

Federal Aid: A Boost to the Southeastern Economy

Cooperation between various levels of government has long been an important element in the financial structure of our Federal system of government. Grants-in-aid from the Federal Government to state and local governments are a crucial element of this cooperation, although grants and shared revenues from state governments to their local governments are of even greater dollar volume. The focus of this article, however, is confined to Federal grants-in-aid to state governments, particularly those in the Sixth Federal Reserve District.

Background

Federal grants-in-aid to subnational governments are not a recent development. They may be traced back to the origins of the nation. Indeed, they even predate the Constitution. In 1785, Congress

provided grants of Federal land for educational purposes in the Northwest Territory. Early in the nineteenth century, the Federal Government began various aid programs which resulted in our system of land grant colleges. Grants for forest fire protection, vocational education, and highways first appeared between 1910 and 1920. A new period of growth in Federal aid began with the Depression in the 1930's and continued through the Second World War. In the 1960's, another period of growth for Federal aid coincided with national concern over poverty and other social problems.

Federal aid has grown until there are now about 500 separate grant programs. Although Federal aid historically has been granted to state governments, part of the recent aid for social programs has gone directly to local governments. Nevertheless, even today most Federal aid goes directly to the state governments, with only about 12 percent granted directly to the local governments.

Traditionally, Federal aid has been restricted to specific uses. By limiting the use of funds to only particular purposes or projects, the Federal Government has exercised considerable influence

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over the uses of a large part of our economic resources. This is one of the primary purposes of aid programs. Indeed, there are good reasons to believe that had the various aid programs not been undertaken, many of the public services and facilities we enjoy today might never have been provided. Federal aid has stimulated the provision of mass public education; it has helped to develop a unified national highway network; it has made better medical facilities possible; and it has promoted the development of numerous other facilities.

Although Federal grants-in-aid are given primarily to the states, much of the aid emanating from the state governments to local governments is made possible by Federal aid to the states. Essentially, Federal aid frees other state revenues that may then be passed on to local governments. One may be sure that if Federal aid to the state governments were discontinued, the various state governments would either be forced to curtail their aid to local governments or to raise additional revenues by imposing higher taxes.

In addition to specifying usage, Federal grants-in-aid often contain other conditions. For example, suppose that a grant is made for a particular purpose. The Federal Government may impose the additional condition that the state or local government provide funds to match at least a portion of the grant. For example, out of a total of \$100,000, the Federal Government might provide one dollar for every dollar provided by the subnational government. Thus, if the state or local government provides \$50,000, the Federal Government would provide \$50,000. For a state with higher income, the Federal Government might require that the subnational government raise more matching funds, perhaps two dollars for every dollar the Federal Government provides.¹

Differences between allocations and matching formulas among states are often deliberate and are usually intended to assist poorer states in achieving a minimum level of public services. Indeed, one important purpose of many aid programs is the redistribution of economic resources from wealthier areas of the nation to poorer areas. Differences in the abilities of various states

¹There are several types of grants under various names. A grant might be referred to as a project grant, or a formula grant, or both, depending upon the conditions under which it is given. This article ignores technical nomenclature and refers to grants as either conditional, matching, or both. The reader should not attach any particular importance to these terms.

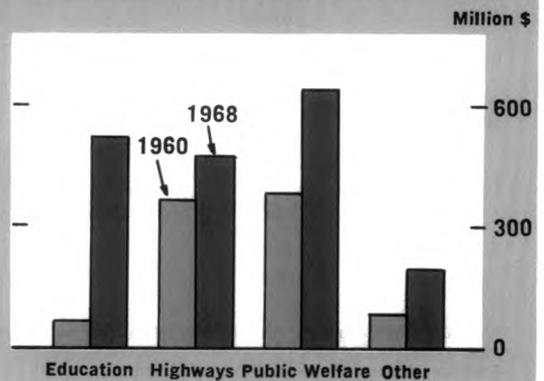
to tax equitably is taken into account so that at least a minimum program is possible in every state. A state with low per capita income might receive a larger allocation of funds or have a smaller matching ratio than another state with high per capita income. The method of achieving this equalization varies from one grant program to another.

