Alternative Methods for Distributing State Aid to Local Governments in New York

Christine K. Ranney, Lee M. Day, and Michael R. Hattery

This paper simulates alternative distributions of general purpose state aid to local governments under different combinations of criteria: tax capacity, effort, and revenue needs. Revenue needs are based on Tobit estimates of the costs of providing average levels of 16 categories of services. Segmenting the sample into high and low population jurisdictions provided a more realistic set of cost estimates. Available revenues or capacity are determined by multiplying each jurisdiction's tax bases by standard tax rates. A Need-Capacity gap, the difference between needed revenues and available revenues, is used as a needs-based distribution strategy for general purpose aid. Finally an effort gap, based on above average tax efforts was added to the Need-Capacity gap to define a Need-Capacity-Effort strategy.

The State of New York has a long history of assistance to local governments. In 1946 a system of shared taxes was replaced with a general purpose aid system where the amount of general purpose aid was detached from specific revenue sources. The distribution of major portions of general purpose aid to local governments was and still is based on population and class of government. The level of per capita aid and, presumably, the level of service provided per capita is highest for cities, followed by towns outside villages, villages, and counties, in descending order. Further, the constant per capita amount to all jurisdictions within a class, villages for example, presumes that the same types of service are provided by all governments of the same class. The validity of the implicit assumptions of the aid formula was challenged when first implemented in 1946 and continues to be challenged today.

Numerous commissions, committees and studies have investigated the aid distribution system in New York (NYS Legislative Commission on State-Local Relations). Criticisms have been of two types: 1) the failure to use multiple criteria for the distribution of aid (for example, fiscal capacity and fiscal effort in addition to need), and 2) the inadequacy of measures currently used under the need criterion. The research reported here addresses both criticisms.

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The objective of this study is to develop and evaluate alternative methods of aid distribution based upon combinations of criteria, specifically, tax capacity, tax effort, and revenue needs. The development of a measure of need that accounts for differential service provision costs is a necessary first step. Cost functions for sixteen service areas are estimated for a sample of jurisdictions in the state. Given the estimated cost functions, a measure of need based on the cost of providing standard levels of each service is predicted for each jurisdiction in the state (except New York City). Alternative aid distribution methods are then simulated using estimated need along with measures of tax capacity and effort. Each step will be presented, in turn, preceded by a discussion of previous research on intergovernmental aid in New York and elsewhere.

The research reported here is the second phase of a research project funded under contract with the New York State Legislative Commission on State-Local Relations. Some of the data utilized for estimating the service area cost functions were collected in Phase One. A rather lengthy and comprehensive survey instrument, completed by local public officials, was administered in the Spring of 1984. For each service listed on the survey, local officials were asked whether or not they provided the service, how they produced it, how they financed it, and whether or not they thought the service was mandated.

Preliminary evaluation of the data from the sample of 240 New York jurisdictions (22 cities, 25 counties, 122 towns, and 71 villages) indicates that
the presumed homogeneity of functions and service structures within cities, towns, villages or counties does not exist (Hattery, et al.). With service level defined as the number of services provided within a general service area category, such as law enforcement, the data exhibits considerable variability in the level of services provided within types of government. Further, the study did not reveal any clear-cut local government hierarchy of service provision as implied by the current formula. In fact, it was found that some villages provided higher levels of services than some cities, yet all cities receive higher amounts of aid per capita than all villages under the current aid formula.

**Intergovernmental Aid**

The literature on intergovernmental aid reveals a great variety of specific criteria or measures for distributing aid. These criteria are based on three major concepts: fiscal capacity, effort, and need. Fiscal capacity is conceived as the capacity to raise local revenues. It is sometimes referred to as tax capacity in recognition of the difficulty of measuring user fees especially when user fees bypass the local government accounting system and budget by going direct to a private producer. Often-suggested measures of fiscal capacity are per capita income, market value of assets, full value assessment, or capacity as measured by a representative tax system such as that used by the United States Advisory Commission on Intergovernmental Relations (1982). Fiscal effort is a concept similar to plant utilization in manufacturing. It is the ratio of revenues raised to fiscal capacity, or the utilization rate of fiscal capacity. Often suggested measures are effective property tax rate, effective sales tax rate, or locally raised revenues divided by fiscal capacity-Fiscal needs recognizes that not all services delivered by all units of government are essential, that some minimum level of service delivery is expected of all units of government, regardless of their fiscal capacity. Measures often suggested include minimum service levels perhaps as reflected by expenditures per capita; service needs for special populations reflected by such measures as percent poor, percent children, and percent elderly; higher costs of achieving specific levels of service output, e.g., higher input costs, especially labor costs in metropolitan areas.

