

THE IMPACT OF FEDERAL TAXES AND DISBURSEMENTS ON MICHIGAN

An Analysis of Issues and Implications

....A Discussion Paper....

Kurt Gorwitz, Sc.D.

Vice President for Research

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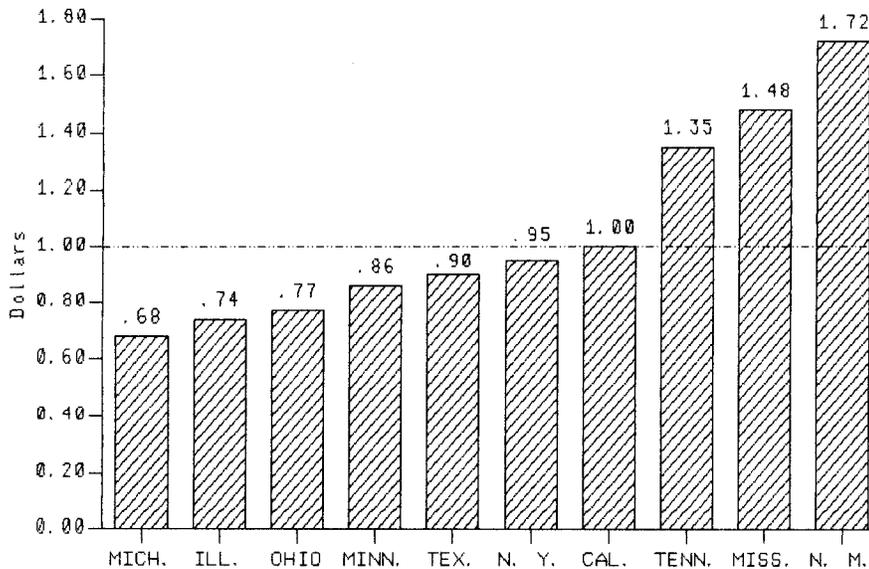
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INTRODUCTION

Michigan pays far more in federal taxes than it receives back in the form of federal aid and other disbursements. Moreover, the disparity between these two sums exceeds that of any other state in the union. In recent years this situation has further injured Michigan's faltering economy. Despite the severe recession and record-high unemployment which Michigan experienced last year, on the average, each of its 9.2 million residents sent \$944 more in taxes to Washington in 1982 than was returned here. If funds had been disbursed on the basis of state unemployment or per capita income, Michigan still did not fare well. California and New York, whose average income is higher and levels of unemployment lower than Michigan's, both received proportionally more federal funds than this state. In fact, 28 of the 50 states received more money back than they paid in federal taxes. One state, New Mexico, received \$1.72 for every dollar it paid in taxes.

FIGURE 1

AMOUNT IN FEDERAL FUNDS
RECEIVED FOR EVERY DOLLAR PAID
IN FEDERAL TAXES



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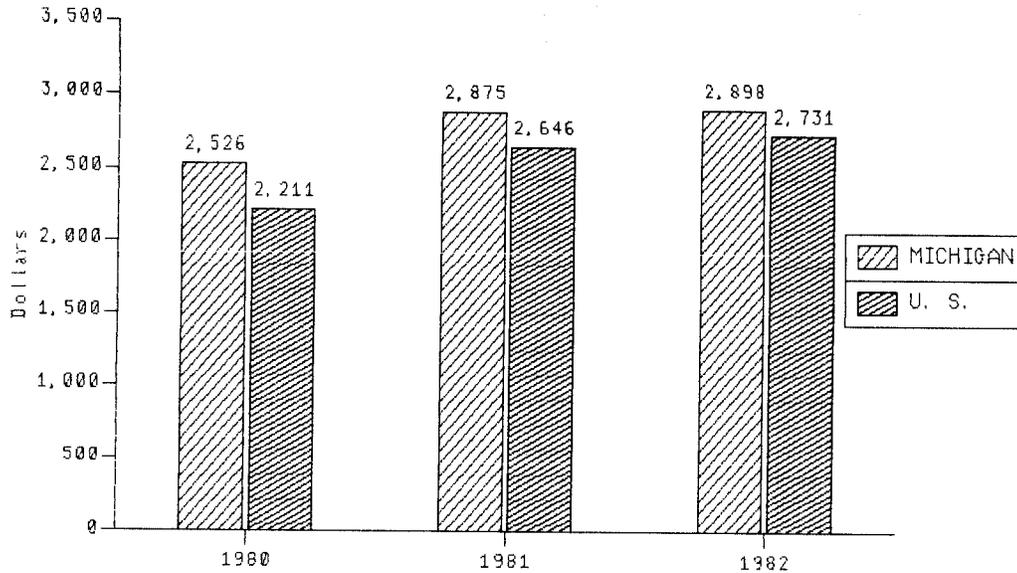
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Federal per capita tax collections in Michigan were \$167 higher than the national average (\$2,898 vs. \$2,731) while disbursements were \$653 lower (\$1,954 vs. \$2,607). The 1980-81 and 1981-82 budgets cut \$81.8 billion in spending authority for health and social services combined with a hike of \$28.2 billion for military programs. This shift resulted in a net loss to Michigan of approximately \$2 billion in federal funds. The proposed 1983-84 U.S. budget recently submitted by the Reagan administration to Congress seeks to expand the buildup of our

