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TAX FEATURES

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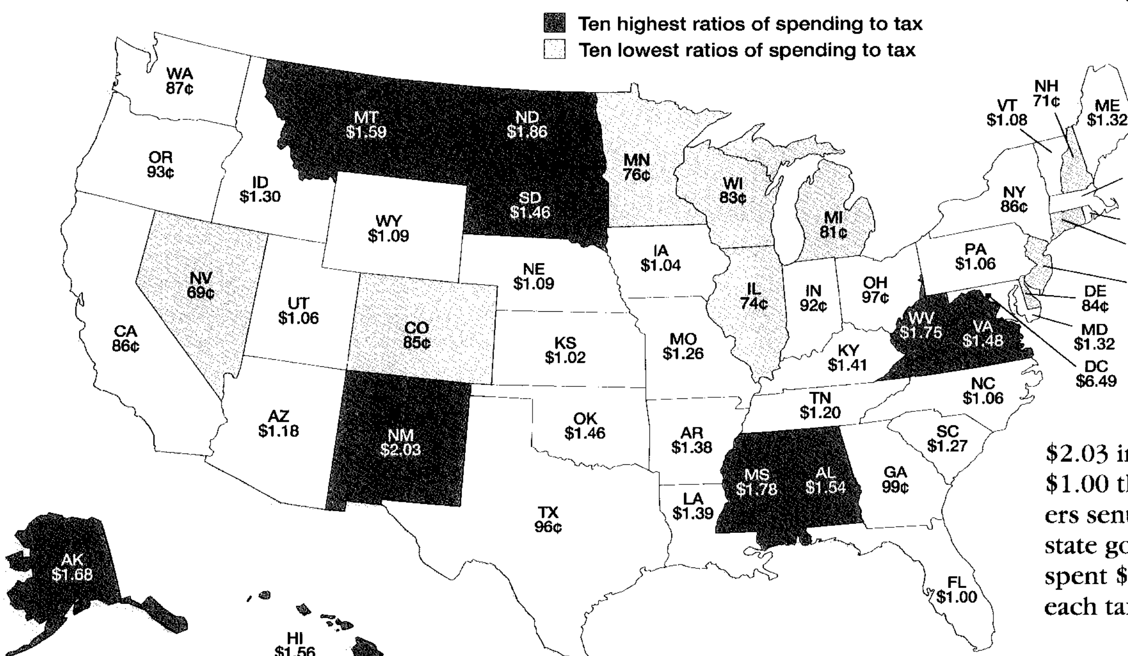
Federal Tax and Spending Patterns Benefit Some States, Leave Others Footing the Bill

Taxpayers in New Mexico benefited the most from the give-and-take with Uncle Sam during 2000, while the ratio of federal spending to taxes was lowest in Connecticut, according to a new study by Tax Foundation senior economist Scott Moody.

Titled *Federal Tax Burdens and Expenditures by State* (see Publication Summary on page 2), the report shows the federal tax burden falling much more heavily on some states than others. By comparing each state's tax burden to an adjusted set of the Census Bureau's most recent data on federal spending (2000), Moody calculates which states got the best deal in 2000 from Uncle Sam's tax and spending policies (see map and Table 1).

Federal Spending by State for Each Tax Dollar Sent to Washington

FY 2000



The Beneficiaries of Federal Financing

Uncle Sam spent $2.03 in New Mexico for every $1.00 that New Mexico's taxpayers sent to Washington. No other state got a 2-1 ratio, but Uncle Sam spent $1.86 in North Dakota for each tax dollar, $1.78 in Missis-

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sippi, and $1.75 in West Virginia. (Though not comparable as a state, the District of Columbia is by far the biggest beneficiary of federal spending: In 2000 it received $6.49 in federal outlays for every dollar its taxpayers sent to the U.S. Treasury.)