These concepts can be used singly or in combination to represent quite different strategies or philosophies with respect to intergovernmental aid. But it is the combination strategies that appear most interesting in that they allow us to offer decision makers a variety of policy options and at the same time allow them to explore the effects of alternative weights or values on different segments of the American belief system. For example, a combination need-capacity or a need or capacity strategy could encourage the targeting of aid to the most needy jurisdictions. Addition of an effort-based bonus could reward those who make an extraordinary effort to help themselves.

The Massachusetts system, as described by Katharine Bradbury et al., is an example of a combination strategy, more specifically a needs-capacity strategy. The heart of the Needs-Capacity (NQ strategy is the calculation of a gap. The gap is calculated by subtracting from the needed revenues, that level of revenues that would be available if a community taxed its tax base at some average or standard rate. Needed revenues could be defined as the cost of providing some average or standard level of services in the community. The gap between needed revenues and revenue capacity then becomes a measure of the need for intergovernmental aid. The need for intergovernmental aid, as distinguished from needed revenues, could be considered a needs-based distribution strategy for general purpose aid. If the gap is zero, the need for intergovernmental aid is zero. The key to this kind of needs-based aid strategy is a standard of comparison. Needed revenue is based not on the level of services provided by a jurisdiction but on expenditures required to provide some standard level of services.

The Needs-Capacity strategy does not provide a mechanism for rewarding high effort. If we can define an effort gap as the difference between some extraordinary effort and an average or standard effort, we could add the effort gap to the Need-Capacity gap to create a Need-Capacity-Effort Gap. Think for example of defining extraordinary tax effort as the difference between tax revenue when a community taxes its tax base(s) at some higher-than-average rate and that level of tax revenue it would receive if it taxed its tax base(s) at an average or standard rate. The use of the Need-Capacity-Effort gap strategy in addition to considering the need for intergovernmental aid would provide an effort bonus to those jurisdictions that made an extraordinary effort to help themselves. This strategy along with the Need-Capacity strategy are evaluated in this paper.

**Estimation of Need**

Both aid distribution strategies require estimates of need, defined here as the cost of providing a stan-
ard level of service. To predict need for all jurisdic-
tions in the state we begin by utilizing the Phase
One sample of 240 governmental units and estimate
indirect cost functions (Q) for each of i = 1, . . . , 16
service areas. In general form,

\[ C_i = C_i(w_1, \ldots, w_n, q_i, S), \]

where the \( w_j, j = 1, \ldots, n, \) are input prices, \( q_i \) is
output for service area \( i, \) and \( S \) is a vector of char-
acteristics of the jurisdiction assumed to affect cost.
This cost function assumes cost minimizing behavior
and is convenient to use because, at least theoreti-
cally, it is a function of observable variables.

Certainly, costs (or expenditures), input prices, and
jurisdiction characteristics are directly observ-
able. However, obtaining output measures for ser-
vice is problematic. As a proxy for service output or
level we calculated service indices based upon
responses to the Phase One survey. By intent, the
survey was organized in a service hierarchy or cat-
egory scheme that provided the basis for aggre-
gation into sixteen service areas: law enforcement,
fire prevention and control, animal control, health
services, social services, services to the aging, re-
creation and culture, planning, highway, sewer, san-
itation, water, public transportation, community
development, economic development, and natural
resources. With some exceptions, the index for
service area \( i \) (IND;), the service level, is a simple
summed scale of the presence \((=1)\) or absence \((=0)\) of provision of each service included in the
service category.

The empirical specification of the cost function
for the \( i \)th service category is

\[ C_i = b_0 + b_1LCOST + b_2NLCOST + b_3DENTOV + b_4POPTOV + b_5POPTOV^2 + b_6INDj + b_7INDPOPi + b_8TOWN + b_9CITY + b_{10}VILLAGE + b_{11}OTHREVi + \sum b_{(11 + n)}S_n + U_j, \]

where the variables are as described in Table I and
the number of terms, \( n, \) in the summation depends
upon service area. For example, MILEAGE would
be included in \( S \) when estimating highway and
perhaps other costs. Likewise, when estimating social
service costs, the extent of poverty (POV) may be
important. The values of these variables do not
differ by service area, but whether they are in-
cluded does differ by service area. It was not pos-
sible to determine labor and nonlabor cost by service
area. Hence, LCOST and NLCOST, as well as the
variables in \( S, \) are not subscripted. Note that OTH-
REVi is not included in \( S \) because we do observe it
for each service area.

