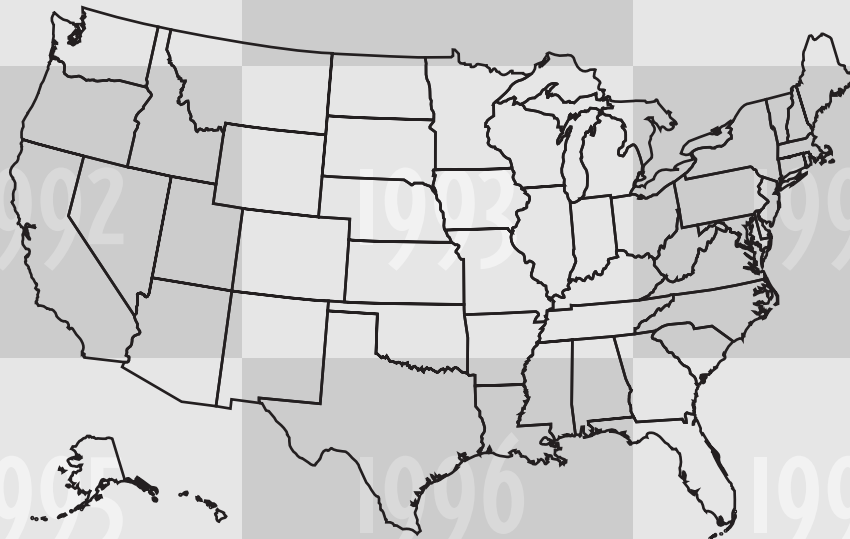




The Federal Budget and the States

FISCAL YEAR 1999



Retrospective Issue • 1983-1999

24th Edition

INTRODUCTION

Daniel Patrick Moynihan

REPORT

Herman B. Leonard

Jay H. Walder



A JOINT PUBLICATION

Taubman Center for State and Local Government
John F. Kennedy School of Government
Harvard University

Office of Senator
Daniel Patrick Moynihan
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This is the twenty-fourth edition in an annual series of reports beginning with Fiscal Year 1976. Since 1992, the body of the report has been prepared by the Taubman Center for State and Local Government at the Kennedy School of Government at Harvard University and the introduction by Senator Daniel Patrick Moynihan.

LIST OF TABLES

Table 1	<i>Balance of Payments, FY 1999</i>	4
Table 2	<i>Per Capita Changes in Actual Balance of Payments, Spending, and Taxes, FY 1983/84–FY 1998/99</i>	5
Table 3	<i>Balance of Payments, FY 1999</i>	20
Table 4	<i>Per Capita Spending by Program by State, FY 1999</i>	31
Table 5	<i>Distribution of Spending by Program for Each State, FY 1999</i>	31
Table 6	<i>Per Capita Changes in Actual Balance of Payments, Spending, and Taxes, FY 1983/84–FY 1998/99</i>	37
Table 7	<i>Budget Percentages of Federal Spending by Area, FY 1983/84 and FY 1998/99</i>	40
Table 8	<i>Variability of Spending Areas and Taxes, FY 1983/84 and FY 1998/99 and Index of FY 1983/84–FY 1998/99 Change</i>	40
Table 9	<i>Total Expenditures, FY 1998/99</i>	43
Table 10	<i>Defense, FY 1998/99</i>	44
Table 11	<i>Major Base Closings</i>	45
Table 12	<i>Defense Salaries, FY 1998/99</i>	46
Table 13	<i>Defense Procurement, FY 1998/99</i>	47
Table 14	<i>Social Security, FY 1998/99</i>	48
Table 15	<i>Comparing FY 1998/99 and FY 1983/84 Social Security Benefits</i>	50
Table 16	<i>Medicare, FY 1998/99</i>	51
Table 17	<i>Comparing FY 1998/99 and FY 1983/84 Medicare Benefits</i>	53
Table 18	<i>Grants, FY 1998/99</i>	54
Table 19	<i>Taxes, FY 1998/99</i>	56

