

CALIFORNIA'S BALANCE OF PAYMENTS WITH THE FEDERAL TREASURY FY 1981-2000

“CALIFORNIA TAXPAYERS PAID A RECORD \$29 BILLION WINDFALL TO WASHINGTON IN 2000, AGAIN BREAKING THE STATE'S OWN DEFICIT RECORD AND ENDURING A 14TH STRAIGHT YEAR AS A DONOR STATE”

APRIL 2002

In fiscal year 2000, California's "trade deficit" with the federal government worsened for the sixth year in a row. The state's taxpayers endured their 14th consecutive year of sending more money in taxes to Washington than were received back in federal government expenditures in the state. Californians have subsidized the rest of the nation for nearly a decade and a half, and the trend is growing.

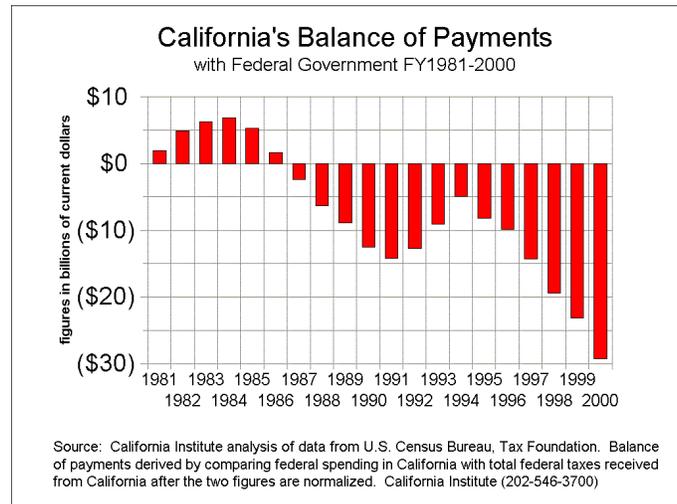
CALIFORNIA BALANCE OF PAYMENTS

In 2000, Californians sent nearly \$30 billion more to Washington in federal taxes than the state received back in federal spending. This \$29.3 billion total was an all-time record for any state, surpassing the previous mark -- also set by California in 1999 -- of \$23.1 billion. The state's exchange with Washington was thus more than \$6 billion further into the red than just one year prior.

It has been many years since the heyday of California's federal spending surpluses. The defense buildup during Ronald Reagan's first Presidential term in the early 1980s kept California's federal balance of payments in the black for six straight years, peaking at \$6.8 billion surplus in fiscal 1984. As defense procurement began to decline in the mid 1980s, however, California's federal funding advantage waned. The state's balance shifted from the black into the red in 1987, and it has remained there ever since.

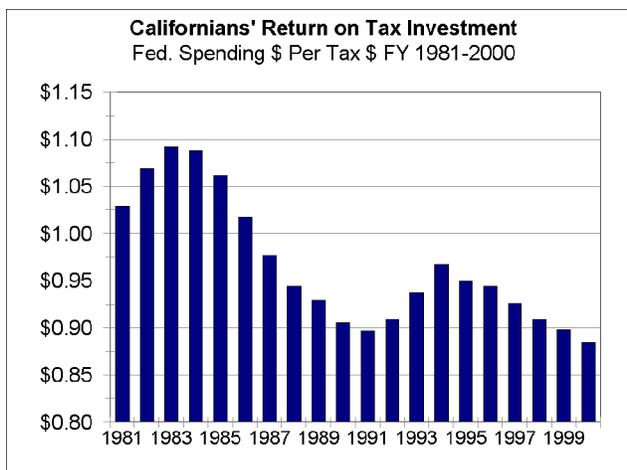
By 1990, California's losses over just four years had already erased the inflows won throughout the early 1980s. From 1981 to 1986, federal spending in California exceeded taxes paid by \$26.9 billion -- a sizeable surplus. From 1987 to 1990, however, California taxpayers sent \$30.2 billion more to Washington than came back in spending. By fiscal year 2000, the 14-year combined tally had grown to \$175 billion, and the trend shows no signs of abating in the foreseeable future.

In the early 1990s, the balance figure dipped from a nearly \$15 billion loss in 1991 to just



a \$5 billion shortfall in 1994. But the retreat was short-lived, and deficits have charged forward at a steady clip ever since, rising an average of \$4 billion per year for the past six years.

