California Institute Special Report: California's Balance of Payments with the Federal Treasury, Fiscal Years 1981-2003

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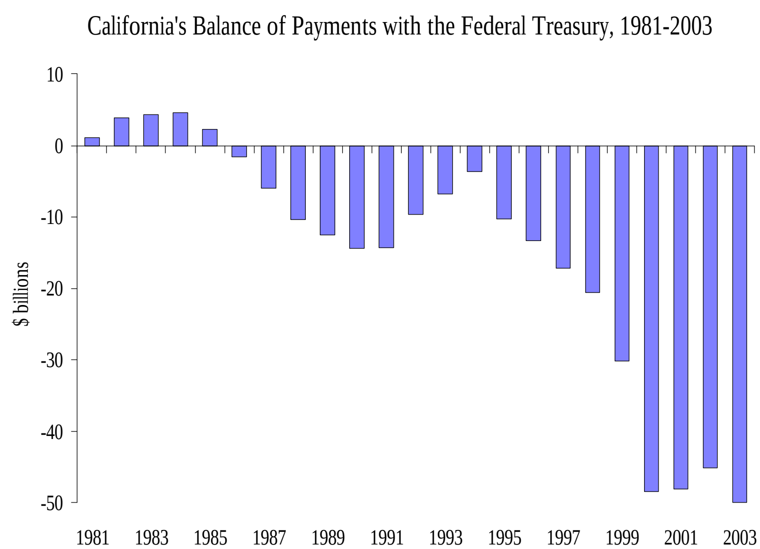
In fiscal year 2003, Californians' tax payments to the federal treasury exceeded federal spending in the state by $50 billion, a record high. Much of that discrepancy, however, may be attributed to demographic factors such as youth and wealth. For every tax dollar paid by Californians in 2003, the federal government spent 79 cents for grants, wages, contracts, retirement benefits, etc. It was California's 18th year in a row as a net donor state.

[PLEASE NOTE: This document incorporates recent changes to California's federal tax burden data and balance of payments data for fiscal year 2002 and prior. Updated federal tax receipt records from Californians were lower than previously reported by the Tax Foundation for 2002, so the state's spending imbalance for that year has been corrected from a $58 billion shortfall to a $45 billion shortfall and from a 77 cents per tax dollar shortfall to 81 cents for 2002. The 2003 shortfall was 79 cents – which now constitutes a new low and a 2 cent drop from the year before. For details, see the Source Data section below.]

The Balance of Payments between California and Washington

In 2003, Californians sent $50 billion more to Washington in federal taxes than the state received in federal expenditures. Representing a slight increase from levels that have held steady for three preceding years, the Golden State's imbalance set a new record for any state, surpassing the previous mark (set also by California, in 2000 and 2001) of $48 billion.



To a large extent, however, two demographic factors help explain California's spending versus taxing shortfall. (A third key factor, declining contract and defense spending, is discussed later.) First, state residents' income levels exceed the national average, yielding above-average income tax receipts – an effect amplified by the progressive nature of the federal income tax system. Second, and more significantly, California's population is considerably younger than average. Thus, the state houses fewer recipients of Social Security and Medicare payments – parts of a fast-growing budget sector that now accounts for nearly half of the nation's total federal expenditures. Because of these two demographic influences, California's status as a donor state should be expected to some degree.

The Imbalance in Context: A Chronology

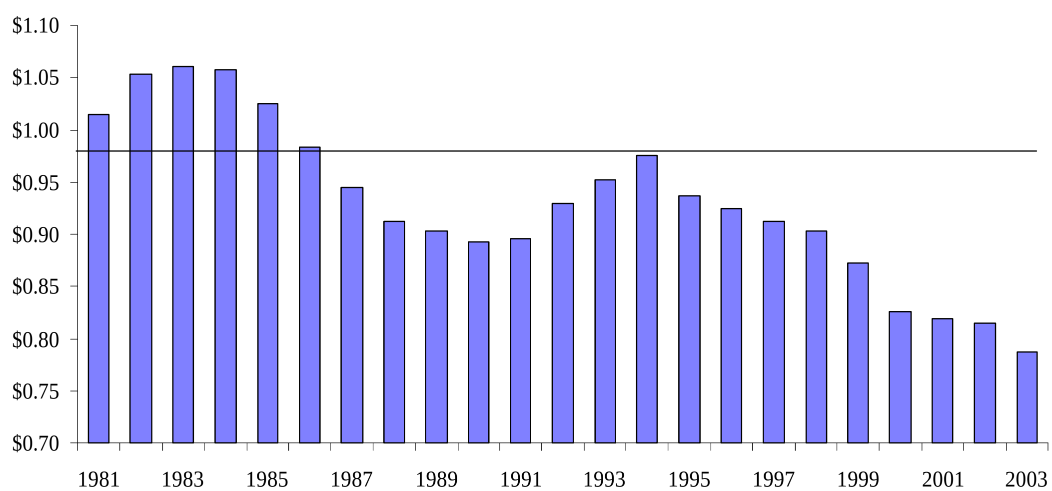
It has been many years since California's federal spending relationship was in surplus. The defense buildup during Ronald Reagan's first Presidential term in the early 1980s kept the state's balance of payments solidly in the black for six straight years. During the six years between 1981 and 1986, federal expenditures in California exceeded federal taxes paid by a total of $16 billion – with a single-year high-water mark of a $4.6 billion surplus in 1984.

As defense procurement began to wane in the mid 1980s, however, California's federal funding advantage declined, and the state's balance shifted into the red in 1987 and has remained there ever since. By 1990, California had erased the inflows of the early 1980s, and the 17-year combined deficit tally since 1987 has now grown to $363 billion. During the recession of the early 1990s, the state's balance figure recovered somewhat, dipping from a $14 billion loss in 1991 to just a $4 billion shortfall in 1994. But the retreat was short-lived, and deficits rose sharply after that; the imbalance leapt by an average of $7.4 billion each year for six years, reaching $48 billion in 2000 and remaining near that mark today.