LIST OF FIGURES

Figure 1	<i>Per Capita Balance of Payments, FY 1999</i>	1
Figure 2	<i>Map of States with Greatest Per Capita Balance of Payments Surpluses</i>	2
Figure 3	<i>Map of States with Greatest Per Capita Balance of Payments Deficits</i>	3
Figure 4	<i>New York Balance of Payments Deficits 1983–1999</i>	10
Figure 5	<i>Federal Spending in New York, FY 1999</i>	10
Figure 6	<i>Cover of The Economist, October 28, 2000</i>	13
Figure 7	<i>Per Capita Balance of Payments, FY 1999</i>	21
Figure 8	<i>Total Balance of Payments, FY 1999</i>	22
Figure 9	<i>Per Capita Taxes and Spending Compared to National Averages</i>	23
Figure 10	<i>Map of Per Capita Balance of Payments, FY 1999</i>	24
Figure 11	<i>Map of Per Capita Federal Taxes Collected, FY 1999</i>	25
Figure 12	<i>Distribution of Federal Spending by Program, FY 1999</i>	28
Figure 13	<i>Map of Per Capita Federal Spending, FY 1999</i>	29
Figure 14	<i>Geographic Distribution of Per Capita Federal Spending by Program A–E (defense, non-defense discretionary, Social Security, Medicare, assistance programs)</i>	30
Figure 15	<i>Per Capita Spending by Program by State, FY 1999</i>	32
Figure 16	<i>Distribution of Spending by Program for Each State, FY 1999</i>	32
Figure 17	<i>Map of FY 1998/99 Social Security Spending — Difference from Predicted Value</i>	49
Figure 18	<i>Map of FY 1998/99 Medicare Spending — Difference from Predicted Value</i>	52
Figure 19	<i>Map of FY 1998/99 Grants Spending — Difference from Predicted Value</i>	55

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This is the ninth year of our fruitful association with the Taubman Center for State and Local Government at the John F. Kennedy School of Government at Harvard University. Professor Herman B. "Dutch" Leonard, the Baker Professor of Public Management at the Kennedy School, and Jay H. Walder, Lecturer in Public Policy, once again led our joint effort. As always, we are indebted to them for their singularly creative analysis. Surely there has been no equivalent in the long history of American federalism.

Marcia Ciro of Paper Trace Studio coordinated the report's layout and graphic design, helping us to present detailed statistical information in a clear fashion.

Many thanks to Jason Klurfeld, Therese Lee, and Gray Maxwell, formerly of my staff, who now serves as Legislative Director to Senator Dianne Feinstein of California.

DPM

For the past nine years, we and other researchers from the Kennedy School's Taubman Center have prepared the body of *The Federal Budget and the States* reports. This has accorded us the rare opportunity of working with Senator Daniel Patrick Moynihan on a project that he began at the outset of his senate career twenty-four years ago. Senator Moynihan is possessed of a unique intellectual vigor and curiosity, and to find these qualities in a senior statesman with his graciousness and generous spirit has been a true personal and professional privilege for which we are deeply grateful.

"We will not see his like again."

HBL and JHW

The Federal Budget and the States

Fiscal Year 1999

Executive Summary

Herman B. Leonard and Jay H. Walder

A. Alfred Taubman Center for State and Local Government

John F. Kennedy School of Government

Harvard University

Figure 1

The graph to the right shows the per capita balance of payments for each state, Fiscal Year 1999.

A wide disparity in the financial flows between the Federal government and each of the states has been a consistent feature of U.S. fiscal policy over the two decades captured in this report series (and probably for many years before that). While arguments are often put forth highlighting the benefits of uneven tax payments and Federal spending across our diverse nation, citizens and legislators continue to raise concerns about whether states receive a “fair share” of Federal domestic spending or pay more than their “fair share” in Federal taxes.

