PUBLIC FINANCING OF COMMUNITY SERVICES

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> "Governors predict bankruptcy for their states in the immediate future if additional funds are not forthcoming. Mayors forecast a total collapse of city services unless they receive additional revenues from the state and Federal governments. Taxpayers are faced with increased rates of existing taxes or the imposition of new taxes. Indeed, the nation's Federal system of government appears to be in fiscal jeopardy."–New England Letter, First National Bank of Boston, June, 1971.

Fiscal crisis characterizes many local and state governments in America today. Expressions of concern and proposed solutions come from the nation's President and the man-on-the-street. Proposals range from drastic curtailment of public services to greatly expanded state and federal participation in their delivery and financing. The revenue-sharing plan of the Nixon administration prompted much debate on this and other alternatives for federal assistance to state and local governments. Recent court decisions on discrimination in education resulting from widely varying local property tax bases will lead to major changes in methods of financing public schools, and in state and local tax systems. People are now taking a close look at systems of providing and paying for public services at all levels of government, and at intergovernmental relationships. This is good for the nation's political health; better government should result if citizens are adequately informed on available policy choices as to governmental organization and financing public services.

Expenditures of state and local governments increased 179 percent in current dollars and 75 percent in real terms from 1959 to 1970; and an additional increase of 25 - 30 percent is expected by 1975 [5]. Local government expenditures went up from $36.3 billion in 1959 to $92.5 billion in 1970 (in current dollars and including programs financed in part by funds from state and federal governments). Local governments are responsible for 27 percent of all government spending and raise 18 percent of the revenue to pay for public services and facilities.

Local and state expenditures have increased at a faster rate than revenues, gross national product and personal incomes in the U.S. since 1952. Fiscal crises have developed recently because expenditures rose 7 percent annually in 1960-64 and 12 percent in 1965-71, while revenues were growing at an annual rate of 4-6 percent.

Rising local-state government spending has been caused mainly by demands of more citizens for additional and better public services. As our citizens become better educated, they expect more from government as the best means of attaining a multitude of public policy goals in an increasingly complex society. Our population grew from 151 million in 1950 to 208 million in 1972, with more young and older people–groups with high public service requirements. Population of metropolitan counties increased by 45 million people in 20 years, from natural growth and rural-urban migration; public service needs in these areas expanded accordingly. Rural people, too, want and are getting improved schools, roads, recreational facilities, police and fire protection and water and sewer systems, for better living and economic development. The cost of more and better public services in both urban and rural areas is often financed by higher local property taxes. The desire of city dwellers to "get away from it all" places additional loads on public facilities in rural communities. Since 1965, serious inflation has boosted prices of items purchased by government and

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has necessitated paying higher wages and salaries to public employees.

PUBLIC FINANCE PROBLEMS IN THE 70's

Three basic questions must be answered in providing and financing public services:

1. Which public services should logically be provided by local, state and federal governments in sparsely populated areas, in metropolitan areas, and in the country in-between?
2. What level of spending is necessary to provide "adequate" facilities and services?
3. How should the cost of public services be allocated among citizens of the community, state and nation?

Our approach to answering these questions in America has been pragmatic. We have called upon all levels of government to meet citizens' expanding public service demands. Through the political process, we have created a very complex federal system with many units of government and a host of elected and appointed public officials. Responsibility for supplying and financing public services is shared among these governments through a wide variety of programs and techniques. Stresses have developed which threaten the system but which will lead to major changes, especially in methods of financing public services.

Serious fiscal unbalances exist among the three levels of government. The role of the federal government has increased as our society has changed technologically, economically, socially and politically. Local and state governments have often failed to deal adequately with problems associated with these changes. The federal government has important advantages in financing public services through borrowing and taxation. Its main revenue source, the progressive income tax, grows faster than gross national product; its elected officials are less likely to suffer defeat at the polls after a tax increase. Other imbalances are: near-monopolization of the property tax by local school boards; welfare expenditure patterns favoring minimum-outlay states over those with more generous systems; and metropolitan expenditure-revenue structures which favor suburban districts over inner cities.

Proliferation of local governments in the form of special districts is another serious problem of this decade. While the number of school districts has declined by more than 60 percent since 1957, the number of special districts increased by 50 percent. There are still well over 80,000 units of local government in the U.S.; leading states are: Illinois, 6400; Pennsylvania, 4900; Nebraska, 4300 and Minnesota, 4100. Most of these were established to initiate and operate specific programs which local or state governments are not prepared to handle, and to gain access to federal and state grant-in-aid funds. State constitutional and legislative limits on spending and taxing authority of local governments have encouraged the formation of special districts to by-pass these restrictions. Thus, authority for and financing of many programs are divided and shared with a loss of local administrative discretion even though local governments are still the largest providers of domestic public services. Problems of conflict, coordination, overlapping and citizens' understanding and participation are intensified.

