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Runaway Spending Leads to a Budget Crunch

by Amy K. Frantz

Most states, including Iowa, are facing budget shortfalls. Some place the blame for the deficits on tax cuts or the economic recession. However, the spending binge of the late 1990s is clearly the main cause of the crisis. As revenue was steadily coming in to the states' coffers, state officials increased spending without considering the future consequences. In Iowa, Governor Vilsack and the State Legislature increased total state spending by 8.6% between Fiscal Years 1999 and 2001.[1]

If states had limited their spending increases to the percentage of inflation plus population growth, most would not be facing the drastic situation they are today. This is confirmed by a new *Briefing Paper* from Cato Institute, "States Face Fiscal Crunch after 1990s Spending Surge," by Chris Edwards, Stephen Moore, and Phil Kerpen. An excerpt from the Briefing Paper summarizes the authors' thoughts on the current budget situations of the states:

> Suppose that a fictitious Governor Spendthrift had planned for a 6 percent rise in her state budget, but Governor Frugal planned for an increase of 3 percent. Then suppose that actual revenue growth in both states turned out to be 3 percent. That would be no problem for Frugal. But Spendthrift would describe her situation as a 3 percent "shortfall." Yet Spendthrift's actual problem is a "spending excess" caused by an overly optimistic budget plan.[2]

The authors of the Briefing Paper attribute the budget problems today to a lack of restraint in spending, not a lack of revenue. "U.S. Bureau of the Census data show that total state tax collections grew 7.1 percent in FY98, 5.2 percent in FY99, 8.0 percent in FY2000, and 3.7 percent in FY01."[3] Tax revenue continued to grow even though many states enacted tax cuts during the late 1990s.

However, instead of enacting additional tax cuts or returning some of the tax revenue to the taxpayers as rebates, states chose to spend the excess revenue. Often the excess spending was in the form of expensive, on-going projects or expansion of eligibility for existing programs. This created spending commitments that would continue to rise into the future, even when the economic boom came to an end.

State policymakers need to implement controls to limit spending growth during economic booms. The authors demonstrate that "if state governments, in aggregate, had limited annual

A Publication of:
Public Interest Institute *at* Iowa Wesleyan College
600 North Jackson Street
Mt. Pleasant, Iowa 52641-1328
Phone: 319-385-3462 Fax: 319-385-3799
E-Mail: public.interest.institute@limitedgovernment.org Web Site: www.limitedgovernment.org

spending growth to a benchmark of inflation plus population growth beginning in FY90, they would have generated savings of $93 billion by FY01."[4]

In Iowa, actual tax revenue increased 56 percent from 1990 to 2001, according to the authors' calculations, based on U.S. Bureau of the Census data.[5] However, if Iowa had limited its tax revenue growth to the rate of inflation plus population growth, tax revenue would have been limited to an increase of 43 percent.[6] A 43 percent increase in revenue hardly seems draconian!

States would be in better fiscal shape than they are today if they had not spent to excess when tax dollars were rolling in. Some states showed a bit more restraint than others, but overall general-fund spending in the 50 states increased from $274.7 billion in FY90 to $518 billion in FY03.[7] What is the solution to the fiscal crisis? The authors suggest a short-term and long-term solution:

> States should turn current budget problems into opportunities to weed out excessive and wasteful spending added during the boom years. To avoid running into serious budget crunches in the future, states should adopt budget caps that prevent excessive growth in revenues and spending during economic booms.[8]

Iowa should adopt a Constitutional Amendment to place a fair and reasonable limit on the growth of total state spending. Controlling spending in the good times will prevent budget crises during economic downturns.

ENDNOTES:

[1]David Hogberg and Amy K. Frantz, "Iowa's State Budget: Spending Our Way to a Crisis," Public Interest Institute *Policy Study*, October 2002, p. 3.
[2]Chris Edwards, Stephen Moore, and Phil Kerpen, "States Face Fiscal Crunch after 1990s Spending Surge," Cato Institute *Briefing Paper*, February 12, 2003, p. 3.
[3]Ibid., p. 4.
[4]Ibid., p. 5.
[5]Ibid., p. 6.
[6]Ibid.
[7]Ibid., p. 3.
[8]Ibid., p. 14.

Amy K. Frantz is a Research Analyst with Public Interest Institute.