

Note to the Coalitions:**GETTING TO THE BOTTOM OF FEDERAL
SPENDING AND TAXATION PATTERNS IN THE
NORTHEAST-MIDWEST REGION**

Since their founding in the mid-1970s, the Northeast-Midwest Institute and the Northeast-Midwest Congressional and Senate Coalitions have tracked and analyzed federal spending and taxation patterns. In doing so, the Institute and other organizations gained insight into regional equity relative to the flow of federal funds. Past analyses suggest that the majority of states in the Northeast and Midwest contribute more in taxes to the federal government than they receive back in federal spending, clearly underscoring the importance of the Northeast-Midwest region in fiscal support of the nation as a whole.

The Northeast-Midwest Institute has not provided information on federal taxation patterns for Northeast-Midwest states since its 2005 Flow of Funds Reports because its source of refined estimates, the Tax Foundation, ceased to produce them. This *Note to the Coalitions* provides an explanation of what data are still available, their limitations, and what they tell us about the characteristic position of many Northeast-Midwest states as “donor” states—states that receive fewer federal dollars than they pay in federal income and other taxes. We do so by considering a case example: the State of New Jersey.

Adjusted vs. Crude Taxation Data

In the past, the Tax Foundation based its tax burden estimates on tax collection data from the U.S. Treasury Department but adjusted the state-level numbers using formulas based on definitions and data from the National Income and Products Accounts of the U.S. Commerce Department's Bureau of Economic Analysis. Their proprietary methodology attempted to account for taxes collected in one state but effectively paid by residents or entities in other states. For example, the Tax Foundation method distributed federal corporate income taxes collected in one state more broadly to areas in other states under the assumption that a corporation's consumers, workers, and shareholders nationwide bear that tax burden. Similarly, The Tax Foundation assigned excise taxes on oil solely to the states where those taxes were collected but distributed them more broadly under the assumption that consumers throughout the nation bear that tax. Unless these corporate and excise taxes are distributed to reflect who really bears the burden, use of the Treasury data will overestimate the tax burden on states where those taxes are assessed: Louisiana for oil and gas excise taxes, for example, and New Jersey for corporate taxes.

The adjusted taxation data are no longer readily available to the Northeast-Midwest Institute. Still, the crude data are easily accessed, and though less precise on a state-by-state basis, still informative of regional trends. The tables below, for example, use 2009 crude numbers only and do not take distribution considerations into account. Nevertheless, the crude data here present similar patterns to the historic adjusted flow patterns: Northeast-Midwest states are still the majority of donor states, and states such as Minnesota, Delaware, Connecticut, and New Jersey receive some of the smallest returns on their contributions.

Factors Influencing Rate of Federal Spending and Taxation: A Focus on New Jersey

Many factors influence a state's relative position nationally in the flow of federal funds. By way of illustration, we discuss New Jersey's 2009 ranking as a major donor state and consider possible explanations for this status. Table 1, below, shows the ratio of federal dollars received to federal taxes paid by each state in 2009, according to raw data from the Internal Revenue Service and the U.S. Census Bureau.¹ It suggests that states like Hawaii and Mississippi experienced the largest return per dollar paid to the federal government. On the contrary, New Jersey (48th), Connecticut, Minnesota, and Delaware all received less than one dollar on every federal tax dollar they contributed. The ranking based on net flow of federal funds, or federal tax payments minus federal funds received (Table 2), posits New Jersey as the largest donor state, with a difference of \$22.9 billion between tax payments and funds received. Table 3 shows that on a per capita basis (i.e., controlling for population size), New Jersey, along with Minnesota and Delaware, is still a major donor, with a net flow of \$2,630 per resident paid to the federal government. It is worth noting that 2009 data is unique because of the federal stimulus; this increase in the flow of federal funds to states can explain why so few states appear as donor states (ratio of less than 1.00) in the table below compared to past analyses.

