



More State Debt Won't Grow Iowa's Economy

by David Hogberg

During this legislative session, Governor Tom Vilsack and many State Legislators are trying to establish a massive economic development fund. This fund would give taxpayer money to favored businesses in Iowa in the hopes of spurring state economic growth. The problems with such schemes are that government economic development spending is ineffective and government is not very good at picking economic winners and losers (see Institute BRIEFS 9-33 and 10-9). Another problem with such schemes is that they require the state of Iowa to incur a large amount of debt.

Some kinds of debt can further economic progress. A student obtaining a loan to finish his or her education, a couple taking on a mortgage to buy a house, or an entrepreneur incurring debt to start up a business are all examples of indebtedness that can further economic growth. But in those examples, the persons taking on debt are required to pay it back. In general, people behave more responsibly when they have to repay the money.

A state economic development fund, however, operates on the OPM principle—Other People's Money. Businesses that receive money from the economic development fund will often receive it in the form of a grant or investment which they do not have to pay back. Hence, the price for failure—and the incentive to succeed—will not be as high as it would be if the businesses had to repay the money. Rather, it will be the state government that takes on debt to finance the fund, and it will be taxpayer money which will pay off the debt.

State government debt is not conducive to economic growth. When a state government takes on debt it creates a future funding obligation for which tax revenue is needed. This increases the pressure on a state government to keep taxes high and to put off tax reduction. Businesses are less likely to invest in a state under pressure to keep taxes high.

The data displayed in Table 1, on page 2, confirms this. Table 1 compares the 10 states with the lowest amount of state-held debt as a percentage of personal income to the 10 states with the highest amount of debt during the 1992-2001 period. As the table shows, the states that averaged the lowest amounts of debt during this period had higher average rates of growth in real personal income, real per-capita personal income, employment, and population.

Interestingly, Iowa is one of the 10 lowest debt states, but with the exception of real per-capita personal income, its economic growth is worse than the average for the 10 states with the highest debt. This suggests that Iowa's lackluster economic growth is due to factors other than debt, such as Iowa's tax and regulatory burden. What the overall results show is that taking on new state debt is what Iowa definitely *should not* do.

Spurring Iowa's economy requires cutting taxes and streamlining business regulations. Incurring more government debt will only ensure that Iowa's lackluster economic performance of recent years will continue.

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Table 1: State Debt and Economic Growth, 1992-2001						
10 States With Lowest Debt	Average Net Tax-Supported Debt as a Percentage of Personal Income, 1992-2001		1992-2001 Growth In:			
	Personal Income	Real Personal Income	Real Per-Capita Personal Income	Employment	Population	
Colorado	0.17%	73.7%	24.9%	27.6%	23.7%	
Nebraska	0.18%	36.8%	16.9%	9.3%	6.3%	
Idaho	0.32%	54.3%	13.7%	25.8%	21.2%	
Iowa	0.46%	31.2%	14.8%	3.5%	3.9%	
Wyoming	0.57%	40.0%	19.9%	14.0%	6.0%	
Arkansas	0.75%	36.6%	11.4%	8.6%	10.8%	
North Carolina	0.90%	50.4%	15.1%	13.7%	17.1%	
Oklahoma	0.92%	34.7%	13.9%	10.8%	7.2%	
Indiana	0.92%	36.1%	14.7%	10.6%	7.3%	
Tennessee	0.94%	43.0%	14.3%	15.9%	12.9%	
Average	0.61%	43.7%	15.9%	14.0%	11.6%	
10 States With Highest Debt						
Vermont	4.34%	39.0%	17.9%	6.5%	9.9%	
Louisiana	4.35%	31.8%	15.1%	4.1%	9.2%	
Kentucky	4.42%	35.8%	14.2%	7.5%	13.2%	
Washington	4.76%	48.5%	16.2%	14.5%	15.9%	
New York	6.40%	31.0%	14.2%	4.1%	7.6%	
Delaware	6.79%	14.2%	8.4%	-4.4%	-6.2%	
Rhode Island	7.43%	31.2%	13.9%	3.7%	1.4%	
Massachusetts	8.16%	45.2%	24.6%	5.4%	8.9%	
Connecticut	8.89%	35.1%	18.3%	3.3%	1.6%	
Hawaii	10.89%	11.2%	-4.5%	4.6%	3.3%	
Average	6.64%	32.3%	13.8%	4.9%	6.5%	

Sources: "2001 State Debt Medians," Moody's Investors Service Municipal Credit Research, Bureau of Labor Statistics, Bureau of Economic Analysis

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