In the day-to-day process of formulating policy and administering the government, the financial flows to and from each of the states have rarely been examined outside of the context of individual programmatic issues. Over the past few years, bitter fights over allocation formulas dominated the legislative discussion during the overhaul of Federal social assistance programs and the reauthorization of Federal highway and transit programs. This program-specific debate about the fair and equitable distribution of Federal funding will undoubtedly be revived in the context of other Federal programs and/or revisited in the context of the transportation and social assistance programs that have been the focus of recent attention.

Looking beyond selected programmatic initiatives, it is no secret that the economic impacts of Federal spending and tax collections vary significantly across the states.

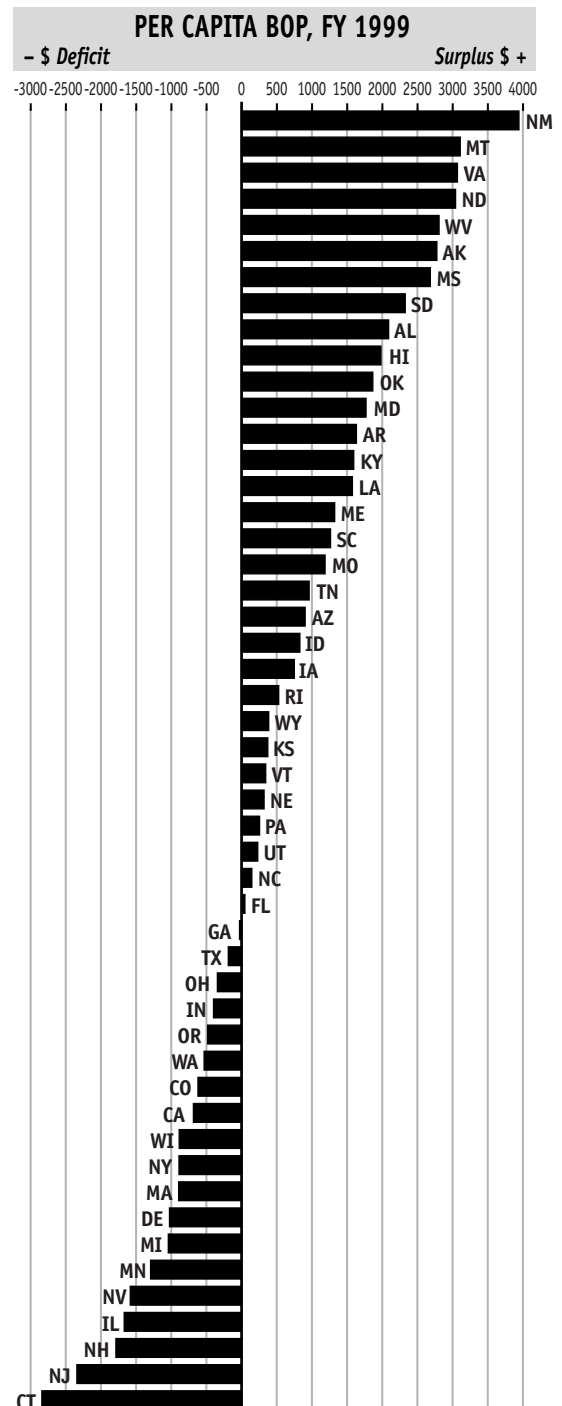
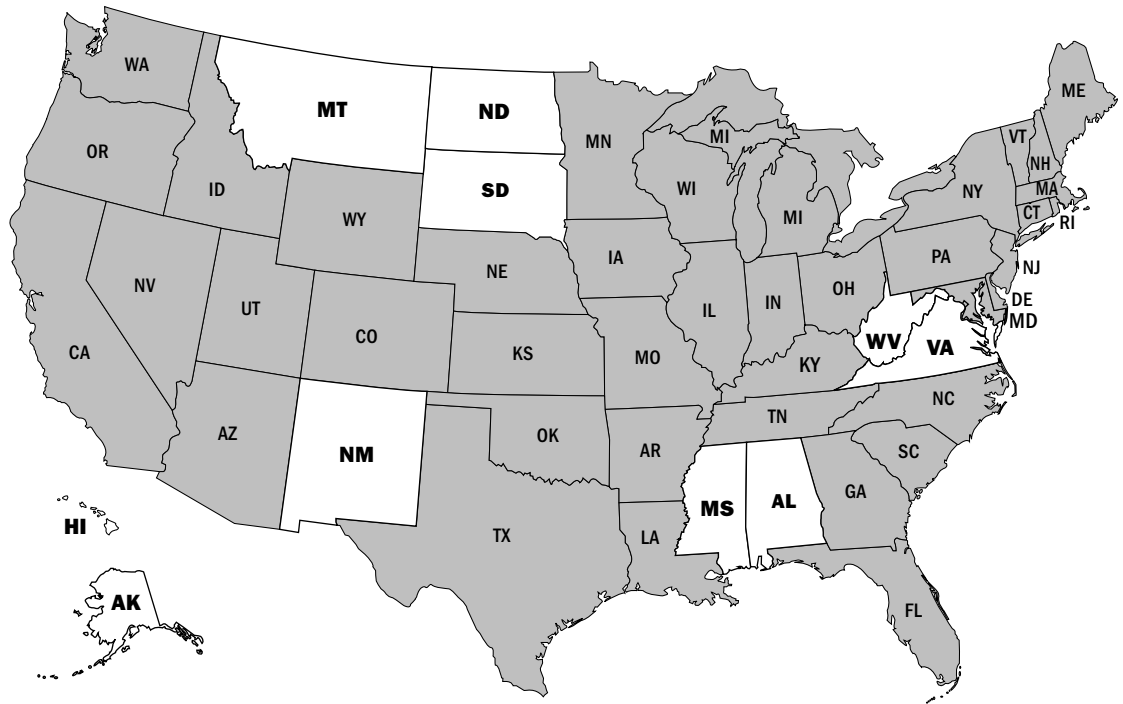


