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Fiscal Capacity of States, Fiscal 2002

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States and their local governments vary both in their needs to provide basic public services and in their abilities to raise revenues to pay for those services. A forthcoming joint study by the Tax Policy Center and the New England Policy Center at the Federal Reserve Bank of Boston uses the Representative Revenue System and the Representative Expenditure System frameworks to quantify those disparities across states by comparing each state's revenue capacity, revenue effort, and necessary expenditures with the average capacity, effort, and need in states across the country. Below, we present main concepts and selected findings from the study. For each state, we define the key concepts as follows:

- *Revenue capacity* is the total revenue that a state (and its localities) would have raised if it were to apply a uniform set of taxes and charges "representative" of policies prevailing across the 50 states. The calculations cover a standard set of taxes and charges for all states. For each tax term, the representative rate is the ratio of actual nationwide collections to the potential nationwide tax base.
- *Revenue effort* is the ratio of actual revenues to revenue capacity. Revenue effort provides an index of the extent to which a state and its local governments are taxing their available resources compared with other states.
- *Expenditure need* is a measure of the cost of providing public services at an average level given the state's characteristics. It is the sum of adjusted expenditure shares for a set of identified expenditure items based on demographic and economic circumstances. Those shares also reflect price differences in the cost of providing service. The expenditure share for education, for example, depends on the number of school-age children, the number of those children who live in poverty, and factors that affect the cost of providing education, such as teacher salaries.
- *Expenditure effort* is the ratio of actual expenditures to expenditure need.
- *Fiscal capacity* is the ratio of revenue capacity to expenditure need.

The study estimates that New England and Middle Atlantic states tend to have high revenue capacity and low expenditure needs compared with the national average. Thus, states in those two regions tend to have high fiscal capacity, or a relatively high capability to cover their expenditure needs using their own resources. South Central states, however, have low fiscal capacity — that is, a low level of revenue-raising capacity given what it would cost to provide a standard set of public services to their citizens.

For more findings, including details by state and an explanation of methods used, see Yesim Yilmaz, Sonya Hoo, Matthew Nagowski, Kim Rueben, and Robert Tannenwald, "Measuring Fiscal Disparities Across the U.S. States: A Representative Revenue System/Representative Expenditure System Approach, Fiscal Year 2002," Urban Institute and the Federal Reserve Bank of Boston, October 2006.

Indexes of Revenue Capacity, Revenue Effort, Expenditure Need, Expenditure Effort, and Fiscal Capacity, by Region, Fiscal 2002, National Average = 100

	Revenue Capacity	Revenue Effort	Expenditure Need	Expenditure Effort	Fiscal Capacity
New England	123	88	94	114	131
Middle Atlantic	109	111	98	123	111
East North Central	97	100	100	98	97
West North Central	97	100	95	102	102
South Atlantic	97	96	99	92	98
East South Central	85	95	106	82	80
West South Central	88	98	107	80	82
Mountain	97	95	99	93	98
Pacific	107	102	101	108	106

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