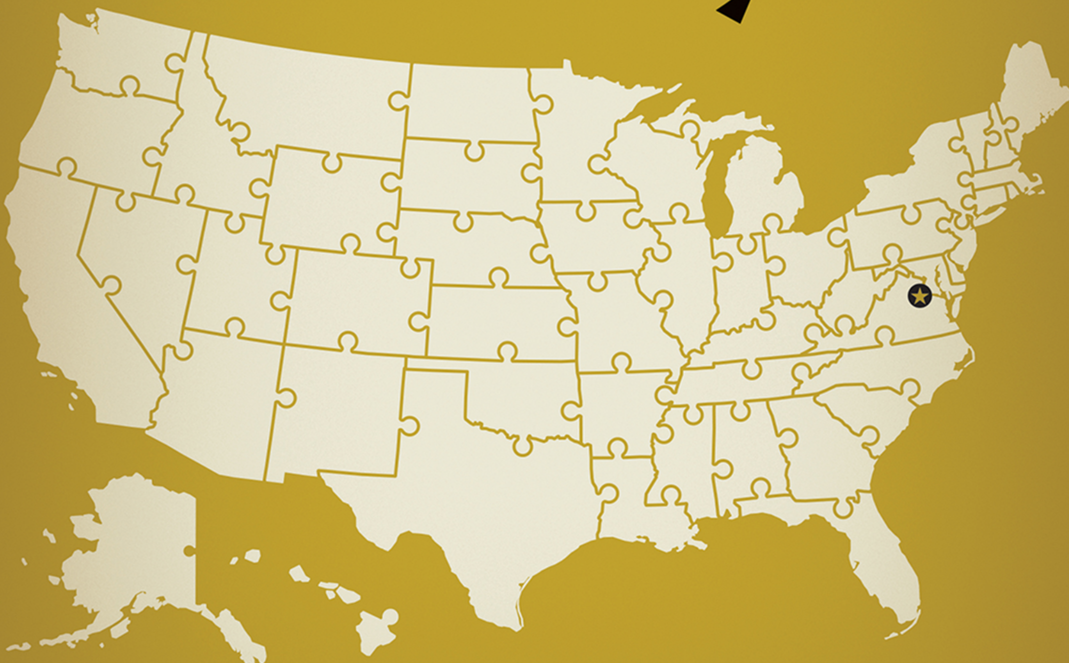
Perspectives on Political and Economic Governance

American Federalism Today



EDITED BY

MICHAEL J. BOSKIN

DISCUSSANT REMARKS AND DISCUSSION

Federalism in Key Areas of Policy

Discussants: Thomas Nechyba and Dennis Epple

Thomas MaCurdy: John, do you think these rules should be modified now that the interest rate has such a big impact on the fiscal side? Given the large size of national debt, a single 1 percentage point in interest significantly increases government spending.

John B. Taylor: Actually, the rules are fine. What's wrong with the rules?

MaCurdy: Well, before, the rules didn't have such a fiscal impact on the interest payments.

Taylor: Well, that's a disadvantage. That's a disadvantage. They have a higher interest rate.

MaCurdy: It's definitely a disadvantage. These rules were established thirty years ago, and I understand the rules better in that context. Now, do you think there should be any compensation for the fact that when the Federal Reserve raises the interest rate, a large increase in spending occurs? We will have soon more than a trillion dollars spent on interest in upcoming budgets.

Taylor: So you're asking should the high interest rates be discouraged because it affects spending? I say no. You have a monetary policy to focus on peak inflation of 2 percent. And let me just mention that this is also an international issue. It's not just the Fed, it's Europe, it's Russia, it's China, it's Japan. And by the way, they all know these things. We talk about it all the time. So there's a possibility that they will move in that direction.

MaCurdy: So your position would be no, even though the circumstances are different now, there should be no difference in the rule for what we had, say, twenty years ago.

Taylor: Well, think about it. Should we change the 2 percent target for inflation? No, I don't think so. It used to be 1.5; 2 is a reasonable number. Some people say it should be 3 or 4. Let's stick with 2.

Can you go back faster to these fiscal and monetary targets? No, I think this is the right speed. Should you have other things? Maybe the exchange rate should matter. The exchange rate is a factor more for some countries than for others.

