Learning from the Laboratory of Fiscal Reform

The Bradley Working Group on State Finances met in Indianapolis on October 26, 2010, as a joint effort between the Bradley Foundation and Sagamore Institute to gather together some of the nation's brightest minds on state economic and fiscal issues.

Why?

Because the majority of U.S. states are in a financial mess.

Susan Stinn

Members of the Bradley Working Group convened at Sagamore Institute to develop recommendations for better state fiscal policy.

The group met with leading officials in Governor Daniels' administration to learn from the Midwest's laboratory of fiscal reform: Indiana. Under Governor Daniels' leadership, the state has generated hundreds of millions of dollars in savings through competitive outsourcing and aggressive cost-cutting, all of which were well underway before the financial crisis of 2008. As a result, Indiana has weathered the crisis better than most states, many of which suffered as a result of the bureaucratic profligacy that often overtakes a government when times are good. The rating agencies have rewarded Indiana with its first AAA rating, making it just 1 out of 11 states in America to meet the high standard.

In its general discussion, the group focused on identifying the main sources of states' fiscal crises and then turned to some potential solutions that policy makers and private sector leaders could consider adopting.

Key insights that emerged from the day:

Policy makers in Washington and at the state level need to understand the roles that spending and debt play in states' fiscal conditions. There is a lot of focus on debt these days, but in many cases, the bulk of states' fiscal problems stems from out-of-control spending more than from debt.

We need policy makers to adopt a principled resistance to the "bailout temptation." The idea that the federal government may need to bail out large troubled states such as California and Illinois receives more support from policy makers and advisers across the ideological spectrum than one might think. Given that spending is at the heart of so many states' poor fiscal conditions, state bailouts would reward profligacy and set a dangerous precedent.

Incentives need rewiring across the board. For instance, states would do well to consider constitutional spending caps, and the federal government should ensure that no stimulus funding goes to public payroll support. Any stimulus funding should, in fact, have more rather than fewer strings

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The group also met with Mitch Daniels to discuss his monetary philosophy and policies. Pictured above: Bradley Foundation representatives Daniel Schmidt (left) and Michael Hartmann (right) with Daniels (center).

Susan Stinn

Sagamore Fellow Ryan Streeter (center) led the group discussion.

attached to the use of the funds to ensure that taxpayer dollars go to productive activity. Too many states are hardwired to increase spending on nonproductive objectives.

Policy makers need to understand how municipal debt practices have changed and to be open to a range of possible reforms. While states have begun using debt for such activities as budget deficit support and other nonproductive activity, we have also seen an explosion in foreign investment in state and local debt. The federal government's behavior suggests that it will treat foreign-held state debt as a "too big to fail" issue and intervene when states run into trouble. Without a statutory ban on such bailouts and other reforms, investors will continue to treat such debt as backed by the U.S. government.

Finally, the growing curse of state pension dysfunction cries out for reform. As mentioned above, spending is a greater threat to long-term state sustainability than debt in most cases. The flawed assumptions on which pension benefits are calculated as well as the outdated policies that govern payments to retired workers all need reform, not just as a matter of modernization but as an economic growth issue. Unreformed pension policy will increasingly be directly related to credit rating downgrades, business flight, and population outmigration.

Sagamore Institute, under the direction of Ryan Streeter, will continue this effort in collaboration with working group participants.

Bradley Working Group on State and Municipal Finance Participants

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