Federal Spending by State Per Dollar of Federal Tax

FY 1990 and 2000

	Expenditures Per Dollar of Taxes		Ranking	
	FY90	FY00	FY90	FY00
Total	$ 1.00	$ 1.00	-	-
Alabama	$ 1.43	$ 1.54	6	8
Alaska	1.20	1.68	20	5
Arizona	1.25	1.18	16	22
Arkansas	1.31	1.38	12	14
California	.89	.86	38	40
Colorado	$ 1.16	$ .85	21	41
Connecticut	.78	.62	45	50
Delaware	.75	.84	48	42
Florida	.96	1.00	34	31
Georgia	.94	.99	36	32
Hawaii	$ 1.13	$ 1.56	23	7
Idaho	1.28	1.30	14	17
Illinois	.75	.74	47	46
Indiana	.88	.92	39	36
Iowa	1.08	1.04	26	29
Kansas	$ 1.06	$ 1.02	29	30
Kentucky	1.27	1.41	15	12
Louisiana	1.30	1.39	13	13
Maine	1.22	1.32	19	15
Maryland	1.23	1.32	18	16
Massachusetts	$ 1.08	$ .86	25	38
Michigan	.82	.81	44	44
Minnesota	.86	.76	41	45
Mississippi	1.66	1.78	2	3
Missouri	1.36	1.26	8	19
Montana	$ 1.44	$ 1.59	5	6
Nebraska	1.12	1.09	24	24
Nevada	.77	.69	46	48
New Hampshire	.74	.71	49	47
New Jersey	.68	.66	50	49
New Mexico	$ 2.05	$ 2.03	1	1
New York	.83	.86	43	39
North Carolina	.93	1.06	37	28
North Dakota	1.52	1.86	3	2
Ohio	.99	.97	30	33
Oklahoma	$ 1.24	$ 1.46	17	11
Oregon	.95	.93	35	35
Pennsylvania	.96	1.06	33	26
Rhode Island	1.06	1.18	28	21
South Carolina	1.32	1.27	11	18
South Dakota	$ 1.35	$ 1.46	9	10
Tennessee	1.14	1.20	22	20
Texas	.97	.96	31	34
Utah	1.34	1.06	10	27
Vermont	.87	1.08	40	25
Virginia	$ 1.44	$ 1.48	4	9
Washington	.96	.87	32	37
West Virginia	1.39	1.75	7	4
Wisconsin	.86	.83	42	43
Wyoming	1.07	1.09	27	23
Dist. of Columbia	$ 5.59	$ 6.49	–	–

Source: Tax Foundation, based on federal expenditure data from the Bureau of the Census.

States Where Taxes Exceed Spending

If some states are beneficiaries, then clearly some must be benefactors — states where so much is collected in federal taxes that any federal largesse they receive is overwhelmed.

With the highest FY 2000 federal tax burden per capita (164 percent of the national average), even above-average federal spending (102 percent of the national average) couldn't prevent Connecticut from having the lowest federal spending-to-tax ratio (0.62). That means Connecticut only received 62¢ in federal spending for every dollar its taxpayers sent to Washington. Other states that had low federal spending-to-tax ratios in FY 2000 are New Jersey (66¢), Nevada (69¢), New Hampshire (71¢), and Illinois (74¢).

Trends in Spending-to-Tax Ratios

Table 1 at left shows which states' ratios rose or fell between 1990 and 2000. Factors influencing the shifting of federal dollars include the location of people who receive Social Security, Medicare and other substantial federal entitlements, the location of federal employees, federal procurement decisions, and grants to state and local governments.

States Where Spending Has Grown Compared to Taxes

The state that raised its ratio the most during the 1990s is Alaska. Federal spending there rose from $1.20 to $1.68 for each dollar in taxes. This 48¢ increase over the decade beat out Hawaii, where federal spending increased 43¢ per dollar of tax, West Virginia (36¢ more spending per tax dollar), North Dakota (34¢ more spending per dollar), Oklahoma (22¢ more spending per tax dollar), and Vermont (21¢ more spending per tax dollar).

