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# **EVALUATING THE FISCAL POLICY OF STATES: WHO ARE THE SINNERS, WHO ARE THE SAINTS?**

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What is the Role of State Governments in Our Fiscal System?

**RESPONSIBILITY NO. 1: Provide Services:**

TOTAL = ED. + WELFARE + HEALTH/HOSP + HIGHWAYS + PRISONS

$$\begin{array}{ccccccc} \$5000 & = & \$1800 & + & \$1350 & + & \$372 \\ & & (36\%) & & (27\%) & & (8\%) \end{array} \quad \begin{array}{ccc} + & \$350 & + \\ & (7\%) & (3\%) \end{array}$$

**At a Tax Rate on Personal Income of:**

$$\tau = .09$$

**RESPONSIBILITY NO. 2: Managing Our Public Wealth:**

$$W = [K + CASH] - [DEBT + UFL]$$

**OUR FOCUS IS ON WEALTH MANAGEMENT**

**FIGURE 1: ALL STATES, ASSETS AND LIABILITIES**

$$W = [K + \text{CASH}] - [\text{DEBT} + \text{UFL}]$$

$$W = [\$7,600 + \$2900] - [\$2900 + \text{?????}] = \$7,600 + \text{?????}$$

**K = REPLACEMENT COSTS OF EXISTING INFRASTRUCTURE**

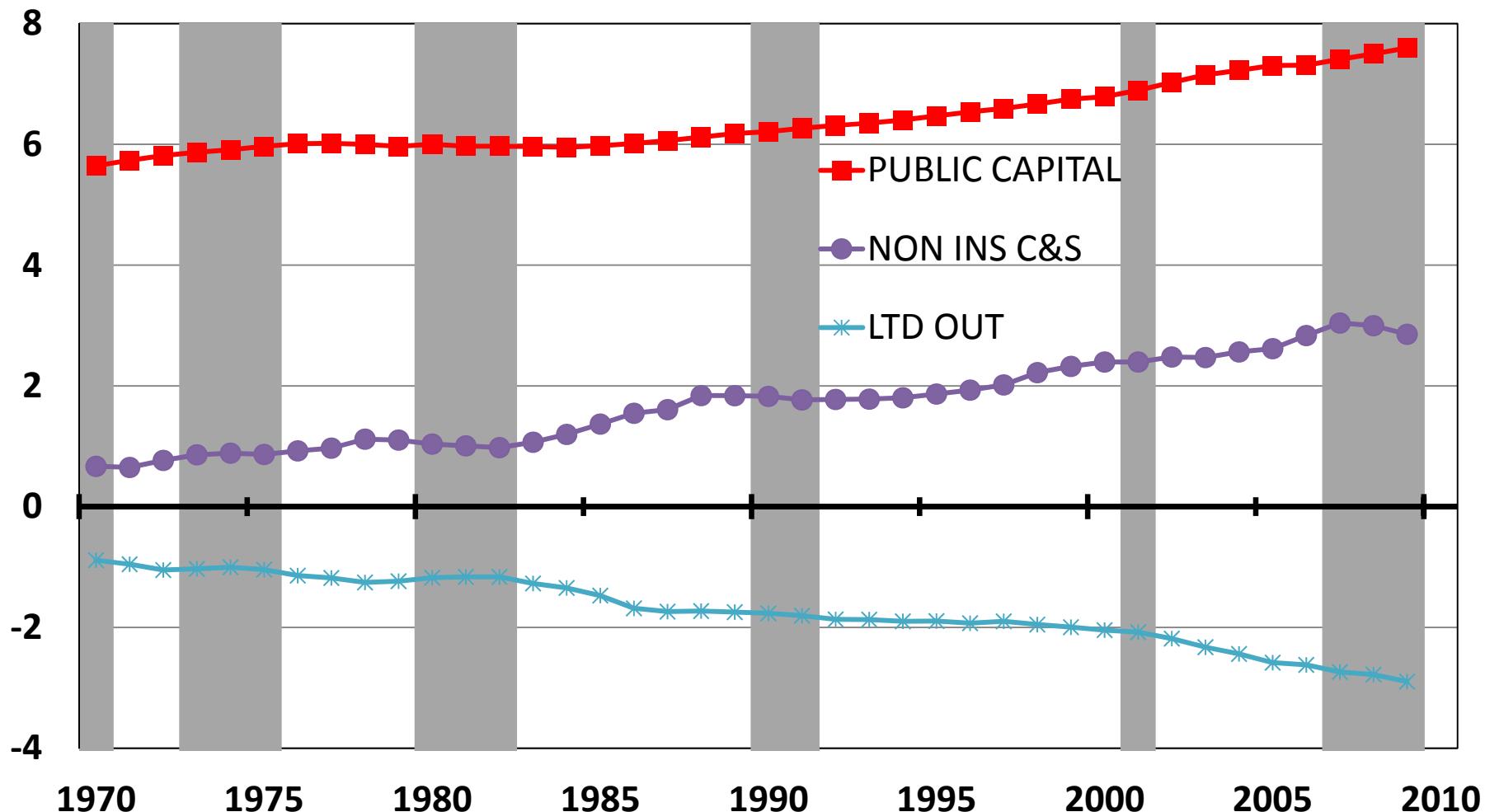
**CASH = MARKET VALUE OF NON-TRUST CASH AND SECURITIES**

**DEBT = MARKET VALUE OF OUTSTANDING DEBT**

**UFL = UNFUNDDED PENSION LIABILITIES**

**Figure 1**  
**Assets & Liabilities**  
**(2005 Dollars)**

\$ - Per capita (1000s)



## **ESTIMATES OF UFL: STATE & STATE MANAGED PLANS**

1972: \$3,500/PERSON

1982: \$4,800/PERSON

1990: \$4,200/PERSON

2008: \$6,625/PERSON

Source, 1972-1990: R.P. Inman, “Do You Know How Much Money is in Your Public Purse?” *Business Review, Federal Reserve Bank of Philadelphia*, August, 1995.

Source, 2008: R Novy-Marx and J. Rauh, “The Liabilities and Risks of State-Sponsored Pension Plans, *Journal of Economic Perspectives*, Fall, 2009.

## **INSERT TABLE: STATE UFL (TERMINATION VALUES)**

### **FIGURE 2: ARE WE CLOSING THE GAP?**

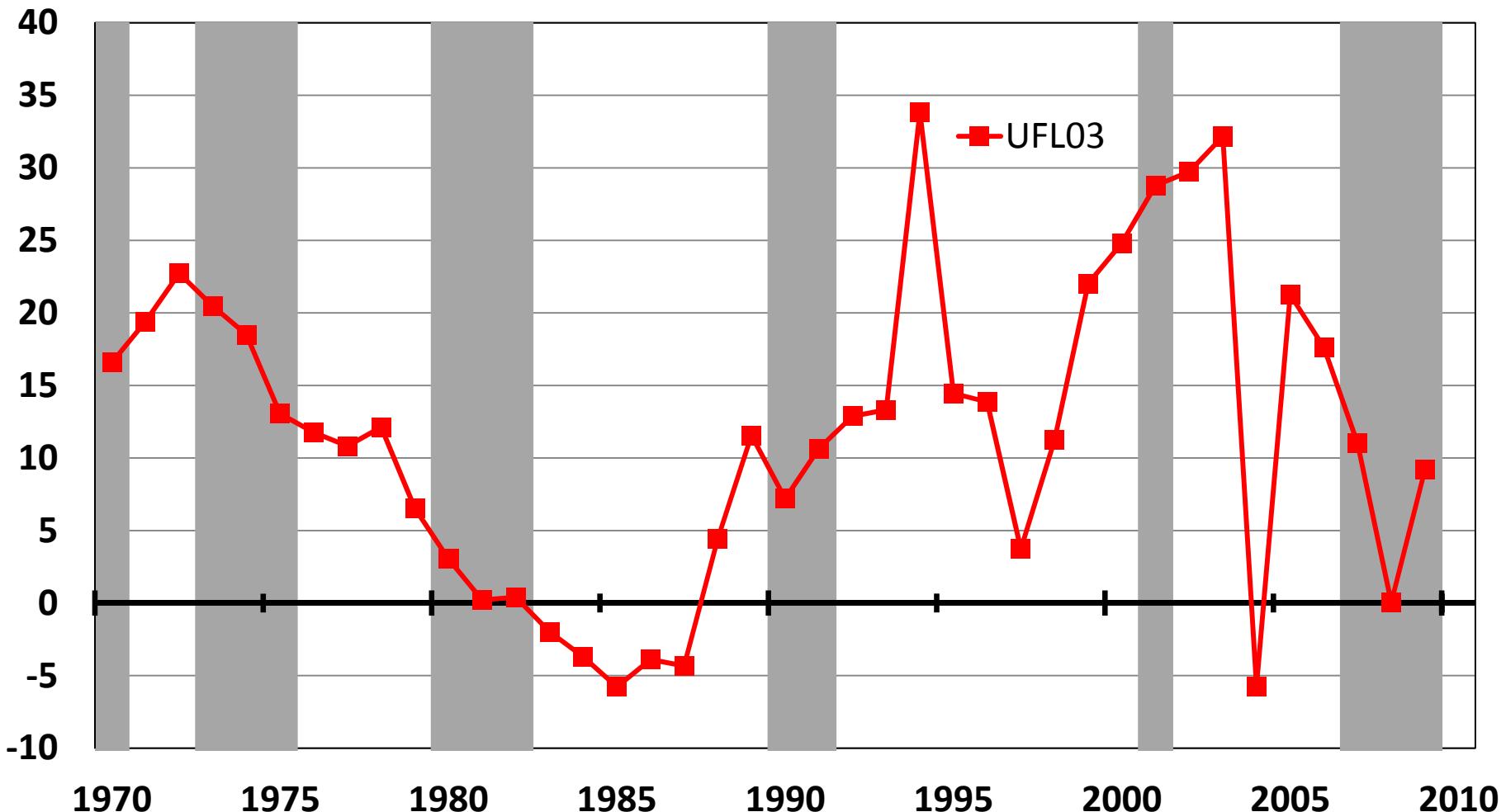
# STATE PENSION UNDERFUNDINGS [TERMINATION VALUES]