The Imbalance in Context: California's Return on the Dollar

The taxing-versus-spending imbalance means that every California man, woman, and child paid $1,409 more in federal taxes in 2003 than he or she received in federal funds and services. The per capita discrepancy was the state's second highest on record; the 2000 amount was slightly more – $1,423.

California Return on Investment: Federal Expenditures in California per Federal Tax Dollar Paid, FY 1981-2003



Put slightly differently, California received 79 cents in federal payments and services for every dollar sent to Washington. The "return on the dollar" figure represents a decline from 98 cents in 1994 and 90 cents in 1998, and it is a record low return for the state.

The balance of payments figure is calculated by comparing federal spending attributable to each state (excluding spending in territories and non-allocable costs such as intelligence, overseas operations, and interest on the national debt) against federal tax and fee revenue dollars collected by states. The tax burden figure is then adjusted to provide an "apples-to-apples" comparison between the two numbers. For more details, see Methodology, below.

The state's return on investment has edged downward for two decades. During the early and middle 1980s, California received back more than a dollar for each tax dollar paid, reaching an apex of $1.06 in 1983-84. The return fell below $1 in 1985, bottomed out at 89 cents in 1990, rebounded to 98 cents in 1994 (the year of the Northridge earthquake and the trough of the state's recession), and has fallen steadily since then.

Yet California is not the worst off among the states. California ranks 45th out of 51 states plus D.C. in balance of payment returns. In 2003, New Jersey ranked lowest, receiving just 58 cents for each dollar paid in. (Other states with the most significant balance shortages included New Hampshire (65 cents), Connecticut (67 cents), Minnesota (69 cents), Nevada (70 cents) and Illinois (72 cents).

Not surprisingly given its concentration of federal facilities, the District of Columbia displayed by far the highest return, $6.59 per dollar in 2003. Excluding the District of Columbia, New Mexico ranked first with a balance of $2.00 in returns for every dollar paid to the federal government. The next largest returns per dollar were in Alaska ($1.90) and Mississippi ($1.83).

[As noted above, the Tax Foundation recently corrected tax burden statistics for several past fiscal years, including 2002, to accommodate revised IRS data. As a result, the 2002 return to California per dollar of taxes has been changed from the previously-reported 77 cents to a new amount of 81 cents. For details, see Source Data, below.]

Components of the Balance of Payments Deficit: California's Share of Population, Federal Tax Burden, and Expenditures

Two primary factors comprise the balance of payments: taxes and expenditures. In addition, to further explore equitability, this report includes the state's share of the U.S. population as an illustrative benchmark. In 2003, California housed 12.2 percent of the nation's residents, paid 13.4 percent of federal taxes and received back 10.9 percent of federal payments and expenditures.

Population

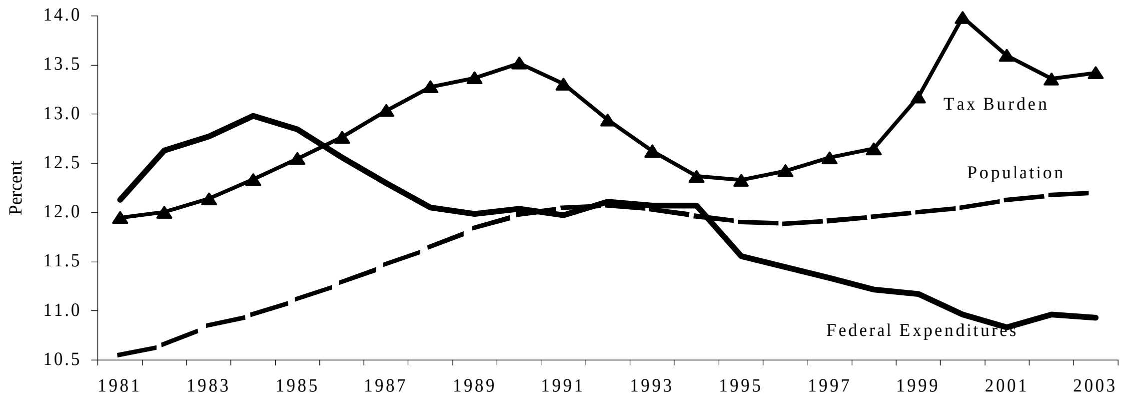
California is home to nearly one in eight Americans. In sharp contrast to steep population increases during the 1980s – when California's share of the national population rose from 10.5 percent in 1981 to 12.0 percent in 1990 – throughout the 1990s the state's share remained relatively stable. In recent years, California's share of the nation's population has been rising slowly, from 11.9 percent in 1996 to 12.2 percent in 2003. A number of federal grant programs distribute funds to state and local governments based in whole or in part on population data. Some have argued the existing methodology for collecting census population data that avoids using statistical sampling methods for estimating population totals, fiscally disadvantages California and other rapidly-growing urban and poorer states.

Federal Taxes

At 13.4 percent, California's share of the nation's $1.75 trillion tax burden remained relatively stable for the third year in a row in 2003. The state's percentage share had been between 12.3 and 12.6 percent for six years, between 1994 and 1998. It then rose sharply for two years – peaking at 14.0 percent in fiscal year 2000 – before falling back to 13.6 percent in 2001 and 13.4 percent in 2002 and 2003.

The recession during the early 1990s affected California's economy more profoundly than that of most other states, and the state's relative share of federal income tax contributions declined from 1991 through 1995. (Despite the state's economic woes, however, California remained a donor state with respect to the rest of the country throughout the period.) Before the recession, from 1987 through 1991, California's share of federal taxation had again held steady somewhat above 13 percent, the same level as today.