Figure 2

The ten states in white have the greatest Federal per capita surpluses.



Some states do receive considerably more in Federal spending than they pay in Federal taxes, while the tax burden for other states far exceeds the spending they receive. We note a persistent, but often misunderstood, pattern in the geography of these financial flows. In general, residents of states in the Northeast and Great Lakes regions pay much more in Federal taxes than they receive back in Federal spending, while many Sunbelt and Great Plains states get more from the Federal government than they send to Washington in taxes.

Figure 1 depicts the state-specific effect of Federal spending decisions and tax collections for Fiscal Year 1999. The states at the top of the graph have a balance of payments surplus — they gain economic activity from their financial relationship with the Federal government. The donor states at the bottom pay more in Federal taxes than they receive in spending. Significant surpluses and deficits were common — nearly half of the states had surpluses or deficits that exceeded

20 percent of the average per capita Federal spending level (about \$5,500).

At one end of the spectrum, ten states had surpluses of approximately \$2,000 or more per capita. While there was no obvious geographic pattern to these states, there was a noticeable concentration in just a few areas of the country (see Figure 2). New Mexico has consistently led the nation with the greatest per capita balance of payments surplus and its FY 1999 surplus of about \$4,000 per capita was more than \$800 greater than the surplus for Montana, the next highest state.

Among the states with net outflows to the U.S. treasury, Connecticut continued to have the highest per capita balance of payments deficit in the nation. Its deficit of almost \$2,800 per capita was more than \$500 greater than New Jersey, the state with the next largest deficit. Seven other states, primarily located in the Northeast, mid-Atlantic and Great Lakes regions, had deficits of more than \$1,000 per capita. Figure 3 shows the ten states with the largest deficits.

Figure 3

The ten states in black have the greatest Federal per capita deficits.