The third major public finance problem is the growing resistance among taxpayers to local and state increases and to the imposition of new taxes. Evidence of taxpayers' unrest comes from the high percentage of failures among bond issues and tax measures in recent elections, and from the high rate of political mortality among public officials associated with tax increases. Contributing to citizens' dissatisfaction are inflation and war, both largely beyond individual control, so resentment is expressed against local and state officials and policies. Unwillingness to support adequate public services at local and state levels is often a more serious barrier than inability to do so. The Advisory Commission on Intergovernmental Relations estimated that, in 1966-67, the revenue effort of local governments was below the national average in 34 states; that of state governments was below average in 29 states [1]. This unwillingness reflects citizens' beliefs and attitudes toward government: apathy; antagonism; misunderstanding and misinformation on role of government in our society; and desire for more and better public services but lower taxes.

CHOICES IN FINANCING LOCAL PUBLIC SERVICES

Local governments, more than 81,000 of them exist and have a future in providing domestic public services in America because:

1. Their traditional role is still important–elementary and secondary education, roads and streets, protection of person and property, collection of taxes, disbursement of funds, record keeping and elections.
2. New units are continually being created for special purposes, including eligibility for state and federal grants and to get around constitutional and legislative limits on spending and taxing.

3. People want them in order to have greater control over policy decisions and to keep governmental power dispersed.
4. Many public facilities and services can best be provided by local units; the nation and most states are too complex to solve all problems at those levels.
5. Citizens of local communities can be active participants in the great game of American politics.

What Local Government Can Do

All local units of government are "creatures of the state," dependent upon state constitutions, legislation and judicial decisions for their organization, powers and duties, and methods of operation, including the collection and spending of public funds. Although constitutions and laws can be changed and court decisions overturned, choices in financing local public services are limited in the short run by this legal framework. If more revenue is needed to pay for improving existing services or for new services and methods of delivery, the principal alternatives are: higher rates for authorized taxes and other charges up to legal ceilings; addition of authorized, but not utilized, new taxes; borrowing; creation of new special districts; and obtaining state or federal funds available under present grant-in-aid programs.

In most non-metropolitan districts, raising more tax revenue from existing sources means higher property tax levies. This tax is the only large revenue source which local governments can administer under delegated authority. It provides nearly 90 percent of the tax revenue and 40 percent of the total revenue of local governments with over half of property tax revenue going to support public schools. For units already up to their legal levy ceilings, it has no immediate potential for raising additional revenue. In many communities, taxpayers are imposing psychological limits on local property taxes by rejecting tax-supported bond issues and defeating efforts to lift legal limits of referendum. Taxpayers' revolts are widespread in spite of exemptions, "circuit-breakers" to reduce its regressivity, and state laws to improve assessment and administration.

The property tax has been condemned as a "poor" tax for 100 years. Its weaknesses were well summarized by Ronald Welch [7]: "—the property tax is the most unpopular of all major taxes now employed in the United States. It is under attack from all sides. It is denounced by welfare economists as our most regressive major tax, by businessmen as our most inflexible tax, by farmers as our most unfair tax, by the aged as our tax least related to ability to pay, by guardians of the law as our most dishonestly assessed tax, by students of government as our most ineptly administered tax, and by conscious or instinctive disciples of Henry George as our most repressive tax." Despite these inherent weaknesses, it will not be abandoned so long as local governments exist. Improvements in its administration, although possible and desirable, cannot make this a "good" tax in terms of accepted principles of public finance. In my opinion, its use should be restricted primarily to property-related services but not so narrowly defined as to exclude activities which maintain or increase property values, e.g., paying off bonds for certain capital improvements.

The Advisory Commission on Intergovernmental Relations, in its Tenth Annual Report, commented prophetically on the issue of reforming school finance to assure equality of educational opportunity.

> "Quite possibly, judicial intervention rather than gubernatorial or State legislative leadership, will prove to be the vital ingredient in this - one of the most critical of the current urban crises. A veritable revolution in local government structure and financing in the United States would ensue if the judiciary should adopt the doctrine that every pupil should have substantially the same fiscal backing or - in the case of the disadvantaged youngster - substantially more."

The judiciary has done just that - in California, Minnesota, Texas and New Jersey; similar suits are pending in more than 20 other states. The California Court held that financing public schools by heavy reliance on local property taxes "makes the quality of a child's education a function of the wealth of his parents and neighbors" and denies "equal protection" under the 14th Amendment to the U.S. Constitution. Such decisions will probably be appealed to the U.S. Supreme Court; if upheld, major reforms in local and state tax structures will be necessary. Other serious questions are raised regarding local control, uniformity vs. diversity, collective bargaining by teachers, and equalization formulas, but these are beyond the scope of this paper.