State	ABO		Population (N)	$(L - A) * 10^9 / N$
	Treasury Rate (L)	Pension Assets (A)		
Alabama	61.8	21.4	4,708,708	\$ 8,579.85
Alaska	21.7	12.4	698,473	\$ 13,314.76
Arizona	73.5	24.8	6,595,778	\$ 7,383.51
Arkansas	30.4	14.6	2,889,450	\$ 5,468.17
California	699.7	329.6	36,961,664	\$ 10,013.08
Colorado	86.2	28.8	5,024,748	\$ 11,423.46
Connecticut	69.1	20.1	3,518,288	\$ 13,927.23
Delaware	10.9	5.8	885,122	\$ 5,761.92
Florida	186.3	96.5	18,537,969	\$ 4,844.11
Georgia	110.1	53.1	9,829,211	\$ 5,799.04
Hawaii	24.2	8.1	1,295,178	\$ 12,430.72
Idaho	16.6	8.7	1,545,801	\$ 5,110.62
Illinois	233.0	65.7	12,910,409	\$ 12,958.54
Indiana	49.8	19.6	6,423,113	\$ 4,701.77
Iowa	35.0	18.0	3,007,856	\$ 5,651.87
Kansas	30.3	10.2	2,818,747	\$ 7,130.83
Kentucky	63.4	21.1	4,314,113	\$ 9,805.03
Louisiana	54.8	18.4	4,492,076	\$ 8,103.16
Maine	20.1	8.3	1,318,301	\$ 8,950.91
Maryland	72.1	28.6	5,699,478	\$ 7,632.28
Massachusetts	86.9	32.7	6,593,587	\$ 8,220.11
Michigan	103.1	39.5	9,969,727	\$ 6,379.31
Minnesota	91.0	35.9	5,266,214	\$ 10,462.92
Mississippi	44.2	15.5	2,951,996	\$ 9,722.24
Missouri	75.2	33.1	5,987,580	\$ 7,031.22
Montana	12.4	5.3	974,989	\$ 7,282.13
Nebraska	11.6	5.5	1,796,619	\$ 3,395.27
Nevada	36.3	18.8	2,643,085	\$ 6,621.05
New Hampshire	12.5	4.3	1,324,575	\$ 6,190.66
New Jersey	191.2	67.2	8,707,739	\$ 14,240.21
New Mexico	39.8	15.9	2,009,671	\$ 11,892.49
New York	325.7	192.8	19,541,453	\$ 6,800.93
North Carolina	101.8	64.0	9,380,884	\$ 4,029.47
North Dakota	6.3	2.7	646,844	\$ 5,565.48
Ohio	281.4	114.7	11,542,645	\$ 14,442.10
Oklahoma	45.9	15.8	3,687,050	\$ 8,163.71
Oregon	80.7	42.9	3,825,657	\$ 9,880.66
Pennsylvania	164.5	64.3	12,604,767	\$ 7,949.37
Rhode Island	20.5	6.6	1,053,209	\$ 13,197.76
South Carolina	63.5	20.3	4,561,242	\$ 9,471.10
South Dakota	10.3	5.6	812,383	\$ 5,785.45
Tennessee	49.6	26.4	6,296,254	\$ 3,684.73
Texas	268.4	126.1	24,782,302	\$ 5,742.00
Utah	31.2	14.7	2,784,572	\$ 5,925.51
Vermont	5.7	2.4	621,760	\$ 5,307.51
Virginia	89.6	41.3	7,882,590	\$ 6,127.43
Washington	86.4	43.5	6,664,195	\$ 6,437.39
West Virginia	18.3	7.2	1,819,777	\$ 6,099.65
Wisconsin	114.6	58.4	5,654,774	\$ 9,938.51
Wyoming	9.8	4.4	544,270	\$ 9,921.55

\* State populations are from the 2009 Statistical Abstract (July 2009)

**Figure 2**  
**Annual Pension Underfunding**  
**(2005 Dollars)**

\$ - Per capita



## MANAGING OUR PUBLIC WEALTH

1. WHAT STATES ***DO***:

**SUR/REVENUES =**

TAXES/FEES + AID + INTEREST/WDRAW + PROFITS + ASSET/SALES

**SUR/EXPENDITURES =**

WAGES/BEN + PENCONT + MAINTENANCE + GRANTS + INTEREST

**SUR/REVENUES - SUR/EXPENDITURES = SUR**

SUR > 0, Funding for Next Year, or Savings

SUR < 0, Need to Borrow Against Next Year

**2. FOR WEALTH MANAGEMENT, WHAT STATES *SHOULD DO*:**

**PPWSUR/REVENUES =**

TAXES/FEES + AID + INTEREST/WDRAW + PROFITS + ASSET/SALES

**PPWSUR/EXPENDITURES =**

WAGES/BEN + “NORMALCOST” + MAINTENANCE + GRANTS

+ INTEREST + “DEPRECIATION”

**PPWSUR/REVENUES - PPWSUR/EXPENDITURES = PPWSUR**

PPWSUR > 0, Funding for Next Year, Savings

PPWSUR < 0, Need to Borrow Against Next Year

**3. SUR > PPWSUR**

**“FLOWS” = “CHANGES IN STOCKS”**

$$\text{PPWSUR} = (p - \rho)\ell + [k - \delta(K_0 - A) - vA] + [s - c] + [-d]$$

$(p - \rho)\ell$  = Overfunding of Normal Cost, Supplemental Cost Contribution

$[k - \delta(K_0 - A) - vA]$  = Net Investment - Market Value of Sold Assets

$[s - c]$  = Net Contributions to Cash, “Rainy Day” Fund Build-Up

$[-d]$  = - [New Borrowing - Repayment], Changes in Stock of Debt Outstanding

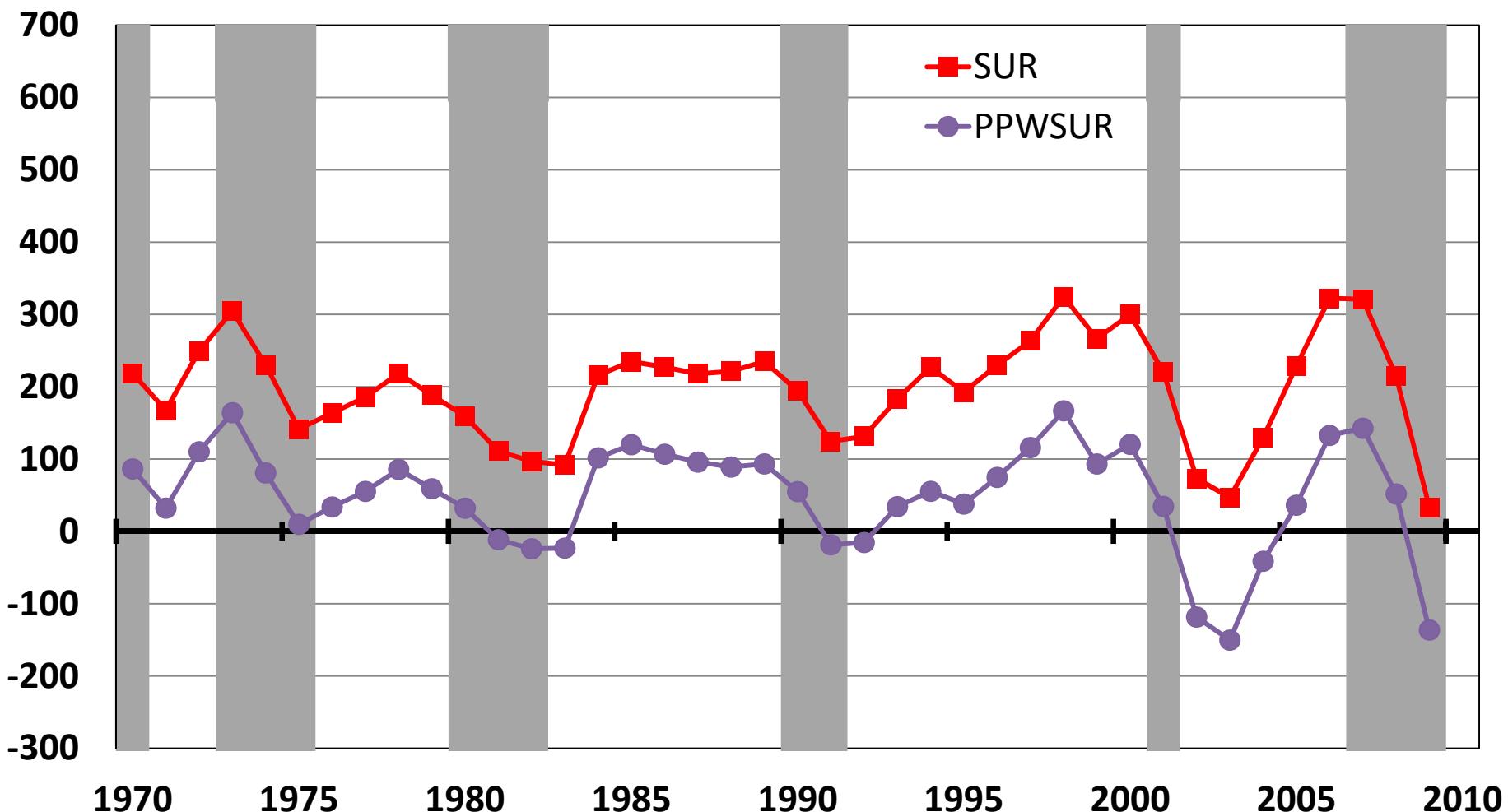
**LET’ S SEE HOW STATES ARE DOING**

**FIGURE 3:** State Fiscal Surpluses

**FIGURE 4:** SUR/Revenues & SUR/Expenditures

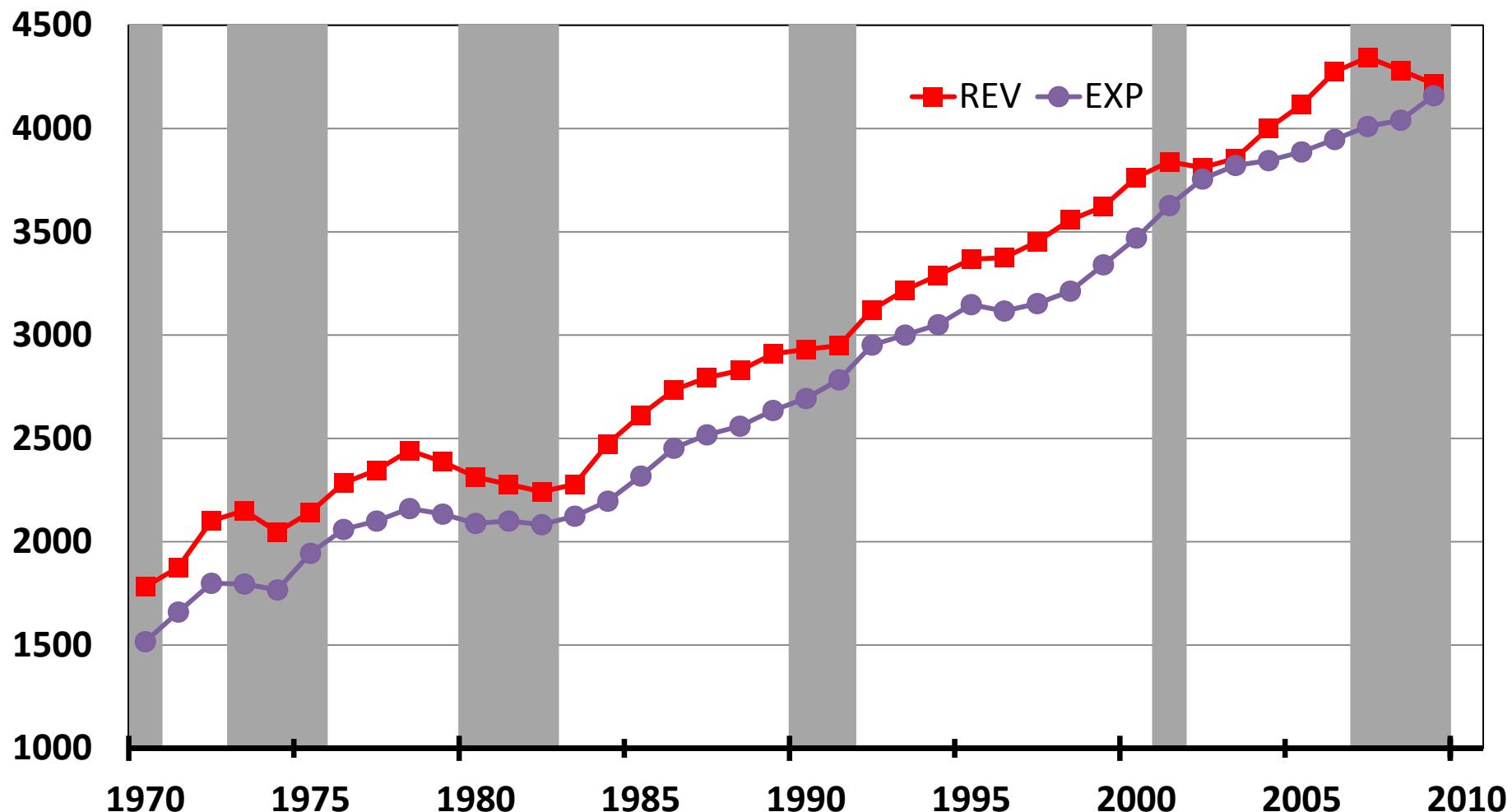
**Figure 3**  
**State Fiscal Surpluses**  
**(2005 Dollars)**

