United States General Accounting Office

GAO

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

July 1990

DISTRESSED COMMUNITIES

Public Services Declined in New Jersey Despite Targeted State Aid

GAO

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

Human Resources Division

B-236433

July 9, 1990

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

Dear Mr. Chairman:

This report provides information about the condition of basic public services in poorer communities in New Jersey. It examines these conditions in the context of changing federal-local fiscal relations due to declining federal aid and the loss of general revenue sharing. The report also examines local efforts to cope with existing fiscal problems and assesses whether state policies helped to offset these circumstances. This is the first of three case studies on this subject. The other two case studies are on fiscally distressed communities in California and Texas.

Copies of this report are being sent to other congressional committees and subcommittees and other interested parties.

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

Sincerely yours,

Linda G. Morra

Linda G. Morra
Director, Intergovernmental and
Management Issues

In 1987, New Jersey reduced the negative impact of the loss of GRS funds by expanding a program of fiscal assistance targeted to its poorest municipalities. State funding more than offset GRS losses of $1.2 million in Passaic and $225,000 in Bridgeton. However, public services declined despite local efforts and state aid, suggesting that problems were increasing at a faster rate than state aid. Overall, outcomes in Passaic and Bridgeton show that poorer communities have serious problems that cannot easily be solved. Yet state aid helped in both communities because services would have declined even further without these funds.

Principal Findings

Federal Aid for Local Public Services Fell in the 1980s

When domestic problems have been unresolved at lower levels of government, the federal government has often intervened through financial aid and regulation. Grants-in-aid spending in the 1960s and 1970s reflected increased federal involvement in local public affairs. However, in the 1980s federalism policies changed and budget priorities shifted, causing federal aid to municipalities and counties to decline substantially. These factors also led the Congress to end the GRS program in 1986 (see pp. 10-14).

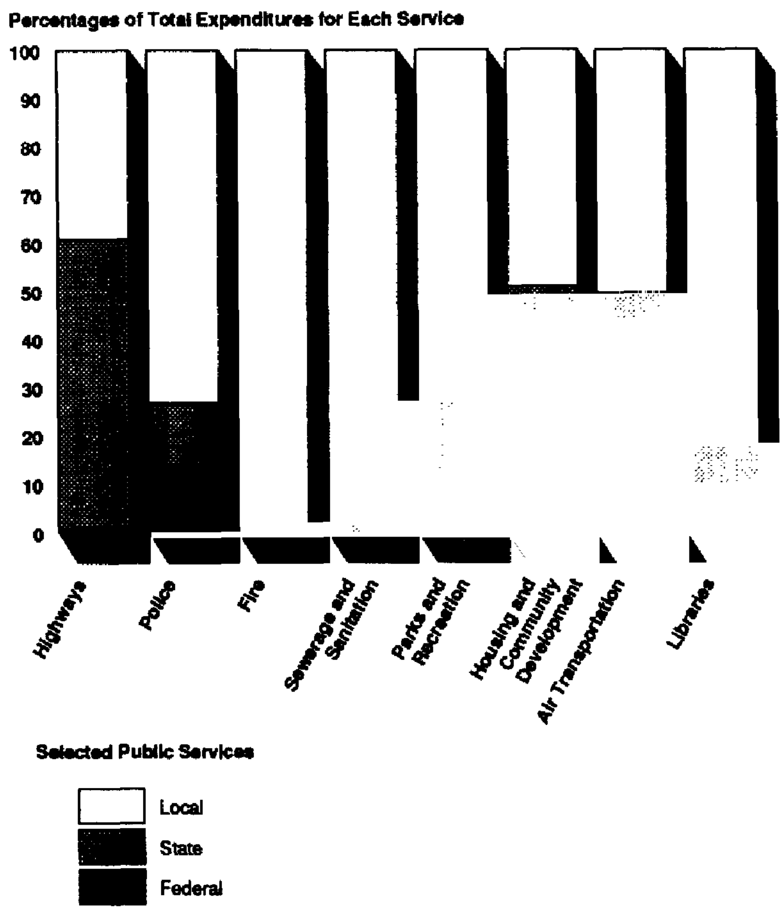
Poorer Communities Are at Greater Risk

All local governments have had to adjust to shrinking federal support. However, because poorer local governments have higher service needs but fewer resources of their own, they have had greater difficulty absorbing these cuts. In New Jersey, a growing fiscal gap between wealthier and poorer communities, relatively weak property tax bases, and relatively greater public service responsibilities compounded the problems of poorer communities such as Passaic and Bridgeton (see pp. 15-16).

Reductions in Public Services Was the Strategy Relied on Most

Poorer governments—like all governments—have a number of coping strategies to choose from when public service needs exceed revenues. These strategies include management improvements and tax and user fee increases. They also include reductions in program spending and postponement of capital investments. Existing fiscal pressures led Passaic and Bridgeton to use all four strategies before as well as after 1986. During both periods, management improvements in administration and

Figure 1.1: Percentage of Total Direct Expenditures for Selected Public Services, by Type of General Government (FY 1987)



Source: GAO calculations based on Bureau of Census, Government Finances in 1986-87.

After Rising for Two Decades, Federal Aid to Local Governments Has Fallen

American public opinion strongly favors keeping the provision of public services close to the grassroots. Yet public opinion has also supported federal financial and regulatory intervention, especially when problems are unresolved at lower levels of government. Problems unresolved at lower levels of government have often spurred new federal initiatives. Grants-in-aid spending reflected these increased federal commitments to localities as aid rose steadily until 1978, as figure 1.2 shows.

Table 1.1: Per Capita Federal and State Aid to Local Governments (Constant 1982 Dollars[a])

	Fiscal years 1980	Fiscal years 1987	Percentage change
Direct federal aid to local governments			
Total	**$120.07**	**$67.84**	**−44%**
Public welfare	1.36	1 63	20
Education	9.49	5.45	−43
General revenue sharing	25.94	8.60[b]	−67
Highways	0.68	0.97	44
Housing and community development	20.97	24.44	17
Health and hospitals	1.16	1.05	−9
Other	60.47	25 69	−58
State aid to local governments[c]			
Total	**$461.80**	**$474.93**	**3%**
Public welfare	50.69	54.57	8
Education	298.25	305.38	2
Highways	23.51	22.73	−3
Health and hospitals	11.87	13.53	14
Other	77.48	78 71	2

[a]Dollar amounts are rounded. Percentage change is computed using unrounded data.

[b]The last quarterly revenue sharing payment was paid in October of 1986. This figure includes a few quarterly payments that some local governments received before the program's funding expired.

[c]May include federal aid passed through to localities

Sources: Aid and U.S. population from Bureau of the Census, Government Finances in 1979-80, Government Finances in 1986-87, and Statistical Abstract of the United States The implicit price deflator for state and local government purchases of goods and services is from Bureau of Economic Analysis, Survey of Current Business.

The Rise and Demise of General Revenue Sharing

General revenue sharing was originally introduced as the fiscal centerpiece of the Nixon administration's "New Federalism." This sweeping presidential initiative would have nationalized welfare through the Family Assistance Plan. It would have consolidated 129 categorical grants (totalling $11.3 billion) into six decentralized block grants. And it would have created a $5 billion program of unrestricted intergovernmental aid—general revenue sharing—distributed to virtually every state and local government in the United States.

President Nixon advanced this package of general and special revenue sharing proposals during a period in which many prominent economists predicted that the federal government would soon experience large budget surpluses. However, sharing excess federal revenues was not the services and because poorer communities received relatively more funds per capita than their wealthier neighbors, GRS was a particularly valuable resource for fiscally distressed communities.

These observations notwithstanding, precisely identifying the effects of GRS on spending priorities in the communities we visited was difficult because GRS funds are unrestricted.[3] That is, GRS funds could be spent for any purpose that the local government could legally spend its own revenues for, making GRS dollars virtually indistinguishable from local revenues. We can, therefore, report the impacts of GRS funds on local public services as described by local officials in the communities we visited. We cannot, however, link the loss of GRS dollars to public service problems with precision. This does not mean that general conclusions about the impact of the program's expiration cannot be drawn. GRS losses were one factor contributing to general fiscal pressures that caused the public service problems we observed.