Michael J. Boskin: Let me make a couple of quick comments. Tom, I think part of the response to your question is that market interest rates will go up if we let inflation stay high. So getting inflation back down is a way to get them back down.

MaCurdy: You're saying there's much more of a balancing act than we used to have, that it's more complicated than it was.

Boskin: That's a fair point. But I think some of the implications John's drawing out are, number one, if we have a more stable macro environment, that will also mean potential for a more stable fiscally federal system, where we don't have these massive, gigantic splurges of spending during recessions.

MaCurdy: Those numbers you're citing are CBO [Congressional Budget Office] budget scoring numbers. If you read CBO reports now, they have this whole block in them stating, "Don't believe our numbers, they're too optimistic."

Joshua Rauh: Also, they don't assume these deficits are going to have any real impact on interest rates themselves, either directly or through a Fed attempt to fight inflation?

MaCurdy: For scoring purposes, CBO is required to produce forecasts assuming continuation of current law. CBO reports used to have a little footnote discussing qualifications. Its reports now include large text boxes essentially saying these numbers are not real, we have to do this.

Boskin: I think we could all conclude that the inflation and the fiscal and monetary mess we're in—hopefully on the latter, we're starting to come out of it a little bit—have dramatic implications for what the federal government's going to be able to do. What responsibilities lie with the state and local level? If the economy's growing more rapidly, it's a lot more revenue for state and local governments. If the economy's growing more slowly, it's a more challenged fiscal environment. If we can get the denominator growing more rapidly, it's much less so.

MaCurdy: That is really a big deal because the fiscal obligations are primarily in absolute levels, not in terms of GDP.

Boskin: Absolutely. The single most important thing is that we get the economy growing more rapidly, whereas the policies now all seem to be loading weight on growth.

Taylor: You mean low growth?

Boskin: Low growth. Loading weight to grow, getting harder to grow, more weight is being placed on the scales of trying to grow. Making it harder to grow, more fiscal policy weight on a scale.

MaCurdy: I'd probably say right now the problem is we can't get our growth rates up enough.

Boskin: That's a fair point. But every bit helps.

Thomas Nechyba: Let me get started. When Dennis [Epple] and I sat down and we calculated how much time we have for six papers, we calculated we have about two and a half minutes per paper, which we can't possibly do. So we're only going to say some things and I'll start so Dennis can fill in all the rest. And I'll start by just setting a stage, and I'm going to try to be provocative towards the end, particularly for this audience, but I'll work my way up to it. And I'll start with Paul [Peterson] and Carlos's [Lastra-Anadón] paper on competitive federalism, because they set up what we call fiscal federalism, where you've allocated responsibilities to state and local [and] national governments based on sensible criteria. They articulate some of the real advantages of local provision, but then there are real reasons why you actually need to have some extra funding coming in from the higher levels of government.

One of those reasons that has become more important is that tax bases have become more mobile, and so it's easier for federal governments to raise money. If everything that is best spent locally has to be raised locally, we would get too little funded, opening a strong argument for fiscal interaction between more central and more local governments. It's not the only reason for fiscal interaction but an important one. That's a space we want to talk about, that interaction between the high-level and the lower-level governments. And what Paul warns us of is as this interaction increases, this dependence of lower-level governments on revenues from higher-level governments, there may come a point where we run into the danger that in fact the competitive federal system isn't what it is supposed to be. And the key ingredient that Paul points to, which I agree with completely—and there's a literature on this—is that really the key is for lower-level government budgets to remain hard. If those budgets become soft budget constraints, where local and state governments can essentially view the federal government, in our case, as the piggy bank, then you're distorting decisions in a way that goes exactly counter to a healthy competitive federalism, as Paul calls it.

So the trick is to do this in a way where you don't get to that point, and where you—as we've talked about before—don't impose excessive regulations and kill all the advantages of actually providing things at the more local level that we've talked about that I won't review here. So the question is, at what point does the fiscal interaction between central and local governments erode healthy federalism, and Paul and Carlos do a lot of work on trying to classify different kinds of expenditures. They have to make lots of decisions about what to call "developmental" and what to call "redistributive." And we could probably sit for an hour and quarrel with different aspects of that, but you have to make some decisions in any analysis like this. The same is true with the tax incidence assumptions in their paper, but in the end you make some decisions and you hold those constant and see where your assumptions take you. And Paul and Carlos's analysis comes up with this conclusion: we're not in trouble yet, but we may be getting in trouble soon.