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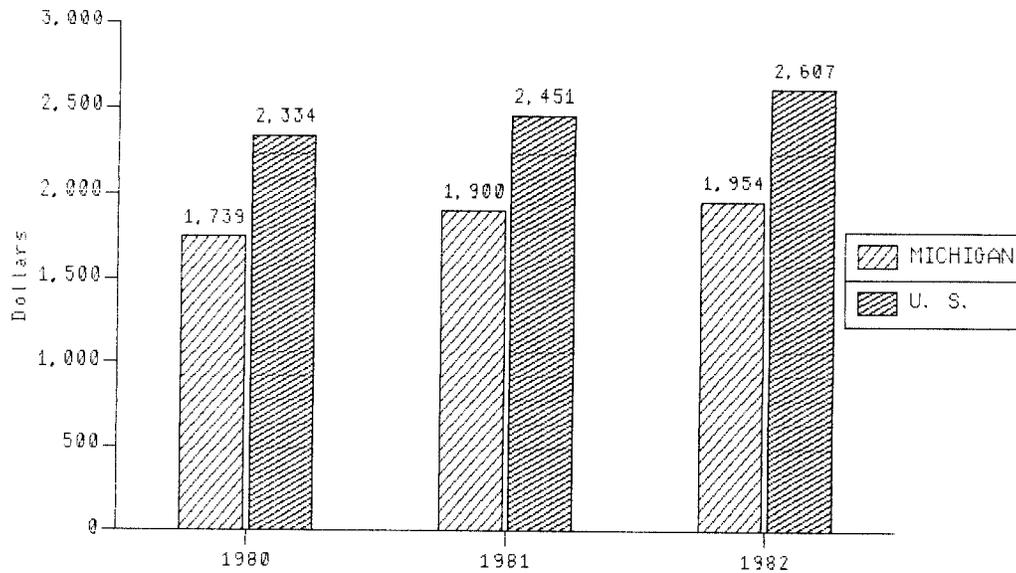
FIGURE 2
 AVERAGE PER CAPITA
 FEDERAL TAX COLLECTION FOR
 MICHIGAN AND THE UNITED STATES



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FIGURE 3
 AVERAGE PER CAPITA
 FEDERAL FUND DISBURSEMENTS
 FOR MICHIGAN AND THE UNITED STATES



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national defense capability with military expenditures increasing 10 percent after adjustment for inflation. This would be financed by additional limitations on funding for many domestic programs and support services. If enacted as recommended, this budget would widen the disparity between payments Michigan sends to Washington and the funds returned here. This would reduce the strength of Michigan's economic recovery.

REASONS FOR MICHIGAN'S SHORTFALL

The 1981-82 U.S. budget, with this state's share of federal funds, is summarized in the table on page 4. The Census Bureau estimates that Michigan has 9.22 million residents, 4.0 percent of the U.S. population (1982). That figure has been employed to compute this state's proportionate share of federal expenditures. Based on this, Michigan should have received \$24.1 billion of the \$603.6 billion U.S. budget. It actually received \$18.0 billion, \$6.1 billion or 25.3 percent less.

Michigan residents received slightly more than their proportionate share (4.3 vs. 4.0 percent) in the three major programs which account for three-fourths of the \$286.1 billion in federal direct payments to individuals--Social Security, Medicare, and food stamps. This "overpayment" amounted to \$636 million and resulted from a number of factors. First, a relatively larger number of elderly live in this state. Second, Michigan's three-year recession forced more people into the state's entitlement programs. Third, Michigan pays higher-than-average welfare grant stipends. Since the state's financial contribution to these programs is matched with federal funds, this has the effect of increasing the amount of federal funds sent here. In other programs involving direct payment to individuals, Michigan residents received 3.2 percent of the total \$74.7 billion budgeted, \$535 million less than the state's proportionate population share.

