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GAO

Report to the Chairman, Committee on
Finance, U.S. Senate

April 1990

COMMUNITIES IN FISCAL DISTRESS

State Grant Targeting Provides Limited Help





United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

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April 13, 1990

The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

This report responds to your request that we assess whether states are meeting the needs of fiscally distressed communities, particularly in light of the expiration of federal revenue-sharing in 1986. We identified numerous state general fiscal assistance programs available to fiscally distressed communities. In this report, we (1) examine the extent to which these programs reduce differences in tax burdens among general purpose local governments in 48 states and (2) compare the success of these state programs with that of the old federal revenue-sharing program in reducing differences in tax burdens between distressed and better-off communities.

Copies of this report are being sent to other interested congressional committees and members, as well as to national associations representing state and local governments. We also will make copies available to other interested parties upon request.

Please contact me at (202) 275-1655 if you or your staff have any questions concerning this report. Other major contributors to it are listed in appendix XIV.

Sincerely yours,

A handwritten signature in cursive script that reads 'Linda G. Morra'.

Linda G. Morra
Director, Intergovernmental and
Management Issues

The most direct means of reducing such disparities is by targeting state and federal grant funds to fiscally distressed communities, thereby reducing their tax burdens compared with “better-off” communities. State and federal grant programs have the inherent flexibility to serve such policy ends. Unrestricted general fiscal assistance grants are better suited than special purpose grants to achieving disparity reduction goals. Special purpose aid is aimed at satisfying specific public service needs that may not correspond to where fiscal disparities are greatest.

This report focuses on how general fiscal assistance grants reduce disparities among general purpose local governments. In performing its analysis, GAO examined data for 1985 (the last year of the federal revenue-sharing program), conducted a 50-state telephone survey, and interviewed state officials in 11 states. Because of data limitations, GAO did not separately analyze the disparity-reducing effects of services provided directly by state governments, or local education and special purpose aid to local governments.

Results in Brief

State and federal grant programs reduce local financing burdens. However, grants from both have decreased as a share of local revenues. Between 1977 and 1987, state and federal aid dropped from 40 to 31 percent of local revenues. Reductions in state aid accounted for 2 points of the 9 percentage point drop; an overall reduction in federal aid accounted for the rest. As a result, local governments have had to finance an increasing share of their expenditures from local resources.

At the same time, differences in per capita incomes widened between poorer and more affluent counties. As the ability to bear tax burdens is directly related to income, this suggests that fiscal disparities between poorer and more affluent communities have increased.

In GAO’s analysis of 1985 data, disparities between fiscally distressed communities, such as Starr County, Texas, and better-off communities existed in all states. But the extent of disparities differed substantially across states.

States provided \$10.9 billion in general purpose fiscal assistance to local governments in 1985² and federal revenue-sharing added another \$4.6

²We used fiscal year 1985 data because this was the latest local government tax data available for our analysis. Analysis of more current data on state programs should yield results similar to those presented here, as states infrequently change the formulas used to distribute this aid.

**Federal Revenue-Sharing
More Targeted to
Distressed Communities**

The amount of disparity reduction achieved depends on both how much funding is provided and the extent to which it is targeted to fiscally distressed local governments. Even though it had less than half the funding of most state programs, the federal revenue-sharing program produced a greater reduction. In 31 of the 48 states analyzed, federal revenue-sharing reduced disparities more than did state programs because it was more targeted to distressed communities (see p. 42).

Recommendations

GAO is making no recommendations.

Agency Comments

GAO did not solicit agency comments.

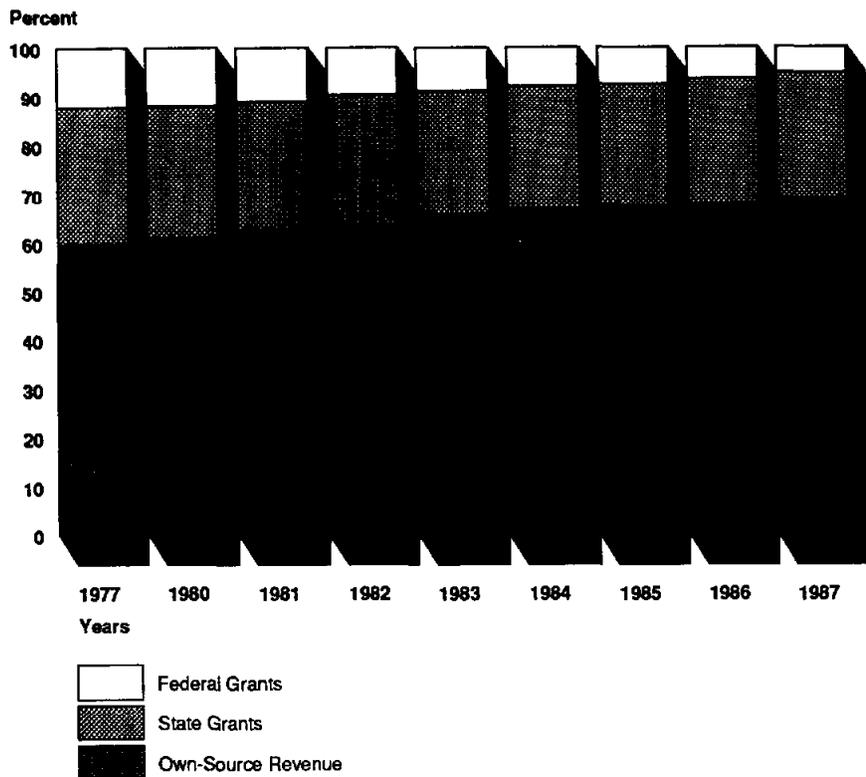
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Figure 1.1: Distribution of Local Government Revenue Sources (1977-87)



Source: U.S. Bureau of the Census, *Governmental Finances*, table 29 for 1985-1987, table 23 for 1980 and 1982-84, and table 24 for 1977 and 1981.

increased because of the relative declines in the amount of state and federal aid to localities.

Local Fiscal Disparities: A Matter of Public Concern

Fiscal disparities—that is, differing abilities to finance comparable local public services—are an inherent result of using a decentralized approach to providing public services. Such differences can lead to wide variations in (1) the level of public services among localities with comparable tax burdens or (2) tax burdens among localities providing comparable service levels.

Differences in tax burdens relative to services received raise equity concerns that ultimately must be answered through the political process:

this \$4.6 billion program exacerbated disparities. At that time, we estimated that the expiration of federal revenue-sharing could increase fiscal disparities among local governments on average by 10 to 15 percent.³

Objectives, Scope, and Methodology

Several members of the Congress have proposed a less expensive and more targeted replacement for the general revenue-sharing program. To help assess the need for such a program, the Chairman of the Senate Finance Committee asked us to examine the extent to which state and federal assistance programs enable local governments to meet their public service needs with comparable local tax burdens.

To do so, we developed the following objectives: (1) to assess the relative extent of local government fiscal disparities within each state, (2) to identify state policies and strategies that affect the magnitude of these disparities, and (3) to assess the extent to which state and federal general fiscal assistance programs alleviated them in 1985, the year before the expiration of federal revenue-sharing.

The uses of general fiscal assistance grants are unrestricted; local officials can use them to finance any of the services they provide. Because of their unrestricted nature, general fiscal assistance programs easily can be designed to reduce the gap between fiscally distressed and better-off communities. Consequently, the programs represent a pool of resources that could be used for this purpose. Some states have designed their general fiscal assistance aid to reduce fiscal disparities but many have not. Our analysis assesses the extent to which general fiscal assistance programs reduce the gap between fiscally distressed and better-off communities, whether or not they were intended to do so. While our study analyzes the disparity reduction achieved on a state-by-state basis, it does not assess reductions in disparities among local governments across states.

We conducted our review between October 1987 and March 1989 in accordance with generally accepted government auditing standards. To develop information on applicable policy issues and economic theory, we did a literature search and reviewed GAO's past work in this area.

³Our report, *Local Governments: Targeting General Fiscal Assistance Reduces Fiscal Disparities* (GAO/HRD-86-113), examined fiscal disparities among general purpose local governments and the impact of federal revenue-sharing on reducing those disparities.

on state programs should yield results similar to those presented in this report because states infrequently change the formulas used to distribute this aid.

- used per capita income, averaged over the years 1980-84, as a proxy for local revenue-raising capacity. Income is a comprehensive measure of residents' "ability-to-pay," widely used by analysts when measuring tax burdens. We did not use the legal tax base from which local governments directly raise their revenues, because residents' personal incomes better measure ability-to-pay taxes than their property values.
- used the 1984 population as a proxy for public service needs among local governments. Data required for more precise measures of public service needs in every state does not exist. While many factors determine public service needs, most are associated with population size.
- did not attempt to reflect the varying costs of providing similar public services in different localities. No consistent unit-cost data applicable to local governments across the states exists.

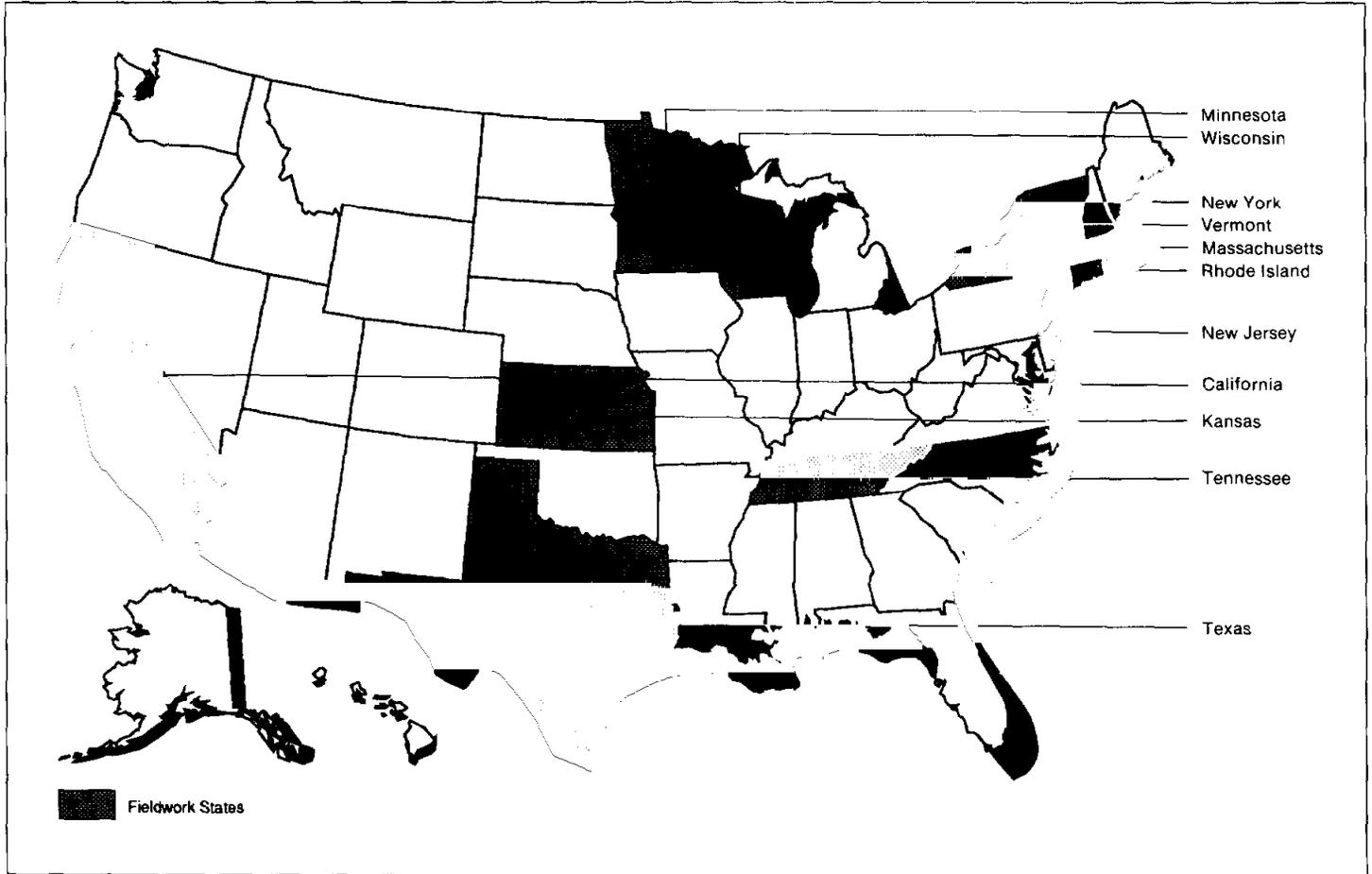
Identifying State Strategies

To identify state policies and strategies to reduce fiscal disparities among local governments, we conducted a 50-state telephone survey. In each state, we contacted senior staff members of the executive and legislative branches to obtain a broad overview of how each state deals with local fiscal disparities. State program descriptions and discussions of state law in this report are based on information obtained from these interviews and explanatory materials provided by these officials. We also interviewed officials from the U.S. Bureau of the Census, National Association of State Budget Officers, and the Advisory Commission on Intergovernmental Relations.

In addition, to develop an in-depth understanding of their policies for addressing fiscal disparities, we visited 11 states: California, Kansas, Massachusetts, Minnesota, New Jersey, New York, Rhode Island, Tennessee, Texas, Vermont, and Wisconsin. In selecting them, we balanced differences in geographic location, population, and approaches to providing state general fiscal assistance.

Our field work enabled us to relate the results of our statistical analyses of disparities to specific state strategies and policies that alleviate them (see apps. II through XII).

Figure 1.3: States Selected by GAO for Fieldwork



The Nature of Fiscal Disparities

Two basic factors separate better-off communities from those that are fiscally disadvantaged:

1. The tax burdens borne by local residents to finance public services and
2. The level and quality of services these taxes finance.

Better-off communities can finance relatively high levels of public services with relatively low tax burdens. But disadvantaged communities must bear relatively high tax burdens that can finance only relatively low levels of public services.

Two New Jersey cities, Woodbine and Alpine, illustrate an extreme example of fiscal disparities (see fig. 2.1). In 1983, Woodbine had the lowest per capita income (\$5,013) of all New Jersey communities and Alpine the highest (\$39,004). With a tax burden equal to 1.7 percent of its residents' per capita income, Woodbine raised \$83 per resident in 1985. In comparison, Alpine enjoyed a more favorable fiscal situation. With a tax burden equal to 0.6 percent of its per capita income, it raised \$232 per resident. Thus, with a tax burden about one-third of Woodbine's, Alpine raised almost three times as much revenue.

statewide average can provide services at a lower effective tax rate than relatively poor communities.¹

- The unit cost of providing public services. For example, the starting salary of a police officer in San Francisco, California was just over \$29,000 in 1987 compared with about \$16,000 for a similar position in Glen County, California. Even allowing for its higher per capita income, San Francisco must bear a higher per capita tax burden for each policeman it hires per 1,000 residents than Glen County does.
- The level of public service needs among communities, resulting from differences in geographic or socioeconomic conditions. For example, Highland Park and Metuchen are two New Jersey communities with almost equal populations. Yet, Metuchen has 132 miles of streets to maintain, five times more than Highland Park. In 1985, Metuchen's expenditures for streets were \$435,000 compared to \$279,000 for Highland Park.

Local governments have limited ability to alter socioeconomic characteristics that contribute to the rise of fiscal disparities, especially over the short run. The value of tax bases, which are the sources of revenues to pay for public services, depends largely on a community's economic condition and its prospects for employment and business opportunities. Through economic development strategies, communities with relatively low tax bases may augment their taxable resources. But even when successful, these developments require years to reach fruition. Similarly, unit costs of services, such as wages and salaries or office space and land are largely influenced by remunerations available in the private sector. Also, a community faced with relatively high public safety and welfare service needs is ill-suited to alter the underlying causes of long-term societal problems such as crime and poverty. Therefore, local governments that are fiscally disadvantaged may require state and federal government assistance in meeting their public service needs.

Centralizing Service Delivery Affects Local Disparities

States differ significantly in the extent to which they centralize service delivery. On average, state governments delivered just over half of all noneducation public services in 1985, but there was significant variation. Some states, such as Vermont and Alaska, provided over three-quarters of such services to their residents, while in Florida and Nevada, the state provided less than 40 percent.