Federal Aid in the Sixth District

Federal grants-in-aid come in almost as many varieties as there are programs. Instead of describing in detail every type of grant, we may classify aid into six broad categories for highways, education, public assistance, health and hospitals, employment security, and other miscellaneous programs. Of these, public assistance, highways, and education are the most important and account for about 90 percent of all Federal aid to state governments.

Federal aid has been an especially important source of funds to the state governments in the Southeast, primarily because these states typically have lower incomes. In 1968, Federal aid accounted for 28.1 percent of the combined general revenues of state governments in the Sixth Federal Reserve District. For the nation as a whole, Federal aid accounted for only 22.3 percent of the general revenues of all state governments. The relatively greater dependence of Southeastern states on Federal aid has lessened, however. In 1960, Federal aid accounted for 27.2 percent of the general revenues of District states but made up only 19.4 percent of all state governments. Thus, whereas aid is becoming a larger

Federal aid to District state governments grows during the 1960's.



part of state revenues in the nation as a whole, it has remained a relatively constant part of state revenues in the District. This change, at least partly, reflects rapid income growth in District states and the increasing ability and willingness of District state governments to raise revenue

from their own sources. Federal aid, however, continues to be relatively more important to South-eastern states than to all state governments combined.

Among District states in 1960, Louisiana received the largest amount of total aid—\$200.4

TABLE I
FEDERAL AID TO DISTRICT STATES*

1960

| | <u>Total</u> | <u>Education</u> | <u>Highways</u> | <u>Public Welfare</u> | <u>Health and Hospital</u> | <u>Employment Security Administration</u> | <u>Other</u> |
|-----------------|------------------|------------------|------------------|-----------------------|----------------------------|---|----------------|
| Alabama | 141.8 (43.40) | 11.8 (3.62) | 50.7 (15.51) | 64.7 (19.81) | 4.6 (1.42) | 4.5 (1.39) | 5.5 (1.65) |
| Florida | 171.4 (34.61) | 15.9 (3.21) | 80.4 (16.24) | 61.8 (12.49) | 4.3 (.88) | 6.1 (.98) | 2.9 (.81) |
| Georgia | 153.2 (38.85) | 12.8 (3.24) | 57.0 (14.45) | 67.2 (17.05) | 7.0 (1.78) | 4.8 (1.23) | 4.4 (1.10) |
| Louisiana | 200.4 (61.54) | 8.6 (2.64) | 73.4 (22.55) | 105.7 (32.45) | 5.1 (1.57) | 3.9 (1.21) | 3.7 (1.12) |
| Mississippi | 98.8 (45.38) | 9.3 (4.28) | 37.7 (17.33) | 39.0 (17.92) | 3.8 (1.75) | 3.6 (1.66) | 5.4 (2.44) |
| Tennessee | 140.3 (39.34) | 11.4 (3.20) | 66.8 (18.73) | 43.1 (12.09) | 6.8 (1.91) | 4.4 (1.23) | 7.8 (2.18) |
| District States | 905.9 (42.80) | 69.8 (3.30) | 366.0 (17.29) | 381.5 (18.03) | 31.6 (1.49) | 27.3 (1.29) | 29.7 (1.40) |

