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RALLY CRY!

Mobilizing State Government to Defend Its Self-Interest

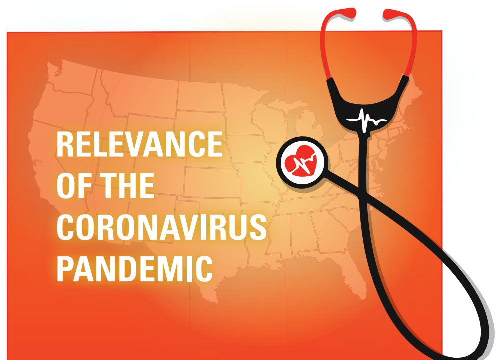
By Edward J. Mazur and Mary B. Scott

Americans have often demonstrated an amazing capacity to succeed when working together on complex interconnected efforts. For example, consider what is involved in placing an interplanetary space capsule atop a rocket at the Kennedy Space Center, sending it all the way to Mars, landing at a predetermined location, and successfully carrying out a scientific mission. Beyond the extraordinary technology is the sheer magic of the achievement — completed while Earth and Mars spin on their axes and both planets orbit the sun. Unfortunately, in the important area of intergovernmental programs and services, which are critical to state government operations, the proven ability of the United States to sustain complex interconnected efforts seems lacking or is, at best, under-utilized.

Growth and Sustainability of Intergovernmental Programs

State governments depend on financial flows from the federal government to support all manner of programs and services. These flows began to increase substantially in the 1960s when the "War on Poverty" began, and the construction of our national highway system was at full throttle. Over the years, Congress passed legislation to establish state-run programs for education, social services, public health, clean water and air, job training, public safety, and a host of other initiatives intended to promote national goals for equality of opportunity and economic advancement. These goals often represented more than individual states could afford or, in some cases, were ready to accept politically.

Some programs, especially grants, were established through significant cooperation among Congress, federal agencies, and individual states, often emerging from pilot experimentation carried out by states. At other times, the federal government mandated requirements for states in a more coercive manner "to centralize and nationalize policy in major areas formerly controlled by states and localities," such as harmonizing drivers' licensure requirements to reduce national security vulnerabilities.[1] The late Paul L. Posner, managing director for strategic issues at the Government Accountability Office (GAO) and a professor at George Mason University, noted the "positioning and cohesion of state and



RELEVANCE OF THE CORONAVIRUS PANDEMIC

This article was prepared before the coronavirus pandemic fully impacted the United States. Unfortunately, the crisis further weakened the financial condition of the federal government and adversely affected states' near-term financial condition.

The authors believe it is now even more important for the nation's governors and other state government stakeholders to exert shared leadership in guiding the financial future of the federal government and rebuilding our nation's financial health. This will require dedicated, long-term, attention and engagement.

local governments play a pivotal, if not surprising, role in the politics of federal mandates." His descriptions of state leadership responses, depending on circumstances, remain insightful:

- "often disarmed by their lack of political cohesion on key policy issues."
- "often swept away by the compelling political appeal of major federal mandates and preemptions."
- "supporters of mandates to put a floor under competition from other states that can undermine their policy initiatives."
- "impact(ful) when taking cohesive positions and mobilizing their memberships to advance their interests."[1]

This historic thrust to create intergovernmental programs was accompanied, over time, by a growing number of dollars flowing to states from the federal government. While some states eagerly accepted the funds and their associated responsibilities, some were less enthusiastic. The dichotomy persists today, for instance, in the differences among states in accepting or rejecting federal funds to support the expansion of Medicaid benefits.[2]

Notwithstanding the occasional hesitancy to accept federal dollars for specific federally endorsed programs, states, overall, have accepted federal monies as well as the requirements of accountability for these funds, recording and reporting program accomplishments, and transparency in program impact on citizens. As a result, intergovernmental programs have become deeply integrated into state government operations and deeply ingrained in citizens' expectations of state governments. This integration has become so thorough, however, that the role of the federal government in funding certain state services and programs is often overlooked. Accordingly, it has become less clear who is responsible for assuring the long-term sustainability of such services and programs — although, indeed, the burden of assurance rests with the leaders and stakeholders of state governments.