¹The use of per capita income measures may overstate the true tax burden. Some communities are able to shift a substantial share of their local tax burden to nonresidents by "exporting" taxes. For example, Stratton, Vermont, is a major ski resort. In 1987, town residents owned only 2 percent of the taxable real estate in the town.

Chapter 2
Fiscal Disparities: Their Nature, Sources,
and Extent

Table 2.1: Share of Public Services Delivered by State Governments, by State (Fiscal Year 1985)

State	Percent of public services delivered by state	State	Percent of public services delivered by state
Vermont	78.6	Nebraska	55.3
Alaska	75.4	Idaho	55.2
Rhode Island	74.7	Missouri	55.2
Maine	72.2	Oklahoma	54.9
North Dakota	71.3	Michigan	54.3
West Virginia	66.3	New Jersey	54.2
Connecticut	66.1	Wyoming	52.6
Massachusetts	65.8	Mississippi	52.0
South Dakota	65.3		
Kentucky	63.3	U.S. Average^a	51.3
Oregon	62.4		
South Carolina	61.6	Tennessee	50.6
Maryland	61.4	Wisconsin	49.6
Pennsylvania	60.0	Iowa	48.3
New Hampshire	59.8	Ohio	47.8
Washington	59.1	Texas	46.0
Montana	59.1	Minnesota	45.8
Alabama	59.0	Kansas	44.0
Arkansas	58.9	Indiana	43.5
New Mexico	58.3	Colorado	42.2
Utah	57.7	California	41.2
Illinois	57.2	New York	41.1
Louisiana	56.0	Florida	38.8
Georgia	55.9	Arizona	38.6
North Carolina	55.8	Nevada	38.0
Virginia	55.5		

Source: U.S. Bureau of the Census, *Governmental Finances, 1984-85*.

^aWe calculated the U.S. average by weighting each state's share of state-delivered services by its respective population size.

Grants from states and the federal government can be classified into two groups:

1. Categorical grants³ support specific program activities ranging from very narrowly defined functions, such as medical care for low-income

³This includes all intergovernmental aid whose use is restricted to specific program areas, regardless how broad. This definition would encompass block grants.

Chapter 2
Fiscal Disparities: Their Nature, Sources,
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Table 2.2: Share of Local Public Services Financed by State and Federal Grants, by State (Fiscal Year 1985)

State	Percent	State	Percent
Oklahoma	64.4	Oregon	34.3
South Carolina	61.1	Alabama	32.6
Mississippi	60.7	West Virginia	30.0
Arizona	58.4	Pennsylvania	29.9
Wisconsin	57.0	Virginia	29.7
California	56.2	Washington	29.0
Arkansas	48.2	Connecticut	27.9
Idaho	47.8	Kentucky	23.8
Michigan	47.8	New York	23.7
Nevada	46.7	Vermont	23.7
New Mexico	46.1	Rhode Island	23.0
Minnesota	43.8	Texas	22.1
Louisiana	43.3	Montana	21.8
Indiana	42.3	Alaska	19.9
Ohio	42.0	New Hampshire	18.4
Iowa	39.8	Maryland	16.3
Missouri	38.6	North Carolina	15.8
North Dakota	38.4	Florida	15.2
Tennessee	38.3	Kansas	11.7
Nebraska	37.5	Maine	10.4
Wyoming	37.3	Utah	8.6
Massachusetts	36.9	Colorado	8.5
South Dakota	36.0	Georgia	2.8
New Jersey	35.6	Illinois	35.4
U.S. Average	34.8		

Source: U.S. Census Bureau, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files). Local public services exclude public education, and grants exclude state and federal aid-to-education.

Half of Tennessee's highway aid is distributed equally among the counties, 25 percent is distributed by land area, and the remaining 25 percent by population.

Federal categorical aid usually is allocated by formulas, most often based on program costs or such usage factors as population or potential caseloads. In fact, few state or federal categorical programs allocate funds according to residents' taxpaying ability.

share of the state's total population, the other 35 percent according to their percentage of the state's total assessed tangible property. The county government receives half of the county area's allotment and the remainder is divided among its municipalities according to their share of the county's population.

At the federal level, general revenue-sharing was the major general fiscal assistance program that used a tax-based targeting method to distribute aid. This program allocated funds on the basis of the tax burdens, per capita incomes, and populations of local governments.

Other State Policies Affecting the Extent of Local Disparities

The way local geographical boundaries are set and the extent of local restrictions on revenue-raising can increase or decrease the extent of local fiscal disparities.

Boundaries Can Affect Disparities

Establishing geographic boundaries for local governments creates communities with differing fiscal capacities if fiscal needs and resources are not evenly distributed. Although it is theoretically possible to draw community boundaries so each community has an equal ability to raise revenue, in practice this has not been done. Giving local governments the ability to adjust their political boundaries can affect the extent of fiscal disparities, as illustrated by the situation in Texas.

Texas home rule cities⁸ can unilaterally annex adjacent unincorporated areas. As the population of adjacent areas increases, home rule cities have the option of annexation—with or without the consent of the neighboring communities. Thus, annexation allows central cities to expand their tax bases while providing outlying areas with municipal services such as water and sewer. Such policies long have been credited with lessening the deterioration of central city tax bases caused by out-migration in Texas.

While this policy has been successful in preventing the erosion of some central cities' tax bases, it has not completely solved the problem of local fiscal disparities. For example, many poor unincorporated areas in the state—particularly near the border—have grown in population but

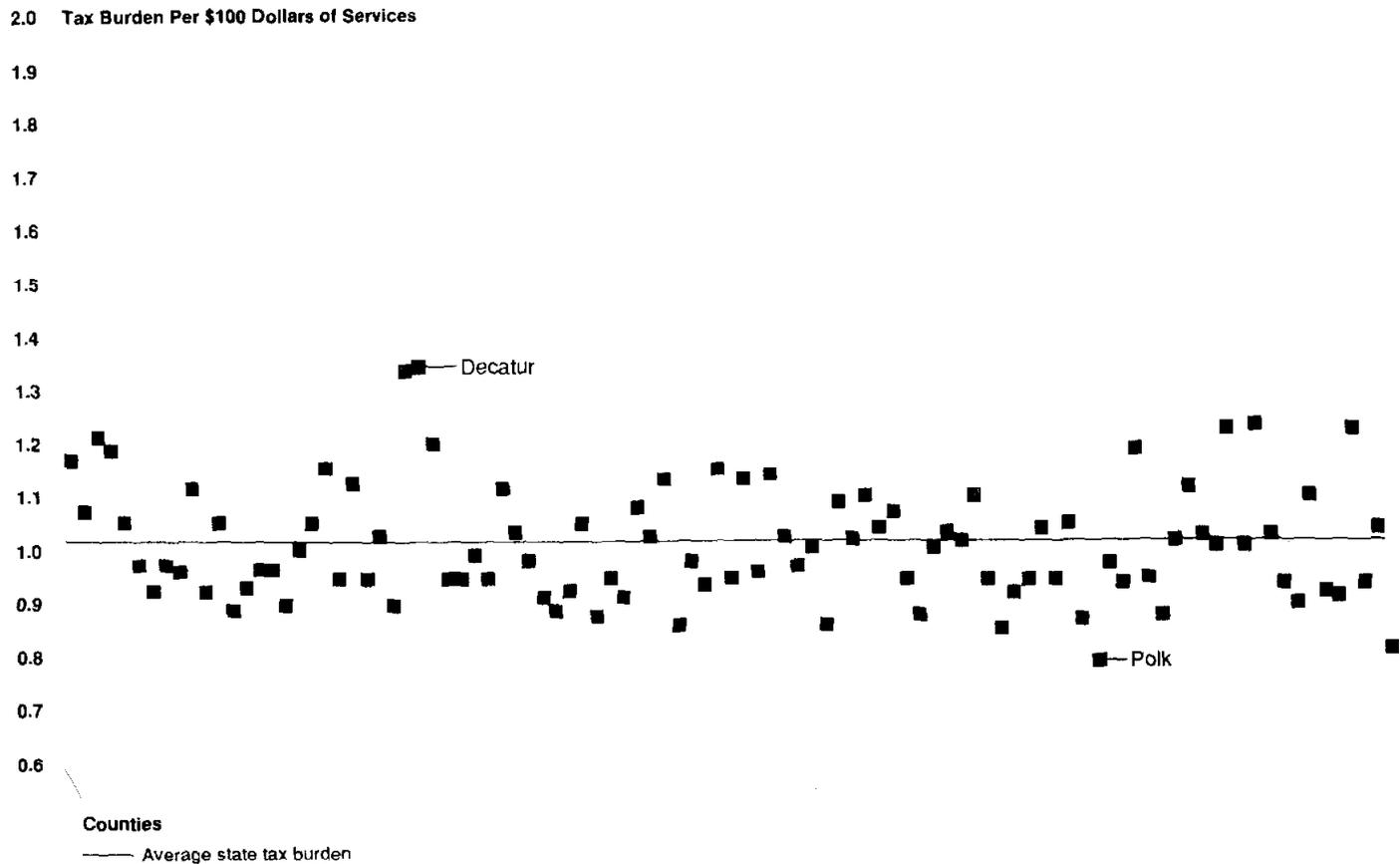
⁸The state constitution of Texas allows any city with a population over 5,000 to adopt a home rule charter. Home rule cities have the power to do anything they wish that is not specifically prohibited by state law. Of the 1,121 municipalities in Texas, 217 are home rule cities.

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Fiscal Disparities: Their Nature, Sources,
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average resident tax burden per \$100 of expenditures. Tax burdens are local taxes as a percent of a county's average personal income.

The dispersion in tax burdens for Florida counties is shown in figure 2.2. The largest burden was in Union County, where residents pay taxes equal to 1.94 percent of their income for each \$100 of public services they receive. In contrast, the lightest burden was in Palm Beach County, where residents pay taxes equal to 0.69 percent of their income for each \$100 of public services they receive. Thus, the heaviest burden was nearly three times the lightest.

Figure 2.3: Dispersion of County Tax Burden Per \$100 Dollars of Public Services in 99 Iowa Counties (Fiscal Year 1985)



Note: The 99 counties are arrayed alphabetically on the horizontal axis.

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

For the 48 states in our analysis, we constructed an index of local fiscal disparities. The state in which local disparities were equal to the national average was assigned an index value of 100. Table 2.3 uses this index to rank the states. It shows that the potential range of fiscal disparities, in the absence of general fiscal assistance, is substantial. Kentucky's fiscal disparities would have been three times greater than Nevada's.¹¹

¹¹We measured local disparities by the standard deviation in local tax burdens per dollar of services. The standard deviation is a statistical measure of dispersion that provides an empirical method for measuring disparities. See app. I for a discussion of why we chose this measure of dispersion.

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Fiscal Disparities: Their Nature, Sources,
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State	Index no.
States with relatively small disparities:	
Connecticut	87 ^a
Minnesota	86
Ohio	85
Nebraska	81
California	80
Washington	80
Pennsylvania	76
Montana	74
Rhode Island	72
North Dakota	72
Kansas	70
Indiana	67
Oregon	61
Wyoming	60
Iowa	54
Nevada	53

Note: See app. I for the actual standard deviations and the methodology used to calculate them.

^aA state with disparities equal to the national average would have an index number of 100. We rounded the index numbers and grouped the states into thirds to develop the three categories. New York's index number was 87.1, while Connecticut's was 87.0.

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

The extent of potential disparities—large or small—is not systematically correlated with state population or geographic sizes. Some low-population states such as Wyoming and Nevada would have a relatively small range of disparities, while others such as Alaska and South Dakota would have a wide range. Populous states such as Florida and Texas would have large disparities, while California and Ohio would not. Of the four geographically largest states, Alaska and Texas have large disparities while California and Montana do not. However, there is a regional pattern. Potential disparities are most prominent in the Southwest (see fig. 2.4). They are less evident in the western and northern Plains states. Despite these regional trends, neighboring states can vary widely in the range of disparities, e.g., North Dakota and South Dakota, New Jersey and Pennsylvania, and Utah and Nevada.

Federal Revenue-Sharing Reduced Local Fiscal Disparities More Than Did Most State Programs

In 1985, state general fiscal assistance to communities totaled \$10.9 billion and federal revenue-sharing added another \$4.6 billion. Together, these programs comprised about 12 percent of total local revenues and reduced fiscal disparities among local governments by 18 percent. Analyzed separately, state programs reduced disparities by about 9 percent and federal revenue-sharing by about 11 percent.¹ Despite substantially more funding, most state programs reduced disparities less than did federal revenue-sharing. If they were to target existing aid more specifically to fiscally distressed localities, many states could further reduce disparities without additional funding.

General Fiscal Assistance: An Important Local Revenue Source

General purpose fiscal assistance, both state and federal, is an important source of revenue for local governments. States provided \$10.9 billion, or \$47 per person, in fiscal year 1985, and the federal government allocated \$4.6 billion, or \$19 per person. In 1985, state and federal general fiscal assistance comprised 12.3 percent of local government revenues (see table 3.1). In 10 states, it accounted for more than 20 percent of revenues; in 17, less than 10 percent.

Table 3.1: State and Federal General Fiscal Assistance as a Percentage of Local Revenues, by State (Fiscal Year 1985)

State	Percent of local revenues		
	Combined	State	Federal
Nevada	38.5	35.9	2.6
New Jersey	38.2	35.3	2.9
Wisconsin	32.8	29.2	3.7
New Mexico	31.9	27.2	4.7
Mississippi	31.1	22.8	8.3
South Carolina	27.5	17.6	10.0
Wyoming	26.7	22.3	4.3
Massachusetts	26.1	22.4	3.7
Arizona	25.3	22.3	3.0
Minnesota	22.7	19.6	3.1
Michigan	19.9	15.7	4.2
West Virginia	18.6	4.0	14.6
Arkansas	18.4	9.0	9.5
North Dakota	17.8	12.8	5.0
Florida	17.5	14.6	3.0
Idaho	16.5	8.9	7.7
Indiana	16.1	11.7	4.4

(continued)

¹The overall disparity reduction for general fiscal assistance programs is less than the disparity reduction achieved by the state and federal programs separately because, in some states, state and federal aid offset each other.

local revenue in 33 states. Within these states, state aid ranged from a high of almost 36 percent of local revenues (in Nevada) to a low of 4.5 percent (in New York). In the 15 states where federal revenue-sharing was greater than state aid, federal aid never exceeded 15 percent of local revenues.

Funding levels for state general fiscal assistance programs varied considerably by state for several reasons. In some cases, a high degree of funding was related to a state's concern about local public service needs. For example, states with large general fiscal assistance programs such as Minnesota and Wisconsin have programs aimed in part to reduce disparities among their local governments. In other cases, it was an explicit political choice to have small general assistance programs. For example, Kentucky, Texas, and Utah provided very little aid, in part because they have state constitutional provisions that prohibit general fiscal assistance grants to local governments. And in other states, officials expressed the view that ameliorating fiscal disparities was not a state government responsibility, nor was it seen as an important policy issue.

Larger or Better-Targeted Aid Programs Would Reduce Fiscal Disparities

Looking at disparity reduction from a national perspective, states with the widest disparities (identified in table 2.3) would need to have larger or more targeted general fiscal assistance programs compared with states where disparities are smaller.²

Five of the 16 states with the widest disparities, when measured without considering state and federal general fiscal assistance, had large programs. Funding, expressed as a percent of local revenues, substantially exceeded the 8.7 percent national average. They were: New Jersey (35.3 percent), New Mexico (27.2 percent), Arizona (22.3 percent), Florida (14.6 percent), and Alaska (12.6 percent). If these relatively highly funded aid programs were more targeted to fiscally distressed local governments, substantial disparity reductions could be achieved.

At the other extreme, general assistance provided 1 percent or less of local revenues in 7 of the 16 states (Colorado, Oklahoma, Texas, Vermont, Utah, Kentucky, and Missouri). These states cannot reduce disparities by much, even with highly targeted programs, because of relatively low funding.

²In general, increasing the funding of existing state general fiscal assistance programs would reduce fiscal disparities. However, if the increased funding were distributed among local governments according to each local government's share of state taxes collected (return-to-origin assistance), disparities would be unaffected.