California Share of Federal Expenditures, Tax Burden, and Population, FY 1981-2003



As has been true for more than half a century, California's $235 billion contribution to the federal treasury in 2003 was by far the largest federal tax-dollar total of any state, according to the Tax Foundation, well above both New York's $145 billion and Texas's $122 billion. Most states and the nation as a whole experienced a substantial reduction in federal taxes between 2000 and 2003. The nation's total tax burden reached a high of $1.98 trillion in 2000, and declined 12 percent to $1.75 trillion in 2003. Likewise, after spiking to $277 billion in 2000, California's tax burden declined 15 percent to $235 billion in 2003.

(Although this report focuses on 2003 because that is the most recent year for which comparable spending data are available, the Tax Foundation also estimated the federal tax burden by state for Fiscal Year 2004. It predicted that California's 2004 tax burden will amount to $249 billion, 13.5 percent of the nation's $1.84 billion total.)

Federal Spending

Total federal expenditures in California rose to $220 billion in fiscal year 2003, a 6 percent increase from 2002, according to the U.S. Census Bureau's Consolidated Federal Funds Report for fiscal year 2003. Calculated as a percentage of the $2 trillion total that the U.S. government spent in all states, California's share of federal expenditures declined slightly to 10.9 percent in 2003 from 11.0 percent in 2002, largely because procurement spending grew more rapidly in other states.

For much of the past decade, California's share of federal spending has changed little. After rising from 12 percent in 1981 to 13 percent in 1984 – propelled largely by military procurement contracts won by California's aerospace industry – federal spending in the state gradually declined to the 11 percent range by the late 1990s.

Federal Taxation and Spending Per Capita

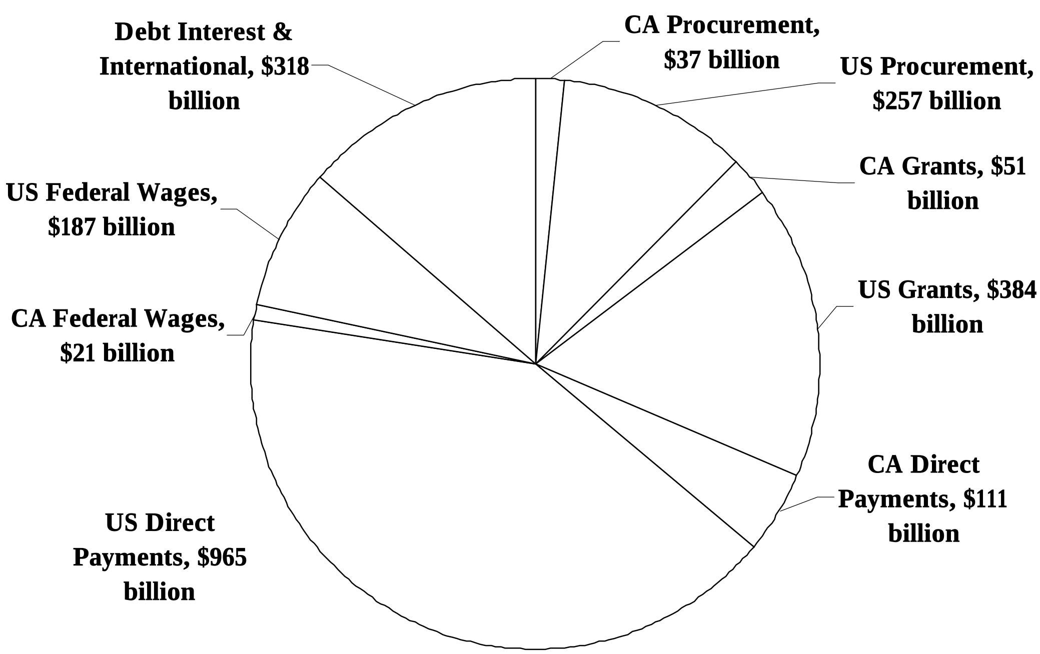
In 2003, the federal government spent a total of $6,192 per capita in California, compared to $6,910 per capita nationwide, a spending shortfall for the state of 12 percent.

On the taxation side of the ledger, Californians paid in $6,611 per capita to the federal treasury, compared to a national average of $6,011 per capita, or a discrepancy of 9 percent.

The 2003 spending discrepancy was larger than any recorded year except 2001, and the federal tax discrepancy was the largest since data collection began.

(Please note that due to adjustments, subtracting taxing amounts from spending amounts per capita will not yield a relevant balance figure. For details, see Methodology, below.)