Figure 1. Direct Federal Revenues as a Percentage of Total State Revenues

States	Direct Federal Revenues to State ($ Billions) for FY Ending in 2017	Percentage of Total State Revenues – All Sources
States (Top 5)		
1. Montana	$3.9	53.2%
2. Rhode Island	$4.9	50.5%
3. South Dakota	$2.4	46.4%
4. Louisiana	$16.3	45.5%
5. Arkansas	$10.0	45.4%
States (Median)		
25. Maryland	$14.4	30.8%
26. Maine	$3.0	30.7%
State (Lowest)		
50. Hawaii	$1.5	10.6%
50 State Average		**31.7%**
50 State Total	**$745**	

State Governments Have Become Materially Dependent on Federal Dollars

The capability of state governments to provide services and benefits to citizens depends on financial resources. This is true whether the services and benefits are solely the creation of the state, or they are intergovernmental programs, sponsored jointly by the state and the federal government. And these funds are substantial.

Federal Flows That Come Directly to States

In the 2017 fiscal year (FY), the most current year for which data is readily accessible, the 50 states took in over $2.4 trillion from all sources. Of that amount, $745 billion came directly from the federal government. On average, 31.7% of all dollars available to the states came from the federal government.[3] **Figure 1** illustrates the range of federal dollars received by states as a percentage of

Figure 2. Direct and Indirect Federal Flows as a Percentage of State GDP

States	Total Direct & Indirect Federal Flows to State ($ Billions) Fiscal Year Ending in 2017	Percentage of Total State GDP
States (Top 5)		
1. Arizona	$156.3	52.6%
2. Mississippi	$39.8	39.5%
3. Alabama	$74.3	38.5%
4. Maine	$21.0	37.7%
5. New Mexico	$32.9	36.2%
States (Median)		
25. Michigan	$109.3	24.0%
26. Colorado	$77.6	23.9%
State (Lowest)		
50. Wyoming	$6.1	15.9%
50 State Average		**22.6%**
50 State Total	**$3,984**	

total state revenue. (Note: the range is extraordinarily broad, from 53.2% to 10.6%.)

Federal Flows That Come Indirectly to the States

In FY2017, the economies of the 50 states were also enriched by $43.5 billion in federal monies sent directly to local governments, principally for education and social services.[4] Businesses within states received $443.8 billion as payment for goods and services provided to the federal government.[4] The largest component of federal dollars sent to states, however, consisted of $2,751.6 billion sent to individuals, mainly in salaries and wages, social insurance, retirement and health care benefits, and grants and loans for higher education.[4]

Figure 2 illustrates the combined direct and indirect flows from the federal government to states, amounting to $4 trillion, or 22.6 % of the combined gross state domestic product, which totaled $17.7 trillion.[4] **Figure 2** also shows this financial dependency ranges from 52.6% down to 15.9%, and it represents significant contributions to the economies of the respective states.[4]

Figure 3 illustrates the remarkable array of payments made by the federal government to individuals in states. The various social insurance programs, combined with Medicare benefits, account for more than 60.3% of all such payments. Student loans and education grants account for 17.3%, while wages, disability benefits, and retirement benefits of the federal civilian and military workforce account for 16.3 %.[5]

Federal Funding Versus State Contributions

Figure 4 illustrates, per capita, the balance of flows into state economies from the federal government versus flows out to the federal government in the form of taxes paid. For FY2017, the average per capita inflow to the 50 states was $12,279, versus $10,389 in taxes paid to the federal government.[6] The difference of $1,890 contributes to the federal deficit.