GRS Losses Are Especially Hard for Poorer Communities to Absorb

Fiscal disparities characterize the situation in which different communities must tax their citizens and businesses at different levels to obtain similar public services. This occurs because neither fiscal circumstances nor the need for public services are uniform across communities. Such disparities make it harder for poorer communities to provide adequate public services on their own. Often communities with the greatest needs have the least resources to meet them. In poorer communities, even very high tax rates can fail to produce revenues sufficient to meet service needs. Yet when tax rates are already high relative to surrounding localities, raising them is likely to exacerbate existing problems of middle-class flight and declining business investment.

Nationwide, these kinds of imbalances between needs and revenues grew over the past decade. The number of counties where per capita income was below 70 percent of the national average rose from 711 to 871 between 1978 and 1987, a 22-percent increase. (See fig. 1.3.) In contrast, the number of counties where per capita income was above 130 percent of the national average rose from 54 to 72, a 33-percent increase. Moreover, populations have become larger in both wealthier and poorer counties in the United States. A smaller fraction of the U.S. population lived in middle-income counties in 1987 than in 1977.

[3]See, for example, Catherine Lovell, "Measuring the Effects of General Revenue Sharing: Some Alternative Strategies Applied to 97 Cities," in Revenue Sharing, David Caputo ed., (Lexington, Mass.: D.C. Heath and Co., 1976), pp. 49-65.

also have the power to affect equity, effectiveness, efficiency, and accountability in local government institutions and public services.

Some state policies make it more difficult for communities to meet their basic public service responsibilities. Tax and expenditure limitations constrain service delivery. Unreimbursed state-mandated programs may also cause problems. Other state policies can help. State assumption of services lifts responsibility from the shoulders of local governments, including poorer communities. Through mandate reimbursement, states can compensate localities for the costs of oversight and administration of state regulations. Targeting reimbursements can reduce certain mandated costs that fall heavily on poorer communities.[4]

Most directly, states can help poorer communities to meet their public service responsibilities as well as to lessen the negative impacts of declining federal aid through their grant-in-aid systems. During the 1980s, when federal aid decreased, state aid to local governments increased, from an average $462 to $475 per capita (constant 1982 dollars). However, most of this growth was in education, health, and criminal justice programs—areas in which federal aid was either not as substantial as state aid (e.g., education) or where it did not decline as much (e.g., health). Meanwhile, local revenue raising outpaced aggregate increases in state aid during the 1980s. Thus, in 1980, states provided 33 cents for every dollar of own-source municipal revenues. In 1987, this figure was 29 cents. Similarly, in 1980 states provided 64 cents for every dollar of county own source revenues. Yet, in 1987 this figure was 50 cents. Other research we have done shows that, by and large, general state aid to local governments has not been targeted to poorer communities.[5] Because aid is predominantly distributed on a per capita or return-to-place-of-origin basis,[6] poorer communities continued to receive less aid than their wealthier or larger neighbors during this period.

[4]Legislative Mandates: State Experiences Offer Insights for Federal Action (GAO/HRD-88-75, Sept. 27, 1988).

[5]Fiscally Distressed Communities: State Grant Targeting Provides Limited Help (GAO/HRD 90-69, May 13, 1990).

[6]Transfers of state funds to local governments on a return-to-place-of-origin-basis are also called "distributions on a source basis" or "shared taxes," although the latter term is sometimes used more narrowly in reference to specific portions of state taxes distributed back to the local government where the taxes were collected.

We carried out our work between September 1988 and March 1989 in accordance with generally accepted government auditing standards.

Wide Fiscal Disparities in New Jersey Put the Poorest Communities at the Greatest Risk

New Jersey has enjoyed sustained economic growth and prosperity in recent years. In 1978, New Jersey ranked sixth among the 50 states in per capita income. In 1988, it ranked second. Not all of the state's communities have shared in this increased prosperity, however, and an already large fiscal gap between wealthier and poorer communities grew. New Jersey municipalities depend heavily on property taxes for revenue. They also play a key role as public service providers. These two circumstances have contributed to disproportionate fiscal burdens on poorer communities. Passaic and Bridgeton are two such municipalities.[1]

New Jersey Is a State of Wide Economic Contrasts

New Jersey made substantial economic progress over the past decade. In 1978, the state's personal per capita income was $9,247—14 percent higher than the national average. In 1988, personal per capita income was $21,882—33 percent higher. Although New Jersey's 1978 unemployment rate was 7.2 percent—18 percent higher than the national average—in 1988, its rate was 3.8 percent—31 percent lower.

New Jersey's municipalities did not benefit equally from this economic expansion. As a result, the unemployment rates of 53 of New Jersey's 567 municipalities exceeded the state average by 50 percent or more in 1987. Similarly, 42 municipalities had 1985 per capita incomes of at least 30 percent below the state average. Much of the population growth and business expansion over this period occurred in coastal and central New Jersey, while other areas lost ground economically. These differences have caused a fiscal polarization in which an increasing number of communities in New Jersey are either very wealthy or very poor. (See fig. 2.1.)

[1]Counties and municipalities are the only units of general-purpose local government in New Jersey. As provided by statute, New Jersey's 21 counties are governed by elected boards of chosen freeholders. New Jersey's 567 municipalities use the names city, town, township, borough, or village interchangeably, but they are all municipal corporations by statute. This report focuses on municipalities rather than counties because New Jersey municipalities have wider variation in economic and fiscal conditions than counties.

Municipalities Are Key Service Providers

As a matter of state law and custom, municipalities play a key role in the delivery of public services in New Jersey.[3] Counties are the dominant providers of welfare, hospitals, and corrections service's. Municipalities are the dominant providers of police, fire, parks and recreation, libraries, and sanitation services, as table 2.1 shows.

Table 2.1: Percentages of State and Local Direct General Expenditures for Selected Services in New Jersey, by Type of Government (1987)

Figures are percentages

	Total	Municipalities	School and special districts	Counties	States
Highways	100.0	18.7	5.1	8.1	68.1
Police	100.0	75.9	0.0	6.8	17.3
Fire	100.0	87.9	11.6	0.5	0.0
Sewerage and sanitation	100.0	42.4	54.6	2.5	0.5
Parks and recreation	100.0	30.0	0.0	24.0	46.0
Housing and community development	100.0	10.5	68.6	8.3	12.6
Air					
Transportation	100.0	45.9	0.0	54.1	0.0
Libraries	100.0	71.5	0.0	22.9	5.5
Education	100.0	10.8	61.9	7.2	20.1

Note. Columns may not add to 100 percent because of rounding. In New Jersey, cities and townships are called "municipalities" and they do not overlie each other.

Source. Bureau of the Census, Government Finances in 1986-87

Municipalities Rely Heavily on Property Taxes

New Jersey fiscal policies restrict local government revenue sources. In particular, according to state officials we interviewed, local sales taxes may not be imposed. And, only one New Jersey municipality, Newark, has permission to levy a payroll tax. As a result, in fiscal years 1986-87, property taxes accounted for 94.5 percent of all municipal tax revenues.

[3]In 1986-87 local governments delivered 59 percent of all public services in New Jersey. Nearly all types of local services are delivered mostly by municipalities and counties. The principle exceptions to this are primary and secondary education, which is the responsibility of school districts, and housing and community development and sewerage, which are provided by special districts.

