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The regional war for Federal aid

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Is IT really true that current patterns of Federal aid steal from the Northeast and subsidize the Sunbelt? The facts will certainly play an important role in current efforts to change the regional impact of Federal policy. The rhetorical charges of theft have been abundant. Two years ago, *The Washington Post* announced "A New Federal Favoritism for the Sunbelt States." *The Village Voice* not long after headlined, "Regional Robbery: How Washington Saps the Northeast." More recently, Senator Moynihan contended in *The New York Times*, "The crucial point is that . . . the redistributional mode of government, with its bias against New York, is now firmly established in Washington. It is sustained by the rewards it provides to others." And a *National Journal* staffer predicted in the *Times*, "There's going to be a terrific political issue when the Northeast wakes up to the fact that it's being milked to death for tax money going outside the region." These charges followed a dramatic June 1976 *National Journal* article entitled, "Where the Funds Flow: A *National Journal* Survey Shows that There Is a Massive Flow of Wealth from the Northeast and Midwest to the Faster-Growing West and South." The *Journal* updated its analysis a year later with 1976 data, reaching the same general conclusions. To our knowledge, since the *National Journal* series, no alternative calculation of net flows of regional aid has been constructed. But the political and empirical questions are far more complex than such journalistic accounts recognize.

One problem with these efforts is that they too readily incorporate elements of the Federal budget whose geographic incidence (who really pays and benefits) is in reality impossible to determine. Defense spending is one major example. As *National Journal* admitted in its 1977 update article, available methods cannot specify the ultimate geographical incidence of defense contract expenditures. The article nevertheless allocated these expenditures to states based on the location of prime contractors. But the Defense Department estimates that half of its contract expenditures are eventually paid to subcontractors whose location is not recorded. It is misleading to conclude that all the money stays in the regions where the prime contractors are located. For instance, West Coast firms would have been prime contractors for work on the B-1 bomber and Supersonic Transport, although firms located in New England would have received a great deal of the subcontracting work from both projects. Without data on the geographical incidence of subcontracting work, inclusion of such data can lead to serious distortion of the facts. Similar problems attend the analysis of state-by-state allocation of defense-related wage and salary payments. Large chunks of this income immediately flow out of the region through consumption and savings behavior. For example, local multipliers are notoriously low in remote areas where military bases are often located, so wages received there may filter to many other regions as expenditures on automobiles, clothing, processed food, insurance, and other goods.

The inclusion of corporate taxes in the payments from states constitutes a second serious distortion. In employing corporate taxes as state contributions, *National Journal* cautioned that these figures are "probably not perfectly accurate either," citing a Dreyfus Corporation study which concludes that allocation of corporate profits geographically biases the figures in the direction of New York City and other areas that house corporate headquarters. The appropriate question is not in which region, state, or city profits are officially recorded, but who ultimately pays the corporate income tax and where these people are located. If, as some claim, consumers pay the bulk of the tax, then the tax should be allocated on the basis of the national distribution of consumers. For instance, General Motors' tax would not be allocated to Michigan, where its payment originates, but among those states where the consumers of GM's products live. If, as others contend, the corporate tax is borne by the stockholders, then the correct allocation would reflect the state residences of stockholders. Economists have been unable to reach any agreement in this debate. Until they do, corporate income taxes should be excluded from regional balance-of-payments calculations.

The popular accounts also ignore benefits that accrue to individuals and corporations from tax deductions, preferential rates, and deferrals. While they are as difficult to allocate as taxes in general, we might expect them to favor those regions with higher per capita incomes and greater concentrations of corporate headquarters. Therefore, their exclusion may underestimate "preferential" Federal treatment of the Northeast.

These criticisms do not amount to mere nitpicking. The *National Journal* study admits that "spending for defense accounts for nearly all the Federal spending disparities among the Northeast, Midwest, South, and West." Therefore, its exclusion from the distributional total would deflate the popular rhetorical astonishment. Corporate income taxes are also significant. In 1975, they amounted to $40.6 billion, approximately one-third the size of Federal individual income tax receipts. And tax deductions, while they are not aggregated in the budget, may amount to more than $100 billion. Thus, conclusions about regional distribution will be seriously affected by how one treats these components.

Competing facts

In describing the massive flow of wealth from the Northeast, the popular accounts rely on "letting the facts speak for themselves." For instance, *National Journal* presented data on the distribution of various categories of Federal spending compared to taxes paid in by the states. This information was then evaluated in light of facts about changes over time in various measures of economic growth (population, employment, income, unemployment rates, and the like). From this juxtaposition of facts the article concluded that the North's loss is the Sunbelt's gain: "[The] rich get richer: Although there were notable exceptions, the study indicated a heavy flow of Federal dollars away from—rather than toward—the states and regions of the nation in the most severe economic straits."