And I think that's a very sensible place to end. I'll quibble slightly with your adopting Mitt Romney's language about productive and dependent people. I don't think you actually needed to make that a point in the paper, and I think it has the potential to rub people the wrong way and then miss the large point you are trying to make. It didn't work out for Mitt Romney very well. So I would suggest changing that. But let me step back a little bit and say, okay, we understand all the advantages of local provision, of local provision of goods and services, even if the financing comes in part from somewhere else. But if that was all there is, we'd just have local governments. We'd just have local governments do everything. So I want to focus a little bit on just creating a simple lens through which to think about fiscal federalism. And I'm going to boil it down to something very simple and oversimplify and say, well, there are basically two reasons why we look to central governments to be involved in this relationship within this fiscal federalism system.

One of them is spillovers. If what you're producing has benefits elsewhere, then the local government doesn't have the right incentives to produce the right quantity. And so there's a role for the higher-level government to realign those incentives. And then the other is, I'm going to call it equity. There are certain categories of goods where we simply think that there ought to be at least a minimum level of access to those public goods and services for everybody. And for that category of goods, we worry that if we have purely decentralized provision, then there are going to be people left behind. There'll be pockets where that's just not done, in particular poor areas and so forth. So spillovers and equity are the two parts of the lens I want to use. When I then think about the papers we've heard about infrastructure, healthcare, and education, I want to take that lens to those places.

I'll try to wrap up quickly, but I was basically trying to say: Let's take a simple lens and cast it on three of the papers that talked about specific categories of fiscal federalism. Let's think about spillovers and equity concerns as really being the reason we're drawing central governments into the fray while trying to preserve the benefits of local provision. I won't talk much about the infrastructure paper, but infrastructure, if you think about the two parts of my simple lens, is an area where we go to central financing or central involvement because of spillovers. It is all about spillovers. It's really not about equity at all—it's not about some communities having more potholes than others and us thinking that's not fair. And what emerges from that spillover focus in the fiscal federalism literature is the recommendation that you have the central government pay for the portion that spills over. If it's 30 percent, then that's 30 percent the central government would cover to get the incentives aligned. And it has to come in the form of a matching grant so that the local government bears only 70 percent of the cost. And of course you have to pay attention to all the other things that were mentioned in the infrastructure paper.

Then let me turn to the fifteen most depressing minutes that we've had today, which is the healthcare paper. If you haven't looked at the paper, you need to. I mean, the level of detail and richness in that paper is extraordinary. You are going to learn stuff by reading that paper, just about what there is, to begin with. It's sort of a tour de force of the healthcare system, but then the paper takes you down a bunch of alleys of possible solutions that end up being dead ends. Much of what people think about, they argue, won't solve the fundamental crisis we are facing in terms of the cost of the healthcare system. One thing we could do, however, and what we should do, they argue, is to block-grant healthcare to the states and allow innovation and cost savings and things like that to happen there.

When we think about why are we looking in healthcare to the government—the central government—in my lens, it's really much less about spillovers and it's all about equity. We care about the fact that we want some basic level of access to healthcare for everyone. And yes, there are some spillover issues, but I think that's just not the primary motivation as it is for infrastructure. And if equity is the primary motivation for fiscal federalism in healthcare, then block granting is actually exactly the right tool that you'd want to use. In that case, unlike the case of spillovers, you don't want to distort incentives through matching grants to cause local governments to want to spend more. Matching grants lower the price for local governments, but block grants don't. They just make funds available at the more local level to insure the equity concerns are met in places with fewer resources.

In other words, with healthcare, you're not trying to internalize spillovers; you're trying to make enough resources available for state and local governments to then be able to run programs innovatively and so forth. And so I'm not sure the paper actually talks about the second part that you mentioned in the talk, that yes, we should do block grants and then we should start cutting them to bring costs down. I'm not sure that I saw that part in the paper, but that is a way to curb the overall expenditures on healthcare while hoping that local innovations will fill in the gaps. But how much we can do that, and how far we can get to addressing the cost problem without decimating healthcare, by simply block granting, is anybody's guess. But it certainly seems like a very sensible way of moving in a direction that's consistent with the theory of fiscal federalism that we have.