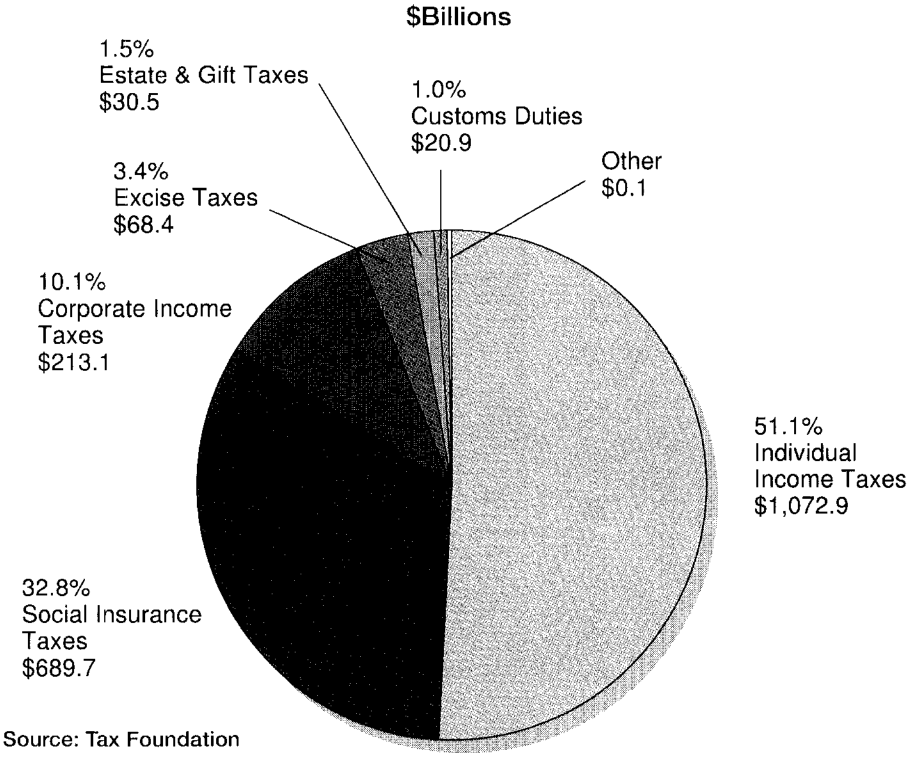
States That Have Lost Federal Spending Compared to Taxes

States that have not fared so well include Colorado, Utah, Massachusetts and Connecticut. Of these, Colorado saw the largest decline, with its federal spending-to-tax ratio falling from $1.16 in FY 1990 to 85¢ in FY 2000. Utah's

Federal Tax Collections by Type of Tax

Fiscal Year 2001e

$Billions



Source: Tax Foundation

has dropped 28¢, Massachusetts 22¢, and Connecticut 16¢.

Nationwide Federal Tax Data

In FY 2001 the federal government will collect $2.099 trillion in tax revenue, a 5.9 percent increase over FY 2000. By FY 2002 this figure is expected to rise 2.4 percent to $2.149 trillion. The pie chart at left illustrates that virtually all of the FY 2001 tax revenue comes from four sources.

The largest federal revenue source, the individual income tax, is expected to raise $1.073 trillion, or 51.1 percent of the total. Social insurance taxes, which fund programs such as Social Security and Medicare, will raise another $689.7 billion, or 32.8 percent of the total. Levies on corporate income will raise $213.1 billion, or 10.1 percent of the total; and excise taxes imposed on beer, wine, tobacco, gasoline and other products will bring in $71.1 billion—3.4 percent of total federal taxes.

All estimates for 2001 and 2002 are based on the President's Budget released in April 2001 and therefore assume a tax cut smaller in those two years than the one that eventually passed. This would not affect the spending-to-tax ratios in the report, however, since those are all based on 2000 data.

Federal dollars shift for several reasons: the location of people who receive Social Security, Medicare and other federal entitlements; the location of federal employees; federal procurement decisions; and grants to state and local governments.

Other levies—such as estate and gift taxes ($31.1 billion) and customs duties ($21.4 billion)—will raise the balance of federal tax revenue.

The column chart below illustrates how federal taxes have increased in nominal dollars over the years. The federal government will collect an estimated $7,597 for every man, woman and child in the nation during FY 2001. That's up 5.1 percent from 2000's level, and this per capita federal tax burden is expected to grow another 1.5 percent to $7,712 in FY 2002.