TABLE 1. Ratio of Federal Dollars Received from to Federal Dollars Sent to Washington, D.C. by State, 2009²

| Rank | State | Ratio | Rank | State | Ratio |
|------|----------------|-------|------|----------------|-------|
| 1 | Hawaii | 3.65 | 26 | Oklahoma | 1.54 |
| 2 | Mississippi | 3.42 | 27 | Missouri | 1.53 |
| 3 | New Mexico | 3.35 | 28 | Indiana | 1.45 |
| 4 | West Virginia | 3.13 | 29 | Utah | 1.45 |
| 5 | Alaska | 3.04 | 30 | Georgia | 1.41 |
| 6 | Alabama | 2.72 | 31 | Louisiana | 1.39 |
| 7 | Virginia | 2.65 | 32 | Nevada | 1.37 |
| 8 | Montana | 2.64 | 33 | Washington | 1.37 |
| 9 | South Carolina | 2.63 | 34 | New Hampshire | 1.36 |
| 10 | Maine | 2.33 | 35 | North Carolina | 1.34 |
| 11 | Idaho | 2.17 | 36 | California | 1.31 |
| 12 | Kentucky | 2.15 | 37 | Pennsylvania | 1.27 |
| 13 | Vermont | 2.11 | 38 | Colorado | 1.24 |
| 14 | North Dakota | 2.09 | 39 | Massachusetts | 1.20 |
| 15 | Maryland | 2.07 | 40 | Texas | 1.13 |
| 16 | Arizona | 1.95 | 41 | Arkansas | 1.06 |
| 17 | South Dakota | 1.94 | 42 | Rhode Island | 1.06 |
| 18 | Kansas | 1.70 | 43 | Ohio | 1.04 |
| 19 | Iowa | 1.67 | 44 | Nebraska | 1.02 |

¹ Census Bureau data on federal spending by state exclude dollars that could not be distributed by state or that were unavailable. Such amounts include interest payments on national debt, international payments and foreign aid, current operational expenses not included under salaries or procurement, expenditures for selected agencies, and foreign outlays.

² Unlike past analyses produced by the Northeast-Midwest Institute, these rankings are based on crude data sets and do not take into consideration taxes collected in one state but effectively paid by residents or entities in other states. Additionally, unlike past analyses, these rankings do not adjust for budget deficits or surpluses in order to make national spending equal to national taxation (i.e. for every national tax dollar, the nation receives \$1 in federal spending).

| Rank | State | Ratio | Rank | State | Ratio |
|------|-----------|-------|------|-------------|-------|
| 20 | Michigan | 1.64 | 45 | New York | 1.01 |
| 21 | Wyoming | 1.64 | 46 | Illinois | 1.00 |
| 22 | Florida | 1.59 | 47 | Connecticut | 0.95 |
| 23 | Wisconsin | 1.59 | 48 | New Jersey | 0.78 |
| 24 | Tennessee | 1.56 | 49 | Minnesota | 0.68 |
| 25 | Oregon | 1.55 | 50 | Delaware | 0.59 |

Table produced by Dr. Michael Lahr, Rutgers University. Sources: *Internal Revenue Service Data Book, 2009*, Publication 55B, March 2010; Consolidated Federal Funds Report for Fiscal Year 2009: State and County Areas, U.S. Census Bureau, August 2010.