Federal Expenditures in California and Other States, FY 2003



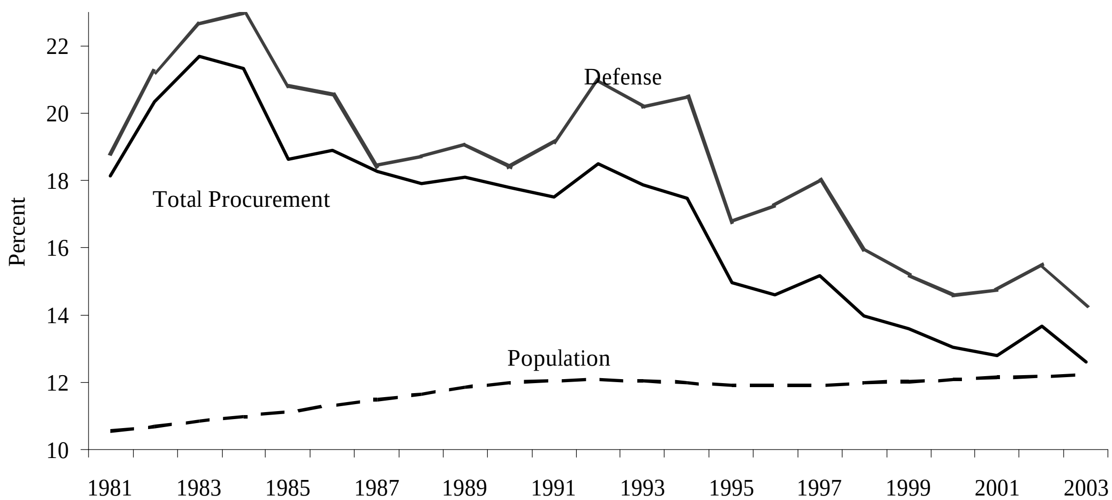
Broad Categories of Federal Spending

The Census Bureau divides federal spending into four primary components – procurement, direct payments, salaries and wages, and formula and other grants to states and local governments. California's share of federal procurement spending declined sharply, to 12.6 percent in 2003 from 13.7 percent in 2002. Direct payments in California edged upward slightly to 10.3 percent of the nation's total, remaining near the proportion that the state has maintained for several years (the long-term trend has been slowly downward for a decade). Federal salary and wage spending in California remained flat at 9.9 percent, holding below the 10 percent threshold for the fourth year in a row. And California's share of federal grant program expenditures (including formula grants) held steady at 11.8 percent, below the state's percentage of the total U.S. population. Each of these four categories is discussed in greater detail below.

Procurement

Resuming a downward trend that has persisted for 20 years, California's share of federal procurement (which includes defense and other contract spending) declined to 12.6 percent in 2003. In the same year, the nation's procurement spending leapt from $254 billion to $294 billion, an increase of nearly 16 percent from 2002, whereas spending in California rose from $35 billion to $37 billion, less than half as rapidly. For the first time since 1986, the state's total federal procurement expenditures exceeded the state's previous high-water mark of $35 billion. (Were those dollars adjusted for inflation, however, the state's receipts would remain well below that threshold. After adjusting for inflation, California's procurement awards are now roughly half of their 1985 levels.)

California Share of U.S. Total Procurement, Defense Procurement, & Population, FY 1981-2003



For the past two decades, no category of federal spending has declined more precipitously in either spending or California share than procurement. By 1998, federal procurement expenditures in California had fallen dramatically to $25 billion, the lowest level in current-dollar terms since 1981.

Declining contract expenditures by the Department of Defense, which spends two of every three federal procurement dollars, accounts for much of the reduction. California's share of total U.S. procurement expenditures (defense and non-defense combined) held nearly steady at the 18 percent mark for a decade before declining to about 15 percent for 1995-97, and now has been below 14 percent for five years. California's share of procurement spending for national defense was once as high as 23 percent, in 1984, when the Department of Defense spent $29 billion in the state. In 2003, continuing the slow but steady decline that has persisted for nearly two decades, the state received just 14.2 percent of defense contracts, $26 billion of the $201 billion total distributed nationwide. (The state's share of all defense spending, including contracts and other categories, was 13 percent, $39 billion of the nation's $320 billion.)

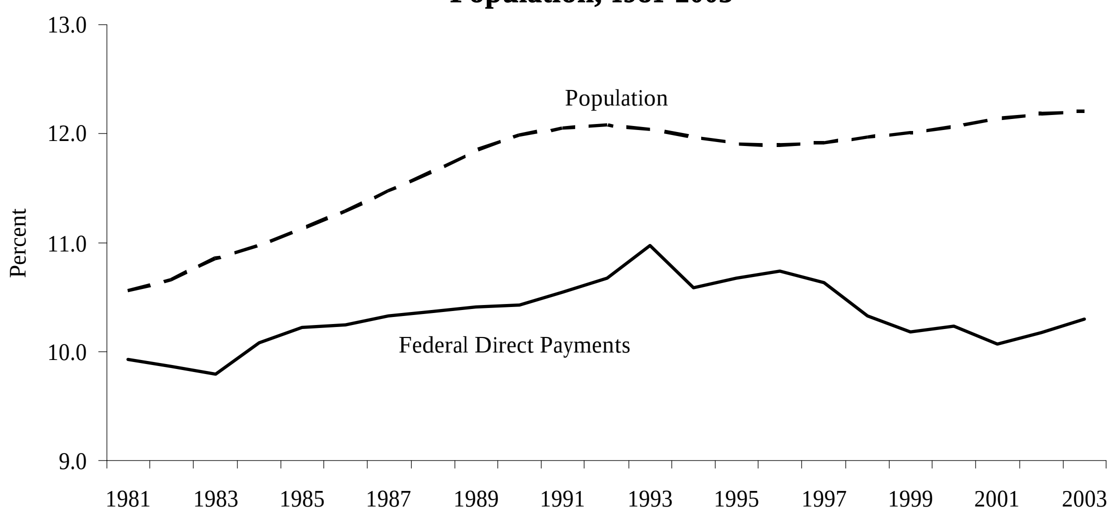
Direct Payments

Representing nearly half of total federal expenditures and more than $1 trillion annually, the direct payments category is comprised of Social Security, disability, retirement and other payments directly from the federal government to individual recipients. Roughly half of direct payments come in the form of Social Security checks, while another 20 percent are Medicare payments.

Federal spending for direct payments, both in California and nationwide, has increased every year for the past two decades. Californians' share of direct payment dollars remained relatively constant throughout the early and mid-1990s, roughly tracking California's share of the nation's older population. Recently, that share declined from 10.7 percent in 1997 to 10.1 percent in 2001, and then rebounded to 10.3 percent in 2003.