Publication Summary

General: Special Report No. 105; ISSN 1068-0306; 8pp.; $10 or $50/yr. for 10 issues on varied fiscal topics

Title: Federal Tax Burdens and Expenditures by State

Author: J. Scott Moody

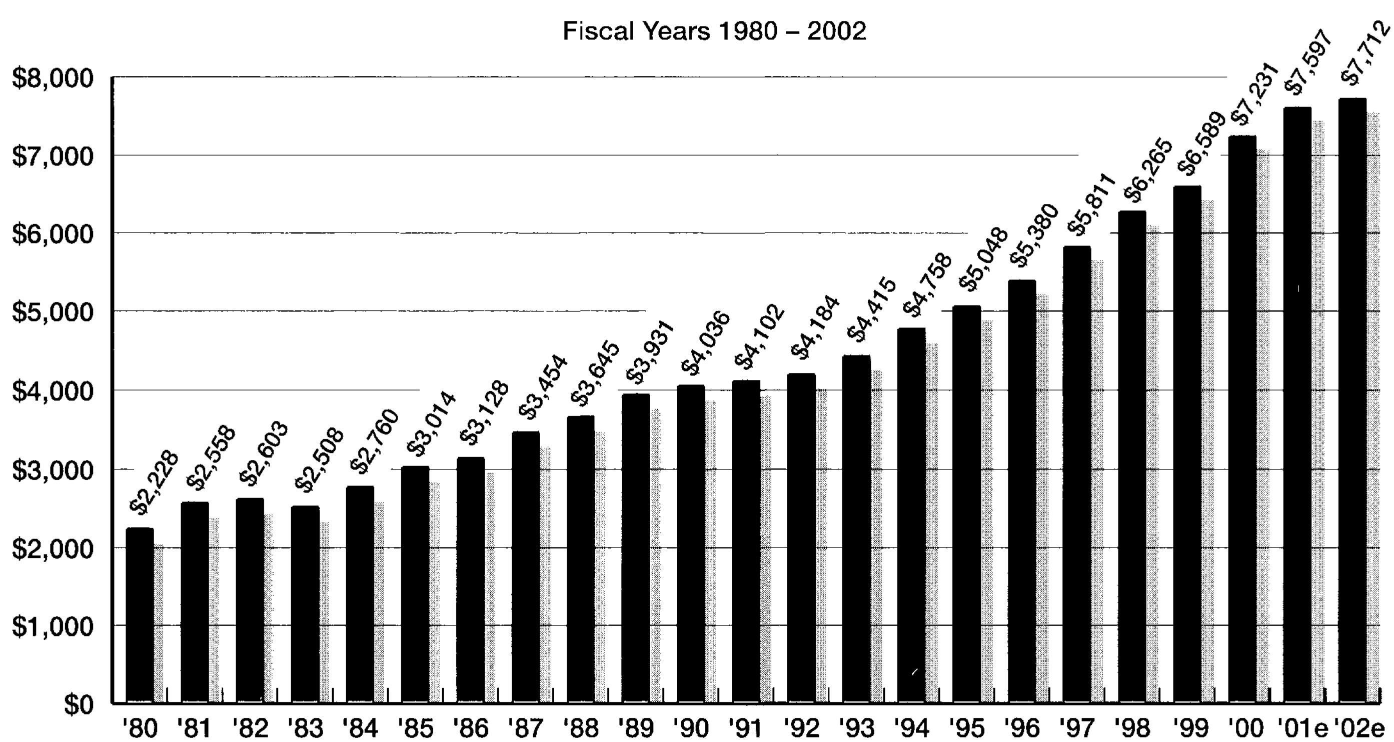
Date: July 2001

Subject: Calculation of how much each state's citizens pay in federal taxes, including adjustments for federal taxes collected in other states. The tax burden in each state is then compared to federal funds that are spent in each state.

Tables: Federal Tax Burden by State, FY2000–FY2002; Federal Tax Burden Per Capita by State, FY2000–FY2002; Federal Expenditures Per Capita by State and Type, FY2000; Federal Taxes and Expenditures Per Capita as a Percentage of the U.S. Average, FY2000; Adjusted Federal Expenditures Per Dollar of Taxes, FY2000

Federal Tax Burden Per Capita

Fiscal Years 1980 – 2002



A Woman's Touch: Lessons from the 2001 Tax Bill

by U.S. Senator Blanche Lincoln (D-AR)

The tax bill President Bush signed in June was the largest tax relief package in 20 years. In all the debate and commentary about this package, one story that hasn't been told is the significant role women in Congress played in developing the final bill.