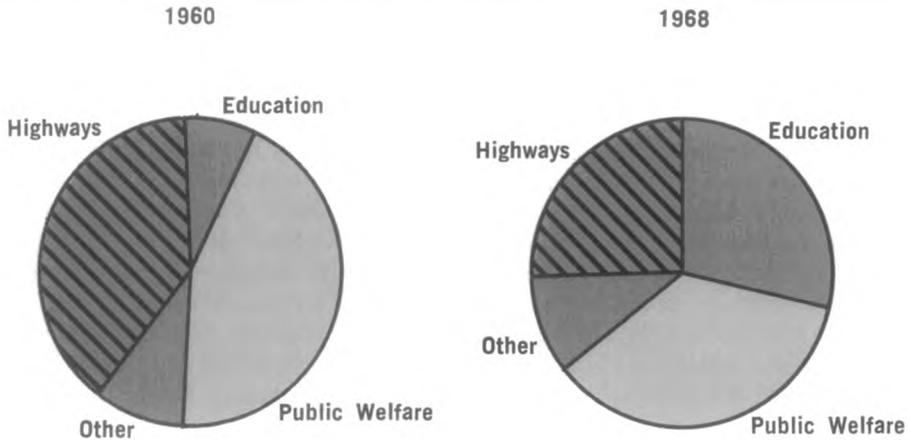
1968

| | | | | | | | |
|-----------------|--------------------|------------------|------------------|------------------|----------------|----------------|----------------|
| Alabama | 308.3 (86.47) | 95.8 (26.86) | 75.0 (21.03) | 105.9 (29.69) | 10.5 (2.94) | 8.8 (2.46) | 12.3 (3.49) |
| Florida | 327.7 (53.20) | 101.7 (16.51) | 80.8 (13.12) | 102.3 (16.61) | 19.3 (3.13) | 11.9 (1.93) | 11.7 (1.90) |
| Georgia | 360.9 (78.65) | 100.0 (21.80) | 98.9 (21.55) | 125.2 (27.29) | 15.7 (3.42) | 10.0 (2.18) | 11.1 (2.41) |
| Louisiana | 346.5 (92.86) | 67.0 (17.96) | 85.2 (22.82) | 168.6 (45.16) | 10.5 (2.81) | 8.6 (2.30) | 6.6 (1.81) |
| Mississippi | 203.2 (86.76) | 71.4 (30.48) | 42.6 (18.17) | 60.9 (25.99) | 8.8 (3.75) | 6.8 (2.92) | 12.7 (5.45) |
| Tennessee | 289.0 (72.69) | 86.1 (21.65) | 88.5 (22.26) | 80.1 (20.14) | 10.1 (2.54) | 8.4 (2.11) | 15.8 (3.99) |
| District States | 1,835.6 (75.33) | 522.0 (21.42) | 471.0 (19.33) | 643.0 (26.39) | 74.9 (3.07) | 54.5 (2.24) | 70.2 (2.88) |

*Amounts of aid are in millions of dollars. Per capita amounts, in parentheses, are in dollars.

Source: Federal Reserve Bank of Atlanta

AID TO EDUCATION LEADS IN GROWTH



million (Table I). Florida ranked second, and Georgia, Alabama, Tennessee, and Mississippi followed respectively. If converted to per capita terms, the ranking differs. Louisiana still received the highest amount—\$61.54 per person. Mississippi, however, received the second-highest figure, while Alabama, Tennessee, and Georgia followed. Florida ranked lowest in per capita terms.

The growth of Federal aid is reflected by the 1968 total. In 1968, Georgia received the most aid—\$360.9 million. But in per capita terms, Georgia, with \$78.65, ranked fourth among District states. Louisiana received the second-highest total aid, but the highest amount per capita—\$92.86. Mississippi again received the lowest total aid, but still this was enough to place the state second in per capita terms.

In the 1960's, not only the level but also the composition of aid to District states changed markedly. At the beginning of the decade, Federal aid for highways and public assistance accounted for over 80 percent of all aid received by the six state governments. These categories accounted for between 78 percent of all aid to Mississippi and 89 percent of all aid to Louisiana. Highway aid was largely concentrated on the interstate highway system. Public assistance aid was directed primarily to the aged, disabled, blind, families with dependent children, or to programs such as

low-rent housing.

By 1968, the picture had changed. Aid for highways and for public assistance declined in relative importance, so that it made up only about 60 percent of all aid to District state governments. Much of this shift in emphasis can be explained by the approaching completion of the interstate highway system. Of all District states, only Georgia received more aid for highways in 1968 than it did in 1965. As a whole, the District received over \$50 million less for highway purposes in 1968 than in 1965. During this period, aid for public assistance, on the other hand, continued to grow but not enough to offset the decreased aid to highways.

