

# The Federal Budget and the States

## Fiscal Year 1997

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### A NOTE ON THE FEDERAL FISC

Technically, the term “Fisc” refers to a state, Federal, or royal treasury. In this report, we adopt a geographic perspective and we utilize the term “Fisc” to refer to the financial flows between the Federal government and the states. We look at a range of taxes that represent the total Federal tax burden, including: individual income tax; corporate income tax; estate and gift taxes; employment taxes; Social Security taxes; and, excise taxes. On the other side of the equation, we consider: payments from the Federal treasury to state and local governments, Federal employees, individuals (e.g., Social Security payments) and government contractors. The net balance of these financial flows is the Federal Fisc.

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As the nation seems poised to record its first balanced budget in 30 years, debates about the fairness or equity of the distribution of Federal spending are more sharply focused and louder than ever before. The share that a state’s citizens and businesses receive of the approximately \$1.3 trillion in domestic Federal spending, and the share that a state’s taxpayers pay of the roughly equal amount collected in Federal taxes, have a substantial impact on economic activity. Nor is it any great secret that these impacts vary considerably across the states. Citizens in some states receive much more in Federal spending than they pay in taxes; for other states the tax burden far exceeds spending.

There is no definitive consensus as to whether an important *purpose* of the Federal financial system is to redistribute economic activity across states, or whether such redistribution is merely a *result* of decisions taken with other motivations. There are at least three starkly differing conceptions of the Federal financial role embedded in different parts of the ongoing debate:

- That the Federal Fisc should be *designed to be neutral* across states — that is, that each state should “get back” a close approximation of what it pays in. Under this conception, the Federal government would be operating mainly as a unified tax system, but its existence would not change the resources available, on balance, for programs in individual states;
- That a central purpose of the Federal financing system should be *to rebalance*

*the resources* available across the states, using resources available from states with wealthier taxpayers or stronger economies to finance programs that would not otherwise be possible in less wealthy states using their resources alone; and

- That net redistribution of resources and economic activity across states is *a more or less accidental by-product of individual programs* designed to achieve important Federal purposes. Following this logic, programs are located wherever activities need to be or can best be carried out and are financed through a unified tax system based largely on income but that makes little or no direct reference to location.

Given this lack of consensus, it should be no surprise that concerns about whether states receive a “fair” proportion of Federal expenditures — or pay more than their “fair” share in Federal taxes — have become a prevalent feature of Federal policy debates. Consider, for example, the recent battles for the reauthorization of the Federal surface transportation programs (officially known as the Intermodal Surface Transportation Efficiency Act or ISTEA). For many years, during the most active period of Interstate Highway construction, Federal apportionment formulas were not principally concerned with the geography of supporting tax revenues.<sup>1</sup> Congressional representatives were focused instead on the significant new highway construction being generated. This focus on Federal spending changed as the Interstate Highway system neared completion. The

<sup>1</sup> Construction of the Interstate Highway system was supported by an excise tax on gasoline sales and motor vehicle fees.

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**A NOTE ON THE COST OF LIVING INDEX (COL INDEX)**

Average per capita income is a key factor in the balance of payments equation through its influence on Federal tax burdens and the distribution of the means-tested portion of allocable Federal expenditures. However, Federal tax policy does not take into account discrepancies in the cost of living across states nor do Federal programs (with the notable exceptions of some entitlement programs such as Medicare and Medicaid) adjust the level of outlays to account for regional cost of living differences. The real level of services provided by a given level of nominal spending varies with the costs of providing those services in a state. Residents of higher-cost states receive fewer real services from a given nominal level of Federal spending than residents of lower-cost states. In addition, changes in costs over time affect the real level of services even within a given state.

To facilitate a comparison of the real impact of fiscal flows to and from the Federal government, we adjust all tax and spending data in this study by a State Cost of Living Index (COL Index). This index was developed by Herman B. Leonard and Monica E. Friar of the Kennedy School of Government at Harvard University and is presented in a working paper entitled, "Variations in Cost of Living Across States" (Taubman Center for State and Local Government, 1998). The index measures the relative changes in costs across states and across time for the past 16 years using regional and selected area Consumer Price Indices applied to family budget data. (Appendices A and B provide a more detailed explanation of this data adjustment.) Unless otherwise noted, all tax and spending figures are reported in cost-adjusted, 1997 dollars.

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1987 highway legislation guaranteed donor states a minimum funding allocation equal to 85 percent of their contribution to the Highway Trust Fund and this minimum was increased to 90 percent when the ISTEA legislation was enacted in 1991.<sup>2</sup>

As legislators geared up for reauthorization of surface transportation legislation in 1997, the flows of funds between the states became the primary focus of attention. One group of states, the STEP-21 coalition, called for the minimum funding allocation for each state to be increased to 95 percent of the money it contributes to the Highway Trust Fund. Senator John Warner of Virginia summed up the concerns of these Sunbelt and midwestern states when he threatened that the legislation "will not see the light of day unless *fairness* is brought into the formula. It is as simple as that"<sup>3</sup> (emphasis added). Regional disputes on the equity of transportation funding were clearly at the heart of the stalemate that delayed passage of new legislation until May, more than six months after the ISTEA authorization expired.

Ultimately, Congress relied on a traditional solution to resolve the surface transportation stalemate — increasing the "size of the pie" to ensure that almost every state will receive funding at least equal to the prior year's level. The spending levels authorized in the successor legislation to ISTEA, officially known as the Transportation Equity Act for the 21st Century or TEA-21, fall well outside of the budget parameters that had been agreed to by the President and the Congress. Such a "traditional solution" cannot be replicated on a wide-scale basis without jeopardizing plans for balanced budgets and tax relief in coming years.

A similarly bitter and intense debate surrounded the recent overhaul of Federal welfare programs. Having provided the states discretion to set program rules, there is relatively little policy to be set at the Federal level other than the distribution of Federal funding levels across states. For example, in the past, Federal grants for welfare matched state contributions, so that states had an incentive to contribute more. If the new block grants were distributed based on prior year allocations, states that were receiving a relatively large amount of Federal support because of their own efforts would more or less receive permanently higher funding as a result — even if they reduced their own efforts. No surprise then that coalitions formed in Congress in the interest of finding "*fair formulas*" to allocate and distribute funds.<sup>4</sup>

One problem with these policy debates is that the extent and direction of subsidies between the states is widely misunderstood. Not much can be said about the overall fairness of the geography of Federal spending by examining individual programs by themselves. In this annual report, we step back from the distribution of each Federal pro-

2 In reality this was an artificial constraint. Congress adopted a policy that utilized existing surpluses in the Highway Trust Fund as a means to allow highway spending to exceed the amount of gas taxes earmarked for road construction. As a result, almost all states were able to get more in highway spending than they sent to Washington in taxes. See David Luberoff, "A Tale of Two Tables," *Governing*, May 1997.

3 David Luberoff, "A Tale of Two Tables," *Governing*, May 1997.

4 At one point, Senator Kay Bailey Hutchison of Texas, joined by a group of 30 Senators from Sunbelt states and California, proposed an AFDC formula that would take child poverty rates and the size of the state into account. If it had been enacted, more money would be directed to Southern states and states with small populations. See Monica E. Friar and Herman B. Leonard, *The Federal Budget and the States*, FY 1994, page 66.

gram and look instead at the geography of the approximately \$1.3 trillion of domestic taxing and spending that the government undertakes each year. To the extent that policy decisions are driven by beliefs about the distribution and equity of Federal funds across the states — and, to a considerable extent, they *are* — we hope that this research can help to bring those policy forces into alignment with the realities instead of the myths.

To undertake this analysis, we obtained geographic data on Federal tax collections and the location of Federal expenditures.

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**AS AN INTERESTING SIDENOTE,** Thomas Anton credits President Lyndon Johnson with the initiation of steps that led to a comprehensive database of Federal expenditures by state. In preparation for a meeting in Texas with a group of state governors, President Johnson had a series of reports prepared to show each governor how much his or her state was receiving from the Federal government. Following this meeting, the Bureau of the Budget established a regular basis for the collection and publication of this information (an extremely labor-intensive effort at the time). The Bureau of the Census took over this effort beginning with Federal FY 1981 and the methodology was revised at that time. See Anton, Thomas J., “Outlays Data and the Analysis of Federal Policy Impact,” in Norman J. Glickman, ed. *The Urban Impacts of Federal Policies* (Baltimore, MD: The Johns Hopkins University Press, 1980) page 122.

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Appendix A details the sources of our data. The National Tax Foundation annually presents estimates of Federal tax collections by state, and these estimates underlie our analysis of the geography of Federal taxes. The Bureau of the Census provides reasonably consistent historical geographic data on Federal expenditures; these figures provide the basis for our analysis of expenditures.

Appendix B lays out in detail the concepts and methodology we have developed and applied. For purposes of the analysis presented here, we exclude those aspects of Federal spending that do not occur domestically (for example, defense expenditures made in other countries), or for which we cannot get geographic data on the recipient distribution

(most prominently, interest payments on the Federal debt). So as not to treat the Federal deficit as a free source of resources (each dollar of debt, and the interest on it, is eventually paid — even if only by issuing additional debt), we distribute an amount of taxes equal to the total amount of domestic spending for which we can get geographic allocation information.<sup>5</sup> Throughout the report, we adjust figures for taxes and spending to account for differences in costs of living in different states.<sup>6</sup> These indices are listed in Table C-2 of Appendix C. Thus we are examining the flows of “purchasing power” gained or lost as a result of each state’s financial relationship with the Federal government.