This taxing-versus-spending imbalance means that every individual California man, woman, and child paid \$864 more in federal taxes last year than he or she received in federal funds and services. Put differently, California receives only 88 cents in federal services for every dollar sent to Washington -- a decline from 90 cents in 1999 and the lowest return in at least 20 years.



California is not the worst off among the states. According to the Washington D.C.-based, non-partisan Tax Foundation, California ranks 40th among all states in balance of payments. The biggest winner, New Mexico, ranked first with a balance of \$2.03 in return for every dollar paid to Washington, while Connecticut ranked 50th, receiving just 62 cents for each dollar paid.

The balance of payments figure is calculated by comparing federal spending attributable to each state (excluding unallocable costs such as overseas defense operations and interest on the national debt) against federal tax and fee revenue dollars collected by state. The tax burden figure is then adjusted to provide an "apples-to-apples" comparison between the two numbers.¹

COMPONENTS OF THE DEFICIT: CALIFORNIA'S SHARE OF THE U.S. POPULATION, FEDERAL TAX BURDEN, AND FEDERAL EXPENDITURES

Two primary factors comprise the balance of payments: taxes and spending. For fairness and fair-share assessment purposes, we also include the state's share of the U.S. population as an illustrative benchmark.

In 1999, California housed 12.0% of the nation's residents, but it paid 12.6% of federal taxes and received back just 11.1% of federal payments and expenditures.

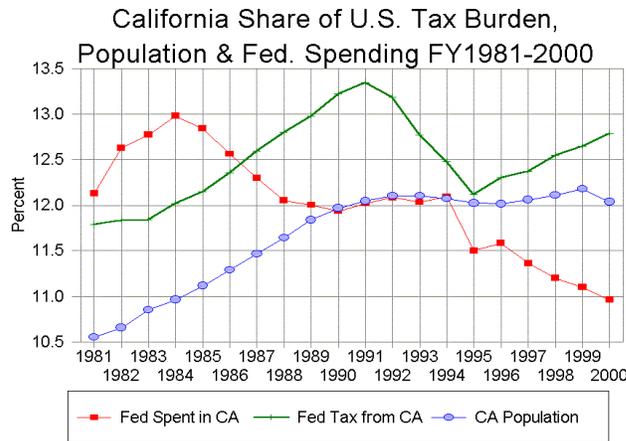
Population: With 12% of the U.S. population, California is home to nearly one in eight Americans. According to the Census Bureau, this figure remained relatively stable throughout the 1990s -- a marked contrast with the 1980s, during which California's share of the national population rose steadily from 10.5% in 1981 to 12.0% in 1990. Some charge that the Census Bureau's counting techniques underestimate California's population and thus its share of the

¹ The federal government generally operates in surplus or deficit in any given year, so national totals for expenditures and tax burden never match. Thus, we adjust each year's tax burden figure to equalize it with spending, thereby deducing California's fair share of any surplus or deficit and creating a balance. In fact, without that adjustment, California's raw balance of payments figure would have been far more stark. The unadjusted balance of payments figures for 2000 had California a donor state to the tune of \$77.7 billion. Since there was a budget surplus that year, however, the adjustment recognizes that even the average state also paid somewhat more in taxes than it received in spending.

national total.

Taxes: California's share of the nation's \$2 trillion tax burden increased to 12.8% in fiscal year 2000, rising from 12.6% in 1999 and 12.1% in 1995. The state's increasing share of the nation's federal tax burden is due in part to a rebounding economy in California relative to other

states. The share remains below the peak in 1991, when California shouldered 13.4% of the nation's federal tax burden. Between 1991 and 1995, a debilitating recession -- considerably worse in California than in other states -- served to reduce the relative share of federal contributions from our state's taxpayers. Yet despite its greater misery, the state remained a donor state with respect to the rest of the country throughout the 1990s recession.



Sources: U.S. Census Bureau, The Tax Foundation, The California Institute.
Data prepared by the California Institute for Federal Policy Research (202) 546-3700.

As has been true for more than half a century, California's \$253 billion contribution to the federal

treasury in 2000 was by far the largest raw total of federal tax dollars of any state, well above both New York's \$159 billion and Texas's \$137 billion, according to the Tax Foundation.

Federal Spending: California's share of total federal spending receipts declined to 11.0% in 2000 -- a steady decline from 11.1% in 1999, and from 11.6% in 1996.² And these late-1990s levels remain well below the 12% level at which California's federal receipts had hovered for the preceding seven years. In the early 1980s, federal spending in California leapt from 12% in 1981 to 13% in 1984, propelled largely by military procurement contracts won by California's aerospace industry, before settling back to the 12% mark in 1988. Spending in California remained at 12% of the U.S. total until 1994 when the current decline began.

