

**The Federal
BUDGET
and ★ the
STATES
Fiscal Year 1995**



INTRODUCTION
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REPORT
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DPM

The Federal Budget and the States Fiscal Year 1995

Executive Summary

Figure 1
The graph to the right shows the per capita balance of payments for each state, Fiscal Year 1995

Federal tax collections and spending programs have substantial and widely varying impacts on the economics of individual states. In effect, each state runs a balance of payments surplus or deficit with the Federal government. Put another way, each state indirectly subsidizes or is being subsidized by the other states. As the graph to the right depicts, the balance of payments distribution across the states is quite wide. Twenty-five states had surpluses or deficits that exceeded \$1,000 per capita.

On average, the Federal government collects and spends nearly \$5,000 for each man, woman, and child in the U.S. A careful analysis of the most recent census data (FY 1995) reveals that in some states, Federal spending in excess of tax payments is more than 15 percent of citizens' total income. In other states, citizens experience the opposite results — a balance of payments deficit equal to nearly 10 percent of their personal income.

Moreover, there is a striking consistency in the balance of payments (BOP) over the last several years. With few exceptions, states with large BOP surpluses in FY 1995 held a similar position in recent years. In fact, eight of the ten states with the largest BOP surpluses this year were in the "top 10" last year as well (with Kentucky and Montana as the exceptions).

A similar — and even more striking — result holds for BOP deficits. All of the ten states with the largest deficits were also in that position last year. Perhaps more importantly, a geographic pattern arises here as well. With the singular exception of Nevada, states with large BOP deficits in FY 1995 are concentrated in the Northeast and Midwest.

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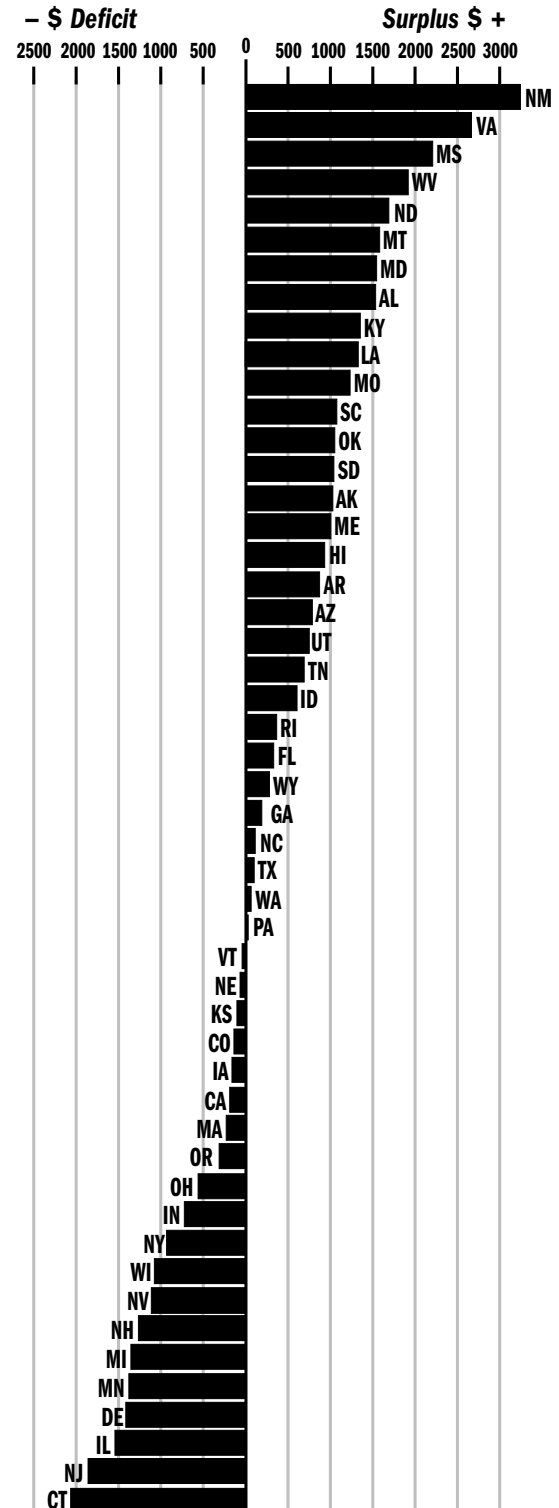
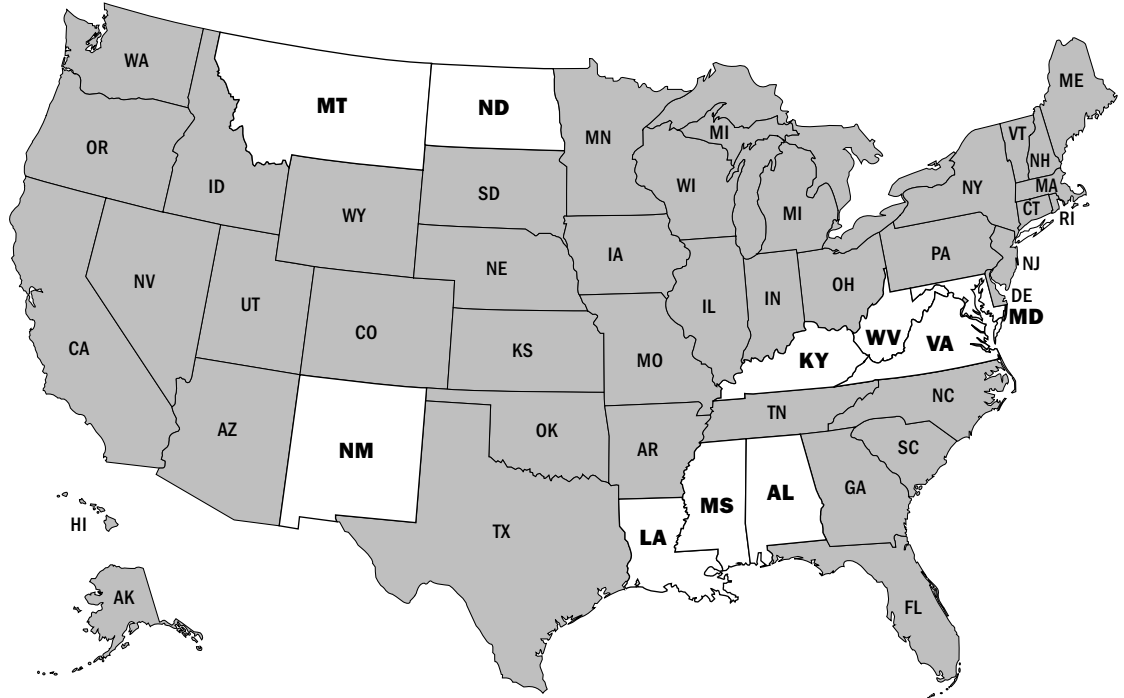