With the reduced flow of aid to highways, resources have become available for other purposes, particularly education. The Eighty-eighth Congress initiated several educational programs and expanded others. Vocational education, construction of higher education facilities, and numerous other programs began to receive new or expanded Federal assistance in the mid-1960's. Aid to education jumped from about \$70 million in 1960 to \$522 million in 1968. In 1960, aid to education accounted for only about 9 percent of all Federal aid to Florida—the highest proportion of any District state. By 1968, over 19 percent of all aid to Louisiana was earmarked for education,

and this represented the smallest proportion of any District state. In Mississippi, the state representing the highest proportion in 1968, over one-third of Federal aid was directed to education.

The remaining aid categories have stayed fairly constant over the decade. Aid for health and hospitals includes grants for construction of hospitals and medical facilities for control of tuberculosis, cancer, heart disease, and communicable diseases. These programs amounted to 3.5 percent of all aid to the District in 1960 and 4.0 percent in 1968. Administration of employment security programs represented 2.9 percent of all Federal aid to the District in 1960 and 2.8 percent in 1968. All other aid programs constituted 3.5 percent of aid in 1960 and grew to only 4.0 percent by 1968.

Aid as an Important Source of Funds

Up to this point we have considered primarily the allocation of Federal aid. But how important is the aid as a source of funds to state governments? Does it finance a significant part of their expenditures in certain areas? To answer this, let us ask how much of a state government's expenditures are financed by Federal aid. It is helpful to make a distinction between types of state expenditures. Both direct and total expenditures must be considered. For example, *direct expenditures* for education represent only expenditures made directly for educational purposes by the state government but do not include expenditures that are merely transfers to local governments. *Total expenditures* for education include direct

TABLE II
FEDERAL AID AS A SOURCE OF FUNDS IN DISTRICT STATES

Percentage of Direct Expenditures

| | 1960 | | | 1968 | | |
|-----------------|-----------|----------|----------------|-----------|----------|----------------|
| | Education | Highways | Public Welfare | Education | Highways | Public Welfare |
| Alabama | 20.3 | 44.9 | 79.7 | 41.1 | 45.2 | 74.9 |
| Florida | 22.9 | 39.3 | 78.5 | 44.4 | 32.1 | 76.2 |
| Georgia | 18.9 | 54.6 | 76.0 | 36.9 | 57.0 | 80.9 |
| Louisiana | 10.7 | 43.4 | 65.0 | 29.8 | 38.9 | 72.1 |
| Mississippi | 23.7 | 54.0 | 75.0 | 71.3 | 39.2 | 72.4 |
| Tennessee | 25.8 | 51.0 | 73.0 | 44.6 | 51.5 | 73.3 |
| District States | 19.4 | 46.0 | 73.1 | 43.2 | 43.5 | 74.5 |

Percentage of Total Expenditures

| | 1960 | | | 1968 | | |
|-----------------|-----------|----------|----------------|-----------|----------|----------------|
| | Education | Highways | Public Welfare | Education | Highways | Public Welfare |
| Alabama | 6.8 | 33.8 | 79.7 | 20.0 | 35.1 | 74.9 |
| Florida | 6.1 | 36.6 | 78.5 | 15.1 | 29.9 | 76.2 |
| Georgia | 6.3 | 43.4 | 72.7 | 16.6 | 44.0 | 75.3 |
| Louisiana | 3.6 | 39.8 | 65.0 | 12.2 | 35.0 | 72.1 |
| Mississippi | 7.5 | 40.5 | 75.0 | 27.1 | 30.1 | 72.4 |
| Tennessee | 7.6 | 41.0 | 73.0 | 20.5 | 40.1 | 73.2 |
| District States | 6.1 | 38.9 | 73.1 | 18.3 | 35.6 | 73.7 |

Source: Federal Reserve Bank of Atlanta

expenditures and any transfers from a state government to local governments that are restricted for educational purposes.

