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# 10 Reasons to Oppose a Stimulus Package for the States

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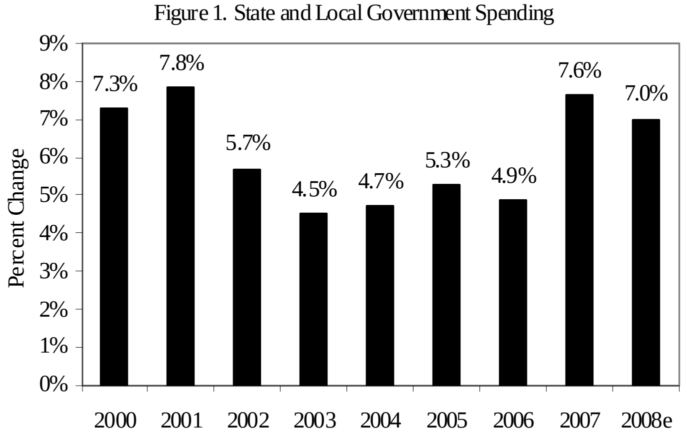
The U.S. economy is in recession, and federal policymakers want to help by applying some old-fashioned Keynesian medicine. They are considering a "stimulus" bill of up to $700 billion, with substantial spending going to state and local governments for infrastructure, Medicaid, and other activities. Such subsidies for the states would be ill-advised for at least 10 reasons.

**1. The Federal Government Is Broke**. The federal government faces a $1 trillion deficit this year and massive red ink down the road from Social Security and Medicare. Rather than increasing subsidies, policymakers should cut the roughly 800 current aid programs for the states. Most of these programs are inefficient and hugely bureaucratic.[1] Federal spending on state activities is a failed experiment of the 1960s that should be cut, not expanded.

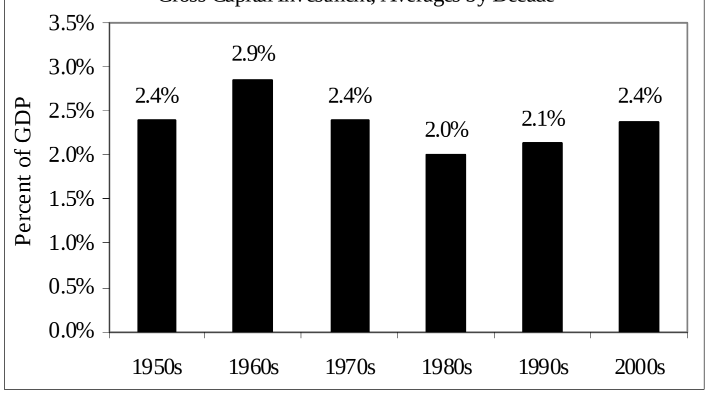
**2. Spending Is the Problem**. Rapid spending growth has pushed many state budgets into deficit, repeating the error committed before the last recession in 2001. Figure 1 shows that total state and local spending rose 7.6 percent in 2007 and 7.0 percent in 2008, based on data through the third quarter.[2] State policymakers should be cutting their budgets, not asking for federal help to spend more.

Figure 1. State and Local Government Spending




Source: Author's calculations based on U.S. Bureau of Economic Analysis data.

Figure 2. State and Local Government
Gross Capital Investment, Averages by Decade




Source: Author's calculations based on U.S. Bureau of Economic Analysis data.

**3. State Infrastructure Is Well Funded**. Despite complaints that "our highways are crumbling," state spending on infrastructure has been at fairly high levels in recent years. Figure 2 shows that state and local government gross capital investment has averaged 2.4 percent of gross domestic product this decade, which is higher than in the 1980s and 1990s.[3]

If states need more infrastructure, they should look to private financing, as many foreign countries have done. Privatized highways, bridges, airports, and seaports are the wave of the future. A further reform would be to repeal the Davis-Bacon rules so that taxpayers get more bang for the buck on their infrastructure spending by not having to pay inflated wage rates on government-funded projects.

**4. A Keynesian Stimulus Ignores the Long Run**. Economists in the Keynesian tradition believe that federal spending expands aggregate demand and spurs short-run economic growth. Economists in the monetarist tradition believe that any such positive effects would be short lived, and economic output would soon fall back to its pre-stimulus level. Economists in the rational expectations tradition argue that a Keynesian stimulus would have no effect on output, even in the short run. The reason is that the private sector would take actions to nullify the stimulus. For example, businesses might cut their investment in response to increased government spending.