As in almost all issues, the facts do not speak for themselves. An alternative accounting of Federal government fiscal behavior produces quite different conclusions. The popular calculus includes four categories in the redistributed pot: Federal salaries, Federal public works, transfer payments to individuals, and Federal grants to state and local governments. The first two, as we have noted, are very difficult to allocate geographically due to subcontracting and multiplier effects. The third category contains payments explicitly aimed at distressed persons that are not intended to be distributed among regions equally. The fourth category, however, contains those programs whose origins have largely been associated with the emergence of regional fiscal imbalance and with demands for Federal equalization. We should reasonably expect this set of expenditures to be equitably allocated across regions. The facts are that such payments do not favor the Sunbelt. Table I shows that the Northeast and West actually receive larger per capita allocations than the East North Central, West North Central, and West South Central regions.

TABLE I. *Per Capita Federal Aid to States, Fiscal Year 1977*

REGION	AID (in dollars)
New England	296
Mid-Atlantic	306
East North Central	237
West North Central	246
South Atlantic	260
East South Central	286
West South Central	238
Rocky Mountain	295
Pacific	286
U.S.	269

Source: Department of the Treasury, *Federal Aid of States: Fiscal Year 1976 and Transition Quarter*, and Census Bureau population estimates and projections.

This outcome is not surprising, given the variables influencing the distribution of aid. Many aid programs require matching funds on the part of recipient governments, so to the extent that some states choose not to tax themselves as much as others, they tend to forego Federal aid. Thus the states with the lowest revenue efforts tend to be lowest in per capita grant allocations. Large per capita state and local government expenditures tend to be associated with higher income levels, which lead to higher levels of aid through the matching process. Thus, the Northeast and Pacific regions, with higher incomes, enjoy larger grant allocations. Another distribution variable, land area, is used to allocate Highway Trust Fund monies. As a result, the more sparsely populated but expansive Rocky Mountain and Pacific states receive relatively large allocations for this purpose.

Nor has Federal aid to states been insensitive to changing regional economic patterns, particularly the economic rise of the South and the decline of the Northeast. Table II presents data on recent changes in per capita personal income and Federal aid for each of the nine Census regions. Table III presents the same data as a percentage of the U.S. figures. In the early 1960's, the Rocky Mountain and Pacific Coast regions were above-average recipients of Federal aid, receiving 166 and 142 percent of the national average, respectively. At that time, both regions registered higher per capita income than the three regions of the South, which received less per capita aid. The three regions of the Northeast received the lowest per capita aid, but also enjoyed the highest per capita income.

By 1976, the New England and Mid-Atlantic regions had significantly increased their relative aid positions from 90 percent to 110 percent and from 65 percent to 114 percent of the U.S. average, respectively. At the same time, the Rocky Mountain and Pacific regions had declined to 110 percent and 106 percent of the national average. The other Sunbelt regions experienced either a loss in relative aid positions or a lower growth rate than the Frostbelt regions, even though their per capita incomes have yet to catch up to those of the latter.

From these observations, it could be argued that while the economic advantage of the Northeast states' economies has diminished, they still rank above the national average in per capita income and the Federal aid distribution is changing in their favor. The Mid-Atlantic region's relative-aid allocation has increased from 35 percent below the U.S. average (the lowest) to 14 percent above the average (the highest), although its somewhat diminished per capita income advantage is still relatively high.

We are well aware that our data do not "prove" that the Northeast is really the major beneficiary of Federal aid. This alternative calculation has its own weaknesses: For instance, it relies on only one, imperfect indicator of economic well-being. We use it only as a rebuttal to the glib interpretations of previous accounts. This exercise demonstrates that simply citing data does not necessarily clarify the issues. Without an explicit normative framework, each party to the debate emphasizes what it considers to be a politically

TABLE II. *Per Capita Aid and Income by Region for Selected Years*

Region	1961 Aid (in dollars)	1961 Income (in dollars)	1970 Aid (in dollars)	1970 Income (in dollars)	1976 Aid (in dollars)	1976 Income (in dollars)	1961-70 Change in Aid	1961-70 Change in Income	1970-76 Change in Aid	1970-76 Change in Income	1961-76 Change in Aid	1961-76 Change in Income
New England	35.0	2502	118	4300	296	6590	237%	72%	151%	53%	745%	165%
Mid-Atlantic	25.2	2631	116	4475	306	6932	360	70	164	55	1115	165
East North Central	32.8	2417	83	4135	237	6793	153	71	186	64	625	180
West North Central	44.8	2104	104	3751	246	6130	132	78	137	63	450	190
South Atlantic	35.5	1901	113	3615	260	6007	218	90	130	66	630	215
East South Central	46.1	1569	146	2986	284	5195	217	90	95	74	515	320
West South Central	45.5	1882	122	3407	238	5895	169	81	95	73	425	215
Mountain	64.6	2123	156	3601	295	5990	141	70	89	66	355	180
Pacific	55.2	2678	148	4381	286	7078	168	64	93	62	420	165
U.S.	39.0	2274	116	3966	269	6441	197	74	132	63	590	185