State Aid Is Substantial, but Could Be More Effectively Targeted

State aid to municipalities in New Jersey is substantial compared with the national average (see table 2.2). In 1986-87, New Jersey provided 37 percent of general revenues, compared with a national average of 20 percent. The state could reduce the disparities between wealthier and poorer communities through increased targeting of its general state-local assistance, which totaled $1,099 million in fiscal year 1989.[6] Only 19 percent of this aid was distributed according to need. As a result, despite a high level of aid, local property tax burdens still vary widely among New Jersey municipalities. For example, in 1987, equalized property tax rates ranged from 12.2 percent in Winfield Township to 0.6 percent in Mantoloking Borough, with a state average of 1.9 percent. Forty-eight municipalities (comprising one-fifth of the state's population) had rates that exceeded this average by 50 percent or more.

GRS Was Valued Because It Could Be Used for Local Public Services

In 1979, its peak year, GRS provided $102 million to New Jersey municipalities, which was equivalent to 3 percent of municipal own-source revenues.[7] Poorer municipalities, including Passaic and Bridgeton, received more GRS funds per capita than the average municipality in New Jersey. In 1986, municipal per capita payments averaged $9.06. However, GRS provided $21.54 per capita in unrestricted aid to Passaic and $11.97 to Bridgeton. Between 1979 and 1986, Passaic received an average of $887,000 annually—8 percent of own-source revenues, equivalent to 62 percent of all federal aid. In Bridgeton, annual GRS funding averaged $307,000, or 18 percent of own-source revenues and 85 percent of all federal aid.

GRS did not represent a large share of revenues in either community, although it was a substantial share of federal aid. Nevertheless, local officials regarded these funds as very important. Unlike most other sources of intergovernmental aid, GRS funds could be spent on virtually any local public service need or priority.

[6]New Jersey has nine general fiscal assistance programs. Two programs account for $844 million and compensate localities for the state's preemption of public utility taxes. These are the Public Utilities Franchise and Gross Receipts Tax Program ($685 million) and the Business Personal Property Tax Replacement Revenue Program ($159 million). More detail on these and the other seven programs is contained in appendix VI of Fiscally Distressed Communities: State Grant Targeting Provides Limited Help (GAO/HRD-90-69, April 13, 1990) Washington, D.C.

[7]Own-source revenues are those local tax and other revenues not derived from intergovernmental grants-in-aid programs.

In economic terms, Passaic and Bridgeton are communities with few resources of their own. According to the most recent data available:

- The rate of population growth in New Jersey was 7.0 percent between 1970 and 1987. During this period both Passaic and Bridgeton lost population. Passaic's population declined 2.3 percent, while the decline in Bridgeton was 8.4 percent.
- Statewide, equalized property values per capita averaged $46,884. In Passaic this figure was only about one-third of the state average—$16,763. In Bridgeton equalized property value per capita was $11,989—less than 25 percent of the statewide average.
- Overall, 9.5 percent of all New Jersey's citizens have incomes below the national poverty line. Yet, 23.5 percent of Passaic residents and 23.1 percent of Bridgeton residents fall in this category.
- Statewide, 14 percent of New Jersey's children live in homes with incomes below the poverty line. However, in Passaic, 38 percent of all children live in these conditions. In Bridgeton, 37 percent of all children live in homes with incomes below the poverty line.

Revenue and Expenditure Trends Are Declining or Lagging Behind State Average Growth

Municipal revenue and expenditure data help to illustrate the public service consequences of concentrated demographic, social, and economic problems.[9] Trend data from Bridgeton and Passaic illustrate declining service delivery in dramatic fashion, as table 2.4 shows.

[9] Service outputs (e.g., the degree of police services provided) cannot be measured directly. Constant-dollar expenditures per capita are a rough proxy for output because a wide variety of state and local policy and administrative actions change expenditures from year to year.

Actions Taken by Poorer Communities Had Some Positive but More Negative Impact on Public Services

Passaic and Bridgeton used all four strategies described in chapter 1—improved administration, increased tax revenues, reductions in program spending, and postponement of capital investments—to cope with their fiscal distress and declining federal aid. However, the techniques they relied on most were spending cuts and postponement of capital investments. Passaic and Bridgeton were already fiscally distressed in 1987. Thus, they had been using all these strategies before general revenue sharing expired. They continued these strategies to help offset the loss of $1.2 million in fiscal year 1986 GRS funds in Passaic and $225,000 of these same funds in Bridgeton.

Management Strategies Helped to Maintain Services With Less Revenue

Both Passaic and Bridgeton improved their administration and program operations to maintain services with less revenue. Notable strategies were improvements in revenue collection techniques, the institution of efficiencies in service delivery, and increased reliance on volunteers to deliver public services.

Improved Revenue Collection Techniques Increased Available Funds

One sign of fiscally distressed municipalities is lower-than-average rates of property tax collections. Low rates are problematic because property taxes are the major source of all tax collections for New Jersey municipalities and because efficient collection yields more revenue at lower tax rates.[1] The state average yield was more than 96 percent of property taxes levied in fiscal year 1987. However, only 4 of the 10 most distressed municipalities in New Jersey collected more than 90 percent of taxes due that year.

Because of its more rigorous enforcement, Passaic had the highest collection rate (98 percent) of New Jersey's 10 most distressed cities in fiscal year 1987. In Passaic, if property taxes are not paid promptly, the city institutes foreclosure proceedings quickly. It uses profits from sales of these properties to pay back taxes. Bridgeton has not been as successful as Passaic. However, it is attempting to increase its property tax collection rate (86.7 percent in 1987). The city is automating tax collection records and speeding up foreclosures.

[1] The failure to collect taxes owed is a problem of efficiency in the tax collection process that produces a gap between total tax liabilities and tax revenues. When a large share of taxes owed by taxpayers is uncollected, tax rates may have to rise to compensate for revenue losses. This, in turn, puts a greater burden on taxpayers who pay their taxes.

average municipality's budget in New Jersey. In Bridgeton, it accounted for 5.7 percent. In Passaic, this figure was 15.7 percent. Although Passaic supplements its fire department with a volunteer auxiliary force, professional firemen provide its primary fire protection. In contrast, Bridgeton (which has a lower population density than Passaic) now uses volunteers extensively, limiting its professional firefighters to two per shift.

Both communities relied on volunteering in other areas as well. In Bridgeton, for example, police personnel worked without compensation on weekends to renovate office space for the department. Also, Bridgeton employees at times clean their own offices during off-duty hours.

Significantly Increasing Local Revenues Is Not a Viable Solution

Both Passaic and Bridgeton raised taxes when GRS expired. As described in chapter 1, increasing taxes in poorer communities such as Passaic and Bridgeton puts a disproportionate share of public service burdens on local taxpayers. It also negatively affects the ability of the these communities to compete for new businesses and residents. High property tax rates encourage residents and businesses to move to neighboring communities or even other states with lower rates. This, in turn, further increases the burden on the remaining residents and businesses.

Cutting Programs and Delaying Capital Investments Were the Primary Strategies Used

Both Passaic and Bridgeton used management improvements and tax increases to cope with general fiscal distress and the loss of GRS. Yet public service reductions and postponements played the major role in their overall strategies. Programs were cut, planned programs were abandoned, and public works projects were postponed.

Programs Were Abandoned

Fiscal pressures not only force municipalities to cut programs, they also prevent them from instituting new programs that are needed. For example:

- City officials in Passaic cited the need for a preventive medicine public health clinic to address the city's high infant mortality, hypertension, and diabetes rates.
- Both Bridgeton and Passaic officials want to expand police services, instituting more proactive strategies to control and prevent crime. Drug-related crime is increasing in Passaic and Bridgeton. Public officials we spoke with reported that services have declined to such an extent in this area of high national priority that they can only react to reports of crimes.

Nevertheless, it identified certain changes to improve the state aid system. Most important, the commission believed that the current system of unconditional municipal grants is not well targeted. In 1985, the wealthiest 20 percent of municipalities received $165 per capita in such grants, while the poorest 20 percent received $134.