As a new member of the Senate Finance Committee, I had the opportunity to exert a good deal of influence on the final tax bill. The end result is that we crafted a bipartisan compromise on tax relief with numerous family-friendly provisions that will benefit a larger number of taxpayers than the President's original proposal would have.

Women's issues are people's issues, my colleague Pat Schroeder, the former Congresswoman from Colorado, has always said. And what's more of a people's issue than taxation, which directly affects people's pocketbooks and bank accounts?

Historically, one reason that women's voices haven't influenced fiscal policy debates is that women simply weren't there to be heard.

Historically, one reason that women's voices haven't influenced fiscal policy debates is that women simply weren't there to be heard.

The last big tax cut bill came out of the 97th Congress in 1981. At that time, there were only 23 women in the entire Congress, only two of whom were serving in the Senate. At that time, there

One of the best arguments for a tax cut was to return some of the surplus to the working and middle-class families who struggle with the high cost of living.

were no women on the Senate Finance or the House Ways and Means Committees.

Twenty years later we face a significantly different landscape. In the 107th Congress, we have 75 women in Congress, 13 of those in the Senate.

More importantly, we have more women in positions to influence tax policy. We're still not an overwhelming presence: I'm one of only two women on the Senate Finance Committee. The

Taxpayers with Adjusted Gross Incomes under $20,000 pay more than 25 percent of the telephone tax, in addition to paying more than 20 percent of alcohol taxes, gas taxes, and tobacco taxes.

House Ways and Means Committee currently has only three women. That's a total of five women on two powerful Congressional committees with jurisdiction over revenues and taxation. It's a good start, but we have to do better.

We hear a great deal of talk about bipartisanship these days, but for women on Capitol Hill, it's particularly important that we work together to get results. Despite our gains over the last two decades, we're still very much a minority in Congress.

For now, it means that we have to collaborate across party lines to make sure women's perspectives are represented in the debate. This proved to be an effective strategy this spring when the children's tax credit provision of the tax bill was considered.

In his original proposal, the President had made doubling the child tax credit one of the cornerstones of tax relief. This was an excellent suggestion which would benefit thousands of low-income families. There was widespread bipartisan support for this measure.

But that didn't mean the President's proposal couldn't be improved upon. I teamed up with my Republican colleague Olympia Snowe of Maine to not only double the child tax credit but to

Elected to the U.S. Senate in 1998, Blanche Lincoln is the newest member of the Senate Finance Committee.

make it partially refundable as well.

This wasn't easy, since some of our colleagues were against it from the start. Sen. Snowe and I had to build the case that the partially refundable child tax credit was not just another spending program for people who aren't taxpayers, as some of our colleagues claimed.

While it's true that low-to-middle income families do not pay much in income taxes, they do get hit by taxes at all levels of government. At the Federal level, payroll taxes used to apply to just the first several thousand dollars of income, but in the last 25 years, the taxable amount has risen from less than $20,000 to over $80,000, and the rate is higher now too.

Federal excise taxes are the most regressive of all. According to Tax Foundation research, taxpayers with Adjusted Gross Incomes under $20,000 pay more than 25 percent of the telephone tax, in addition to paying more than 20 percent of alcohol taxes, gas taxes, and tobacco taxes.

And at the state and local levels, low-to-middle income taxpayers get hit hard by sales taxes, income taxes and state-level excise taxes on popular consumer products. Added together, these non-income taxes take substantial fractions of income from hardworking families.

Women will have to assert themselves more vigorously in matters of public finance and fiscal policy to ensure that we are taken seriously and have the opportunity to influence the contours of the debate.

So I wasn't about to let anyone get away with saying these people are not taxpayers. If we were going to celebrate the budget surplus by granting a tax cut, then the best argument for it was to return some of the surplus to the working and middle-class families who face a high cost of living. I buy four gallons of milk every week for my family of four, so I understand what it costs to feed and clothe a family.