Because some service areas are not provided by
some jurisdictions, the dependent variables are limited
with a lower bound of zero. Thus, changes in the
explanatory variables affect not only the cost level
for jurisdictions providing services, but may also
affect the number of jurisdictions that do or do not
provide services. In such limited dependent variable
cases. Ordinary Least Square (OLS) estimation
yields inefficient estimates of the parameters and
inaccurate estimates of the expected values of the
dependent variable. Specifically, forecasts based
on OLS estimates can be negative. Tobit analysis
(Tobin, 1958) avoids these problems and is utilized
for this study.¹

Preliminary Tobit analyses yielded projected cost
estimates that were particularly high for low pop-
ulation municipalities. This problem, encountered
by others, has been resolved by segmenting the
sample by population size when analyzing local
government expenditures (Stinson and Lubov, 1982).
Accordingly, we estimated cost functions for high
and low population municipalities separately and
were able to obtain a much closer correspondence
between actual and projected values for both groups.
The population thresholds for segmenting the sample
were determined for each service by inspecting
bivariate plots of total expenditures for the service
versus population. The plots were examined for the
presence of a point at which the relationship be-
tween expenditures exhibited a marked change. In
general, a population level of 8,000 was used to
sort municipalities into the low \(<8,000)\) or high \(>8,000)\) group.

The Tobit estimates of the cost functions for
jurisdictions with populations of more than 8,000
and less than 8,000 are presented in Tables 2 and 3,
respectively. A sequence of likelihood ratio tests
were conducted to obtain the final specifications
reported in the tables. For the set of jurisdiction-
type dummy variables, F-tests were undertaken to
determine whether the set should be included in the
specification. If so, the coefficients are reported
in the table. All other coefficients reported therein
are significant at the 95 percent confidence level
based on asymptotic t-statistics. The coefficients
cannot be directly interpreted as marginal changes
in total costs as would be the case if they were
obtained from OLS. Note that for Health and Social
Services, only counties were included because few
towns, cities, or villages provided any of the ser-
vice within the category. The state designates

¹ An anonymous reviewer pointed out that a more flexible alternative
approach would be to utilize the Heckman-type two-step sample-selection
correction procedure which involves estimating a logit or probit model for
determining the probability of providing the service, calculating a bias-
correction factor, and using that factor in OLS estimation of service costs.
Table 1. Variable Definitions

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>$C_i$</td>
<td>Jurisdiction operating cost of providing service area i in (FY 1984). (^a)</td>
</tr>
<tr>
<td>LCOST</td>
<td>Labor cost per jurisdiction employee (FY 1984) including wages(^b) and fringe benefits(^c).</td>
</tr>
<tr>
<td>NLCOST</td>
<td>Nonlabor cost per jurisdiction employee (FY 1984). (^c)</td>
</tr>
<tr>
<td>DENTOV</td>
<td>Density of jurisdiction. (^d)</td>
</tr>
<tr>
<td>POPTOV</td>
<td>Population of jurisdiction. (^e)</td>
</tr>
<tr>
<td>POPTOV^2</td>
<td>POPTOV x POPTOV</td>
</tr>
<tr>
<td>IND_i</td>
<td>Jurisdiction level of service index for service area i.</td>
</tr>
<tr>
<td>INDPOP_i</td>
<td>IND, x POPTOV</td>
</tr>
<tr>
<td>TOWN</td>
<td>1 if jurisdiction is a town, 0 otherwise.</td>
</tr>
<tr>
<td>CITY</td>
<td>1 if jurisdiction is a city, 0 otherwise.</td>
</tr>
<tr>
<td>VILLAGE</td>
<td>1 if jurisdiction is a VILLAGE, 0 otherwise (omitted category is COUNTY).</td>
</tr>
<tr>
<td>OTHEREV_i</td>
<td>Revenues from other municipalities for provision of services within service area i(^e)</td>
</tr>
<tr>
<td>S</td>
<td>Jurisdiction characteristics including percent in poverty (POVERTY), percent over 65 years of age (ELDERLY), percent youth (YOUTH), education levels (ED), percent of housing with plumbing (PLUMBING), and road mileage (MILEAGE). (^e)</td>
</tr>
</tbody>
</table>