To remedy this problem, the commission recommended that New Jersey fold five existing municipal aid programs into a single program. Under the single program, no municipality would receive less funds than it had before. However, the poorest communities would receive much more. Giving these communities extra help would significantly reduce their effective property tax rates. The commission estimated that the proposed Municipal Equalization Aid Program would cost $351 million more than New Jersey's existing system in the first year. New Jersey has not enacted the Municipal Equalization Aid Program, although those we interviewed expected the state legislature to revisit commission findings during the 1991 legislative session.

New Jersey Has Taken Action to Help Its Poorest Municipalities

While the distribution of state aid continues to favor wealthier communities, the state has taken some measures to help its poorest communities. New Jersey's Distressed Cities Program factors need and tax effort into distribution decisions. This program meets short-term financial crises in its poorest municipalities. Low program funding ($17.5 million) and the small number of municipalities (10) participating in the first year were consistent with this narrow purpose (see table 4.1).

Table 4.1: Aid Distributed Under the Distressed Cities Program

State fiscal year	Funding level (in millions)	Number of municipalities aided
1987	$17.5	10
1988	70.0	48
1989	120.5	50
1990	120.0	40

The program's structure also reflects the aim of providing carefully targeted, stop-gap financial help in two ways. First, eligibility criteria assure that only distressed communities qualify.[3] Second, allocations are discretionary. According to those we interviewed, the Distressed Cities Program is unique among New Jersey general fiscal assistance programs

[3]These criteria are property tax rates, equalized property values, and percentage of Aid to Families With Dependent Children population.

State Aid More Than Replaced General Revenue Sharing in Passaic and Bridgeton

Passaic and Bridgeton rank 8th and 10th on the states' index of fiscal distress.[4] As such, they have been recipients of benefits under the Distressed Cities Program since 1988. As table 4.2 shows, the amounts Passaic and Bridgeton received more than offset their GRS losses. For example, in fiscal year 1986 (the last full GRS program year) Passaic received $1.1 million in revenue sharing funds. Passaic's 1990 allocation under the Distressed Cities Program was $4.9 million. In constant dollars, this figure is 280 percent greater than its 1986 GRS allocation. Similarly, Bridgeton received $225,000 in revenue sharing funds. In comparison, its 1990 state-aid allocation was $740,000 in constant dollars, 180 percent greater.

Table 4.2: Funds Passaic and Bridgeton Received From Distressed Cities Program and From GRS

Dollars in thousands

	Distressed cities program		GRS	
Fiscal Year	Bridgeton	Passaic	Bridgeton	Passaic
1986	•	•	$225	$1,162
1987	•	•	•	•
1988	$800	$2,500	•	•
1989	1,100	3,300	•	•
1990	740	4,850	•	•

Sources: Department of Community Affairs and municipal budgets of Passaic and Bridgeton

Conclusions

Recent increases in state aid to Passaic and Bridgeton reflect New Jersey aid policies. State officials told us the state continues to distribute funds from current state aid programs according to existing formulas. However, it targets new aid to its poorest communities, thereby helping to lessen local public service problems. Some local coping strategies were efforts to maintain existing services. These efforts notwithstanding, essential services, such as police and fire, declined, and needed capital investments were postponed in both Passaic and Bridgeton. This suggests that these communities' public service problems were increasing at a faster rate than state aid.

The continuation of such declines despite state and local efforts to halt them shows that Passaic and Bridgeton have serious problems. They are

[4]The state's Office of Management and Budget developed this index to determine eligibility for Distressed Cities funds. The index is actually a composite ranking, computed by ranking the sum of rankings of each of the state's 567 municipalities on eight factors: (1) unemployment rate, (2) per capita income, (3) percentage of the housing stock built before 1940, (4) percentage of the housing stock that is substandard, (5) percentage of the population receiving AFDC, (6) the rate of population change, (7) equalized property tax rates, and (8) equalized property valuation per capita.

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problems that will not easily be solved even with all levels of government working together. Higher-than-average public service needs and less productive tax bases are long-term conditions that place substantial pressure on public service delivery. Nevertheless, we found that targeted state aid helped by lessening the extent to which spending for local public services declined in the two communities we visited.

because it does not distribute funds according to a statutory formula. Instead, eligible communities must submit applications for funds to the State Department of Community Affairs. The department examines municipal revenue and expenditure policies. Then it sets funding levels based on its own evaluation of budgetary conditions. State officials we interviewed preferred this method to a statutorily based distribution system. Flexibility, they believe, is important when responding to unanticipated municipal budget shortfalls.

State officials told us that funding is not automatic from year to year. Moreover, amounts of funding can change as a result of variations in short-term local budget conditions. Nonetheless, the program appears to be evolving in the direction of a stable source of general purpose aid to New Jersey's poorest communities. First, budget crises have become a way of life in these municipalities. Communities such as Passaic and Bridgeton face perennial budgetary shortfalls due to persistent gaps between public service needs and local resources. As a result, many of their names appear on the list of beneficiaries each year. For example, 34 municipalities received funding in at least 3 of 4 program years. Moreover, current state policy favors reducing disparities as a way of promoting fairness in public services. New Jersey expanded the Distressed Cities Program significantly in the aftermath of the expiration of GRS. It has maintained this higher level of effort despite recent state budget problems.

In 1988, the state increased program funding from $17.5 to $70 million. It more than quadrupled the number of communities assisted. This expansion was an effort to offset the negative impacts of the loss of GRS in New Jersey's poorest communities. Thereafter, in 1989, funding increased in Passaic although it declined in Bridgeton, as table 4.2 shows.

State Aid Offset the Loss of General Revenue Sharing in New Jersey's Poorest Communities

New Jersey reduced the negative impacts of the loss of general revenue sharing by expanding a program of fiscal assistance to its poorest municipalities. For most local governments, New Jersey's Distressed Cities Program did not fully replace federal funds. However, the poorest communities fared better in comparison with GRS because the state program is more targeted. Despite this, public service conditions in Passaic and Bridgeton continued to decline. This suggests that while state aid helped, public service problems in these two communities were increasing at a rate faster than the growth of state aid.

New Jersey Shows Concern About the Problems of Poor Municipalities

In December, 1984, the New Jersey State and Local Expenditure and Revenue Policy Commission was established. This state commission examined state and local finances and spending and recommended changes to improve public service delivery. In conducting its work, the commission's objectives, in part, were to

- create an adequate balance between local resources and local service responsibilities,
- achieve a better division of state and local taxes, and
- attain a fairer distribution of tax burden.

In 1988 the commission issued its findings. According to this panel, New Jersey relies too heavily on localities to provide public services. It gives too little attention to the adequacy and appropriateness of local tax resources. State and local taxes are unfairly distributed. And local government responsibilities and resources are mismatched.[1] For example, court, public assistance, and mental institution programs are state programs. Yet local governments provide or partly finance these services. They finance most of their share with local property tax revenues. As a result, the commission observed, "traditional local services, such as public safety, roads and bridges and recreation, are crowded out or provided at significantly lower levels."[2] The panel viewed problems as especially serious in New Jersey's poorest communities. They have the highest needs, but the fewest resources of their own.

The commission said that state aid is not a long-term solution to the demographic, social, and economic problems that underlie fiscal distress.

[1] New Jersey State and Local Expenditure and Revenue Policy Commission, Summary Final Report, July 1988, p. vi.

[2] New Jersey State and Local Expenditure and Revenue Policy Commission, Final Report, July 1988, p. vi.

Service Cuts Reduced Costs

Passaic and Bridgeton reduced services to their residents after GRS expired. However, service cuts were not new. Both Passaic and Bridgeton have cut services in the past to meet budget shortfalls. Examples of actions taken before and after the expiration of GRS include the following:

- Bridgeton eliminated its rescue squad.
- Bridgeton eliminated its city bus service when it lost federal matching funds.
- Both Bridgeton and Passaic eliminated police foot patrols.
- Passaic cut the size of its police force from 144 in 1986 to 129 in 1988. Bridgeton cut its police force from 56 in 1985 to 51 in 1988.
- Bridgeton eliminated its Crime Prevention Unit.
- Bridgeton closed its municipal swimming pool and a town beach in 1988.
- Passaic reduced the number of employees in its recreation department from eight to two since 1981. Equipment was neither repaired nor replaced.