Federal spending totals are comprised of expenditures in various categories. In accounting for federal dollar flows, the Census Bureau divides spending into five components: Procurement; Grants to States and Local Governments (mostly formula grants); Salaries and Wages; and Direct Payments to Individuals. California's 2000 share of federal spending on procurement (which

² To assess federal spending, we use the Census Bureau's annual Consolidated Federal Funds Report, but we alter their U.S. total figures by backing out funds not spent in states or D.C., such as spending in Puerto Rico and the territories, as well as so-called undistributed funds (those appropriated but not spent). For example, of the nation's \$1.63 trillion defined by Census as spent in 2000, \$20.1 billion was undistributed and \$13.7 billion was spent in territories. Thus, we set the U.S. total spending figure at \$1.60 trillion, and California's percentage share is calculated to be slightly higher. While our report shows California's share of total spending as 11%, the Census report's figure is 10.7%.

The impact is most pronounced in the procurement category, which accounts for \$16.5 billion of the nation's undistributed spending, where our analytical method gives California 13.1% of procurement funds, while the Census Bureau report sets the state's share at 12.1%.

includes defense and other contract spending) declined sharply from 13.6% to 13.1% in 1999, a big drop compared to the prior 0.2% fall in the prior year, but still not as drastic as the 1998-1999 freefall from 15.2% to 13.8%.

Californians' share of all U.S. direct payments to individuals (which includes massive outlays for Social Security and medicare payments) recovered slightly, rising from 10.2% in 1999 to 10.4% in 2000, but the long term trend is downward, from 10.5% in 1998 and 10.8% in 1997. The state's share of all

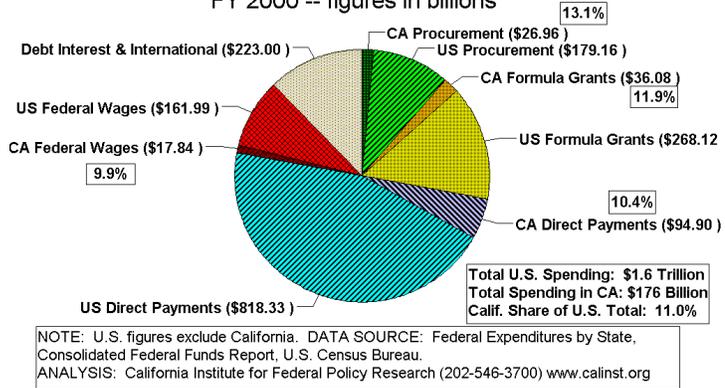
federal salaries and wages continued its downward march, decreasing from 10.3% in 1999 to just 9.9% in 2000. Meanwhile, California's share of federal formula and categorical grants to state and local governments dropped as quickly as it had risen the prior year -- after jumping upward significantly from 12.1% to 12.6% in 1999, formula grant funds in 2000 fell back down to 11.9% of the U.S. total, the lowest level in seven years.

Parallel analysis of the same data in a slightly different fashion shows that, in FY 2000, the federal government spent \$5,187 per capita in California, while it spent \$5,819 per capita nationwide, more than an 11% discrepancy.

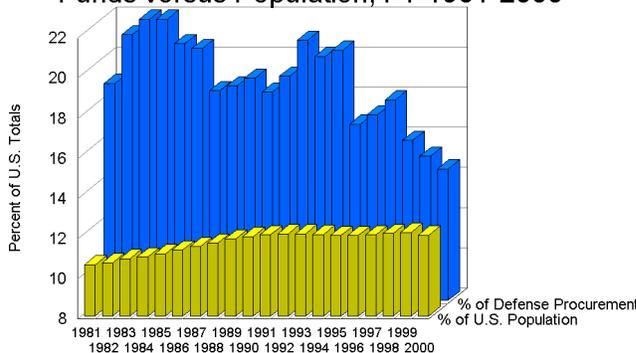
It is important to remember that federal tax burden figures for each year largely reflect the economic condition of the prior year -- i.e., in 2000, California taxpayers filed taxes on their 1999 earnings.