**Chapter 3
Federal Revenue-Sharing Reduced Local
Fiscal Disparities More Than Did Most
State Programs**

average-income counties. After general fiscal assistance aid, Starr County's fiscal disadvantage falls from \$37.21 to \$29.36, a 21-percent reduction. Similarly, the income of the average resident in Robertson County was about 20 percent below Wheeler County's average income and his/her fiscal disadvantage without general fiscal assistance would be \$7.46. After general fiscal assistance aid, however, this disadvantage falls to \$7.31, a 2-percent reduction. For local governments in all 254 county areas in Texas, general fiscal assistance aid was distributed among county areas in a way that reduced these fiscal disadvantages by 15.5 percent, on average, as shown in table 3.2.

**Table 3.2: Reduction in Fiscal Disparities
Attributable to Combined State and
Federal General Fiscal Assistance, by
State (Fiscal Year 1985)**

State	Disparity reduction		
	Percent	As a percent of U.S. average (U.S. = 100)	Per capita general aid
Nevada	54.7	302	\$227
South Carolina	39.7	219	57
Arkansas	36.1	199	38
West Virginia	34.4	190	29
Maine	32.6	180	48
Arizona	32.5	180	146
Louisiana	28.7	159	47
Florida	27.5	152	90
Tennessee	26.4	146	48
Alabama	26.1	144	37
Rhode Island	24.4	135	52
Iowa	24.1	133	63
Mississippi	23.8	131	86
New Jersey	23.2	128	133
Minnesota	23.1	128	155
South Dakota	22.7	125	44
Michigan	22.5	124	100
Illinois	22.1	122	52
New Hampshire	21.2	117	41
Nebraska	21.1	117	49
Idaho	20.7	114	41
New Mexico	20.6	113	141
Alaska	20.4	112	264
Vermont	18.7	103	23
Massachusetts	18.5	102	147
Georgia	18.4	102	22

(continued)

Targeting More Important Than Funding in Reducing Fiscal Disparities

In reducing fiscal disparities, the amount of general fiscal assistance aid is less important than its targeting. The 10 states with the largest per capita assistance, as listed in table 3.2, reduced disparities about 25 percent, on average. However, this was not significantly different than the 10 states with the least per capita assistance, which reduced disparities by about 14 percent, on average. While the states with high per capita amounts of aid achieved 11 percent more disparity reduction, they averaged almost eight times more assistance than that provided by states with low amounts of per capita aid.⁵

Vermont and Georgia reduced disparities more than the national average with per capita assistance aid at about one-third the national average. These states could have accomplished such reductions only by highly targeting their aid programs to their most fiscally distressed governments. Such success demonstrates that improved targeting of state aid programs can meaningfully reduce local disparities, even with relatively few dollars.

Disparity Reduction Mixed in States With Widest Disparities

Among the 16 states with the widest disparities shown in table 2.3, 9 had state programs that reduced disparities more than the national average (see table 3.3). The programs in four states (Alaska, Arizona, New Jersey, and New Mexico) reduced disparities more than the national average because of their comparatively high funding levels. General assistance grants in these states equaled or exceeded \$120 per capita—over two-and-one half times the national average. Florida achieved the largest reduction (21.8 percent) through a combination of above-average funding (\$75 per capita) and targeting to disadvantaged communities. The four other states with above-average reductions (South Dakota, Maine, Louisiana, and Tennessee) provided below-average funding, ranging between \$25 and \$30 per capita, but had better-than-average targeting to disadvantaged localities.

⁵The correlation between all states' percentage disparity reductions and their per capita assistance was a low .32. This signifies a weak statistical relationship between funding levels and the size of disparity reductions.

Chapter 3
**Federal Revenue-Sharing Reduced Local
 Fiscal Disparities More Than Did Most
 State Programs**

sharing in 17 states, only Arkansas had a program whose targeting effectiveness was superior to that of federal revenue-sharing. In a majority of the 31 states, federal revenue-sharing did better even though the per capita amount of its assistance was less (see table 3.4).

**Table 3.4: Reduction in Fiscal Disparities
 Attributable to State and Federal General
 Fiscal Assistance, by State** (Fiscal Year
 1985)

States	State program		Federal revenue-sharing	
	Disparity reduction (percent)	Per capita grant	Disparity reduction (percent)	Per capita grant (percent)
United States	8.8	\$47	11.0	\$19
Federal revenue-sharing superior:				
West Virginia	(2.4)	6	37.3	23
Mississippi	1.4	63	24.1	23
Maine	17.5	27	22.2	21
Alabama	5.5	18	21.6	19
Idaho	4.8	22	18.8	19
North Carolina	(0.5)	30	17.0	20
Vermont	2.5	2	16.9	21
Kentucky	(0.3)	2	15.9	20
Georgia	3.8	3	15.5	19
Rhode Island	11.8	31	15.2	21
Texas	0.6	3	15.0	15
Michigan	12.2	79	13.7	21
New Mexico	12.4	120	13.3	21
Wisconsin	6.6	175	13.0	22
North Dakota	0.7	47	12.8	18
Utah	1.3	1	12.4	22
New Hampshire	11.9	29	12.3	12
Pennsylvania	0.9	3	12.1	18
Missouri	1.1	1	11.0	16
Wyoming	9.5	159	10.9	31
Oklahoma	3.3	3	10.2	17
Maryland	5.6	33	10.0	20
Kansas	5.1	19	9.0	16
Ohio	8.1	36	8.8	18

(continued)

in Kentucky, North Carolina, and Montana also were primarily return-to-origin programs.

The main reasons that state general fiscal assistance programs generally did not reduce local fiscal disparities as effectively as did federal revenue-sharing were:

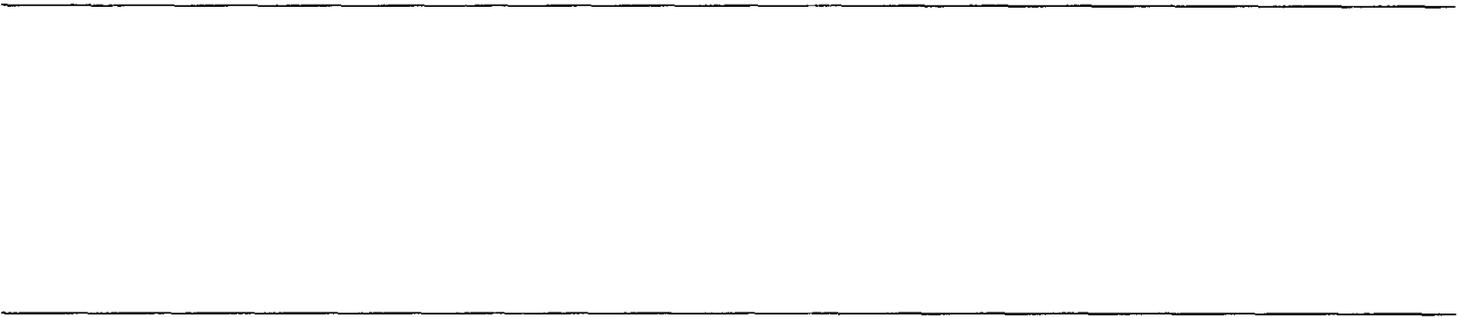
1. Most state programs were not designed to achieve disparity reduction as was intended by the federal revenue-sharing program. This is especially true of state programs that distribute funds on a return-to-origin or per capita basis.
2. General fiscal assistance programs may be poorly designed unintentionally and thus not achieve the fiscal disparity reduction objectives desired by state policymakers.

State Reaction to Loss of Federal Revenue- Sharing Minimal

The expiration of federal revenue-sharing in October 1986 ended the annual flow of \$4.6 billion to local general purpose governments. The most common state response was to do nothing. Other reactions included creating new general fiscal assistance programs, increasing local taxing authority, and better targeting of funds. We identified 13 states, as of 1987, that had responded to the loss of general revenue-sharing. Their responses varied. For example, Rhode Island and Delaware created new general assistance programs. Massachusetts increased funding for its major general fiscal assistance program. Connecticut officials cited the termination of federal revenue-sharing as a contributing factor in the expansion of existing general assistance programs and creation of a new one. And New Jersey expanded one of its aid programs for its municipalities.

Other states, such as Illinois and North Carolina, responded by increasing the taxing authority of local governments. This left the decision to replace revenue-sharing funds to the individual communities. However, this approach will have little effect on fiscal disparities because it does not increase the revenue-raising capacity of distressed communities compared with those that are better-off.

Another approach was to increase the targeting of funds to distressed communities, as Rhode Island did. In 1987, Rhode Island had seven separate general fiscal assistance programs, each with its own distribution formula. In 1988, the state eliminated these programs and created a new



to bear to finance a “foundation” service level. One such foundation level might be the state-wide average of local government expenditures, or perhaps 25 percent or some other percentage of the state-wide average. A high tax burden needed to finance a foundation service level would indicate a poor fiscal condition; a relatively low tax burden, a good fiscal condition. Fiscal disparities then would be defined as differences in these tax burdens compared with the state-wide average of all such tax burdens.

We chose the power-equalizing criterion because:

1. Unlike the foundation approach, an analyst need not make a value judgment about what should be the foundation service level a state’s general assistance program guarantees local governments.
2. The power-equalizing criterion explained the distribution of state general assistance grants better than the foundation criterion in 9 of the 11 states included in our field visits.

Measuring the Reduction in Fiscal Disparities

If fiscal disparities are defined as tax burden differences per dollar of services provided across communities, a summary statistic is needed to express these differences. From various statistical measures of dispersion, including the range, interquartile range, and coefficient of variation, we chose the standard deviation.

Because the standard deviation averages differences between each observation and the average value, it represents an absolute measure of dispersion. This was more appropriate for our analysis because small absolute differences in tax burdens are of no policy significance even if relative differences are large. If grants finance a large share of local services, local tax burdens will be small, and small tax burden differences need not concern us. The standard deviation will measure the average size of these differences.

In contrast, the coefficient of variation expresses the standard deviation as a percent of the average value. It would indicate large relative differences in local tax burdens even though absolute differences were small. This would lead to the conclusion that disparities were large even though they were of little policy significance. The range and interquartile range were rejected as summary statistics because they use only two observations in measuring the dispersion in tax burdens per dollar of public service benefits.

Appendix I
Definition and Measurement of Local
Fiscal Disparities

most influential observation deleted. After deleting the next most influential observation, we continued this process until the estimated disparity reduction stabilized (i.e., did not change substantially when successive observations were deleted).

When analyzing state general assistance, we deleted observations only if doing so resulted in showing a larger disparity reduction for the state program. Thus, our analysis tends to overstate the disparity reduction provided by state general assistance. We did this to show the state program in the most favorable light. In the case of federal revenue-sharing, we did the opposite, deleting influential observations only if they reduced the amount of disparity reduction. This resulted in underestimating the disparity reduction achieved by the federal program and ensured that our conclusion regarding the superior targeting of the federal program is a conservative one.

After completing our sensitivity analysis, we deleted no observations in 35 of the 48 states included in our analysis and no more than four in any 1 state. Thus, relatively few observations had to be deleted.

The results of our analysis are shown in table I.1. The standard deviation in tax burdens per dollar of services in the baseline (i.e., $\sigma[t/e] = \sigma[1/y]$) is shown in the first column of numbers. Column 2, which expresses each state's standard deviation as a percent of the U.S. average, represents the extent of fiscal disparities in each state compared with the national average. These figures were reported in table 2.3 (ch. 2). The third column shows the standard deviation after the receipt of general fiscal assistance aid. The fourth column, the percentage disparity reduction (i.e., the percentage difference in standard deviations with and without general assistance aid) that were reported in column 1 of table 3.2

**Appendix I
Definition and Measurement of Local
Fiscal Disparities**

State	Before	Index (U.S.=100)	After	Disparity reduction (percent)
South Dakota	0.196	148	0.152	22.7
Tennessee	0.257	127	0.189	26.4
Texas	0.259	128	0.219	15.5
Utah	0.228	113	0.197	13.6
Vermont	0.272	134	0.221	18.7
Virginia	0.225	111	0.198	12.2
Washington	0.162	80	0.141	12.7
West Virginia	0.216	107	0.142	34.4
Wisconsin	0.179	88	0.151	15.9
Wyoming	0.122	60	0.102	16.6

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental File for Fiscal Year 1984/85" (computer-based files).

An Alternative Approach Not Taken

Another possible approach was to analyze the reduction in fiscal disparities provided by state and federal general fiscal assistance grants net of the state and federal taxes used to finance them. We did not do this because we could not identify the specific taxes used to finance these programs and obtain the data on a county-by-county basis.

This "net fiscal incidence" analysis would produce different results, depending on the progressivity of state taxes. For example, if the incidence of state taxes used to finance state programs is more regressive than those used to finance the federal program, our methodology would understate the disparity reduction of the federal program compared with state programs. If the reverse is true, that is, state taxes are more progressive than federal taxes, our analysis would understate the disparity reduction of state programs compared with the federal program. Similarly, if the progressivity of state taxes is greater in one state than another, this could alter the ranking of states in table 3.2, where they are ranked by how much their general assistance programs reduced disparities.

Appendix II
General Fiscal Assistance Programs
in California

Funding Level \$75.6 million for state fiscal year 1986-87.

Revenue Source 30 percent of the 10 cent tax on each package of cigarettes.

Key Allocation Factors Local sales taxes and population.

Formula Return to origin and per capita needs. The revenues first are split between counties and cities according to their share of the local sales tax. The funds allocated to counties are based solely on their share of the local sales tax. Of the funds allocated to cities, 50 percent is distributed on the basis of population and the remaining 50 percent on the basis of each city's share of the local sales tax.

Mobile Home and Commercial Coach License Fee Program

Objective To prevent revenue losses to local governments and school districts due to the state's administrative takeover of this program from the counties.

Funding Level \$13.6 million for state fiscal year 1986-87.

Revenue Source An annual license fee on mobile homes and coaches equal to 2 percent of their market value.

Key Allocation Factors Market value of mobile homes and coaches.

Formula Return to origin. Funds are distributed to cities, counties, and school districts according to the location of the mobile home or commercial coach being taxed. Taxes on vehicles located within a city are split evenly between the city, county, and school district. If the vehicle is located

**Appendix II
General Fiscal Assistance Programs
in California**

Funding Level \$338.9 million for state fiscal year 1986-87.

Revenue Source State appropriation.

Key Allocation Factors Not applicable.

Formula Return to origin. Localities are fully reimbursed for the property tax revenues lost by the exemption of a homeowner's first \$7,000 of assessed valuation.

**Open Space
Subventions Program**

Objective To partially compensate local governments for the property tax revenue lost by assessing land on the value of its limited use (i.e., open space or agricultural) rather than full market value.

Funding Level \$14.9 million in state fiscal year 1986-87.

Revenue Source State appropriation.

Key Allocation Factors Land acreage.

Formula Return to origin. Localities receive funds based on a partial reimbursement for revenue lost under this program as follows:

- Cities**
1. Prime agricultural land in cities with populations over 25,000 at \$8.00/acre.
 2. Prime agricultural land in cities with populations between 15,000 and 25,000 at \$5.00/acre.

2. \$28.1 million on a proportional basis to the cost-of-living adjustment to which counties would have been entitled for 1987-88 for certain health programs if one had been provided.
3. \$27.4 million on a basis proportional to the cost-of-living adjustment counties would have received in 1987-88 for the Medically Indigent Services, Community Services Block Grant, Aid to Families with Dependant Children (AFDC), Foster Care, and the Community Mental Health Program.
4. \$27.4 million according to a number of factors relating to county costs for state-mandated programs.

For the second year of the program, funds are distributed as follows: The state pays a portion of a county's nonfederal share of costs for specified mandated programs (AFDC, Food Stamp Administration, Community Health Services) that exceeds the percentage of the county's expenditures of general revenues for those programs in fiscal year 1980-81.

Appendix III
General Fiscal Assistance Programs
in Kansas

Funding Level	\$19.6 million for state fiscal year 1987.
Revenue Source	State appropriation equal to 3.5 percent of the state sales and use tax credited to the State General Fund during the preceding calendar year.
Key Allocation Factors	Population and assessed valuation of real and personal property.
Formula	Return to origin/per capita needs, as follows: <ol style="list-style-type: none">1. Funds first are distributed to county areas. Of this distribution, 65 percent is based on the county's share of the state's total population and 35 percent on the county's share of the total assessed valuation of real and personal property in the state.2. The county government receives half of the funds allocated to the county. The remaining 50 percent is divided among all cities within the county according to population.