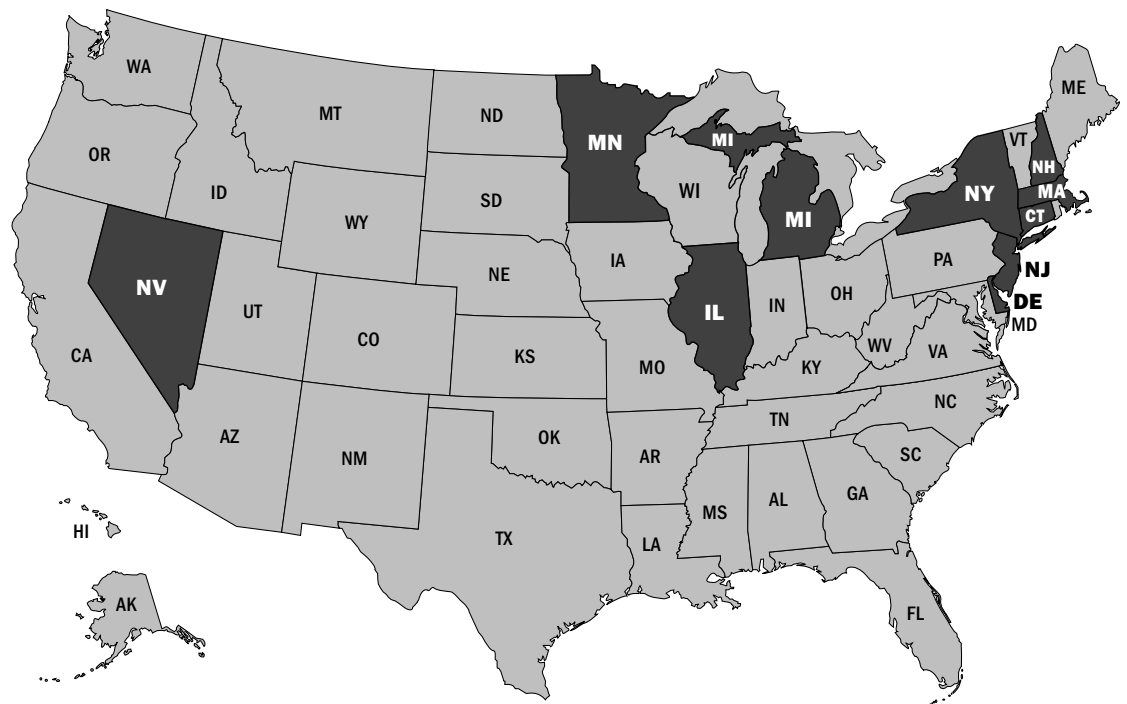


Table 1 presents an alphabetical listing of the states with the FY 1999 per capita balance of payments and the total surplus or deficit for each state. Eleven states had total surpluses that exceeded \$5 billion. The total surplus for Virginia was over \$21 billion, by far the largest in the nation, and the surplus for Maryland exceeded \$9 billion. Outside of the Washington DC area, Alabama led the nation with a surplus that also exceeded \$9 billion. All eleven of the states with net inflows that exceeded \$5 billion were in the South and the combined surplus for these states was about \$96 billion.

California's deficit of approximately \$23 billion was the highest in the nation. This was the result of its very large population of 33 million residents (almost 12 percent of the total U.S. population), combined with its moderate per capita deficit of about \$700 (12th largest in the nation). The total deficit for Illinois was also more than \$20 billion, and three other states — New Jersey, New York, and Michigan — had total deficits in excess

of \$10 billion. The combined outflow from this group of five states alone was over \$88 billion, and the total for the ten states with the largest deficits was about \$118 billion.

The FY 1999 results continue long-standing trends. The geography of surpluses and deficits has been extremely consistent over time — the states with the largest per capita surpluses and deficits have changed only slightly over the past seven years. Moreover, the few changes that we observe in recent years do not appear to be related directly to shifts in the priorities of U.S. domestic spending, changes in the occupancy of the White House, or the majority control of the Congress.

