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Matching funds hindered growth of Texas economy

By **ANTONY DAVIES**
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While free money from the federal government sounds like a good deal - who doesn't want a six- or seven-figure check from Uncle Sam to pay for state programs - it turns out that things are a bit more complicated than that.

There's overhead, for instance. Obtaining federal matching funds requires substantial lobbying by state officials, time that might otherwise be spent finding in-state means of addressing problems paid for by matching funds. Once the money is received, continued attention and maintenance on the federally funded projects is required, tying up legislative and financial resources that might otherwise be spent more productively.

And, of course, they are called "matching funds" for a reason - Texans have to come up with a chunk of cash for Washington to match. This means diverting tax revenue from other uses, imposing new taxes or increasing existing taxes. What kind of impact does this have? Looking at data for Texas from 1970 through 2006, we find that a \$10 billion increase in federal matching funds is associated with a \$20 billion decline in the state's GDP. On average, Texas is worse off after receiving matching funds than it would have been had it refused the money.

Previous studies have shown that federal matching funds are overwhelmingly used to fuel consumption spending (e.g., spending on goods and services that are used up quickly) rather than investment spending (e.g., spending on infrastructure). Unfortunately, government consumption spending is associated with reduced economic growth, as a state borrows money to undertake projects with little long-term value, and later winds up with a hefty bill and nothing to show for it.

Another problem with federal matching funds is that "free money" encourages the state to do things that aren't being done already. When the private sector isn't providing a good or service that politicians want, it's often because the benefits of providing it don't outweigh the costs. This should be a red flag to any right-thinking state legislator, but it's usually just interpreted as a green light to spend more money.

A telling lesson is found in my own state's capital city. Harrisburg, Pa., is close to bankruptcy because of the nearly \$300 million it spent building a new incinerator. Private investors had an opportunity to invest in the new incinerator, but determined that the risk was not worth the investment. Rather than taking this as a warning that the investment was unwise, the city plowed ahead and borrowed to the hilt - only to see the predictions of the private investors come to pass.

When a state accepts federal matching funds, it not only diverts current tax dollars to projects that would not otherwise be supported, but also requires that the state raise additional future tax dollars to maintain the spending that the matching funds initiated. To put it simply: If spending the money is such a good idea, then why does Texas have to be bribed into it?

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The end is near for the Lone Star State — at least it is if you listen to the hundreds of protesters who have gathered in Austin in recent weeks to protest proposed spending cuts to plug Texas' \$27 billion budget hole. Education, the arts and medical spending are among the categories on the chopping block, and even the GOP can't agree on whether the cuts are a good idea.

Much of the hand-wringing has to do with the loss of federal matching funds - a promise by the federal government to provide Texas with money for a program if the state first spends money of its own. If the state cuts its share of this money, the matching funds from Washington are cut along with it.

But this isn't nearly the tragedy that advocates' hyperbole would suggest. An analysis of more than 40 years of data that I completed with a colleague at Duquesne University demonstrates that matching

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