Sources: U.S. Census Bureau, *Governmental Finances* and *Statistical Abstract of the United States*, various years.

TABLE III. *Per Capita Aid and Income as a Percent of the U.S. Average*

REGION	1961 AID	1961 INCOME	1970 AID	1970 INCOME	1976 AID	1976 INCOME
New England	89.9%	110.0%	101.7%	103.3%	110.2%	103.3%
Mid-Atlantic	64.8	115.7	99.8	112.8	113.7	108.4
East North Central	84.2	106.3	71.0	104.3	88.2	103.7
West North Central	115.1	92.5	89.6	94.6	91.5	98.0
South Atlantic	91.3	83.6	96.8	91.2	96.6	93.4
East South Central	118.4	69.0	125.8	75.3	105.5	79.2
West South Central	116.7	82.8	104.6	85.9	88.4	90.6
Mountain	165.9	93.4	134.2	90.8	109.8	93.1
Pacific	141.8	117.8	127.2	110.5	106.2	110.5

Sources: Same as Table II.

advantageous set of facts. An analysis which merely compares states' fiscal balance-of-payments without acknowledging the different targets of Federal programs will not get us far.

Fair share?

Previous accounts have never made their criteria of regional justice explicit. For instance, the original *National Journal* article concluded, "In each category of spending, the disparities among the states are hardly surprising. But when they are added together and placed alongside the Federal tax burden in each state, the results are astonishing indeed." But if the parts of the whole are reasonable, and simple addition is employed, why should the sum be astonishing, unless the authors are implicitly relying on the crude notion that despite the different purposes of various Federal programs, the money must in the end be distributed equally?

The implicit acceptance of "equal receipts for equal payments," applied indiscriminately to all areas of expenditures, leads to indefensible claims of inequities. Suppose the rural-electrification program is scrutinized for "equal treatment." Of course, we would find that disbursements go disproportionately to states with greater land area and rural populations. If we then demanded that all states be treated equally, we would be negating the point of the program, which is to ensure that all rural families have electricity, regardless of what state they live in. Similarly, it is hardly accidental that

The Federal government's "regional bias" thus appears to lie not in its overall fiscal unfairness but in its enthusiasm for a particular set of projects and programs.

If Federal policies of this sort are the culprits, then we can add two more reflections to our criticism of fiscal-flows analysis. The first is that budgetary analysis alone does not give us a comprehensive picture of the government's role in regional growth patterns. In fact, it may miss the most significant actions. FHA loans involve subsidies which do not appear in the Federal budget but which have been quite important in favoring new home construction, especially in suburban areas, over maintenance of the existing housing stock. Regionally-biased Federal loan guarantees, which do not appear in the fiscal accounts (such as those in the $1.2 billion Coastal Zone public infrastructure program and the proposed $10 billion national development bank) are currently proliferating. Other non-budgetary government influences, such as the regulation of transportation rates, tariff decisions, energy price regulations, environmental policy, and Federal financial policy all have regional consequences which cannot be captured with regional balance-of-payments analysis. They can, with differing degrees of difficulty, be looked at with macroeconomic models.

Second, if a few large programs are a major source of Federal regional bias, then we need not pursue the task of a detailed analysis of every category of Federal expenditure—an apparently impossible task anyway. It would be far more useful to concentrate on defining the problems to be solved, identifying the policies associated with them, and deciding which policy tools to use in their solution.

The energy example

A good candidate for current scrutiny is the energy program now under debate. The Carter proposal seems to have been drafted with little consideration of its regional impact, despite the existence of models in the Department of Energy that can roughly predict the changes that it will foster. Indeed, it could be attacked as an anti-urban, anti-Eastern policy.

Several features of the energy policy may seriously bias future regional location patterns. The Department of Energy has let many of its huge research and development contracts to the same industrial-military complex that fueled Sunbelt growth. Similarly, the location of new Federal facilities associated with energy development seems to be biased in the Western direction. An example is the location last year of the Solar Energy Research Institute in Golden, Colorado, a prototypical exurban community. (The proximity of skiing in Aspen and Vail may have been as strong a locational incentive for Washington bureaucrats as was the winning bid by Midwest Research.)

