our budget was on “automatic pilot,” meaning it was automatically increased each year without a vote of the legislature or a signature by the governor. We had actually reached a point where more than all of our revenue growth was spent each year even before the legislature convened.

We lacked accountability in the spending of our tax dollars. Instead of relying on our elected officials to choose the right amounts—instead of holding them accountable for taxes and spending—we had a government on autopilot. Public employee unions and liberal interest groups dominated the policy agenda.

After nearly 20 years as a state legislator, lieutenant governor, and governor, in 1991 I reached a point where I was frustrated with the status quo and completely determined to bring about fundamental change—even if it involved taking a big political risk. What needed to be done was clear. To return Iowa to fiscal integrity, we had to control spending and reduce the size of government. These are phrases Americans have heard for a long time, but they are words we turned into action in Iowa.

Our first step was to take the state budget off of autopilot. Instead of increasing school funding without a vote of the legislature, we now require that the legislature and governor set the amount of school funding each year.

Other areas such as Medicaid, indigent defense, and foster care had long been out of control, consuming a greater portion of our state budget. Finally, we took the bull by the horns and addressed each one of these controversial areas, making necessary program reforms which controlled costs and restored accountability. Through better management of these programs, we proved that we could deliver quality services while controlling costs. Naturally, liberal special-interest groups predicted disaster, and we heard horrible predictions about how children and the elderly would suffer. We have proven the skeptics and the champions of the status quo wrong.

In addition to the program reforms, we also dramatically curtailed the ability of the legislature to spend money and instituted significant permanent spending reforms. The legislature is now allowed to spend only 99 percent of revenue projections at the beginning of the legislative session. In the past, when it looked as if tax receipts were up while the legislature was in session, that money was ripe for the picking. Special interests with a pet project or new program lined up for their share because there was more available to spend.

Not only did we use very conservative revenue estimates, but we required that if revenue exceeded expectations, it had to be used to reduce the deficit. And when the deficit was gone, we used it to fill a 10 percent “rainy day fund” or, as we call it, cash reserve and economic emergency accounts. These funds are protected and cannot be spent without an extraordinary 60 percent vote of the legislature. Our reserve funds are designed specifically to make deficits a thing of the past in Iowa.

These reforms have truly made a difference. We went from a \$400 million deficit to an \$800 million surplus in five years, making more than a \$1 billion turnaround. When we put our balanced budget plan in place, the goal was to balance it in three years, but we did it in two.

In addition to runaway spending, government had gotten way too big, complex, and inefficient. Like the federal government of today, our state government was mired in process rather than results, paperwork rather than progress, and complexity rather than accountability. Undeniably, our next challenge was to reduce the size of government.

Back in 1986, I called for a total reorganization of state government. At the time, we had 68 departments and were heavy on middle management. We actually had supervisors who supervised the supervisors. The layers of bureaucracy made for an inefficient, costly operation which consumed too many of our limited resources. It is never an easy decision to cut the size of government, but we realized it was what we had to do. We cut the number of agencies from 68 to 25 and the number of state employees by 2,200.

But downsizing government involves more than just having fewer people on the state payroll; it means empowering front-line employees—those who actually do the work the agency is there to perform—to do the best job they can do without unnecessary oversight and too many supervisors. In Iowa, the number of state government supervisors and middle-level management has been reduced by 18 percent, indicating that our downsizing has been effective.

Controlling spending and downsizing government were essential to restoring fiscal integrity in Iowa. All of the tough decisions we made to bring our budget into balance by controlling spending and reducing the size of government have paid off. The publication *State Budget & Tax News* reported last fall that Iowa is the state with the highest percentage budget surplus in the nation—18 percent. That is nearly twice as much as Maine, which ranked second.

Now, in my 15th year as governor, I finally have the first Republican legislature in my tenure. In the legislative agenda I presented in my Condition of the State Address in January, I recommended several bold steps to reduce the tax burden on Iowa taxpayers.

I am proud to say that the first bill I signed into law this year was the total repeal of the state inheritance tax for family members. The death tax had long been an unfair burden on family farmers and small businesses. It drove successful Iowans out of state in their retirement years.

The next major piece of legislation was a 10 percent across-the-board reduction in state income taxes. It is the largest tax cut in the history of our state and will allow every taxpayer to keep more of what he or she earns. We also cut taxes for fast-growing small businesses. I am convinced that as a result of these tax reductions, more quality jobs will be created, incomes will rise, and Iowa will be more competitive in the global economy of the 21st century. I am optimistic that we will be in a position to cut taxes even more next year.

With all of this said, I think you probably have a better understanding of what we have done in Iowa. I believe the Iowa experience bears lessons for our nation.

The United States is confronted with a huge deficit, just as the state of Iowa was five years ago. Spending is out of control, and we continue to feed a costly bureaucracy. A generation of overspending, overpromising, and not understanding the long-term implications of our federal government's bad habits has put us on the verge of national bankruptcy.

A \$5 trillion national debt not only robs future generations of the economic opportunity that is the bedrock of the American Dream, but is a huge burden on today's economy, causing higher consumer interest rates. Every family that owns a home, every young professional who buys a car, and every student who goes to college pays more because our national leaders have

failed to make the tough decisions necessary to do at the federal level what every American family must do at home: balance their checkbook.

Iowa is one of 49 states that are required by law to balance their budgets. I wholeheartedly believe we need a balanced budget amendment to the United States Constitution. I applauded the leadership in both houses of Congress for their valiant effort at passing a balanced budget amendment. It passed the House last year, but fell one vote short in the Senate this year thanks once again to President Clinton's arm-twisting. Constitutionally requiring the federal government to be fiscally responsible is good, appropriate public policy, and we the people should continue to pursue it until it becomes the law of the land.

