No more bailouts for state and local governments

Michael Lafaive and Joe Coletti

September 5, 2020

The Trump administration and congressional leaders are at loggerheads over another COVID-19 relief package that may effectively provide state and local governments with another bailout. Discussions suggest it would range from $200 billion to $1 trillion. Our view is that it should be zero. There are too many negative consequences associated with going more deeply into debt, particularly when there are superior solutions available.

The federal government debt is expected to exceed the size of the nation's entire economy by the end of this month, something that hasn't happened since World War II. That debt — made larger by more bailout money — will have to be serviced with interest, which will crowd out other necessary spending and likely require either higher, growth-killing taxes or cuts to core government services. For the sake of the country, it is time to say no to more federal debt.

The COVID-19 pandemic hit the country hard, and the federal government has responded with four rounds of legislative relief so far. There also were executive orders in August that extended assistance to households and businesses, with questionable legal authority. These included direct payments to taxpayers, forgivable loans to businesses to keep people employed, and extended and expanded unemployment benefits for people who could not work. States and local governments received $150 billion for unexpected expenditures directly arising from the pandemic, on top of billions earmarked for education, Medicaid and other continuing programs.

The state and local assistance came with restrictions that it could be used only for new expenses directly related to the pandemic, but states and cities found they could call any variety of spending pandemic-related. For example, Idaho cut property taxes for the year. Detroit used some of its federal dollars to hire a lobbyist. For one-third of the states, the state portion of their federal payment alone was equal to 20 percent of their general fund budget for the year. So, it is not surprising that even with typical "pork" spending, some states still have not appropriated all they have received.

Besides the questionable uses of money already spent, and large amounts still unspent, there are a number of big problems associated with another bailout. The first bears repeating: The federal government cannot afford it. Its debt is more than $26 trillion. By taking on more red ink, the government risks crowding out other priorities, be they national defense or infrastructure, or any other item.

States are in a good position to solve their own budget shortfalls. Chris Edwards of the Washington-based Cato Institute wrote recently that total state and local tax revenue fell just 3 percent, or $13 billion, from the first quarter of this year to the second. Federal aid to state and local governments, however, leapt by $192 billion. “State-local governments are not short of money in general,” he says. We agree.

In our home states of Michigan and North Carolina, we’ve seen this firsthand. Fiscal 2021 shortfalls were forecast to hit $3 billion in the Great Lake State. The state’s official fiscal 2021 estimate in August? A shortfall of just $12.4 million. With roughly $800 million still in Michigan’s “rainy day fund” and plenty of ways to cut spending, that gap should vanish without relying on the feds. Before the pandemic hit, 34 states had fund balances greater than 10 percent of their general fund appropriations, according to the National Association of State Budget Officers.

North Carolina’s revenue for the fiscal year came in $500 million ahead of May’s forecast. Between its rainy day fund and unreserved fund balance, the state started the 2021 fiscal year with enough money on hand to cover 10 percent of its $24.4 billion general fund budget. Legislators had waited to appropriate a quarter of the state’s federal coronavirus dollars with the hope of being able to use some of the money to fill in pandemic-related revenue shortfalls. Now they plan to use $557 million to increase benefits for all unemployed people and to help families pay expenses related to remote learning. One legislator explained, “Nobody wants to send any of the money back to Washington.”

Most states can meet their needs without another round of federal funds, and their lawmakers will spend every dollar they receive from Washington and justify it as entirely necessary. Congress, though, cannot know what states need. It’s better not to provide states with more money because overcompensating them will leave the country worse off.