Assumption of a much larger share of school financing by state, and possibly the federal government will provide substantial property tax relief in most communities. This might lessen taxpayers' resistance to relatively small future increases in local property tax rates to pay for some roads and streets, better police and fire protection, sanitary facilities, libraries, and local parks and recreational facilities.

Sales and income taxes are possible sources of additional tax revenue for local governments, especially those in metropolitan areas. Local sales taxes are authorized in 25 states and used, but not generally, in 22 states; for example, in Nebraska only Lincoln and Omaha levy city sales taxes although any incorporated municipality could do so. Many communities fear that a local sales tax would "drive business away;" others have too small a retail sales base for the tax to be productive. Local income or payroll taxes are used widely in Kentucky, Maryland, Michigan, Ohio and Pennsylvania and by selected local governments in other states. Local income taxation obviously works best in employment centers with large numbers of middle and upper income people. Enforcement and administration of both taxes are simplified and improved when "piggybacked" on state taxes.

Other limited sources of revenue used by various local governments are: motor fuels taxes; excise taxes on tobacco; real estate transfer taxes; fees for motor vehicle registration and operator's licenses; fines for violating local ordinances; and charges for business licenses, inspections, building permits. Charges for services provided by public utilities are common for electricity and water, and are increasing for sewers, parks, swimming pools, golf courses and other facilities. These are sometimes set high enough to help pay for other governmental activities.

Borrowing is used extensively by local governments for capital construction to be paid for as facilities are used. Responsible use of credit is good fiscal policy in communities experiencing economic growth; it shares the cost with future residents. Going into debt to try to save a declining community should be avoided unless success is reasonably certain; otherwise higher taxes for debt service could actually hasten the decline. Local government borrowing is usually restricted by the states through debt limits, ceilings on property tax levies for debt service ,and requiring referenda on bond issues. Such restrictions probably create more problems than they solve, such as increased use of higher-cost revenue bonds; and formation of more special districts to circumvent debt and tax limits.

Intergovernmental transfers are important sources of funds for most local governments. With such financial assistance, public services can be continued and expanded which might otherwise be impossible. Any community seeking to upgrade or expand public services should explore the possibility of obtaining state or federal funds available under existing grant-in-aid programs. Although not the complete and painless answer to all local public finance problems, grants-in-aid and revenue-sharing are fiscal facts of life in our federal system of government.

State Assistance to Local Government

In addition to establishing the legal framework for local governments, the states provide administrative and financial assistance to their subdivisions.

Indirect financial help has come from the diminishing importance of the property tax as a source of state tax revenue - from over half in 1900 to two percent now. Although 43 states still collect property taxes, only three states - Arizona, Vermont and Washington – obtain more than 10 percent of total tax revenue from this source. Local governments, especially school districts, have increased their property tax levies enough to offset this shift several times over. Elimination of all remaining state property taxes, while good state tax policy, would "free" only $1.1 billion for property tax relief or increased local government revenue.

Taxing authority of local governments could be expanded and made more flexible by liberalization or removal of present restrictions on property tax rates and borrowing while retaining appropriate safeguards. Ability of local governments to provide and finance public services can be further enhanced if more states would authorize local nonproperty taxes and other broaden existing authority. Such local taxes are needed in many communities because property tax revenue increases more slowly than economic growth and cost of public services in an inflationary period, and it bears little relation to ability-to-pay as measured by current income flow. Local sales and income taxes should be collected by the state and returned to taxing districts for efficient administration.

Direct financial assistance in the form of state grants-in-aid and revenue sharing accounts for one-third of total general revenue of local governments. In 1969-70 state aid went mostly to local schools (60 percent), welfare (18 percent), and roads and streets (9 percent). State (and federal) grants-in-aid are a recognition of the inability of local governments to balance costs and benefits of public services in an urban-industrial society. Wide differences persist in quality of local services and in amount of state support the "big three" after 50 years. State assistance to schools varied from 87 percent in Hawaii to 8.5 percent in New Hampshire.

The Serrano Decision (California) will force major changes in school finance when it becomes "the law of the land." Options being considered among the states include: (1) statewide property tax, or pooling and redistribution of local property tax revenue; (2) greatly expanded state aid from sales and income taxes; and (3) transfer of local school taxes from wealthy to poorer districts. People in rural areas should realize that the first option would shift a part of urban school costs to farm property.

Revenue sharing is relatively unimportant as a form of state aid to local governments but will increase in the future. So far, its main use has been to replace revenue lost from property tax relief measures.

The main policy issues in state financial aid are: whether such assistance should be earmarked or without strings; local control vs. state supervision; and formulas for distributing aid funds.