\$ - Per capita



**Figure 4**  
**State Revenues and Expenditures**  
**(2005 Dollars)**

\$ - Per capita



## **THE AGGREGATES, MAY HIDE THE PROBLEMS:**

Looking at Individual States

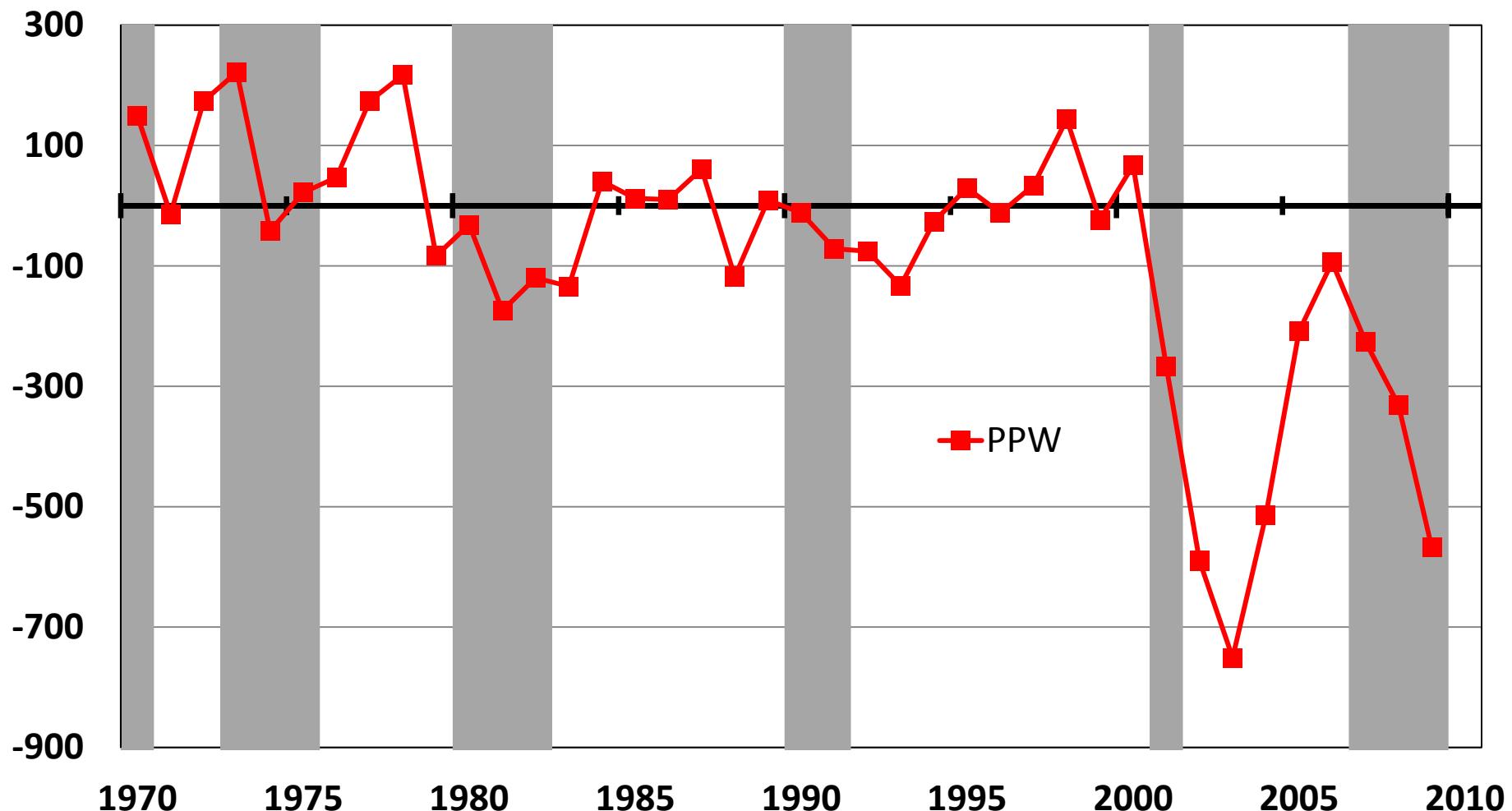
**FIGURES 5a-e:** The “Headline States”

**FIGURES 5f-5h:** District 3 States

**FIGURES 5i-5k:** Have the Candidates “Walked the Walk”

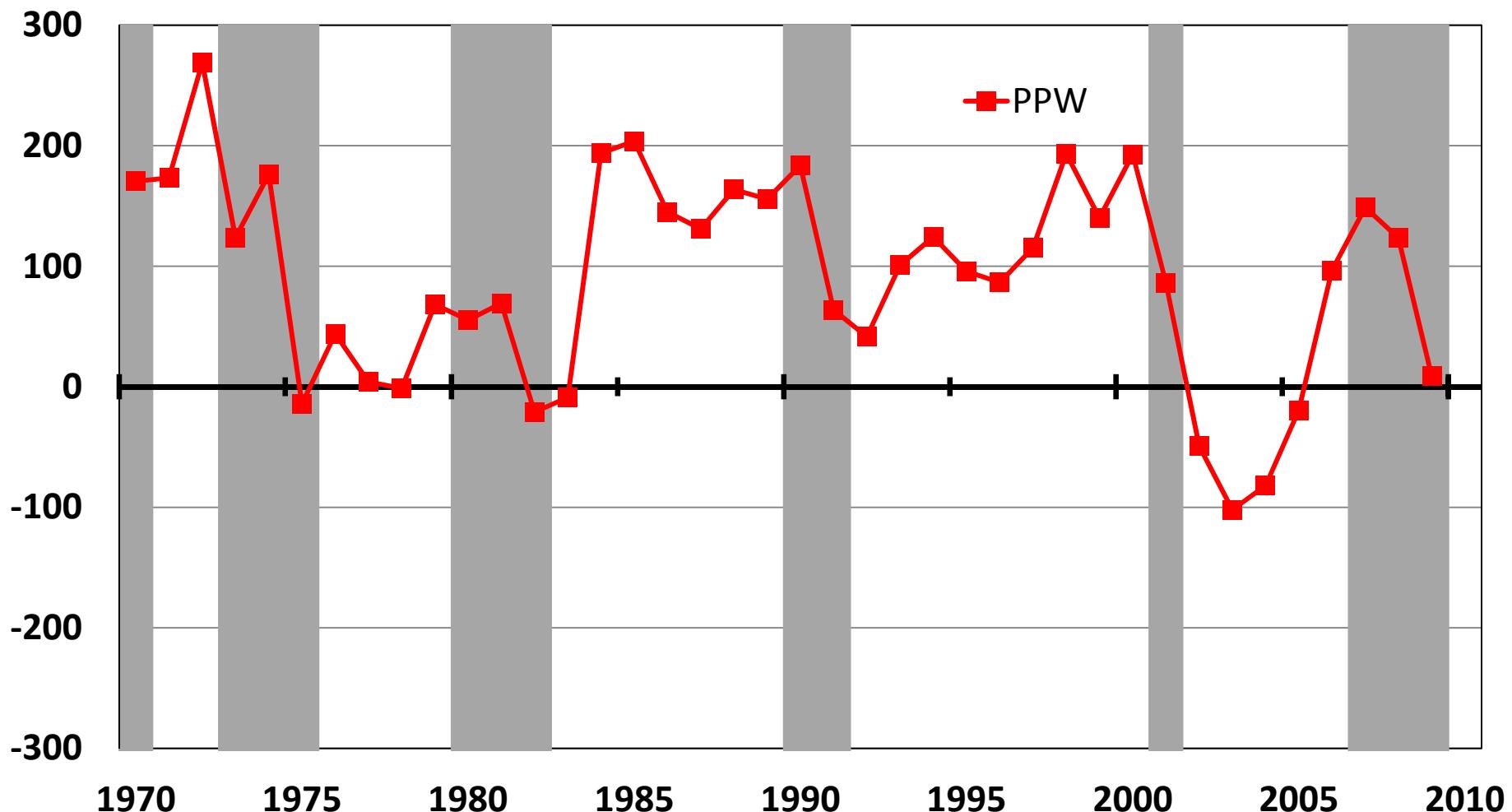
**Figure 5a**  
**PPWSUR: California**  
**(2005 Dollars)**

\$ - Per capita



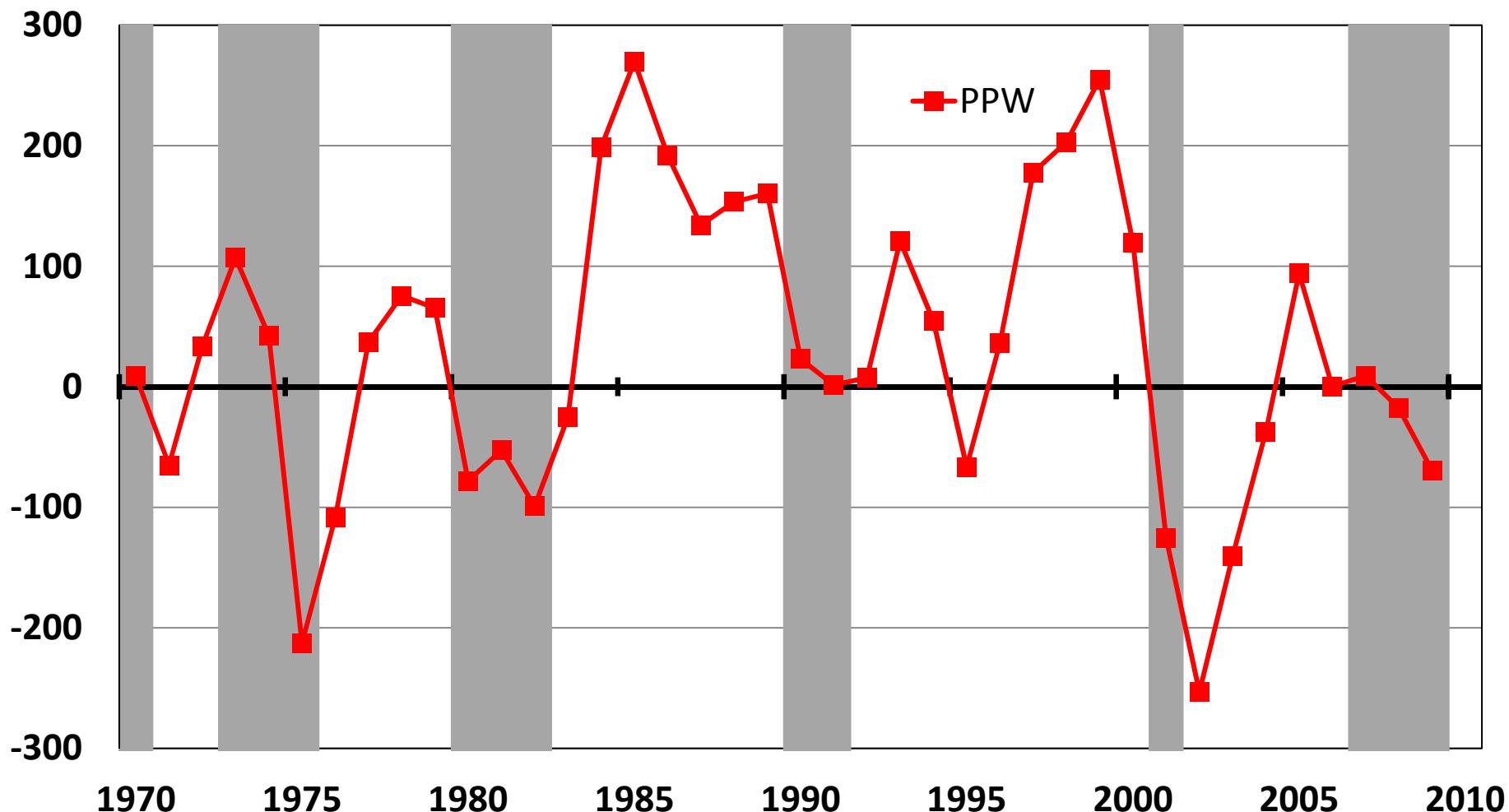
**Figure 5b**  
**PPWSUR: Illinois**  
**(2005 Dollars)**