\(^a\) Source: New York State Comptroller’s Bureau of Municipal Research and Statistics within the Division of Municipal Affairs.
\(^b\) Source: New York State Public Employee Retirement System and Police and Firemen’s Retirement System database.
\(^c\) Calculated by subtracting labor cost from total operating cost and then dividing by the number of employees for each jurisdiction.
\(^d\) Source: 1980 Census of Population and Housing. For towns with villages, the village population has been deducted from the total. Hence POPTOV and DENTOV reflect a town-outside-village (TOY) adjustment.
\(^e\) Sources: The mileage data were obtained from the New York State Department of Transportation and the remaining variables from the 1980 Census of Population and Housing.

counties to administer most social services. A similar argument can be made for Health, although many towns, cities, and villages do provide some health services. For Planning, two equations were estimated, one for counties and one for towns, cities, and villages. No Planning index was calculated for counties due to inconsistencies in the survey instruments between counties and towns, cities, and villages. Therefore, town-city-village and county planning costs were estimated with and without an index term, respectively. For these services, the split by population size was not undertaken. Therefore, the results for these services are included in Table 2 but not Table 3. Because the primary purpose for estimating the cost functions is to forecast standard need levels for simulation purposes, only a general analysis of the Tobit results will be undertaken.

To determine whether jurisdiction types explain differences in service provision costs, dummy variables for municipal type (town, city, and village) were included in the cost function specifications, where appropriate. For high population jurisdictions, fourteen of the cost functions were specified with jurisdictional dummy variables. Table 2 shows that for seven of these fourteen services municipal types significantly affected costs. In Table 3, six of the thirteen service cost estimates for low population jurisdictions are significantly affected by the municipal-type variables. There is not an exact correspondence in terms of which service costs are significantly affected by municipal types between the two population size groups. Even within a size group the relative magnitudes differ a great deal across jurisdiction types and services.

Preliminary specifications of the cost functions included a number of variables (S) hypothesized to affect service provision costs depending upon the service area. As reported in the tables, the only two variables that significantly do so are MILEAGE and BELOWPOV. MILEAGE may be reflecting service level for those with positive coefficients among high population jurisdictions [Law, Highway, Sanitation, Water, Economic Development, and Natural Resources] and low population jurisdictions (Law, Fire, Highway and Sanitation). The negative coefficients of MILEAGE for the cost of providing Sewer and Transportation by high population jurisdictions may be reflecting some economics of size. With the exception of BELOWPOV, which has a large effect on the cost of Community Development services for high population jurisdictions, none of the socio-demographic variables such as percent elderly were...
Table 2. Tobit Estimates of Service Cost Functions for Municipalities with Population ≥ 8,000

<table>
<thead>
<tr>
<th>SERVICE AREA</th>
<th>CONSTANT</th>
<th>LCOST</th>
<th>NLCOST</th>
<th>DENTOV</th>
<th>POPTOV</th>
<th>POPTOV²</th>
<th>IND</th>
<th>INDPOP</th>
<th>TOWN</th>
<th>CITY</th>
<th>VILLAGE</th>
<th>OTHREV</th>
<th>MILEAGE</th>
<th>BELOWPOV</th>
<th>R²</th>
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<tbody>
<tr>
<td>Law</td>
<td>-67.0</td>
<td>0.9</td>
<td>-134.5</td>
<td>0.130</td>
<td>7.34</td>
<td></td>
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</tr>
<tr>
<td>Fire</td>
<td>-3,019.6</td>
<td>-0.034</td>
<td>6.51</td>
<td>1,958.5</td>
<td>5,152.0</td>
<td>2,768.6</td>
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<td></td>
<td></td>
<td></td>
<td>.79</td>
</tr>
<tr>
<td>Animar</td>
<td>31.0</td>
<td>1.4</td>
<td>-0.001</td>
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</tr>
<tr>
<td>Health</td>
<td>46,224.0</td>
<td>-3,563.7</td>
<td>456.9</td>
<td>54.5</td>
<td>0.94</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td></td>
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<tr>
<td>Social Services</td>
<td>134,340.0</td>
<td>-3,176.9</td>
<td>376.7</td>
<td>-466.7</td>
<td>3,605.9</td>
<td>29.78</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.98</td>
</tr>
<tr>
<td>Aging</td>
<td>120.4</td>
<td>4.0</td>
<td>-829.3</td>
<td>-1,320.6</td>
<td>-4.83</td>
<td>9.9</td>
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<tr>
<td>Recreation</td>
<td>-3,271.1</td>
<td>51.1</td>
<td>-0.012</td>
<td>-0.34</td>
<td>2,943.0</td>
<td>3,461.0</td>
<td>3,017.4</td>
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<tr>
<td>Highway</td>
<td>3.3</td>
<td>46.2</td>
<td>-0.019</td>
<td>-2.13</td>
<td>8.0</td>
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<td>.87</td>
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<td>Sewer</td>
<td>-1,738.1</td>
<td>33.1</td>
<td>-0.009</td>
<td>452.0</td>
<td>-1.31</td>
<td>-6.0</td>
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<tr>
<td>Sanitation</td>
<td>-3,967.4</td>
<td>31.7</td>
<td>-0.106</td>
<td>4.39</td>
<td>2,865.9</td>
<td>3,120.8</td>
<td>3,582.2</td>
<td>6.24</td>
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<td>Water</td>
<td>-7,416.7</td>
<td>-0.026</td>
<td>4.99</td>
<td>7,991.5</td>
<td>7,9248</td>
<td>7,179.8</td>
<td></td>
<td>4.9</td>
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<tr>
<td>Transportation</td>
<td>-2,082.3</td>
<td>36.7</td>
<td>-0.022</td>
<td>2.98</td>
<td>-9.0</td>
<td>-1.31</td>
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<td></td>
<td></td>
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<td>.71</td>
</tr>
<tr>
<td>Planning (Co)</td>
<td>-507.6</td>
<td>28.3</td>
<td>0.9</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
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<tr>
<td>Planning (TVC)</td>
<td>-94.8</td>
<td>2.3</td>
<td>3.6</td>
<td>0.20</td>
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<td>.71</td>
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<tr>
<td>Community Development</td>
<td>-90,007.5</td>
<td>26.6</td>
<td>-0.023</td>
<td>1.27</td>
<td>4,532.5</td>
<td>5,5188</td>
<td>6,548.5</td>
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<td></td>
<td></td>
<td>34,238.0</td>
<td>.53</td>
</tr>
<tr>
<td>Economic Development</td>
<td>-796.1</td>
<td>0.003</td>
<td>2.6</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td>.70</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>-60.1</td>
<td>0.003</td>
<td>46.98</td>
<td>-0.43</td>
<td>-220.9</td>
<td>-99.5</td>
<td>-143.57</td>
<td>0.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.94</td>
</tr>
</tbody>
</table>

