FINANCING AND PROVIDING GOODS AND FACILITIES

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A review of the principles of fiscal federalism provides justification for the assignment of government functions to various levels of government. Service provision should be assigned to the lowest possible governmental unit, so service levels can vary to meet the preferences of citizens. Larger units of government usually contain more heterogeneous populations and the service level provided is less likely to satisfy citizen preferences. Small units can be more homogeneous, so services are more likely to meet the preferences of residents.

However, small units are at a disadvantage in the presence of economies of scale in service provision. Large scale provision is sometimes required to minimize costs, so larger units are able to provide services at lower cost to taxpayers. Small units can also create problems with "benefit spillovers." Small governments, responding to their constituencies, provide a particular level of services. If these services benefit people outside the jurisdiction—the benefits of highways to commuters is one example—then the services may be underprovided. A larger unit which includes within its constituency more of the beneficiaries of public services will more likely provide services at the appropriate level.

The assignment of public service functions should also take into account resource capacity. Revenue sources must be adequate to support the assigned functions. If fiscal disparities exist, meaning that some jurisdictions face higher provision costs and have fewer taxable resources than others, higher levels of government may wish to provide grants-in-aid to equalize tax burdens and service levels. At the federal level, the trend has been toward less aid to local governments. Aid as a percentage of state and local expenditures rose from just under 10 percent in 1954 to more than 25 percent in 1978, but has since declined to a bit more than 15 percent in 1988. A continuation of this downward trend is expected.

Economies of scale are often present in the provision of education by local schools. Larger schools can offer more programs; smaller schools sometimes have difficulty providing the courses required by the state curriculum. Curriculum requirements in Minnesota will increase in 1990 and rural high schools with enrollments under 300 are expected to have difficulty providing the additional courses. Consolidation may be required, though it is often difficult to achieve. Some state education aid programs encourage the continuation of small school districts. This was mentioned as a particular problem in North Dakota. In Minnesota, however, aid will be assigned to the pupil, rather than to the school district. Pupils can choose which school to attend, taking their aid with them, a program intended to create beneficial competition among schools. Small schools could survive by specializing in particular programs, if school superintendants could be induced to cooperate. Lack of cooperation among local administrators is another barrier to consolidation, though Iowa has had some success with a program to share administrators across districts.

Small schools offer some advantages. Pupils may need to spend an unacceptable amount of time on buses when sparsely populated rural districts are consolidated. Some rural districts may have the resources to provide a full scope of services. Districts in western Kansas with local severance tax bases were cited as an example. Such districts may not need to consolidate. Satellite technology may provide an answer to some rural school problems. Courses can be offered to many small districts simultaneously through television linkups. A barrier to this approach, however, is the requirement in many states that a satellite link have a certified teacher at each reception point, eliminating some of the potential cost savings.

Rural governments are often faced with limited revenue capacity. Jurisdictions with little industry must impose high property tax burdens on homeowners, especially when states grant substantial property tax breaks to agriculture. Faced with high tax burdens, voters are unlikely to approve high levels of public services, so rural citizens receive fewer public services than their urban counterparts. State aid programs could correct this fiscal disparity, but state aid formulas often do not take account of the special problems of low density rural areas.

The desire for a larger tax base can lead to competition among jurisdictions. In Virginia, cities are frequently involved in "annexation wars" when two or more jurisdictions attempt to extend their boundaries to include industries in unincorporated areas. Courts are burdened by the resulting litigation. In Delaware, jurisdictions with public utilities engage in similar competition in search of additional utility customers. Washington state has succeeded in removing some of these conflicts from the courts through a boundary review board.

Local governments also compete in offering tax breaks and public services to firms as inducements to locate within their boundaries. This strategy sometimes succeeds in bringing new jobs, income and tax revenue. But tax breaks and special services to new firms increase the tax burden on all other taxpayers and can lead to curtailments of other services. Tax increment financing can be a particular problem. Under this strategy the additional taxes generated by a new business are used to pay for the tax breaks and new services offered. The plan is often advertised as "paying for itself." But sometimes a new firm reduces the profitability and tax payments of existing businesses. The construction of a new retail mall, for example, may reduce sales in main street stores, cutting tax revenue from existing sources. Extension educators can play a role in helping local government officials understand alternative taxing and spending strategies.