**TABLE 2. Net Flow of Funds from the Federal Government
(Revenues minus Expenditures) by State 2009**

| Rank | State | Difference (in thousands) | Rank | State | Difference (in thousands) |
|------|----------------|---------------------------|------|---------------|---------------------------|
| 1 | Virginia | 96,955,719 | 26 | Oklahoma | 13,218,590 |
| 2 | California | 81,101,609 | 27 | Oregon | 11,857,357 |
| 3 | Florida | 65,527,191 | 28 | Iowa | 11,754,593 |
| 4 | Maryland | 47,670,016 | 29 | Alaska | 9,544,843 |
| 5 | Michigan | 35,952,311 | 30 | Colorado | 9,321,392 |
| 6 | Alabama | 34,580,578 | 31 | Maine | 8,136,201 |
| 7 | Arizona | 30,656,774 | 32 | Idaho | 8,038,368 |
| 8 | South Carolina | 29,097,397 | 33 | Montana | 6,788,989 |
| 9 | Pennsylvania | 29,073,021 | 34 | Utah | 6,431,161 |
| 10 | Kentucky | 26,698,304 | 35 | Nevada | 5,123,424 |
| 11 | Texas | 26,586,488 | 36 | South Dakota | 4,610,174 |
| 12 | Tennessee | 24,498,061 | 37 | North Dakota | 4,502,057 |
| 13 | Georgia | 24,430,749 | 38 | Ohio | 4,336,656 |
| 14 | Missouri | 23,632,000 | 39 | Vermont | 3,725,373 |
| 15 | Mississippi | 23,244,879 | 40 | New Hampshire | 3,104,162 |
| 16 | Wisconsin | 22,637,637 | 41 | Wyoming | 2,444,309 |
| 17 | North Carolina | 21,481,748 | 42 | Arkansas | 1,574,732 |
| 18 | New Mexico | 19,283,185 | 43 | New York | 1,528,084 |
| 19 | Indiana | 19,040,146 | 44 | Rhode Island | 607,795 |
| 20 | Washington | 17,972,280 | 45 | Nebraska | 325,600 |
| 21 | Hawaii | 17,862,408 | 46 | Illinois | -60,852 |
| 22 | Kansas | 14,330,646 | 47 | Connecticut | -2,095,141 |
| 23 | Massachusetts | 13,781,921 | 48 | Delaware | -5,546,353 |
| 24 | West Virginia | 13,475,736 | 49 | Minnesota | -21,955,589 |
| 25 | Louisiana | 13,474,152 | 50 | New Jersey | -22,901,696 |

Table produced by Dr. Michael Lahr, Rutgers University. Sources: *Internal Revenue Service Data Book, 2009*, Publication 55B, March 2010; Consolidated Federal Funds Report for Fiscal Year 2009: State and County Areas, U.S. Census Bureau, August 2010.

**TABLE 3. Per Capita Net Flow of Funds from the Federal Government
(Revenues Minus Expenditures) by State 2009**

| State | \$ | Rank | State | \$ | Rank |
|----------------|--------|------|-------------------|----------------|-----------|
| Hawaii | 13,791 | 1 | Florida | 3,535 | 26 |
| Alaska | 13,665 | 2 | Oregon | 3,099 | 27 |
| Virginia | 12,300 | 3 | Louisiana | 3,000 | 28 |
| New Mexico | 9,595 | 4 | Indiana | 2,964 | 29 |
| Maryland | 8,364 | 5 | Washington | 2,697 | 30 |
| Mississippi | 7,874 | 6 | Georgia | 2,486 | 31 |
| West Virginia | 7,405 | 7 | New Hampshire | 2,344 | 32 |
| Alabama | 7,344 | 8 | Utah | 2,310 | 33 |
| Montana | 6,963 | 9 | Pennsylvania | 2,307 | 34 |
| North Dakota | 6,960 | 10 | North Carolina | 2,290 | 35 |
| South Carolina | 6,379 | 11 | California | 2,194 | 36 |
| Kentucky | 6,189 | 12 | Massachusetts | 2,090 | 37 |
| Maine | 6,172 | 13 | Nevada | 1,938 | 38 |
| Vermont | 5,992 | 14 | Colorado | 1,855 | 39 |
| South Dakota | 5,675 | 15 | Texas | 1,073 | 40 |
| Idaho | 5,200 | 16 | Rhode Island | 577 | 41 |
| Kansas | 5,084 | 17 | Arkansas | 545 | 42 |
| Arizona | 4,648 | 18 | Ohio | 376 | 43 |
| Wyoming | 4,491 | 19 | Nebraska | 181 | 44 |
| Wisconsin | 4,003 | 20 | New York | 78 | 45 |
| Missouri | 3,947 | 21 | Illinois | (5) | 46 |
| Iowa | 3,908 | 22 | Connecticut | (596) | 47 |
| Tennessee | 3,891 | 23 | New Jersey | (2,630) | 48 |
| Michigan | 3,606 | 24 | Minnesota | (4,169) | 49 |
| Oklahoma | 3,585 | 25 | Delaware | (6,266) | 50 |

Table produced by Dr. Michael Lahr, Rutgers University Sources: *Internal Revenue Service Data Book*, 2009, Publication 55B, March 2010; Consolidated Federal Funds Report for Fiscal Year 2009: State and County Areas, U.S. Census Bureau, August 2010.