1 Population cutoff is 5,750 rather than 8,000.  b Includes all counties and no towns, villages, or cities.
2 No index available.  d Counties excluded.
NA = not applicable. This indicates that the variable was excluded from the specification.
Table 3. Tobit Estimates of Service Cost Functions for Municipalities with Population < 8,000

<table>
<thead>
<tr>
<th>SERVICE AREA</th>
<th>CONSTANT</th>
<th>LCOST</th>
<th>NLCOST</th>
<th>DENTOV</th>
<th>POPTOV</th>
<th>POPTOV2</th>
<th>IND</th>
<th>INDPOP</th>
<th>CITY</th>
<th>VILLAGE</th>
<th>OTHERV</th>
<th>MILEAGE</th>
<th>R-</th>
</tr>
</thead>
<tbody>
<tr>
<td>Law</td>
<td>-291.6</td>
<td>16.8</td>
<td>-1.6</td>
<td></td>
<td></td>
<td>3.9</td>
<td>185.5</td>
<td>75.9</td>
<td>0.0014</td>
<td>.7</td>
<td>.0011</td>
<td>.0015</td>
<td>.7</td>
</tr>
<tr>
<td>Fire</td>
<td>-20.5</td>
<td>1.8</td>
<td>-0.2</td>
<td>1.07</td>
<td>-0.22</td>
<td>-0.70</td>
<td>-15.7</td>
<td>-2.9</td>
<td>.0011</td>
<td>.66</td>
<td>.0011</td>
<td>.0015</td>
<td>.65</td>
</tr>
<tr>
<td>Animal</td>
<td>-1.6</td>
<td>0.1</td>
<td>-0.1</td>
<td>1.05</td>
<td></td>
<td></td>
<td></td>
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* Only thirteen of the sixteen services are reported here. As noted in the (exl the other three, Planning, Social Services, and Health are treated differently. The results for those services are reported in Table 2.

b Only city and village dummy variables are included. No counties were included in this population size group. Therefore, the omitted dummy variable is TOWN.

c Population cutoff is 5,750 rather than 8,000.
It may be the case that total population overwhelms differences in characteristics within the population in determining costs. Of particular interest is the fact that at least one of the two terms based on our calculated service indices (IND and INDPOP) is significant for eleven of thirteen and thirteen out of sixteen of the service areas provided by low and high population jurisdictions, respectively. The significance of these terms is important for two reasons. First, the significance of the service level indices suggests that we may have made a first step toward solving a problem that has plagued researchers for some time, the lack of a useful proxy for service level or output. Second, specific values of each service area index are used as proxies for the standard service levels in the simulations.

