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The State-Federal Balance of Payments

How much does each state get back for every dollar it sends to Washington? After many years without an answer to that question, a new analysis by the New York comptroller's office tackles the issue.

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THE STATE-FEDERAL BALANCE OF PAYMENTS

It isn't really news that our federal system is redistributive. The federal government collects revenues through the federal tax system and spends resources through: a) direct payment to individuals, b) grants, c) the purchase of goods and services, and d) wages and salaries for federal military and civilian employees.

It stands to reason that there is not equality between the revenues that flow to Washington from a given state and the spending it receives through the federal budget process. On the contrary, both the federal tax code and federal spending are designed to move resources from those who have relatively more to those who have relatively less. Specifically:

1. The federal personal income tax code is progressive; tax rates increase as incomes rise. That means that states with a relatively high proportion of wealthy residents contribute more per capita to federal revenues than states with poorer populations.
2. Many federal grants target funds to people and areas with lower incomes. For example, Medicaid's matching rate varies based on state per capita personal income, and most K-12 education funding is allocated based on concentrations of low-income, school-aged children.

On the basis of these two features, the federal government plays a "Robin Hood" function, collecting money from residents of better-off states and reallocating it to residents of less-well-off states. What complicates the narrative is the role of other types of spending, which aren't allocated in quite so stark a redistributive fashion.

- Federal employees and military bases can be located in any state.
- Federal purchases of goods and services are made irrespective of the underlying wealth of a state. Indeed, the jurisdictions that benefit the most from such spending are the **District of Columbia**, **Maryland**, and **Virginia**, all of which rank among the wealthiest jurisdictions in the country.
- Direct payments to individuals consist primarily of Social Security and Medicare payments. These payments flow mostly to retirees, who may be located anywhere.

Notwithstanding these considerations, there has been a steady demand for an answer to the following question: how much does our state get back for every dollar we send to Washington?

For many years, the answer was provided in an annual report prepared by **New York** Senator Daniel Patrick Moynihan's office. When that effort ceased, the Tax Foundation provided an analysis of federal tax and spending data. Its last report was issued in 2007 and based on fiscal year (FY) 2005 data. Since then, those outdated reports have been the go-to resource for answering the question of which states "win" and "lose" in their fiscal relationships with the federal government.

Even though federal taxes and spending are generally stable from year to year, the period since FY 2005 has held a number of important tax and budget changes. Notably, the Great Recession led to an expansion of federal spending, followed by a contraction and then several years of modest growth.

Moreover, both policy changes and demographics have affected spending on Social Security, Medicare, and other entitlements. Finally, the scaling down of foreign wars has had important implications for procurement spending. The upshot is that the FY 2005 data are probably not a good

proxy for the current state of states' fiscal relationship with the federal government.

NEW YORK STEPS UP TO THE PLATE

Last month, the New York Office of the State Comptroller has stepped in to fill the void. Its report, *New York's Balance of Payments in the Federal Budget*, provides per capita tax and spending comparisons for all 50 states and the District of Columbia based on FY 2013 data. (It excludes the District of Columbia from most of its rankings because it is an outlier, but includes the data on which the rankings are based.)

While the study focuses primarily on per capita figures, this issue of *State Policy Reports* makes use of the raw data to calculate the ratio of spending per dollar paid in taxes. The results are listed on the table to the right. It shows the **District of Columbia** receiving $3.97 in spending for every dollar sent to Washington, while **New Jersey** receives just $0.77 for each dollar it sends.

Most states are net recipients of federal funds, due to the fact that the federal government spends more money than it takes in. Because some federal revenues and spending could not be traced to or from individual states, the study allocated a total of $2.6 trillion in taxes and $3.2 trillion in spending (compared to actual revenues and spending of $2.8 trillion and $3.5 trillion). The gap between revenues and spending is large, which explains how the average state received $1.22 in spending for every $1.00 in taxes paid.

Only 11 states received less in spending than they provided in taxes. **Colorado's** ratio is just less than a dollar, but rounds up to $1.00. Most of these 11 states are among the states with the highest personal incomes, so they receive a relatively low Medicaid matching rate; the program is so large that it has a big influence on state results.