Passaic and Bridgeton Postponed Needed Capital Purchases and Public Works Projects

Both communities postponed needed capital projects and improvements. While these actions save dollars in the near term, they often are not efficient over time. Timely maintenance results in less cost than major repairs. Examples of these kinds of postponements include:

- Bridgeton's fire chief would like to build a second fire house to cut response time. However, this is not financially possible.
- Bridgeton's fire department has been unable to replace or upgrade its equipment. The department's ladder truck reaches nine stories. However, the city has an 11-story apartment building that houses senior citizens.
- Some of Passaic's streets, sewers, and waterlines are over 100 years old and in need of repair. The city works on one street at a time as funds become available.
- Bridgeton's police department extends the life of police vehicles up to 180,000 miles. According to Bridgeton's Chief of Police, neighboring Vineland retires police cars after 60,000 miles.
- In 1986, Bridgeton canceled 14 capital projects. The City Engineer said that the last time the city could upgrade its infrastructure was when it obtained an Economic Development Administration federal grant.
- Bridgeton lacked the funds to comply with several state mandates, such as asbestos removal, recycling leaves, and repairing local dams.

Property taxes provide the largest share of locally raised revenues in New Jersey municipalities. Even so, improving the management of secondary revenue sources can increase revenues. For example, municipal fines are a small but important source of revenue. Passaic has stepped up enforcement of collection procedures for such times, according to an official we interviewed. This action produced a revenue increase of 30 percent, from $294,000 in 1982 to $388,000 in 1987. However, a 3-year collection backlog still existed in 1988, and Passaic has recently sought help from a private contractor. Bridgeton has been less successful in collecting fines due to staffing shortages. It had $330,000 in outstanding fines in 1987. The city has added staff and computerized its collections tracking system to address this problem.

Cash management practices were also improved. Passaic invests available (i.e., reserve) funds in securities that yield higher interest income than bank savings accounts do. In part, this resulted in interest income amounting to $660,000 in Passaic in 1987, 4 percent of own-source revenues. Bridgeton had investment income exceeding $100,000, 3 percent of own-source revenues. State officials recommended that the city review its investment practices to increase this return. One specific recommendation was to consolidate city accounts, which would enable a greater return on savings.

Increased Operating Efficiency Saved Money

Passaic and Bridgeton found ways to increase their operating efficiency. Passaic's fire department combined its operations in two fire houses rather than four. The Bridgeton Police Department prolongs the useful life of its patrol cars by often using high-mileage vehicles for less rigorous use. Bridgeton places unrepaired and unoccupied police cars in high-crime neighborhoods in order to create the impression of a police presence. Rising insurance costs caused Bridgeton and Passaic to drop their workmen's compensation and liability insurance policies. The communities are now self-insured. Passaic estimated that this saved $300,000 in the first year and $200,000 in subsequent years. While self-insurance is becoming a common municipal strategy for coping with escalating liability insurance costs, it carries serious risks. Claims—however high—are now paid directly from municipal reserves.

Volunteerism Saved Money for Passaic and Bridgeton

Fire protection is a major expense in many municipalities in New Jersey. Costs depend in large part on the ratio of volunteer to professional firefighters. Volunteer firefighters save communities money. In fiscal year 1987, the cost of fire protection accounted for 8.7 percent of the

Table 2.4: Percentage Changes in Revenues and Expenditures for Selected Items in All New Jersey Municipalities and Passaic and Bridgeton (1978-87)[a]

Figures are percentages

	Statewide	Passaic	Bridgeton
Property tax revenues	27	21	−13
Total municipal spending	3	−18	3
Police services	11	−24	−17
Fire/rescue services	8	51[b]	−18
Public works	16	6	−7
Recreation	−10	−67	−44
Libraries	9	−14	−20

[a]All figures are calculated on a constant-dollar, per-capita basis.

[b]Although Passaic consolidated firehouses (from four to two) and reduced the number of full-time-equivalent fire protection employees, it also purchases new equipment and began construction of a new fire house.

Source: GAO calculations based on State of New Jersey, Division of Local Government Services, Statements of Financial Condition of Counties and Municipalities, Annual Report of the Division of Local Government Services: 1978 and 1987.

One reason for the aforementioned spending declines is the rapidly rising costs of providing health and human services in Passaic and Bridgeton. Municipal expenditures for these poverty-driven categories of spending did not rise statewide in constant-dollar terms. However, expenditures rose steadily in Bridgeton and Passaic, putting pressure on other categories of spending.

Passaic and Bridgeton Have High Service Needs, but Few Resources

In social and structural terms, Passaic and Bridgeton are communities with high service needs. Located 12 miles from New York City, Passaic is a densely populated municipality. Bridgeton, located near the Delaware border, has a population density about average for a city its size in New Jersey. As table 2.3 shows, Passaic's and Bridgeton's socioeconomic characteristics suggest that they have higher-than-average needs for public services than other New Jersey municipalities.[8]

Table 2.3: Socioeconomic Characteristics in All New Jersey Municipalities and in Passaic and Bridgeton[a]

	All	Passaic	Bridgeton
Pre-1940 housing[b]	29.8%	59.4%	52.5%
Substandard housing[b]	0.9%	3.9%	1.9%
Non-English speaking population[c]	3.1%	15.7%	1.8%
Percentage of population			
Age 16-17 not enrolled in high school	8.8%	20.8%	25.2%
Unemployment rate in 1987	3.2%	7.11%	0.0%
AFDC recipients in 1988 as a percentage of 1986 population	0.3%	4.2%	7.2%
Rate of violent crime per 100,000 population in 1988	583	1,509	1,717

[a]Data for "all municipalities" are averages, except housing, unemployment rate, and AFDC recipients,which are the median values for all 567 municipalities.

[b]Housing data are a percentage of year-round housing units.

[c]Non-English speaking population is the percentage of population (age 5 and over) who speak English poorly or not at all.

Sources: Percentage of population speaking English poorly or not at all and percentage of population age 16-17 not enrolled in high school are from Bureau of the Census, 1980 Census of Population, Vol. 1, Characteristics of the Population, Chapter C, PC80-1-C32. Crime rates per 100,000 population are GAO computations based on data from U.S. Department of Justice, Federal Bureau of Investigation, Uniform Crime Reports 1988, pp 65, 94, and 97 All other data are from the New Jersey Department of Treasury, Office of Management and Budget, Division of Planning

[8]Because public service needs are difficult, and sometimes impossible, to measure directly, researchers use socioeconomic indicators as proxy measures. Rationales for using proxies are both methodological and theoretical. Methodologically, proxies are selected because statistically they are significantly related to more direct but less easily measured indicators of service needs. Alternatively, proxies are sometimes selected based on what is known about local public services. For example, other factors equal, a community of detached, single-family houses can be expected to consume fewer resources than a community of older, multifamily, multistory residences to attain similar levels of fire protection. Proxies are also selected based on arguments that the poor are less able to substitute private for publicly provided goods, including education, libraries, health, housing, and parks and recreation.

Table 2.2 shows that New Jersey municipalities rely more on property taxes than municipalities nationwide.[4]

Table 2.2: Comparison of Revenue Sources for FY 1986-87—New Jersey Local Governments Versus the U.S. Average

	Municipalities		All local government	
	New Jersey	U.S.	New Jersey	U.S.
Share of general revenue				
From federal government	2.3	6.5	4.0	4.8
From state government	37.0	20.3	33.2	33.3
All taxes	45.2	42.5	48.4	38.6
Property	42.7	20.9	47.3	28.4
General sales	0.0	7.3	0.0	4.2
Income—individual and corporate	0.0	6.2	0.0	2.4
Other taxes	2.5	8.1	1.2	3.6
Fees and user charges	8.6	14.8	8.5	13.2
Miscellaneous revenue	6.9	15.9	5.8	10.1

Note: Columns may not add to 100 percent because of rounding. Table uses Bureau of the Census definition of municipalities in New Jersey and the United States.