Even a cursory examination reveals that Federal aid constitutes a large portion of state expenditures in the three major categories—education, highways, and public welfare (Table II). For example, in 1968, Federal aid to education financed over two-thirds of all direct expenditures for education by the state government in Mississippi. This was the highest percentage for any District state. Louisiana was the lowest state, with about one-third of direct educational expenditures financed by Federal aid.²

When total educational expenditures are considered, Mississippi again relies most heavily on Federal aid, with over one-fourth of total state government expenditures financed by Federal aid. Louisiana is the least dependent of the District states. For the District as a whole, 43 percent of direct state expenditures and 18 percent of total expenditures were financed by Federal aid.

For highways, Federal aid accounted for about 44 percent of direct expenditures by District state governments and for about 36 percent of total expenditures. The relatively small difference in these percentages indicates that transfers from state to local governments make up a smaller part of total highway expenditures than they do for other categories. Federal highway aid was most important to Georgia, where Federal aid was 57.0 percent of direct expenditures. Highway aid was least important to Florida, where payments of \$81 million represented only one-third of direct expenditures. As a percentage of total highway expenditures, Georgia again was most dependent, and Florida was least dependent.

When considering aid for public assistance, the distinction between direct and total expenditures makes little or no difference. Only in Georgia are there any significant intergovernmental payments which are earmarked for public assistance. In the District as a whole, Federal aid accounted for 74.5 percent of direct state expenditures for public assistance and 73.7 percent of total expendi-

tures. Aid was most important in Georgia and Florida, where payments respectively represented 80.9 percent and 76.2 percent of direct expenditures for public assistance. In Georgia this represented only 75.3 percent of total public assistance expenditures. Although aid payments for public assistance to Louisiana were larger in total (\$168.6 million) than in any other District state, they accounted for the smallest percentage—72.1 percent—of expenditures for any District state. This reflects the strong welfare programs carried on by the Louisiana state government.

Federal Aid as a Source of Income

Clearly these figures indicate Federal aid is an important source of *finances* for District states' expenditures in three major areas. But is it also a source of *income* to the District states? The share of expenditures financed by aid for any particular program is not a particularly good measure of the real impact of aid in a state. For example, if the Federal Government had never provided the aid, it is conceivable that state governments would have made the same expenditures themselves and financed them through higher state taxes. A much more accurate appraisal of the *real* initial impact of Federal aid would be to ascertain its direct effects on the levels of income in the various states. For every dollar of Federal aid granted, a dollar of Federal taxes must have been collected to finance the aid. The important question is whether the taxes collected in any state are the same as the aid which is given to that state. In the case of the District states, the answer is negative. Since District states are generally below the national average in income levels, they would more than likely receive more aid than they pay in taxes to finance the aid. What results is a geographical redistribution of income. This is in keeping with the objective of having at least a minimal program in every state. Presumably, poorer states would not be able to provide these programs without some outside assistance. Federal aid is the vehicle through which this is done.

There are two effects which tend to redistribute income through Federal aid programs. Even if aid were paid on a strictly per capita basis, there would be some redistribution, since the Federal tax bill is not paid on a strictly per capita basis. Poorer states tend to pay less per person because the tax system is progressive. In addition, many aid programs allocate proportionately more funds to poorer states. This augments the redistribution

²These computations are based on educational expenditures by the state governments only. If expenditures by local governments were also included, the importance of Federal aid to education would be reduced considerably. This observation does not alter the obvious implication of the data that Federal aid payments are a significant source of financing for educational expenditures by the state governments in the Southeast.

TABLE III
Net Per Capita Gains in 1968
Resulting From Federal Aid to:

| State | District State Governments | District State and Local Governments Combined |
|-------------|----------------------------|---|
| Alabama | \$38.58 | \$34.96 |
| Florida | -15.04* | -18.60* |
| Georgia | 22.27 | 17.22 |
| Louisiana | 38.24 | 33.61 |
| Mississippi | 48.82 | 44.65 |
| Tennessee | 18.22 | 16.47 |

* Net Loss

Source: Federal Reserve Bank of Atlanta

effect resulting from the progressiveness of the tax system.