\$ - Per capita



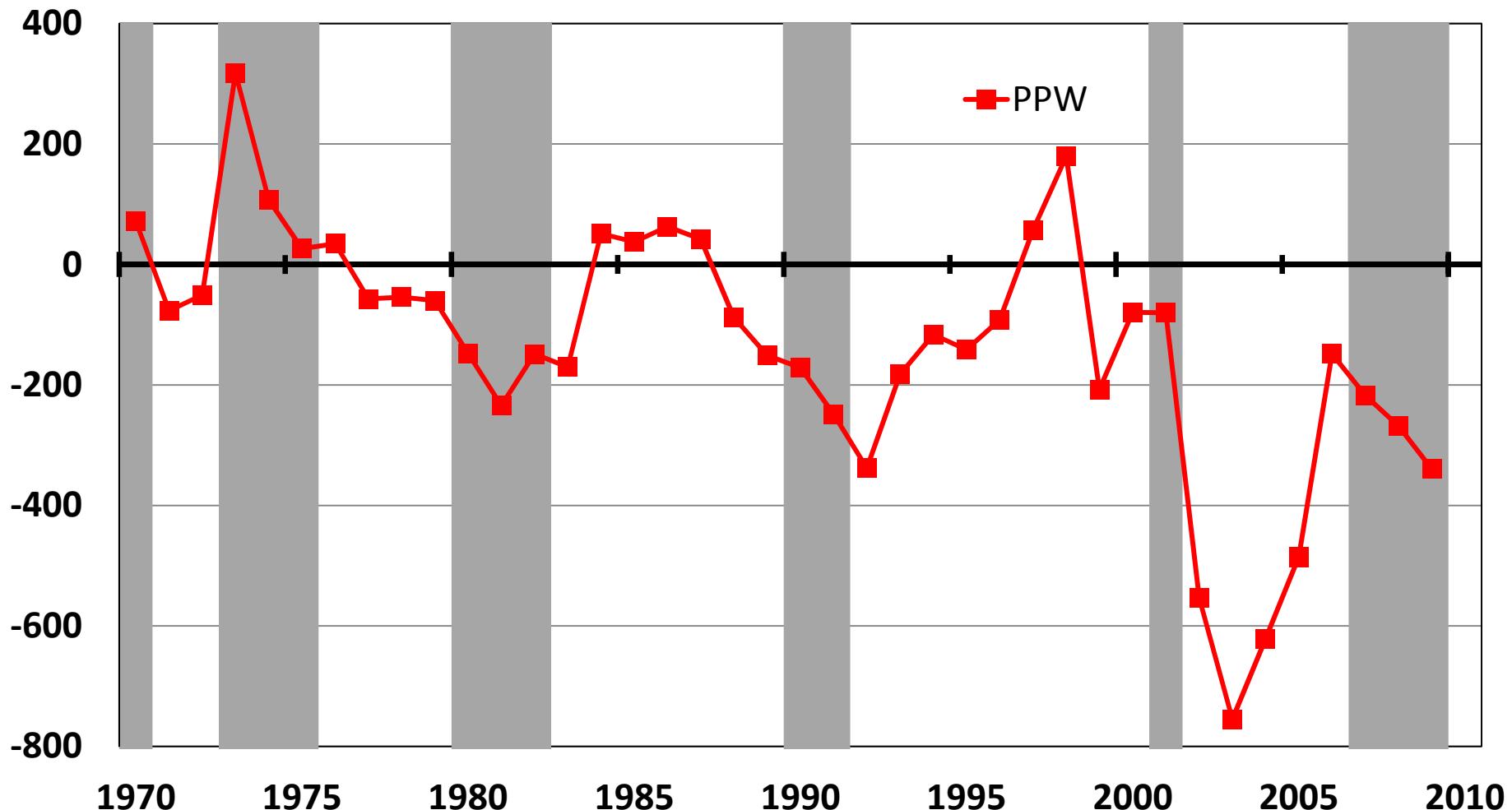
**Figure 5c**  
**PPWSUR: Michigan**  
**(2005 Dollars)**

\$ - Per capita



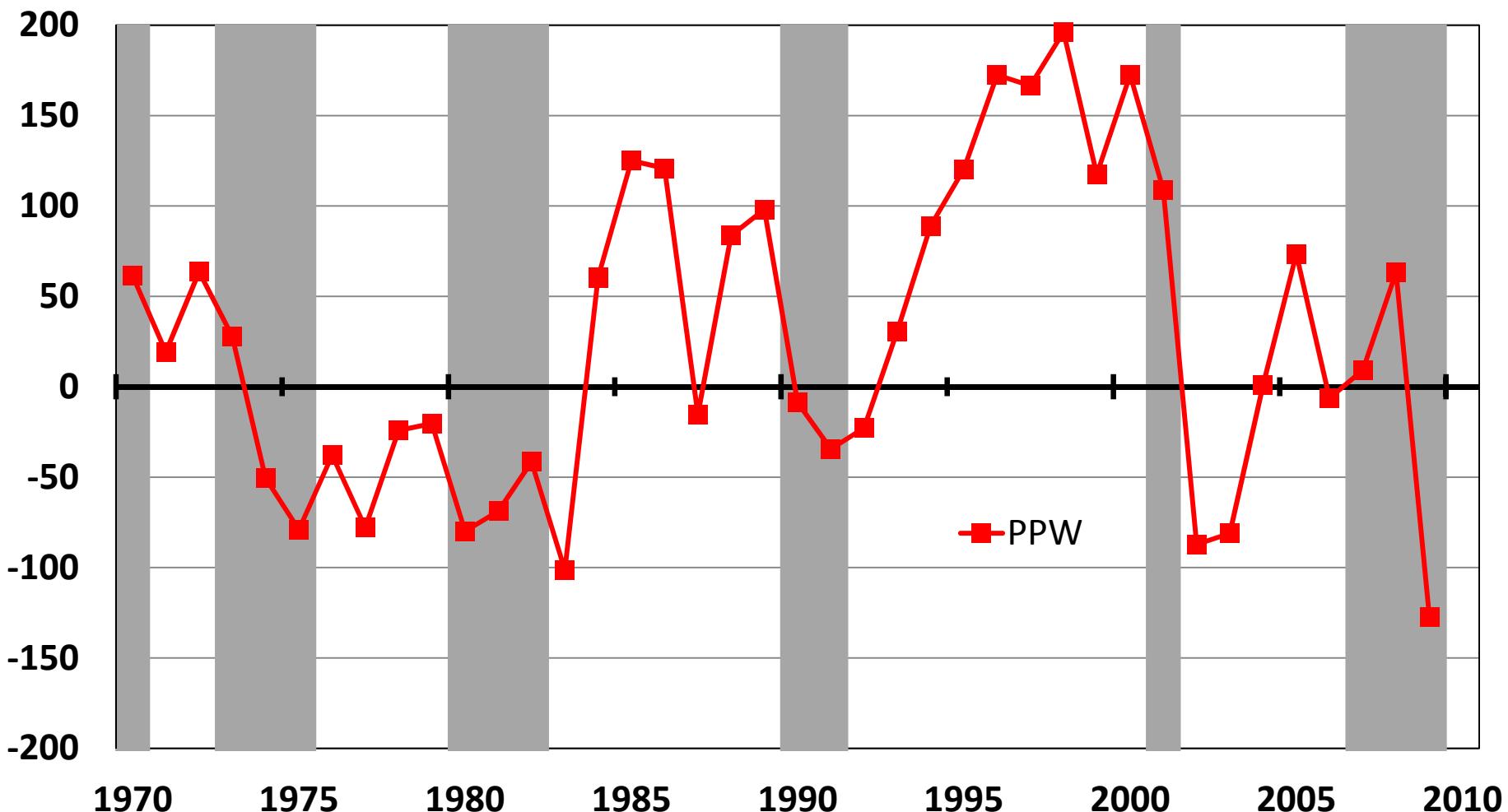
**Figure 5d**  
**PPWSUR: New York**  
**(2005 Dollars)**

\$ - Per capita



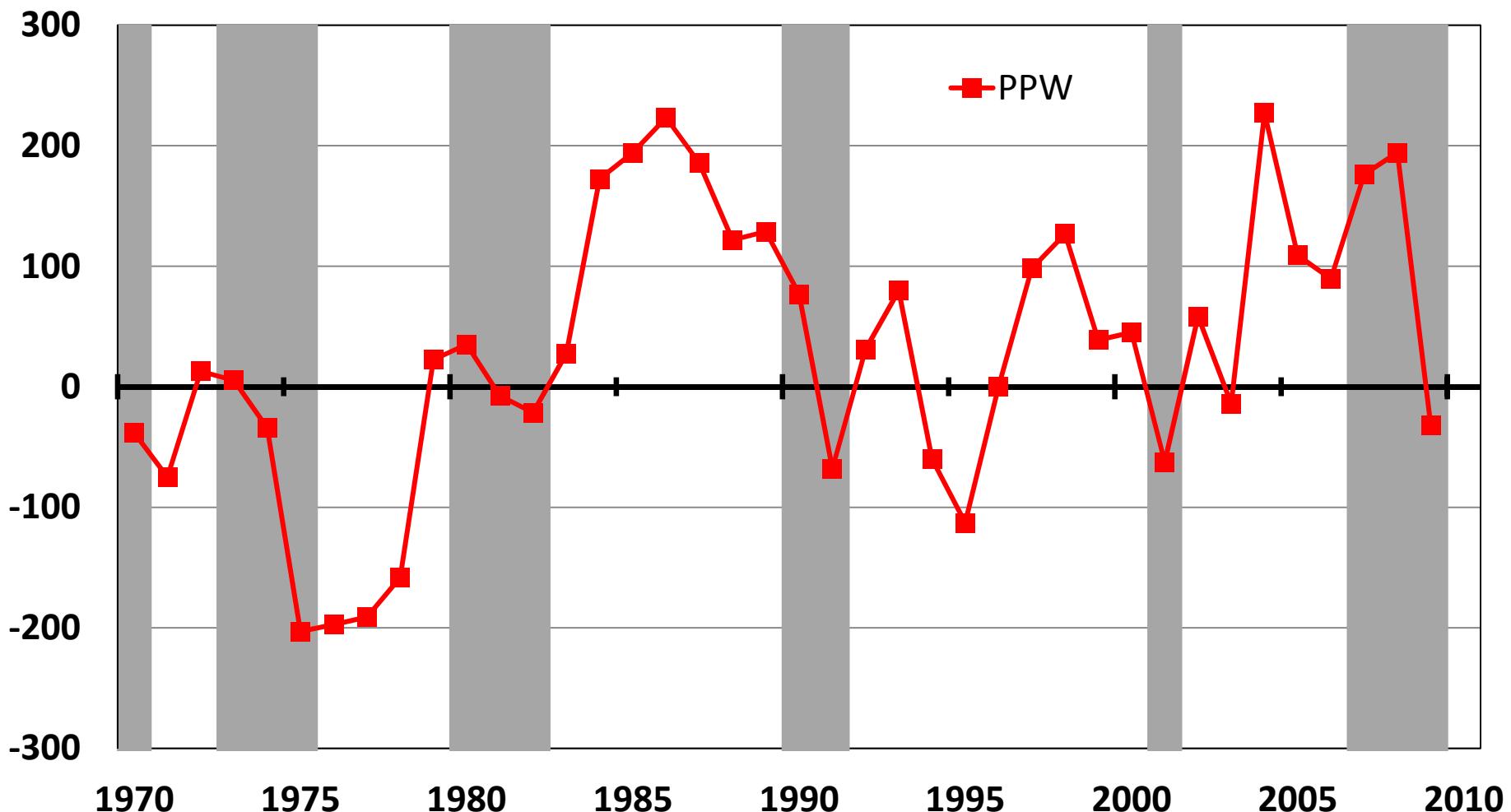
**Figure 5e**  
**PPWSUR: Ohio**  
**(2005 Dollars)**

