State Budgets Outgrow State Incomes

The size of state governments increased between 1969 and 1998, a fact not likely to surprise even the most casual follower of public affairs. Less well known perhaps is the extent to which programs funded by state governments expanded during these three decades. Government spending in the typical (median) state grew from $1,696 per capita in 1969 to $3,593 in 1998 (both numbers are denominated in constant 2000 dollars). Figure 7.1 illustrates this growth, which amounts to a 75 percent (continuously compounded) real increase, or an average annual growth rate of 2.6 percent. By comparison, personal income per capita in the median state grew by 49 percent in inflation-adjusted dollars, an average annual growth rate of 1.7 percent. Over these three decades, state governments annually grew nearly 1 percentage point faster than state income.

Figure 7.2 illustrates the growth of state governments in a slightly different way, in this case using the ratio of government spending to income in the median state. In 1969, state spending equaled 10.7 percent of state income. This climbed to 13.3 percent in 1998, a 21 percent increase. Again, this alternative indicator reveals that state government spending annually grew almost 1 percentage point faster than income in the typical state. In short, during the last three decades of the twentieth century the size of the state public sector expanded markedly in relation to the private sector. This spending surge surely resulted in part from the progressive nature of state tax structures. As we found in chapter 4, the state personal income tax was progressive in 39 out of 40 states and the state sales tax was progressive in 22 out of 46 states. Tax progressivity ensures that government revenue growth will outpace income growth even without an explicit tax rate increase.

What happened to the size of the federal government during this period of state government expansion? The path of federal expenditures as a share of U.S. income, as shown in figure 7.2, tracks the path of state expenditures between 1969 and the mid-1980s. In 1969 fed-
eral spending as a share of U.S. income equaled 24 percent, reached a peak of 28 percent in 1983, and then began a downward trend. Federal spending declined to 22 percent in 1998, below its 1969 level. In the mid-1980s, the paths of state and federal spending parted ways; state spending continued its upward march even as federal spending trended downward. Thus, while the size of the federal government sector in relation to income remained considerably larger than the

![Fig. 7.1. State spending growth compared to income growth, 1969–98](image-url)
Fig. 7.2. State spending growth compared to federal spending relative to income, 1969–98
typical state government sector, state spending increased relative to income while federal spending did not.\textsuperscript{3}

The splurge in government spending was not uniform among the states. Figure 7.3 ranks the states in terms of growth in state spending per capita between 1969 and 1998 (adjusted for inflation in 2000 dollars). Figure 7.4 ranks the states in terms of growth in spending as a share of state income. New Jersey experienced the largest spending growth by either measure, growing 114 percent in per capita terms and 61 percent in relation to income. Nevada experienced the smallest growth in state spending per capita, 39 percent. Figure 7.4 shows that in only two states, Nevada and Vermont, did income growth outpace state spending growth over these three decades. Virginia, the median state in terms of per capita spending growth, grew 75 percent and Florida, the median state in terms of spending as a share of income growth, grew 25 percent.

What accounts for this vast disparity in the growth of spending among the states? The simple convergence thesis merits some attention. In this view, competition among states would motivate policymakers in low-spending states to match the programs and services offered in high-spending states. Policymakers in high-spending (and therefore high-revenue) states would be motivated to constrain government growth to bring the tax burden in closer accord with the relatively low-spending, low-tax states. The relevance of these convergence forces can be seen in figure 7.5, which plots the average level of spending per capita in 1968 and 1969 (in logged form) on the horizontal axis and the growth in real per capita spending (1969–98) on the vertical axis. The obvious negative pattern in these data suggests the presence of a convergence process. For example, Nevada and Vermont, which experienced the slowest growth in government spending over the period, were among the states with the highest level of per capita spending in 1968–69. New Jersey, which experienced the fastest per capita spending growth (116 percent), had the fourth smallest level of per capita spending in 1968–69.

Figure 7.6 plots this convergence relationship using state spending as a share of income, and again the data pattern clearly indicates the negative trade-off. By and large, states with large governments in the late 1960s tended toward slow growth and states with initially small governments tended toward rapid growth over the next three decades.

The convergence pattern in state government spending can be explicated using the alternative and more rigorous technique shown in
Fig. 7.3. Comparison of state spending growth, 1969–98 (ranked by growth in real spending per capita)
Fig. 7.4. Comparison of state spending growth, 1969–98 (ranked by growth in spending relative to income)
Fig. 7.5. Effect of initial government size on growth in spending per capita
Figures 7.7 and 7.8. Figure 7.7 plots the coefficient of variation in spending per capita, and figure 7.8 plots the coefficient of variation in spending as a share of income. The dispersion in spending per capita across states dropped 32 percent, from 0.029 in 1968 to 0.019 in 1998. Similarly, the dispersion in spending as a share of income across
states dropped 33 percent, from 0.11 in 1968 to 0.07 in 1998. In sum, a process of interstate fiscal competition appears to play a pertinent role in driving aggregate spending policies over the course of the three decades. It is important to note that the forces of convergence over the two-decade period, 1977–98, appear far less impressive. For example, the dispersion in spending as a share of income in 1998
equaled its value in 1977 (see fig. 7.8). Likewise, figure 7.7 shows that much of the convergence in spending per capita occurred in the early 1970s. Spending dispersion remained almost flat for 20 years, from 1975 until 1994.