**Calculating Standard Need**

The cost function estimates provide the basis for predicting the cost of providing a standard level of each service for every jurisdiction in the state. To predict these costs, the weighted average of the service level index (AVEIND) and that average multiplied by actual population (AVEINDPOP) replace IND and INDPOP for prediction purposes. The weights were used to correct for differences in distribution of municipal types in the sample compared to the state. Thus, AVEIND and AVEINDPOP, along with actual values for the remaining variables are multiplied by the corresponding estimated coefficients from Table 2 or 3 and transformed through the Tobit framework to obtain $C_f^j$, the cost to the $j$th jurisdiction of providing a standard level of the $i$th service. The method by which these standardized costs are utilized for projecting needed revenues is described in the following section on simulation.

**Simulation**

In the remainder of this paper we will be concerned with utilizing these cost estimates and other data from the financial accounting system to simulate the effects of alternative general strategies and specific policy options on the distribution of per capita state aid. The two general strategies to be investigated are combination strategies: a Need-Capacity gap and a Need-Capacity-Effort gap. The policy options will include alternative standard tax rates and alternative weights on Need-Capacity and Effort gaps.

It is assumed that all jurisdictions are held harmless at the current dollar amounts of per capita aid and the simulations are concerned only with possible changes in the formula for the distribution of appropriations above the hold harmless level. The appropriations to be distributed under the new alternatives are assumed to be at the $100 million level.

The general framework of taxation will be held constant. For example, only counties and cities will be allowed to levy a sales tax. City and county sales tax rates may change but the limit on local sales tax rates of 3 cents (with exceptions for a few jurisdictions) remains. All jurisdictions retain the right to levy a tax on real property but the tax rate will be allowed to vary. All other taxes and fees are assumed to be held constant at the FY1984 levels, i.e., only the rates on real property and county and city sales tax rates will be allowed to vary. New taxes are not considered.

In equations (3) through (7) below, the general procedure will be to: a) define and compute Needed Revenue ($NR$) and Revenue Capacity ($RC$) and use these calculations to compute a need-capacity gap ($NCGAP$) for each jurisdiction; b) calculate an effort gap ($EGAP$) for the jurisdictions making an extraordinary effort to raise revenues; and c) add the effort gap to the need-capacity gap to form a need-capacity-effort gap ($NCEGAP$) strategy. Needed Revenue is defined as

\begin{equation}
NR_j = \text{Needed Revenue in the } j\text{th jurisdiction,}
\end{equation}

where: $CGG_j = \text{total operating cost of general government support activities in the } j\text{th jurisdiction,}$

$C_{sij} = \text{the total operating cost of providing the } i\text{th service at the } s\text{th standard level}$

the $C_{sij}$ are calculated as described in the previous section.

It should be noted that an accounting system designed for maintaining accountability does not include depreciation on buildings or other investments. Also, while operating costs were estimated for average levels of service, alternatives such as a standard deviation unit above or below the average could be considered.

Revenue Capacity for jurisdiction $j$ is defined as

\begin{equation}
RC_j = B_{1j}t^1_j + B_{2j}t^2_j + K_j,
\end{equation}

where: $B_{ij} = \text{the real property tax base at full value assessment in the } j\text{th jurisdiction,}$

$t^s_j = \text{the standard real property tax rate}$
B_{2j} = \text{the county (or city) sales tax base}
\tau_{2s} = \text{the standard county (or city) sales tax rate}
K_j = \text{other income to the government of jurisdiction } j, \text{ included fees, user fees, other property taxes, federal and state aids and income derived from services performed for other governments.}

Any analyst initiating work of this kind would be well advised to become acquainted with the idiosyncrasies of the state accounting system. In New York for example, county sales tax revenues may be distributed to cities, towns and villages via a sales tax credit against the property tax levied by the county in those jurisdictions. Thus county property tax revenues must be adjusted to include those sales tax credits before the revenue is divided by full-value assessment to obtain the property tax rate. Other states probably have a large number of pitfalls of this type.