Figure 3. Schedule of Direct Payments to Individuals — For the 50 States

Category of Direct Payment to Individuals	Payments – Fiscal Year Ended 2017 ($ Billions)	Percentage of Total Direct Payments
Social Security Retirement Insurance	$698.0	25.4%
Medicare Payments	$685.9	24.9%
Direct Student Loans	$455.6	16.6%
Civilian Salaries and Wages	$153.1	5.6%
Social Security Disability Insurance	$138.8	5.0%
Military Active Duty, National Guard & Reserve Salaries and Wages	$93.6	3.4%
Social Security Survivors Insurance	$82.4	3.0%
Federal Retirement and Disability Payments – Civilian	$80.7	2.9%
Veterans Compensation for Service – Connected Disability	$69.8	2.5%
Payments for Excess Earned Income Tax Credits	$59.6	2.2%
Supplemental Security Income	$54.5	2.0%
Federal Retirement and Disability Payments – Military Retirees & Survivors	$52.7	1.9%
Federal Pell (Education) Grants	$20.4	0.7%
All Other Direct Payments to Individuals	$106.5	3.9%
Total Direct Payments to Individuals	**$2,751.6**	**100.0%**

Figure 4. Direct/Indirect Federal Flows Received Per Capita and Federal Taxes Paid Per Capita

States	Population	Direct/Indirect Federal Flows Received Per Capita Fiscal Year Ending 2017	Federal Taxes Collected from State Per Capita Fiscal Year Ending 2017	Direct/Indirect Flows Received vs. Taxes Collected Per Capita
States (Top 5)				
1. Arizona	7,048,876	$22,179	$6,232	$(15,947)
2. Virginia	8,465,207	$18,689	$10,299	$(8,390)
3. Maryland	6,024,891	$17,757	$11,825	$(5,931)
4. Alaska	739,786	$17,584	$7,299	$(10,284)
5. Minnesota	5,568,155	$16,423	$18,755	$2,332
States (Median)				
25. Florida	20,976,812	$12,102	$9,194	$(2,908)
26. South Dakota	873,286	$12,052	$9,015	$(3,036)
State (Lowest)				
50. Wisconsin	5,792,051	$9,882	$9,166	$(716)
50 State Total	**324,451,430**			
50 State Average		**$12,279**	**$10,389**	**$(1,890)**

Where is the Risk to State Governments in All of This?

Nowhere is the linkage between state governments and the federal government more critical than in the relative financial condition of these interconnected elements of American government. While state governments, in some manner, must continuously work toward maintaining a balanced budget and sound long-term financial strength, the federal government has traditionally not operated under similar constraints. The absence of such constraints has led to a situation in which the current indebtedness and financial obligations of the federal government are approaching a level that nearly outstrips the economic wealth of the entire nation.

To illustrate this point, **Figure 5** summarizes the reported financial condition of the federal government for FY2018,[7] and it is not a pretty picture. The federal liabilities, intragovernmental debt, and social insurance obligations totaled $85 trillion. This amount equates to:

- 419% of the nation's 2018 gross domestic product of $20.3 trillion.
- 79% of the total estimated household and nonprofit net worth of $107.9 trillion.[8]

According to the *2018 Financial Report of the U.S. Government* (federal financial report): "…absent policy changes, the federal government continues to face an unsustainable long-term fiscal path."[9] Given this information, state government leaders and stakeholders may want to start asking:

- Is it more likely than not that the federal government will, over time, experience significant challenges in meeting its growing reported liabilities and fulfilling its currently reported social insurance obligations?
- How long will our federal government be able to borrow seemingly without restraint?