Direct payment expenditures in California rose from $91 billion in 2000 to $111 billion in 2003, and the state's share of the national total increased slightly, to 10.3 percent. This percentage growth marks only the second time California's share of such payments has increased in the past decade.

California Share of Federal Direct Payment Expenditures and Population, 1981-2003



Nationwide, direct payments from the federal government continued to grow, rising from $260 billion in 1981 to $1.1 trillion in 2003. Last year alone, direct payments expenditures nationwide rose by $50 billion compared to the amount in 2002. The $110 billion received by Californians in 2002 is more than four times the $26 billion received in 1981.

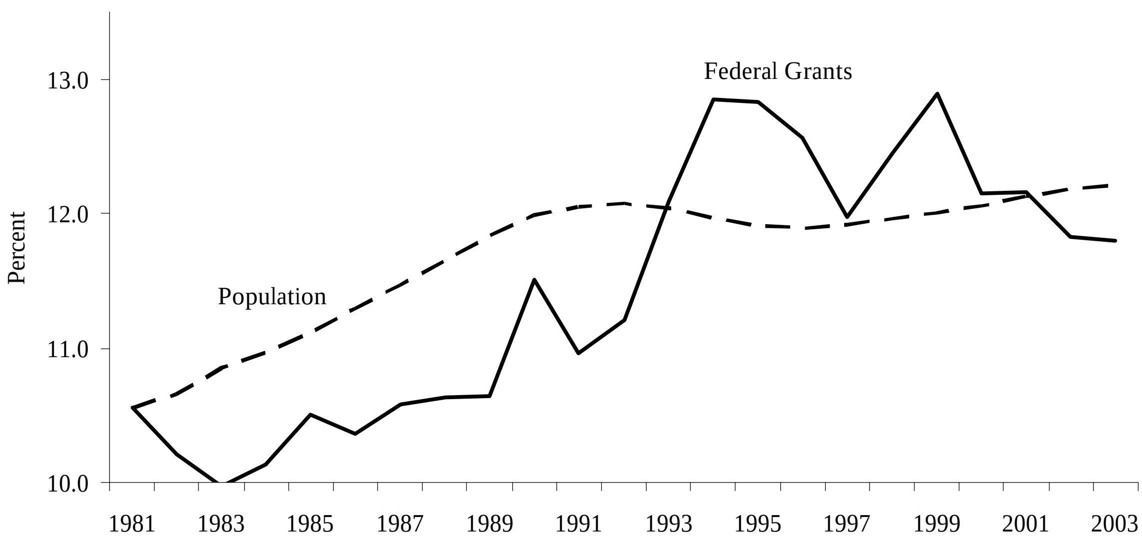
Grants

The bulk of federal grant spending is distributed to states by congressionally designed formulas, often based on population, income, poverty, and similar data. (Formula grant program spending represents approximately 85 percent of the grants category; the remainder is spent on competitive or project grants.)

Of total grant payments to states – comprised primarily of federal formula grant expenditures for such programs as Medicaid, highways and transit, welfare, education assistance, and nutrition programs – California's overall receipts rose from $48 billion to $51 billion, and the state's share of the nation's total remained unchanged at 11.8 percent in 2003. Grant expenditures in all states continued to increase steadily, from $364 billion in 2001 to $407 billion in 2002 and $435 billion in 2003.

After holding steady in the 1980s at 10.5 percent of the nation, California's share of federal grants to state and local governments rose sharply to nearly 13 percent in 1994. The share of grant spending then fluctuated for several years between 12 and 13 percent, before settling below the 12 percent mark. More than 60 percent of the nation's $435 billion in 2003 grants funding was distributed pursuant to four programs: Medicaid, highway planning and construction, welfare, and Title I education grants.

California Share of Federal Grant Expenditures and Population, 1981-2003



In 2003, federal Medicaid distributions to states from the Centers for Medicare and Medicaid Services for Medicaid grants totaled $169 billion, and California received $18 billion or 10.6 percent of the total. In 2002, the state received $15.4 billion, or 10.4 percent, of the $148 billion U.S. total. And in 2001, California's Medicaid receipts amounted to $14.1 billion, or 10.6 percent, of the $133 billion distributed nationwide. The state's current percentage share is currently slightly more than the approximately 10 percent share received throughout the preceding decade. California's share of Medicaid funding has long been reduced by the use of a per capita income factor in the "FMAP" (the Federal Medicaid Assistance Percentage in the Medicaid formula), which shifts funds to states with below-average income. California' youthful population, moreover, keeps the state's Medicaid expenses somewhat below the national average – older enrollees, particularly those in long-term care, tend to be associated with considerably higher costs per patient. New York, on the other hand, with a population only two-thirds of California's but with a larger proportion over age 65, received $4 billion more in federal Medicaid funds in 2003 than did California.

With regard to transportation funding, for many years, California has received fewer highway planning and construction funds than the state's motorists have paid into the highway trust fund in gasoline taxes, and the states' share of highway money remains relatively low. In 2003, California received $2.2 billion in highway planning and construction funds out of the $29 billion distributed nationwide, or approximately 7.6 percent of the U.S. total. The state received slightly more than 9 percent of federal highway grant funding over the life of TEA-21, the transportation law that authorized funds from 1998 through 2003. The state's low highway funding share is mitigated somewhat by the state's relatively large share of the federal transit budget. In 2003, California received $756 million, or 14.8 percent, of the $5 billion distributed nationally under federal transit formula grant programs.

When the 1996 federal welfare reform law replaced the Aid to Families with Dependent Children entitlement program with the Temporary Assistance for Needy Families (TANF) block grant, California was home to 21.7 percent of the nation's adult welfare recipients. With that figure locked in, the state has continued to receive the lion's share of the nation's welfare spending ever since 1996. Although total national expenditures for federal highway programs ($29 billion in 2003) are greater than for welfare ($17 billion), California received more in federal welfare payments ($3.7 billion) than in payments under the highway program ($2.2 billion). As has been the case since welfare reform's enactment, California in 2003 received nearly 22 percent of the nation's expenditures for TANF's State Family Assistance Grants.