To make sure our tax relief was as broad-based as possible, we needed a partially refundable child tax credit to ease the tax burden of these families who are caught in the clamp of rising prices and regressive taxes.

Sen. Snowe and I stood firm on that one, and we got it done. Thanks to the support of Sen. Jim Jeffords, I-VT, and others, we were able to follow through with doubling the credit and making it partially refundable. Plenty of working families will see the benefits of that tax credit now. But that never would have happened if we hadn't had two women on the Finance Committee to stand up for them.

It was a similar story with many of the other provisions in this package which reflect the needs and interests of lower- and middle-income families. We doubled the adoption tax credit. We increased contribution amounts and deductibility for retirement accounts and education savings accounts. We eliminated the marriage penalty for an overwhelming majority of American couples. And we accelerated many of these provisions to bring relief to middle-class and working families on the front end.

We managed all of this within the framework of a tax cut that saved $250 billion over President Bush's original proposal. These savings will make it possible for us to focus on several other issues that are important to the American people, such as shoring up the Social Security Trust Fund, reforming Medicare and retiring a sizable portion of the national debt.

All of these accomplishments are, at least in part, attributable to the influence of women during the process.

One critical lesson we should take from this year's tax debate is that social policy and fiscal policy are inextricably linked. This means women will have to assert themselves more vigorously in matters of public finance and fiscal policy to ensure that we are taken seriously and have a significant influence on the contours of the debate. More and more, women on Capitol Hill must accept that if we want to make a difference in social policy, we're going to have to fight for a seat at the table when we're discussing fiscal policy.

The Tax Foundation invites a national leader to provide a "Front and Center" column each month in Tax Features. *The views expressed are not necessarily those of the Tax Foundation.*

New Study Describes Expansion of Rural Electric Cooperatives into Propane Market

Co-ops Founded to Electrify Rural America Now Use Government Subsidies to Gain Competitive Advantage in Other Ventures

An established phenomenon on the U.S. economic landscape is the rapid expansion of government-supported enterprises that use their tax subsidies and other special privileges to break into markets not originally contemplated when their subsidies were granted.

In this context, "government-supported enterprise" can mean anything from a government creation like the Postal Service to a private, non-profit organization that receives tax exemptions because of its charitable charter.

A new study in the *Tax Foundation Background Paper* series explores one such case: the movement of rural electric cooperatives into the propane gas market. Titled "The Growth of Government Supported Enterprises: The Case of Rural Electric Co-operatives Entering the Propane Market," this paper by economist William P. Orzechowski of Orzechowski & Walker analyzes the considerable distortions that are occurring in the propane market as a result of the co-ops' entry.

The Effect of Special Privileges

Orzechowski starts with a general description of rural electric cooperatives, focusing on the special privileges they enjoy. He finds the co-ops to be a classic example of the type of privileged firm that is documented in economics literature as a potential cause of market inefficiencies.

He then analyzes the propane gas market and finds that it fits the model of a competitive market that would be damaged by the entry of firms with special privileges.

How Do Co-ops Use Subsidies?

Rural co-ops now supply approximately 11 percent of the nation's electricity. Their special privileges include federal and state income tax exemptions, loan guarantees and interest rate subsidies, preferential access to federal power, and even monopoly franchises.

Orzechowski points out that many scholars question the need for subsidies at all, asserting that co-ops were successful at delivering power to remote rural areas long before the subsidies were enacted. Nevertheless, once enacted, the subsidies should be passed along in savings to the rural consumers of electric power.

Instead, co-ops have used these funds to invade ancillary markets, such as the propane gas market, creating considerable controversy. With assets accumulated during their taxpayer-subsidized provision of rural electricity — a huge customer base, managerial expertise and equipment — co-ops are perfectly equipped to enter the propane market.

Ironically, rent-seeking costs can devour most of the taxpayer-provided subsidy that could have been available to customers as discounts.

In response to protests from existing propane suppliers that the co-ops' special privileges make competing with them nearly impossible, co-ops have set up propane subsidiaries for the express purpose of claiming that their propane businesses do not benefit from the co-op's subsidies.

Are Co-ops Rescuing a Failed Propane Market?

