

In Search of a Post-Partisan Fiscal Federalism

Kirk J. Stark

Professor of Law, UCLA





Introduction

- “Post-Partisan”[®] – [poʊst • ˈpɑr-tə-zən]
 - *“a new kind of politics, one that can excavate and build upon those shared understandings that pull us together as Americans.” ~BHO, POTUS₄₄*

- “Fiscal Federalism” – [ˈfɪs-kəl • ˈfɛd-ər-ə-lɪz-əm]
 - 1. *“a public sector with both centralized and decentralized levels of decision-making in which choices made at each level concerning the provision of public services are determined largely by the demands for these services of the residents of ... the respective jurisdiction.” ~ OATES (1972)*
 - 2. *the set of policies by which the U.S. federal government provides fiscal assistance state and local governments*



Fiscal Assistance to State & Local Governments

- There are 3 principal sources of fiscal assistance to state/local governments (data from CBO 2008 for FY2007):
 - Direct federal grants (e.g., Medicaid): \$444 billion
 - Deduction for state/local taxes: \$51 billion
 - Exemption for interest on state/local bonds: \$37 billion

- Exaggerated and unsupportable statement of basic thesis:
 - These policies have always systematically favored (and continue to systematically favor) wealthy, high-income states that are least in need of fiscal assistance due to their robust own-source revenues.
 - The foregoing statement is \approx 78 percent true.



Fiscal Disparities among U.S. States (2005)

[based on “representative tax system” methodology]

- 2005 Per Capita RTS Fiscal Capacity for entire U.S.: \$3,726

- *Rich States* -- Top Five States in RTS Fiscal Capacity:
 - 1. Alaska: \$5,344
 - 2. Wyoming: \$5,134
 - 3. Massachusetts: \$5,019
 - 4. Connecticut: \$4,910
 - 5. Delaware: \$4,904

- *Poor States* -- Bottom Five States in RTS Fiscal Capacity:
 - 46. Alabama: \$2,997
 - 47. Louisiana: \$2,985
 - 48. Arkansas: \$2,892
 - 49. West Virginia: \$2,763
 - 50. Mississippi: \$2,607



A Closer Look: **Massachusetts** & **Arkansas**

<input type="checkbox"/> United States:	<u>Per Capita Revenue Collections</u>	
■ Individual Income Tax:		\$ 813
■ Retail Sales Taxes:		\$ 887
■ Property Tax:		\$1,132
■ All Taxes Combined:		\$3,726
<input type="checkbox"/> Massachusetts:	<u>Capacity</u>	<u>Actual</u>
■ Individual Income Tax:	\$1,124	\$1,506
■ Retail Sales Taxes:	\$ 962	\$ 605
■ Property Tax:	\$1,932	\$1,607
■ All Taxes Combined:	\$5,019	\$4,482
<input type="checkbox"/> Arkansas:	<u>Capacity</u>	<u>Actual</u>
■ Individual Income Tax:	\$ 567	\$ 676
■ Retail Sales Taxes:	\$ 771	\$1,199
■ Property Tax:	\$ 723	\$ 422
■ All Taxes Combined:	\$2,892	\$2,909



A Closer Look: **Massachusetts** & **Arkansas**

Per capita Fiscal Capacity and Federal Grants (2005)

