The Economist

America's fiscal union

Greek Americans

Which American states enjoy the biggest fiscal transfers?

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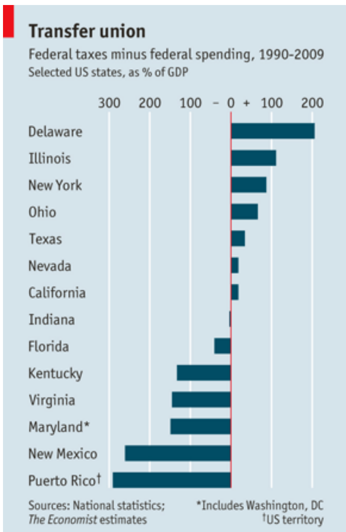
IN MAKING their latest deal to save the euro on July 21st, the 17 members of the single currency took another small step towards a fiscal union. America made that leap 220 years ago, when the new federal government took on the debts incurred by individual states in their revolutionary war against Britain. That debt, wrote Alexander Hamilton, America's greatest treasury secretary, was "the price of liberty".

Ever since, federal debt has been backed by the full faith and credit of the entire United States (state debts are a different matter). America's good credit has survived war and depression. It is holding up even as Republicans in America's House of Representatives threaten not to increase the congressional limit on federal borrowing. That would force the government to choose between paying its bondholders and its pensioners. If the ceiling does not rise, the roof may fall.

Europe still has a long way to go before it is as fiscally united as America. It could not contemplate anything like the transfers that America's federal system allows. Take Virginia, for example. In 2009, according to the Census Bureau, the federal government spent $155.6 billion in this state where the revolutionary war was won. But the Internal Revenue Service collected only $58.6 billion in federal taxes. Virginia, in effect, ran a deficit of $97 billion. Indeed over the 20 years from 1990 to 2009, according to calculations by *The Economist*, it ran a cumulative deficit of over $590 billion.

That amounts to about 145% of Virginia's 2009 economic output, similar to the debt-to-GDP ratio of Greece. If America were like the euro area, Virginia would have to bear the burden itself. But as part of a fiscal union, it can rely on others to help.



Virginia is not however the most "indebted" of America's states, according to these calculations (see chart). That honour falls to New Mexico, which has a 20-year deficit worth over 260% of its GDP. Puerto Rico, which is a territory, rather than a full state, has an even bigger debt ratio.

Twenty American states have paid more in federal taxes than they have received in federal spending. The biggest "creditor", relative to the size of its economy, is Delaware, which has a 20-year surplus of almost $125 billion, more than twice its GDP. Its contribution is perhaps flattered by the taxes paid by the many firms incorporated in the state. Ironically, creditor states have also elected the three Democrats most involved in trying to raise the debt ceiling: Harry Reid, a senator from Nevada, Nancy Pelosi, a congresswoman from California, and Barack Obama, once a senator from Illinois.

These transfers are already far bigger than anything the Europeans could match, but the figures actually understate matters. For example, they exclude any interest payments on federal debt, which add up to over $4 trillion since 1990. If those payments were made by debtor states in proportion to their cumulative deficits, the debts of states like New Mexico and Mississippi would rise to over 500% of GDP.

Debtor states enjoy enormous fiscal transfers, backed by taxes raised elsewhere and bonds the whole union must repay. That commitment to repay has never been questioned. Even now bondholders remain remarkably sanguine about the risk of default. But the political impasse may have done more subtle damage. When the national debt is "an object of established confidence", Hamilton argued, "it answers most of the purposes of money." Money-market funds have recently been busy swapping Treasuries, especially one-month bills, for cash. More than 220 years after Hamilton made his case for a fiscal union, America's national debt no longer answers all of the purposes of money.

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