In fiscal year 2002, California received $1.4 billion (or 14.6 percent) of the $9.6 billion distributed nationwide from the Title I Education for the Disadvantaged program, the federal government's largest K-12 education grant. This percentage reflects the continued growth in the state's share of Title I from an 11 percent average during the 1990s. The program is authorized under the No Child Left Behind Act.

For Special Education Grants to States, funded pursuant to the Individuals with Disabilities Education Act (IDEA), California received $863 million (10.7 percent) of the nation's $8 billion in 2003 distributions. The state's share has increased since a formula change, instituted largely because of efforts by the California Congressional delegation, began to operate in FY 2000.

For further California-focused information regarding formula grant programs, including in-depth analyses of the highway and welfare programs, consult Federal Formula Grants and California, a joint project of the Public Policy Institute of California (PPIC) and the California Institute for Federal Policy Research, at http://www.calinst.org/formulas.htm .

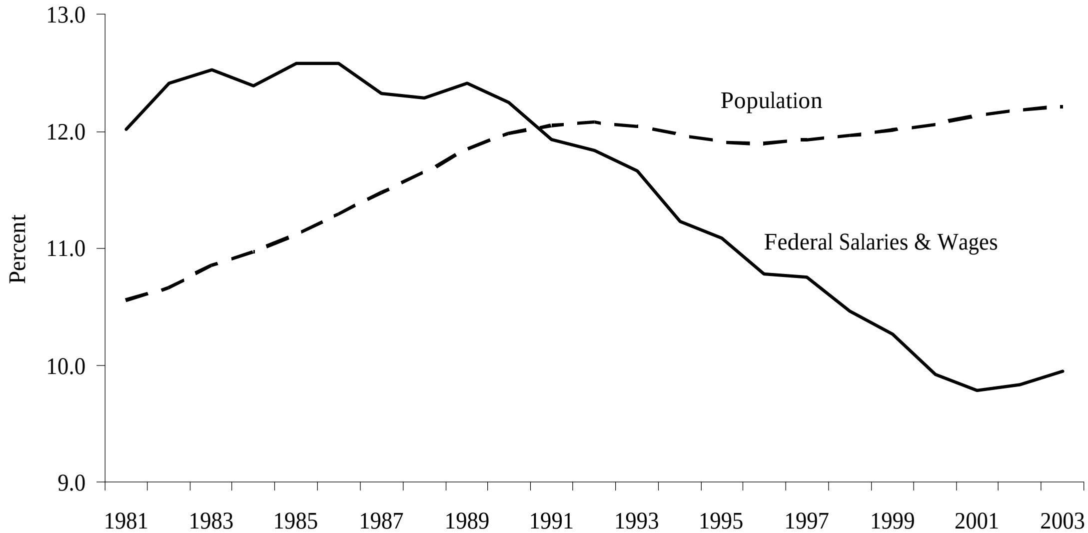
Salaries and Wages

In the fourth major category of federal spending, California's share of salaries and wages paid to federal employees remained just below 10 percent of the U.S. total. Total federal salary and wage spending in the state has risen from $19 billion in 2002 to $21 billion in 2003, keeping pace with a similar increase nationwide.

California's federal salary and wage levels have been pushed downward by employment reductions associated with military base closures. Prior to the shuttering of a number of military installations, ordered by base closure rounds in 1988, 1991, 1993, and 1995, California's share of federal salaries and wages had peaked in 1986 at 12.6 percent of the nation's total.

Despite the fact that the state housed just 15 percent of military personnel before the closures began, California was called upon to shoulder 60 percent of the nation's net

California Share of Federal Salaries and Population, 1981-2003



personnel cuts ordered by those four base closure rounds. After a 10-year hiatus, the Department of Defense plans to conduct a military base closure round in 2005. Recent statistics estimate that California houses nearly 300,000 military and civilian DOD personnel, with a total payroll of approximately $10 billion.

Spending Within California

California's 15 largest counties house 83 percent of the state's population – and a proportionate share of most federal spending categories – although they accounted for 94 percent of the state's procurement receipts in 2003. Not surprisingly, federal receipts vary greatly from county to county.

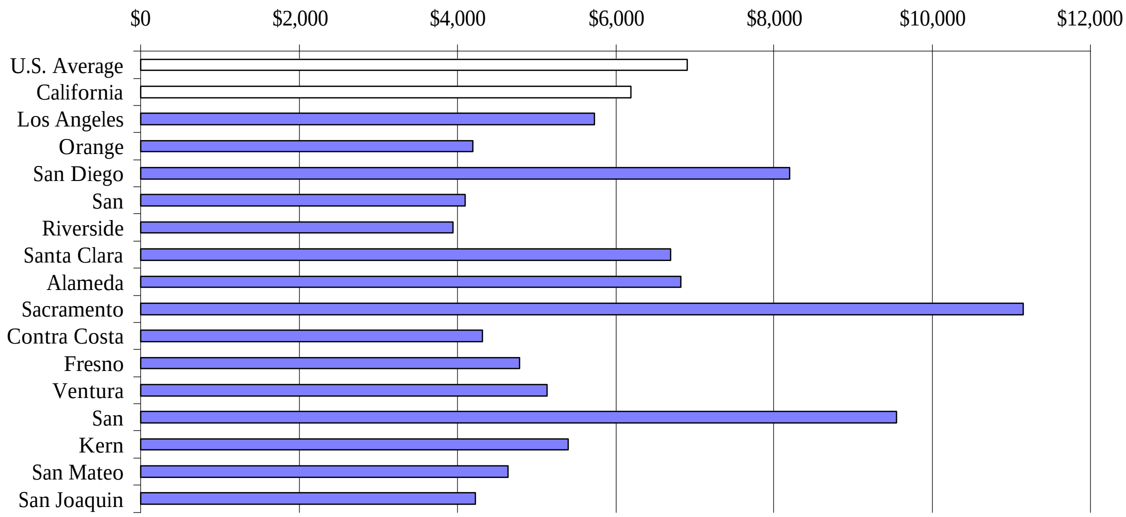
Whereas Los Angeles County's $57 billion in federal receipts represented more than 25 percent of the state total, per capita federal spending in Los Angeles County ($5,728) was below the average for both the state ($6,192) and the nation ($6,910). Per capita federal receipts in the largest counties ranged from a high of $11,150 in Sacramento County to a low of $3,943 in Riverside County, $4,105 in San Bernardino County, and $4,205 in Orange County. (Because of the presence of the state government, $8.8 billion in formula grant spending was attributed to Sacramento County, thereby artificially inflating its total. Many of the grant dollars initially distributed to Sacramento County are subsequently redistributed to other parts of the state.)