Despite confident claims by some economists advising the government about how to fix the recession, the reality is that economists do not have an accurate model of the short-run economy, and their advice is often in error. Policymakers should be more humble about their ability to control the short-term ups and downs in the economy. Their actions, which are usually based on faulty or incomplete information, are just as likely to destabilize the economy as to improve it.

Further, government actions to fix short-term problems often create long-term damage, such as by putting the nation further into debt. Besides, a recession is a needed adjustment process for the economy after a shock or bubble. Policy interventions may interfere with that process by distorting market signals and slowing the movement back toward economic equilibrium.

All that said, economists do know a lot about policies that foster long-run growth, and that is the proper focus of government policymaking. Long-run growth comes from work, investment, entrepreneurship, and innovation. To expand the supply of those items, governments should focus on microeconomic policy reforms.

**5. Rising Federal Debt Is Fiscal Child Abuse**. Spending on a stimulus package would be funded by additional government borrowing. The burden of that borrowing would fall on young people and future taxpayers. Federal policymakers are leaving a terrible fiscal legacy to the next generation, and a stimulus package would only make matters worse.

**6. A Bailout Would Flout State Fiscal Traditions**. Nearly all the states have statutory or constitutional restrictions on budget deficits and government debt levels. Many of those restrictions were put in place a century ago so that politicians would live within the “allowance” that taxpayers provided them with. A federal bailout of the states goes against the spirit of those state fiscal traditions, which were designed to encourage restraint.

Another tradition that the states should heed is their historic policy independence from the federal government. President-elect Obama met with the governors to discuss a bailout in Philadelphia’s historic Congress Hall. But the once proud and self-governed states that sent representatives to Philadelphia in the 1790s have become so smothered by federal subsidies and regulations that they are becoming little more than regional divisions of Big Government in Washington these days.

**7. A Bailout Would Delay State Reforms**. Many states have short-term budget gaps, but face a larger fiscal crisis from long-term spending promises. State and local governments have unfunded obligations in their pension and retiree health care plans of at least $2 trillion, as a result of often gold-plated benefit packages for workers.[4] Adding to state fiscal woes is rapidly rising Medicaid spending, which has been fueled by the expansion of benefits in many states. A federal bailout would likely encourage state policymakers to delay needed restructuring in Medicaid, retirement plans, and other spending areas.

**8. State Situations Vary**. While some states have large budget gaps, there are more than a dozen states that do not.[5] The latter states certainly do not need help from Washington, yet if Washington only helps the states with the big deficits, it would be unfair to the states that have been better managed.

**9. Bailouts Beget More Bailouts**. If state politicians know that they will be bailed out by the federal government when they get into trouble, they will be more likely to make irresponsible choices that produce another fiscal crunch. They will overexpand programs, issue excessive debt, and fail to build up their rainy day funds. President-elect Obama should consider that bailouts of state governments and automobile firms would create a dangerous precedent and would likely lead to a long line-up of hand-out seekers at the White House gates.

**10. Opportunity for Restructuring**. Some pundits and policymakers view current state budget gaps as a calamity. But today’s fiscal challenges provide state policymakers with an opportunity to restructure. State employee benefit packages should be renegotiated, infrastructure privatized, business subsidies ended, and expensive health care programs cut back.

At the federal level, policymakers should resist their impulse to try and manipulate short-run growth. Such actions will only get the government further into debt and could delay an economic recovery. Instead, Congress and the new administration should focus on policies to foster long-term growth and fiscal stability, such as business tax reforms and entitlement program cuts.

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[1] Chris Edwards, “Federal Aid to the States,” Cato Institute Policy Analysis no. 593, May 22, 2007.
[2] U.S. Bureau of Economic Analysis, National Income and Product Accounts, Table 3.3, www.bea.gov/national/nipaweb.
[3] Ibid.
[4] Chris Edwards and Jagadeesh Gokhale, “Unfunded State and Local Health Costs: $1.4 Trillion,” Cato Institute Tax and Budget Bulletin no. 40, October 2006.
[5] www.ncsl.org/summit/budgetmap.htm.