



Federal funding harms state policy

John Hood

May 31, 2019

When North Carolina governors and lawmakers talk about “the state budget,” they rarely tell you the whole truth.

It’s not that they are trying to deceive you. They are simply speaking a kind of political shorthand that, unfortunately, fails to convey the full breadth and cost of state government.

Our state budget contains several discrete funds with their own design, function and revenue sources. Last year, they totaled \$54.5 billion in expenditures. Some \$23.9 billion of that, or 44 percent, consisted of the General Fund. It receives the proceeds of state income taxes, sales taxes and other levies, while housing state expenditures on education, human services, public safety and general government.

The General Fund is what politicians typically refer to as “the state budget.” It’s obviously of great importance and interest. But the General Fund encompasses less than half of the state budget. Federal appropriations (28 percent), highway funds (7 percent), and programs funded by other taxes and fees (21 percent) account for the rest.

For the sake of both accuracy and accountability, policymakers and those who report or comment on their actions should be more comprehensive in their presentation of fiscal data. North Carolinians can’t make informed decisions at election time, or engage effectively with public officials in-between elections, if they aren’t getting the full story.

In particular, by focusing so much on the General Fund, our current discourse about the state budget obscures the large role that federal dollars play in state government. During the immediate aftermath of the Great Recession, for example, General Fund appropriations fell. But state government simultaneously received significant increases in federal funding, largely offsetting the overall fiscal effect (although not necessarily the effect on specific agencies or programs).

The consequences of federal funding go far beyond the immediate fiscal effects, however. What Congress appropriates, Congress must first expropriate. If you are a North Carolina taxpayer, you are also a federal taxpayer. While the net flow of funds may be positive to our state at a given point in time — especially if direct expenditures on federal installations such as military bases are included in the calculation — North Carolinians are no less on the hook than all other Americans for the massive borrowing binge both parties have been on in Washington, D.C.

In other words, there’s really no such thing as “free” federal money for states. It’s costly, in more ways than just the obvious.

Chris Edwards lists some of them in a new research paper for the Cato Institute. One dynamic is called the “flypaper effect.” When Congress creates a new grant-in-aid program for states, its offer of federal money entices state legislatures to spend additional dollars of their own on the same things, often in the same way.

If you think politicians and bureaucrats in Washington always know best, and that there is just one best way to solve public problems, the this flypaper effect shouldn’t worry you. If not, it should.

Another, related problem is the extra cost states incur for handling complex federal grants. Here in North Carolina, a new report by the General Assembly’s Program Evaluation Division took the administration of Gov. Roy Cooper to task for squandering lots of time and millions of dollars in ineffectual efforts to deliver federal aid to victims of Hurricane Matthew, which ravaged a significant swath of the state in 2016. For one of the programs in question, North Carolina had spent only 1 percent of allocated federal funds through the end of 2018.

Cooper's officials defended themselves in part by challenging some of the division’s definitions and interpretations of existing law. As you can see, even seen in the best possible light, the episode illustrates how involving multiple levels of government can prove cumbersome and confusing.

The Cato Institute paper concludes, and I agree, that federal aid ought to be a much-smaller share of state budgets. “Americans want more responsive and effective government,” Edwards writes, which requires “devolving power to the states and reviving competitive federalism.”