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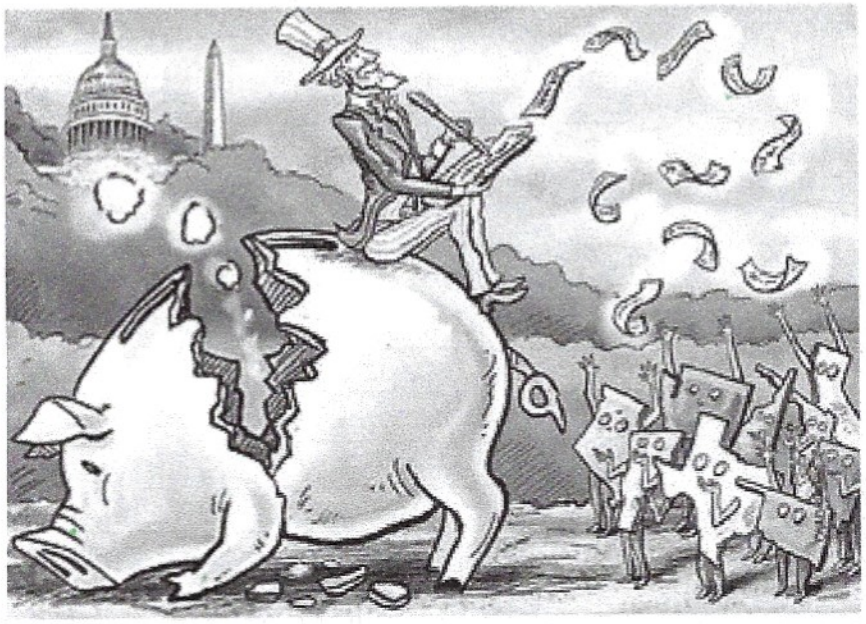
Musk and Ramaswamy can end Washington's habit of paying for everything from bike paths to bus stops.



Got Debt? Try Some Fiscal Federalism

By John F. Cogan

Excessive spending has been a way of life for lawmakers in Washington for more than half a century. Since 1969 federal outlays have exceeded revenue every year, except briefly during the hightech bubble of the late 1990s. Elon Musk and Vivek Ramaswamy's Department of Government Efficiency will attempt to put an end to this fiscal profligacy. Both men will soon discover that the root cause of this problem lies with the federal government's abandonment of federalism in fiscal matters.

We have all been taught that the Constitution limits the federal government's powers—that there is a sharp division between federal, state and local responsibilities. Yet this couldn't be further from the truth in fiscal affairs: It is difficult to think of a single activity that state and local governments spend money on that isn't also financed by Washington's check-writing machine. The feds spend on local roads, social services, police and fire protection and education. Washington also appropriates funds for building and maintaining municipal parks and playgrounds, bike paths and hiking trails, city sidewalks, bus stops, railroad crossings, traffic signs and stop lights, and beautification projects. This is all in addition to its most costly outlays on the plethora of welfare, disability, healthcare and income-support programs.

My analysis of federal budget data shows that the chronic federal budget deficits since the 1950s are due to the federal government's failure to raise tax revenues required to finance its spending on state and local activities. The federal government has instead chosen to take on and finance additional responsibilities by using debt alone. This is a sharp, and dangerous, break from its past fiscal restraint.

The Founders believed that, among its benefits, federalism would serve as an effective constraint on federal spending and a barrier to structural budget deficits. They figured that a constitutional balanced-budget requirement was unnecessary, and the historical record mainly vindicated them.

From 1789 to the first decade of the 20th century, Congress largely adhered to James Madison's view that the federal spending power was limited to executing the Constitution's enumerated powers. Congress

repeatedly rejected bills appropriating federal aid to elementary and secondary education, income support for citizens, and state grants for the poor. Notable exceptions were made for the Cumberland Road, waterway clearance projects beginning in the 1820s and cash aid for land grant colleges in 1890. Yet the constitutional barrier that prevented federal spending on state and local activities largely held. The federal government experienced budget deficits only during war and economic recession—and, in other years, ran budget surpluses to pay down any debt it had incurred.

Fiscal federalism started to erode more seriously around World War I. Congress began spending on state and local activities through new programs that matched states' spending on their existing efforts for highway construction, vocational education and rehabilitation, agricultural extension services and maternal and child health. These small programs were inconsequential for the federal budget totals but nevertheless planted the seeds for future expansions.

Policymakers finally abandoned fiscal federalism during the Great Depression. It was initially unclear whether this would be temporary or permanent. The Supreme Court, by concluding in the 1930s that Congress had the authority to spend to promote the "general welfare," ensured the latter.

Following World War II, and especially during the peak years of the Great Society (1965-74), the federal government greatly expanded its spending on activities that were traditionally regarded as state and local affairs. Federal spending increased from around 18% of gross domestic product in the early 1960s to 21% in 2019 and an estimated 24% in 2024. New expenditures on traditionally state and local activities as a share of GDP accounted for more than the growth in total federal spending during this period. Meanwhile, tax revenues remained mostly between 16.5% and 18.5% of GDP. In other words, the entire increase in national debt is traceable to the federal government's spending on state and local activities. The consequences for the national debt are mainly unchanged even if we set aside Social Security and the Medicare Hospital Insurance program. Until the last decade, payroll taxes adequately financed both programs. Only in recent years have they contributed to the rise in national debt.

The abandonment of fiscal federalism has affected more than our towering national debt—it has also begun to undermine our security. National defense should be the federal government's highest priority. Yet since the 1950s spending on traditionally state and local affairs has taken its place. Funding these projects has come at the expense of the defense budget, which as a share of the federal total has fallen from around 60% in the mid-1950s to some 13% today. That level is wholly inadequate to meet rising global threats.

The federal government needs to reverse its priorities, prizing national defense and returning state and local affairs to their proper place. Sorting out which programs should go first could be a natural starting point for Messrs. Musk and Ramaswamy.

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