The Federal Budget and the States — A Retrospective

Senator Moynihan published the first report in this series in 1977, after having been in the Senate for only half a year. That first report grew out of his concern that Federal tax and spending policies

Table 1: Balance of Payments, FY 1999

STATE	PER CAPITA	RANK	TOTAL (IN MILLIONS)	STATE	PER CAPITA	RANK	TOTAL (IN MILLIONS)
AL	2,091	9	9,139	MT	3,109	2	2,745
AK	2,777	6	1,720	NE	320	27	533
AZ	904	20	4,319	NV	(1,583)	46	(2,865)
AR	1,633	13	4,166	NH	(1,787)	48	(2,147)
CA	(685)	39	(22,688)	NJ	(2,342)	49	(19,076)
CO	(620)	38	(2,514)	NM	3,944	1	6,862
CT	(2,840)	50	(9,320)	NY	(890)	41	(16,189)
DE	(1,025)	43	(772)	NC	146	30	1,115
FL	47	31	707	ND	3,043	4	1,928
GA	(29)	32	(228)	OH	(344)	34	(3,873)
HI	1,982	10	2,350	OK	1,866	11	6,266
ID	829	21	1,038	OR	(483)	36	(1,601)
IL	(1,669)	47	(20,241)	PA	256	28	3,076
IN	(399)	35	(2,373)	RI	528	23	523
IA	750	22	2,151	SC	1,265	17	4,914
KS	373	25	990	SD	2,327	8	1,706
KY	1,595	14	6,317	TN	961	19	5,270
LA	1,576	15	6,892	TX	(189)	33	(3,789)
ME	1,324	16	1,660	UT	230	29	490
MD	1,770	12	9,155	VT	343	26	203
MA	(895)	42	(5,526)	VA	3,069	3	21,094
MI	(1,042)	44	(10,277)	WA	(533)	37	(3,070)
MN	(1,294)	45	(6,180)	WV	2,808	5	5,074
MS	2,684	7	7,431	WI	(887)	40	(4,659)
MO	1,187	18	6,490	WY	386	24	185

were contributing to the general economic decline in the state that he had been elected to represent. His belief was that an accurate understanding of the flow of funds between New York residents and the Federal treasury would be a critical first step in correcting what he knew to be an *unequal*— and what he perceived to be an *inequitable*— distribution of Federal funds. Senator Moynihan's imminent retirement from the United States Senate is a natural occasion to review the geographic shifts in Federal spending and taxing decisions that have taken place during his Senate career. While there has been a good deal of stability in the balance of payments patterns reported annually in *The Federal Budget and the States* series, there have been significant changes when we look across a longer period of time.

With this in mind, this report contains a fifteen-year analysis of the shifts in the

geography of Federal spending and taxes. More specifically, we compare data on the geography of Federal spending and taxes in FY 1983 and FY 1984 to similar data for the two most recent fiscal years (FY 1998 and FY 1999). We average data for two years to minimize the impact of any single-year anomalies that may have occurred.

The Big Picture

Table 2 shows the aggregate changes for each state in per capita balance of payments, total Federal spending, and Federal tax payments over the 15-year retrospective period. Many states experienced relatively modest movement in their overall balance of payments position — nearly half of the states moved by \$500 per capita or less, and for 10 of those states, the change over the 15-year period was less than \$200 per capita. The changes for the other states were larger, and for some of these states the changes were quite dramatic indeed.

The change in Connecticut's balance of payments position with the Federal government was most striking. Over the 15-year period, Connecticut's balance of payments moved from a small surplus to the largest deficit in the nation. The decline of nearly \$2,500 per person was far larger than the decline for any other state. New Hampshire, Nevada, Massachusetts, and California also experienced declines of \$1,000 or more. The gains over the same period at the other end of the spectrum were also striking. Citizens in Oklahoma and Alaska saw their balance of payments move up by over \$2,500 per capita and North Dakota, Montana, and West Virginia experienced net increases of more than \$2,000 per capita.