Private Club and Drinking Establishment Liquor Tax Program

Objective	To share with local governments the tax revenue collected under this program. Each local government must allocate one-third of the proceeds to its general fund, one-third to its parks and recreation fund, and one-third to a substance abuse fund.
Funding Level	\$7.6 million for state fiscal year 1987.
Revenue Source	70 percent of the state's 10 percent tax on alcoholic drinks served by clubs, caterers, and drinking establishments.

General Fiscal Assistance Programs in Massachusetts

Additional Assistance Program

Objectives	To equalize fiscal disparities between local governments, maintain the ability of communities to provide essential services, and provide property tax relief.
Funding Level	\$714.7 million for state fiscal year 1987 (July 1 to June 30).
Revenue Source	State appropriation.
Key Allocation Factors	Needs and fiscal capacity.
Formula	<p>Tax base equalizing. Only increases in funding are allocated each year by the formula below. Every community's base level of funding is guaranteed to equal what it received the year before. Aid increases must be at least 50 percent of the increase received the year before, but cannot be more than 50 percent greater than that increase. Beginning in fiscal year 1988, Boston's aid is set by the legislature and not subject to the formula. The basic formula is:</p> <p>Need = cost of local services – local revenue capacity.</p> <p>Massachusetts develops a cost index for every community within the state. Starting with a statewide average cost of providing services, the state adjusts each community's cost up or down according to eight cost factors:</p> <ol style="list-style-type: none"> 1. Weighted full-time student population. Students with special needs, and bilingual, vocational, and AFDC students receive extra weight in the formula. 2. Population density. 3. Manufacturing employment.

Lottery Distribution Program

Objective	To equalize fiscal disparities between local governments, maintain the ability of communities to provide essential services, and provide property tax relief.
Funding Level	\$195.0 million for state fiscal year 1987.
Revenue Source	Funded by net receipts from the state lottery.
Key Allocation Factors	Property tax revenues and population.
Formula	<p>Tax base equalizing. The entitlement for each community is determined by its population and property tax revenues as follows:</p> <p>Population x 10 x revenues,</p> <p>where revenues is the statewide average per capita equalized property tax levy expressed as a percent of each community's equalized revenues.</p> <p>This entitlement is adjusted by a coefficient to bring allocations calculated for each community in line with funds available:</p> <p>Coefficient = funds available for distribution/all entitlements statewide.</p>

Homestead Credit Program

Objective	To facilitate the ownership of family homes.
Funding Level	\$598.0 million for fiscal year 1987.
Revenue Source	State appropriation.
Key Allocation Factors	Market value of homesteads.
Formula	Return to origin. Local governments and school districts are reimbursed by crediting 54 percent of the property tax payment on the first \$68,000 of market value for each homestead within their jurisdiction. The maximum credit per homestead was capped at \$700 for fiscal year 1987.

Taconite Homestead Credit Program

Objective	To compensate homeowners in areas where taconite (low-grade iron ore) production companies pay production taxes to the state as opposed to local property taxes, from which they are exempt.
Funding Level	\$11.2 million for state fiscal year 1987.
Revenue Source	State appropriation of taconite production taxes.
Key Allocation Factors	Local property taxes

General Fiscal Assistance Programs in New Jersey

Public Utilities Franchise and Gross Receipts Tax Program

Objective	To compensate local governments for the state preemption of taxation of public utility property and to share with them the franchise fees paid by public utilities.
Funding Level	\$685 million for state fiscal year 1986.
Revenue Source	State appropriation based on state taxes assessed on public utility operations.
Key Allocation Factors	Value of utility property.
Formula	Return to origin. Proceeds of this tax are distributed to municipalities according to their share of the public utility's scheduled property within their jurisdiction. Maximum aid is limited to \$700 per capita or 75 percent of the aid received in 1979, whichever is greater.

Business Personal Property Tax Replacement Revenue Program

Objective	To compensate municipalities for the elimination of the local property tax on business personal property.
Funding Level	\$158.7 million for state fiscal year 1986.

Bank Corporation Business Tax Distribution Program

Objective	To return to municipalities 25 percent of the taxes collected under this program.
Funding Level	\$16.2 million for state fiscal year 1986.
Revenue Source	State appropriation equal to 25 percent of the bank corporation business taxes collected.
Key Allocation Factors	Bank deposits.
Formula	Return to origin. Municipalities receive 25 percent of bank corporation business taxes according to their share of total in-state deposits held by banks in offices within their jurisdiction.

Financial Business Tax Distribution Program

Objective	To return to municipalities 25 percent of the taxes collected under this program.
Funding Level	\$1.6 million for fiscal year 1986.
Revenue Source	State appropriation equal to 25 percent of the financial business taxes collected.

Appendix VI
General Fiscal Assistance Programs in
New Jersey

Revenue Source State appropriation from proceeds of the state income tax.

Key Allocation Factors Population.

Formula Per capita needs. To be eligible, a municipality must have an effective property tax rate exceeding \$1 per \$100 of valuation. Funds are allocated to all eligible communities on a per capita basis.

**Municipal Purposes
Tax Aid Program**

Objective To provide property tax relief.

Funding Level \$30.0 million for state fiscal year 1986.

Revenue Source State appropriation funded by unapportioned proceeds from the public utility franchise and gross receipts tax.

Key Allocation Factors Population and equalized assessed valuation.

Formula Per capita needs/tax base equalizing. Municipalities may qualify for funds from either of two separate allocations:

1. 23/27ths of the total allocation is distributed to eligible municipalities; 50 percent is based on population and 50 percent on the extent to which their per capita equalized assessed valuation is less than the state average. To be eligible for funds from this distribution, a municipality must have had a property tax rate equal to or greater than the state average for the previous year and its per capita equalized assessed valuation must be less than 90 percent of the state average.

**Distressed
Municipalities
Program**

Objective To aid distressed municipalities (enacted starting fiscal year 1987).

Funding Level \$17.5 million for fiscal year 1987.

Revenue Source State appropriation.

Key Allocation Factors Need and fiscal capacity.

Formula Per capita needs. To be eligible, cities must qualify as distressed under such criteria as high property tax rates, low equalized property values, AFDC population, and population. The Department of Community Affairs distributes the funds to eligible cities as it sees fit. There is no specified allocation formula.

New York City	There is no special formula. New York City which encompasses five counties, receives both the county and city allotment.
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State-Local Revenue-Sharing Program— Special City, Town, and Village Aid Component

Objective	To provide special unrestricted aid to all general purpose governments in the state except counties and New York City.
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Funding Level	\$96.4 million in fiscal year 1987-88.
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Revenue Source	State appropriation.
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Key Allocation Factor	Population, fiscal capacity, and land area.
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Formula	Per capita needs/tax base equalizing. The allocation for towns and villages is based on land area, 1979 local revenues, 1980 Census population, and 1980 full valuation of taxable real property. The allocation for 53 cities uses the 1970 Census population and 1979 full value real property tax rates. The remaining eight cities receive specific amounts as cited in the legislation.
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State-Local Revenue-Sharing Program— Excess Aid Component

Objective	To provide revenue for the general purposes of local governments.
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Appendix VII
General Fiscal Assistance Program in
New York

New York City	The city receives 40 percent of the total allocation.
Cities, Towns, and Villages	The locality's share (49 percent of the total) is based on its percentage of the local revenues of all localities.

Emergency Financial Assistance to Eligible Municipalities

Objective	To provide emergency financial aid to eligible localities in the state. Eligible local governments are Erie County, Buffalo, Niagara Falls, Yonkers, Rochester, and Syracuse.
Funding Level	\$36.2 million in fiscal year 1987-88.
Revenue Source	State appropriation.
Key Allocation Factor	Fiscal capacity
Formula	Per capita needs. Eligible localities receive allocations as specified in appropriation legislation.

Emergency Financial Aid to Certain Cities

Objective	To provide financial assistance to all cities with populations above 100,000 and below 1,000,000 that have constitutional tax limits and/or large amounts of tax-exempt property.
Funding Level	\$28 million in fiscal year 1987-88.

General Fiscal Assistance Programs in Rhode Island

Note: We have not described the seven general fiscal assistance programs that existed in Rhode Island for fiscal year 1987. Instead, we have described the new state general revenue-sharing program that replaced those seven programs in fiscal year 1988.

State General Revenue-Sharing

Objective	To provide state aid to local governments.
Funding Level	\$37.1 million in fiscal year 1987-88.
Revenue Source	State appropriation for state fiscal year 1987-88 equal to 6.1 percent of the state's combined sales and income tax receipts. Future year allocations are scheduled to increase by 5.5 percent.
Key Allocation Factor	Population, tax effort, and per capita income.
Formula	<p>The state used the federal revenue-sharing formula as the basis for the new program's distribution mechanism. The amount each municipality received was based on:</p> $\text{Municipality's population} \times \text{tax effort} \times \text{income} \div \text{total state's population} \times \text{tax effort} \times \text{income}$ <p>Regardless of the allocations generated by this formula, each municipality was guaranteed at least 10 percent more aid than it received from the seven programs in fiscal year 1986-87.</p>

**Appendix IX
General Fiscal Assistance Programs
in Tennessee**

Formula

Return to origin. Revenues are distributed to the city in which a taxpayer resides. If a taxpayer resides outside the corporate limits of any city, the funds revert to the county of residence.

**Mixed Drink Tax
Program**

Objective

To share tax revenue with cities and counties.

Funding Level

\$10.0 million for state fiscal year 1986-87.

Revenue Source

50 percent of the 15-percent tax on mixed drinks.

Key Allocation Factors

Property taxes paid.

Formula

Return to origin. Half of the revenues earmarked for local distribution are allocated between cities and counties according to their share of the county property tax for schools. The remaining half is returned to the city where the tax is collected. If the tax is collected in an unincorporated area, it goes to the county.

**Alcoholic Beverage
Excise Tax**

Objective

To share tax revenue with counties.

Funding Level

\$5.9 million for state fiscal year 1986-87.

**Appendix IX
General Fiscal Assistance Programs
in Tennessee**

Funding Level \$4.2 million for state fiscal year 1986-87.

Revenue Source 97 percent of the severance tax on coal is earmarked for counties. One-third of the severance tax on crude oil and natural gas production is earmarked for counties.

Key Allocation Factors Severance tax collections.

Formula Return to origin. Funds are distributed to counties where the tax was collected.

**Tennessee Valley
Authority In Lieu of
Taxes Program**

Objective To compensate local governments for the difference between actual tax losses resulting from the exemption of property owned by Tennessee Valley Authority (TVA) and what local governments receive directly from the TVA.

Funding Level \$39.8 million for state fiscal year 1986-87.

Revenue Source Portion of the money received by the state from the TVA.

Key Allocation Factors Assessed value of TVA property.

Formula Return to origin. The state determines what tax revenue local governments would have received if TVA property was taxable. Subtracting what counties and cities receive directly from TVA, the state pays the difference.

General Fiscal Assistance Programs in Vermont

Vermont had no single general fiscal assistance program exceeding \$1 million in fiscal year 1987. However, it has developed the Property Tax Rebate Program to ensure that individual residents are not overburdened by high property tax rates. The primary local revenue source used to finance local services is the property tax. The community imposes the necessary property tax rate to raise the revenue to pay for its services. Vermont refunds to residents the property tax paid that exceeds a set percentage of their household income. The percentage varies with income as follows:

- Under \$4,000—3.5 percent.
- \$4,000-7,999—4.0 percent.
- \$8,000-11,999—4.5 percent.
- \$12,000 and over—5.0 percent.

The program is open to all Vermont residents, including both homeowners and renters. For renters, the state considers 24 percent of the rent paid as property taxes. In 1988, the state rebated almost \$13 million to Vermont residents for property taxes paid in 1987. Of this amount, about \$11 million went to households with incomes less than \$20,000.

Vermont's program ensures that no homeowner or renter pays property taxes that exceed 5 percent of household income. A community may impose a high tax rate, but the state will, in effect, pay that portion of the tax rate that exceeds the applicable percentage of a resident's income. In addition, it provides property tax relief only to residents. Nonresidents (who own 20 percent of the market value of the property in the state), do not benefit from this program because the state restricts eligibility to full-time Vermont residents.

Counties receive aid under the same formula except that only 85 percent of the 3-year average of local purpose revenues is used, as opposed to 100 percent.

3. Utilities. The annual payment of this component is designed to compensate local governments for the cost incurred for providing services to public utilities whose property is not subject to local taxation. The amount of the payment is determined by the location of the public utility property. If the property is located within a town, the town receives a payment equal to a tax rate of \$3 per \$1,000 of book value and the county payment is equal to a tax rate of \$6 per \$1,000 of book value. If the property is located within a city or village, the county's tax rate is reduced to \$3 per \$1,000 of book value, while the city or village receives a payment equal to a tax rate of \$6 per \$1,000 of book value. The maximum payment is limited to \$300 per capita for a municipality and \$100 per capita for a county. In 1987, \$13.6 million was distributed under this component.

4. Minimum/maximum payment, designed to ensure stability in the program by preventing wide fluctuation of local aid payments in any 1 year. The minimum payment in any year may not be less than 95 percent of the previous year. These minimum payments are funded by establishing a maximum growth limit for each year. For 1987, this was 4 percent over what was received the previous year. In 1987, \$14.3 million was redistributed under this component.

State Property Tax Credit Program

Objective	To provide property tax relief.
Funding Level	\$146.7 million for the general government tax credit for state fiscal year 1987.
Revenue Source	State appropriation.

State and Federal Intergovernmental Aid to General Purpose Local Governments, by State (Fiscal Year 1985)

Dollars in millions

State	Total aid	Categorical aid		General assistance	
		Dollars	Percent	Dollars	Percent
United States	\$53,307	\$37,999	71	\$15,308	29
Colorado	595	521	88	73	12
Pennsylvania	1,778	1,519	85	259	15
Virginia	880	751	85	129	15
New York	10,325	8,760	8	1,564	15
Washington	794	655	83	139	18
California	10,622	8,651	81	1,971	19
Missouri	446	361	8	85	19
Oklahoma	317	251	79	67	21
Kentucky	371	289	78	82	22
Georgia	558	432	77	126	23
Utah	168	129	77	38	23
Maryland	985	755	77	231	23
Ohio	2,477	1,896	77	580	23
Oregon	502	383	76	120	24
Montana	91	69	76	22	24
Vermont	46	34	74	12	26
Alaska	518	379	73	139	27
Texas	926	640	69	286	31
North Dakota	144	99	69	45	31
Iowa	570	387	68	183	32
Indiana	963	649	67	314	33
Kansas	245	160	65	86	35
Arkansas	253	164	65	90	35
Louisiana	591	380	64	211	36
Connecticut	371	235	63	136	37
Idaho	112	71	63	41	37
Alabama	404	256	63	149	37
Illinois	1,627	1,027	63	600	37
North Carolina	825	520	63	305	37
Michigan	2,441	1,533	63	908	37
Nebraska	209	131	62	79	38
Minnesota	1,671	1,026	61	645	39
Florida	2,540	1,554	61	986	39
Tennessee	578	353	61	225	39
Rhode Island	107	58	54	50	46
New Hampshire	86	46	54	40	46

(continued)

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Appendix XIII
State and Federal Intergovernmental Aid to
General Purpose Local Governments, by State
(Fiscal Year 1985)

State	Total aid	Categorical aid		General assistance	
		Dollars	Percent	Dollars	Percent
Arizona	946	500	53	445	47
South Dakota	64	33	52	31	48
Wyoming	197	101	51	97	49
Wisconsin	1,866	930	50	936	50
Maine	107	51	48	56	52
West Virginia	105	49	46	57	54
Mississippi	383	158	41	225	59
South Carolina	319	130	41	189	59
New Mexico	332	132	40	200	60
Massachusetts	1,381	528	38	853	62
Nevada	266	59	22	207	78
New Jersey	1,202	206	17	996	83

Note: Total aid column does not necessarily sum to aid component columns due to rounding of categorical and general fiscal assistance amounts. Excludes Delaware and Hawaii. Does not include aid received by county units of government in Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, Rhode Island, and Vermont, where our units of analysis are municipalities and towns.