Figure 5. Analysis of Federal Liabilities, Intragovernmental Debt, and Social Insurance Obligations ($ Billions)

Source of Financial Statement Data: 2018 Financial Report of the U.S. Government

Federal Liabilities	2018	2017
States (Top 5)		
Publicly-held Debt	$15,813**	$14,724*
Federal Employee & VA Benefits – Unfunded Portion	$7,982	$7,700
Other – Payables and Liabilities	$1,563	$1,473
Intragovernmental Debt		
Owed to Social Security, Medicare and Other Trust Funds	$5,825	$5,644
Federal Social Insurance Obligations – Present value of future expenditures more than future revenues		
Social Security	$16,100	$15,400
Medicare – Parts A, B & D	$37,600	$33,500
Other	$100	$100
Total Liabilities, Intragovernmental Debt & Social Insurance Obligations	**$84,983**	**$78,541**
Current-dollar GDP [a]	**$20,273**	**$19,348**
Total Liabilities and Obligations as % of GDP	**419%**	**406%**

**78.0% of 2018 GDP *76.1% of 2017 GDP

[a] Source: "The estimates of (2017) GDP used in the calculations of the deficit and borrowing relative to GDP reflect the revisions to historical data released by the Bureau of Economic Analysis (BEA) in July 2018. GDP for FY 2018 is based on the economic forecast for the President's 2019 Budget, adjusted for the BEA revisions." October 15, 2018, *Joint OMB/Treasury Statement on Budget Results for Fiscal Year 2018*, See: https://home.treasury.gov/news/press-releases/sm522

- When will the "drip, drip" of ever-increasing interest payments on the federal debt push out the ability of the federal government to fund the programs and services upon which state governments have become so reliant?

Risks Reported for Years but Largely Ignored

Comptrollers General of the U.S., going back decades, have expended considerable energy in alerting all — who would listen — to the declining fiscal strength of the federal government. The GAO,[10] Congressional Budget Office (CBO),[11] and Department of the Treasury (Treasury)

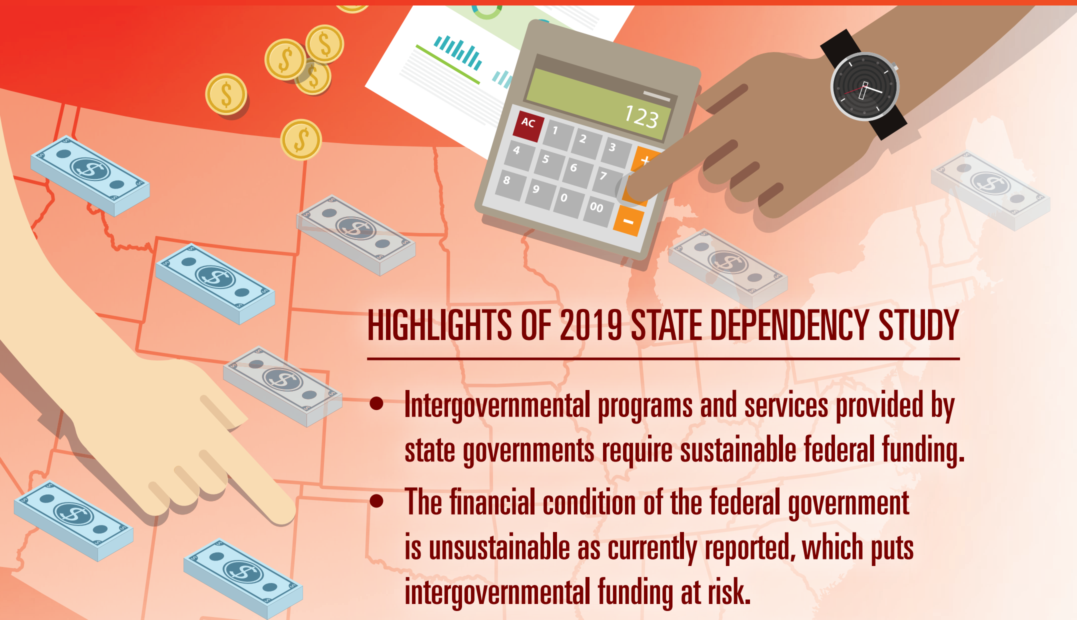
each publish clear and convincing annual reports that identify the fiscal condition of the federal government as unsustainable — and have done so for many years. The Social Security and Medicare Trust Funds publish annual assessments,[12] illustrating the time limits on their ability to sustain these programs at current levels. All of these responsible people, from responsible components of our government and its financial management, have each issued the cry that our federal government cannot be sustained on its current path.