The Makings of a Donor State

Possible explanations for a state's donor status are: a) a relatively low receipt of federal spending, generally; b) a relatively high contribution of taxes, generally; or c) both. As shown below, New Jersey simultaneously generates a larger amount of federal tax dollars than most other states while receiving relatively fewer dollars back in federal spending.

Receipt of Federal Spending (i.e., Federal Expenditure)

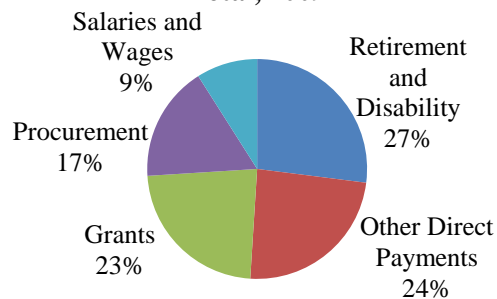
Many factors influence federal spending patterns, but demographic realities and their relationship to federal assistance programs are paramount. These demographic characteristics include a population's age composition, health, and economic well-being. Other drivers of federal investment in a state include: the incidence of emergency situations; industry mix; and presence of federal facilities, which determines federal expenditure on employee benefits, wages, and salaries. Data from the U.S. Census Bureau's Consolidated Federal Funds Report for fiscal year 2009 confirm that New Jersey received federal spending that was below average; that is, New Jersey has a relatively low receipt of federal spending. How is this determined, and how do the state's funding levels compare to national averages?

The major categories of federal spending are:

- *Retirement and Disability*: Social Security payments of all types, federal employee retirement and disability payments, veterans benefits, and other related federal expenditures
- *Other Direct Payments*: Medicare, federal unemployment insurance benefits, refunded Earned Income Tax Credits, agricultural assistance, Food Stamps, education grants, federal employee benefit premiums, rent supplements and assistance, disaster assistance, and other direct federal payments to entities and individuals (aside from retirement and disability payments)
- *Grants*: payments to state and local governments and nongovernmental recipients for block grants, formula grants, project grants, and cooperative agreements from all major departments and agencies of the federal government and for a wide variety of programs and purposes
- *Procurement*: spending for the government's purchase of goods and services, including utilities and building leases
- *Salaries and Wages*: pay to both civilian and military employees of the federal government, based on place of employment rather than place of residence

Figure 1 highlights the percent of total federal spending in each major category, nationally.

FIGURE1. Spending Category as Percent of U.S. Total, 2009



Now, we turn to more detailed state-specific information. Table 4, below, shows that New Jersey's per capita amount for Procurement was 22 percent below the national mean; Grants were 19 percent below. In addition, the state's per capita amount for Retirement and Disability—which was 38th highest in the nation—was three percent below the national mean. Per capita, New Jersey also received fewer dollars in federal Salaries and Wages than most other states, ranking the state 41st. Only the total for Other Direct Payments was above the national average (by 7%).

TABLE 4. Per Capita Federal Spending by Major Category: Fiscal 2009 (New Jersey)

| Category | Per-Capita Amount (in Dollars) | Rank among 50 States for Per Capita Amount | State Per Capita Amount as % of U.S. Per Capita Amount |
|---------------------------|-----------------------------------|--|---|
| Retirement and Disability | 2,741.60 | 38 | 96.9% |
| Other Direct Payments | 2,612.09 | 20 | 106.7% |
| Grants | 1,927.54 | 44 | 80.7% |
| Procurement | 1,383.96 | 23 | 78.3% |
| Salaries and Wages | 596.32 | 41 | 62.1% |
| Total | 9,261.51 | 38 | 89.1% |

