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How to Stop Wasting Money on Government Bailouts

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Free, up-to-date, readily available data on state and local governments' finances are the key to more effectively targeting federal aid.

There is little question that the federal government did a poor job of allocating funds to state and local governments during the Covid-19 pandemic, and that a primary factor in this failure was a dearth of reliable, up-to-date financial statistics on these recipient governments. Thankfully, a new measure tacked onto the National Defense Authorization Act offers hope that federal aid to state and local governments will be more carefully targeted in the next financial emergency.

The American Rescue Plan Act (ARPA), passed in March 2021, included $350 billion in aid to state and local governments, purportedly aimed at covering projected revenue shortfalls and added expenses that arose from the pandemic. A few analysts pointed out that the projected revenue shortfalls were not materializing, and that the added expenses had already been covered by the CARES Act. But the state-and-local-government lobby won the debate based on stale, model-based estimates such as one produced by the National League of Cities, which projected a $360 billion shortfall for local governments alone.

In the months after ARPA passed, it became obvious that the bailout package was seriously oversized and poorly targeted. To take one example, the State of California received $26 billion of the ARPA funds, only for Governor Gavin Newsom to issue a revised budget projecting $76 billion in previously unanticipated revenue a few months later. In California and across the country, the unneeded ARPA aid was spent on dubious initiatives, exacerbating inflation in 2022. California used some of its ARPA funding for renter education, while New York's Onondaga County devoted a portion of its federal award to supporting the production of art films in central New York State.

Of course, many in the state-and-local-government lobby see all this as a feature rather than a bug, and will continue to advocate for more federal aid at any opportunity. And, admittedly, the small-government advocates on the other end of the spectrum are always going to oppose federal bailouts. But those in between the two poles should prefer better-targeted aid packages. While the State of California clearly did not need the federal money, the city of Anaheim, struggling with lost revenue due to a state-mandated lockdown of Disneyland, had a better case for relief.

But the poor condition of state and local financial statistics made a targeted ARPA bailout impossible. The Census Bureau publishes an Annual Survey of State and Local Government Finances, but the report appears on a two- to three-year lag. Private entities such as the Bloomberg corporation and the Urban Institute collect more current data but only make it available to paying subscribers. When ARPA was being debated in Congress, free, up-to-date data simply weren't available to lawmakers, and the absence of such data hampered their ability to make informed decisions about the law.

If we are to avoid this problem in the future — if we are to produce comprehensive free data on state and local finances in anything approaching real time — the entire system of collecting these statistics must be overhauled. State and (at least the biggest local) governments should publish their revenues, expenditures, assets, and liabilities in a consistent format that can be easily compared and aggregated.

Fortunately, Congress has just taken an important first step in this direction. The recently passed National Defense Authorization Act included a provision that instructs the Securities and Exchange Commission to develop and implement financial-reporting standards for governments that issue municipal bonds. This provision is part of the Financial Data Transparency Act (FDTA), a separate proposal that was folded into the larger NDAA during the negotiations over the latter's passage.

The purpose of the FDTA is to modernize all forms of financial and regulatory reporting by, among other things, transitioning away from traditional forms to machine-readable data submissions, just as the old paper IRS forms have been largely superseded by the electronic filing of tax returns.

The FDTA only applies to governments that issue municipal bonds, but an earlier law called the Grant Reporting Efficiency and Agreements Transparency (GREAT) Act of 2019 instructed the Office of Management and Budget to develop financial-reporting standards for state and local governments receiving more than $750,000 in federal grant funds each year. Unfortunately, the OMB dropped the ball on the implementation of the GREAT Act during the Covid-19 pandemic, and the Biden administration has yet to rectify that failure. Now would be a great time for the OMB and the SEC to collaborate on developing reporting standards that all state and local governments and the Census Bureau can use.

The state-and-local-government lobby opposed the FDTA on the grounds that it was an unfunded mandate. They alleged that it would cost billions to retrofit state and local systems to meet the new data-reporting standards. This is an overestimate, and even if it weren't, there would still be plenty of unused American Rescue Act money available to cover the costs of complying with the new standards. Now that the FDTA has passed, all taxpayers should hope that state-and-local-government financial officers, who are tasked with providing stakeholders timely and accurate data, will cooperate with regulators to make financial-data transparency a reality at the lowest possible cost.

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