Mobilizing State Governments to Defend Their Self-Interest

In December 2019, the Reginald F. Lewis College of Business at Virginia State University published a research report we wrote, entitled *Intergovernmental Financial Dependency — 2019 Edition: An Annual Study of Key Dependency Measures for the 50 States*.[13] This 53-page report contains several tables that show the individual categories of federal flows upon which states are dependent, and permits comparing dependency between states. Our hope in sharing the study is to help state and local government leaders better understand the degree to which their governments are dependent on federal funding and the risks associated with that dependency, and to encourage leaders to address federal unsustainability.

The report offers specific recommendations to elected officials, standard-setting bodies, regulatory agencies, and professional organizations on actions to take to "flatten the curve" and return our federal government, over time, to a more stable, sustainable fiscal condition. We suggest:

- **All governors** request the Secretary of the Treasury to (a) issue them bound copies of the annual federal financial report within 14 days of its release, and (b) send a Treasury official to personally brief each governor on key information and trends.
- **Governors** each appoint a permanent working group of senior state officials and other advisors to sustain focus, from a state perspective, on ways to reduce federal deficit spending and slow and reverse the growth in publicly held federal debt.
- **The National Governors Association and National Association of State Budget Officers** coordinate information sharing among the state working groups and set up support meetings between each governor and that state's congressional delegation to discuss the federal fiscal condition and trends in direct and indirect federal funding received by the state.
- **The National Conference of State Legislatures** (a) request the Treasury Secretary brief members on the federal fiscal condition during their national conferences, with emphasis on long-term budgetary projections and the on-going and projected lending capacity of domestic and foreign investors to absorb publicly held federal debt, and (b) issue bound copies of the annual federal financial report within 14 days of its release to senior elected legislative officials.
- **The Governmental Accounting Standards Board** (a) expedite an "active project" to address material, widespread underreporting of intergovernmental financial dependency by state and local governments, and (b) recognize the general unwillingness of state comptrollers to report on this matter without a requirement.
- **The Federal Accounting Standards Advisory Board** strengthen existing standards by requiring the following supplemental



HIGHLIGHTS OF 2019 STATE DEPENDENCY STUDY

- Intergovernmental programs and services provided by state governments require sustainable federal funding.
- The financial condition of the federal government is unsustainable as currently reported, which puts intergovernmental funding at risk.
- Sustained engagement and leadership from the nation's governors and other key stakeholders of state government can help return the federal government, over time, to a more sustainable fiscal condition.

information in the annual federal financial report:

- The year-end maturity distribution of public debt.
- A two-year schedule of (a) month-to-month changes in the outstanding balances of publicly held debt, showing both issuances and redemptions of significant debt maturities; and (b) changes in ownership of publicly held debt by major holders.
- A supporting two-year schedule of changes in holdings by individual "foreign and international" investors.

