Dem plan for $3 trillion in new coronavirus aid is too costly – States must cut spending

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May 12, 2020

A proposal by House Democrats announced Tuesday to spend over $3 trillion more to deal with the impact of the coronavirus pandemic would send the federal deficit skyrocketing and place an enormous burden on taxpayers to fund. This is why it drew immediate objections from Republicans.

The Democratic proposal, which was announced by House Speaker Nancy Pelosi of California, comes on top of earlier massive spending as part of the nation's coronavirus response, including the $2.2 trillion CARES Act approved by Congress and signed into law in March by President Trump.

The new Democratic proposal includes about $1 trillion for state, local and tribal governments, Fox News reported, along with a new round of $1,200 in stimulus payments to most Americans.

The proposal would also continue $600 in extra weekly unemployment insurance benefits through January, set aside $175 billion to subsidize rent and mortgage payments, and suspend student loan payments through September.

The federal aid already approved is generous and the additional $3 trillion in spending is more than we can afford. Uncle Sam does not have an unlimited amount of cash and should not borrow unlimited amounts.

The federal government is already aiding state health, education, and unemployment systems while offering the states emergency loans. But the states are not subdivisions of the federal government. They should tackle their budget challenges by tapping rainy day funds, furloughing nonessential workers, and cutting low-priority programs.

Supporters of additional federal spending seem to think that states are feeble and unable to fend for themselves. But the states have powerful tax bases, rainy day funds, and a large ability to borrow. Local governments are wards of state governments, not the federal government.

We need to remember that federal spending is not a free lunch. It will require more borrowing and thus higher federal taxes down the road – taxes that will ultimately land on residents of the 50 states.

Congress has already provided about $300 billion in aid to the states. In addition, the Federal Reserve has created a “municipal liquidity facility” to lend money to cash-strapped governments. On top of this, state unemployment insurance systems can tap the federal government for loans. That is enough federal aid.

Congress bailed out the states during the recession a decade ago, yet in the end state and local tax revenues fell just 5 percent in 2009 before resuming growth, according to Bureau of Economic Analysis data. State-only tax revenues fell 10 percent in 2009 before resuming growth.

If the revenue dip during the current crisis is similar, states can handle it with the aid they’ve already received and their own budget actions. States can delay less-critical spending, such as highway construction, and they can furlough nonessential workers, as many businesses have done.

Half of all state-local spending is for employee compensation, according to Bureau of Economic Analysis data, which means that furloughs can save a lot of money.

Democratic and Republican supporters of additional federal aid are using the Washington Monument strategy – that is, claiming that high-profile or critical local services are at risk.

Sen. Bill Cassidy, R-La., recently argued: “The tax revenue necessary to pay for police, fire, sanitation and airport ground crews is not there. Once these workers are laid off, there is no one to provide essential services to support employers and homeowners.”

But those three critical services – police, fire and sanitation – account for just 7 percent of state and local government budgets. Why not trim the less-critical 93 percent instead?

Cassidy mentions “airport ground crews.” But why not furlough some of those workers since airport traffic is down? And why not cut urban transit, since demand is in decline?

Certainly, states should not be increasing their budgets, as Pennsylvania’s Democratic Gov. Tom Wolf wants to do.

More federal aid would also create bad incentives. It would encourage state leaders to extend shutdowns, which are inflicting huge pain on the private sector.

As tax revenues dip from shutdowns, governments will have to tighten their belts along with the private sector, and that will create a good incentive for politicians to reopen the economy.

Longer-term incentives are also important. Because states need to balance their budgets, they are supposed to build rainy day funds during the boom years to cover revenue losses during the bust years. Rainy day fund balances today are higher than before the recession a decade ago, which is good news.

However, rainy day funds vary from more than 10 percent of annual spending in 18 responsible states to less than 5 percent in 12 irresponsible states. New Jersey, Pennsylvania, Illinois and Kansas have saved virtually nothing. The more that the federal government bails out states during crises, the less responsible states will be in the future.

Some states are facing particularly steep revenue drops during this crisis, particularly energy-producing states. But many of those states – including Wyoming, Alaska and North Dakota – knew their vulnerability, planned ahead, and have amassed large rainy day funds.

California lawmakers know that the state's budget is highly dependent on volatile income tax revenues, and they also built a substantial rainy day fund.
Going forward, another solution is for states to rely less on volatile income taxes and more on stable sales taxes. During the last recession in 2009, state-local income tax revenues fell 15 percent while sales tax revenues fell just 7 percent.

A final way that states can prepare for recessions is to pay down debt during booms, which improves credit ratings and creates room to borrow during crises.

New Jersey Democratic Gov. Phil Murphy wants to issue debt to close his state's budget hole, which would have been easier if the state did not have one of the highest debt loads and worst credit ratings.

The coronavirus pandemic and the business shutdowns and stay-at-home orders could not have been foreseen by federal, state and local government officials. But emergencies sometimes arise without warning and it is the job of government officials to deal with them.

State governments have already received a record level of federal aid to cope with the pandemic and now need to shoulder the responsibility to meet their remaining needs with their own resources and necessary cuts in non-essential spending.