The debate in our nation's capital today is over the budget agreement reached by President Clinton and Congress and how it will be enacted. Before I discuss the budget agreement, I want to make something very clear. The Republican leaders in Congress—Speaker Gingrich, Senator Lott, Congressman Kasich, Senator Domenici, and others—have been very accessible to the governors and have genuinely listened to our concerns during the 104th Congress and on into the 105th.

In just a little over two years, this Republican Congress has shifted the discussion in Washington, D.C., toward a balanced budget—something what was a rarity during the years of Democrat control. Furthermore, a debate over federalism and returning power to the states was unheard of in the past.

During welfare reform last year, they stood with us on the side of giving states the flexibility necessary to make welfare reform work, empowering people and enabling them to become self-sufficient citizens and get off welfare. Together, we embarked on a historic transformation of the social welfare system. While it is not perfect, it is a significant step in the right direction, and we will be able to help individuals escape the culture of dependency.

This year, governors expressed our concern to Congress about the President's disastrous plan to cap Medicaid spending while failing to give the states necessary flexibility to make reforms. Capping Medicaid spending at the federal level would merely shift the burden for this costly entitlement program to the states while at the same time forcing us to live under the liberal eligibility rules and mountainous constraints dictated by Washington. If the President's plan were enacted, it would essentially turn the keys of state treasuries over to the federal government and allow them to obligate and spend state tax dollars. The worst thing is that it would allow them to do to state budgets what they have done to the federal budget.

It appears that the Republican congressional leaders have listened to governors and did not agree to the President's proposal to cap Medicaid. Governors believe a much more prudent approach would be to give states the flexibility and authority to restructure programs while assuring low-income Americans access to quality health care.

I think credit must be given where credit is due. The budget deal is the most significant step toward a balanced budget in modern times. But with that said, and having the experience I have had in balancing our state budget, it would not be right for me to say I did not have serious reservations about the proposed budget compromise.

A strong economy and \$225 billion more in tax revenue over the next five years made it possible for President Clinton to get more discretionary spending and Republicans to get some tax reductions. As I understand it, this budget plan will balance the budget, cut taxes, increase

domestic spending, and increase defense spending. Apparently, we are going to eliminate the deficit by spending more and taking in less. At face value, this budget is no pain and all gain.

Looking through the compromise, it is apparent that the fundamental changes necessary to make a balanced budget a long-term reality just are not in this agreement. Instead of curtailing the growth of entitlements—which I think we all agree needs to be done to get the budget under control in the long term—this budget deal opens the door for new entitlements and mandates on the states through President Clinton's new children's health insurance programs. I am all for helping children, but we do not need to create another entitlement program. State after state is already expanding coverage for uninsured children, and we will continue to do so.

I do not question the legitimacy of the \$225 billion windfall the Congressional Budget Office found the day the budget deal was reached. In Iowa, we have had tax revenue that exceeded expectations for the last five years. But instead of treating that money like a shot in the arm of big government for more spending and additional programs, we directed it toward reducing the deficit, filling our 10 percent cash reserve and economic emergency accounts, and then providing tax reductions.

If there is unanticipated revenue, I believe it should be used for deficit reduction, not more spending. At a minimum, current obligations should be met before undertaking new spending programs that will impair the nation's ability to control spending in future years.

In 1995, Congress went boldly forward with fundamental change, similar to what we did in Iowa. They challenged the status quo, engaged the advocates of bigger government, and understood the need for real reform. I am not a member of Congress and was not involved in the behind-the-scenes budget negotiations. I cannot pretend to know when is the best point to compromise and what deal is best. It very well may be that the budget deal that was reached is the best we can do with Bill Clinton in the White House. That is a decision for Congress to make.

What I do know is that balancing the budget in the long term rests on our ability to make real reforms and control the size and cost of government. The American people are tired of being misled on the issue of balancing the budget. It has been promised time and time again, and a lot of Americans are skeptical that it will be balanced in the year 2002, when most of the key players in cutting this deal—including the President—will no longer be in office.

I believe we must return to the path of real reform that Congress started on in 1995. America can no longer afford business as usual. We must stop mortgaging our future and saddling our children and grandchildren with more and more debt. I know I speak for many governors when I say that we stand ready to work with the Congress and the President to achieve the real reform and fundamental change necessary to balance the budget and restore fiscal integrity.

The federal government must continue to loosen its grip on the states and lose its fear of empowering states, communities, and the people. We must also accept the fact that government—at any level—is not able to solve every problem.

We need not only a government that is smaller, but also a government that is simpler. When we began welfare reform last year, there were 330 means-tested entitlement programs in the federal bureaucracy. In job training, there are still 160 different federal programs today. And the federal government has 700 programs for education on the books. It is time we realize that it does not make sense to have a program for every problem. A simpler, more accountable

system would do more to empower people and enable them to achieve their full potential and live the American Dream.

The President and Congress need to recognize that true fiscal reform will come only by making hard choices, setting priorities, and being realistic. Simply pushing the burdens off on the states with all the federal strings attached will not work. More unfunded mandates and less flexibility will destroy the fledgling movement toward new federalism. We need a partnership, not a dictatorship.

In many states, we have made tough choices and hard decisions. Republican governors have led the effort to reduce the size and cost of government and to make tough decisions to control spending. Now it is Washington's turn.

The American people want a balanced budget. They know it will not come without fundamentally changing the size, scope, and mindset of government. We learned that lesson in Iowa. It is my hope that the federal government will learn it as well.

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