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# Features



## Local Government: Trends and Prospects

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Local governments have grown rapidly—both in size and complexity—in an attempt to expand and improve public services. The impetus for this trend is largely the result of increased State and Federal assistance—both for planning and financing local improvements. Current social, economic, and

political conditions affect the ability of local governments to finance the wide range of services for which they are responsible. In rural America, local governments may find it more difficult to provide desired public services, particularly in communities that experience rapid population growth.

This article summarizes the major issues affecting the performance of local governments in recent years. Special emphasis is directed to the unique conditions that local officials in nonmetro America will likely face.

### Growth in Size of Government

It is no surprise that governments have increased in size. However, the extent of the public sector's growth and recent changes in this trend are not widely understood. Total government spending has mushroomed over the past 20 years.

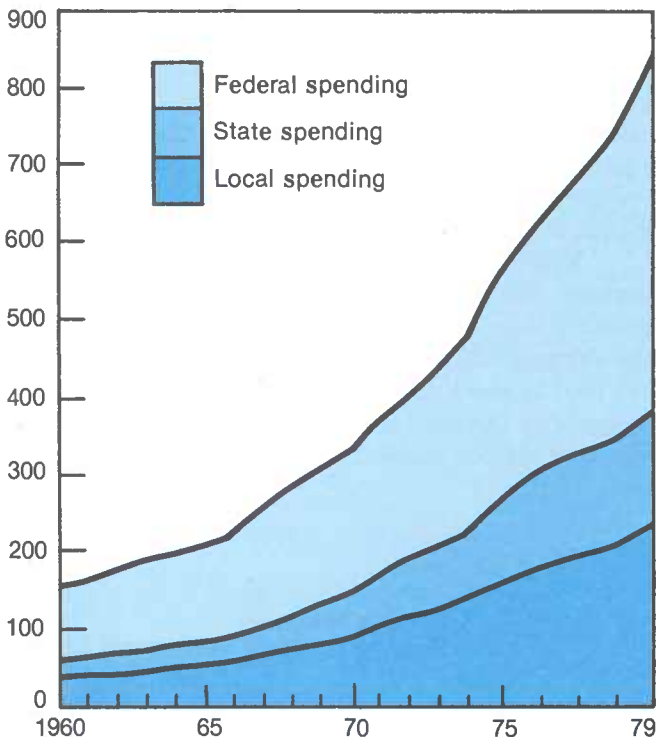
\*Authors are on the research staff of the State and Local Government Program Area, Economic Development Division.

Figure 1

### Government Spending Increased

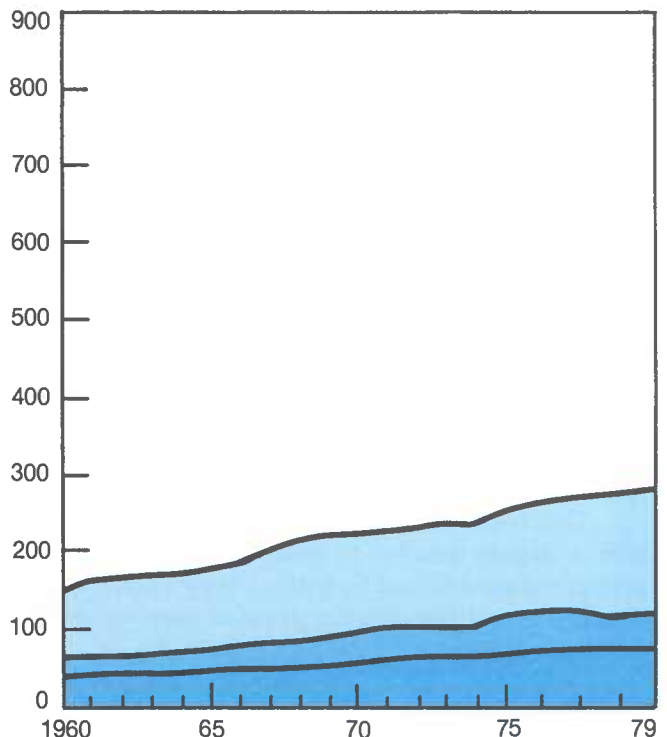
Actual Dollars: Quadrupled

\$ billion



Deflated Dollars: Nearly Doubled

\$ billion (1960 dollars)



Intergovernmental transfers are included in expenditures of the recipient government.  
Source: U.S. Census Bureau.