The federal income tax system causes states, such as California, which have an above average income level to pay more in taxes than the average state, despite the fact that vastly higher housing prices and other costs of living mean that the average Californian may actually have considerably less disposable income than the average resident of a lower-taxed state. An annual salary of \$60,000 in Arkansas or South Dakota affords a vastly different buying power and standard of living compared to the same salary in Santa Clara or Orange Counties, yet federal income tax rules treat them identically.

Federal Spending in California vs U.S.
FY 2000 -- figures in billions



California % share of DOD Procurement Funds versus Population, FY 1981-2000



Prepared by the California Institute for Federal Policy Research (202-546-3700).
Data Source: Consolidated Federal Funds Report, U.S. Census Bureau.

PROCUREMENT

In FY 2000, total federal spending nationwide on procurement rose 8.5%, from \$190 billion to \$206 billion. In California, the rise was barely half as strong, with procurement spending rising 4.5%, from \$25.8 billion to \$26.9 billion. This follows a smaller decline for the prior year, when the U.S. rose 3.4% and

California 1.7%, which in turn came on the heels of an actual decline for the two prior years.

Over the last fifteen years, no single category of federal spending in California has experienced a more precipitous decline than procurement. In 1998, federal procurement expenditures in California declined to their lowest level since 1981 in current-dollar terms, and the last two years' slight uptick does not repair the situation. The figures would be far more stark if inflation were taken into account. After adjusting for inflation, California's procurement awards are now less than half of their 1985 levels.

Overall procurement expenditures by the Department of Defense, which spends nearly two of every three federal procurement dollars, accounts for much of the decline. California's share of total U.S. procurement expenditures (defense and non-defense) held nearly steady at the 18% mark for a decade, declined to about 15% for 1995-97, and dropped to its 13.1% low point over the last three years.

California's share of procurement spending for national defense was once as high as 23%, a level reached in 1984. Falling below the 15% mark for the first time in memory during FY 2000, the state's share of 14.6% culminated a three year, short term drop and perpetuated a long term backslide which has continued for more than a decade and a half.

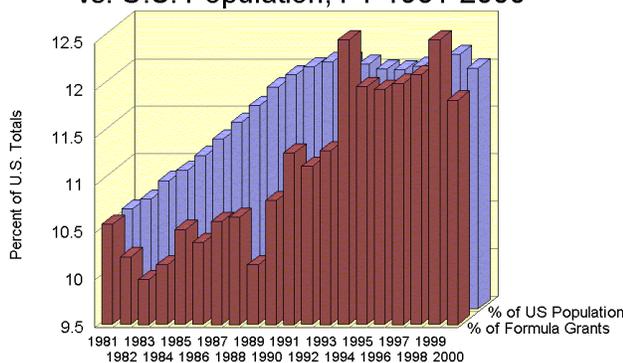
FORMULA GRANTS

Formula grants spending in the state dropped sharply from 1999 to 2000, but much of the decline is attributable to a correction of the prior years aberrant rise. For the most part, California's share of federal grants to state and local governments has remained stable at roughly 12% for six consecutive years. In 1999, grants funding had risen significantly to 12.6% after remaining stable at roughly 12% for four consecutive years. In 2000, the share fell to 11.9%.

The bulk of these grant funds are distributed to states by congressionally designed formulas. The formulas are sometimes based at least partially on population and income data gathered during the decennial census, and, therefore, many of these data are significantly outdated by the time the next decennial census is conducted. The California Congressional delegation has fought for years to correct this funding lag.

Roughly 60% of the \$304 billion in U.S. grants funding was distributed pursuant to four programs: Medicaid, highway grants, welfare, and Title I education grants. In the single largest federal formula program, Medicaid, California's share was 10.6% in FY 2001. The state received \$14.1 billion of the \$132.7 billion distributed nationwide. While the state's share represents a slight increase over the roughly 10% share the state received during the preceding decade, California's share of Medicaid funding has long been artificially reduced by the inappropriate use of a per capita income factor, which shifts funds to other states.

Calif. Share of Federal Formula Grants vs. U.S. Population, FY 1981-2000



Sources: U.S. Census Bureau, Office of Management & Budget, California Institute. Data prepared by the California Institute for Federal Policy Research, 202-546-3700.

California also is perennially a donor state with regard to the federal highway trust fund. For many years, California has received back less in road projects than it has put into the fund in gasoline taxes. In 2001, California received \$2.25 billion in highway planning and construction funds out of the \$27.6 billion distributed nationwide, or 8.1% of the U.S. total. However, the negative overall transportation fund expenditure share is somewhat softened when transit funds are calculated in the mix. California received \$995 million or 24.3% of the total \$4.1 billion distributed nationally under federal urbanized area transit formula grants.