Other large counties with relatively high per capita receipts in 2003 included San Francisco, at $9,547, and San Diego, at $8,204. San Francisco's high receipts are likely attributable to federal grants receipts and federal wages, both of which are more than double the state and national averages. In San Diego, high receipts are associated with strong procurement receipts and with very strong salary and wage performance, related to the area's major military presence.

In addition to Riverside, San Bernardino and Orange Counties, relatively low per capita federal receipts were logged in the Counties of Sonoma ($4,369), Contra Costa ($4,317), San Joaquin ($4,228), Stanislaus ($4,157), and Tulare ($4,182).

An attached table shows total and per capita federal spending, as well as amounts for the four primary spending categories, for all 58 California counties. The table is also available on the California Institute website, www.calinst.org .

Federal Expenditures Per Capita, United States, California, and California's 15 Largest Counties



Factors that Contribute to the State's Shortfall

A variety of factors likely contribute to the widening of the state's taxes-versus-spending disparity; three stand out as key drivers: age, income, and reduced defense spending.

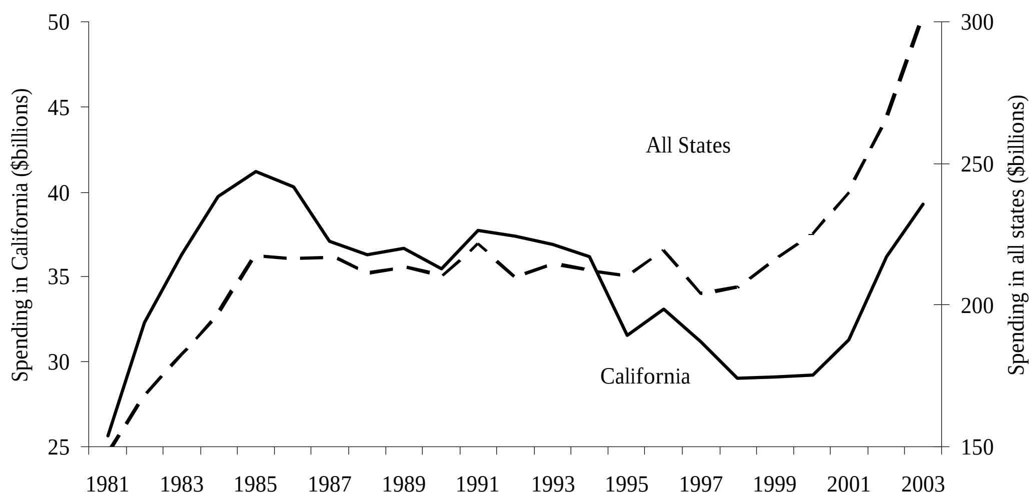
First, as discussed previously, California is a relatively young state and thus has fewer residents receiving payments under Social Security and Medicare, which constitutean increasingly large slice of the federal budget pie. According to the U.S. Census Bureau, 10.6 percent of Californians were age 65 or older in 2003, compared to 12.4 percent of all U.S. residents – as such, California had the 6th lowest percentage of its population over the age of 65.

Second, California remains a relatively prosperous state. Despite economic downturns in the early 1990s and this decade, incomes of California's residents remain above the national average. Thus, the state's residents pay proportionally more in federal income taxes under a progressive tax system.

Third, a key non-demographic factor in California's ongoing funding disparity is the state's slippage over the past 20 years in federal defense spending, including both contract procurement and military and civilian wages and salaries. The nation's total defense contract spending had fallen from $123 billion in 1991 to $108 billion in 1998 (a drastic drop-off even before accounting for inflation) but expenditures then began a rebound that reached $183 billion in 2003. California's defense procurement funding, on the other hand, experienced a faster fall and a slower recovery – dropping from $23.6 billion in 1991 to $17.3 billion in 1998, and climbing back only as far as $17.9 billion in 2000 before three growth years brought the 2003 total to $26 billion. Whereas the early 1980s saw nearly one-fourth of defense contract dollars spent in California, the state's share fell to a record low 14.2 percent in 2003.

A review of *total* dollars spent on defense – procurement and otherwise – yields even more dramatic findings. From 1981 to 1985, California and the nation followed a similar path – total DOD expenditure increased by 50 percent in both the state (from $25.6 billion to $41.2 billion) and the nation (from $147 billion to $218 billion). The similarities end then, however, with the nation's total spending remaining level and California's dropping sharply. Whereas the nation's total distributed defense spending remained level for 15 years (deviating no more than 6 percent from the 1985 amount), spending in California retreated sharply, with spending in 2000 ($29.3 billion) nearly 30 percent less than in 1985 ($41.2 billion). For the last three years, defense spending has grown rapidly in both the state and the nation. However, whereas the nation's total has ascended to new heights ($301 billion in 2003), even three years of defense spending growth in California has still not restored California to its previous high-water mark. At $39.2 billion in 2003, total federal defense spending in the state remained $2 billion below the comparable figure from 18 years prior.

