Richard J. Reeder on Rural Governments

Facing New Fiscal Strains

Just as rural governments learned how to handle the "coping with growth" challenge of the 1970s, a new generation of fiscal problems has surfaced. The new fiscal strains are on the whole more difficult to deal with than the old ones. Most arise from renewed economic hardship rather than from economic growing pains.

Today's strains come at a time when General Revenue Sharing has been eliminated and other federal aid has been frozen or reduced. Thus, responsibility for easing the fiscal strains of rural local governments lies increasingly with the states. Many rural states are themselves hard pressed by the new fiscal strains of the 1980s, especially those in the Plains and in the South. The way rural states respond to their fiscal problems in the coming years will test the effectiveness of decentralized decisionmaking in our federal system of government.

Rural Governments In Trouble

The most dramatic of the new rural fiscal strains is associated with the farm and energy economies. Beginning in the early 1980s, depressed agricultural prices and declining farmland values placed increased fiscal pressures on rural states and their local governments.

Two recent surveys covering city and county governments confirm that rural local governments are currently experiencing problems in raising revenues. A March 1987 survey by the National League of Cities (NLC) found that most (53 percent) of the small cities surveyed anticipated a decline in general revenue for FY 1987. This number is up markedly from FY 1986, when 28 percent of the small cities had declining revenues. It also contrasts sharply with the experience of large cities. Only 8 percent of the large cities expected revenue declines in FY 1987. Because general revenue is used for most operating expenses, and includes taxes, fees, and intergovernmental revenue, it is an important indicator of fiscal well-being.

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City fiscal conditions, FY 1987

Percent of cities experiencing

Population size	Decrease in general revenue	Decrease in spending	More than a 5 percent shortfall in revenue
All cities	38	21	26
More than 300 thou.	8	5	8
100-300 thou.	18	10	17
50-100 thou.	34	22	26
10-50 thou.	33	24	27
Less than 10 thou.	53	28	35

Source: National League of Cities, City Fiscal Conditions in 1987.

These revenue conditions account for decreases in spending and the shortfall in revenues (relative to expenditures) experienced by one third of the towns and cities with less than 10,000 population. Because deficit financing is limited for local governments, such fiscal imbalances cannot be sustained for long. Many cities surveyed by NLC increased their tax rates and their user fees in FY 1987.

Spending cuts were also fairly common. Capital spending was cut more often than spending on current services. Cutting capital spending may be an expedient short-term approach to fiscal problems. However, inattention to capital needs will have negative, long-term consequences.

A 1985-86 survey by the National Association of Counties (NACo) shows similar signs of fiscal strain for rural counties. The NACo survey found 17 percent of the rural counties (under 50,000 population) with "no increase" in own source general revenue during a period from 1981-86 when inflation increased state and local government costs by about 28 percent. Only 4 percent of urban counties (over 50,000) had a decrease in own source general revenue in the 1981-86 period.

The survey indicated that insufficient tax base, legal limits on taxes, limited ability to increase user fees, and federal aid cuts were particularly problematic for rural counties. Although rural counties complained more about federally mandated requirements than did urban counties, the most universal problem for rural county governments was state mandates without funding. This underscores the primary importance of state governments in dealing with the fiscal problems of rural local governments.

More State Aid In Doubt

State aid is important to local governments. It accounts for over one third of local government general revenue and is five times as great as federal aid to local governments. Much of state aid goes to finance local schools. Hence, the success of current efforts to upgrade local education in places where local governments are struggling financially will depend to a large extent on state aid.

Some states are aggressively coming to the assistance of local governments. But there are great disparities among states. Heavily populated states with large urban populations, such as New York, Massachusetts, California, and Michigan increased state aid substantially, while the more lightly populated rural states provided only marginal increases, often not even keeping pace with inflation. For example, in 1985, the state aid increase was less than 2 percent in Montana and Idaho. State aid actually declined in Oregon (-8.4 percent); New Hampshire (-5.4 percent); and Wyoming (-2.5 percent).

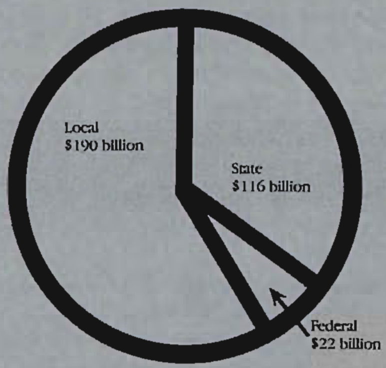
There is no reason to suppose things have improved much since 1985. Many rural states are still feeling the effects of depressed farm and energy industries. In the year ending in March 1987, state government tax collections declined in Alaska (-36 percent); North Dakota (-12 percent), Oklahoma (-11 percent); Louisiana (-8 percent), and Texas (-7 percent). In these states, severence taxes fell markedly because of the energy slump.

Only marginal increases in tax collections were recorded in Mississippi (0.4 percent); Oregon (0.7 percent); South Dakota (1.4 percent); Arkansas (1.6 percent); Minnesota (2.9 percent); and West Virginia (3.1 percent), all having significant agriculture and resource-based industries which have suffered from global economic fluctuations. Until the economy improves, local governments in these and other rural states probably cannot expect much in the way of additional state aid.

Nowhere is the presence of urban/rural fiscal disparities more noticeable than in the southeast. There, a few states with healthy, growing metropolitan areas (Florida, Georgia, North Carolina, Virginia, Maryland, and Tennessee) have done relatively well in the 1980s. However, other, more rural states have lagged behind.

Compounding their fiscal problem is the increased effort many southern states and localities are making to improve government services—particularly education. Acting under the perception—perhaps correct—that the best way to continue rural economic development in the region is through improved education and training, even the poorest southern states have made efforts to upgrade and reform education over the past few years. But recent economic difficulties in some of these states may now stifle their education reforms.

Sources of Local Government Revenue in Fiscal Year 1985



Federal excludes aid "passed through" State governments.
Local is net of local payments to States.
Source: U.S. Department of Commerce, Bureau of the Census.

Federal Aid Dims, Too

The prospects for federal aid are fairly bleak, also. In the first quarter of 1987, federal aid to state and local governments was up only 2.5 percent from the 1985 aid level of $99 billion. Over this same period, state and local government costs increased by about 10 percent. With the termination of the General Revenue Sharing (GRS), federal aid has actually declined about $5 billion in the past year. There will be no federal aid for many rural local governments because GRS was the only federal program providing them funds.

The trend over the past 10 years has been one of fiscal decentralization. Fueled by the need to reduce federal budget deficits, this trend is shifting fiscal responsibilities from federal to state and local governments. Perhaps due to their own severe financial situation, most rural states have not done much recently to alleviate local government fiscal pressures.

Nevertheless, Iowa is proposing to provide money for local property tax relief; Idaho, South Carolina, and North Dakota are providing new revenues to local governments. Even some urban states, such as New York and Massachusetts, have proposed increasing assistance to rural governments. Thus, the jury is still out on whether decentralized fiscal decisionmaking will aggrevate or mitigate disparities between the have and have not jurisdictions, many of which are rural. C