Michigan received a negligible share (an average of 1.2 percent) of all federal funds in salaries and wages of military personnel and civilian defense staff, salaries and wages of other federal employees, defense procurement contracts, and other procurement contracts. Of the \$223.9 billion in expenditures in these four categories, Michigan received only \$2.7 billion. To put this in another perspective, Michigan realized only one-third of the \$4.6 billion which would have been spent here for military purchases if these had been allocated on a per capita basis. This figure was even lower for other federal purchases--21.9 percent of the state's \$1.3 billion proportionate share. This \$6.2 billion difference is attributable to the following factors:

1. Except for some small sites, Michigan has no national military installations and there are no prospects of any being established here.
2. Federal offices for the Midwest Region, which includes Michigan, are located mainly in Chicago; most agencies maintain few or no local offices in this state. Consequently, only a small proportion

FEDERAL DISBURSEMENTS IN MICHIGAN AND TOTAL UNITED STATES BY TYPE--1981-1982

	Total U.S. * Expenditure	Expenditures in Michigan Amount*	Michigan Percent	Fair Share * (4.0% of Total)	Shortage or (Excess) *
TOTAL	\$ 603,576	\$ 18,016	3.0	\$ 24,143	\$ 6,127
Grants to State & Local Government	88,221	3,634	4.1	3,528	(106)
Agriculture	6,705	189	2.8	268	79
Education	7,186	270	3.8	287	17
Environ. Prot. Agency	4,044	162	4.0	162	-----
Hlth. & Hum. Services	34,415	1,742	5.1	1,377	(365)
Hous. & Urban Develop.	9,213	342	3.7	369	27
Labor	5,660	334	5.9	226	(108)
Transportation	12,064	338	2.8	483	145
Treasury	4,731	186	3.9	189	3
All Other	4,203	71	1.7	168	97
Salaries & Wages	78,043	889	1.1	3,122	2,233
Defense-Military	28,974	208	0.7	1,159	951
Civilian	21,701	289	1.3	868	579
All Other	27,368	392	1.4	1,095	703
Direct Payment to Individuals	286,081	11,545	4.0	11,443	(102)
Social Security	152,192	6,364	4.2	6,088	(276)
Medicare	48,988	2,284	4.7	1,960	(324)
Fed. Ret. & Dis. Pay.	33,172	435	1.3	1,327	892
Veterans Programs	14,739	437	3.0	590	153
Food Stamps	10,222	445	4.4	409	(36)
Supp. Sec. Income Pay.	6,828	199	2.9	273	74
Ins. Pay for Railroad Workers	6,129	139	2.3	245	106
All Other	13,811	1,242	9.0	552	(690)
Procurement Contracts	145,816	1,823	1.3	5,833	4,010
Defense	114,281	1,547	1.4	4,571	3,024
All Other	31,535	276	0.9	1,262	986
All Other	\$ 5,415	\$ 106	2.0	\$ 217	\$ 111

* Millions of dollars

SOURCE: U.S. Department of Commerce, Bureau of the Budget: Federal Expenditures by State for Fiscal Year 1982.

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(1.4 percent) of salaries and wages for federal employees in nondefense agencies was spent in Michigan.

3. Most of the nation's military manufacturing capability is now concentrated in the southwest and west. Potential prime contractors located there have the knowledge and experience to participate successfully in the highly competitive bidding process. Although legislation has been enacted to assure that some federal contracts go to high unemployment areas such as Michigan, the state has not fully exploited these opportunities.
4. The federal government purchases a wide range of goods and services for its other agencies, ranging from pencils and paper clips to complex equipment. Michigan's small proportion (0.9 percent) of such contract dollars could be increased if the state Commerce Department broadened its efforts to bring federal purchase requests to the attention of local manufacturers listed in the Michigan Manufacturers' Directory and provided them with assistance and guidance in preparing contract proposals.

HISTORICAL BACKGROUND

The government's fiscal bias toward Michigan and the industrial northeast and midwest can be traced back at least to the early 1900s. For much of the present century, the federal government maintained a de facto policy of transferring tax dollars collected in this 18-state region to less developed states to promote their economic growth and advance their level of education. The south and southwest states were the primary beneficiaries of this policy. The fact that most House and Senate committee chairs represented the south and southwest reinforced this policy. Since much of the nation's industrial base and wealth was concentrated in the northeast, and to a lesser extent in the midwest, this deliberate policy to reduce the economic and educational gap prevailing between the states was largely unnoticed, met little opposition, and appeared fully justified.