The difference between the changes experienced by citizens in Connecticut and

**TABLE 2: Per Capita Changes in Actual Balance of Payments, Spending, and Taxes
FY 1983/84–FY 1998/99**

<i>Change in Balance of Payments</i>		<i>Change in Spending</i>		<i>Change in Taxes</i>	
Connecticut	\$(2,461)	California	\$(775)	Connecticut	\$1,783
New Hampshire	(1,513)	Connecticut	(678)	Minnesota	1,269
Nevada	(1,357)	Nevada	(538)	Massachusetts	1,248
Massachusetts	(1,274)	New Hampshire	(354)	Georgia	1,232
California	(1,105)	Utah	(326)	Florida	1,220
Washington	(955)	Washington	(261)	New Hampshire	1,159
Missouri	(825)	Missouri	(61)	North Carolina	1,151
Utah	(823)	Massachusetts	(26)	Tennessee	1,056
Minnesota	(742)	Hawaii	332	South Dakota	981
New York	(477)	Kansas	410	Michigan	968
Georgia	(446)	New Jersey	420	Maryland	933
New Jersey	(435)	New York	433	New York	910
Florida	(243)	Minnesota	527	Illinois	876
Michigan	(121)	Delaware	637	Wisconsin	873
Wisconsin	(113)	Arizona	648	Vermont	861
Illinois	(105)	Colorado	724	New Jersey	855
Vermont	(62)	Oregon	752	South Carolina	849
Oregon	(20)	Wisconsin	760	Nevada	819
Colorado	43	Illinois	771	Nebraska	802
Delaware	109	Georgia	786	Oregon	772
Arizona	114	Vermont	799	Missouri	764
Kansas	156	Michigan	848	Alabama	751
Tennessee	193	Rhode Island	873	Virginia	738
Indiana	275	Indiana	901	Washington	694
Nebraska	293	Ohio	931	Colorado	680
Ohio	326	Mississippi	955	Idaho	640
North Carolina	336	Florida	978	Arkansas	635
South Carolina	358	Idaho	1,019	Pennsylvania	634
Idaho	378	New Mexico	1,036	Indiana	627
Maryland	382	Pennsylvania	1,072	Kentucky	613
Rhode Island	402	Nebraska	1,094	Ohio	605
Mississippi	416	Texas	1,149	Maine	573
Pennsylvania	439	South Carolina	1,207	Iowa	539
Hawaii	509	Arkansas	1,238	Mississippi	539
Virginia	592	Tennessee	1,249	Arizona	534
Arkansas	603	Maine	1,283	Delaware	527
Maine	710	Maryland	1,315	Utah	497
Alabama	925	Virginia	1,330	Rhode Island	471
New Mexico	944	Alaska	1,459	California	330
South Dakota	999	North Carolina	1,487	Kansas	255
Texas	1,004	Alabama	1,675	Wyoming	231
Iowa	1,411	Wyoming	1,744	Texas	145
Kentucky	1,465	Louisiana	1,778	New Mexico	92
Wyoming	1,513	Oklahoma	1,860	Montana	(53)
Louisiana	1,997	Iowa	1,950	West Virginia	(75)
North Dakota	2,191	South Dakota	1,980	Hawaii	(176)
Montana	2,350	North Dakota	2,009	North Dakota	(183)
West Virginia	2,386	Kentucky	2,078	Louisiana	(218)
Oklahoma	2,534	Montana	2,296	Oklahoma	(674)
Alaska	2,812	West Virginia	2,311	Alaska	(1,352)

**CRITICAL METHOD-
LOGICAL CONCEPTS
AND CHOICES**

We made the following methodological choices to define more precisely the concept of the flow of Federal funds to and from each state as that term is used in this report:

- 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 payments 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, or if there is an overall surplus, it is not a net cost to the economy); 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.

Alaska, the two states with the most extreme situations, is over \$5,200 per capita. In effect, the Federal government imparted a net economic torque that provided a major impulse in the economy of Alaska while at the same time a Federal economic brake was being applied to Connecticut. Other states experienced significant, but less intense, versions of this same phenomenon.

