



Federal funds create a fiscal illusion

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When he was a high-ranking conservative Republican in the U.S. House of Representatives, Mike Pence was a chief critic of Washington's out-of-control spending and growing debt. Now that he is Indiana's governor, Pence is dependent on the same federal largesse that he bemoaned. Most Hoosiers would be surprised to know that under Pence's first budget proposal, federal funds would have accounted for around 35 percent of state spending.

Indiana state government is not unique in this regard and Pence's predecessor, Mitch Daniels, was similarly dependent on federal money. Indeed, Daniels signed an executive order on his first day in office creating the state Office of Federal Grants and Procurement to increase Indiana's take from the federal honey pot.

As a candidate, however, Pence said that he wanted to turn the OFGP into an "office of federalism" that would take a "Thanks, but no thanks" approach to those federal handouts with too many strings attached. Unfortunately, the governor has adopted a convenient "have your cake and eat it too" definition of federalism.

It is not what James Madison had in mind. Nor does it appear the administration will be saying "no thanks" too often given that the Pence budget proposal envisions more than a third of the funds coming from Washington.

The appeal of federal funds to governors is obvious: They get to spend additional money without having to raise taxes on their voters to pay for it. A problem with this arrangement is that it creates a fiscal illusion — state taxpayers perceive the cost of government to be cheaper than it really is. In effect, the federal money and a large part of the annual budget appears to be "free." But Hoosiers should be mindful that every dollar Washington sends to Indianapolis is a dollar taken from taxpayers in Indiana and the other states. (The return is actually less than a dollar since the federal bureaucracy takes its cut). The situation is no different when the federal dollars go instead to, say, Sacramento. In addition, economists have found that federal subsidies to the states lead to higher state taxes and spending in the long-run because the federal "seed money" creates a demand for more government.

One could argue that so long as Hoosiers have to send money to Washington, Indiana might as well get a share of the loot. That's an understandable sentiment, but the blatantly self-serving manner in which the Pence administration goes about distributing the bounty should give Hoosiers pause.

I point specifically to the lieutenant governor's office, which has a budget almost entirely funded by the federal government (92 percent). Lt. Governor Sue Ellspermann serves merely as a goodwill ambassador — the goodwill often coming in the form of gifts from taxpayers to various interests. In keeping with the set up established by the Daniels administration, she oversees a portfolio of programs used to centrally plan the state's economy.

The big money to fund that portfolio comes from the federal Community Development Block Grant program, borne out of the Great Society's belief that federal handouts could solve the woes of poorer communities. Instead, it has turned into a slush fund for politicians.

The state Office of Community and Rural Affairs doles out the block grant money, making sure to give the Pence administration the credit. For example, a press release with a formulaic title is issued, "Lt. Governor Sue Ellspermann Awards the City of Rushville \$15,000 for a Public Library Feasibility Study." It makes no mention that the money came from the federal government; there is only a generic quote meant to be inserted in a praising editorial.

In summary, so long as the public continues to view federal funds spent by state politicians as being free, the odds of a governor taking a principled stand are somewhere around zero. And while it is unrealistic to expect Pence to say "no" to every dollar that Washington sends his way, it would be nice to see a governor who claims to favor smaller government be more straightforward when it comes to distributing tax dollars.

A start would be to instruct his lieutenant governor to stop pretending to be Santa Claus with other people's money.

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