This is apparent when looking at the top-ranking states as well. Many of them are relatively poor states that have a high federal Medicaid

Federal Spending per Dollar of Taxes Paid, FFY 2013

Rank	State	Amount
1	District of Columbia	$3.97
2	Mississippi	2.57
3	New Mexico	2.34
4	West Virginia	2.11
5	Alabama	2.08
6	Kentucky	2.01
7	Maine	1.87
8	South Carolina	1.85
9	Hawaii	1.76
10	Arkansas	1.74
11	Virginia	1.69
12	Idaho	1.67
13	Arizona	1.59
14	Tennessee	1.58
15	Missouri	1.56
16	North Carolina	1.53
17	Maryland	1.47
18	Louisiana	1.47
19	Oklahoma	1.45
20	Alaska	1.45
21	Montana	1.40
22	Georgia	1.39
23	Vermont	1.37
24	Ohio	1.36
25	Michigan	1.32
26	Indiana	1.32
27	Florida	1.29
28	South Dakota	1.28
29	Pennsylvania	1.28
30	Rhode Island	1.27
31	Oregon	1.26
32	Delaware	1.23
	U.S. Average	**1.22**
33	Kansas	1.15
34	Iowa	1.15
35	Nevada	1.14
36	Utah	1.14
37	Texas	1.11
38	Washington	1.09
39	Wisconsin	1.08
40	Nebraska	1.00
41	Colorado	1.00
42	California	0.99
43	North Dakota	0.97
44	New Hampshire	0.93
45	Massachusetts	0.92
46	Illinois	0.91
47	New York	0.91
48	Minnesota	0.86
49	Connecticut	0.83
50	Wyoming	0.81
51	New Jersey	0.77

Source: Reports, *based on New York State Comptroller*

matching rate. Others—such as **Hawaii** and **Virginia**—benefit from other aspects of federal spending (a large military presence in both states, and many federal employees and contractors in Virginia).

The methodology for the study is provided in an appendix, but not in great detail. For example, the report states that various sources were used for federal revenues, "and were used as the basis for the estimates of revenues generated by each state." It does not, however, walk the reader through exactly what adjustments were made to the data.

CHANGES OVER TIME

Reports was curious to see how state results have changed since the last Tax Foundation report was released. The table on the next page compares results from the two years. At the outset, one important difference stands out: the Tax Foundation adjusted all of its data to be deficit neutral. So, while the New York study reflects the fact that federal spending exceeds federal revenues, the Tax Foundation sets the two equal.

Why? According to the Tax Foundation website, "During fiscal years in which the federal government runs deficits, some spending is financed through borrowing. This creates implicit tax liabilities for states that must be repaid eventually." To reflect these tax liabilities, the following adjustments were made to state tax burdens:

1. The total federal tax burden was increased by the size of the federal deficit.
2. This total burden was allocated among states based on each state's proportion of the actual federal tax burden.
3. Adjusted spending per dollar of tax ratios were calculated by dividing actual spending by the adjusted tax figure.

This difference in approach between the two years is apparent on page 5, as 33 states (including the District of Columbia) exceeded $1.00 in federal spending per tax dollar paid in FY 2005, versus 40 in FY 2013. It also is apparent in the national average, $1.00 in FY 2005 versus $1.22 in FY 2013.

In addition, it isn't clear what other differences between the two analyses might exist. While both are tackling the same issue, they almost certainly use different data sources. When the Tax Foundation was doing its analysis, the Census Bureau still published the *Consolidated Federal Funds Report*. That publication no longer exists, so data must be collected from other sources. That's just one example of potential causes of variance between the two studies.

That said, the comparison offers some useful insights when viewed in terms of the relative rankings of states (rather than the actual return on the dollar). The table shows that a number of states had similar ranks in the two years. Sixteen states changed ranks by less than three positions. To a large degree, these are states that are either relatively rich, so they hold low ranks in both years, or relatively poor, so they hold high ranks in both years. Examples of the former are **California**, **Connecticut**, **Minnesota**, **New Jersey**, and **Washington**. The latter include **Mississippi**, **New Mexico**, and **West Virginia**.

More interesting are the states at the two extremes. At the top are the states that saw their return on the federal tax dollar improve markedly between FY 2005 and FY 2013. Five states' rankings improved by double digits: **Nevada**, **Michigan**, **Delaware**, **North Carolina**, and **Georgia**. Seven states saw their ranking decline by double-digit ranks: **North Dakota**, **Wyoming**, **South Dakota**, **Alaska**, **Nebraska**, **Louisiana**, and **Kansas**.