Figure 7.9 illustrates changes in spending levels for the individual states by comparing spending per capita in the late 1990s to the levels three decades earlier. The states’ rankings in terms of average
spending per capita in the 1995–98 period are shown on the horizontal axis, and the states’ rankings in the 1969–72 period are shown on the vertical axis. The state with the largest spending receives a rank of 1, and the state with the smallest spending receives a rank of 47. New York tops the list in the late 1990s (with spending equal to

Fig. 7.9. Changes in relative spending over three decades (1 = highest spending per capita; 50 = lowest spending per capita)
$5,016 per capita), followed by Delaware, Connecticut, Massachusetts, and Rhode Island. Clearly states in the Northeastern region of the United States tend to be the big spenders by this measure. At the other end of the scale, Texas had the lowest per capita spending in the late 1990s ($2,703 per capita), followed by Florida, Missouri, Tennessee, and Arizona.

Figure 7.10 also ranks the states in terms of spending, in this case measuring government size in spending as a share of state income. Again rankings are provided for 1995–98 (the horizontal axis) and for 1969–72 (the vertical axis). Using this indicator, New Mexico had the highest spending in the late 1990s (20 percent of state income), followed by West Virginia, Montana, North Dakota, and Mississippi. Note that this indicator of state government size yields a quite different ranking than that based on per capita spending, as shown in figure 7.9; Northeastern states no longer dominate the high end of the spending scale. Colorado had the lowest spending as a share of income in the late 1990s (10 percent of state income), followed by Florida, Illinois, New Hampshire, and Texas. The contrast in the state rankings shown in these two figures reveals that these two commonly used indicators of the size of government provide materially different conclusions.

Figures 7.9 and 7.10 make it easy to identify the extent to which the relative size of state governments remained constant over the 1969–98 period. States for which relative state spending remained unchanged over these three decades fall along the 45 degree line. For example, in figure 7.9 Texas falls on the 45 degree line in the top right corner, indicating that Texas ranks as the lowest spender in per capita terms at the beginning and at the end of the three decades. Delaware falls on the 45 degree line in the bottom left corner, indicating that Delaware continued to hold the second biggest spender spot throughout the three decades. Only two other states maintained the same relative spending ranking, Illinois and Missouri.

State government spending per capita in New Jersey gained the most ground in relation to other states. New Jersey rose from thirty-fourth position in the early 1960s to eighth position in the late 1990s. Note that this result conforms to the growth rankings in figure 7.4, which showed that government spending in New Jersey grew more than in any other state. The second biggest increase in spending per capita occurred in South Carolina, which moved ahead of 20 states, from thirty-ninth rank to nineteenth rank.

More generally, figure 7.9 identifies the states in which spending
increased relative to other states as those lying above the 45 degree line, where a greater distance from the 45 degree line indicates a larger relative increase in spending. Symmetrically, the states in which spending decreased relative to other states lie below the 45 degree line. On that front, Nevada experienced the largest relative spending decrease, dropping below 22 states, from the sixth position...
to the twenty-eighth position. Figure 7.10 provides the identical analysis, ranking the states based on spending as a share of state income as an alternative indicator of government size. By that measure, Ohio shows the largest increase in spending relative to other states. Colorado shows the largest decrease in spending relative to other states.

Commentary

The outburst of federal debt in the 1970s and even more in the 1980s drew considerable media attention and perhaps diverted attention away from state fiscal developments. By comparison to federal fiscal events, state governments seemed to be performing relatively well, especially with regard to debt-financed expenditures. What seems to have been lost on most observers is that the growth of federal spending reversed course in the mid-1980s; yet in the typical state spending continued to grow almost 1 percentage point faster than income for the remainder of the twentieth century. In fact, the growth in state government spending failed to outpace income growth in only two states (Vermont and Nevada) in the final three decades of the twentieth century.

The data in this chapter reveal extensive diversity among states with respect to the size and growth in state government spending. A simple convergence thesis explains some but not much of the spending diversity among states, particularly in the years after 1975. Chapters 8 and 9 proceed to investigate in considerable detail the economic, demographic, institutional, and ideological factors that appear to explain these wide variations in state spending patterns.