Which brings me to the last topic, which is education. And I'm going to ask you for a second to forget everything that you know about how education works in the US. We've learned from Rick's [Eric A. Hanushek] paper that it's the most complicated system in the world, and it's not producing the results we want. It is not working very well at all. And we've learned that there are big disparities across states. And when I now put my lens on and ask why we would ask higher-level governments to become involved—spillovers or equity—I find myself concluding that, well, it's actually both with education. It's certainly equity. Kids need to have access to some basic opportunities. And it's human infrastructure of a kind, and it has the kind of spillovers that physical infrastructure has. Not all the spending that you do investing in kids is going to stay within your jurisdiction—it will have large benefits that transcend local and state boundaries, just like interstate roads.

So if infrastructure is all about spillovers and healthcare is all about equity, education has both elements. And if you imagine coming down from Mars and knowing the basic principles of fiscal federalism and seeing how we are thinking about healthcare and infrastructure, and then you compare that to what we do in education, you would be puzzled, because you would say, wait a second. It seems like the argument is even stronger for federal funding in education—not only for equity as in healthcare but also for spillover reasons as in physical infrastructure. And yet we have almost no federal involvement on the fiscal side in education. We have some other kinds of federal involvement, some of which—as Rick goes through in his paper and argues—is kind of backward, but almost all the money for education comes from local and state governments.

And that's the provocative element of my comments, which is to say: if you knew nothing about the history of how we got to this point, you'd expect education to be largely financed at the central level but provided at the state and local level. I mean, we obviously know the history of how we got here, and so we understand why that is not the case. Education emerged from the bottom up, and that's how the system kind of emerged and that's how we got to where we are. And there were big healthcare initiatives in the sixties, and since then, from the federal government. So that started from the top down. But if you're simply looking at the basic principles, you would be wondering why on earth we're doing this in education. Why are we doing it this way? And I understand that probably the big concerns about, well, if the federal government were really to block-grant big money to states and say, go and implement a good education policy, that the fear is, of course, that all the restrictions would come along with it and they'd start running schools.

But that's the same problem in other areas—like healthcare and infrastructure—where we think we can use block grants or matching grants to harness the power of local control and local decision making while at the same time addressing spillovers and equity concerns. So I'll conclude with that and have us ponder whether we shouldn't just go move to a very different system, especially in light of the evidence Rick presents that we are not doing very well in education under the current way of doing things. I'm curious to see what people think.

DENNIS EPPLE: As Tom [Nechyba] explained, he and I agreed we would each comment on papers in both sessions but with each taking primary responsibility for a subset of papers. My primary focus is on three papers, those by Rick, Michael [McConnell] and Valentin [Bolotnyy], and Josh [Rauh] and Jillian [Ludwig].

I think Rick's is a superb paper. It was educational to me to read it. The only part of the education system that you hadn't touched on much in your paper, Rick, was local delivery of education. However, you did take on that topic in your talk today. In addition to charter schools and private schools, a long-standing form of school choice in the US is parents voting with their feet. Regarding this form of school choice, Boston is very interesting from a research perspective, because school districts and municipality boundaries are coterminous. By contrast, in most places in the US, the boundaries criss-cross, complicating the task of analyzing the combined effect of local public services provided by municipalities and school districts.

When I was a graduate student a "few" years ago, the prevailing theory was that wealthy people would move into a suburb; poor people would then move into the suburb to share the benefits provided by the wealthy; the wealthy would then move on to another suburb; and so on. In short, there would be an endless game of musical suburbs. What we see is nothing of the sort. The graph on the screen shows median incomes of Boston municipalities in 2010 on the vertical axis and median incomes in 1970 on the horizontal axis. The 1970 incomes are inflation adjusted to 2010 dollars for comparability. What is most striking about this graph is that the hierarchy of municipalities by income in 2010 is remarkably similar to the income hierarchy in 1970. We do not see musical suburbs. Households do vote with their feet, but residential choice is typically followed by long-term occupancy, not frequent relocation.

A household's preferred suburb is very much dependent on the household's income and the associated ability of the household to afford housing in the suburb. Over time, communities tend to maintain their place in the income hierarchy. The sorting by income observed in the Boston metropolitan area is prevalent in all US metropolitan areas.