Federal Spending per Dollar of Taxes Paid, FY 2013 and FY 2005

	FY 2013 (unadjusted)		FY 2005 (deficit-neutral)		
State	**Amount**	**Rank**	**Amount**	**Rank**	**Change in Rank**
Nevada	$1.14	35	$0.65	50	15
Michigan	1.32	25	0.92	38	13
Delaware	1.23	32	0.77	45	13
North Carolina	1.53	16	1.08	28	12
Georgia	1.39	22	1.01	33	11
South Carolina	1.85	8	1.35	17	9
Idaho	1.67	12	1.21	21	9
Arizona	1.59	13	1.19	22	9
Ohio	1.36	24	1.05	32	8
Florida	1.29	27	0.97	35	8
Maine	1.87	7	1.41	14	7
Tennessee	1.58	14	1.27	20	6
Oregon	1.26	31	0.93	37	6
Arkansas	1.74	10	1.41	15	5
Indiana	1.32	26	1.05	31	5
Kentucky	2.01	6	1.51	10	4
Hawaii	1.76	9	1.44	13	4
Vermont	1.37	23	1.08	27	4
Rhode Island	1.27	30	1.00	34	4
New Hampshire	0.93	44	0.71	48	4
Alabama	2.08	5	1.66	8	3
Missouri	1.56	15	1.32	18	3
West Virginia	2.11	4	1.76	6	2
Maryland	1.47	17	1.30	19	2
California	0.99	42	0.78	44	2
Mississippi	2.57	2	2.02	3	1
Washington	1.09	38	0.88	39	1
Wisconsin	1.08	39	0.86	40	1
Colorado	1.00	41	0.81	42	1
District of Columbia	3.97	1	5.55	1	0
Virginia	1.69	11	1.51	11	0
Pennsylvania	1.28	29	1.07	29	0
Illinois	0.91	46	0.75	46	0
Connecticut	0.83	49	0.69	49	0
New Jersey	0.77	51	0.61	51	0
New Mexico	2.34	3	2.03	2	-1
Texas	1.11	37	0.94	36	-1
Minnesota	0.86	48	0.72	47	-1
Oklahoma	1.45	19	1.36	16	-3
Massachusetts	0.92	45	0.82	41	-4
New York	0.91	47	0.79	43	-4
Utah	1.14	36	1.07	30	-6
Montana	1.40	21	1.47	12	-9
Iowa	1.15	34	1.10	25	-9
Kansas	1.15	33	1.12	23	-10
Louisiana	1.47	18	1.78	5	-13
Nebraska	1.00	40	1.10	26	-14
Alaska	1.45	20	1.84	4	-16
South Dakota	1.28	28	1.53	9	-19
Wyoming	0.81	50	1.11	24	-26
North Dakota	0.97	43	1.68	7	-36
U.S. Average	**$1.22**		**$1.00**		

Source: Reports, *based on New York State Comptroller for FY 2013, Tax Foundation for FY 2005*

What might explain such large shifts? The likeliest explanation is Medicaid, since it is a) very large and b) has a federal matching rate that is adjusted annually, based on a state's relative per capita personal income. *Reports* compared each state's Medicaid matching rate in FY 2005 to its FY 2013 rate, and calculated the change. The results are shown on the right.

Among the states with the largest increases in their Federal Medical Assistance Percentages (FMAPs) between the two years are the five states that registered double-digit improvements in their balance of payments with the federal government: #1 **Michigan**, #2 **Delaware**, #3 **Georgia**, #6 **Nevada**, and #7 **North Carolina**.

Similarly, the five states with the largest declines in their FMAPs—**North Dakota**, **South Dakota**, **Louisiana**, **Wyoming**, and **Alaska**—are also among the seven states with double-digit declines in their rank on the balance-of-payments exercise. The other two states with double-digit declines in their balance-of-payments ranks—**Nebraska** and **Kansas**—also saw significant declines in their FMAPs between the two years.

What this says is that Medicaid goes a long way toward explaining changes in a state's terms of trade with the federal government. While not the sole determinant, the program is so large that changes in a state's FMAP can swing millions of dollars. The FMAP itself reflects changes in a state's underlying well-being, as measured by its per capita personal income.