- **The Municipal Securities Rulemaking Board** study the adequacy of offering documents to accompany the issuance of municipal securities and on-going disclosure requirements, in light of the reported unsustainable federal fiscal condition and the known key measures of intergovernmental financial dependency of state governments.
- **Treasury**, in conjunction with OMB's Office of Federal Financial Management (OFFM), the leadership of USAspending.gov, and representatives of selected federal departments consider:
  - Adding data to USAspending.gov to show the amount of federal FY spending within the jurisdiction of each state for:
    - Medicare benefit payments.
    - Civilian salaries and wages paid to federal employees.
    - Active duty military and National Guard & Reserve salaries and wages.
    - Federal civilian, military, and survivor retirement and disability payments.
    - Payments of Excess Earned Income Credit.
  - Explore the feasibility of building into USAspending.gov, perhaps as a component of its DataLab function, access to data on federal funding flows to individual state governments.
- **OFFM** sponsors discussions on the incentives, challenges, process, and other considerations necessary to focus intergovernmental cooperation on improving federal fiscal sustainability, to include:
  - Promoting increased use of USAspending.gov and key measures of intergovernmental financial dependency to support discussions on reducing federal deficit spending.
  - Improving methods to assess the economic impact on states of alternative federal legislative proposals and administrative actions in federal programs that directly fund state coffers or indirectly impact state economies.
  - Requiring state auditees to disclose in the notes of their Single Audit reports the name, employer identification number, and prior year's total reported federal expenditures for each department, agency and other unit issuing a separate Single Audit report.
- **The National Association of State Auditors, Comptrollers and Treasurers (NASACT)** request Treasury to:
  - Routinely provide each state auditor, comptroller, and treasurer with a copy of the annual federal financial report and establish a designated Treasury representative to respond to inquiries.
  - Collaborate with NASACT in the development of alternative methods for preparing long-term (i.e., 10-year) projections of the lending capacity of current and future investors in U.S. publicly held securities.
- **Bond rating agencies** give concentrated, ongoing attention to the reported federal financial condition and critical measures of states' intergovernmental financial dependency.

These recommended actions, if initiated soon and executed over the coming years, can have a positive impact on slowing, then halting, the further decline in the federal government's fiscal condition. If applied conscientiously, over the next decade or two, leadership from the individuals and organizations cited might well begin to restore our federal government to a healthier fiscal condition. That is our hope.[14]

Endnotes

1. Posner, Paul L. "The Politics of Coercive Federalism in the Bush Era," *Publius: The Journal of Federalism*, Volume 37, Issue 3, Summer 2007; pp. 390-412.

2. *Status of State Medicaid Expansion Decisions: Interactive Map*, KKF.org

3. Mazur, Edward J. and Mary B. Scott. *Intergovernmental Financial Dependency—2019 Edition: An Annual Study of Key Dependency Measures for the 50 States*. (Reginald F. Lewis College of Business, Virginia State University, Nov. 2019) p. 8. (The report can be accessed online at http://business.vsu.edu/IFD/2019AnnualStudy).

4. See Endnote 3, p. 30-31.

5. See Endnote 3, p. 11.

6. See Endnote 3, p. 43.

7. *2018 Financial Report of the United States Government*, p. 10, "Table 1: The Federal Government's Financial Position and Condition."

8. "Federal Reserve's Estimate of Household and Nonprofit Organization Net Worth" for the third quarter of 2018.

9. See Endnote 7, Statement of the Comptroller General of the United States, p. 40.

10. GAO. *The Nation's Fiscal Health: Actions Needed to Achieve Long-Term Fiscal Sustainability* (GAO-19-611T), June 26, 2019.

11. CBO. *Long-Term Budget Outlook Report*, June 25, 2019.

12. Trustees of the Social Security and Medicare Trust Funds. *Summary of the 2019 Annual Reports*.

13. See Endnote 3, p. 2.

14. For related thought leadership by Edward J. Mazur in earlier issues of the *Journal*, see "Last Call for Common Sense: In Addressing the Fiscal Sustainability of the U.S. Government" (Spring 2016) and "Our Nation's Governors: Walking a Tightrope Without a Net" (Summer 2011).

Edward J. Mazur, CPA, is a nationally recognized author and speaker on the subject of intergovernmental financial dependency. During his career, he served on both GASB and FASAB, as the first controller appointed under the CFO Act to head OMB's Office of Federal Financial Management, as State Comptroller of Virginia, as senior public sector advisor for CliftonLarsonAllen, and as president of NASACT. Winner of AGA's Author Award in 2012 and again in 2016, he is a member of AGA's Richmond Chapter.

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