Figure 2

The states in white have the greatest Federal per capita surplus



When we look back over a longer period — extending our view to fifteen years — there has still been remarkable stability in the balance of payments rankings for about half of the states. Portions of the Northeast and Midwest have been consistently in deficit. By contrast, some states (primarily in the South) have consistently run surpluses.

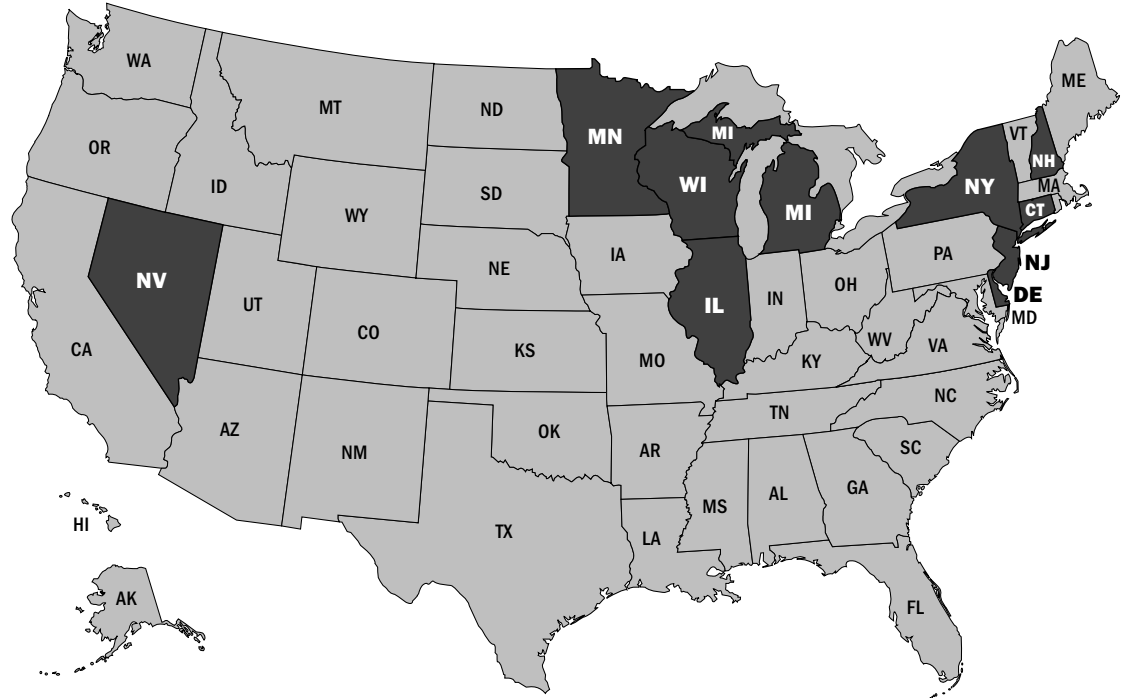
On the other hand, several states have had quite volatile balance of payments rankings over the last fifteen years, and others have experienced significant shifts in one direction or the other. The “oil states”, for example, began this period with a deep balance of payments deficit but ended with a surplus. By contrast, several of the New England and Pacific states have experienced significant declines in their balance of payments positions. And a few states have seen both a rise and a subsequent fall (or the reverse) in their positions as first one force and then another dominated their dynamics.

