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# THE CASE AGAINST A FEDERAL BAILOUT OF THE STATES

*BRIAN M. RIEDL*

State capitals are busy with lawmakers working to eliminate red ink: 31 states must fill a combined $17.5 billion budget gap before June 30, according to the National Conference of State Legislatures. Rather than encourage them to reform their budgets and reduce costs, Senator Thomas Daschle (D–SD) has proposed a $40 billion federal bailout to prop up state spending. Because it would lead to higher federal taxes, this bailout would not save taxpayers any money. Furthermore, it would encourage the same overspending that created these crises. It would be better to practice spending discipline and allow low taxes to aid economic growth, which will in turn help balance state budgets.

**Reckless State Spending.** High spending, not low tax revenues, is to blame for state budgetary crises. Between 1990 and 2000, inflation-adjusted state tax revenues skyrocketed by 46 percent. Even following the "worst fiscal conditions since World War II," tax revenues in 2003 remain 39 percent above 1990 levels. During that same period, however, state general fund spending grew by over 50 percent. In 2000, total state expenditures exceeded $1 trillion for the first time ever. Then, when the 2001 recession forced belt-tightening in households across America, states decided the time was right for their largest spending *increase* in 12 years—8.3 percent.

States even outspent the federal government, which increased inflation-adjusted spending by 29 percent since 1990—and that includes fighting a war. If state governments in 1990 had committed themselves to growing no faster than the federal government, they could have balanced their 2003 budgets and had enough money left over to reduce taxes by $525 per household. Aligning new spending with the inflation rate would have increased that tax relief fund to $1,372 per household. Instead, states spent all of their new revenue and then some.

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California exemplifies this mindset. State lawmakers, blessed with a 28 percent increase in tax revenues between 1999 and 2003, responded by hiking spending by 36 percent—turning a $10 billion budget surplus into a deficit. And they still have not learned. When Governor Gray Davis announced a $35 billion budget shortfall for 2003, his projection included not just the cost of funding current programs, but also billions in additional new spending. Not even the largest budget deficit in state history has slowed the governor's appetite to expand government.

**Robbing Peter to Pay...Peter.** Sending federal aid to states would not save taxpayers a dime because the same taxpayers who fund state budgets also fund federal budgets. Like a family responding to unaffordable MasterCard debt by running up the Visa instead, a federal bailout would run up families' federal tax bill in order to reduce their state tax bill—solving nothing.

Residents of fiscally responsible states would be hurt the most. States like Wyoming, Michigan, and Colorado generally resisted adding extravagant programs over the past decade. Their shortfalls are therefore far smaller than those of California and New York. Is it fair for California lawmakers to go on a spending spree and then send the tab to Wyoming taxpayers, via Congress?

Basic accountability demands that the unit of government that spends the money should have to collect the taxes. If state spending is financed by state taxes, elected officials cannot spend beyond their constituents' willingness to be taxed; but when states can simply withdraw whatever money they need from the federal ATM, that incentive to weigh benefits against costs vanishes.

States, just like the federal government, waste billions on mismanaged and unnecessary programs. Deficits provide states with a golden opportunity to examine their budgets and reduce wasteful and ineffective spending, which will help them keep taxes low and aid the economic recovery. It is time for states to use their fiscal autonomy to seize control over their own budgets.

**Federal Mandates.** The one exception to state taxing and spending autonomy is the unfunded mandates placed on them by Washington. The best way for the federal government to help states would be to repeal the mandates that micromanage state governments, or at least back them up with the money to carry them out. Less federal meddling would empower states once again to become innovative laboratories of democracies.

This was the idea behind the 1996 Unfunded Mandates Reform Act. The Congressional Budget Office reported just two new major unfunded mandates enacted in the first five years following UMRA, at a collective new cost of just 0.1 percent of state budgets. Accordingly, in May 2001, the Executive Director of the National Governors' Association told Congress that UMRA had been largely a success.

Then, as fast as state budgets collapsed, media reports pointed to a new wave of unfunded mandates in education, homeland security, election reform, and Medicaid. These reports are overblown. A recent mandate to modernize states' voting systems will likely be backed up with federal funds. Most new state spending on homeland security was not mandated by Washington. It was initiated by states that wisely made it a top priority. Finally, state participation in the 2001 federal education reforms and the new federal bioterrorism grants was made voluntary—meaning states can opt out of the programs if federal funds do not cover all costs. Very few unfunded mandates have been enacted in recent years.

Medicaid, with costs split almost equally between Washington and the states, is the most expensive unfunded mandate. Washington deserves much of the blame for designing this expensive and inefficient program. But much of the program's 165 percent increase since 1990 was caused by the states, which expanded program eligibility and added new benefits in areas such as weight-loss help and substance-abuse treatment. If some states want to continue operating gold-plated Medicaid programs, they should be willing to pay the higher costs themselves instead of sending the bill to other states. Also, President Bush's budget provides states with increased flexibility to seek more cost-effective ways to provide Medicaid.

**Conclusion.** State governments have wisely concluded that their constituents should be spared higher state taxes, but the bailout solution would simply raise federal taxes instead. Taxpayers do not care whether they mail their taxes to Washington or their state capital; they care about their total tax burden and whether they are getting their money's worth. Congress should forget accounting gimmicks and cost shifting. It is time for all levels of government to take responsibility for their budgets and reduce excessive spending.

*—Brian M. Riedl is Grover M. Hermann Fellow in Federal Budgetary Affairs in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.*