School choice plays a significant role in this sorting of households across local jurisdictions. In the data we have for school districts, showing the fraction of kids that are on free or reduced-price lunch, you can see how much the achievement scores go upward as you move up the income hierarchy in these jurisdictions. So, Tom MaCurdy, I completely agree with you on the equity issues; we still face the major challenge of finding a way to bring up the bottom part of the educational performance distribution. Great paper, Rick. I really liked it.

I will next turn to the infrastructure paper. I think it's also an excellent paper. Michael and Valentin make a strong case for user fees for funding infrastructure. And I am largely in agreement with their view. Those of you who are older members of this group will know about what may be the most famous user fee ever imposed; it was celebrated in "Charlie on the MTA" [a popular song from 1949]. At that time, the Boston Metropolitan Transit Authority, MTA, proposed a fare increase from ten to fifteen cents. The turnstiles for entering the subway could only accept one coin. Hence, the fifteen-cent fare would be implemented by requiring a dime for a passenger to go through the turnstile on entry and a nickel to exit the turnstile when a passenger reached their destination. Mayoral candidate Walter O'Brien opposed the fare increase. The Kingston Trio popularized the song "Charlie on the MTA," which was a campaign song for O'Brien. Charlie, the protagonist of the song, paid a dime to enter but did not have a nickel to pay the exit fare, stranding him on the train for eternity.

One important form of user fee is the congestion toll. Congestion tolls have caught on elsewhere in the world more than they have here in the US. That would be worth discussing in the paper. It would also be of interest to discuss what happens to the revenues from user fees. David Pearce in 1991 coined the term "double dividend" to capture the idea that congestion fees create more efficient use of the infrastructure and also generate revenues. This was further explored in some subsequent literature.

Turning to another form of user fee, Larry Goulder here at Stanford was one of the most prominent contributors to the literature discussing Pigouvian taxes for environmental externalities. Based on information on the Transport for London web page, the congestion charge for London is £15 if you drive within the congestion charge zone between 7 a.m. and 6 p.m. on a weekday. On Sundays and bank holidays and Saturdays, the toll applies from noon to 6 p.m. Also, if your vehicle does not meet the Ultra Low Emission Zone standards, you must also pay the Ultra Low Emission Zone charge. So they're really addressing two externalities at once, congestion and pollution. The London toll appears to be a relatively successful application of user fees. The London transport authority, Transport for London, reported in April 2005 that two years on, congestion within the charging zone has reduced by 30 percent, and the volume of traffic in the charging zone has reduced by 15 percent.

An example much closer to where I reside is the Pennsylvania Turnpike. As you probably know, the Pennsylvania Turnpike was the first limited-access highway in the US, and it's financed by user fees. Your entry point to the turnpike and your exit point are electronically recorded. The fee you pay depends on how far you have traveled. In 2007, the state legislature required the Pennsylvania Turnpike to transfer the following amounts in millions of dollars annually to the Commonwealth—the state calls itself the *Commonwealth*—to support transportation projects statewide: $750 in 2008, $850 in 2009, $900 in 2010, and $450 annually from 2011 through 2057. So, basically, user fees on the turnpike are now turned into fees to finance transportation elsewhere in the state. In the fifteen years since then, since 2007, the Turnpike Commission has transferred nearly $8 billion in funding to the Pennsylvania Department of Transportation. The vast majority of that was borrowing by the Turnpike Commission to hand over the money to the state government. So the Turnpike Commission now has a larger outstanding debt than the state of Pennsylvania, and they have to pay it off in the next thirty years.

When I found out about the use of turnpike fees, my first reaction was, "Wow, this is just outlandish." But then it also raises an interesting issue. The turnpike is in some respects close to a monopoly. If you want to get across southern Pennsylvania, the turnpike is the only practical way to go. So, from an efficiency standpoint, maybe it's not a bad way to fund other state projects, because not very many vehicles are going to be deterred from using the turnpike. So I feel a little less strongly about use of funds from the turnpike than I first did, but I am still dubious about it.