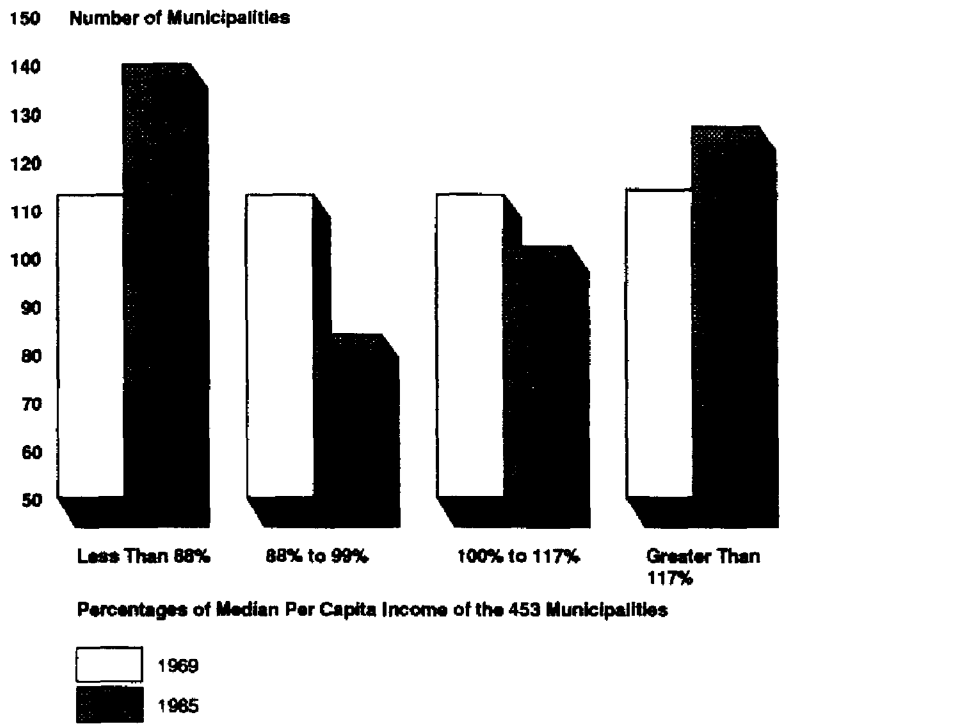
Source: Bureau of the Census, Government Finances in 1986-87, Series GF-87-5, Table 29, pp. 46 and 77.

This heavy reliance on property taxes can place municipalities with low property values at a serious fiscal disadvantage. New Jersey's average equalized property valuation per capita was $46,884 in 1987.[5] Yet 82 of the state's 567 municipalities had equalized property valuations per capita that were 50 percent or more below the state average. In contrast, 143 municipalities exceeded the state average by 50 percent or more.

[4]This situation is not likely to change in the near future. A July 1988 report by the New Jersey State and Local Revenue and Expenditure Policy Commission rejected local nonproperty taxes as a way of rationalizing local service delivery and reducing public service burdens among the poorest communities. The following reasons were cited: "Revenue diversification would not offer significant potential to reduce local resource disparities. Diversification has detrimental effects on economic growth and land use. Finally, it can have administrative difficulties and taxpayer compliance issues which make local-option taxes problematic to employ efficiently and effectively."See New Jersey State and Local Expenditure and Revenue Policy Commission Report, pp. 56-57.

[5]In New Jersey, municipalities assess property for purposes of property taxation. The state's Division of Taxation computes a measure of property value called "equalized value" that standardizes these locally assessed values in order to allow valid statewide comparison of the value of property in local governments. The Division bases its computational procedure on comparison of assessed valuations and sales prices in each local unit.

Figure 2.1: Number of New Jersey Municipalities Above or Below the Median Per Capita Income
(1969 and 1985)



Note: Includes 453 municipalities whose 1986 population was 2,500 or greater. These 453 municipalities included 98 percent of the state's population in 1984

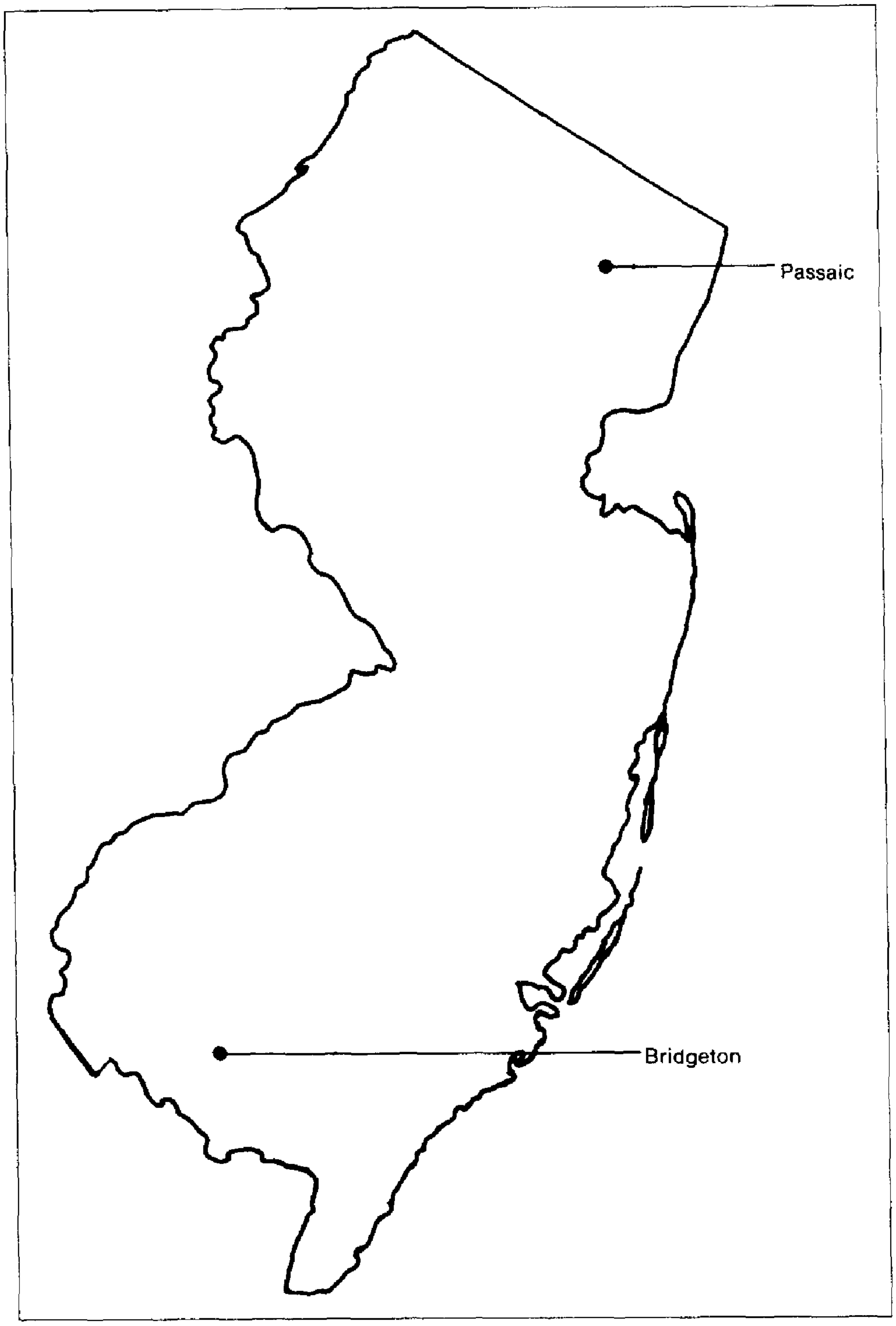
Sources: Census 1984 population and 1969 per capita income data, Office of Revenue Sharing, master file, and Census 1985 per capita income, County And City Data Book, 1988: Places File Set [machine readable data file] prepared and distributed by the Bureau of the Census, 1988.