*The difference between Federal spending received and taxes paid is the “balance of payments” between each state and the Federal government.* A positive balance of payments indicates that a state receives more from Federal spending than it pays in Federal taxes. These states experience a net gain in economic activity as a result of Federal policies and might be described as recipients. A negative balance of payments indicates that the state is a net donor — it pays more in Federal taxes than it receives in Federal spending.

In a system where Federal policies are either explicitly designed to redistribute economic activity across states, or where commitments are made without reference to geography, there will always be donor and recipient states. We have no presumption that the net flow of economic activity is either desirable or undesirable. In this annual report, we simply present what the different outcomes are and try to understand how they come about — that is, to explain the major forces that drive the differences in outcomes across states.

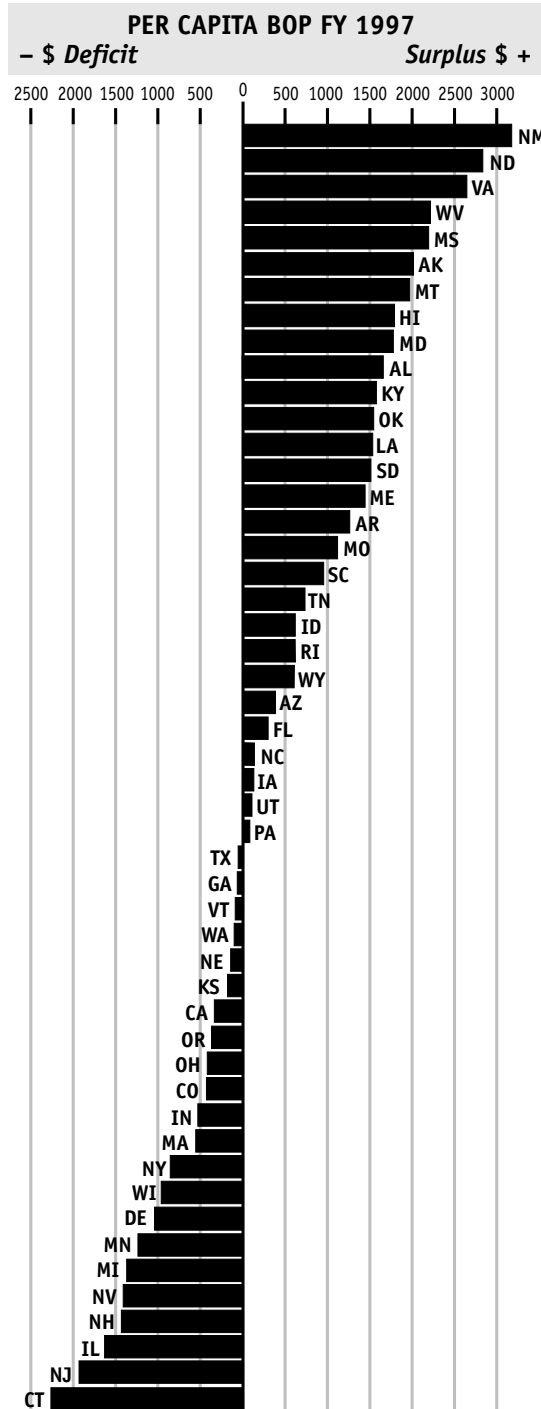
<sup>5</sup> We refer to this as a “balanced-budget” approach to examining the geography of Federal spending. We are thus focusing on the question, “What is the net geographic impact of Federal spending on allocable, domestic Federal programs, together with the tax collections necessary to fund those expenditures?”

<sup>6</sup> The real level of services provided by a given level of nominal spending and the real burden from a given level of nominal taxes will vary depending on the cost of living in a state. Residents of low-cost states receive more real services from a given level of nominal spending than residents of high-cost states; the effect of taxes is reversed.

### The Balance of Payments in FY 1997

A wide disparity in the financial flows between the Federal government and each of the states has been a consistent feature of

**Figure 9**  
The graph to the right shows the per capita balance of payments for each state, FY 1997.



U.S. fiscal policy over the past two decades (and probably for many years before that). In past reports, we have commented that significant balance of payments surpluses and deficits are not confined to a few states. In FY 1997, more than half of the fifty states had balance of payments surpluses or deficits that exceeded \$1,000 per capita, approximately 20 percent of the average Federal spending level (about \$4,900 per capita). Figure 9 depicts each state's per capita balance of payments surplus graphically and is organized in rank order. The states at the top of the graph experienced net inflows as a result of their financial relationship with the Federal government; the states at the bottom are donor states — they pay more in Federal taxes than they receive in Federal spending.

New Mexico has consistently led the nation with the greatest per capita balance of payments surplus and its FY 1997 surplus of almost \$3,500 per capita was almost \$700 greater than any other state. Driven largely by defense spending and intergovernmental grants, Federal spending in New Mexico was about 46 percent above the national average. In contrast, tax collections from New Mexico, which are highly correlated with per capita income, were almost 25 percent below the national average.

North Dakota's per capita balance of payments surplus increased by almost 77 percent over last year and it moved up to the number two ranking in our analysis. Dramatic increases in agricultural subsidies and Federal grants were responsible for a 20 percent increase in Federal spending in the past year.

At the other end of the spectrum, Connecticut's balance of payments deficit has been among the highest in the nation throughout this decade, and its FY 1997 deficit of almost \$2,300 per capita moved it

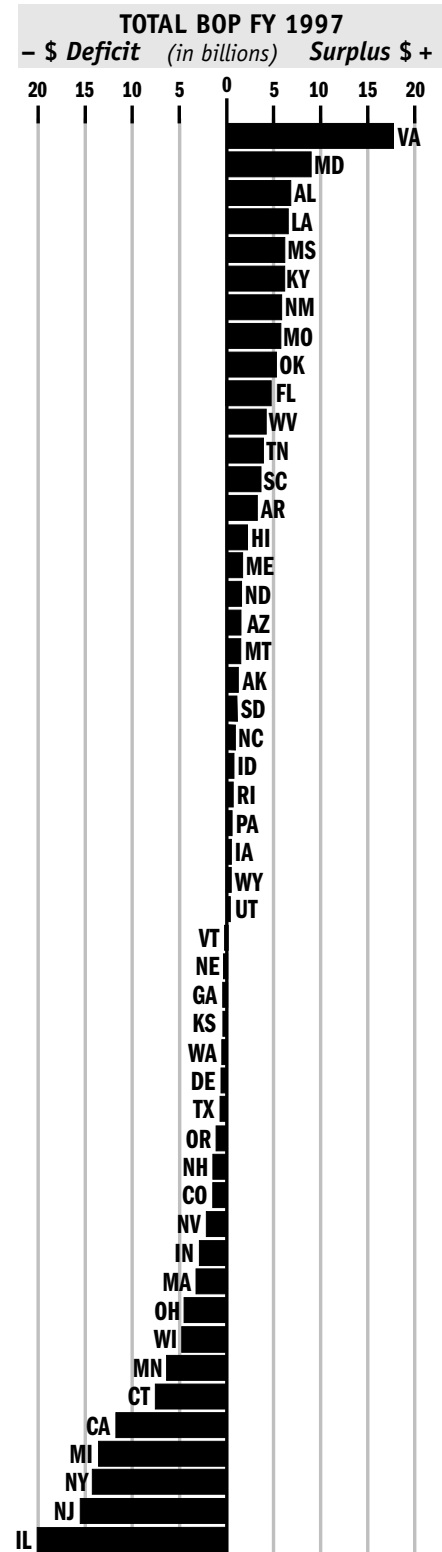
Figure 10  
Total Balance of  
Payments, FY 1997

back into the bottom spot this year. Connecticut residents enjoy the highest per capita income in the nation and Federal taxes collected are almost 40 percent above the national average. Defense spending has fallen by more than 70 percent since the early 1980s which accounts for much of the sharp decline in Federal spending.

Table 2 presents an alphabetical listing of the states with the per capita balance of payments and the total for each state. Five states had total deficits in excess of \$10 billion; Illinois' deficit of \$20 billion was far and away the highest in the nation (Figure 10). The total surpluses for the capital region states of Virginia and Maryland were far greater than for any other states. Outside of the capital region, Alabama led the nation with a total surplus of almost \$7 billion and several nearby states, Louisiana, Mississippi, and