A broad range of programs in health, human services, and other domestic areas was initiated and expanded during the Johnson Administration (1963-68). These programs reduced the number of people living below defined poverty levels and by the 1970s provided Michigan and its residents with an increasing proportion of total federal funds. Recent significant cutbacks in these programs have reversed this trend and materially slowed the flow of federal dollars to this state.

The Detroit Metropolitan Area had been known as America's arsenal of democracy during the Second World War. However, after 1945, most of that area's manufacturing plants speedily shifted back to what was perceived as more profitable automotive production. Defense procurement was not sought and was largely permitted to develop and grow in other areas, mainly in the southwest and west. During much of this period a relatively low percentage of the federal budget was devoted to military programs. Focusing the state's resources on the lucrative automobile industry seemed a wise decision to management, labor, and the general public. This concentration provided the state

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and local units of government with steadily growing levels of revenue to meet perceived needs. The ready availability of relatively high paying jobs led to substantial in-migration and rapid population growth.

In these years of widespread prosperity, the state's automotive industry failed to invest the funds required to upgrade existing manufacturing capability and to implement more efficient new technologies. As its plants became obsolescent, Michigan gradually fell behind other states and, perhaps more importantly, behind foreign countries such as Germany and Japan. As a result, Michigan and the domestic automobile industry became less competitive and less profitable.

The erosion of the U.S. industrial base was accelerated by the 1973 Arab oil boycott and resulting rapid petroleum price escalation. These shocks created a worldwide recession which reduced the demand for autos. At the same time, the American auto industry was also unprepared for the subsequent demand for smaller, more fuel-efficient cars. The industry belatedly commenced a time-consuming and costly redesign and retooling process but in doing so laid off many workers. This further contributed to Michigan's record number of unemployed.

After exhausting its resources, Michigan was able to continue making unemployment payments only by borrowing heavily from the federal government. This debt now exceeds \$2.6 billion and is still increasing. This inflow of funds has balanced, to a limited extent, the outflow produced by the excess of federal taxes over disbursements in Michigan. As job opportunities disappeared, in-migration virtually ceased while out-migration expanded greatly. The number of Michigan residents has decreased 153,000, from 9,262,000 to 9,109,000, since 1980. This will ultimately reduce federal payments based on population.

IMPLICATIONS FOR MICHIGAN'S FUTURE

The United States is committed to an ongoing buildup of its armed forces. Differences between the President and most of Congress are limited to the rate of funding increase for development of our defensive capability. A compromise between the 10 percent sought by President Reagan and the 4-5 percent targeted by Congressional leaders appears likely. This would reduce the 1983-84 defense budget by \$12-15 billion below the proposed level.

While perhaps \$8-10 billion of released funds will be transferred to domestic programs, the rest will be used to reduce an anticipated federal deficit of around \$200 billion. Prospects are minimal that programs in which Michigan received a sizable proportion of funds will be restored to earlier levels. In fact, further curbs on Social Security, Medicare, and food stamps are proposed for 1983-84 and subsequent years. Efforts to obtain a more equitable share of total federal expenditures therefore must focus on obtaining more defense and other procurement contracts and/or subcontracts for Michigan.

Within the next few years, Michigan will have to repay the \$2.6 billion federal loan the state required to fund unemployment insurance payments. Failure to repay this debt would result in annual interest

penalties in excess of \$200 million. The Employment Security Act amendments, adopted in 1982, modified Michigan's Unemployment Insurance Fund. They reduced benefits, increased payroll taxes and were designed to supply the funds needed to make the required repayments. This repayment will additionally increase Michigan's net outflow of public capital funds.

CONCLUSION

Michigan does not receive its proportionate share of federal funds. Despite its declining population, the gap between payments to the federal government and federal expenditures in this state will widen even further because of increasing federal outlays on military items and repayment of the \$2.6 billion debt incurred by the Unemployment Insurance Fund. In the absence of remedial action, this massive cash outflow will retard Michigan's economic recovery in 1983 and subsequent years.

To minimize this gap and promote the welfare of its residents, Michigan must coordinate its efforts with other midwest and northeast states to bring this inequity to the attention of the executive and legislative leaders for their review and action. Legislation and administrative policies to assure that the 18-state region receives a fair share of defense and other federal contracts and subcontracts must be actively espoused in the Congress. Further, Michigan, its local units of government and nonprofit organizations, must coordinate and intensify efforts to seek and obtain grants available for community activities and capital projects.

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