Source: U.S. Census Consolidated Federal Funds Report, 2009

As noted above, New Jersey had relatively low receipts associated with these major categories of federal expenditure. Table 5, below, offers further details on federal spending in New Jersey. This table lists the state's ten largest grant programs in 2009 along with their funding amounts. Each program's per capita funding levels are compared to U.S. per capita amounts. A level above 100 percent in the last column indicates that program funding to the state exceeded the U.S. mean, adjusted for population. In 2009, the majority of New Jersey's federal grant money went to the Medical Assistance Program, followed by the Highway Planning and Construction Program. Two other transportation programs made this top-ten list: Federal Transit Formula Grants and Federal Transit Capital Investment Grants. Other grant programs accounting for the majority of the state's federal grant money were dedicated to education, children's health, and housing and other assistance for low-income families. For a number of these large grant programs, per capita funding amounts for New Jersey fell below national levels.

TABLE 5. Fiscal 2009 Amounts for New Jersey's Ten Largest Grant Programs

| Program | Grant as % of State Grant Total | State Total* (in Dollars) | State Per Capita Amount (in Dollars) | State Per Capita as % of U.S. Per Capita Amount |
|---|--|--------------------------------------|---|--|
| Medical Assistance Program | 37.3% | 6,268,351,329 | 719.86 | 76.7% |
| Highway Planning and Construction | 8.0% | 1,341,261,494 | 154.03 | 81.6% |
| State Fiscal Stabilization Fund (SFSF) – Education State Grants | 4.3% | 729,184,969 | 83.74 | 100.9% |
| Federal Transit Formula Grants | 4.1% | 691,552,151 | 79.42 | 268.2% |
| Section 8 Housing Choice Vouchers | 3.5% | 590,916,625 | 67.86 | 129.3% |
| State Children's Insurance Program (CHIP) | 3.0% | 505,395,001 | 58.04 | 169.6% |
| Temporary Assistance for Needy Families | 2.4% | 404,034,830 | 46.40 | 80.5% |
| Special Education-Grants to States | 2.1% | 359,278,067 | 41.26 | 111.9% |
| State Fiscal Stabilization Fund (SFSF) – Government Services, Recovery Act | 1.4% | 242,148,057 | 27.81 | 102.6% |
| Federal Transit – Capital Investment Grants | 1.4% | 240,692,549 | 27.64 | 207.9% |

* Fiscal 2009 funding may include dollars allocated in previous years.

Source: U.S. Census Consolidated Federal Funds Report, 2009

Why does New Jersey receive relatively little in federal expenditures? The health of New Jersey's population (relatively few disabilities), its relatively low poverty levels, and its low incidence of natural disasters limit the amount of federal funds expended to the state. According to the U.S. Census Bureau's 2009 American Community Survey:

- Only 7.9% of people over 65 were below the poverty level, a percentage which ranked the state 35th in the U.S. for percent of impoverished elderly residents, indicating relatively less need for Medicaid and Social Security Benefits than many other states;
- Relatively few New Jersey residents had a disability (10%, ranking the state 44th in the U.S.), indicating relatively less need for relevant federal support;
- New Jersey had a relatively small percentage of people (of all ages) below poverty level, ranking the state 47th for percent of impoverished residents generally. Poverty levels are factored into federal funding formulas for a number of programs; a low poverty level thus warrants fewer need-based program dollars.

In addition, according to the Federal Emergency Management Agency (FEMA):

- In 2009, New Jersey had relatively few natural disasters; FEMA declared only one major disaster, resulting from severe storms and flooding, thus needing fewer dollars for disaster relief.

Contribution of Federal Taxes (i.e., State Contribution)

The amount contributed by the population of New Jersey into federal coffers is relatively high; in terms of total tax revenue generated in 2009, New Jersey ranked 8th in the nation. How is this determined, and how do the state's contribution levels compare to national averages?

The major categories of federal taxation are:

- *Business Income Tax*: taxes on all businesses, except partnerships
- *Individual and Estate and Trust Income Tax*: include individual income taxes withheld, individual tax payments, and taxes on individual income from trusts and estates
- *Employment Taxes*: withheld from, and paid on behalf of, employees for social security and Medicare
- *Estate and Gift Taxes*: taxes on the right to transfer property at one's death and on the transfer of property by one individual to another
- *Excise Taxes*: paid when purchases are made on a specific good (such as gasoline) or activity

Figure 2 highlights the percent of total gross collection in each major category, nationally; Table 6 reports gross collection amounts by type of tax in New Jersey. When the total gross collection amount is divided by the state's 2009 population, the per capita contribution is \$11,892.