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

**Appendix XII
General Fiscal Assistance Program
in Wisconsin**

Key Allocation Factors

Property tax levy.

Formula

Return to origin. This program is not open to counties. Municipalities share in the distribution according to their share of the 3-year average of the state's total property tax levy for general government purposes. This distribution is varied by a minimum/maximum funding adjustment. No municipality may receive less than 90 percent of what it received the year before. The maximum growth in a municipality's allocation is determined by the amount of aid left when the minimum payments have been made.

General Fiscal Assistance Program in Wisconsin

Shared Revenue Program

Objective	To (1) provide property tax relief, (2) equalize the fiscal capacity of local governments, and (3) compensate localities for utility properties not subject to local taxation.
Funding Level	\$779.4 for state fiscal year 1986-87.
Revenue Source	State appropriation.
Key Allocation Factors	Population and assessed valuation.
Formula	<p>Per capita needs/tax base equalizing. This program distributes funds based on four allocation components:</p> <ol style="list-style-type: none"> 1. <u>Population</u>. This per capita payment ensures that every municipality in the state will receive a payment. Counties receive no payment under this component. The amount received for state fiscal year 1986-87 was about \$30.00 per capita; \$142.7 million was distributed in 1987. 2. <u>Aidable revenues</u>, based on the fiscal capacity of local governments; \$623.1 million was distributed under this component in 1987. The formula for municipalities is: <ul style="list-style-type: none"> Aid = 3-year average of local purpose revenues x tax base weight. (Local purpose revenues = local property tax levies plus certain other local revenues.) Tax base weight = $1 - \frac{\text{equalized property value per capita}}{\text{standardized valuation per capita}}$. The standardized valuation per capita is somewhat like a state-guaranteed tax base. It is set such that funds available for distribution under this component exactly match aid entitlements. For 1987, this was set at \$32,800 per capita.

General Fiscal Assistance Programs in Texas

Mixed Beverage Tax Program

Objective	To share with local governments the taxes collected by the state under this program.
Funding Level	\$44.2 million for state fiscal year 1987.
Revenue Source	25 percent of the state's 12-percent tax on the serving of mixed drinks is earmarked for counties and cities.
Key Allocation Factors	Mixed drink sales.
Formula	Return to origin. Of the tax collected under this program, 12.5 percent is distributed to counties on the basis of where the tax revenue was generated. Another 12.5 percent is distributed to cities on the basis of where the tax was generated.

**Appendix IX
General Fiscal Assistance Programs
in Tennessee**

Revenue Source	17.5 percent of the state's excise tax on alcohol is earmarked for counties.
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Key Allocation Factors	Population and land area.
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Formula	Per capita needs. 75 percent of the funds is distributed to counties according to population. The remaining 25 percent is distributed to counties according to their share of the state's square mileage.
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Beer Excise Tax Programs

Objective	To share tax revenue with cities and counties.
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Funding	\$2.6 million for state fiscal year 1986-87.
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Revenue Source	10.05 percent of the state's beer excise tax is earmarked for counties and 10.05 percent for cities.
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Key Allocation Factors	Population.
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Formula	Per capita needs. The county share is divided equally among each county. The city share is distributed based on population.
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Severance Tax Programs

Objective	To share with counties the taxes collected under this program.
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General Fiscal Assistance Programs in Tennessee

Mixed Beverage Tax Program

Objective	To share tax revenue with cities.
Funding Level	\$92.7 million for state fiscal year 1986-87.
Revenue Source	4.6 percent of the state's general sales tax is distributed to cities less a portion for the University of Tennessee.
Key Allocation Factors	Population.
Formula	Per capita needs. Distribution is based strictly on population.

Individual Income Tax Program

Objective	To share tax revenue with cities and counties.
Funding Level	\$23.1 million for state fiscal year 1986-87.
Revenue Source	3/8ths of the state's tax on individual's dividend and interest income.
Key Allocations Factors	Income taxes paid by local residents.

**Appendix VII
General Fiscal Assistance Program in
New York**

Revenue Source

State appropriation.

Key Allocation Factor

Eligibility determined by population, fiscal capacity, and value of tax-exempt property.

Formula

Return to origin/per capita needs. Eligible localities receive allocations based on their tax losses sustained due to tax-exempt property. The exception is Albany, which receives \$2 million.

Funding Level \$55.7 million in fiscal year 1987-88.

Revenue Source State appropriation.

Key Allocation Factor Population, fiscal capacity, and land area.

Formula Aid is 36.67 percent of the difference between the base year (1984-85) and the projected year when comparing per capita revenue-sharing aid summed with Special City, Town, Village Aid paid to all eligible municipalities. No excess aid is given when the difference is zero or less.

State-Local Revenue-Sharing Program—Needs-Based Aid

Objective To provide revenue for the general purposes of local governments.

Funding Level \$70.0 million in fiscal year 1987-88.

Revenue Source State appropriation.

Key Allocation Factor Unemployment rates.

Formula Per capita needs, as follows:

Counties The county allocation (11 percent of total) is split into two separate parts: One is based on a county's share of the unemployed population of all the counties, the second on a county's share of all social services reimbursements received by all the counties.

General Fiscal Assistance Program in New York

State-Local Revenue-Sharing Per Capita Aid Program

Objective	To provide revenue for general purposes of local government.
Funding Level	\$800.7 million for fiscal year 1987-88.
Revenue Source	State appropriation.
Key Allocation Factors	Population.
Formula	Per capita needs/tax base equalizing. Fifty percent of the funds are distributed among all cities in existence as of April 1, 1968, on the basis of population. The remaining 50 percent of the funds is distributed as follows:
Towns	\$3.55 per capita.
Counties	\$.65 per capita when the average of per capita full value assessment and personal income is \$19,637 or more. An additional \$.05 per capita for each \$245 this average falls below \$19,637.
Cities	\$8.60 per capita when the average of per capita full value assessment and personal income is \$19,637 or more. An additional \$.05 per capita for each \$245 this average falls below \$19,637.
Villages	\$3.60 per capita when the average of per capita full value assessment and personal income is \$19,637 or more. An additional \$.05 per capita for each \$245 this average falls below \$19,637.
Population of Towns Residing Outside Villages	\$2.05 per capita when the average of per capita full value assessment and personal income is \$19,637 or more. An additional \$.05 per capita for each \$245 this average falls below \$19,637.

2. If a municipality is not eligible for funds under that allocation, it can receive funds from the second allocation, which distributes the remaining 4/27ths of the funding. To be eligible, a community must have had a tax rate (primarily, the property tax rate) in excess of 50 percent of the state average and a per capita equalized assessed valuation less than twice the state average. Funds then are distributed to eligible municipalities on the same basis as under the first allocation.

Municipal (Urban) Aid Program

Objective	To provide assistance to distressed communities.
Funding Level	\$40.1 million for fiscal year 1986.
Revenue Source	State appropriation.
Key Allocation Factors	Population, needs, and assessed valuation.
Formula	Per capita needs/tax base equalizing. Municipalities must qualify to receive funding under this program. Eligibility criteria include minimum population, high tax rate, low assessed valuation, and minimum number of AFDC children. Funds are distributed among qualifying municipalities with 60 percent based on their share of AFDC children. Distribution of the remaining 40 percent is based on population, tax rate, and tax base data.

Appendix VI
General Fiscal Assistance Programs in
New Jersey

Key Allocation Factors Financial business taxes.

Formula Return to origin. Municipalities receive 25 percent of the total financial business tax generated within their jurisdiction.

**Payment in Lieu of
Taxes, State Property
Program**

Objective To compensate for local services provided state-owned property.

Funding Level \$14.1 million for fiscal year 1986.

Revenue Source State appropriation.

Key Allocation Factors Assessed valuation of state property.

**Appendix VI
General Fiscal Assistance Programs in
New Jersey**

Revenue Source State appropriation.

Key Allocation Factors Prior taxes on business personal property.

Formula Return to origin. Payment to municipalities is based on what annual tax revenue they generated from this tax prior to its repeal in 1966, supplemented by additional state payments. Funding has been capped since calendar year 1977.

**Insurance Premiums
Tax Distribution
Program**

Objective To return to local governments the taxes collected under this program.

Funding Level \$20.2 million for state fiscal year 1986.

Revenue Source State appropriation funded by the state tax on insurance premiums.

Key Allocation Factors Prior taxes on insurance premiums.

Formula Return to origin. Distribution to counties and municipalities equals the amount received under former program increased by the annual percentage increase of all tax revenues under this program.

**Appendix V
General Fiscal Assistance Programs
in Minnesota**

Formula	Return to origin. After the homestead credit is applied to local tax bills, local governments are reimbursed for 57 percent of the remaining property tax rate up to a maximum credit of \$465 or 66 percent up to a maximum of \$520. The use of 57 or 66 percent is based on such criteria as the value of iron ore produced and the proximity of the homestead to the mines.
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Fiscal Disparities Program

Objective	Allow all communities in the Minneapolis-St. Paul metropolitan area to share in the benefits of the area's economic growth.
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Funding Level	\$1.511 million for fiscal year 1987.
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Revenue Source	40 percent of growth occurring in each metropolitan county's commercial/industrial property tax base.
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Key Allocation Factors	Population and equalized value of local property.
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Formula	Tax base equalizing, calculated as follows: Distribution index = city's population x 2 x average fiscal capacity/ city's fiscal capacity Each city's fiscal capacity is its equalized market value per capita.
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General Fiscal Assistance Programs in Minnesota

Local Government Aid Program

Objective	To reduce the level of local property tax rates and to address disparities between jurisdictions in tax effort and tax capacity.
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Funding Level	\$323.7 million for calendar year 1987.
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Revenue Source	State appropriation.
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Key Allocation Factors	Fiscal capacity and population.
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Formula	Tax base equalizing. There are separate allocation formulas for cities, towns, and counties:
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1. For cities, the fiscal need is estimated by averaging the sum of the property tax levy and local government aid for the past 3 years. The city's fiscal capacity is then estimated by multiplying its property tax rate by its adjusted assessed valuation and the result subtracted from the city's fiscal need. This is the city's preliminary aid figure. Subtracting the aid received the previous year establishes the increase necessary to meet the city's fiscal need completely. This figure is adjusted by the appropriation limit set by the state. This figure is compared with maximum aid figures determined by per capita aid amounts. The lesser of the two figures becomes the aid received by the city less the state's costs for developing demographic data.

2. For towns to receive aid, they must have a property tax rate equal to or more than \$1 per \$1,000 of assessed valuation. They then receive a 4-percent increase over the greater of 60 percent of all aid received in 1983 or 100 percent of the local government aid received in the previous year. This is the aid received less the state's costs for developing demographic data.

3. Counties receive a 4-percent increase over the aid received in fiscal year 1986 less the state's costs for developing demographic data.

4. Service and trade employment.

5. Road mileage.

6. Pre-1940 housing stock.

7. Population below the poverty level.

8. Service level. This variable reflects the different service levels between communities. It is designed to recognize that in small, rural communities, residents privately arrange services such as water and sewer that are provided by governments in larger communities. The state then develops the revenue capacity of each community according to five factors. These are:

1. Property tax capacity.

2. Motor vehicle excise collections.

3. State aid from the previous year.

4. Local reserve. This can be a surplus or shortfall. It equals (net free cash + overlay surplus) – (reserve cushion equal to 2.5 percent of spending or \$100,000, whichever is greatest).

5. Hotel/motel tax capacity.

The need of each community is determined by subtracting revenue capacity from the state's cost calculation. Communities with negative need have their need set at zero. Since the increase in state aid will not meet the total statewide need determined, need is reduced by the percentage of the statewide need that the increase does meet. This results in the covered need for each community. It is adjusted to ensure that no community receives 50 percent more or less than last year's increase in aid.

**Appendix III
General Fiscal Assistance Programs
in Kansas**

Key Allocation Factors Tax revenues from alcoholic drink sales.

Formula Return to origin. Proceeds are distributed to the source of the revenues. Counties receive only the tax collected in unincorporated areas. Cities receive the tax collected within their jurisdictions.

**Severance Tax
Program**

Objective To share with local governments the severance tax on crude oil, gas, and coal collected under this program.

Funding Level \$4.4 million for fiscal year 1987.

Revenue Source 7 percent of the revenue raised by the state's severance tax.

Key Allocation Factors Severance tax revenues.

Formula Return to origin. Counties receive funds equal to 7 percent of the state severance tax collected within their jurisdiction. Counties retain 50 percent of these funds, with the remaining 50 percent going to school districts within their boundaries.

General Fiscal Assistance Programs in Kansas

Local Ad Valorem Tax Reduction Fund Program

Objective	To reduce property tax levies.
Funding Level	\$26.9 million for state fiscal year 1987.
Revenue Source	State appropriation equal to 4.5 percent of the state sales and use tax credited to the State General Fund during the preceding calendar year.
Key Allocation Factors	Population and assessed valuation of real and personal property.
Formula	<p>Return to origin/per capita needs, as follows:</p> <ol style="list-style-type: none"> 1. Funds first are distributed to county areas. Of this distribution, 65 percent is based on the county's share of the state's total population, the remaining 35 percent on the county's share of the total assessed valuation of real and personal property in the state. 2. Each county's allocation is divided among all property tax-levying subdivisions except school districts according to their share of the total property tax levy in the prior year. The county government is included in this distribution.

County-City Revenue-Sharing Fund Program

Objective	To compensate local governments for the elimination of their participation in the cigarette, liquor enforcement, and domestic insurance companies privilege taxes.
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**Appendix II
General Fiscal Assistance Programs
in California**

	<p>3. Prime agricultural land in all other cities at 1.00/acre.</p> <p>4. All other open space at \$.40/acre.</p>
Counties	<p>1. Prime agricultural land within 3 miles of cities with populations over 25,000 at \$8.00/acre.</p> <p>2. Prime agricultural land within 3 miles of cities with populations between 15,000 and 25,000 at \$5.00/acre.</p> <p>3. All other prime agricultural land at \$1.00/acre.</p> <p>4. All other open space at \$.40/acre.</p>

County Revenue Stabilization Program

Objective	To help compensate counties for the rising cost of state-mandated programs (enacted for fiscal year 1987-88).
Funding Level	First-year allocation was \$110.3 million for state fiscal year 1987-88. Subsequent allocation is estimated to be \$15.3 million for state fiscal year 1988-89.
Revenue Source	State appropriation.
Key Allocation Factors	Population and needs (1987-88), needs (1988-89).
Formula	<p>Per capita needs. For the first year of the program, funds were distributed as follows:</p> <p>1. \$27.4 million to counties according to population.</p>

outside a city, the funds are split evenly between the county and school district.

Special Supplemental Subventions Program

Objective	To compensate cities for the revenue loss experienced due to the repeal of the tax on personal property.
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Funding Level	\$56.9 million for state fiscal year 1986-87.
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Revenue Source	State appropriation.
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Key Allocation Factors	Personal property tax collections.
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Formula	Return to origin. Funds are distributed to cities according to their share of the revenue loss sustained due to the repeal of the tax on personal property.
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In 1984-85, cities received 50 percent of the aid received in 1983-84. This percentage has declined by 10 percent each year; funding is to be terminated by 1989-90.

Homeowners' Property Tax Relief Program

Objective	To compensate local governments for the revenues lost due to the homeowner's exemption equal to the first \$7,000 of assessed valuation.
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General Fiscal Assistance Programs in California

Motor Vehicle License Fee Program

Objective	To prevent revenue losses to local governments due to the state's assumption of the personal property tax on motor vehicles.
Funding Level	\$1,547 million for state fiscal year 1986-87.
Revenue Source	An annual license fee on motor vehicles equal to 2 percent of their market value.
Key Allocation Factors	Population.
Formula	Per capita needs. Program revenues are allocated as follows: <ol style="list-style-type: none">1. 40.625 percent to counties on the basis of population.2. 40.625 percent to cities on the basis of population.3. 18.75 percent, primarily to counties according to their population and share of revenues from a tax on business inventories prior to its repeal. Cities that did not levy a property tax prior to Proposition 13¹ received a portion of the 18.75 percent. This distribution to cities was repealed beginning in fiscal year 1988-89.

Cigarette Tax Program

Objective	To offset revenue losses by local governments when the state preempted the right to tax cigarettes.
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¹Proposition 13 was the voter initiative that limited local property taxes to 1 percent of assessed valuation.