\$ - Per capita



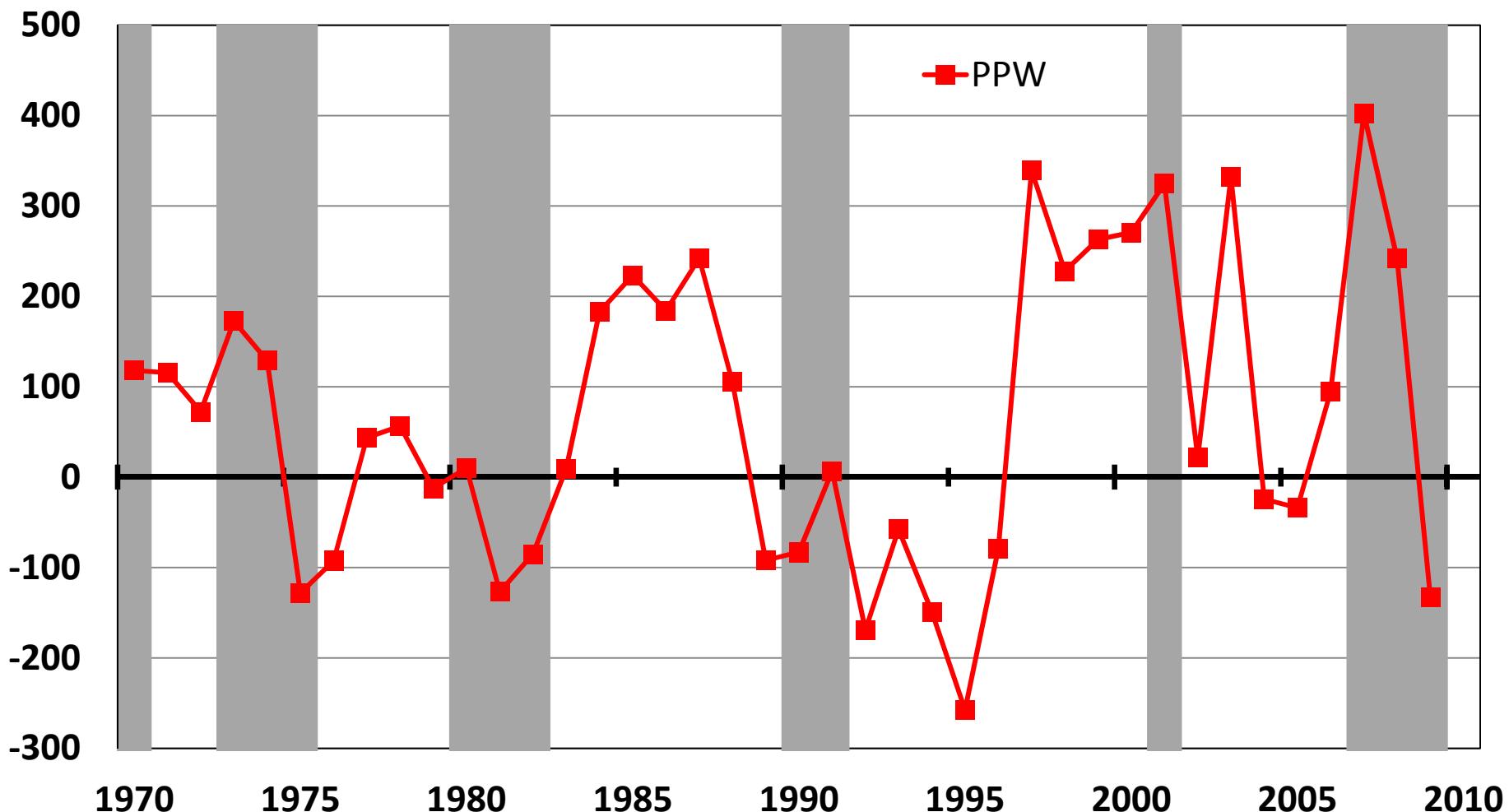
**Figure 5f**  
**PPWSUR: Pennsylvania**  
**(2005 Dollars)**

\$ - Per capita



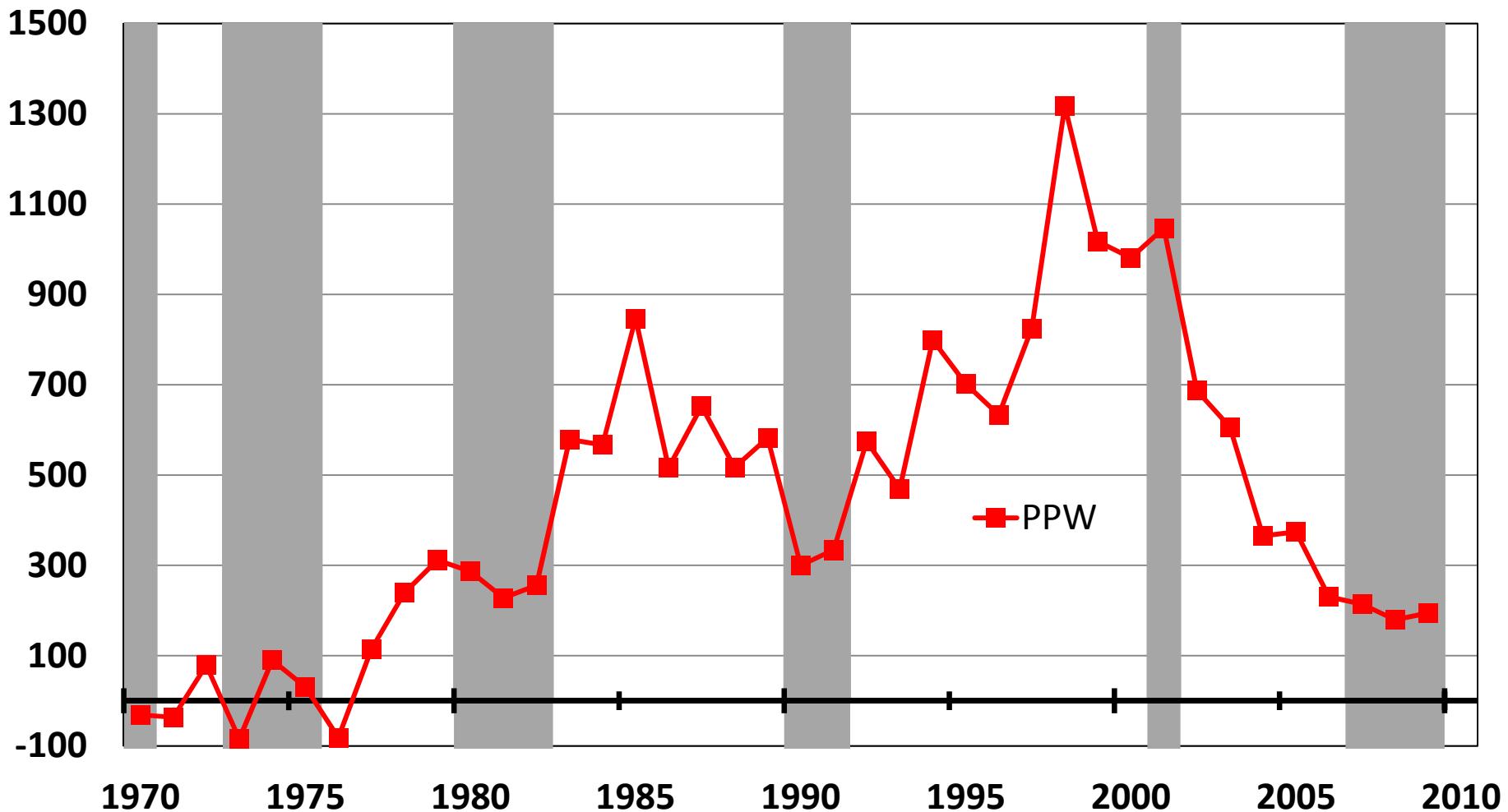
**Figure 5g**  
**PPWSUR: New Jersey**  
**(2005 Dollars)**

\$ - Per capita



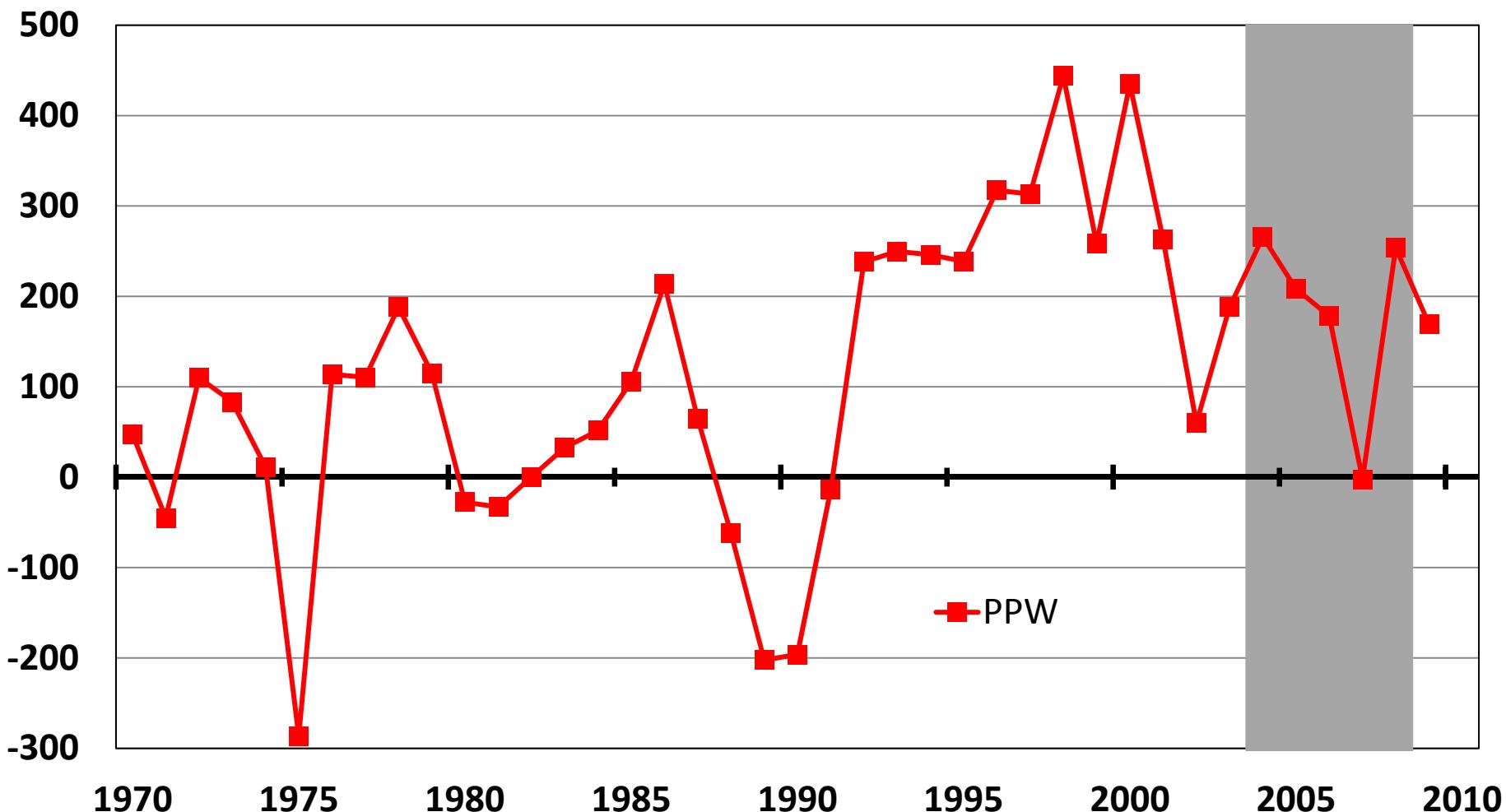
**Figure 5h**  
**PPWSUR: Delaware**  
**(2005 Dollars)**