State and local governments increased spending over fivefold between 1960 and 1979 (fig. 1). Much of this additional spending was due to inflation, but substantial increases also occurred in real spending. Measured in 1960 dollars—to correct for the effects of inflation—local government spending nearly doubled over the past two decades, while total State and Federal expenditures rose by roughly 84 percent. As a result of these increases in real spending, the public sector's share of the Gross National Product rose from 27 percent in 1959 to 32 percent in 1979.

The dramatic growth in State and local government spending slowed noticeably in recent years. Current yearly increases in spending are barely keeping up with inflation. Measured in constant dollars, local spending has remained fairly steady since 1976, while State spending has actually declined.

A similar trend has occurred in public employment levels (fig. 2). State and local government employment more than doubled over the last two decades, far exceeding the rate of population growth. The number of State and local government employees per 1,000 citizens grew from 3.5 in 1960 to 6.0 in 1979.

Growth of public employment also tapered off in recent years. Employment at the local government level grew at an average annual rate of 5.4 percent between 1960 and 1975. Since then, the rate of growth averaged only 1.6 percent a year. Growth in State employment followed much the same pattern. These lower growth rates signify an important change in the role of local governments within our economy.

## Changing Federal and State Roles

One of the most significant trends affecting local governments during the past 20 years has been the increased use of local government units as instruments of Federal and State policy. Although local governments have long received substantial funding from higher levels of government, the importance of both Federal and State aid burgeoned during the sixties and seventies. Federal and State aid to local governments tripled between 1960 and 1979, even after allowing for inflation.

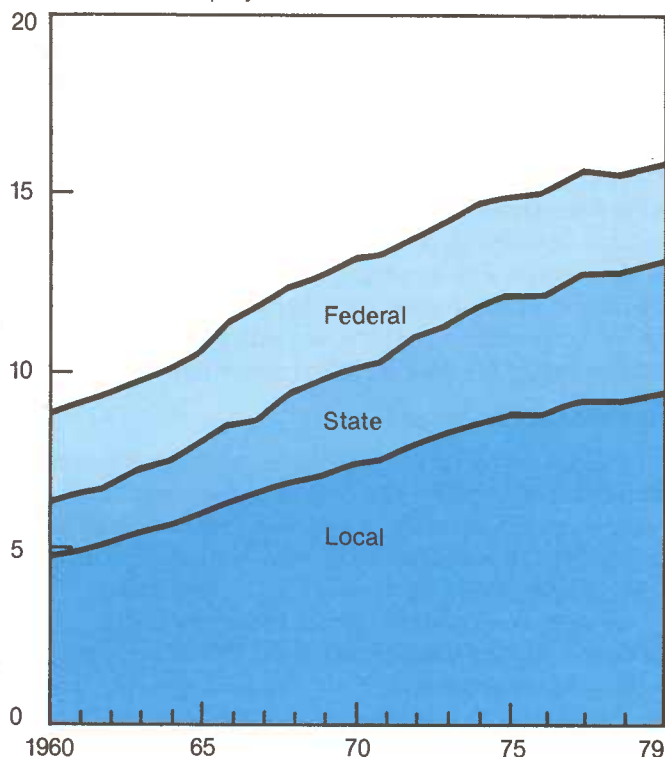
The Federal Government accounted for most of this increase. Federal aid programs—many assisting local governments—tripled between 1962 and 1977, increasing to 492 funded programs at the start of 1978. Federal aid to local governments grew faster than State aid. Federal payments made directly to local governments increased more than 30 times in the 1960-79 period. By 1979, Federal and State funds accounted for nearly 45 percent of local government general revenues (fig. 3).