**Appendix I
Definition and Measurement of Local
Fiscal Disparities**

**Table I.1: Standard Deviation of Local
Tax Burdens Per Dollar of Expenditures,
Before and After Receipt of General
Fiscal Assistance, by State (Fiscal Year
1985)**

State	Before	Index (U.S.=100)	After	Disparity reduction (percent)
Alabama	0.196	94	0.145	26.1
Alaska	0.270	133	0.215	20.3
Arizona	0.183	116	0.124	32.3
Arkansas	0.204	101	0.130	36.1
California	0.163	80	0.137	15.8
Colorado	0.230	113	0.208	9.5
Connecticut	0.176	87	0.150	15.1
Florida	0.295	146	0.214	27.5
Georgia	0.206	102	0.168	18.4
Idaho	0.191	96	0.152	20.7
Illinois	0.195	96	0.152	22.1
Indiana	0.137	67	0.121	11.5
Iowa	0.109	54	0.083	24.1
Kansas	0.142	70	0.123	13.2
Kentucky	0.322	159	0.271	15.7
Louisiana	0.268	132	0.191	28.7
Maine	0.311	153	0.209	32.6
Maryland	0.188	93	0.161	14.6
Massachusetts	0.206	102	0.168	18.5
Michigan	0.193	95	0.150	22.5
Minnesota	0.175	86	0.135	23.1
Mississippi	0.208	105	0.158	23.8
Missouri	0.243	120	0.214	12.0
Montana	0.149	74	0.141	5.3
Nebraska	0.164	81	0.130	21.1
Nevada	0.107	53	0.048	54.7
New Hampshire	0.215	106	0.170	21.2
New Jersey	0.249	123	0.191	23.2
New Mexico	0.265	156	0.211	20.4
New York	0.177	87	0.164	7.0
North Carolina	0.194	96	0.166	14.7
North Dakota	0.995	72	0.091	8.1
Ohio	0.171	85	0.145	15.6
Oklahoma	0.251	124	0.219	12.9
Oregon	0.123	61	0.104	15.7
Pennsylvania	0.154	76	0.134	12.7
Rhode Island	0.151	72	0.114	24.3
South Carolina	0.212	106	0.128	39.7

(continued)

To measure the effect of general fiscal assistance grants on fiscal disparities, we compared the dispersion in local tax burdens per dollar of service benefits with and without the receipt of general assistance grants. If tax burdens are represented by t (per capita taxes paid by residents, r , as a percent of residents per capita income, y) and public service benefits by e (per capita expenditures), the tax burden per dollar of services can be expressed as the t/e . The standard deviation in t/e ratios is represented by $\sigma(t/e)$. The percent reduction in fiscal disparities is simply the percent change in this standard deviation with and without general fiscal assistance grants.

To calculate the reduction in fiscal disparities, we first defined a baseline t/e ratio by assuming that local governments finance all services from local revenue sources. Using this assumption, per capita own-source revenues are set equal to per capita expenditures (i.e., $r = e$, where r is per capita local revenues). The baseline ratio t/e is then equal to $[(r/y)/r]$, or $1/y$. In the absence of general assistance aid, this result implies that the baseline measure of fiscal disparities is $\sigma(1/y)$.

Fiscal disparity after the receipt of grants is represented by $\sigma(t/e)$, where “ t ,” the tax burden, is defined as $[(r-g)/y]$, where g is the per capita grant whose effect is being assessed. If the distribution of grants is disparity-reducing, then by definition the dispersion in t/e ratios would be reduced compared to the baseline case. In fact, if grants were targeted to completely eliminate disparities in fiscal condition, postgrant t/e ratios would be completely equalized and $\sigma(t/e)$ would be equal to zero.

Sensitivity Analysis Performed

We examined data on local tax burdens and per capita expenditures in each of the 48 states included in our analysis. In some instances, the receipt of general assistance aid dramatically changed the t/e ratio for one or a few individual counties within a state. Because the standard deviation can be heavily influenced by extreme values, we did a sensitivity analysis, redoing the analysis with and without potentially influential observations.

In performing the sensitivity analysis, we ranked all observations by the change in their t/e ratio with and without grants. We then calculated the percent reduction in $\sigma(t/e)$ compared with the baseline, $\sigma(1/y)$, with the

Definition and Measurement of Local Fiscal Disparities

In this appendix, we discuss in more detail our approach to measuring the reduction in local fiscal disparities. We elaborate on the conceptual and methodological issues related to measuring fiscal disparities and the effectiveness of general assistance aid in reducing them. After presenting two definitions of fiscal disparities, we explain why we selected one. Additionally, we explain why we chose the standard deviation statistic to measure how much disparities are reduced by state and federal general assistance aid. Finally, we describe the sensitivity analysis we performed to assure that any bias in our analysis is in the direction of showing superior state targeting.

Fiscal Disparities Defined

For this report, we use the so-called “power-equalizing” criterion to define fiscal disparities among general purpose local governments. In the objectives, scope, and methodology section of chapter 1, we first defined the fiscal condition of local governments within each county as the ratio of residents’ local tax burdens to their public service expenditures. Tax burden was defined as local taxes paid, expressed as a percentage of residents’ personal income, and public service expenditures were used to approximate the public service benefits provided by a local government.

By our definition, local governments with relatively high tax burdens per dollar of expenditures have a relatively poor fiscal condition. Conversely, low tax burdens per dollar of expenditures denote a relatively good fiscal condition. For our analysis, we define fiscal disparities as differences in fiscal condition among local governments. In addition, we aggregated local government expenditures up to the county level.¹ Thus, measurement of disparities was based on county averages. In this report, we refer to governments with a poor fiscal condition as “fiscally distressed” and governments in good fiscal condition as “better-off” communities.

This criterion—equalization of average tax burdens per dollar of local government expenditures—also is known in the public finance literature as a power-equalizing or a percentage-equalizing program. It is one of two criteria commonly used in designing grant programs aimed at reducing fiscal disparities.

An alternative definition of fiscal disparity—used in foundation grant programs—is the difference in tax burdens local residents would have

¹See fn. 7, ch. 1.

general fiscal assistance program, in part to help localities offset their loss of federal revenue-sharing funds.

The state decided to use the federal revenue-sharing distribution formula to allocate all funds in its new program. In 1985, before the change in formula, Rhode Island's general assistance programs reduced disparities by 11.8 percent. Federal revenue-sharing, being more targeted to disadvantaged local governments, contributed a 15.2-percent reduction (see table 3.4). By adopting the revenue-sharing formula in 1988 to allocate all its general assistance aid, we estimate that Rhode Island will reduce disparities by 25.1 percent. Thus, Rhode Island, by replacing its old formula with the more targeted federal formula, will substantially reduce disparities.

Conclusion

The degree to which general fiscal assistance aid is targeted to fiscally distressed communities is the factor most responsible for the disparity reductions achieved by state and federal programs. In 1985, state programs provided more than twice the funding provided by federal revenue-sharing. However, they did not reduce disparities as much as the federal program because they were not as targeted to distressed communities as was the federal program, nor in most cases were they intended to be. If states were to target more of this aid to distressed local governments, they could further reduce the differences in tax burdens between distressed and better-off communities without additional funding.

**Chapter 3
Federal Revenue-Sharing Reduced Local
Fiscal Disparities More Than Did Most
State Programs**

States	State program		Federal revenue-sharing	
	Disparity reduction (percent)	Per capita grant	Disparity reduction (percent)	Per capita grant (percent)
Colorado	0.9	6	8.7	17
Indiana	3.9	42	8.6	16
Oregon	8.5	24	8.6	20
Washington	5.8	15	7.9	17
Virginia	4.7	5	7.8	17
Montana	(0.3)	4	6.1	23
New York	2.3	62	5.0	26
State fiscal assistance superior:				
Nevada	52.0	212	10.0	16
South Carolina	27.2	37	23.3	21
Arkansas	25.6	19	15.9	20
Florida	21.8	75	9.1	15
Arizona	20.6	129	8.6	17
New Jersey	18.5	123	9.9	10
South Dakota	18.0	25	7.1	20
Louisiana	17.4	30	13.6	17
Alaska	16.6	223	5.6	41
Minnesota	16.6	134	9.2	21
Tennessee	16.2	30	13.4	18
Iowa	16.1	44	10.8	19
Illinois	15.2	34	8.9	18
Massachusetts	12.4	126	8.5	21
Nebraska	12.0	30	11.3	19
California	11.1	57	5.9	20
Connecticut	8.5	27	7.5	16

Note: States in bold letters are the 16 states where local fiscal disparities are relatively large before receipt of grants (see table 2.3)

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

In four states (West Virginia, North Carolina, Kentucky, and Montana), general assistance programs marginally worsened disparities because they returned revenues to the originating jurisdictions. As discussed earlier, return-to-origin programs provide funding to localities in proportion to the size of their tax bases. In effect, this targets funds to better-off communities as opposed to disadvantaged ones. For example, in West Virginia, the state's primary general fiscal assistance program distributed coal severance taxes to local governments in counties where the coal production took place. Similarly, general fiscal assistance programs

Chapter 3
Federal Revenue-Sharing Reduced Local
Fiscal Disparities More Than Did Most
State Programs

Table 3.3: Reduction in Fiscal Disparities in 16 States With the Widest Disparities
 (Ranked by Per Capita Funding) (Fiscal Year 1985)

State	Percent disparity reduction	Per capita grant
U.S. Average	8.8	\$47
Alaska	16.6	223
Arizona	20.6	129
New Jersey	18.5	123
New Mexico	12.4	120
Florida	21.8	75
Louisiana	17.4	30
Tennessee	16.2	30
Maine	17.5	27
South Dakota	18.0	25
Colorado	0.9	6
Oklahoma	3.3	3
Texas	0.6	3
Kentucky	(0.3)	2
Vermont	2.5	2
Missouri	1.1	1
Utah	1.3	1

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/1985" (computer-based files).

All of the remaining seven states whose general assistance programs had little effect on disparities provided relatively small amounts of assistance (\$6 per capita or less).

Better-Targeted Federal Aid Reduced Disparities More Than State Aid

Overall, federal revenue-sharing was better targeted to disadvantaged governments than state assistance. Despite funding levels almost two-and-one half times the size of federal revenue-sharing, state general assistance grants reduced fiscal disparities less than the federal program. Nationally, state programs reduced disparities by 8.8 percent, the federal program 11 percent.⁶

In 31 of the 48 states, federal revenue-sharing was more effective in reducing local disparities because it was more targeted. While state general assistance programs reduced disparities more than federal revenue-

⁶To measure the reduction in fiscal disparities provided by state general fiscal assistance and federal revenue-sharing programs, we calculated the standard deviations in local governments' tax burdens per dollar of services before and after receiving aid. A decrease in standard deviations then was expressed as a percentage reduction.

**Chapter 3
Federal Revenue-Sharing Reduced Local
Fiscal Disparities More Than Did Most
State Programs**

State	Disparity reduction		
	Percent	As a percent of U.S. average (U.S. = 100)	Per capita general aid
U.S. Average	18.1	100	65
Wyoming	16.7	92	189
Wisconsin	15.9	88	196
California	15.8	87	77
Kentucky	15.7	87	22
Oregon	15.7	86	45
Ohio	15.6	86	54
Texas	15.5	86	18
Connecticut	15.1	83	43
North Carolina	14.7	81	49
Maryland	14.6	81	53
Utah	13.6	75	23
Kansas	13.2	73	35
Oklahoma	12.9	71	20
Washington	12.7	70	32
Pennsylvania	12.7	70	22
Virginia	12.2	67	23
Missouri	12.0	66	17
Indiana	11.5	64	57
Colorado	9.5	52	23
North Dakota	8.1	45	65
New York	7.0	39	88
Montana	5.3	29	27

Note: States in bold letters are the 16 states where local fiscal disparities are relatively large before the receipt of grants (see table 2.3).

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

The national average reduction in fiscal disparities was 18.1 percent. Texas was slightly below the average at 15.5 percent. A few states did much better or worse. Disparities were reduced by more than twice the national average in three states: Nevada (54.7 percent), South Carolina (39.7 percent), and Arkansas (36.1 percent). However, they were reduced by less than half the national average in three others: Montana (5.3 percent), New York (7.0 percent), and North Dakota (8.1 percent).

The remaining four states were near the national average in terms of funding. To offset local disparities as much as states with large programs, they would need to target a larger proportion of their aid to fiscally distressed governments.

General Fiscal Assistance Reduced Disparities

In 1985, combined state and federal general fiscal assistance reduced local disparities among general purpose local governments by 18.1 percent (see table 3.2).³ Much of this reduction was due to targeting, not the amount of aid provided. The reductions varied widely across states—ranging from as much as three times the national average (Nevada, 54.7 percent) to as low as one-third of the average (Montana, 5.3 percent).

A comparison of two counties in Texas, Starr and Wheeler, illustrates how the percent reduction in disparities, shown in table 3.2, can be interpreted. That state's 15.5-percent reduction represents the average reduction in tax burdens borne by the average resident in each county compared with the average-income county. In Starr County, the average resident's income in 1984 was the lowest in the state at \$3,704. This compared with Wheeler County's personal income per resident of \$9,915, which was close to the state average income of \$9,913.⁴ Before general fiscal assistance, expenditures for public services were \$135 per resident in Starr County compared with \$353 in Wheeler County. Yet, the tax burden borne by the average Starr County resident was slightly more than twice that of the average Wheeler County resident, when expressed on a per-dollar-of-service basis.

If a resident of Starr County earning the average income and bearing the typical tax burden, moved to Wheeler County, he or she would pay \$37.21 less in taxes for every \$100 worth of public services. This difference in tax burdens represents the fiscal disadvantage of the average-income Starr County resident compared with the average-income resident in Wheeler County.

State and federal general fiscal assistance aid received by Texas local governments reduced the fiscal disadvantage of low- compared with

³We measured disparities by the standard deviations in local governments' tax burdens per dollar of services. We calculated the standard deviation with and without total general fiscal assistance aid. In every state, the standard deviation was smaller after accounting for general fiscal assistance. The decrease was then expressed as a percentage reduction.

⁴In our analysis, Wheeler's tax burden per dollar's worth of services becomes the standard with which other county area tax burdens are compared.