What are the underlying forces that drive these results? With \$1.2 trillion of annual domestic Federal spending spread over thousands of programs with complex eligibility criteria and distribution formulas, there are, of course, no simple answers. Perhaps that is one of the reasons why Washington rarely turns its attention to “fairness questions” with anything more than a program-specific view. When the debate does include the broader geographic equity questions, it tends to be dominated by three myths:

- The defense budget has been reduced dramatically, and therefore, defense spending is no longer a dominant factor.
- Entitlement spending has been growing rapidly and the few states that receive significant welfare spending (e.g., New York) receive disproportionate shares of overall Federal spending.

Figure 3

The states in black have the greatest Federal per capita deficit



■ State-to-state differences are determined by inflows (Federal spending) not outflows (Federal taxes collected). That is, on a per capita basis, all states feel the burden of Federal taxes roughly equally and, therefore, taxes are not a major determinant of geographic equity.

Our analysis shows that these myths, while pervasive, *are not supported* by the facts. Consider the realities:

Defense: Defense spending has declined significantly in real terms since FY 1986. But defense spending has not lost its punch as a predictor of the net flow of Federal funds to the states. A few states have been, and continue to be, highly successful in attracting defense spending. Their success in this area is a major determinant of their balance of payments position.

Welfare: It is true that the Federal government spends more on benefit programs than it has in the past. It is also true that income support and health care spending are a key determinants of the geography of Fed-

eral spending. But benefit payments to the elderly, not to the poor, make up the bulk of this spending. The nation spends almost ten times as much per capita for Social Security and other Federal retirement programs as it does for Food Stamps and AFDC. Thus, differences across states in the age distribution of their residents have much more to do with the relative balance of Federal funding than differences in poverty rates.

Taxes: Federal taxes, (including personal and corporate income taxes, social security, and excise taxes) collected from each state are strongly correlated with per capita income. Over the course of the 1980s, comprehensive tax legislation drastically reduced marginal tax rates (particularly the top rates). But, far from washing out differences between states, the spread in tax burdens induced by differences in state incomes has widened. The level of taxes has fallen steadily as a percentage of income, yet states with higher per capita incomes now shoulder a greater percentage of the overall tax

bill. While Federal spending is a better predictor of a state's overall position with respect to balance of payments, taxes also exert a strong influence on the outcome.

State Profiles

This annual report, originally prepared by Senator Moynihan to demonstrate inequities for New York, has made a gradual evolution from a New York focus to a national focus. Understandably, many citizens and elected officials are principally concerned with their home state. With this edition, therefore, we introduce a summary for each state, capturing state-specific information and highlights on a single page. These *State Profiles* can be found later in this report.

It is perhaps easiest to think of the information in the State Profiles in terms of the engines that drive the differing per capita balance of payments positions. While different stories are relevant for different states, we have tried to capture data that are generally useful for understanding the state balance of payments outcomes:

- Taxes are strongly related to income. The State Profiles include the real per capita income for each state.
- Payments to individuals and intergovernmental grants (payments to state and local governments) are determined by the demographics of the state. The State Profiles provide information on the proportion of a state's residents that are elderly or poor.
- Defense spending remains a potent factor in the equation. The Profiles include a graphic representation of defense spending over the last fifteen years.

Critical Methodological Concepts and Choices

We made the following methodological choices to define more precisely the flow of Federal funds to and from each state:

- **We considered only Federal spending within the borders of the fifty states (including defense) for which the Bureau of the Census produces geographic data (the main item excluded is the interest payment on the Federal debt);**
- **We allocated taxes in the same amount as spending (reflecting the fact that even if there is a Federal deficit, it is not free); and**
- **We adjusted all figures for taxes and spending to reflect the cost of living in each state.**

A detailed discussion of our data sources and methodology can be found in Appendices A and B.