Municipalities Have Significant Responsibilities but Limited Local Revenue Sources

Without offsetting intergovernmental aid, extreme fiscal polarization, higher-than-average service responsibilities, and heavy reliance on property taxes are likely to create serious local service problems in poorer communities.[2]

[2] As described in chapter 1, assumption of services and intergovernmental aid by higher levels of government are the two primary strategies for reducing fiscal disparities and/or inequities in local public service delivery. According to a recent report of the New Jersey State and Local Expenditure and Revenue Policy Commission, service centralization is not a viable option in New Jersey because public values and traditions favor keeping service delivery close to the grassroots. However, New Jersey aid policies have reduced fiscal disparities among New Jersey municipalities. State aid actions that have been taken are described in chapter 4 of this report.

Figure 1.4: Case Study Municipalities in New Jersey



Objectives, Scope, and Methodology

Our objectives in reporting on public services in poorer communities were to determine

- the condition of local public services in light of reductions in direct federal assistance to local governments and the expiration of general revenue sharing,
- the range of local government responses to these conditions, and
- whether state policies and actions have helped to offset public service problems.

To accomplish our first objective we reviewed trends in direct federal-local aid and drew from our earlier research on trends in the intergovernmental system. We then visited poorer communities in California, New Jersey, and Texas. We collected data on public services from local sources and state documents and we interviewed local officials to gain insights into local trends and conditions.

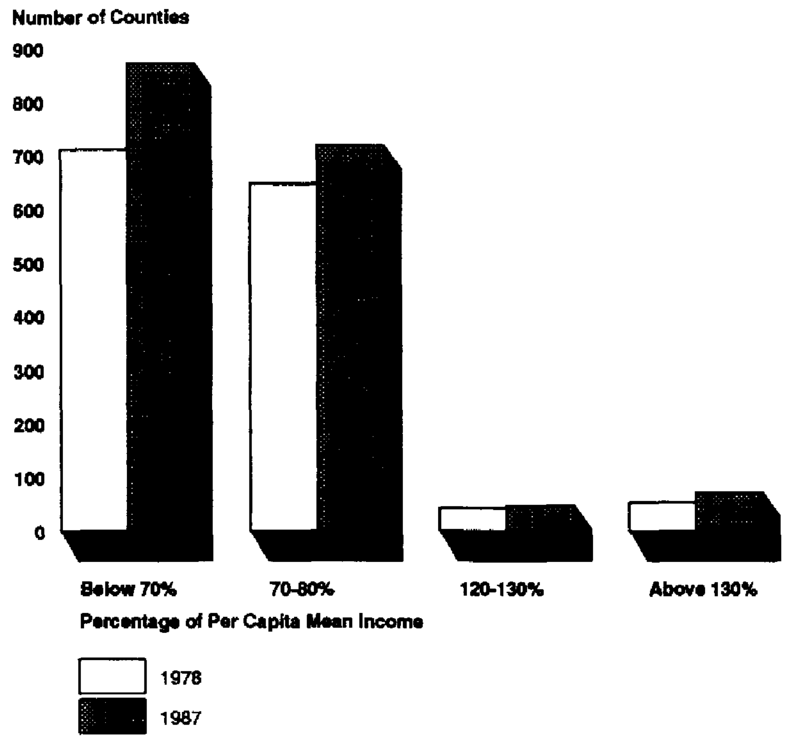
To accomplish our second objective we examined local budgets and other relevant financial documents. We also spoke with public officials and others knowledgeable about the strategies that communities used to cope with their fiscal stress and declining federal aid.

To accomplish our third objective we examined state aid and other state policies to determine whether states that we visited had replaced GRS or otherwise taken steps to lessen the negative impacts of declining federal-local aid and the expiration of GRS.

As stated, we visited communities in California, New Jersey, and Texas. We selected states and chose field sites that were different along dimensions of state-local relations that we believed would help to explain variation in local public service conditions. Differences we considered included variations in kinds of services provided at state versus local levels, state mandating policies, and patterns of state aid to local governments. Within states, we selected communities that were among the more fiscally distressed and that had higher-than-average service needs, as indicated by socioeconomic and other statistical indicators.

This case study is on Passaic and Bridgeton, two of New Jersey's most fiscally distressed communities. (See fig. 1.4.) We also visited wealthier communities in New Jersey. These visits provided a better basis for assessing conditions in poorer communities. However, because wealthier communities were not the focus of our work we did not include information on them in our report.

Figure 1.3: Number of Counties Above or Below the National Per Capita Mean Income in 1978 and 1987



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

State-Local Strategies to Cope With Needs-Revenues Imbalances

Like all governments, poor communities can choose from a variety of coping strategies when public service needs exceed available resources. Management improvements that deliver services more efficiently and/or effectively help to maintain services with less revenue. Raising taxes is another option. In poorer communities, where tax bases are weak, this strategy is not without substantial costs to residents. It also can promote middle-class flight and exacerbate declining business investment. Other strategies—especially delays in infrastructure repair or construction or budget cuts in program staff or services—produce a decline in public services.

States can help poorer communities when local needs exceed local revenues. Because of their superior constitutional positions, states have always been an important factor shaping local government. To varying degrees, states dictate local government structures and services, control local revenue raising, and direct administration of local programs. States administration's principal aim. Rather, as the President described his intentions in the 1971 State of The Union Address:

"The time has come to reverse the flow of power and resources from the states and communities to Washington, and start power and resources flowing back from Washington to the states and communities, and, more importantly, to the people—all across America."

GRS served the aim of decentralization well because recipients were given the broadest possible latitude to determine program spending.

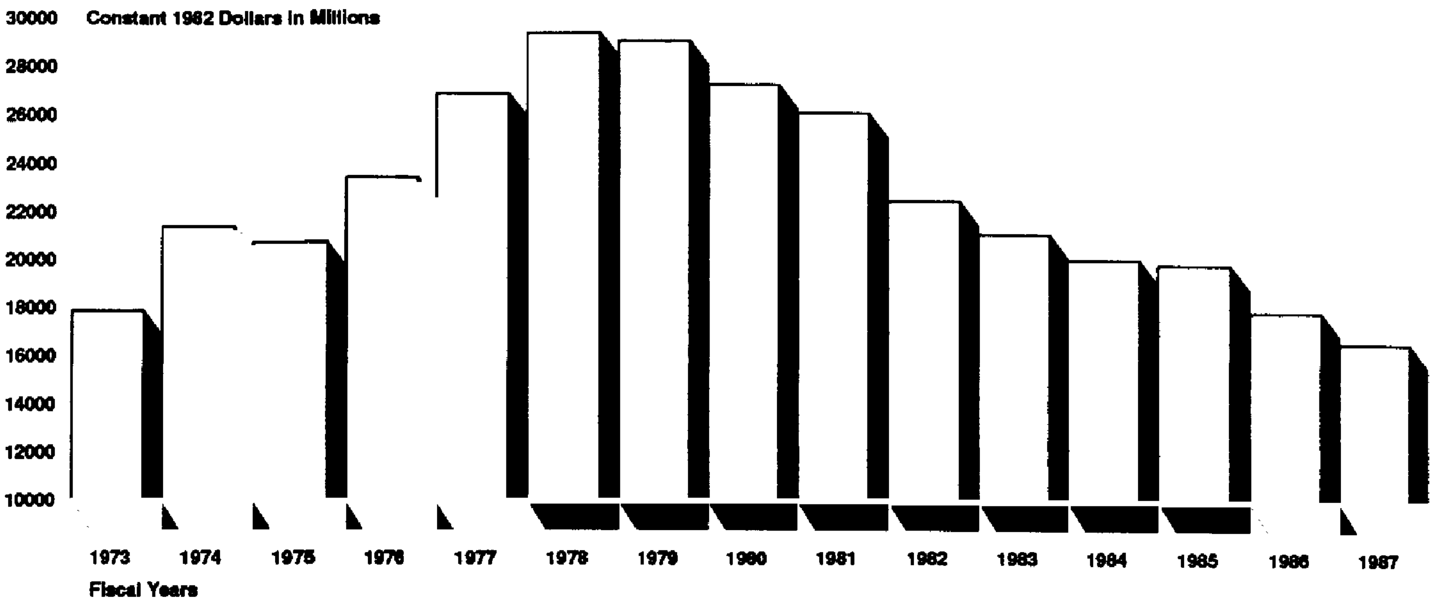
Despite early congressional reservations, GRS was eventually enacted as the State and Local Fiscal Assistance Act of 1972. Over its 14-year life, GRS provided over $78 billion to 39,000 state and local governments. Populous states, such as California, received as much as $8.6 billion in total aid, while rural states, such as Wyoming, received as little as $164 million. As intended, GRS proved to be the least cumbersome and among the most popular of all federal aid programs, from the perspective of recipients.