When federal welfare reform was enacted in 1996, California housed 21.7% of the nation's adult welfare recipients, and therefore the state has continued to receive the lion's share of the nation's welfare program. Thus, even though nationwide totals for highway programs are larger than for welfare -- \$27.6 billion in 2001 for highways versus \$16.6 billion for welfare -- California actually received far more in federal welfare payments (\$3.73 billion) than in payments under the highway program (\$2.25 billion). In FY 2001, California received 22.7% of federal welfare spending under TANF, the Temporary Assistance for Needy Families program.

In FY 2001, the Title I program, the federal government's largest K-12 education grant, sent slightly more than \$1 billion (or 12.4%) of its \$8.1 billion basic and concentration grant funding to California. The 12.4% figure continues a gradual rise in the state's share from an 11% average over the preceding decade, a rise attributable in part to the California Congressional delegation's efforts to counteract usage of outdated census data. Nevertheless, California houses more than 15% of the nation's children living in poverty, but outdated poverty data usage and unfavorable formula factors conspire to sharply reduce the state's share of Title I dollars.

DIRECT PAYMENTS TO INDIVIDUALS

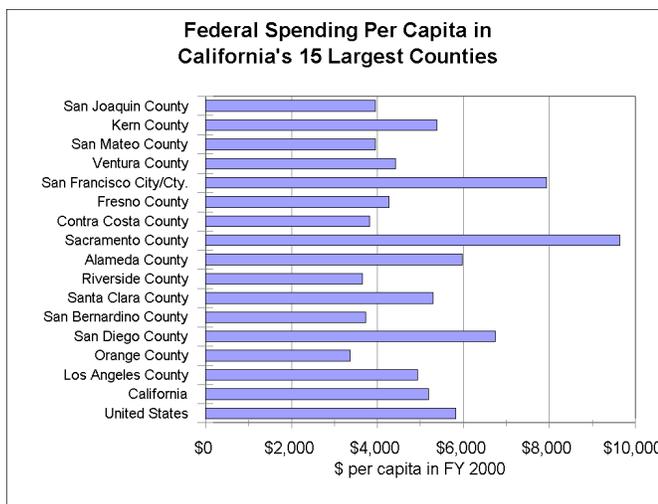
Nationwide, direct payments to individuals from the federal government continued to grow strongly, rising from \$260 billion in 1981 to \$913 billion in 1999. Last year alone, direct payments nationwide rose from \$845 billion to \$913 billion. The \$94.9 billion received by Californians in 2000 is more than triple the \$26 billion received in 1981. Roughly half of direct payments come in the form of social security checks, while another 20% are medicare payments.

Total payments to Californians rose from \$86.2 billion in FY 1999 to \$94.9 billion in 2000. The sharp rise comes in part as a correction from the prior year, during which direct payment figures uncharacteristically declined -- the only time over the past two decades to see a contraction in payments. Californians' share of direct payment dollars remained relatively constant throughout the early and mid-1990s, roughly tracking California's share of the nation's older population. Through the last three years, however, that share declined from 10.8% in 1997, to 10.5% in 1998, and 10.2% in 1999, before rebounding to 10.4% in 2000.

WITHIN CALIFORNIA

California's 15 largest counties house 81% of the state's population and a proportionate share of most federal spending categories, though they account for nearly 92% of the state's procurement receipts. Not surprisingly, federal receipts vary greatly from county to county. While Los Angeles County's \$46.9 billion in federal receipts is nearly 20% of the state total, *per capita* federal spending in Los Angeles county (\$4,930) is below both the average for both the state (\$5,189) and the nation (\$5,817).

Per capita federal receipts in the largest counties ranged from a high of \$9,642 in Sacramento County to a low of \$3,369 in Orange County. (Because of its state government presence, more than \$6 billion in formula grant spending was attributed to Sacramento County, thus artificially inflating its total.) Other counties with relatively high per capita receipts included San Francisco, at \$7,928, and San Diego, at \$6,749. San Francisco's high receipts are likely attributable to federal grants receipts and federal wages, both of which are more than double the state and national averages. In San Diego, high receipts are associated with strong procurement receipts and with very strong military related-salaries and wages. In addition to Orange County, relatively low per capita federal receipts were logged in the Counties of Riverside (\$3,646), San Bernardino (\$3,724), Contra Costa (\$3,817), San Joaquin (\$3,955), Ventura (\$3,955), Fresno (\$4,268), and San Mateo (\$4,417).