The most common justification for government provision of consumer goods is "market failure," that is, for various reasons, the private market fails to provide an essential good or service to all potential customers. Orzechowski shows that in no way could the propane gas business be characterized this way. Evidence indicates that the market is fiercely competitive, with a large number of small and medium sized firms participating in a market that is open to entry by new competitors.

Orzechowski demonstrates that in addition to the obvious waste of economic resources that occurs when taxpayers fund the expansion of an industry that already offers good value due to competitive pressure, more waste occurs in the form of "rent-seeking." Rent-seeking is an economic term that refers to the time and money that both the co-ops and their private sector competitors will inevitably spend in the political arena fighting over the special privileges that give the co-ops a leg up in the market.

Ironically, these rent-seeking costs can multiply so rapidly that they devour all but a tiny fraction of the taxpayer-provided subsidy that could have been available to customers as discounts.

Finally, the study concludes that taxpayers are paying millions to subsidize co-ops with no good economic rationale.

Publication Summary

General: Background Paper No. 37; ISSN 1527-0408; 16pp.; $25 or $60/yr. for 4 issues on varied fiscal topics

Title: The Growth of Government Supported Enterprises: The Case of Rural Electric Co-operatives Entering the Propane Market

Author: William P. Orzechowski, Ph.D.

Date: July 2001

Subject: Explains and quantifies the damage to the competitive, private-sector propane market caused by the entry of government-supported rural electric co-operatives.

FOUNDATION MESSAGE

It's Not the Luck of the Irish — It's Their Low Corporate Taxes

Scott A. Hodge
Executive Director
Tax Foundation

Treasury Secretary Paul O'Neill raised quite a few eyebrows in a May 21 interview with the *Financial Times*, by suggesting that it is time to abolish the U.S. corporate income tax. At a minimum, he argued, simplifying the tax code would improve U.S. global competitiveness. "It would certainly make us more formidable if we had a simplification of this sort."

O'Neill's comments signaled that the administration was not waiting for the ink to dry on the recently passed $1.35 trillion tax bill before it began work on phase two of its long-term tax agenda. Speaking at a Cato Institute forum on June 26, Glen Hubbard, chairman of the president's Council of Economic Advisors, told the audience that the "stars are in alignment in terms of the president's commitment to tax reform. ... It's not just academic head-scratching."

Hubbard said that administration officials were looking at a broad range of tax reform ideas, including lowering corporate and capital gains rates and repeal or reform of the Alternative Minimum Tax.

While the administration is casting about for ideas, they may want to look at the economic miracle taking place in Ireland. I've just returned from Ireland, a country some are now calling the Celtic Tiger. Dublin was the first stop in this year's European Tax Conference, which then went on to Brussels and Rome.

This was the tenth year in which the Tax Foundation has hosted a delegation of senior congressional tax staff — including representatives from the Joint Tax, House Ways and Means, and Senate Finance Committees— to view first hand the tax challenges facing U.S. multinational corporations. Over the past decade, the Tax Foundation has given more than 100 congressional staff the opportunity to get an in-depth perspective on a broad array of international tax and trade policy issues.

In Dublin, we were treated to a tour of Intel's chip manufacturing plant by Bob Perlman, the retiring Vice President for Tax, Licensing and Customs. Intel was among the first U.S. firms to see the advantage of investing in Ireland.

We were then given an impressive day-long presentation by officials from the Industrial Development Agency (IDA) on how the country's low corporate tax structure has stimulated new foreign investment — especially in knowledge-intensive industries — and strong economic growth. According to IDA figures, Ireland's GNP grew 62 percent in real terms between 1993 and 1999, while unemployment fell from more than 14 percent to just 5.5 percent during the same period.

Foreign investment and exports are the engines driving this strong performance. For example, since 1994, fixed investment has grown by an average of 14 percent per year. Indeed, while Ireland accounts for just 1 percent of the European Union's total GDP, it accounts for 6 percent of the inward foreign direct investment flows. Even more impressive, exports have grown by an average of 16.4 percent per year since 1994, with U.S. firms accounting for 70 percent of Irish industrial exports.