**Table 2: Balance of Payments, FY 1997**

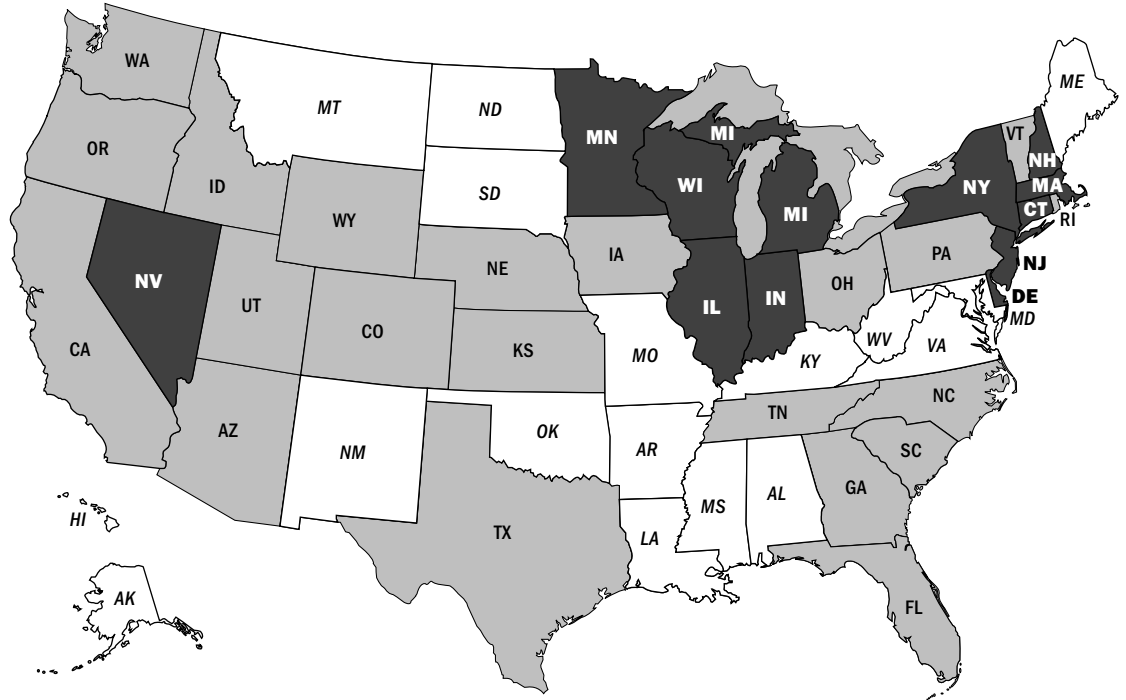
STATE	PER CAPITA	RANK	TOTAL (IN MILLIONS)	STATE	PER CAPITA	RANK	TOTAL (IN MILLIONS)
AL	\$1,603	10	\$6,924	NE	\$(138)	33	\$(229)
AK	2,019	6	1,230	NV	(1,413)	46	(2,370)
AZ	372	23	1,692	NH	(1,419)	47	(1,664)
AR	1,251	16	3,157	NJ	(1,946)	49	(15,674)
CA	(366)	35	(11,800)	NM	3,464	1	5,992
CO	(444)	38	(1,729)	NY	(785)	41	(14,232)
CT	(2,272)	50	(7,430)	NC	134	25	994
DE	(1,030)	43	(754)	ND	2,788	2	1,787
FL	338	24	4,958	OH	(429)	37	(4,801)
GA	(59)	30	(442)	OK	1,539	12	5,105
HI	1,788	8	2,122	OR	(387)	36	(1,255)
ID	637	20	771	PA	44	28	525
IL	(1,688)	48	(20,084)	RI	633	21	625
IN	(511)	39	(2,998)	SC	983	18	3,695
IA	131	26	373	SD	1,507	14	1,112
KS	(174)	34	(451)	TN	741	19	3,979
KY	1,541	11	6,024	TX	(42)	29	(823)
LA	1,521	13	6,618	UT	94	27	193
ME	1,454	15	1,806	VT	(87)	31	(51)
MD	1,767	9	9,001	VA	2,648	3	17,832
MA	(518)	40	(3,169)	WA	(99)	32	(554)
MI	(1,383)	45	(13,515)	WV	2,235	4	4,058
MN	(1,325)	44	(6,209)	WI	(965)	42	(4,987)
MS	2,234	5	6,099	WY	622	22	298
MO	1,108	17	5,987	DC	35,520		18,789
MT	1,925	7	1,692				



**Figure 11**  
**Per Capita Balance**  
**of Payments, FY 1997**

**KEY**

- States with biggest surpluses (over \$1000 per capita)
- States with greatest deficits (over \$500 per capita)
- ▒ Other states



Kentucky, also had total surpluses that were over \$6 billion.

Consistent with our observation in prior years, we noticed a strong geographic concentration of the states with the largest surpluses or deficits. The Northeast and Great Lakes regions are home to almost all of the states with the largest per capita deficits (see Figure 11). There is nothing new in this geographic distribution. The ten states with the highest per capita deficits have not changed in our analysis over the past six years. The combined outflow from these ten states was almost \$87 billion, an increase of about 5 percent in the past year. Moreover, only two of the 17 states in the Northeast and Great Lakes area — Maine and Rhode Island — achieved significant surpluses.

Large surpluses are somewhat less concentrated than large deficits, but there is a noticeable geographic pattern toward the South. Again, there has been almost no change in the past year. Nine of the top ten states were also in the top group in FY 1996.

With a substantial decline in defense spending, Missouri, which ranked fifth in FY 1996, is now 17th in our analysis. The total gain for the ten states with the greatest per capita surpluses was almost \$57 billion, down about \$1 billion from FY 1996.

Of course, two states with similar balance of payments surpluses may have very different underlying situations. Consider the neighboring states of Arkansas and Missouri that have similar balance of payments surpluses. Missouri has been successful in its pursuit of Federal spending, largely due to defense contracts that have been awarded to suppliers in the state. Tax collections were only slightly below average, leaving Missouri with a FY 1997 surplus of about \$1,100 per capita. Federal spending in Arkansas, on the other hand, was only 5 percent above the national average, yet it had a larger surplus of \$1,250 per capita. In this case, tax collections were about 20 percent below the national average, helping to produce the observed balance of payments surplus.

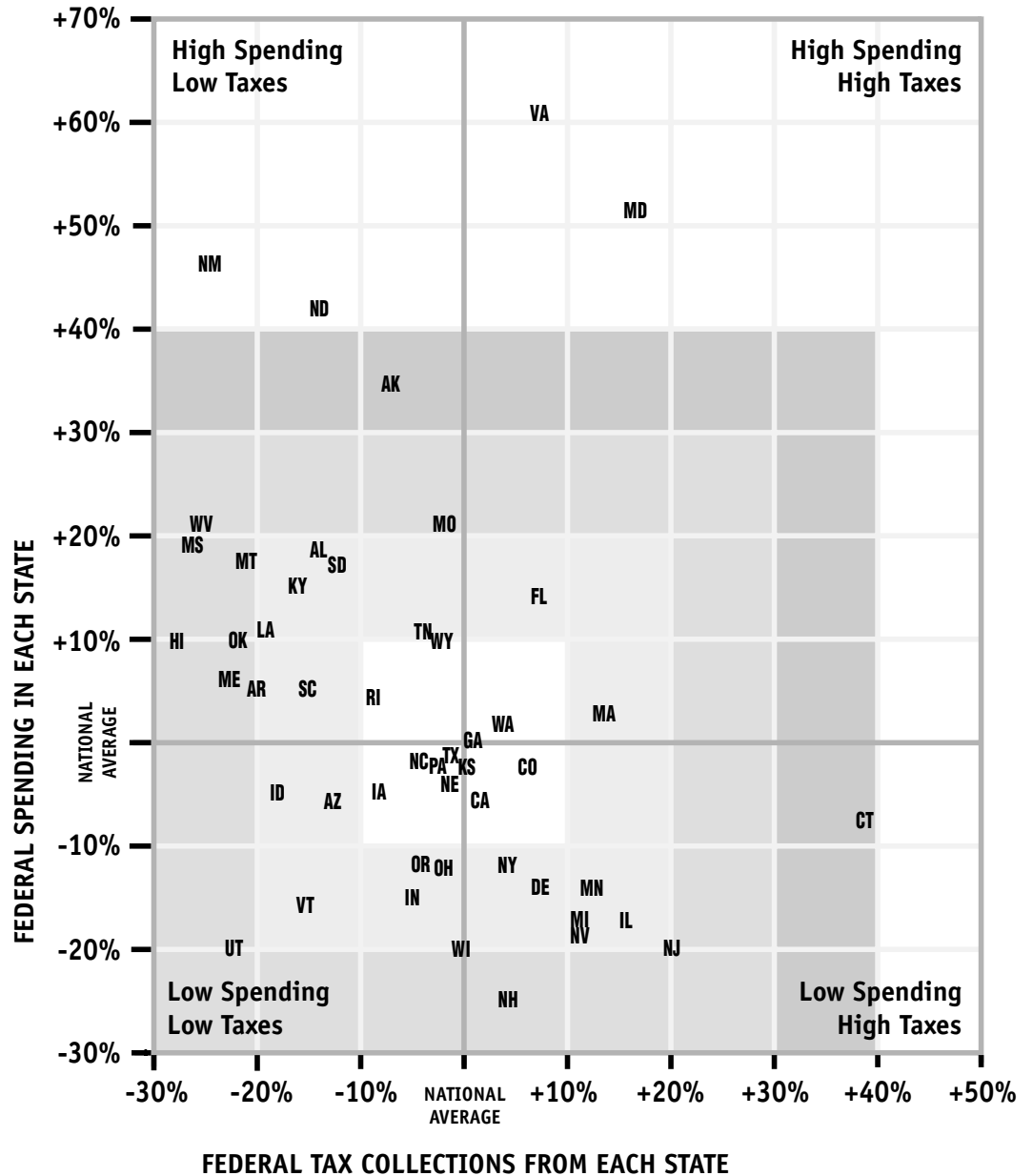
Figure 12 compares taxes paid and Federal spending received to the national average of \$4,917 per capita. The horizontal axis measures Federal tax collections; each state is plotted along this axis according to how much its taxes paid differs from the national average. Similarly, states are plotted along the vertical axis according to the amount that Federal spending in the state differs from the national average. Thus, states whose tax payments and receipt of Federal spending are

close to the national average are plotted near the center of the chart. In practice, relatively few states show up in this area. There are only 11 states whose tax collections *and* Federal spending vary by less than 10 percent above or below the national average.

Moving out from the center, the largest grouping of states occurs in the upper left quadrant, indicating low Federal taxes and high Federal spending. With the exception of Florida and the two states in the capital

**Figure 12**  
*Per Capita Taxes and Spending Compared to National Averages*

Two states with identical balance of payments may have very different underlying situations. The graph separates the effects of taxes and spending and presents the information in comparison to the per capita national averages. The horizontal axis measures Federal tax collections from each state; the vertical axis plots Federal spending. States with high Federal spending and low taxes will appear in the upper left hand corner of the graph. States with high taxes but low Federal spending can be found diagonally across the graph in the lower right hand corner.



region (Maryland and Virginia), all of the states with large balance of payments surpluses appear here. The two states with the largest balance of payments surpluses (New Mexico and North Dakota) stand out with per capita spending that is more than 40 percent above the national average and tax collections that are more than 10 percent below the national average.