As indicated in Table III, Federal aid programs resulted in gains to every District state except Florida. Consider Tennessee as an example. The taxes required to finance the Federal Government's aid programs in 1968 averaged \$76.50 for every person in the nation. However, the average Tennessean paid \$54.47 in taxes in order to finance Federal aid.³ The state government in Tennessee received \$72.69 per person in Federal grants. Thus, Tennessee's average gain would be \$18.22 per person because of the combination of the progressive Federal tax system and the Federal aid programs to state governments. If Federal aid to local governments in Tennessee is also included, the gain is reduced to \$16.47 per person. Of all the District states, Mississippi gains the most. Through either money income or through more or improved government services, an average Mississippian's gain is increased by \$44.65 as a result of Federal aid to state and local governments. This is the highest among District states. Florida is the only

³ Computations are based on the per capita distribution of the Federal tax bill as computed by the Tax Foundation, Inc. For every dollar collected in Federal taxes, the average citizen of the nation obviously pays \$1. However, the average Tennessean pays only 71 cents in taxes. The lower payment by the Tennessean results primarily from his lower-than-average income. An average citizen in states with higher-than-average income would pay more than \$1 in Federal taxes.

District state that does not gain from the programs. The average Floridian paid \$18.60 more in taxes to finance the Federal aid programs than was returned to the state and local governments in aid payments.

Preliminary estimates for the fiscal 1971 Federal budget indicate that these patterns should continue. Table IV shows the estimated tax bills paid by District states in order to finance Federal aid programs and the total grants which these states will receive from Federal grants-in-aid. Also shown is the amount of taxes paid per dollar of aid received. For every dollar of the \$319 mil-

TABLE IV
Estimated Federal Aid and Tax Burdens
In Fiscal Year 1971

| State | Tax Burden | Total Aid* | Tax Burden Per \$1 of Aid Received |
|-------------|------------|------------|------------------------------------|
| | \$ million | \$ million | \$ |
| Alabama | 218 | 416 | .52 |
| Florida | 562 | 427 | 1.32 |
| Georgia | 331 | 490 | .68 |
| Louisiana | 267 | 471 | .57 |
| Mississippi | 116 | 319 | .36 |
| Tennessee | 278 | 385 | .72 |

* Includes aid to local governments

Source: Tax Foundation, Inc.

lion in aid to Mississippi, taxpayers in Mississippi would have paid only \$.36 in Federal taxes. On the other hand, Florida taxpayers would have paid \$1.32 for every dollar of the \$427 million in Federal grants to states and localities in Florida.

Conclusions

As we have seen, Federal grants-in-aid to District states are primarily concentrated in three areas—highways, education, and public assistance. Recently, the trend has resulted in increased emphasis on education and reduced emphasis on highway aid. In all categories, Federal aid is an important source of revenue to District state governments. State government expenditures in these

areas depend substantially on this aid. Without Federal assistance, it is likely that both the quality and quantity of these vital public services would have been seriously reduced.

In addition, we have noted that Federal aid contributes to the incomes of all District states except Florida. Obviously, one cannot expect that every citizen would gain \$10 or \$15 in either higher money incomes or improved government services. Some persons may gain nothing at all. Others—for example, the aged—may gain a great deal. Some benefit through direct payments such as those to the blind. Still others gain indirectly through a better educated citizenry or various general improvements. In most cases, however, it is clear that the impact of the Federal aid pro-

grams has been to inject more into the District states' economies than is withdrawn in taxes to finance these programs.

Finally, let us comment on the future of Federal grants-in-aid. There are renewed efforts to improve present aid programs. Efforts are under way to consolidate and restructure existing programs. New approaches to the welfare programs, such as the Family Assistance Program, have been proposed. Another important step is the proposal for unrestricted sharing of Federal revenues with subnational governments. Hopefully, present efforts should enhance the value of these programs to our Federal system.

ROBERT H. FLOYD

New and Revised Publications

A Review of Florida's Economy 1960-70, revised July 1970

A Review of Georgia's Economy 1960-70, revised August 1970

A Review of Louisiana's Economy 1960-70, revised August 1970

District Manufacturing Index: Technical Note and Statistical Supplement. This supplement gives a detailed discussion of the methods used in computing the District's new production index. It also contains monthly production indexes for the District's individual industries.

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