OTHER FACTORS CONTRIBUTING TO THE STATE'S SHORTFALL

Several factors contribute to the state's taxes-versus-spending disparity. First, happily, California remains a relatively prosperous state. Despite a debilitating economic downturn early in the last decade, the likes of which had not gripped the state for more than half a century, incomes of California's residents remain above the national average. Thus, the state's residents pay relatively more in federal income taxes.

Second, California is a relatively young state and thus has fewer residents receiving payments under Social Security and Medicare, an increasingly large slice of the federal budget pie. In 2000, 10.6% of Californians were age 65 or older, compared to 12.4% of all U.S. residents.

A third key factor in California's ongoing funding disparity is continued slippage in federal procurement spending, to some extent total spending but primarily the state's share thereof. Defense contract spending fell from \$123 billion in 1991 to \$108 billion in 1998, even before accounting for inflation, yet it returned to the \$123 billion level in 2000. California's defense procurement funding, on the other hand, has been faster to fall and slower to recover -- falling from \$23.6 billion in 1991 to \$17.3 billion in 1998, yet climbing back only as far as \$17.9 billion in 2000. While the early 1980s saw nearly one-fourth of defense contract dollars spent in California, the state's 2000 share fell to 14.6%, the lowest level on record.

Despite the state's taxes-versus-spending disparity, opportunistic legislators from other states continue to view California as a drain on the federal treasury and as a competitor for the federal dollars they covet. If that perception were ever valid, it certainly is no longer. As has been the case for more than a decade, California subsidizes the rest of the nation at unrivaled levels.

Sources: Federal Expenditures by State for FY 1981-2000, U.S. Census Bureau, Washington, DC; Federal Tax Burden by State, 2000, The Tax Foundation, Washington, DC; California Institute staff research and analysis.

Federal Spending, Tax and Population Figures for U.S. and California

U.S. Totals:							Tot. U.S. per cap US CA Total			
YEAR	US-total	US-procur	US-grnts	US-wages	US-direct	US-other	US popn	Tax Burden	Tax Burden	Bal of Pmts
1981	572338	119297	94802	92180	259520	6541	229542	581595	2534	846
1982	613658	135412	88267	97136	286070	6773	231822	597472	2577	6784
1983	676080	142088	92286	102131	319195	20379	233806	580619	2483	17606
1984	706451	160150	96744	108649	324390	16519	235847	645043	2735	14210
1985	761642	189009	100828	114721	345987	24375	237950	709400	2981	11631
1986	802969	186497	108954	119645	360945	26614	240162	744578	3100	8848
1987	819155	104005	104005	125895	380073	32998	242321	830536	3427	-3853
1988	849492	164648	109835	133341	404396	37270	244534	884364	3617	-10837
1989	905100	162590	117831	141919	448936	37030	246820	963376	3903	-16411
1990	970415	165781	128947	145012	493266	35797	248710	999473	4019	-16387
1991	1062541	183538	149306	155341	537344	37010	252177	1026910	4072	-9417
1992	1156038	175152	176756	160494	607033	39387	255082	1059276	4153	29
1993	1224690	176340	191029	165036	645979	46306	257908	1130180	4382	3036
1994	1284893	174293	209328	167736	691114	47119	260341	1230933	4728	1725
1995	1326292	177760	224316	165724	711645	46840	262755	1319000	5020	-7266
1996	1359350	180909	220537	167291	743038	46748	265284	1423169	5365	-17679
1997	1416142	172978	224375	163630	775689	57415	267633	1553934	5806	-31354
1998	1442765	183572	264456	165707	829020	10	269727	1689252	6263	-50356
1999	1495951	189883	288303	172788	844976	0	272172	1792675	6587	-60681
2000	1603368	206114	304202	179826	913226	0	281422	1982491	7045	-77730