\$ - Per capita



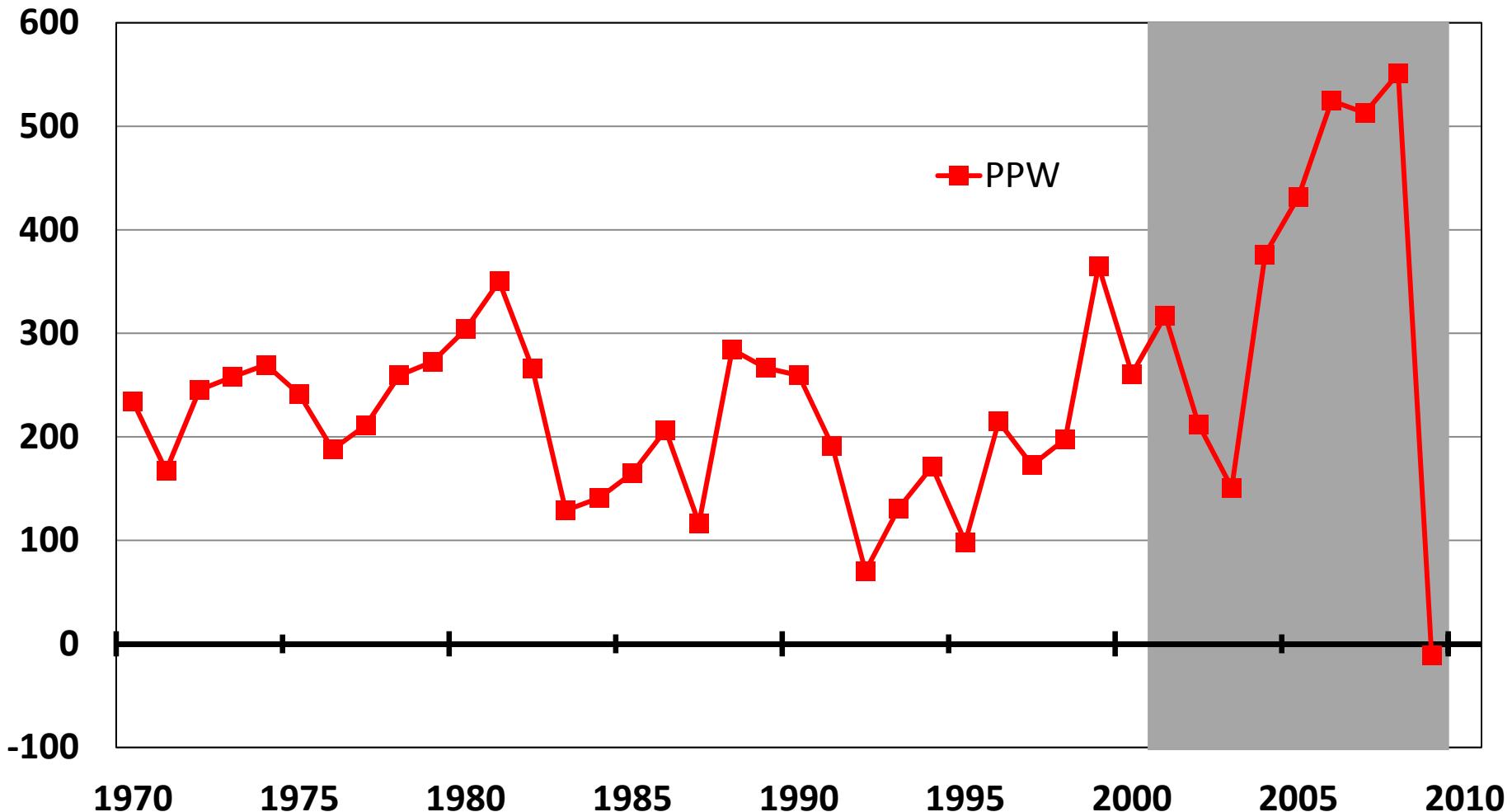
**Figure 5i**  
**PPWSUR: Massachusetts**  
**(2005 Dollars)**

\$ - Per capita



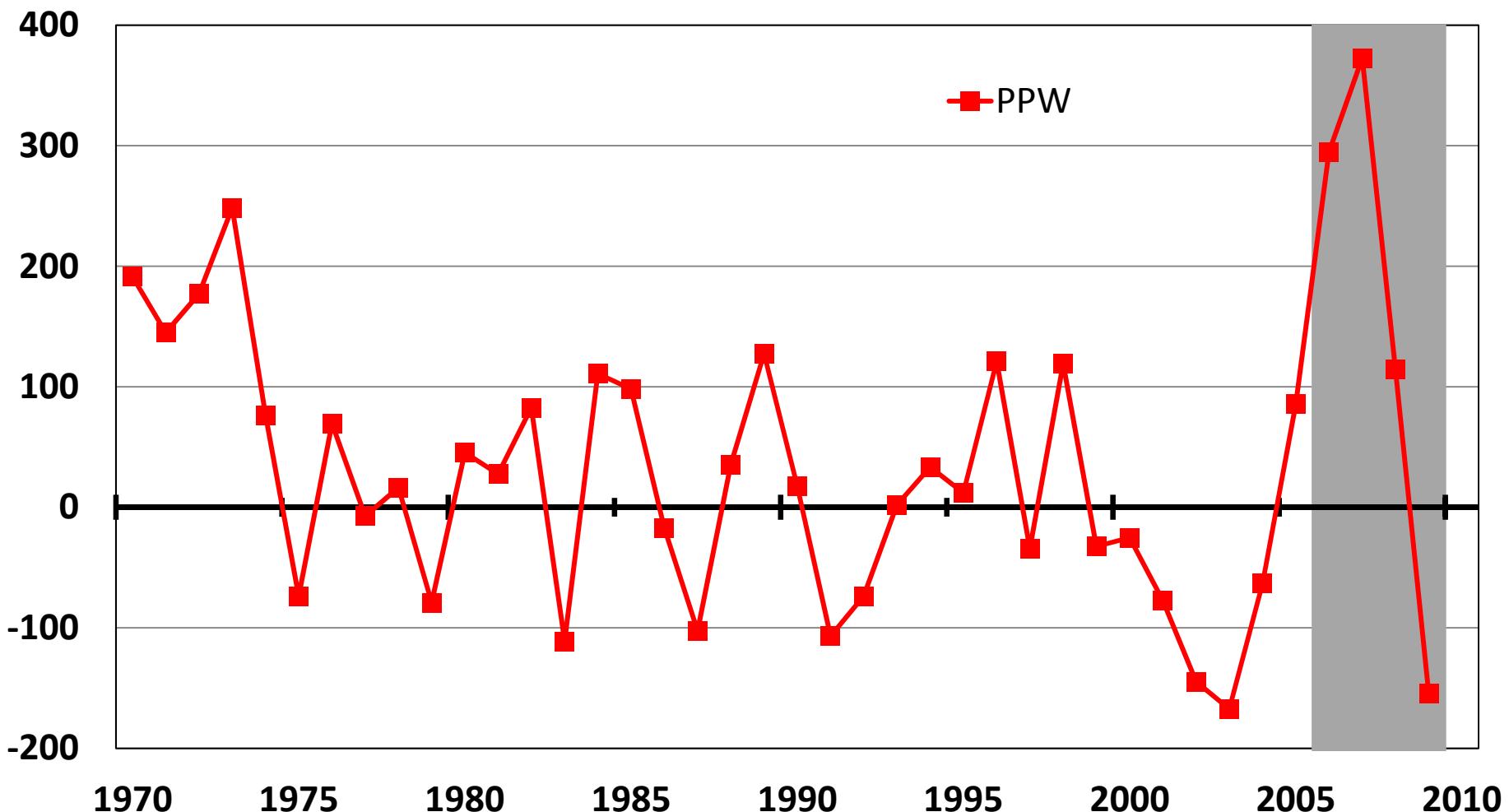
**Figure 5j**  
**PPWSUR: Texas**  
**(2005 Dollars)**

\$ - Per capita



**Figure 5k**  
**PPWSUR: Utah**  
**(2005 Dollars)**

\$ - Per capita



## **LOOKING FOR CAUSES: Who Saves, Who Doesn't**

**FIGURE 6:** Big States vs. Small States

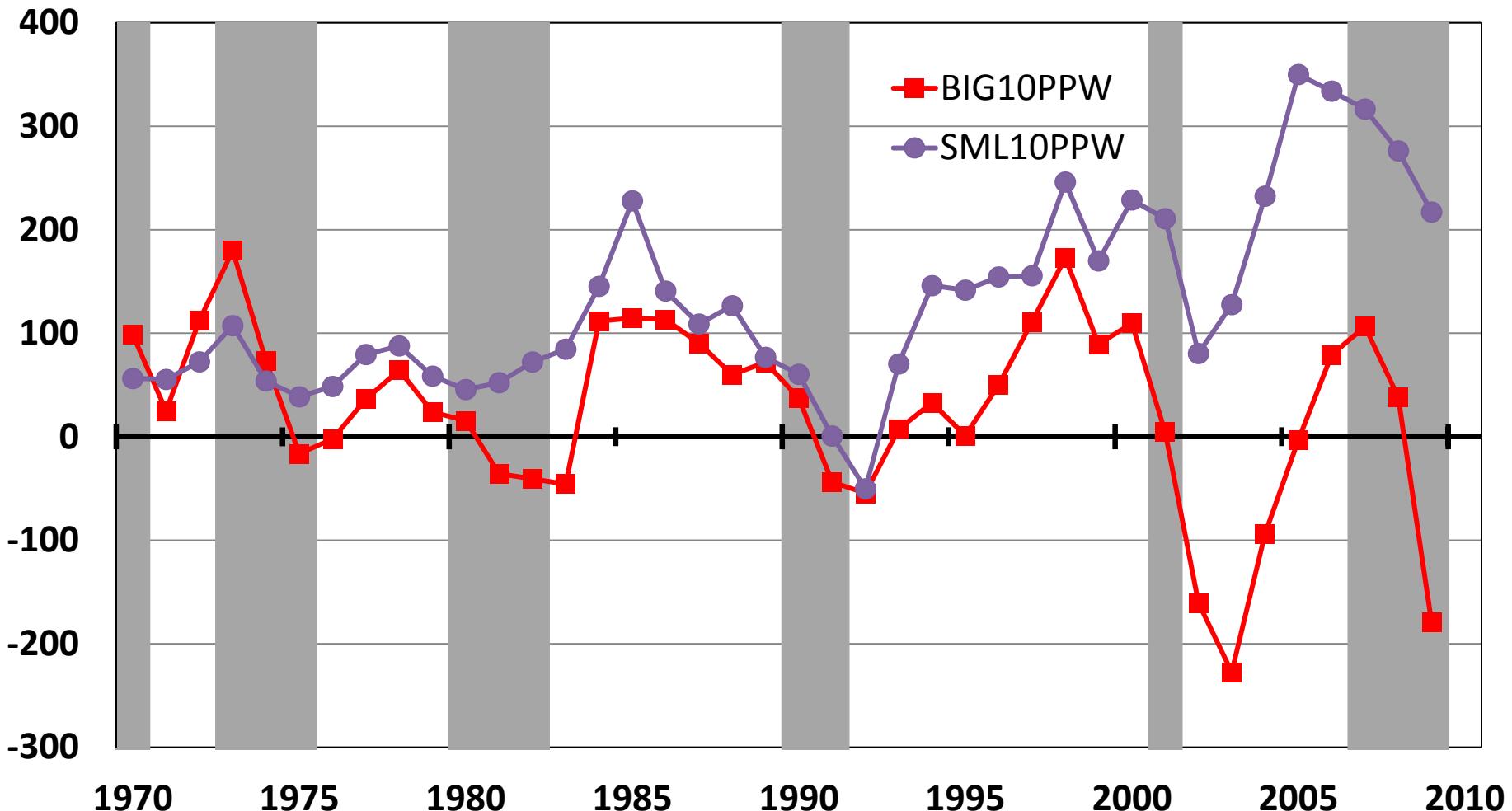
**FIGURE 7:** “Mineral” States vs. the “Rest”