Although President Reagan shared President Nixon's decentralization goals, he gave higher priority to federal tax cuts and reducing domestic spending than to sharing federal tax revenues with state and local governments. Moreover, by 1985, mounting federal deficits convinced the Congress that GRS—a nearly $5 billion line item in the federal budget—was no longer viable. Neither the House nor Senate fiscal year 1986 budget resolutions contained GRS funding, and the funding ended on schedule in 1986.

General Revenue Sharing Was an Important Source of Funds for Local Public Services, Yet Measuring Its Impacts Is Difficult

Virtually all evaluations of the general revenue sharing program concur that GRS funds were used predominantly to support local public services and capital investments. For example, according to official use reports submitted to the Department of the Treasury, GRS primarily helped to maintain or improve local public services. A Brookings Institution monitoring study identified county spending on public transportation (i.e., roads, highways, and mass transit subsidies) as the program category most significantly affected by GRS. Public safety (i.e., police, fire, and corrections) ranked next among identifiable spending categories, followed by capital spending in primary and secondary education. Among municipalities, public safety spending was most affected. Public transportation and environmental protection (i.e., sewerage, sanitation, and water supply) ranked next. Because funds supported essential public

Figure 1.2: Trends in Federal Aid to Local Governments (1972-87)



Source: The Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1981-82 Edition, 1988 Edition, Vol. III; and Bureau of the Census, Government Finances in 1986-87.

In the 1980s, changing federalism policies favored an enhanced role for states in the development and implementation of intergovernmental programs. These programs included some that had previously been federal-local.[1] Additionally, federal budget priorities favored defense and entitlement spending over programs for housing, economic development, and infrastructure. Since the latter kinds of programs were predominantly federal-local, aid to localities declined between 1978 and 1986, when measured in constant dollars. As a percentage share of total municipal revenues, federal assistance dropped 55 percent from 1980 to 1987. As a percentage share of total county revenues, federal aid dropped 60 percent over the same period. As table 1.1 suggests, GRS was the most visible, but by no means the only, program cut.[2]

[1]General Accounting Office, Block Grants: Overview of Experience to Date and Emerging Issues (GAO/HRD-85-46, Apr. 3, 1985), Washington, D.C.

[2]The general revenue sharing program (GRS) was enacted as the State and Local Fiscal Assistance Act of 1972 and amended in 1976, 1980, and 1983. It terminated for states in 1980 and local governments in 1986.

Introduction

Local governments are the workhorses of domestic policy. However, they do not carry out their responsibilities alone. In our federal system of government, responsibilities are shared as well as divided. From the 1960s until the end of the 1970s, the federal government increased its activity in local public affairs, expanding the number and scope of federal grants-in-aid programs and increasing grant funding. As a result, general-purpose local governments, notably counties and municipalities, became more dependent on the federal government. In the 1980s, this trend reversed as federal aid to local governments decreased substantially. In particular, the Congress repealed the $4.6 billion-per-year general revenue sharing program (GRS). All local governments have had to adjust to shrinking federal support. However, poorer communities have higher public service needs but fewer resources of their own, circumstances that present them with greater difficulty in absorbing federal aid cuts.

Local Governments Are Major Providers of Basic Public Services

Apart from a very few programs, such as the administration of social security, the federal government plays a minor direct role in the provision of domestic public services. Instead, the vast majority of these programs are implemented through a partnership among federal, state, and local governments. In this partnership, localities are the workhorses. In 1987, local governments led all general governments in direct spending for police and fire protection, sewerage and sanitation, parks and recreation, housing and community development, air transportation, libraries, and general public buildings (see fig. 1.1).

Abbreviations

FY	fiscal year
GRS	general revenue sharing

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program operations helped to maintain public services with less revenues. Raising taxes also helped, but these efforts were modest because local businesses and citizens already bore higher-than-average tax rates. Because management and revenue-raising strategies were insufficient, Passaic and Bridgeton relied most on program spending cuts and the postponement of capital investments to cope with their fiscal problems and the loss of federal funds (see pp. 29-33).

State Aid Helped to Offset Declining Federal Aid

New Jersey reduced the negative impact of GRS losses in its poorest municipalities by expanding a program of fiscal assistance targeted to its poorest communities. Funding under the New Jersey Distressed Cities Program more than offset GRS losses in both Passaic and Bridgeton. For example, Passaic's 1990 allocation under the state aid program was $4.9 million. In constant dollars, this is 170 percent greater than Passaic's 1986 GRS allocation. Similarly, Bridgeton's 1990 allocation under the state aid program was $740,000. In constant dollars, this is 236 percent greater than Bridgeton's 1986 GRS allocation. Local efforts and state aid notwithstanding, GAO found that public services declined in both Passaic and Bridgeton. These outcomes suggest that poorer communities, such as Passaic and Bridgeton, have serious problems that cannot easily be solved. Nevertheless, GAO found that targeted state aid helped by lessening the extent to which spending for local public services declined in the two communities GAO visited (see pp. 34-38).

Recommendations

GAO is making no recommendations.

Agency Comments

GAO did not solicit agency comments.

Executive Summary

Purpose

At the request of the Chairman of the Senate Committee on Finance, GAO examined the condition of public services in poorer communities in light of recent declines in federal-local aid, including the expiration of general revenue sharing. GAO visited communities in three states to (1) examine these conditions, (2) identify the range of local responses to cope with them, and (3) determine whether state policies and actions have helped to offset lost federal funds and maintain public services. This report is a case study of Passaic and Bridgeton, two of the poorest communities in New Jersey.

Background

Local governments are the workhorses of domestic policy implementation. In our intergovernmental system, the federal government looks to county and municipal governments to provide basic public services, such as police, fire, and public works. It also looks to them to help fulfill national domestic objectives, such as economic development and protection of the environment. After increasing for nearly two decades, federal aid that supported these efforts declined in the 1980s. And the Congress repealed the $4.6 billion-per-year general revenue sharing (GRS) program in 1986.

While GRS funds were a relatively small part of most local government budgets, they were important because—unlike most federal aid—they funded basic public services, such as police and fire protection, and supported local public infrastructure, such as schools and roads. In addition, poorer communities received more GRS funds per capita than their wealthier neighbors.

Results in Brief

New Jersey enjoyed substantial prosperity in the 1980s. Yet not all of its communities participated in this economic expansion. New Jersey experienced large and growing disparities between poorer and wealthier communities. Poorer communities faced more difficulties in coping with the loss of federal funds and the expiration of GRS. These losses came when spending for local public services in the two communities we chose for our case studies—Passaic and Bridgeton—was already declining.

Passaic and Bridgeton used some strategies to cope with their fiscal condition and the loss of federal aid that helped to maintain local public services with less revenues. However, these efforts were insufficient. Thus, the strategies Passaic and Bridgeton relied on most were cutting programs and postponing capital investments.