Another example of user fees run with unintended consequences is the National Flood Insurance Program. I learned about aspects of this program from two research projects, one from having a doctoral student, Caroline Hopkins, who did research on this topic. The other is my niece, Jennifer Argote, who completed a doctoral degree from LSU [Louisiana State

University] recently and gathered a gold mine of data to study this topic. The National Flood Insurance Program [NFIP] is designed to incentivize local communities to harden protection against prospective floods and to prevent location in zones at high risk of flooding. The quid pro quo from the federal government is subsidized insurance. You can probably predict what's happened with this. Local developers and local governments are all for development. My niece shows that with the subsidized premiums, homeowners in high-risk zones do not pay the price that reflects the flood risk. Therefore, people can continue to live in high-risk areas, some of which are repetitively damaged, costing the taxpayer-funded program billions of dollars. In 2022, the NFIP was $20.5 billion in debt. So this is another example of a fee for service, but way too heavily subsidized. I would say there are two issues here. There's a moral hazard issue, that we're subsidizing so much that there is overinvesting in flood zones. There's also a time inconsistency issue, because when there are severe floods, the federal government jumps in and bails out those who have lost their homes even if they are not insured.

My comments note some challenges in keeping user fees from being distorted to serve purposes for which the fees are not well suited. That said, I want to reiterate that I am in broad agreement with Michael and Valentin about the value of user fees. I think they have written an excellent paper.

Let me next turn to the paper by Joshua and Jillian, which is another fine paper. One of the issues that they discuss is unfunded, or underfunded, pension liabilities. My colleague Chester Spatt and I wrote a paper in 1986 on why we have state restrictions on local debt. The background is that prior to state restrictions [being placed] on local debt, municipal defaults were commonplace. In the late 1870s, 20 percent of municipal debt was in default. That made it devilishly difficult for other municipalities to borrow. Defaults often occurred when an undertaking by a local community failed. For example, some communities borrowed to make investments to try to lure the railroad to come through their town. If the effort failed, default often followed. The problem of defaults prompted states to place restrictions on local debt, and that largely ended defaults on local government debt. State governments adopted similar restrictions on state borrowing, and for the same reason.

The nearest to default since adoption of such debt restrictions was New York City in 1975. The city was $150 million in debt and called on then president Gerald Ford to bail them out. And everybody my age or thereabouts knows what the *Daily News* headline said: "Ford to City: Drop Dead." There's a beautiful article, by the way, in the *New Yorker* in 2015, telling the story.

The article conjectures that Jerry Ford probably lost the subsequent presidential election because that headline became such a prominent nationwide news item.

So, what happened when local governments faced binding debt restrictions? Many turned to underfunding of pension liabilities to current and former public employees. Pittsburgh was out in front on this; well, actually, not in front of Philadelphia. Philadelphia was even worse. Instead of raising taxes to raise contemporaneous wages, cities promised generous pension benefits and kicked the can down the road. Eventually the state stepped in, because this problem was getting so severe and public employees were pressuring the state government to fix the problem. The state mandated, with threat of receivership, that the cities had to deal with their unfunded liabilities. The Pittsburgh city government owned all the parking garages in the city. The city paid its unfunded pension liabilities by selling the revenue stream from their parking garages. They didn't sell the garages, presumably because then the private owners would have to pay property tax. So they continue to own them, but they sold the revenue stream.

It was a pleasure to read these excellent papers. Tom [MaCurdy] mentioned the equity issue, and I meant to bring this up in the context of the last paper. The most depressing economics graph I've ever seen was published in the *Journal of Political Economy* by Chinhui Juhn, Kevin Murphy, and Brooks Pierce in 1993. The graph shows real wages. What it shows is from roughly 1960 to 1970, regardless of what percentile of the earnings distribution you were in, you were in a rising tide raising all boats. And then the median went flat, the lower plummeted and the upper took off, and we had this huge increase in income inequality.

Michael W. McConnell: Is that pre-tax?

Epple: Yes. I think these growing public federal program expenditures are in part because of the growing income inequality. There is a graph from a paper by Florian Hoffmann, David Lee, and Tom Lemieux in the *Journal of Economic Perspectives* in 2020 that shows income percentiles from 1975 to 2020. It shows that what's happened is that the increase in income inequality that started in the 1970s has continued. And I think this increasing inequality has been a major driver of why we're seeing more federal spending.