The Tax Side

The distribution of Federal taxes is the deep drumbeat in the background of the changes we observe in the balance of payments. Federal taxes collected in eight states increased by more than \$1,000 per capita between FY 1983/84 and FY 1998/99. Connecticut had the most significant increase in taxes, nearly \$1,800 per capita, but several southern states — Georgia, Florida, North Carolina, and Tennessee — also experienced large increases in Federal tax collections. Alaska was the only state where Federal tax collections declined by more than \$1,000 per capita. Two other oil-producing states, Oklahoma and Louisiana, also experienced substantial declines in Federal taxes. Virtually every component of Federal taxes is closely related to income, and the geography of Federal taxation closely tracks the geography of average individual earnings.

Changes in Spending

Given the growth in overall Federal expenditures, most states experienced substantial increases in Federal spending between FY 1983/84 and FY 1998/99. Forty-two states experienced an increase in real per capita Federal spending, ranging from a little more than \$300 per capita in Hawaii to more than \$2,300 per capita in West Virginia. Of the eight states that saw a decline in real Federal spending, the shortfall in three states —

California, Nevada, and Connecticut — exceeded \$500 per capita. California had the largest per capita spending decline in the country, a fall of 14 percent in constant dollars from the average per capita Federal spending received in FY 1983/84. Adjusting for inflation, Federal spending was \$25 billion lower in California in FY 1998/99 than it was in FY 1983/84.

In addition to the increase in Federal expenditures, there have also been significant changes in the priorities of Federal spending during this time period. Most important, defense spending fell as a fraction of Federal spending by about half, from about 26 percent of domestic expenditures to about 13%. At the same time, mandatory programs, particularly Medicare and Medicaid, drove a large portion of the growth in Federal spending. This change in the budget mix of Federal spending helps to explain some of the changes that we observe in Table 2. The geographic distribution of defense spending across the states is indeed quite different from the geographic distribution of the non-defense components of Federal spending. As funds shifted away from defense, states with formerly high defense spending tended not to experience offsetting growth in Social Security, Medicare, and Medicaid, for example.

The Importance of Defense

Defense spending is particularly important because it has a highly variable and distinctive pattern across the states. Not only did the level of defense spending change, but the pattern of defense spending across the states also shifted considerably. For example, actual FY 1998/99 defense spending in ten states was 50 percent greater than the level that would have been expected if the nationwide decline in defense spending had been dis-

tributed proportionately across the states. At the same time, defense spending in eleven other states was more than 25 percent lower than would have been predicted.

In general, we find that:

- Defense spending is considerably more volatile than any other component of Federal spending, with actual defense spending dispersed widely around the national average. Dollar for dollar, defense spending imparts three times as much variation among the states as any other area of Federal spending;
- The other spending components — Social Security, Medicare, Grants, and Other Federal Spending — are about equally volatile and all of these spending components are much less volatile than defense. States are moderately clustered around the national average and a typical state departs from the national average, in either direction, by about one-third.

The result is that defense drives the outcomes considerably more than one would expect by examining its budget share alone. And, over the time period of this analysis, defense spending became more concentrated in fewer states as the overall level of defense spending declined.

State Profiles

Throughout this report, we focus on the factors that are helpful in understanding the national trends and patterns in the geographic distribution of taxes and spending. Still, the circumstances particular to an individual state are often an important factor in understanding the balance of payments outcomes.

The State Profiles that follow this report capture state-specific information and highlight the different factors relevant for each state. Each profile includes demographic information that helps to understand the distribution of the parts of Federal spending that are largely determined by characteristics of the population. We rank each state according to the overall balance of payments and also in relation to the separate tax and spending data. Continuing a new feature that we initiated last year, each State Profile highlights the distribution of Federal spending by program — defense, non-defense discretionary, Social Security, Medicare, and assistance programs — and by the more traditional “objects of expenditure” that we have used in prior reports in this series. State-specific calculations for the balance of payments, taxes, and spending by program can be compared to national rankings and national averages to gain important perspective. And the historical trends in taxes and spending (adjusted to 1999 dollars) allow for state-specific comparisons over time.

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