Total Federal Defense Spending, California and All States, 1981-2003



Despite the state's taxes-versus-spending disparity, some opportunistic legislators from other states may charge that California receives too much from Washington. Half again larger than any other state, California presents a natural and large target for prospective opponents.

Moreover, some competitors for scarce funding may persist in portraying California as a disproportionately successful siphon from the federal treasury. To whatever extent that perception may ever have been valid, it certainly is no longer. As has been the case for more than a decade, California subsidizes the rest of the nation at unparalleled levels.

Methodology

The federal government generally operates in surplus or deficit, so national totals for expenditures and tax burden rarely match. Thus, this paper adjusts each year's tax burden figure to equalize it with spending, thereby controlling for deficits or surpluses and deriving

California's appropriately comparable share of tax burden. The adjusted tax burden is then subtracted from adjusted spending to derive the balance of payments.

For example, without that adjustment, California's raw (unadjusted) balance of payments deficit for 2000 was $101 billion, instead of the adjusted $47 billion. (Since there was a budget surplus in 2000, the adjustment recognizes that even the average state paid somewhat more in taxes than it received in spending.) This adjustment operated in reverse in 2003 – a deficit spending year for the nation as a whole – when California's unadjusted balance of payments was $15 billion, whereas the adjusted balance was $50 billion. (Likewise, in 2003 the adjustment lowered the state's return per dollar of taxes from 94 cents to 79 cents.)

In addition, this paper adjusts the Census Bureau's expenditure data by deleting spending for territories as well as for undistributed federal funds (those appropriated but not spent) in order to facilitate comparisons among states. For example, the Census Bureau's total for all federal grant spending is $441 billion, whereas this report's states-only total for consistency purposes is reduced to $435 billion. The adjustment is most pronounced in procurement, where more than $30 billion is categorized as undistributed. (In addition, procurement contracts under $25,000 are not tracked by state, and some defense spending is not tracked by geography.) This report thus reduces the Census Bureau report's $327 billion procurement spending total for the U.S. to a total allocable by state of only $294 billion. As a result, the Census Bureau figures show California receiving 11.3 percent of total procurement contract expenditures, whereas this report shows the state receiving 12.6 percent of procurement spending allocated to the states. Likewise, the Census Bureau shows California receiving 10.7 percent of total spending, whereas this report's adjustments yield a slightly larger 10.9 percent return.

In addition, it may be helpful to remember that federal tax burden figures for each year largely reflect the economic condition of the prior year -- i.e., in 2003, California taxpayers paid taxes primarily on their 2002 earnings.

The federal income tax system causes states with above-average incomes, such as California, to pay more in taxes than the average state, despite the fact that vastly higher housing prices and other costs of living mean that the average Californian may actually have considerably less disposable income than the average resident of a lower-taxed state. An annual salary of $60,000 in, say, Arkansas or South Dakota affords a vastly different buying power and standard of living compared to the same salary in Santa Clara or Orange Counties, yet federal income tax rules treat such taxpayers identically.

Source Data

Data sources for this document include the *Consolidated Federal Funds Report* (U.S. Census Bureau, Washington, DC, http://www.census.gov/prod/2004pubs/cffr03.pdf) or CFFR for expenditure data; and *Federal Tax Burden by State* (The Tax Foundation, Washington, DC, http://www.taxfoundation.org) for tax data. The Tax Foundation, a nonpartisan nonprofit based in Washington, employs a tax incidence model to apportion the federal tax burden among states. For further California-focused information regarding federal grants, see *Federal Formula Grants and California*, a joint project of the Public Policy Institute of California and the California Institute for Federal Policy Research, at http://www.calinst.org/formulas.htm .

It should be noted that the Tax Foundation publishes the equivalent of a balance of payments statistic for each state, and that the number for California sometimes varies from that published in this report. The difference exists because of differences between the methodology used by the California Institute and that by the Tax Foundation. The two organizations employ different methods of adjusting for undistributed spending and territorial spending. In addition, the Tax Foundation alters the spending amounts to match the federal tax burden total, whereas the California Institute adjusts the tax burden amount to match total federal spending.

Important Recent Changes in Federal Tax Burden Data

Importantly, in late 2004, the Tax Foundation published major retroactive adjustments of their previously-published estimates of the annual federal tax burden attributable to a number of states, including California.

For most fiscal years, these changes were relatively small for California. However, for fiscal years 2000 and 2002, the state's tax burden figures changed considerably – increasing the state's tax burden for 2000 from prior publications and reducing it for 2002. For 2000, California's tax burden is now estimated to have been $277 billion, rather than $254 billion as previously published. For 2002, the Tax Foundation reduced the state's estimated tax burden from $256 billion to $243 billion.

As a consequence of these adjustments, the California balance of payments data from prior years' versions of this report also required adjustments. This report and its supplementary data incorporate these new tax burden amounts and the new balance of payments data generated thereby. Hence, whereas the 2002 version of this report estimated that California's balance of payments deficit to the federal treasury amounted to $58 billion, it has been adjusted to $45 billion (it since rose to $50 billion for 2003). Likewise, the figure for federal spending per tax dollar for 2002 has been adjusted from 77 cents, as published previously, to a revised return of 81 cents per 2002 tax dollar. As such, the 2003 shortfall of 79 cents per dollar now represents the lowest return recorded.

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