And a frequently mentioned reason for the growing attractiveness of Western coal is the comparatively low cost at which Federally owned land is available to producers. The shift to Western coal production will further disadvantage Eastern manufacturers and undercut the current boom in Appalachian coal fields. Federal land and ocean policy in general, and mineral leasing in particular, may also be encouraging relocation through its generously low rental rates. The interstate highway system, Federal environmental policy, and Army Corps of Engineers water and navigation projects also contribute to the regional shift.

And now the Federal government has a $1.2 billion loan guarantee and grant program to build infrastructure for communities affected by drilling for offshore oil. A proposal by the Carter Administration to mount a similar program for inland energy development (mostly coal) in the West would add another $1.6 billion to this subsidized local public service infrastructure. But the boom employment spurring impact aid will be short-to-medium-lived, since it generally consists of a large construction workforce, building plant and equipment. In the near future, this public-sector capacity may lie idle, possibly attracting yet more manufacturing away from other regions with the offer of in-place services and an unemployed population.

In general, the technological direction of the current Federal energy initiative results in tremendous local dislocations and explosive growth. Nuclear power plants, coal-fired electricity generation, synthetic fuels development, pipeline, and platform construction for offshore oil, plus the activities surrounding the extraction of oil, coal, uranium, and water needed to operate the plants, all involve relatively massive and concentrated production activities in rural and remote places, mostly in the West. If we add the costs of new public infrastructure, migration, and social dislocation, we may find more compelling reasons for pursuing conservation and decentralized technologies.

These growth effects of energy policy are obviously not the only factors that should govern energy decisions. But an administration that is serious about its commitment to urban areas ought to be conducting a more thorough investigation of its own energy package.

Common concerns

The concern for regional-growth consequences of public programs is not a substitute for the equity and efficiency criteria that we alluded to in the criticism of fiscal-flows analyses. It is an additional one, which potentially conflicts with other considerations in structuring Federal programs and policies. Ironically, the introduction of a concern for promoting regional growth fouls up cost-benefit accounting by viewing what is conventionally a cost as a benefit. Jobs created by programs are considered costs of production in a standard cost-benefit analysis. But from the viewpoint of those interested in regional growth, the more jobs created the better. Thus a mandate to produce government services efficiently but to avoid adverse regional consequences may complicate decisions such as whether to mechanize the postal service or promote high-technology coal extraction. Similarly, high poverty rates and low per capita income in the South may be a justification on equity grounds for continued special treatment, even though the Southern economy is currently booming. These conflicts can only be settled through public debate.

Despite the complexity of the issues, we are convinced that the quality of the regional debate can be improved and that superior policies can be designed. Rather than compete over empirical definitions of fairness, the regional caucuses might try to reach agreement on what the extent of the problem is. Past programs with regional consequences, like rural electrification and Federal welfare programs, grew out of national agreement that a particular problem deserved direct attention. If a broad agreement could be reached on the desirable regional consequences of Federal policy, the "regional warfare" would be over.

This may not be as difficult as it seems. The rhetoric of regional conflict exaggerates the extent to which regional interests are at odds with one another. In fact, on many of the issues that are supposed to divide regions, their interests are closer than reports of regional conflict suggest. For instance, the fiscal crisis of central cities is not restricted to Eastern seaboard cities. St. Louis and Detroit have chronic problems. California's cities have problems, too, and the state now has an urban strategy aimed at boosting its central cities. Colorado is seeking ways of helping Denver. Nor are the adverse consequences of regional shifts in economic activity confined only to the declining regions. States like Oregon and Montana are concerned about slowing and controlling economic growth. Small towns experiencing booming development are crying for (and getting) Federal impact aid because they are growing *too* rapidly. It thus may not be Pollyannish to suggest that if regional jealousies could be muted, many regional groups might agree on policies to support local fiscal health and balanced regional development.

If the battle over distribution continues to rage on a "where's mine?" level, it will simply result in more money going to *all* regions through programs with obvious regional biases—a gain in appearance only, since taxpayers are simply going to pay larger amounts of tax dollars to the Federal government to finance the expansion. Then political battles would be confined to those programs, such as revenue sharing, which have obvious regional distributions but which represent a relatively small portion of the budget, while enormous public programs, like energy, which may have the most significant regional impacts, would be left out of the discussion.

The task now at hand is to lay aside the aggregate fairness debate and search for a consensus among regions on where and how the Federal government should help out. By analyzing Federal policy in the ways we suggest, the Federal government might avoid the waste of millions of dollars in a regional battle over public resources.