Another group of states on the left side of the graph has tax payments that are more than 20 percent below the national average — Hawaii, Maine, Mississippi, Montana, Oklahoma, Utah, and West Virginia. All of these states have per capita incomes that are among the lowest in the nation. Utah stands out in this group. Despite its low per capita income, Utah ranked next to last in the country in Federal spending, about 20 percent below the national average. It was the only one of these states that did not have a balance of payments surplus that was greater than \$1,000 per capita.

Most of the states with large balance of payments deficits are grouped in the lower right quadrant, indicating high taxes and low spending. Connecticut is noticeable for tax collections that are almost 40 percent higher than the national average. New Hampshire stands out with the lowest Federal spending level in the nation. Tax collections for Wisconsin, Ohio, Oregon, and Indiana are equal to or below the national average, indicating that the balance of payments deficits for these states are clearly the result of low Federal spending.

Aside from the states in the capital region, only three states exceed the national average for both taxes and spending. Florida's mild weather and tax policies have attracted an elderly population that benefits from non-means tested income and medical support. Payments to individuals — predomi-

nately Social Security and Medicare — make up more than 70 percent of Federal spending in the state. Federal spending in Massachusetts and Washington is only slightly above the national average and has been falling in recent years. The net effect is a balance of payments deficit in each state.

### ***The Geographic Distribution of Federal Taxes***

The distribution of Federal taxes across states is relatively easy to predict, because virtually every component of Federal taxes is closely related to income. Personal income taxes, the single largest component of the Federal tax system, made up almost 47 percent of total FY 1997 tax receipts and corporate income taxes contributed another 12 percent.<sup>7</sup> Social Insurance taxes based on wages (such as Social Security and Medicare), which have declined recently as a percentage of total tax receipts, account for another 34 percent of Federal revenues. Even excise taxes (on fuel, cigarettes, and alcohol) are positively related to income. It is no wonder, therefore, that per capita tax payments are highly correlated with per capita income — in FY 1997, the simple correlation of income and taxes exceeded 0.97. By far, the most important influence determining the amount of taxes paid by a state is the average earnings of its residents.

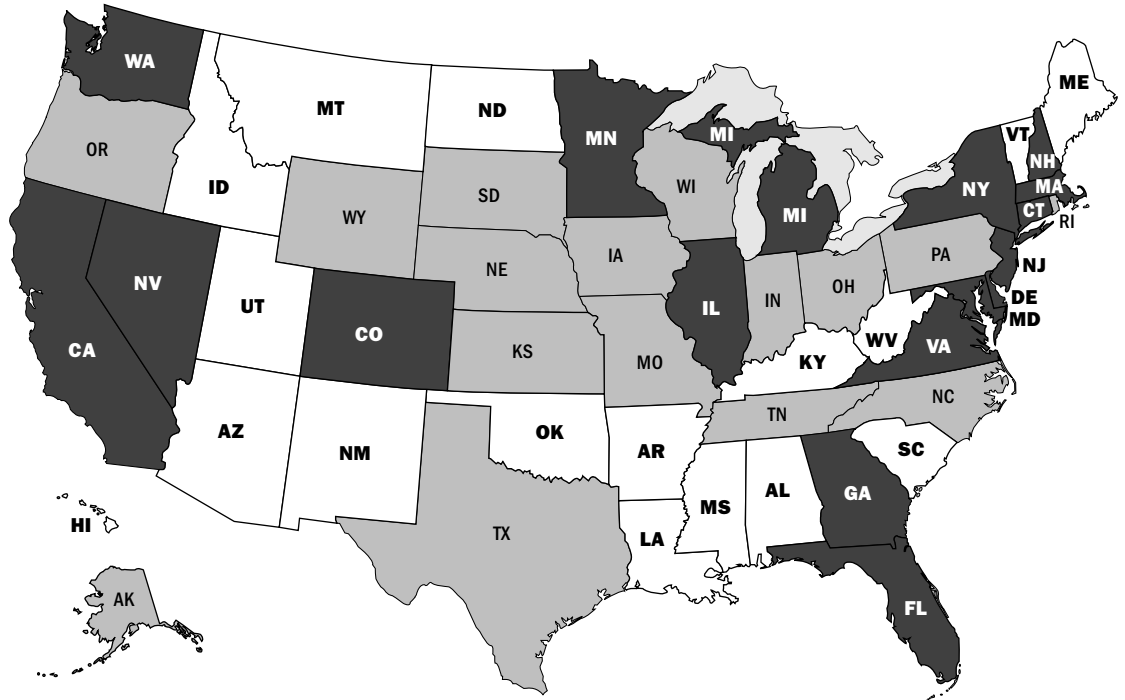
The geography of Federal taxation, thus, directly follows the geography of average individual earnings. Figure 13 provides a map of the states divided into thirds by per capita Federal taxes, with those shaded darkest paying the highest amount of taxes per capita. It is almost identical to the tax distribution we observed last year. The average Federal tax burden of residents of different states varies considerably, but other than the association of high average incomes with

<sup>7</sup> Information on Federal tax receipts is from the Budget of the United States Government, Fiscal Year 1999, Historical Tables, page 29.

**Figure 13**  
**Per Capita Federal**  
**Taxes Collected, FY 1997**

KEY

- Lowest amount of taxes collected (\$3,600 – \$4,300)
- Moderate taxes (\$4,300 – \$4,990)
- Highest amount of taxes collected (\$4,990 – \$6,850)



high Federal tax payments, there is no obvious or very strong geography to this distribution. Northeastern states tend to have relatively high incomes, and pay high Federal taxes, as do several Great Lakes states and a cluster of states (Delaware, Maryland, and Virginia) along the Atlantic coast. Most regions tend to have a mixture of high- and low-taxpaying states. The largest blocks of low-taxpaying states are in the south and in the mountain region of the west; the largest block of middle-income states is in the central part of the nation.

We should note that while the positive association between income and taxes implies that the Federal government's tax system is *redistributive*, it does not necessarily imply that it is progressive. For a tax system to be *progressive*, higher-income households must pay *more than a proportionately higher amount* in taxes. Is the tax system of the Federal Fisc, viewed with regard to its effects across states, progressive? The answer is that it is very mildly progressive — the lowest-income states, on average,

pay about 18 percent of their income in Federal taxes, while the highest-income states pay about 20 percent. Viewed across time, the tax system is a steady force in the Federal Fisc for modest redistribution across the states from wealthier states to poorer states.

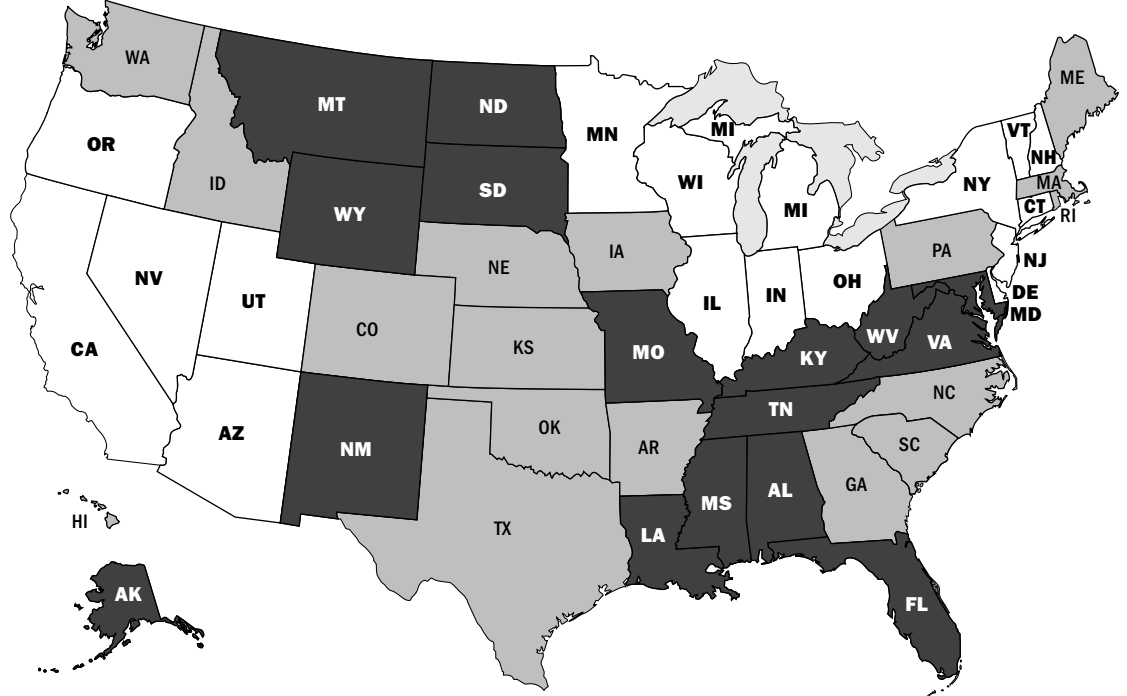
### ***The Geographic Distribution of Federal Spending***

Unlike the geographic distribution of taxes, which is relatively easy to predict because of the strong correlation with income, there are many factors that influence where the Federal government spends money. The demographics and circumstances of individual states shape even the most straightforward policy objectives. For example, the largest component of Federal spending, payments to individuals, is largely determined by the proportion of elderly residents in each state. Agricultural subsidies are concentrated in states with large amounts of farmland. And the geographic distribution of defense spending is determined in large part by the location of defense contractors and existing military facilities.