FIGURE 2. Tax Category as Percent of U.S. Gross Collection Total, 2009

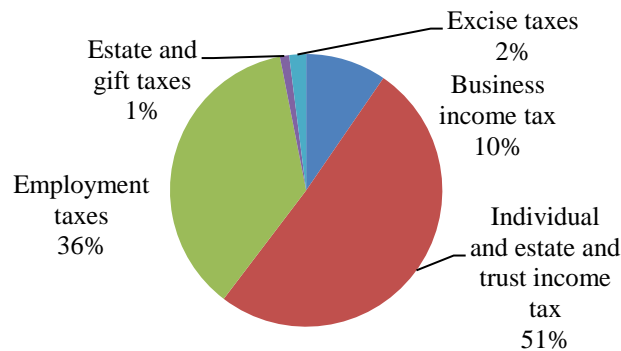


TABLE 6. Internal Revenue Gross Collections by Type of Tax, New Jersey, FY2009
(in thousands of dollars)

| Total Internal Revenue Collections | Business Income | Individual income, employment, and estate and trust income: Total | Estate | Gift | Excise |
|------------------------------------|-----------------|---|---------|--------|---------|
| 103,548,696 | 14,950,946 | 87,095,421 | 483,034 | 60,920 | 958,376 |
| % of Total | 14.4% | 84.1% | 0.47% | 0.06% | 0.93% |

Source: *Internal Revenue Service Data Book, 2009*, Publication 55B, March 2010

Why does New Jersey generate a larger amount of federal tax dollars than most other states? This can be explained in part by its greater-than-average business income tax contribution (at \$14 billion, its gross contribution ranked fourth in the nation in 2009). In addition, the state's relatively high incomes result in increased tax revenue. Consider that in 2009:

- The state had the 2nd highest median household income (\$68,342, inflation-adjusted dollars).

TABLE 7. Top Ten Median Household Incomes among States, 2009

| Rank | State | Median Household Income | Margin of Error (+/-) |
|------|----------------------|-------------------------|-----------------------|
| 1 | Maryland | 69,272 | 696 |
| 2 | New Jersey | 68,342 | 659 |
| 3 | Connecticut | 67,034 | 993 |
| 4 | Alaska | 66,953 | 2,331 |
| 5 | Hawaii | 64,098 | 1,574 |
| 6 | Massachusetts | 64,081 | 680 |
| 7 | New Hampshire | 60,567 | 1,385 |
| 8 | Virginia | 59,330 | 482 |
| 9 | District of Columbia | 59,290 | 1,710 |
| 10 | California | 58,931 | 274 |

Table adapted from American Community Survey ranking, 2009

Thus, it is the combination of low federal receipts to and high federal contributions from New Jersey that amplify the donor position of the state nationally.

Conclusion

Precise rankings by state of relative flows of federal funds are elusive in the absence of a complex formula for tax burden distribution that is sensitive to each state's economic drivers. It is nonetheless possible to detect regional patterns in the flow of federal funds using unadjusted data. For example, in 2009, the raw data suggest that all donor states—Minnesota, Delaware, Connecticut, and New Jersey—were Northeast-Midwest states. We would expect their position in the ranking among all states to remain at the low end in terms of return on the tax dollar, whether or not the data are adjusted. As this *Note to the Coalitions* indicates, however, New Jersey's clear donor status in many ways is good news for the state. The low ranking results from the state's relatively high income levels and greater-than-average business income tax contribution, coupled with a relatively low need for federal aid. It does, however, underscore the importance of states like New Jersey in supporting the fiscal health of the nation generally.

Prepared by:
Colleen Cain, PhD
Senior Policy Analyst
Northeast-Midwest Institute
50 F St. NW, Suite 950
Washington, DC 20001
202.464.4005
ccain@nemw.org

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