California							CA's Fed per cap CA CA Adjusted			
YEAR	CA-total	CA-procur	CA-grnts	CA-wages	CA-direct	CA-other	CA popn	Tax Burden	Tax Burden	Bal of Pmts
1981	69416	21647	10008	11074	25748	940	24216	68570	2832	1937
1982	77501	27521	9016	12048	28224	693	24698	70717	2863	4868
1983	86364	30856	9207	12791	31252	2258	25367	68758	2711	6301
1984	91713	34178	9799	13461	32694	1581	25847	77503	2999	6832
1985	97814	35208	10589	14431	35362	2225	26444	86183	3259	5284
1986	100860	35228	11291	15052	36960	2328	27106	92012	3395	1632
1987	100753	32212	11006	15506	39261	2769	27781	104606	3765	-2420
1988	102366	29457	11676	16380	41941	2913	28468	113203	3976	-6373
1989	108639	29455	11936	17604	46729	2916	29218	125050	4280	-8847
1990	115802	29500	13932	17746	51448	3117	29760	132189	4442	-12544
1991	127684	32101	16885	18519	56631	3549	30380	137101	4513	-14174
1992	139695	32353	19738	18988	64816	3800	30867	139666	4525	-12729
1993	147364	31483	21635	19239	70952	4056	31211	144328	4624	-9033
1994	155391	30416	26219	18830	75466	4460	31431	153666	4889	-5011
1995	152534	26537	26934	18376	75818	4868	31589	159800	5059	-8149
1996	157446	27724	26413	18038	80432	4839	31878	175125	5494	-9826
1997	160874	26247	27014	17587	84090	5936	32268	192228	5957	-14309
1998	161571	25365	32090	17344	86771	1	32667	211927	6487	-19433
1999	166050	25795	36370	17733	86152	0	33145	226731	6841	-23152
2000	175751	26955	36080	17835	94881	0	33872	253481	7484	-29256

California							Per capita			CA Return
YEAR	Total	Procurmnt	Grants	Wages	Dir Pmts	Other	Populn	Tax Burden	Bal of pmts	per tax \$
1981	12.1	18.1	10.6	12.0	9.9	14.4	10.5	11.8	80	\$1.03
1982	12.6	20.3	10.2	12.4	9.9	10.2	10.7	11.8	197	\$1.07
1983	12.8	21.7	10.0	12.5	9.8	11.1	10.8	11.8	248	\$1.09
1984	13.0	21.3	10.1	12.4	10.1	9.6	11.0	12.0	264	\$1.09
1985	12.8	18.6	10.5	12.6	10.2	9.1	11.1	12.1	200	\$1.06
1986	12.6	18.9	10.4	12.6	10.2	8.7	11.3	12.4	60	\$1.02
1987	12.3	18.3	10.6	12.3	10.3	8.4	11.5	12.6	-87	\$0.98
1988	12.1	17.9	10.6	12.3	10.4	7.8	11.6	12.8	-224	\$0.94
1989	12.0	18.1	10.1	12.4	10.4	7.9	11.8	13.0	-303	\$0.93
1990	11.9	17.8	10.8	12.2	10.4	8.7	12.0	13.2	-421	\$0.91
1991	12.0	17.5	11.3	11.9	10.5	9.6	12.0	13.4	-467	\$0.90
1992	12.1	18.5	11.2	11.8	10.7	9.6	12.1	13.2	-412	\$0.91
1993	12.0	17.9	11.3	11.7	11.0	8.8	12.1	12.8	-289	\$0.94
1994	12.1	17.5	12.5	11.2	10.9	9.5	12.1	12.5	-159	\$0.97
1995	11.5	14.9	12.0	11.1	10.7	10.4	12.0	12.1	-258	\$0.95
1996	11.6	15.3	12.0	10.8	10.8	10.4	12.0	12.3	-308	\$0.94
1997	11.4	15.2	12.0	10.7	10.8	10.3	12.1	12.4	-443	\$0.93
1998	11.2	13.8	12.1	10.5	10.5	10.0	12.1	12.5	-595	\$0.91
1999	11.1	13.6	12.6	10.3	10.2	0.0	12.2	12.6	-699	\$0.90
2000	11.0	13.1	11.9	9.9	10.4		12.0	12.8	-864	\$0.88

(Note: "adjusting" the tax burden figure makes it equal the federal spending figure for balance calculation.) Note: Figures not adjusted for inflation. Totals figures in millions. Totals exclude undistributed funds.

Sources: Federal Expenditures by State for FY81-99, Census Bureau; Stat. Abstract of the U.S., 91-99 U.S. Census Bureau; Budget Information for the States for FY 1991-2001, Office of Mgmt & Budget; State Census Data Center, California Department of Finance; Tax Foundation; California Institute.