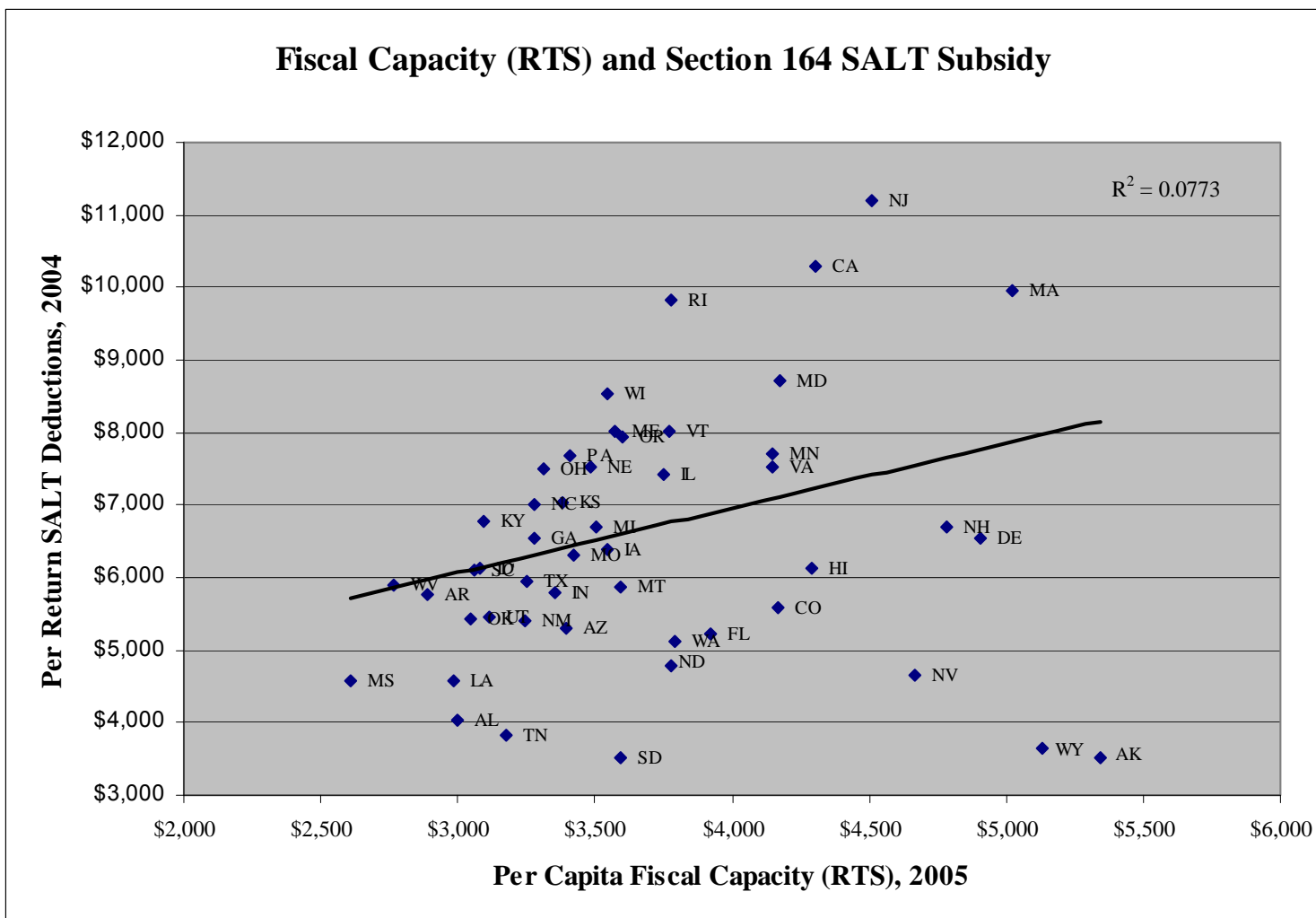
□ **Massachusetts:**

- RTS Fiscal Capacity: \$5,019
- Per Capita Federal Grants: \$1,553

□ **Arkansas:**

- RTS Fiscal Capacity: \$2,892
- Per Capita Federal Grants: \$1,506

Which States Benefit from the SALT Deduction?





A Closer Look: **Massachusetts** & **Arkansas**

Per capita Fiscal Capacity and Deductions for SALT (per itemized return)

- **Massachusetts:** subsidy @ 30%
 - RTS Fiscal Capacity: \$5,019
 - SALT Deductions per Itemizer: \$10,798 \$3,239


- **Arkansas:**
 - RTS Fiscal Capacity: \$2,892
 - SALT Deductions per Itemizer: \$6,187 \$1,856



The Deep Roots of U.S. Fiscal Federalism

- The South and American Federalism

- The Rise of Variable Matching Grants
 - Early Grants-in-Aid (e.g., OAA) featured a simple 1:1 matching grant with no adjustment for fiscal capacity.
 - Southern Democrats pushed for “equalization” but wanted no strings
 - Northern liberals reluctant to underwrite Jim Crow governments
 - compromise: variable matching grant (higher % for low-income states, but 50% floor for high-income states) first appears in Hill-Burton Hospital Survey and Construction Act of 1946
 - 1965: Medicaid’s FMAP formula lifted directly from Hill-Burton text
 - 2009: FMAP is one of the chief devices for delivering \$\$\$ to states



U.S. Equalization? — Simulation Results

- Total cost: \$68 billion (based on 2005 data)
 - ≈ 0.55 percent of U.S. GDP.
 - ≈ annual cost (foregone revenue) of current deduction for state and local taxes
 - ≈ \$25 billion more than we spend on the earned income tax credit (EITC)

- 29 states would receive equalization payments, ranging from \$124 per capita for Oregon to \$1,119 per capita for Mississippi.

- Of the 29 “receiving” states, 19 are **Red States**; 10 are **Blue**. The top 10 states (in terms of per capita payments) are **Red States**.

- Gross Payments
 - **Red States**: \$48 billion, or 70 percent of all equalization payments
 - **Blue States**: \$20 billion, or 30 percent of all equalization payments



Big Winners: the South

□ The Top Receiving States:

<u>State</u>	<u>Per Capita Equalization Payment</u>
• Mississippi:	\$1,119
• West Virginia:	\$ 963
• Arkansas:	\$ 834
• Louisiana	\$ 741
• Alabama:	\$ 729
• Oklahoma:	\$ 681
• South Carolina:	\$ 668

□ Mississippi would receive an equalization grant of \$3.25 billion.

- Total state/local expenditures in Mississippi for FY2005 were \$20 billion.
- \$3.5 billion grant would amount to:
 - a 16 percent increase in revenues for Mississippi
 - a 54 percent increase in federal grants to Mississippi

□ Do we really “trust” them with that kind of money?



Post-Partisan Fiscal Federalism Reforms

- Reform grant formulas to take better account of relative fiscal capacity:
 - incorporate alternative measures of fiscal capacity
 - RTS, RRS, TTR

- Modification of Medicaid's FMAP formula
 - e.g., repeal/modify 50 percent floor

- Repeal/reform the deduction for state and local taxes
 - let the AMT's repeal of SALT deduction run its course
 - SALT credit where credit % is a function of relative fiscal capacity

What's so "Post-Partisan" about all this?