Figure 14

**Per Capita Federal Spending, FY 1997**

- KEY
- Lowest amount of Federal monies received (\$3,680 – \$4,660)
  - Moderate amount of Federal spending (\$4,660 – \$5,400)
  - Highest amount of Federal monies received (\$5,400 – \$7,900)



Other factors are directly political. Congressional election campaigns frequently revolve around the question of “who can bring home the bacon.” In some instances, Congress makes specific geographic decisions, such as the location of military facilities and Federal office buildings or the allocation of highway grants. In other cases, Congress defines the overall program structure and delegates responsibility for the allocation of funds to the appropriate government agency. Of course, congressional decisionmaking is frequently influenced by interest groups inside and outside of the bureaucracy.

Nor should one ignore the impact of changes in national policies. Recent presidents have been successful in articulating policies that have had significant impact over our budget priorities. Over the past two decades, we have seen significant shifts in the priorities of U.S. domestic spending — the defense build-up in the early 1980s and the subsequent curtailment of defense spending as the Cold War ended; the end of general

revenue sharing for state and local governments; the growing importance of entitlement benefits for the elderly and poor as a percentage of Federal spending; and the decline of non-defense discretionary domestic spending in recent years as the country has moved toward a balanced budget, to name only a few of the most obvious.

Finally, state actions themselves impact the allocation of funds from the capital. While it is clear that no state government has an interest in maximizing *all* types of Federal assistance, states have an incentive to maximize certain kinds of Federal spending. For example, fear of becoming a “welfare magnet” may keep states from increasing benefit levels and maximizing Federal reimbursement for programs like Medicaid. Similarly, large Federal grants for unemployment compensation reflect a weakness in the state’s economy, and compensation for black lung disease reflects a serious health crisis. On the other hand, it is easy to see why states would seek to attract Federal grants for economic development, transportation, education, and

## A NOTE ON FEDERAL EXPENDITURES

In our effort to construct the balance of payments statistic, we consider the total flow of funds between the Federal government and the people of each state. That is, we seek to measure the net flows of economic activity between each state and the Federal government. The spending side of the equation accounts for all domestic Federal spending, including Social Security, defense, income support payments, veterans benefits, agricultural subsidies, Medicare, Medicaid, and other grants to state and local governments. We also look at all sources of Federal receipts used to finance these programs.

Direct payments to individuals now account for more than one-half of the allocable Federal expenditures in our analysis. In response to earlier reports in this series, it has been suggested that we should exclude direct Federal payments that flow directly to individuals, since these payments are “transportable” and simply follow the movement of individuals across state lines. The line of reasoning behind this suggestion is that Federal and state policies have almost no impact on the distribution of these benefits across states (state policies, such as income tax and estate laws, certainly have some impact on location decisions, but the impact of these policies is likely overshadowed by considerations of family and weather).

Given this, we wanted to see whether the balance of payments results we observe would change significantly if the payments to individuals, and the social insurance taxes that support these benefits, were excluded from our analysis. We appreciate the assistance of the Tax Foundation, which provided special state-specific tax allocators that exclude the wage taxes linked to these programs.

After comparing this information to our primary analysis, which uses the total flow of funds between the Federal government and each state, we find that our general conclusions still hold. In particular:

- Wide disparities are still apparent in the financial flows between the Federal government and each of the states. The average Federal spending level excluding the direct payments was about \$2,100 per capita. Almost two-thirds of the states had balance of payments surpluses or deficits that exceeded 20% of this spending level. Fourteen states had deficits or surpluses that exceeded \$1,000 per capita, about 50% of the average spending level.
- The concentration of balance of payments deficits in the Northeast and Great Lakes regions is almost unchanged. Florida replaces New York in the group of states with the largest deficits; Connecticut and New Jersey remain the states with the largest deficits in the country.
- Large balance of payments surpluses spread out a little more, as South Dakota and Maine replace West Virginia and Alabama in the ranking of the top ten states. Most of the Southern states continue to have surpluses, but they are smaller than they were before.
- Florida, West Virginia, and Arkansas stand out as states whose surpluses decline significantly. Florida’s balance of payments falls by over \$1,000 per capita and it joins the group of states with the largest deficits. Colorado, Washington, and Wyoming move up the most in our rankings when the direct payments are excluded.

Which measure is most appropriate? The answer depends on the question posed. The narrower set of expenditures is appropriate when concentrating on the impacts of Federal and state policies on the geographic distribution of Federal spending. An even narrower measure, focusing exclusively on the 17 percent of the domestic Federal budget allocated for intergovernmental assistance, may be most appropriate when focusing on funds that flow directly to, and are controlled by, state and local governments.

While these narrower definitions of expenditures may be relevant for these questions, the broadest measure of Federal spending is the most appropriate one for the analysis we present in this report. Economic impacts are apparent from all Federal spending and tax programs — regardless of whether the states administer the programs themselves (as in the case of Medicaid, transportation, or welfare) or the Federal government provides the service directly (defense) or payment is made directly from the Federal government to individual citizens (Social Security). In recent years, many people have noted the negative impact on the economies of certain states from reductions in spending for defense contracts (California is often used as an example). At other times, states have raised concerns about potential cut-backs in Social Security or Medicare payments that are made directly to individuals. These examples underscore our point that salaries paid to Federal employees, payments to Federal contractors, grants to state and local governments, and Social Security checks to individual recipients all offer economic benefits to the states.

public safety. Similarly, salaries for Federal workers, defense contracts, and other Federal procurements all bring economic activity to a state or region; generally, these are viewed positively by citizens and taxpayers.

## FY 1997 Spending Patterns

FY 1997 spending in the fifty states and the District of Columbia totaled \$1.32 trillion, an increase of about 3 percent in unadjusted dollars from the prior fiscal year.<sup>8</sup> The unadjusted per capita spending level rose by slightly less than \$100 — from \$4,824 in FY 1996 to \$4,917 in FY 1997. Adjusting for inflation, the per capita spending level actually fell by 0.3 percent when compared to FY 1996.

Figure 14 highlights the states with the lowest and highest amounts of Federal money received. The regional distinctions that characterize our balance of payments analysis are equally evident from the geographic distribution of Federal spending. That is, the deficit states in the Northeast and Great Lakes regions, along with some of the western states, receive the lowest amounts of Federal spending. Of the 20 states with the highest per capita spending, only one — Maine — is located in these regions. In contrast, Federal spending for a large group of Northeast and Great Lakes states was more than 10 percent below the national average and spending in three of these states — New Hampshire, New Jersey, and Wisconsin — falls below the national average by more than 20 percent.<sup>9</sup>

The range of spending across the states was quite broad. Looking beyond the states in the capital region, which led the nation in Federal spending received, New Mexico received almost \$7,200 per capita, about the same amount it received last year (adjusting for inflation). However, Federal spending in North Dakota, the next state in our rank-

ings, increased by about 20 percent from the prior year. Dramatic increases in agricultural subsidies and Federal grants more than offset a decline in spending for wages and salaries. In contrast, cutbacks in defense spending and Federal grants in New Hampshire left it with the lowest amount of Federal spending in the country — \$3,680 per capita. Utah and Wisconsin are the only other states with total Federal spending under \$4,000 per capita. Table C-3 in the Appendix provides a complete listing of Federal spending by state and the State Profile pages in the back of this book provide additional detail.

#### Comparison to FY 1996

Generally, we would not expect to see fundamental changes in the geography of Federal spending during the course of a single fiscal year. A large percentage of Federal spending is distributed on the basis of population or population-based criteria (e.g.,

income or medical support for the elderly or poor). Since population changes slowly, and many programs use formulas based on the decennial census, we can reasonably expect little year-to-year change in Federal spending. Other Federal spending is related to the maintenance and operation of facilities (e.g., defense installations, national parks) that are rarely, if ever, relocated.

However, many observers have been particularly interested in seeing whether the Republican Congress elected in November 1994 has had a noticeable impact on the geographic distribution of Federal spending. The newly elected Congress certainly made an impact on the final form of the FY 1996 budget (recall the two government shutdowns that resulted from the stalemate with the President), but the FY 1997 budget was the first one developed from the outset with the new majority.

Our comparison of the FY 1997 information in this report with the data set we compiled in FY 1996 reveals few noticeable shifts in the per capita spending for each state. The geographic pattern of states with high Federal spending and low Federal spending is almost unchanged. Moreover, the few changes we observe do not appear to be related directly to significant policy changes brought about by the new congressional majority.

#### What Drives These Results?

Every dollar of either spending or taxation has an impact on the overall geography of the Fisc, but it is useful to inquire whether some areas of spending have more or less impact on the overall results than others. Which factors are most important in determining state balances of payments? The crux of each state's story is how it *differs* from the others, and it is therefore the differences or

8 Federal government expenditures in this analysis do not include the net interest on the Federal government debt, international payments and foreign aid, U.S. Postal Service spending offset by postage and other collections, and expenditures for selected agencies such as the Central Intelligence Agency and the National Security Council. See Appendices A and B for further detail on data sources and methodology.  
9 Federal spending in Utah was also 20 percent below the national average.

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#### A NOTE ON STANDARD DEVIATION

Much of our analysis focuses on how widely individual states vary from each other and from the national average. One way to measure this variation is by "standard deviation," a statistical measure of how widely dispersed a set of values is around its average. Intuitively, the standard deviation measures how far away from the average a randomly selected point from the sample is likely to be. A decrease in the standard deviation indicates that the list of values has become more tightly distributed around its average. A common rule of thumb is that about two-thirds of a sample is likely to be within one standard deviation of the average value, and about 95 percent of the sample is likely to be within two standard deviations of the average.