The states that saw big increases in their FMAPs are those that became poorer relative to other states. The FMAP formula is designed to provide a 55% federal matching rate to a state with per capita personal income equal to the national mean. States with higher incomes receive lower FMAP rates, although the formula specifies a 50% floor, which about a dozen states receive (including many of those states that saw no change in their ranking between FY 2005 and FY 2013). States

Change in FMAPs, FY 2005 to FY 2013

Rank	State	Change
1	Michigan	9.68
2	Delaware	5.29
3	Georgia	5.12
4	Indiana	4.38
5	Ohio	3.90
6	Nevada	3.84
7	North Carolina	1.88
8	Wisconsin	1.42
9	Oregon	1.32
9	Tennessee	1.32
11	Kentucky	0.95
12	South Carolina	0.54
13	Pennsylvania	0.44
14	Idaho	0.38
15	Missouri	0.22
16	California	0.00
16	Colorado	0.00
16	Connecticut	0.00
16	District of Columbia	0.00
16	Illinois	0.00
16	Maryland	0.00
16	Massachusetts	0.00
16	Minnesota	0.00
16	New Hampshire	0.00
16	New Jersey	0.00
16	New York	0.00
16	Virginia	0.00
16	Washington	0.00
29	Florida	-0.82
30	Texas	-1.57
31	Arizona	-1.77
32	Alabama	-2.30
33	Maine	-2.32
34	Utah	-2.53
35	West Virginia	-2.61
36	Mississippi	-3.65
37	Nebraska	-3.88
38	Iowa	-3.96
39	Vermont	-4.07
40	Rhode Island	-4.12
41	Kansas	-4.50
42	Arkansas	-4.58
43	New Mexico	-5.23
44	Montana	-5.90
45	Oklahoma	-6.18
46	Hawaii	-6.61
47	Alaska	-7.58
48	Wyoming	-7.90
49	Louisiana	-9.80
50	South Dakota	-9.84
51	North Dakota	-15.22

Source: Kaiser Family Foundation

with per capita incomes below the national average receive higher FMAPs, ranging as high as 83%. **Mississippi** had the highest FMAP in both FY 2005 and FY 2013, but its matching rate declined from 77.08% to 73.43%.

WORKING AS INTENDED

One of the truisms in public economics is that the national government is in a better position to redistribute income than sub-national governments. In that sense, the impact of Medicaid is evidence that the system is working as intended. More broadly, the results of the balance-of-payments exercise bear this out: less well-off states tend to be net recipients of federal spending while better-off states tend to be net donors. This assumes a deficit-neutral environment; in the current budget framework, most states are net beneficiaries, with future generations bearing the burden of accumulating federal debt.

While the grant system has a redistributive design, the procurement system does not. Including such spending means that **Virginia** and **Maryland** rank high. Including federal salaries boosts states with large military bases, such as **Hawaii**. States with larger proportions of senior citizens may see their results affected by Medicare and Social Security spending. **Florida**, **West Virginia**, and **Maine** are examples of states with large elderly populations.

ENDING WITH QUESTIONS

The New York study shows that some states do better than others in their fiscal relationship with the federal government, and that the results more or less comport with how the federal grant system was designed. But it leaves unanswered some methodological and conceptual issues around such an analysis:

- How does the study account for corporate tax payments that come from states with a large number of corporate headquarters (e.g., **Delaware**), where those payments are decidedly not reflective of the state's tax burden?
- How does it account for people who contribute payroll taxes in one state (e.g., **New York**) and collect the retirement benefits associated with those payments in another state (e.g., **Florida**)?

These are thorny issues, as is the whole notion of "winners" and "losers" in the federal system. But there is demand for such analysis, and New York has filled a longstanding void.

TECHNICAL NOTES

Balance of Payments. The New York State comptroller's report can be found here: http://osc.state.ny.us/press/releases/oct15/102715.htm. The Tax Foundation's historical data are here: http://taxfoundation.org/article/federal-taxes-paid-vs-federal-spending-received-state-1981-2005. The data on historical FMAPs are here: http://kff.org/medicaid/state-indicator/federal-matching-rate-and-multiplier/.

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444 N. Capitol St., Suite 642
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