**FIGURE 8:** “Rust Belt” vs. “Wheat Belt” vs. “Sun Belt”

**FIGURE 9:** “Red” States vs. “Blue” States

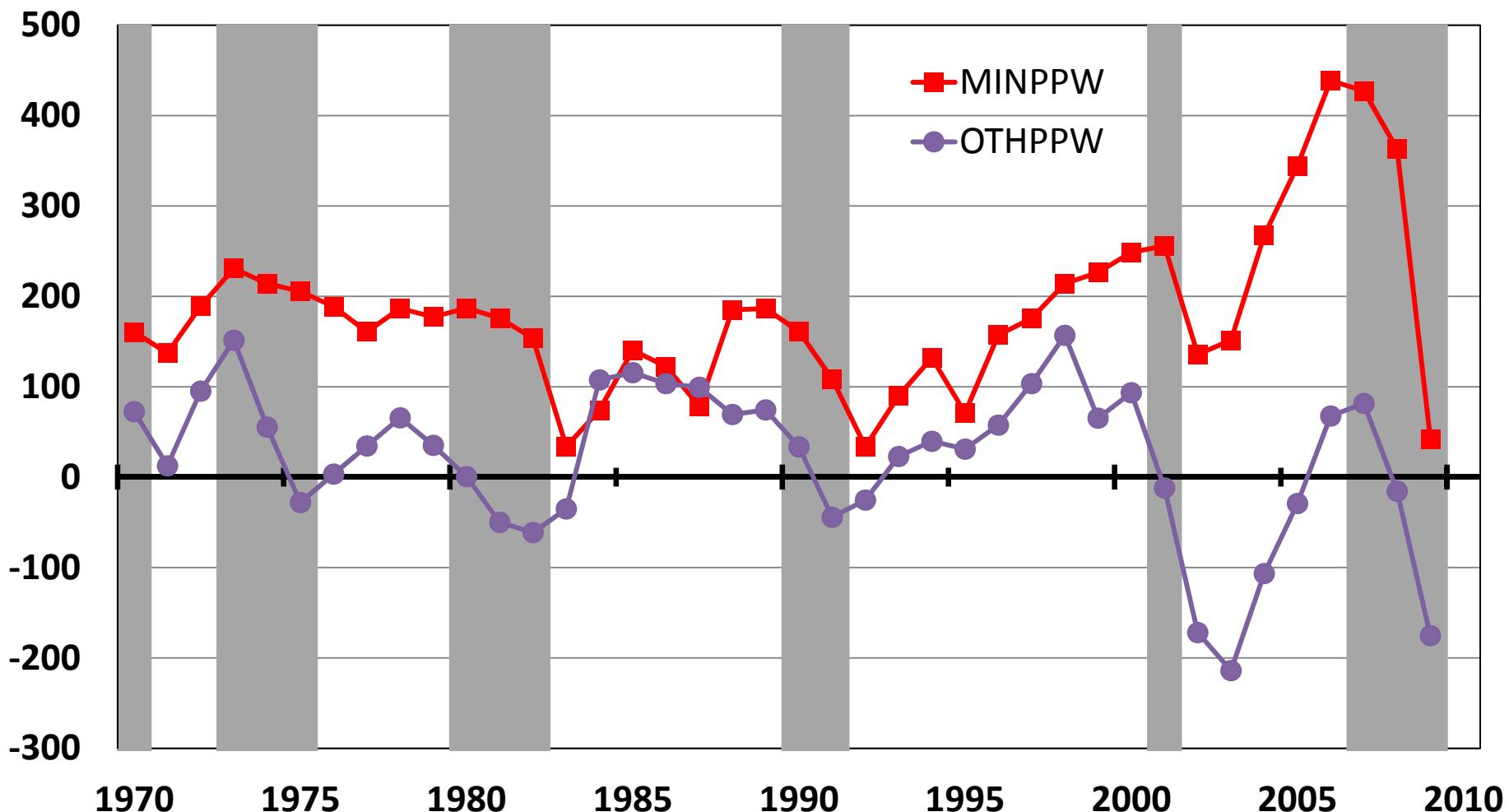
**Figure 6**  
**PPWSUR: Big vs Small States**  
**(2005 Dollars)**

\$ - Per capita



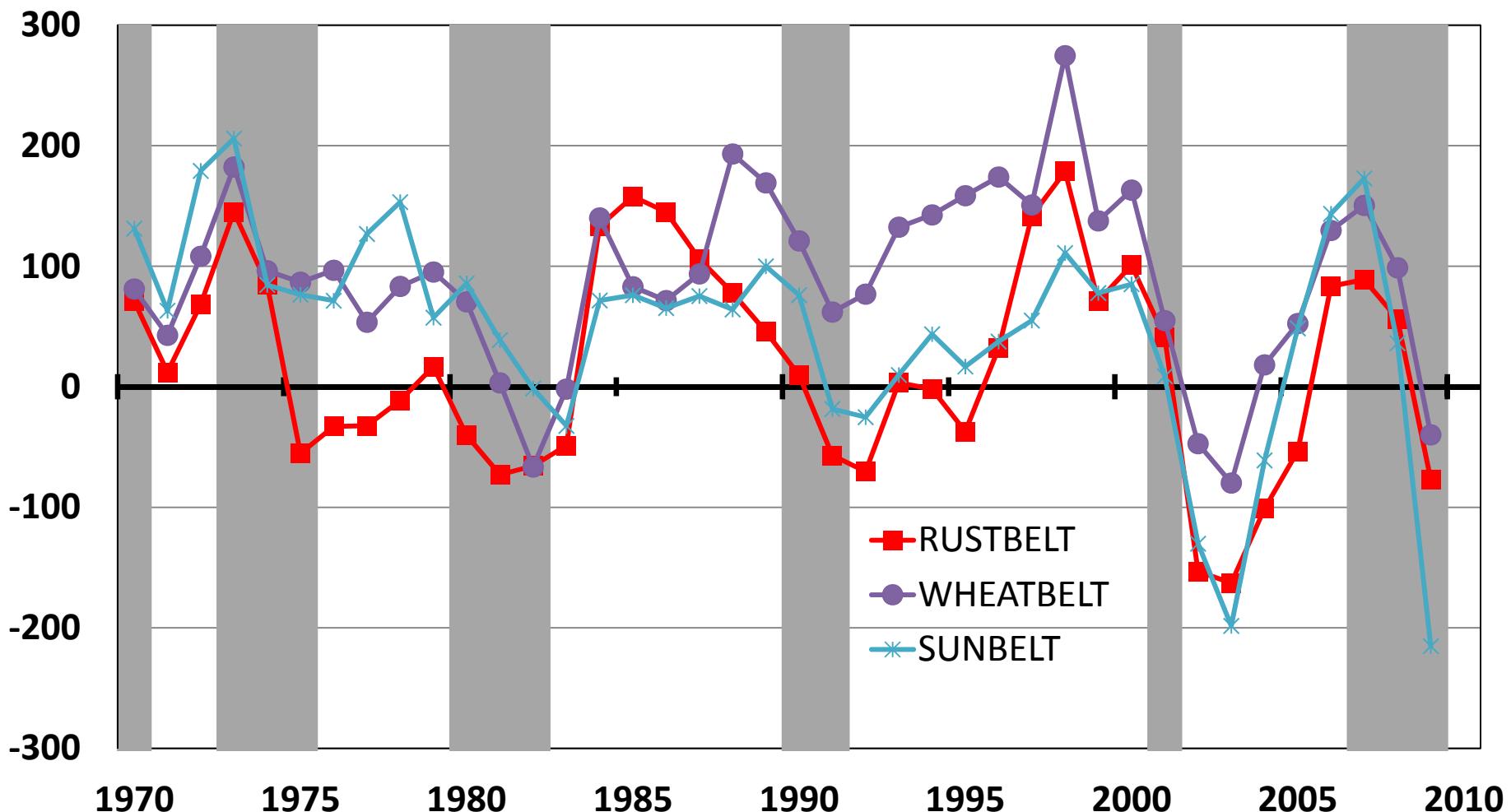
**Figure 7**  
**PPWSUR: Mineral States vs Non-Mineral States**  
**(2005 Dollars)**