Sometimes it is useful to characterize a scattered set of values by measuring each of the values in terms of its percentage variation from the average of the sample. If the average per capita income for the nation was \$20,000 (not an accurate figure; chosen for illustration only), states with a per capita income of \$25,000 have 125 percent of the average; states with \$18,000 have 90 percent of the average. The percentage standard deviation is a measure of how dispersed these percentages are. Thus, if the percentage standard deviation is 10 percent, then about two-thirds of the sample is likely to be between 90 and 110 percent of the mean, and about 95 percent of the sample is likely to be between 80 and 120 percent of the mean.

Federal taxing and spending decisions can change the amount of dispersion in per capita incomes. Thus, we can examine the distribution of state per capita incomes and calculate their standard deviation, and then recalculate the standard deviation after adding Federal spending per capita and subtracting Federal tax payments per capita. If the standard deviation of these per capita resources after the effects of Federal taxes and spending is smaller than the standard deviation before taxes and spending, then the Federal Fisc has tightened the distribution of resources across states, and it has had a redistributive effect.

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**Table 3: Measures of Dispersion of Fisc Components, FY 1997**

	RANGE (1997\$)			AVERAGE (1997\$)	RANGE/ AVERAGE (%)	STANDARD DEVIATION (1997\$)	COEFFICIENT OF VARIATION (%)
	MIN.	MAX.	RANGE				
<b>TOTAL TAXES</b>	<b>\$3,603</b>	<b>\$6,844</b>	<b>\$3,241</b>	<b>\$4,917</b>	<b>66</b>	<b>\$691</b>	<b>14</b>
<b>TOTAL SPENDING</b>	<b>3,680</b>	<b>7,896</b>	<b>4,216</b>	<b>4,917</b>	<b>86</b>	<b>953</b>	<b>19</b>
Grants	546	1,896	1,350	838	161	291	35
Wages	124	1,696	1,572	448	351	355	79
Payments to Individuals	1,512	3,958	2,446	2,819	87	424	15
Procurement	144	2,479	2,335	605	386	467	77
Other Federal Spending	82	1,033	951	206	462	194	94
Defense	204	3,328	3,124	799	391	601	75

dispersion of spending and taxes across the states that are the important influences we are trying to identify. No factor can have much of an impact on very many states if it is only a tiny fraction of the total — and no factor, no matter how large it may be, can have much of an impact on the results unless it varies across the states. Thus, we want to focus on and describe how much and according to what patterns the underlying components of the Fisc differ across states. Do they exhibit a great deal of variation, or only a little? Are most states close to the average, with a few far from the average, or are the states distributed evenly across the whole range? In this section, we examine the *dispersion* of taxes and spending (and the underlying components of spending), with a view toward understanding which components exert the most overall influence in determining the results for individual states.

**How widely do taxes or spending vary across states?** Two simple measures of the dispersion are the range (taking into account the minimum and maximum values across the nation) and the standard deviation of per capita spending across states, shown in Table 3. Table 3 also shows the range as a percentage of the average and the “coefficient of variation” — the ratio of the standard deviation to the average — which gives an indication of the *relative* volatility of taxes and spending, adjusting for its overall scale or magnitude.

Total taxes and total spending each vary across a fairly wide range — the range for taxes is two-thirds of its average and the range of spending is nearly nine-tenths of its average. On the other hand, the standard deviations, which are both less than 20 percent of the average, indicate that many states are quite close to the national average for the overall measures of taxes and spending. Relatively speaking, then, total taxes and total spending are fairly stable across the states; the major variations from the average are driven by fluctuations in the underlying individual components of spending.

The Census Bureau tracks the geographic distribution of Federal expenditures by state, county, and sub-county areas under five broad categories of spending:

- Grants to state and local governments
- Salaries and wages
- Direct payments to individuals
- Procurement contracts
- Other miscellaneous programs

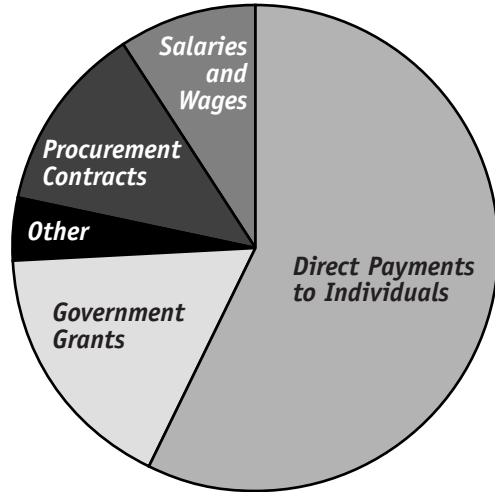
Direct payments to individuals, which include Social Security, Medicare, and other similar Federal retirement and disability programs that have expanded rapidly in the last two decades, make up more than 57 percent of Federal spending in FY 1997 (see Figure 15). Intergovernmental assistance is the next largest category of spending, although it is less than one-third of the size of direct payments to individuals.<sup>10</sup>

<sup>10</sup> Per capita values and state rankings for the components of Federal spending are presented in Appendix C-4 and on each of the State Profile pages that follow this report.

Figure 15

**Components of Federal Spending, FY 1997**

Payments to individuals and intergovernmental assistance make up almost 75% of domestic Federal spending.



The impact on a state's balance of payments generated by a specific spending component tends to be larger when the component is relatively large as a fraction of total spending. But this information, *by itself*, offers relatively little insight into the geographic spending pattern that we observe, since it does not inform us about the dispersion of spending across states or the interrelationship between spending decisions for different components of spending. Certain spending components are widely dispersed, with some states having very high spending and other states receiving very low spending; other spending components vary much less across states. Agricultural subsidies, for example, are concentrated in a small number of states with large areas of farmland, while grants to support public transit systems are similarly concentrated but in high-density urban areas. In general, spending components with greater dispersion will have more impact on the results. Similarly, spending decisions for certain components may be positively or negatively correlated with other Federal spending. In the extreme, a spending component that is highly positively or negatively correlated with another spending component will have relatively little *independent* impact on the results; it will merely accentuate or cancel out the impact of other

factors. Spending components that are distributed in a way that has little relation to other factors are likely to contribute more powerfully to the outcomes for individual states.<sup>11</sup>

In sum, then, the impact on states' balance of payments results generated by a specific spending component tends to be larger when:

- the component is relatively large as a fraction of total spending;
- the component is widely dispersed, with some states having very high and other states very low amounts of that component; and
- the way in which it is distributed across states is markedly different from that of other components.

While many states are quite close to the national average for total spending, the individual components of Federal spending are much more widely distributed. The absolute range of every component (measured from the minimum to maximum values across the 50 states) is relatively wide. Only payments to individuals has a range smaller than its average value; the range for grants to state and local governments is one and a half times its average value, and the range for the other components of Federal spending is three to five times their average value.

Payments to individuals and grants to state and local governments are also substantially less variable *on average* than are wages, procurement (and, therefore, defense), and other Federal spending. Payments to individuals, by far the largest component of Federal spending, also shows the least percentage variation — the average state varies from the overall national average by only about 15 percent (about \$400 out of an average of over \$2,800). The relative stability in this spending area is a major factor in producing

<sup>11</sup> This may seem counterintuitive. Why wouldn't a factor have more power if it were lined up with the other factors? If it is lined up with the others, it contributes less of an *independent* impact on the result; it largely accentuates the other factors. Roughly speaking, there are three ways in which a given component could be distributed in relation to the others: it could be highly positively correlated with others, highly negatively correlated with others, or neither highly positively nor negatively correlated with others. If it is highly positively correlated with one or more other factors, then it will have little *independent* effect; for the most part, it will merely accentuate the effects of the other factors with which it is correlated. If it is highly negatively correlated with one or more other factors, it will similarly have relatively little *independent* effect — it will largely cancel out the impact of some of the other factors. If it is distributed in a way that has little relation to the other factors — that is, if its correlation with them is relatively low — then it is likely to contribute more powerfully to the outcomes for individual states.

the stability across states in overall spending. The second-largest component of spending, grants to state and local governments, also varies relatively little — the average state departs from the national average by only about one-third of the national mean.

By contrast, the remaining components of spending, though smaller, show much more relative variation. Each of wages, procurement (and, therefore, defense), and other Federal spending show average variation around the national mean of about three-quarters or more. Together, these three components account for only about one quarter of Federal spending, but their relatively erratic distribution accounts for a considerable part of the total variation of spending across the states. They are a major factor in the *individual* stories of the balance of payments outcome for many states.

**How are the impacts of the components of Federal spending distributed with respect to one another? Are they highly correlated with one another, either accentuating or attenuating the impacts of the other components?** Intriguingly, with the exception of wages and procurement (both of which are related to defense spending, and therefore to each other), none of the components of spending are highly intercorrelated. Wages and procurement have a simple correlation of about two-thirds. The highest interactions among any two other components (grants and other Federal spending; and grants and wages) are about one-third; most of the simple cross-correlations are one-fifth or less. Thus, with the exception of the defense-related components of spending, the individual spending components are largely independently distributed — and therefore substantial variation in any subcomponent can have a large impact on a given state's overall results.