Average tax rates were assumed as the initial definition of a standard tax rate. City sales tax rates were averaged over 61 cities including a zero for the 33 cities which chose not to levy a sales tax. County sales tax rates were averaged over 57 counties including a zero for four counties that chose not to levy a county sales tax. \(^3\)

Property tax rates were averaged over all 1,606 jurisdictions. It might be argued that the property tax rate should be averaged within type of jurisdiction, that is within counties, cities, villages and towns. Note that cities typically levy higher tax rates than do other jurisdictions. To compute an average property tax rate for cities and to use that as the standard rate of utilization of the property tax base would appear to constitute a bias against cities. For example, for any given minimum level of service, the need-capacity gap would be smaller for cities (because of the higher tax rate for cities) and the amount of aid received by cities would be proportionately lower. Thus the standard property tax rates were derived from the average across all 1,606 jurisdictions.

The Need-Capacity gap is defined as

\[
\text{(5)} \quad \text{NCGAP}_j = \text{NR}_j - \text{RC}_j \quad \text{s.t.} \quad \text{NR}_j > \text{RC}_j.
\]

As a first step in developing another strategy for the distribution of general purpose aid an effort gap is calculated as

\[
\text{(6)} \quad \text{EGAP}_j = \text{OSR}_j - (B_{ij}\tau_1 + B_{2jt_2}),
\]

s.t. \quad \text{OSR}_j > B_{ij}\tau_1 + B_{2jt_2},

where: \text{OSR}_j = \text{own source revenue or total revenue less state and federal aids}

\[B_{ij}\tau_1 = \text{revenue from taxing the full value assessment of real property at standard rate}\]

\[B_{2jt_2} = \text{revenue generated by a sales tax; when sales are taxed at a standard rate for that class of jurisdiction of which } j \text{ is a part.}\]

The Need-Capacity-Effort gap is defined as

\[
\text{(7)} \quad \text{NCEGAP}_j = a_1\text{NCGAP}_j + a_2\text{EGAP}_j,
\]

where: \[a_1 = \text{the weight to be attached to the need-capacity gap}\]

\[a_2 = \text{the weight to be attached to the extraordinary effort as measured by the effort gap.}\]

Finally, within any particular strategy or policy option the distribution of general purpose aid to a jurisdiction is given by

\[
\text{(8)} \quad \text{AID}_j = \sum_j \frac{\text{GAP}_j}{\text{GAP}_j} \times \text{Appropriations}.
\]

Using standard spreadsheet software, the effects of alternative strategies and policy options on the distribution of per capita aid are simulated. Within the two general strategies, Need-Capacity and Need-Capacity-Effort, the alternatives were limited to two different tax rates (average and one standard deviation unit below average) and alternative weights on need-capacity and effort gaps. The procedure can easily accommodate different standard levels of service, but the results using alternative levels of services are not presented here.

The results of eight simulations are presented in Table 4. As a means for interpreting these results, first consider the effect of adding effort as a criterion for distributing aid. Holding tax rates constant at the average level and then at one standard deviation below the average (low rate) implies comparing columns 1, 3, 5 and 7 of Table 4 for average rates and 2, 4, 6 and 8 for low tax rates. In each case adding an effort bonus shifts the distribution toward counties and cities and away from villages and towns. The shift is exaggerated as higher weights are placed on effort, compare for example columns 5 and 7 at average tax rates or columns 6 and 8 at low tax rates.

Lowering the standard tax rate shifts the distri-
Table 4. Simulation Results for Alternative Aid Distribution Strategies: AVERAGE NEEDS

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<th>(1) NC Avg. Rates</th>
<th>(2) NC Low Rates</th>
<th>(3) NCE Avg. Rates High Wt. on NC</th>
<th>(4) NCE Low Rates High Wt. on NC</th>
<th>(5) NCE Avg. Rates Equal Weights</th>
<th>(6) NCE Low Rates Equal Weights</th>
<th>(7) NCE Avg. Rates High Wt. on Effort</th>
<th>(8) NCE Low Rates High Wt. on Effort</th>
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* Weight on NC = 2, weight on E = 1.  
  † Weight on NC = 1, weight on E = 2.  
  ‡ Expenditures are total operating expenditures for 16 services analyzed in this report.
bution of aid toward counties and towns and away from cities and villages when effort is not included as a criterion. In contrast if effort is included among the criteria, lowering the standard tax rate shifts the distribution toward towns only and away from counties, cities and villages. This shift in distribution takes place at all weights on effort considered in this analysis.

The final two columns of Table 4 allow some interesting comparisons with each other and with different aid distribution strategies. First, note that while counties currently make 63 percent of the actual operating expenditures for the sixteen services, they receive only 12 percent of the current aid distribution. In contrast cities currently make 15 percent of the expenditures for services but receive 52 percent of the current aid distribution. The gap strategies, providing between 34 and 52 percent of the aid to counties, represent a middle ground between the current distribution of aid and of expenditures. The gap strategies, providing between 14 and 21 percent of the aid to cities are more closely aligned with the distribution of expenditures than with the current distribution of aid.