\$ - Per capita



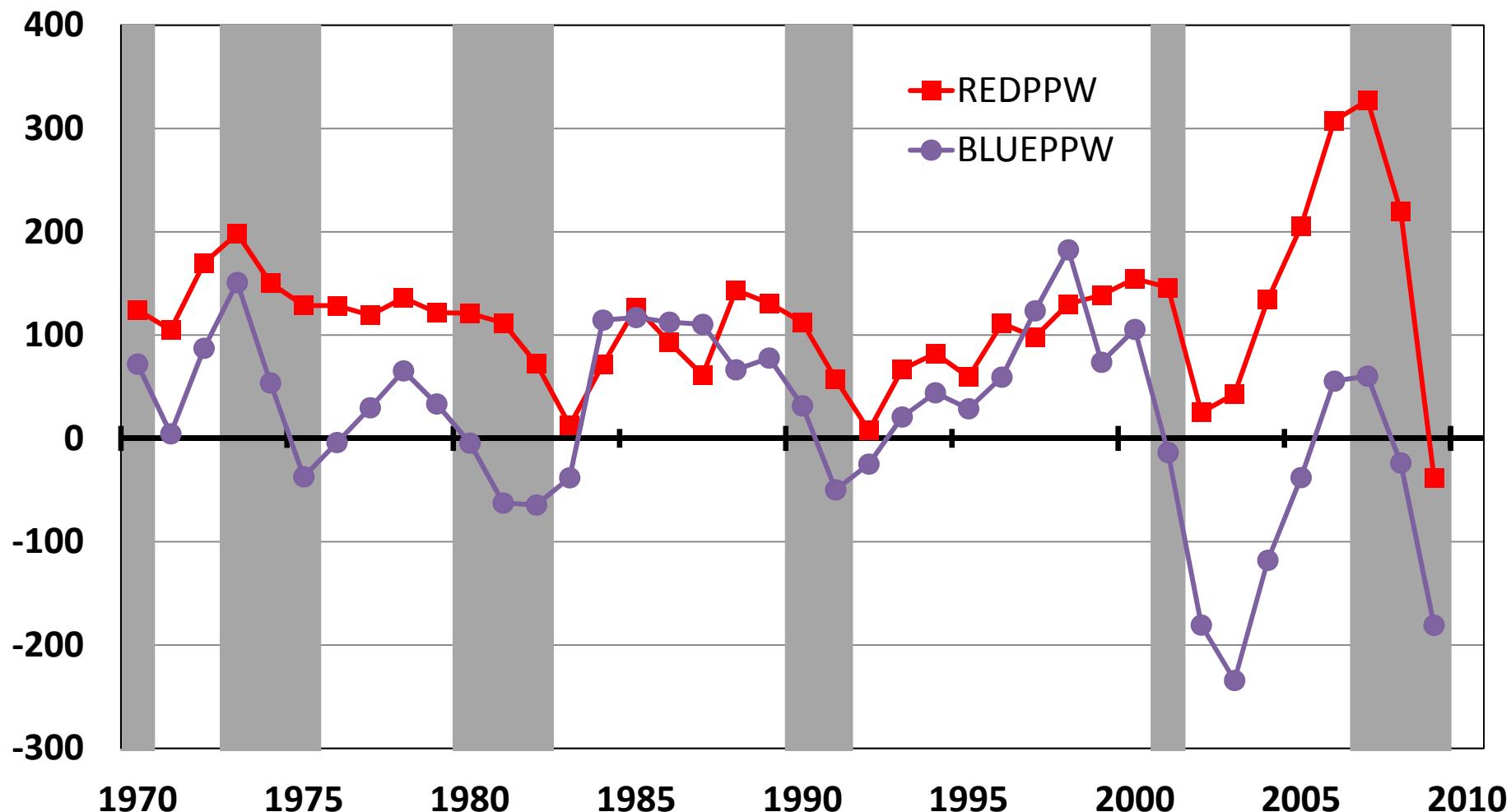
**Figure 8**  
**PPWSUR: Rust vs Wheat vs Sun**  
**(2005 Dollars)**

\$ - Per capita



**Figure 9**  
**PPWSUR: Red States vs Blue States**  
**(2005 Dollars)**

\$ - Per capita



## DISCUSSION

### QUESTION NO. 1: Is This a Problem?

**In the Short-Run:** Sure, but that's why we save.

**In the Aggregate:** Not Really, *Except* for Pensions

**For Some States:** Absolutely, but So What?

- ☞ Will There be a Contagion ala Italy and Greece?
  - ☞ Perverse Fiscal Incentives

## **QUESTION NO. 2: If There is Problem, What to Do?**

### **SOLUTION NO. 1: Federal Bailouts?**

*ARRA was arguably a bailout.*

Source: R. P. Inman, “States in Fiscal Distress,” Regional Economic Development, Vol. 6, Number 1, 2010. (St. Louis, Federal Reserve Bank)

### **SOLUTION NO. 2: Regulation via Balanced Budget Rules?**

*Ex Post, No Override, Independent Enforcer*

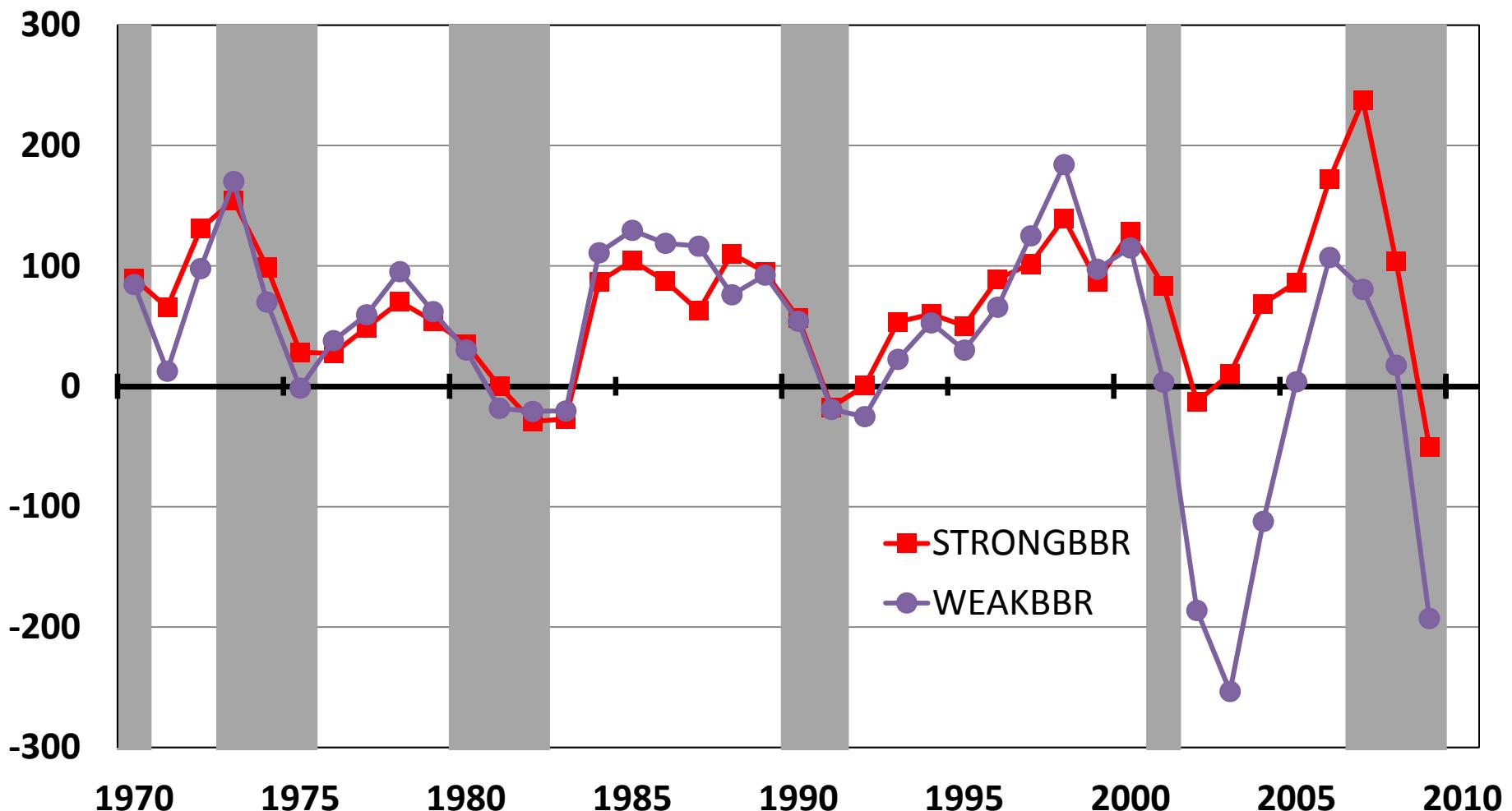
Source: R. P. Inman, “Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU, Horst Siebert (ed.) *Quo Vadis Europe?*, pp. 307-333, 1997, or NBER Reprint No. 2173.

**FIGURE 10:** “Strong” vs. “Weak” BBR States

**FIGURE 11:** “Elected” vs. “Appointed” Supreme Court Enforcement

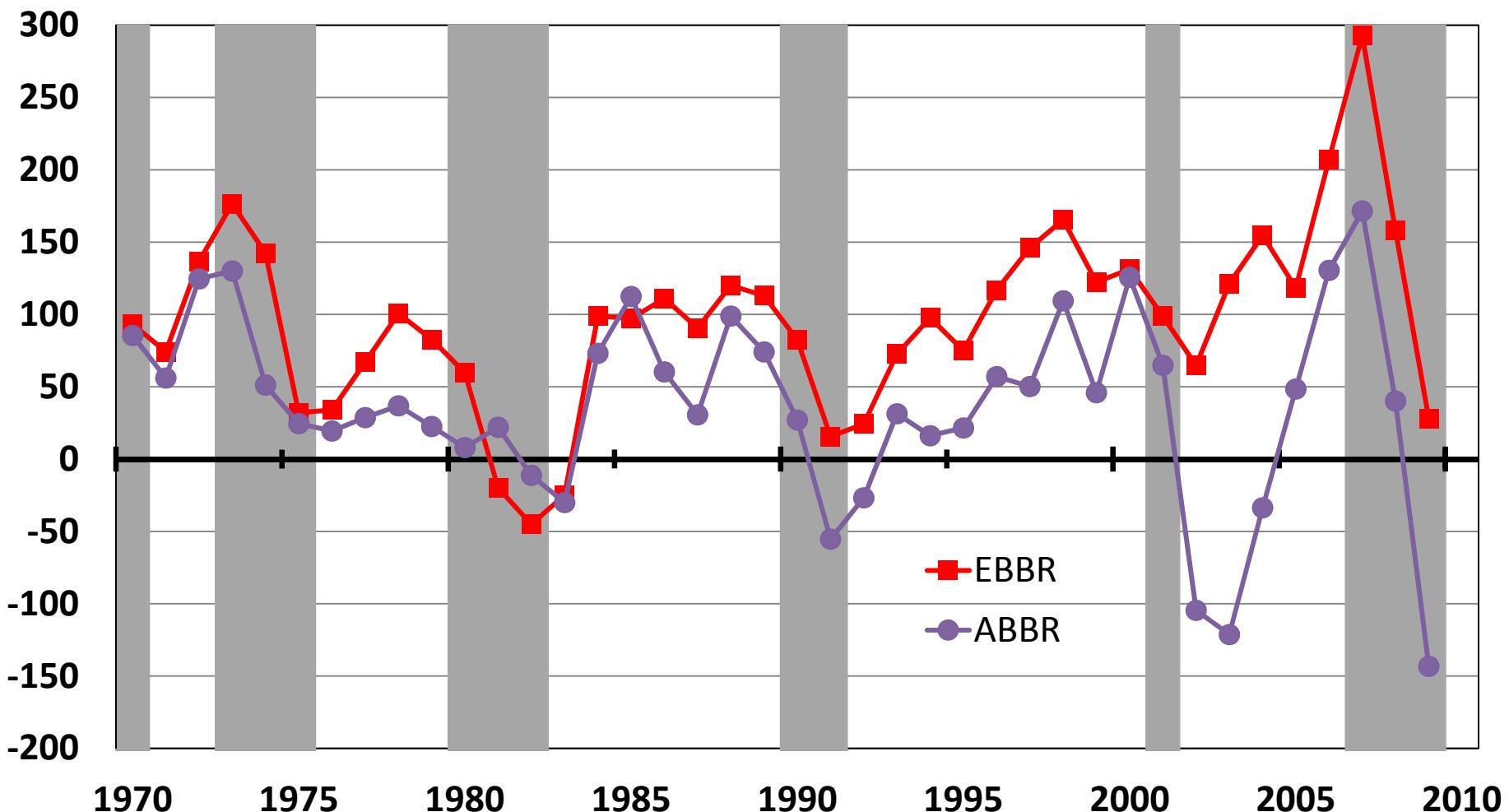
**Figure 10**  
**PPWSUR: Strong BBR States vs Weak BBR States**  
**(2005 Dollars)**

\$ - Per capita



**Figure 11**  
**PPWSUR: (Strong BBR Enforced by) Elected vs Appointed Supreme Court  
(2005 Dollars)**

\$ - Per capita



## SOLUTION NO. 3: Market Discipline?

*No Federal Bailouts, Transparency*

**THE FRB “TRANSPARENCY PROJECT”**