**What are the implications of these results for the relative power of each component of Federal spending in determining the outcomes of states' balances of payments?** Each of the individual components has a wide enough range that a state's being among the largest or the smallest recipients is likely to have a major impact on its overall balance of payments outcome. In spite of their very different averages, the largest four components of spending have similar absolute amounts of variation across the states — the standard deviation for each of the four is between \$300 and \$500 per capita. Other Federal spending, much smaller than the others, has correspondingly smaller variation of about \$200 per capita on average from state to state. Two of these components (wages and procurement), which are closely linked to defense spending, are fairly strongly correlated; since they tend to accentuate each others' variation, the combination of the two of them thus produces more variation (rather than averaging or canceling each other out). Thus, defense spending imparts considerably more variation than its size alone would suggest. By contrast, in spite of its being much larger than any other component, the relatively small percentage variation exhibited by payments to individuals makes it a less important determinant of outcomes than its size would suggest. Thus, in short:

- being near the end of the range in either direction in any spending area is often enough by itself to have a material impact on the overall balance of payments outcome;
- defense spending is a more powerful determinant of outcomes than its budget share alone would suggest;
- payments to individuals is a less powerful determinant of outcomes than its budget share alone would suggest; and

■ broadly speaking, the individual components seem to have more equal weight in affecting overall outcomes than their budget shares would suggest. The smaller areas exhibit more relative variation than the larger areas, so that the distribution of each spending component is important in the overall story and different states will be affected by very different combinations of these forces.

While these measures give some indication of the relative dispersion of spending, focusing on per capita spending alone could be misleading. If the states at the high and low ends of the spending spectrum have small populations, and the larger states are more similar to each other, then in some sense the spending is less dispersed (across the *population*, though not across the *states*) than if the ends of the spending distribution are occupied by very populous states. As it turns out, however, weighting states' results by their populations does not fundamentally change the story about which components most powerfully affect state outcomes. One way of assessing the degree of dispersion in the distribution across the population as a whole is to compute what economists call the "Gini" coefficient, a measure of the degree to which any given amount (income, wealth, spending, and so on) is distributed equally or, by contrast, very differently. Gini coefficients by definition vary from zero (indicating precise equality, with every person in the distribution receiving the same amount) to one (indicating maximum inequality, with all but one person in the distribution receiving nothing and the last person receiving everything).<sup>12</sup>

Table 4 shows the Gini coefficients for the distribution of spending across states. Since we were computing the dispersion

across the nation, we treated each state as receiving its per capita amount times its population, so these coefficients are appropriately population-weighted. The broader measures of taxes and total spending are fairly equally distributed, with Gini coefficients below 0.10. The larger spending components, payments to individuals and grants to governments, are also distributed quite equally. By contrast, wages, procurement, and other Federal spending are distributed more unequally, with Gini coefficients nearing one-third. As a result, defense spending (which is closely linked to procurement and, to a lesser extent, to Federal wages) is also dispersed relatively unequally across the population.

**Table 4: Gini Coefficients of Taxes and Spending Components, FY 1997**

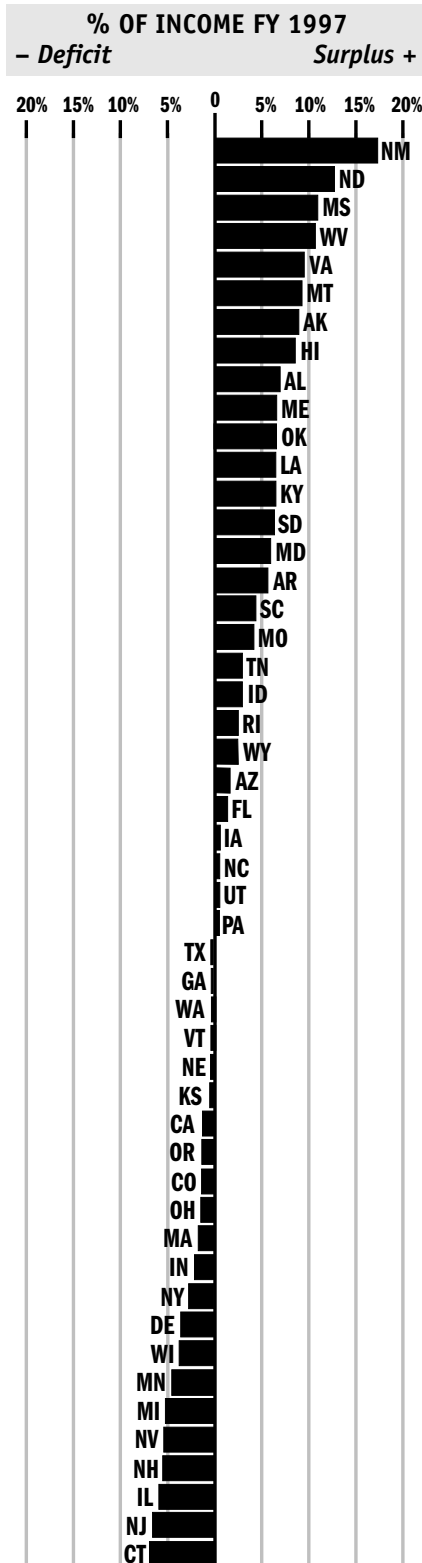
TAXES	0.06
<b>TOTAL SPENDING</b>	<b>0.09</b>
Grants	0.11
Wages	0.33
Payments to Individuals	0.07
Procurement	0.34
Other Federal Spending	0.26
Defense	0.33

### Redistribution and the Federal Fisc

As we observed last year, the most important redistributive features of the Federal Fisc are across *individuals* and not across states. Individuals' earnings range from near zero to tens and even hundreds of millions of dollars; the redistributive impact of Federal taxes and spending across individuals at the extremes of this spectrum is substantial. By contrast, average state incomes vary by only about 25 percent of the average, from barely over \$20,000 per capita in New Mexico and Mississippi to a little over \$32,000 in Connecticut. As a result, the redistributive impact across states is only a very small part of the overall story of the redistributive impact of Federal activity.

12 To compute a Gini coefficient, the distribution is first put in order from those receiving the most per capita. The percentage of the total amount of the item in question that is owned, paid, or received by each group of the population is then computed. Starting with those who received the least, we then form a graph of the cumulative percentage of population and cumulative percentage of the total amount. (At each point on this graph, the cumulative percentage of the population exceeds the cumulative percentage of the amount received or paid, because we started with those who received the least.) In this graph, the 45 degree line — where the cumulative population and cumulative percentage of the distributed amount are identical — denotes complete equality, with each person having the same per capita amount. The Gini coefficient is defined as the area between the 45 degree line and the actual cumulative distribution curve (divided by the area under the 45 degree line so as to scale the Gini coefficient to a maximum of 1). When the Gini coefficient is zero, there is no space between the cumulative distribution curve and the 45 degree line; each person has the same per capita value. When the Gini coefficient is 1.0, the cumulative distribution curve remains at zero as we sweep across the whole population (until we reach the last person, who receives everything). The distribution curve is thus the horizontal axis, and the area between it and the 45 degree line is the whole area below the 45 degree line, and the ratio is thus 1.

Figure 16  
Balance of Payments  
as % of Per Capita  
Income, FY 1997



Nonetheless, questions about the redistributive impacts that the Fisc has *across states* are persistent — and important (at a minimum, because they are *politically* important). The Federal Fisc does create substantial net flows of resources across the nation’s geography. Citizens in New Mexico receive about \$3,500 per capita more in Federal spending than they pay in taxes; this balance of payments surplus is over 17 percent of per capita income in the state. At the other end of the scale, New Jersey, Connecticut, and Illinois experience net outflows equal to more than 6 percent of their per capita income (Figure 16). The difference between being a major surplus and major deficit balance of payments state is a net impact of nearly 25 percent of economic activity in the state — and considerably more than that, once “multiplier” effects of the economic activity generated by the spending of those net receipts are taken into account.

That there is net redistribution of resources and economic activity across states from the impact of raising and spending \$1.3 trillion is no surprise — it would be virtually impossible to arrange for such a large and diverse collection of spending and taxing programs without some redistributive effect. But how much redistri-

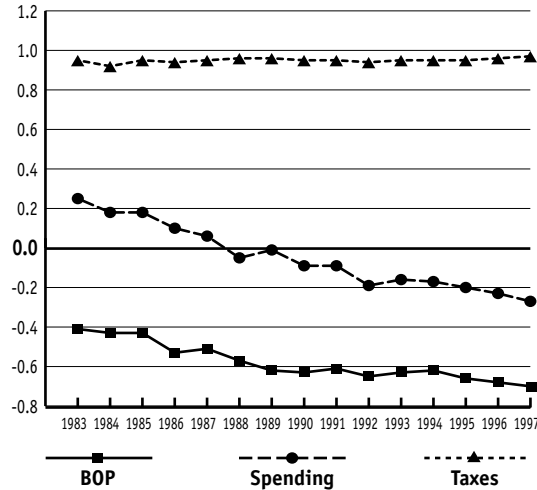
bution is there? Which way does it go? Is it idiosyncratic — are some states lucky, or powerful — or is it systematic? And what are its main determinants? Broadly, the facts are these:

On balance, the Federal Fisc produces a net redistribution from wealthier to less wealthy states. A simple way to characterize the net redistributive effect of the Federal Fisc is to examine the variability of income before and after taxes and spending. The standard deviation of per capita income across the states was about \$2,800 in FY 1997. The standard deviation of *after-tax* per capita income was about \$2,100. And if we subtract per capita Federal spending in each state from per capita income to form a hypothetical “pre-Fisc” per capita income distribution, its standard deviation was \$3,200. Thus, the after-Fisc distribution of average (net) income is more tightly distributed around the average than the pre-Fisc distribution; the Fisc — and indeed, each of the tax and the spending portions of the Fisc separately — imparts a redistributive, variance-reducing impact across the states.