Even though most states no longer rely upon the property tax as a major revenue source, they can, and should, assist local governments in improving its administration and reducing its inequities. Better assessment is the key to improved administration and requires effective state supervision, professional rather than elected assessors, full disclosure of valuation practices, and adequate appeal procedures. Inequities can be reduced by: general adoption of the "circuit breaker" approach to prevent overloads on low income people and exemption of personal property. More research is needed on the effectiveness of preferential assessment, deferred taxes, restrictive agreements, and site value taxation in controlling land use and recapturing socially created increases in land values for social rather than private purposes.

Federal Financial Aid to Local Government

The main purpose of federal aid is to increase the quantity and improve the quality of public services to achieve certain goals of national domestic policy. Such aid is needed because: benefits of public services spill over into other taxing districts; gaps exist between revenue capacity and public service needs; tax hold-down competition among communities restrict expenditures for public services; and state and local tax systems are regressive while the federal system is progressive.

The fiscal situation of local governments would be greatly improved if federal monetary-fiscal policies could effectively control inflation. Cuts in federal income taxes provide only minor help to local governments. Tax credits seem to have their main possibility in encouraging states to overcome their traditional reluctance to adopt and increase income taxes.

Full federal financing and operation of additional programs with shared costs would release local and state funds for other purposes or for tax reductions. Welfare is the most likely candidate for full federal take-over. Such programs now cost local governments about \$6.5 billion a year. States with highest welfare expenditures like New York and California would realize the greatest benefits from federal take-over of public welfare.

The federal government channels nearly \$25 billion a year to local and state governments, mostly through 500 separate grant-in-aid programs. Under these programs, federal funds are allocated for specific purposes by formula or for special projects. Many grants-in-aid require that federal money be matched by local or state funds. This influences local decisions on expenditure priorities and may cause spending and taxes to rise "to get our share of federal money." The number and complexity of grant programs results in duplication and gaps, excessive red tape, and discrimination against small, rural local governments. Effectiveness of these programs in meeting local public service needs could be enhanced by simplification, coordination, and better information and assistance to local public officials.

Some streamlining of the present federal aid system could be accomplished through greater use of block, or broad-purpose grants for education, health, transportation, rural development, etc. Funds would be distributed by formulas according to purposes of the grants and could come from appropriations or a share of the federal income tax. Local and state governments would have considerable discretion over use of funds except for general guidelines. Matching requirements might be retained or eliminated.

Fiscal problems of local and state governments and dissatisfaction with the federal grant system led to recent proposals for general and special revenue sharing. Funds would be obtained by designating a share of federal income tax revenue for this purpose to be distributed to local and state governments by formula. Population, income, local revenue effort and other factors could be included in the formula. Local and state governments would gain access to the largest, most responsive revenue source in the nation. No restrictions would be imposed on the use of general revenue sharing grants while special revenue sharing funds would be similar to block grants.

Proponents of revenue sharing list these advantages: redistribtuion of income; decentralization of power; more progressive total tax system; improved public services under locally administered programs; partial solution to local-state fiscal problems; and additional revenue for local and state governments without political repercussions.

Main arguments against revenue sharing are: large federal budget deficit with unmet national needs; erosion of grant-in-aid system without assurance that essential programs would be continued; separation of spending and revenue functions; local and state revenue sources not fully utilized; unimpressive past records of local and state governments in providing adequate public services; temptation for public officials to spend money for political gain rather than to maximize social benefits.

CONCLUSION

We Americans value our local governments very highly and rely on them to perform a great variety of functions. These activities are shared intergovernmentally, but for many domestic public services "–all local governments act as acquirers of federal and state aid; as adapters of national or state programs to local conditions, needs and values; as initiators of new programs at the state, national, as well as the local level; and as experimenters in the development of new services" [4].

Ed Lutz of Cornell questions much of conventional public administration wisdom on local government organization, points out that those units which have applied the classic public administration approach seem to be in deep trouble, and suggests that "we need to think small enough to focus scholarly attention" upon public policies, programs and institutions within a finite geographic area.

Public service deficiencies in rural areas have been well documented but must be overcome if rural communities are to have a promising future. More money from local, state and federal sources for more and better public services is not the sole answer to rural community development. But adequate public services are essential if growth is to occur and/or quality of life is to be improved in rural areas.

Regardless of the structure of local government, public services must be paid for. I have tried to outline the main choices available to local governments in public financing of community services. Two revolutions in public finance are now beginning and will have profound effects on local and state tax structures in this decade. The first is the crisis in public education which will bring long overdue reforms in school finance. The second will come from the current controversy over revenue sharing which is forcing Congress to abandon its do-nothing policy on local and state tax structures, to consider federal assumption of all public welfare programs, and to study ways to streamline the federal grant-in-aid system.

Our role as educators is to upgrade citizens' ability to make sound decisions on providing and financing public services in our dynamic society.

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