According to IDA economists, U.S. firms are not wage shopping in Ireland. In fact, they are hiring high-skill, high-wage workers. What is drawing U.S. firms to Ireland is the country's 10 percent tax rate for manufacturing.

This rate drew fire from the European Union which claimed that Ireland's low tax rate "unfairly" competed with the higher tax rates in other EU nations. They also attacked the 10 percent rate as "ringfencing" — taxing foreign taxpayers at a lower rate than domestic taxpayers — a practice that the EU and OECD have tried to eliminate with their Harmful Tax Competition projects.

Ireland did respond to the criticism, but rather than "harmonize" its rates upward to match those high-tax countries, it decided to replace the multi-tiered tax system with a uniform 12.5 percent corporate tax rate for all sectors beginning in 2003. While many EU countries are, no doubt, unhappy with Ireland's "race to the bottom," others are already moving to lower their corporate rates to stay competitive.

For example, Great Britain (like Japan) has a top corporate rate of 30 percent. Meanwhile, Australia is lowering its rate from 34 percent to 30 percent, and Germany is lowering its split rate tax (30 percent on distributed profits and 40 percent on retained earnings) to a uniform rate of 25 percent.

To be sure, a country's effective rate may differ markedly from its statutory rate. Still, a strong case could be made that with a top corporate rate of 35 percent, the U.S. is falling behind in the global tax competition race.

During the 1980s, the U.S. set an example by dramatically lowering individual tax rates and broadening the tax base. That became the international trend as nations all over the world followed suit. Since Ireland has already started the trend on the corporate side, the unanswered question is whether Secretary O'Neill can get the U.S. to follow.

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Tax Rebate Prompts Many Questions

Q: When will my tax rebate check arrive?
A: If you are eligible, your check will arrive during a ten-week period starting July 23. The lower the last two digits of your Social Security number, the sooner you'll get the check. (The first mailing goes out to everyone between 00 and 09; the second batch to everyone between 10 and 19; and so on.)

Q: Are we getting a rebate on the taxes we paid last April for calendar year 2000?
A: No, it's actually not a "refund" but an "advance rebate" on the taxes you will owe for 2001, for which we won't have to file a tax return until April 2002.

Q: Who qualifies for a rebate?
A: This is where last year's tax returns come in. Since the government doesn't yet know how much we're going to owe this year, the Treasury will send out rebates to everyone who owed income taxes in 2000, paid them on time, and was not claimed as a dependent on someone else's return. Of the 130 million tax returns filed in 2000, 96 million will qualify for a rebate, 79 million of which will get the maximum.

People who deserve the rebate but don't receive it for any reason will have a chance to claim it as a credit when they file their 2001 returns (see http://www.irs.gov/ind_info/apinfo/index.html for more details.)

Q: How were the rebate amounts of $300 for singles and $600 for marrieds decided?
A: Until this year, 15% was the lowest income tax rate. The tax cut established a lower rate retroactive to January 1, 2001 — 10% on the first $6,000 earned by individuals and the first $12,000 for couples filing jointly. This saves a single taxpayer $300 every year (5% x $6,000) and a married couple filing jointly $600 (5% x $12,000). The rebate checks are the savings for the 2001 calendar year.

Q: Why bother with the rebate checks instead of waiting until April 2002 when we file our 2001 tax returns?
A: Congress wanted to put extra funds in taxpayers' pockets sooner rather than later.

Q: So if the new 10% rate is retroactive to the beginning of 2001, what about other tax rates?
A: The other rate cuts are not retroactive, but the first of three scheduled cuts in those rates has already happened. On July 1, the 28%, 31%, 36%, and 39.6% rates all dropped one percentage point. The Treasury has issued guidance to employers on how to adjust withholding. ●

Barry Joins Tax Foundation

John S. Barry is the Tax Foundation's new director of research and chief economist. Previously a management consultant to leading financial service firms, Mr. Barry also has served as president of America's Future Foundation and as an economic policy analyst at the Heritage Foundation. Mr. Barry holds a bachelor's degree with honors in economics and government from the University of Notre Dame, and is a doctoral candidate in economics at George Mason University.

Mr. Barry replaces Patrick Fleenor who joined the staff of the Joint Economic Committee in May. ●

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