The tax system is highly correlated with income, resulting in higher per capita tax payments from wealthier states. As described in the section above on taxes, all major components of the Federal tax system — personal income taxes and payroll taxes are the most obvious — are directly related to income of one form or another. As a result, the distribution of taxes across the states is strongly related to per capita income. Higher-income states actually pay a slightly higher percentage of their per capita income in taxes; the tax side of the Fisc thus imparts a (mildly) progressive impact on the net distribution of after-Fisc income across the states. Importantly, this impact is highly *systematic*. Because taxes are so highly correlated with

**Figure 17**  
**Correlations of**  
**Balance of Payments,**  
**Spending, and Taxes**  
**with Per Capita Income**

*The tax system has always been highly correlated with income. Federal spending is now negatively correlated with income.*



income, state ranks in per capita tax payments are nearly identical to their ranks in per capita income.

Taken overall, Federal expenditures are *mildly negatively correlated with income*. States with higher per capita incomes, on average, receive slightly less in Federal spending per capita than states with lower per capita incomes. Spending is erratic, with some high-income and some low-income states among the largest recipients for many components of Federal spending. Unlike taxes, where virtually every dollar imparts a redistributive impact in the same direction, some spending components are positively correlated with income (or random in their association with income). On average, however, the wealthiest states receive about \$900 per capita less in Federal spending than the poorest states, or about \$95 less per capita for each additional \$1000 of per capita income.

*Thus, both sides of the Federal Fisc contribute to reducing the variability across states of “after-Fisc” income, although taxes are the more efficient mechanism to achieve redistribution.*

The Federal Fisc appears to be continuing to become more redistributive than it used to be. The Fisc has always been mildly redistributive — the persistent and highly

systematic impact of the tax system, highly correlated with income, meant that on average, higher-income states paid significantly more in taxes, and on average were thus net donor states. The impact of the tax side of the Fisc has not changed much over time. *Spending, however, used to be slightly positively correlated with income and it is now negatively correlated with income* (see Figure 17). The correlation of spending and income has decreased steadily — in the early 1980s, the correlation was about +0.25; by 1990 it was about zero, and by 1997 it had fallen to about -0.25. Correspondingly, the balance of payments has steadily become increasingly negatively correlated with income, falling over the period from about -0.4 to about -0.7.

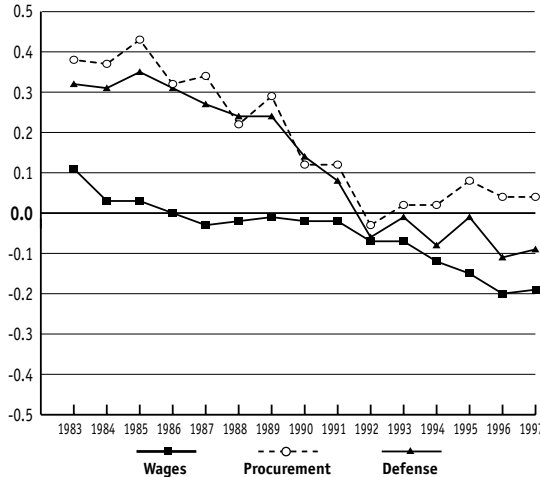
**Why has the pattern of spending redistribution changed over time?**

First, the *mix* of spending has changed. Each of the different components of Federal spending vary in their correlation with income. The fastest-growing portion of the budget — payments to individuals — has always been negatively correlated with income. As this component has grown as a share of the Federal budget, its growth has made the overall mix of Federal spending more oriented toward lower-income states.

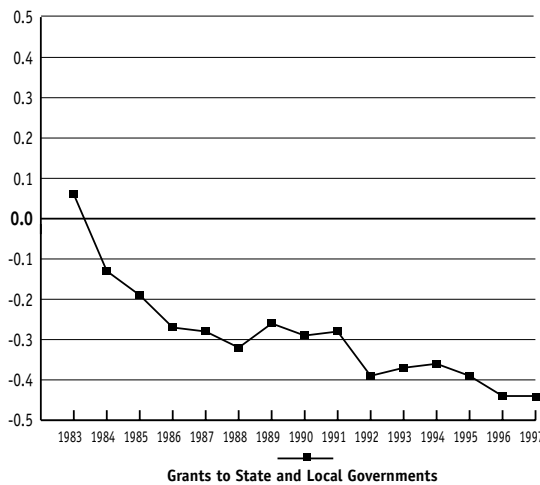
Second, Federal grants to state and local governments — which includes Medicaid — have become larger and have become significantly more negatively correlated with income (that is, significantly more concentrated toward lower-income states). In FY 1983, this portion of Federal spending was essentially uncorrelated with per capita income — receipts of grants to state and local governments bore essentially no relationship to states’ average incomes (see Figure 18). By FY 1997, the correlation between grants and

**Figure 18**  
**Correlations of Spending Components with Per Capita Income**

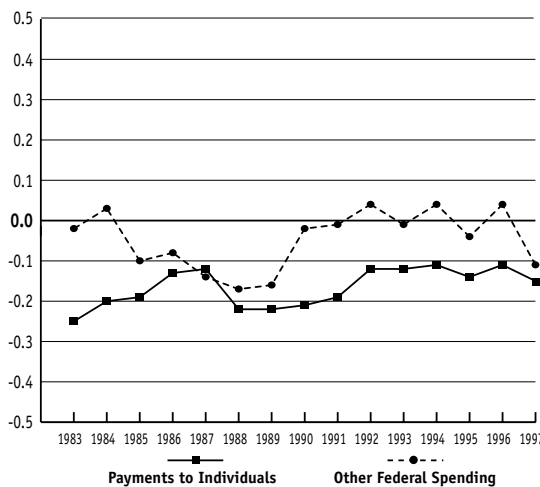
*The distribution of procurement and defense spending has shifted away from higher income states.*



*Federal grants are significantly more concentrated toward lower income states.*



*Payments to individuals and other Federal spending have moved in a less systematic fashion over time.*



per capita income had fallen to -0.4. Part of this change was due to the increase in Medicaid as a component of Federal grants to state and local governments. Part of it was also due to the movement of two tradition-

ally strong recipients of Federal grants — Alaska and Wyoming — in the nation’s income distribution. In the early 1980s, these states were among the highest per capita income states, and the fact that they were among the highest per capita recipients of state and local grants significantly flattened the relationship between per capita income and receipt of Federal grants. By FY 1997, both Alaska and Wyoming had become lower-middle-income states, and this materially increased the negative association between per capita income and receipt of Federal grants.

Finally, both the level and the geographic distribution of defense spending have materially changed. In FY 1981, defense spending was a large component of Federal spending, and was *positively* related to per capita income — wealthier states tended to receive more in Federal spending. This association was, in statistical terms, fairly strong — the correlation between income and defense spending was about +0.4. In large measure, this reflected the very substantial success of a few higher-income states — most notably, California, Colorado, and Connecticut, which ranked 3rd, 6th, and 1st in the national income distribution — at attracting substantial per capita defense spending. Over the course of the late 1980s and 1990s, defense spending in general has declined and, even more significantly, it has declined especially steeply in some of the highest-income states. Thus, the relationship between defense spending and per capita income has significantly shifted, and the (smaller) remaining spending in this area is now very slightly negatively correlated with income (the simple correlation in 1997 was -0.1). The reduction in the scale of this component of the Fisc — and the shift in its relationship to income — have contributed significantly

to the shift in the pattern of Federal spending toward lower-income states.

While it is interesting to note the persistent trend of the Fisc toward more redistribution, it is important to bear in mind that the amount of redistribution achieved through the cross-state flows is modest, and represents only a small portion of the Fisc as a whole. Whatever redistribution there is results only from the net balance of payments. The total net balance of payments of all of the net recipient states is about \$100 billion. If the only purpose of the Federal Fisc were to achieve exactly the redistribution that the Fisc currently creates across states, it could thus be accomplished by raising (from the deficit states) and spending (in the recipient states) a budget of less than 10 percent of the current amount. Of course, redistribution across states is not the central purpose of Federal spending — it may not even be a widely agreed purpose of Federal spending at all. But, at least at a modest level, it is nonetheless one of the Fisc's persistent and increasing impacts.

### ***State Profiles***

Given the complexity of Federal tax and spending decisions, it is impossible to construct a national-level analysis that adequately explains every state's financial relationship with the Federal government. Throughout this report, we have focused on the factors we find helpful in understanding the most recent data released by the Census Bureau and the companion data compiled by the National Tax Foundation. Still, the circumstances particular to an individual state are centrally important factors in understanding the balance of payments outcomes.

The *State Profiles* that follow this report capture state-specific information and highlight the different stories that are relevant for

individual states. Each profile includes important demographic information — state per capita income, cost of living index, poverty rate, population, and the percentage of residents who are young or elderly. The majority of Federal spending (in the form of means tested and non-means tested support programs) is largely determined by the demographics of the state. The state profiles also include detailed information on the FY 1997 balance of payments that can be compared to national rankings and national averages to gain important perspective. Historical trends in taxes and spending (adjusted to 1997 dollars) allow for state-specific comparisons over time.

The information in the *State Profiles* should be considered in the context of the conclusions discussed in this report:

- A ranking near the top or the bottom in taxes or any spending area is often enough by itself to have a material impact on the overall balance of payments outcome.
- Defense spending continues to be an important factor in the equation, despite the decline in defense spending as a proportion of total Federal spending.
- Payments to individuals, which make up more than half of all Federal spending, are a less powerful force in the outcomes than the budget share alone would suggest.
- The smaller areas of spending, which exhibit the greatest variation across states, can be important in the overall story for individual states.