Chapter 3
Federal Revenue-Sharing Reduced Local
Fiscal Disparities More Than Did Most
State Programs

State	Percent of local revenues		
	Combined	State	Federal
Maine	16.1	9.1	7.0
Alaska	14.9	12.6	2.3
North Carolina	14.4	8.7	5.7
Tennessee	14.2	9.0	5.2
Iowa	13.5	9.6	4.0
Nebraska	13.3	8.1	5.1
Rhode Island	13.2	7.9	5.4
South Dakota	13.0	7.2	5.7
New Hampshire	12.9	9.1	3.8
Alabama	12.7	6.2	6.5
U.S. Average	12.3	8.7	3.5
Illinois	12.2	8.0	4.3
Louisiana	12.1	7.7	4.5
Ohio	11.3	7.6	3.7
Oregon	10.7	5.9	4.9
California	9.8	7.3	2.5
Connecticut	9.0	5.7	3.3
Vermont	8.8	0.6	8.2
Kentucky	9.3	0.9	8.4
Montana	9.0	1.3	7.7
Maryland	8.9	5.6	3.4
Kansas	8.7	4.8	3.9
Washington	7.3	3.4	3.8
Utah	7.1	0.5	6.6
Oklahoma	6.6	1.0	5.6
New York	6.3	4.5	1.9
Georgia	5.9	0.8	5.1
Pennsylvania	5.6	0.9	4.7
Texas	5.2	0.9	4.4
Virginia	5.1	1.2	3.9
Missouri	5.0	0.3	4.7
Colorado	4.0	1.0	3.0

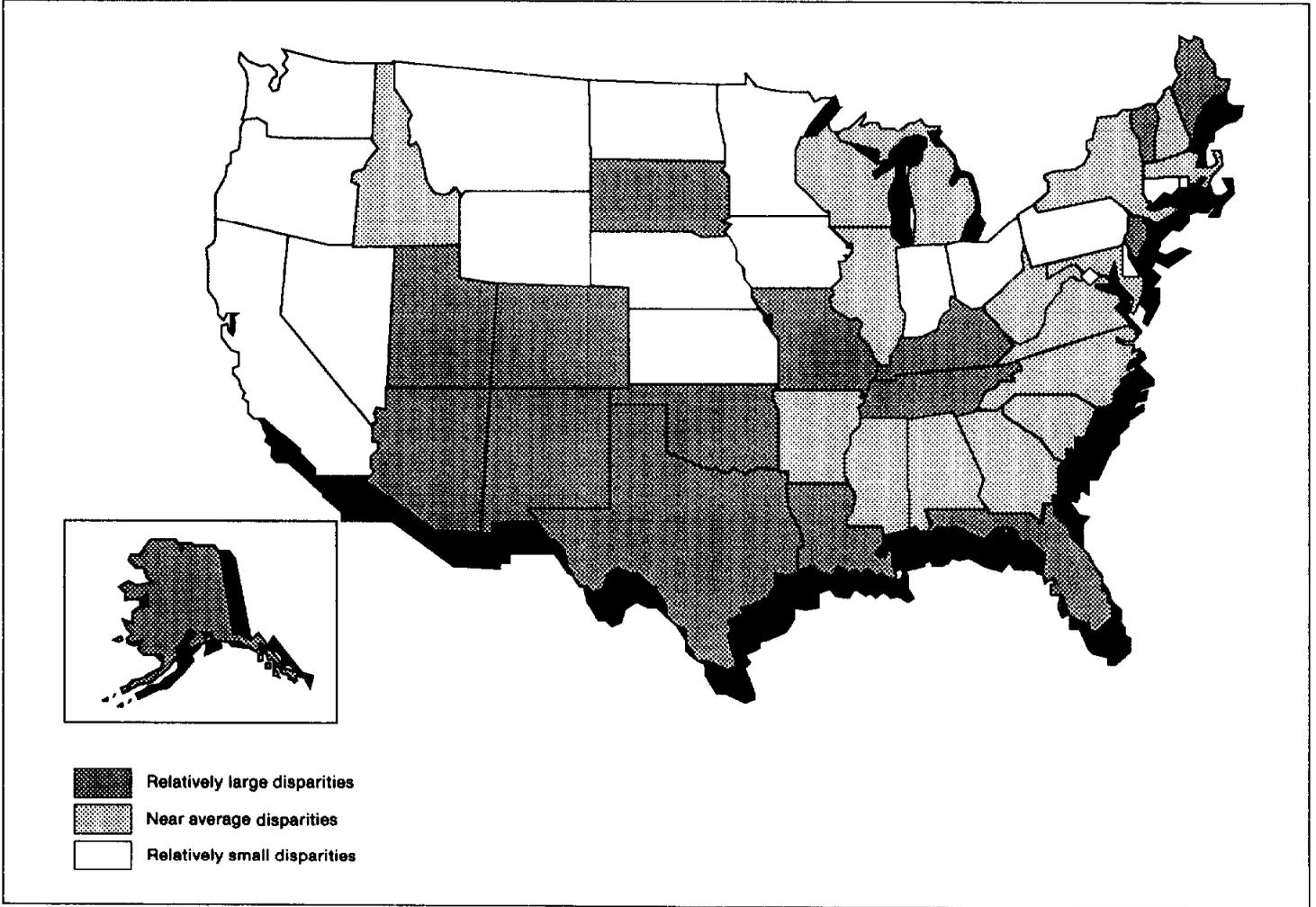
Note: States in bold letters are the 16 states in which local fiscal disparities were relatively large before allowing for the effect of general fiscal assistance grants (see table 2.3). Also, figures do not add due to rounding.

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

Nationwide, state aid was more than twice that of federal revenue-sharing when expressed as a percentage of local revenues—8.7 compared with 3.5 percent. State aid exceeded revenue sharing as a share of

Chapter 2
Fiscal Disparities: Their Nature, Sources,
and Extent

Figure 2.4: Extent of Potential Fiscal Disparities Within Each State (1985)



Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1084/85" (computer-based files).

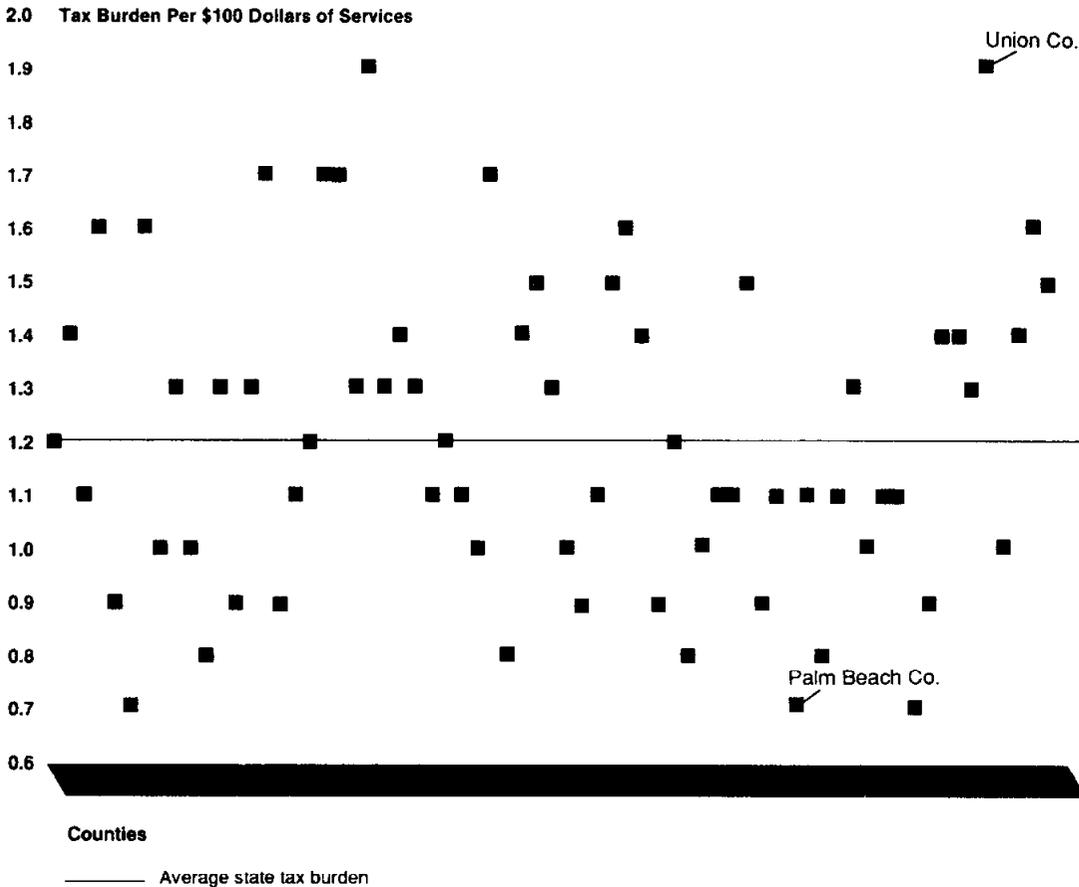
Chapter 2
Fiscal Disparities: Their Nature, Sources,
and Extent

Table 2.3: States Ranked by Extent of Local Fiscal Disparities, Assuming No State and Federal General Fiscal Assistance (Fiscal Year 1985)

State	Index no.
States with relatively large disparities:	
Kentucky	159
New Mexico	156
Maine	153
South Dakota	148
Florida	146
Vermont	134
Alaska	133
Louisiana	132
Texas	128
Tennessee	127
Oklahoma	124
New Jersey	123
Missouri	120
Arizona	116
Colorado	113
Utah	113
States with near average disparities	
Virginia	111
West Virginia	107
South Carolina	106
New Hampshire	106
Mississippi	105
Massachusetts	102
Georgia	102
Arkansas	101
U.S. Average	100
Idaho	96
Illinois	96
North Carolina	96
Michigan	95
Alabama	94
Maryland	93
Wisconsin	88
New York	87

(continued)

Figure 2.2: Dispersion of County Tax Burdens Per \$100 Dollars of Public Services in 67 Florida Counties (Fiscal Year 1985)



Note: The 67 counties are arrayed alphabetically on the horizontal axis.

Source: U.S. Bureau of the Census, "Revenue-Sharing Allocation File for Entitlement Period 17" and "Tax and Intergovernmental Aid File for Fiscal Year 1984/85" (computer-based files).

In contrast, the dispersion in tax burdens among Iowa counties is relatively small, with county tax burdens bunched more closely around the state average, as shown in figure 2.3. The tax burden per \$100 of services was 0.7 percent in Polk County compared with 1.34 percent in Decatur County. Without outside assistance, the dispersion in local tax burdens in Florida would be about two and one-half times greater than among Iowa's counties.

have not been annexed by adjacent cities. There is no economic incentive for municipalities to annex communities with weak tax bases, especially when more resources would have to be spent on services in these areas than would be gained in additional tax revenues.

Unilateral or even negotiated annexation is not legal or feasible in all states. In New Jersey, for example, there are no unincorporated areas. For a local government to expand, it would have to be through consolidation with another local government.

Revenue Restriction May Increase Disparities

Restricting local revenue-raising authority may increase the level of fiscal disparities, especially if local governments with low incomes and high public service costs are prevented from exporting taxes.⁹ For example, New York City imposes a tax on all income earned within the city. This allows the city to pass some of its tax burden to nonresidents.

Yet, most major cities lack the authority to levy an earnings tax on nonresidents who work within their jurisdictions and presumably use many of the city's public services. For example, in 18 of the 20 largest metropolitan areas, the central city had less tax-raising ability than the surrounding suburban communities in 1986.¹⁰ As of 1988, slightly over half of these 18 cities were unable to compensate for this disadvantage by shifting some of their tax burden to nonresidents by means of a local income or payroll tax.

Extent of Local Fiscal Disparities

If localities had to finance all services without outside aid, sizable fiscal disparities would result and differ substantially among states. For example, in Iowa tax burdens per dollar of services received in the most distressed counties were about 70 percent greater than in the "best-off" counties. In Florida, tax burdens in Union County were nearly three times greater than in Palm Beach County.

To estimate the potential extent of local fiscal disparities within each state, we initially assumed that local governments delivered and financed all of the public services now being provided exclusively from own-source revenues. Using this assumption, we calculated a county's

⁹Tax limitation initiatives such as Proposition 13 in California and Proposition 2-1/2 in Massachusetts do not widen fiscal disparities, because all local governments are affected equally.

¹⁰See *Local Governments: Targeting General Fiscal Assistance Reduces Fiscal Disparities* (GAO/HRD-86-113, July 1986) p. 19.

State general fiscal assistance programs use various methods for targeting aid,⁶ e.g.:

1. Return to origin, which does little to reduce local disparities. Essentially, the state collects revenues from a specific tax base and returns all or a portion of those taxes to local governments according to the share of the tax base lying within its borders.⁷ Tennessee, for example, taxes individuals' dividend and interest income. Of the total amount collected, the state keeps five-eighths and returns three-eighths to the municipality or county in which the individual resides. The grant component of this tax does not reduce disparities because more funding is provided to localities whose tax bases generate the most revenues.

2. Needs only, in which the state distributes funds on the basis of population or other indicators of social needs, such as poverty or unemployment. By reducing the local burden of financing these needs, programs contribute to reduced local fiscal disparities. For example, in fiscal year 1986, New Jersey's state revenue-sharing program distributed this aid to municipalities according to each jurisdiction's share of state population (see app. VI).

3. Tax base targeting, in which fund distribution is based on the level of the local tax burden. It is more efficient in reducing disparities than either of the other two approaches because it can reduce the gap between better- and worse-off communities with less funding. In 1987, Massachusetts' Additional Assistance Program used local governments' fiscal capacities and data reflecting their differing levels of social needs to allocate funds. After setting a level of expenditures subject to aid, based on indicators of each local government's social needs, the state estimates the amount of revenues that the local government should be able to raise locally. Then the state's Additional Assistance Program partially fills the gap between the estimated levels of expenditures and revenues.

Several states have created general fiscal assistance programs that use a combination of these three allocation methods to distribute funds. For example, Kansas's County-City Revenue Sharing Program used needs and return-to-origin factors to allocate its aid. The program formula allocated 65 percent of the money among county areas according to their

⁶See app. II-XII for descriptions of specific state programs and formulas in the 11 states we visited.

⁷This includes only the return of state-imposed taxes, not the return of taxes locally imposed but collected by the state. An example of the latter would be a local option sales tax.

pregnant mothers, to more broadly defined activities, such as community services. The \$38 billion in such aid comprised 71 percent of state and federal grant funding in 1985.

2. General purpose fiscal assistance is unrestricted aid that may be used to fund whatever public services local governments deem necessary. Therefore, it is most easily designed to offset fiscal disparities. Nearly all states provided general fiscal assistance, which totaled \$10.9 billion in 1985. The major federal program providing general fiscal assistance was the general revenue-sharing program, which allocated \$4.6 billion among 39,000 local governments in 1985, the year before it was terminated.

Combined, state and federal grants form a significant revenue source for financing locally provided services. Nationwide, they exceeded \$53 billion in 1985⁴ and represented 34.8 percent of local revenues (see table 2.2).

Grant financing of locally delivered services tended to be only slightly greater in decentralized states than in centralized states.⁵ However, there were exceptions among decentralized states. In California, Arizona, and Nevada, the proportion of grants substantially exceeded the national average, but in most other large decentralized states, such as New York and Texas, the proportion was well below the national average.

Grant Targeting Can Reduce Local Disparities

In addition to the level of grant funding, how such funding is targeted also affects the extent of local fiscal disparities. Even when grants finance a relatively small share of local services, disparities can be substantially reduced if the funds are targeted to fiscally disadvantaged communities.

In practice, categorical grants tend to be distributed according to program needs, not the ability of local taxpayers to finance services from local resources. Tennessee's local highway aid program typifies this. It uses highway funds to repair and maintain about 12,000 miles of highways. The state finances about 75 percent of total costs, county governments 25 percent.

⁴See app. XIII for a state-by-state breakdown of this figure.

⁵A weak negative statistical relationship exists between the degree of service centralization (table 2.1) and the degree of finance centralization (table 2.2). The correlation coefficient is -0.20.

Centralizing the delivery of public services at the state level has advantages and disadvantages. It can reduce the size of local fiscal disparities by reducing the reliance on unevenly distributed local tax bases to finance services.² The major disadvantage is that state-provided services are likely to reflect the average preferences of all state residents. Consequently, the level of services provided in each community is less likely to be responsive to local preferences. Decentralized service delivery, on the other hand, allows local governments to respond to such differences.

Nationwide, we estimate state governments deliver over half of all noneducation public services provided to state residents (see table 2.1). For Vermont, the most centralized state, the state government provided 79 percent of all noneducation public services in 1985. The most decentralized state is Nevada, in which the state government directly provided 38 percent of all such public services.