In order to gain some insight into the distributional effects of the different strategies it is useful to define the most needy jurisdictions and compare on a per capita basis the distribution of aid to those jurisdictions with that to other jurisdictions. For example, define needy jurisdictions in terms of need-capacity where the need is defined as the costs of each of the services at a standard level plus the costs of general government support and the capacity is defined as the income generated by taxing the tax base(s) at the standard tax rate plus all other income including federal and state aid. Further, we define the most needy jurisdictions as those 10 percent with the largest gap between needed revenues and available revenues. Note that a large gap between needed revenues and available revenues could arise from either high costs of providing a standard level of services or lower available revenues resulting from lower tax bases. It is useful to make these comparisons on a per capita basis as shown in Table 5.

As expected all aid distribution strategies investigated here gave markedly more aid to the most needy of the counties, cities, villages and towns. But the ratio of aid for the most needy to that for the average jurisdiction was by no means uniform across strategies. For example, at average tax rates comparing columns 1, 3, 5 and 7 for counties, it is seen that the addition of an effort bonus lowers the ratio of the amount received by the most needy counties to that received by the average county and that tendency is exaggerated as the weight on effort increases. This statement is also true for cities towns and villages. Using a comparison of columns 2, 4, 6 and 8 reveals the same conclusions for low tax rates.

Clearly if the objective is to give the most aid to the most needy governments of each type, the need-capacity gap is the preferred strategy followed in order by need-capacity-effort with high weight on NC, NCE with equal weights and NCE with high weight on effort.

Making comparisons across types of governments, note that for all strategies, cities receive the largest per capita aid followed in order by villages counties, and towns. But the spread from top to bottom, cities to towns, is largest for NC strategies and decline as effort is added as a criteria and that decline in spread continues as effort receives a higher weight (compare columns 1, 3, 5 and 7 for average tax rates and 2, 4, 6 and 8 for low tax rates). Although cities and villages would receive higher amounts of aid than counties on a per capita basis, the higher population in counties would mean that the aggregate amount of aid going to counties would far exceed that going to any other type of jurisdiction.

Formulating the information on gainers and losers as shown in Tables 4 and 5 portrays the difficult political tradeoffs facing decision makers regarding intergovernmental aid. Table 5 clearly demonstrates that all the need-capacity and need-capacity-effort strategies analyzed here target aid distribution toward the most needy jurisdictions in contrast to the uniform rate per capita provided to each class of jurisdiction under the current per capita aid grant formulas. But on the other hand, compared to the status quo as reflected in column (9) of Table 4, all of the need-capacity and need-capacity-effort approaches involve substantial redistribution of aid away from cities with counties and villages being the major beneficiaries. Because of this major departure from the status quo, it seems likely that the adoption of any of these strategies would be feasible only if the program were designed as an increment to the current aid distribution.

This research provides a framework for designing alternative methods for distributing state aid to local governments in New York State. The particular strength of this innovative methodology is the fact that all suggested alternatives rest on a solid foundation of service cost estimation. This foundation could be further strengthened with additional research. The current estimation procedure, with a cost function estimated for each service category, presumes that there are no tradeoffs between services when cost conditions change. A joint estimation procedure, wherein all service cost functions are estimated at the same time, would allow for
Table 5. Comparison of Effect of Alternative Strategies on Aid Distribution Per Capita to the Most Needy Jurisdictions

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<td>NCE</td>
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<td>Avg. Rates</td>
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<td>Avg. Rates</td>
<td>Low Rates</td>
<td>Equal Weights</td>
<td>Equal Weights</td>
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<td>4.86</td>
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<td>Average 10% Most Needy Cities</td>
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<td>19.42</td>
<td>15.94</td>
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<td>9.77</td>
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<td>13.25</td>
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<td>2.53</td>
<td>3.65</td>
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<tr>
<td>Average 10% Most Needy Villages</td>
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<td>21.19</td>
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<td>3.79</td>
<td>2.55</td>
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<td>3.53</td>
<td>3.22</td>
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<td>2.54</td>
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</table>

- Weight on NC = 2, weight on E = 1. 
- Weight on NC = 1, weight on E = 2.
interaction between services and is a logical next step for further research. This approach may add further insights into alternative methods for distributing state aid to localities in New York and elsewhere.

References


-29, Department of Agricultural Economics, Cornell University, Ithaca, New York, December, 1986.