Another factor affecting federal spending is the proportion of the population over sixty-five—this came up in Tom's presentation. That proportion has gone from 12.5 percent in 1990 to 17 percent today. The forecast by 2050 is that 22 percent of the US population will be over the age of sixty-five. And so contemplating what that's going to do to government expenditures and deficits is very unsettling indeed.

BOSKIN: We've seen inequality reverse considerably from 2017 to 2019, for example. Not a lot, but even the trend toward increased inequality had reversed for a bit.

EPPLE: Yes, there has been some reversal.

BOSKIN: It actually had reversed. It actually had reversed prior to COVID. Traditional measures.

NECHYBA: But consumption inequality is much less.

BOSKIN: Exactly.

EPPLE: Yes, I absolutely agree with that.

BOSKIN: Taxes and transfers have made a huge difference. And the inequality in consumption is far less than inequality in market income.

I would just make two quick comments. One is on demography. It's not just over sixty-five, but within the elderly population, the elderly are growing much more rapidly. So the fraction of the population over eighty-five is the most rapid, from a lower base, is the most rapidly growing part of the population. Gets back to Jay's point about . . .

I was also going to say, we started with legal issues and what the framers were thinking about when they thought about a federal structure. And we've hit on that a fair amount on and off. For example, the California rule on pensions. There's no state bankruptcy law. So it's maybe somewhat less ambiguous than—maybe more ambiguous than you indicated, Josh, about what would happen, whether Jerry Ford would say, "Clean up your own act, we're not going to do anything." But for a locality, that isn't the case. And we've seen states come in and bail out school districts and towns and cities, etc. But it seems to me, we get back again to this confluence of the legal system and politics and the economics being deeply intertwined maybe in David Kennedy's marble cake formulation. Do I have . . . anybody make any additional comments?

Eric A. Hanushek: Clarifying question, I didn't understand why it mattered how you spent the user piece.

Epple: First of all, if I wasn't clear, let me say that I think Jerry Ford did exactly the right thing by not bailing out New York City. I think it matters what you do with the user fees, again, from a potential moral hazard perspective.

Hanushek: But you can do bad things with it and you can also have bad incentives.

Epple: As I said at the outset, I'm very, very, very strongly in agreement with you about user fees. But then I was thinking about a couple of examples, and I'm not even sure it was misguided what the Turnpike [Commission] did, but it really strikes me as a bit of an issue. The National Flood Insurance Program is more problematic. But my general concern when you're generating a surplus with a user fee is—

Hanushek: It encourages you to do bad things.

Epple: Yes, I think that is a significant risk. I don't mean to be too much of a pessimist. As I said, I am very much in accord with the view that user fees are the way to go.

Rauh: Well, your example, the fact that the Turnpike Authority's ability to issue bonds to borrow was much greater than that of the state government. And so it becomes then a vehicle for borrowing and for circumventing balanced budget requirements.

Hanushek: That's what New York State did, they sold the turnpike because they had a zero-debt requirement and they couldn't go into debt, so they sold the turnpike.

MaCurdy: Actually, Tom [Nechyba], I have a concern about your analysis examining this spillover and equity program by program. In the area of healthcare, there's clearly a trade-off and balancing across multiple programs. For example, most services for mental health are paid through state funds. The federal government deems such services as part of its responsibilities, and to assist states in paying for these services, [it] overcompensates states in covering healthcare programs jointly paid for by the feds and states. So the state has more funding in mental health. The feds typically impose regulations governing what states must abide by to receive extra funding in shared programs. I would suspect this phenomenon also happens in school funding. The federal government doesn't look at it program by program. But it's surprising how much influence they have, given how low their contribution is, through regulations.

Boskin: That's a pretty fundamental point we all teach in public economics, that there's a permeable membrane between spending and mandates and rules and regulations. And we saw a horrible example of that in the housing markets and rules and regulations leading into the financial crisis.

Val's done some important work on this and I think some pieces of it were overstated, but basically it came clear: if Congress can't spend more money, they'll try to find other ways to accomplish its objectives. We're all human, and that may be creative funding via turnpikes or whatever it happens to be. I do want to end on one deep insight, but more of a fun quip, is that George Schultz, who started his cabinet position (actually it wasn't yet a cabinet position) as director of the budget, was fond of saying that from his observation over a long span of time, both Democrats and Republicans want to spend more, but Democrats enjoy it more.