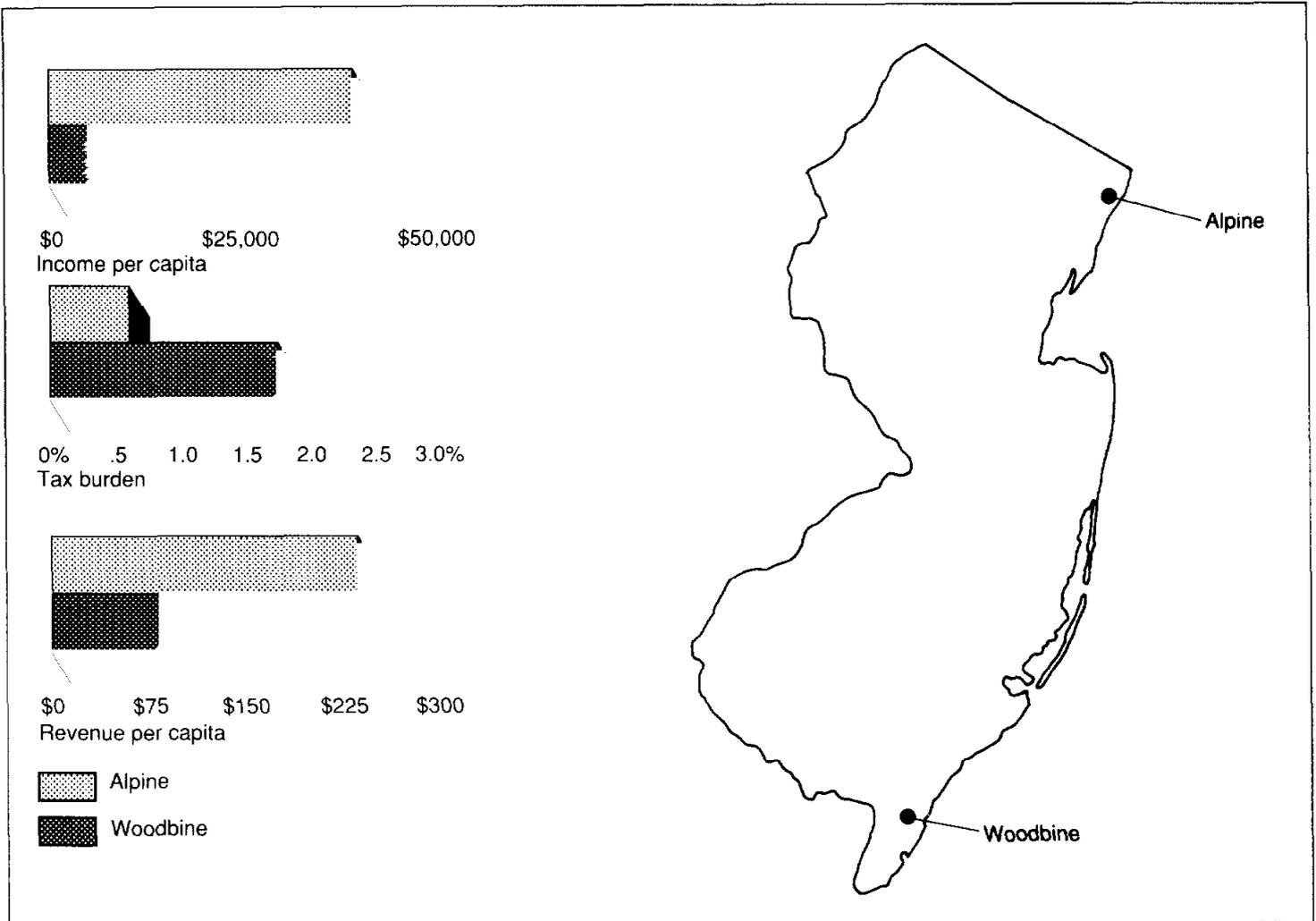
The range of service centralization shown in table 2.1 reveals a pattern among small and large states. States with small populations and land area tend to be centralized and provide services at the state level. This includes all six New England states which, except for Massachusetts and Connecticut, have relatively small populations. Decentralized states tend to be geographically large (Nevada and Arizona), more populous (New York and Florida), or both (California and Texas). About 11 percent of the U.S. population lives in the 12 most centralized states and about 44 percent in the 12 most decentralized states.

Level of Grant Financing Another Factor

Another means of reducing local fiscal disparities is through the provision of grants used to finance local services. Decentralized states, where local governments deliver a larger proportion of services, provided grants that were only slightly larger than those provided in centralized states. Consequently, decentralized states are unlikely to offset local disparities to the same extent as more centralized states.

²Fiscal disparities can be narrowed by service centralization if states deliver services on the basis of relative community needs and the incidence of state taxes with respect to personal income is more progressive than the incidence of local government taxes.

Figure 2.1: Illustration of Fiscal Disparity Between Alpine and Woodbine Boroughs, New Jersey (1983)



Socioeconomic Sources of Fiscal Disparities

Fiscal disparities arise in part from communities' differing socioeconomic characteristics, such as:

- The ability of communities to bear local tax burdens. As the Woodbine/Alpine example shows, communities with per capita incomes above the

Fiscal Disparities: Their Nature, Sources, and Extent

Fiscal disparities are differences in communities' abilities to provide comparable levels of public services with comparable tax burdens on local residents. They arise from differing socio-economic factors, such as (1) the financial ability of local residents to bear tax burdens, (2) the unit cost of providing services, and (3) social conditions that affect public service needs, including high crime rates or poverty concentrations.

To a large extent, the fiscal disparities arising from such socioeconomic differences are beyond the ability of local governments to control. As a consequence, these governments seek state and federal assistance so they can provide basic public services while keeping local tax rates comparable to those of neighboring communities. Such aid can ameliorate the fiscal disparities among localities, depending on the degree to which it is targeted to those with relatively high tax burdens per dollar of services received.

How the responsibility for delivering public services is divided between the state and its local governments is another factor affecting the degree of fiscal disparity. States differ significantly in the extent to which they centralize service delivery. Nationwide, we estimate, state governments delivered over half of all noneducation public services provided to state residents in 1985. Significant variation existed among states. In some, such as Vermont and Alaska, the state provided over three-quarters of such services to its residents, while in others, such as Florida and Nevada, the state provided less than 40 percent.

If localities had to finance all the services they provide locally without state or federal grants, sizable fiscal disparities would result and their degree would differ substantially among states. For example, local fiscal disparities would be relatively small in Iowa, where they would be about half the national average. The tax burden per dollar of public services in Iowa's most distressed county would be about 70 percent greater than in the "best-off" county. In contrast, fiscal disparities would be relatively large in Kentucky, New Mexico, and Florida. In Florida, for example, the tax burden per dollar of services would be nearly three times greater in the most fiscally distressed counties than in the "best-off."

Other factors that influence the magnitude of local fiscal disparities, discussed but not analyzed in this report, are the setting of local government boundaries and state restrictions on the ability of local governments to shift taxes to nonresidents.

**Assessing How Much State
and Federal General
Assistance Reduces
Disparities**

To measure the effects of state and federal general fiscal assistance aid in reducing local fiscal disparities, we calculated per capita spending on local public services first without and then with the receipt of general fiscal assistance aid. We then compared the standard deviation in local tax burdens per dollar of public service benefits before and after the receipt of aid. The percent decrease in the standard deviation measured the disparity reduction attributable to general fiscal assistance aid.⁸ It represents the average reduction in tax burden differences between fiscally distressed and “better-off” communities. We then applied this method to state and federal aid separately in order to compare how much each reduced disparities.

In performing our analysis, we analyzed only the distribution of state and federal general fiscal assistance grants. We did not consider other factors that could reduce disparities among local governments. Among these are special purpose state and federal aid programs and services provided directly by state governments to local communities. A more comprehensive analysis also would take into account who pays the state and federal taxes used to finance the grant programs. For a more complete discussion of this issue, see p. 53.

⁸See app. I for a more complete discussion of issues related to the definition of fiscal disparities and measurement methodology.

Assessing the Relative Extent of Fiscal Disparities Within a State

As an indicator of a local government's fiscal condition, we used the ratio of its average effective tax rate to its per capita expenditures.⁴ Local effective tax rates serve as an indicator of the tax burden borne by local residents, and per capita expenditures indicate the public service benefits they receive.

Next, we defined local fiscal disparities as differences in the fiscal conditions of local governments. We chose the standard deviation in local fiscal conditions as a summary measure of fiscal disparities in each state.⁵ To identify the states with the largest disparities, we ranked the 48 states⁶ in our analysis by the degree to which fiscal disparities were larger or smaller than the national average of all states.

To overcome the unavailability of some data as well as certain other analytical problems, we

- limited our review to general purpose governments. Only they were eligible to receive federal revenue-sharing, and this study was intended to help the Congress assess the possible need for a replacement program. Consequently, school and special districts (which provide a single service) were excluded.
- totaled all economic, fiscal, and demographic data to the county area level within each state. This simplified the analysis, gave us comparable units of analysis,⁷ and eliminated the need to account for the varying structure of local government service responsibilities in each state. By averaging out differences among individual governmental units within each county, this approach tends to understate disparities and yield conservative estimates of the extent of fiscal disparities in a state.
- used fiscal year 1985 state and local government tax and grant data. We did so because we wanted to compare the targeting of state and federal general fiscal assistance aid and 1985 was the last year the federal program provided aid to local governments. Analysis of more current data

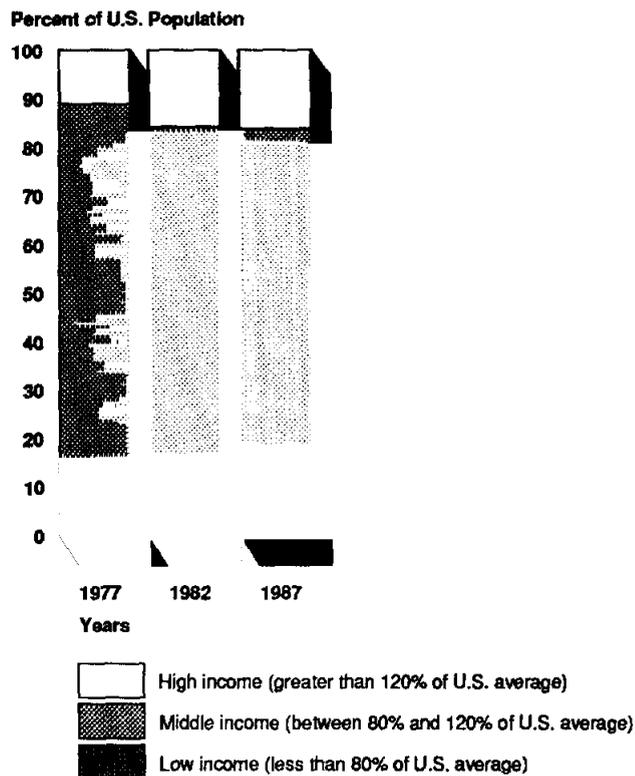
⁴Effective tax rates, which differ from statutory tax rates, are measured as the percentage of the average resident personal income in a county area that all local taxes represent.

⁵See app. I for a more complete discussion of issues related to the definition of fiscal disparities and our measurement methodology.

⁶We excluded Delaware and Hawaii because they have too few local units of government to obtain statistically meaningful results.

⁷For selected states, however, we used municipalities as our unit of analysis because either there were too few counties to serve as units of observations or the county governments had limited governmental responsibilities. These states were Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, Rhode Island, and Vermont.

Figure 1.2: Share of U.S. Population Living in Low-, Middle-, and High-Income Counties (1977-87)



Source: GAO calculations, based on U.S. Department of Commerce, Bureau of Economic Analysis Data.

1. Should taxpayers in poor communities bear higher tax burdens than rich communities to finance their basic public service needs?
2. Should disparities serve as an incentive for residents and businesses to move to communities with plentiful public services and low taxes?

State officials assign differing degrees of significance to these equity concerns. Our survey of state officials and state aid programs shows that state perceptions of local fiscal disparities cover a wide range. Some states regard them as an important public concern that merits remedial action, while others see them as outside their scope of responsibility.

In part, federal concern about local fiscal disparities prompted the creation of the federal general revenue-sharing program in 1972. Some members of the Congress have expressed concern that the 1986 expiration of

Introduction

A major benefit of our federal system of government is its ability to provide for a wide range of public services desired by its citizens. The federal government provides services that address national needs, such as defense and regulation of interstate commerce. Typically, services from state governments benefit citizens across the entire state, such as the construction and maintenance of highways. At the local level, services are tailored to reflect the needs and preferences of local residents.

The nearly 39,000 general purpose local governments¹ in the United States include 3,042 county, 19,200 municipal, and 16,691 township governments.² The fact that they delivered 46 percent of all public services offered to state residents in 1985 underscores the important role of these governments.

Local governments have shouldered an increasing share of the cost of public services provided at the local level. In the decade since 1977, the local share of general revenues raised at the local level increased 16 percent, from 60 to 69 percent, as shown in figure 1.1. Federal aid as a percentage of total local revenues fell almost three-fifths, from 12 to 5 percent. The expiration of federal revenue-sharing in 1986 accounts for about 44 percent of this decrease. Over this same time period, the state share of local revenues fell slightly, from 28 to 26 percent.

The ability of local taxpayers in low-income counties to shoulder a larger share of service costs has deteriorated compared with more affluent areas. Since 1977, the income gap between poorer and more affluent communities has widened. The number of residents living in counties with incomes more than 20 percent below the national average has risen from 16 to 19 percent of the U.S. population (see fig. 1.2). This 19-percent increase implies that income growth for most low-income counties lagged behind the national average. In contrast, incomes in the most affluent counties have increased faster than the national average. Their share of the U.S. population has risen from 11 to 16 percent, a 45 percent increase.

As the ability to bear tax burdens is directly related to income, this suggests that fiscal disparities between poorer and more affluent areas have increased. At the same time, local financing responsibilities have

¹General purpose local governments include counties, municipalities, and towns. This excludes both school districts and special purpose districts for reasons discussed on pg. 14.

²Source: U.S. Bureau of the Census, 1987 Census of Governments, Vol. 1, Governmental Organization, table 3, p. 3

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Abbreviations

AFDC	Aid to Families with Dependent Children
FY	fiscal year
GAO	General Accounting Office
TVA	Tennessee Valley Authority

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billion. Combined, this aid reduced disparities by approximately 18 percent. But when separately analyzed, federal revenue-sharing was targeted more to distressed communities than was state aid. As a consequence, although the federal program had less than half the funding of state general fiscal assistance, it reduced disparities more than did most state programs.

Using existing levels and sources of funding, local fiscal disparities could be reduced further if states targeted more of their aid to fiscally distressed communities.

GAO's Analysis

Extent of Disparities

Absent state and federal grants, fiscal disparities would be large in most states. For example, there would have been a 3-to-1 disparity in tax burdens between Florida's best-off and worst-off counties. In Union County, residents would have had to pay taxes equal to 1.9 percent of their income for each \$100 of public services they received, while in Palm Beach County residents would have had to pay taxes equal to just 0.7 percent of their income for each \$100 of services (see pp. 28-29).

In contrast, fiscal disparities would be smallest among Iowa counties. The tax burden per \$100 of expenditures for services would be 70 percent higher in the most disadvantaged county compared with the best-off county. This 1.7-to-1 tax burden disparity was half the national average (see p. 29).

General Fiscal Aid Has Little Effect

Nationally in 1985, state general purpose fiscal assistance and federal revenue-sharing reduced tax burden disparities between fiscally distressed and better-off counties by 18 percent. Results varied widely by state, ranging from a 55-percent reduction in Nevada to 5.3 percent in Montana.³ When analyzed separately, the federal program reduced disparities on average by 11 percent and state programs by almost 9 percent (see p. 33).⁴

³GAO excluded Delaware and Hawaii because they contained too few localities for statistical analysis.

⁴The overall disparity reduction for general fiscal assistance programs is less than the disparity reduction achieved separately by the state and federal programs because state and federal aid offset each other in some states.

Executive Summary

Purpose

Between 1977 and 1987, direct federal aid to counties, cities, and townships declined by about three-fifths, to 5.2 percent of local revenues. Although the cuts occurred in a number of programs, the 1986 expiration of the \$4.6 billion general revenue-sharing program accounted for 40 percent of the reductions and affected nearly 39,000 local governments.

Concerned that the funding cuts may have had a serious effect on fiscally distressed communities, the Chairman of the Senate Finance Committee asked GAO to examine (1) how well state governments were meeting these communities' fiscal needs and (2) how the loss of revenue sharing affected such communities.¹

GAO's primary objectives were to

- identify states with wide differences in local tax burdens (fiscal disparities) and
- discuss the extent to which state general purpose fiscal assistance programs reduce disparities between the fiscally distressed and better-off communities.

Background

Fiscally distressed communities are those in which residents bear substantially higher tax burdens in order to obtain levels of public services comparable to better-off communities. Such tax burden differences are referred to as "fiscal disparities." They arise from differing socioeconomic factors, such as (1) the financial ability of local residents to bear tax burdens; (2) the unit cost of providing services; and (3) social conditions, including high crime rates or poverty concentrations, that affect public service needs.

Some policymakers are concerned about fiscal disparities, seeing large differences in tax burdens as inequitable. The difference between Starr and Wheeler counties in Texas provides an example of the inequity. In 1984, the average personal income of Starr County was the lowest in the state while that of Wheeler County residents was equal to the state average. If a Starr County resident earning the county's average income and bearing the typical tax burden were to have moved to Wheeler County, he would pay \$37.21 less in taxes for each \$100 of public services.

¹This report focuses on state responsiveness to local fiscal needs; in a separate study, GAO is examining the effects of the loss of federal aid.