Accompanying the growth in financial assistance, both Federal and State governments increasingly imposed new responsibilities, procedures, and activities on local governments—either as conditions for receiving financial assistance or as direct legal mandates.

Figure 2

### Local Government Employment Grew Most

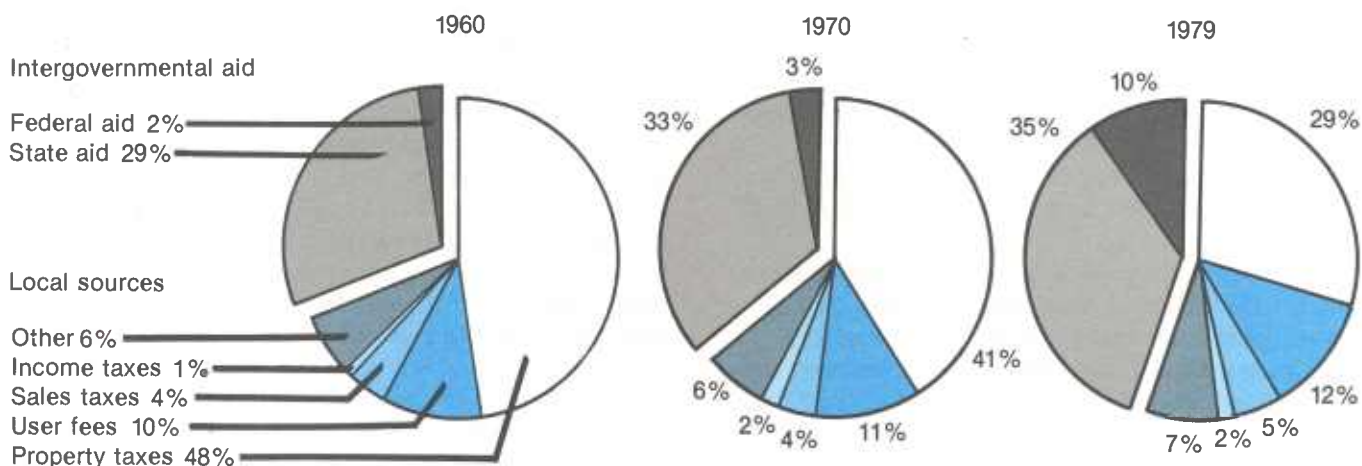
Thousands of employees\*



\*Number of full- and part-time civilian employees.  
Source: U.S. Census Bureau.

Figure 3

## Local Government Revenue Sources Changed



State aid includes Federal pass-through funds.

"Other" includes taxes on selected products, license fees, and interest earnings.

Source: U.S. Census Bureau.

State-imposed mandates have long been a part of the intergovernmental system, but Federal mandates are a relatively new development (fig. 4). The number of mandates imposed by both levels of government, however, virtually exploded during the sixties and seventies.

Most mandates attempt to establish national or statewide standards in policy areas that are deemed to have special importance. Examples are uniform standards set for affirmative action, civil rights, energy conservation, environmental protection, and workers' rights.

The imposition of mandates has been a growing concern to local officials. It raises a number of sensitive issues. The most frequently voiced concern is probably the growing pressure placed on local budgets. By one estimate, as many as half of local budget actions are in response to State or Federal requirements. Even when local officials agree that the mandated activity is worthwhile, they dislike being compelled to pay the added costs from already tight local budgets.

Another issue centers on the progressive loss of local government autonomy as spending priorities and service standards are set by higher levels of government. One troublesome aspect is that mandates sometimes impose service-provision methods that are inefficient or inappropriate in smalltown rural settings. For example, sophisticated and expensive waste disposal methods, while appropriate for large urban centers, are often inappropriate and too costly for smaller rural communities.

## Structural Changes

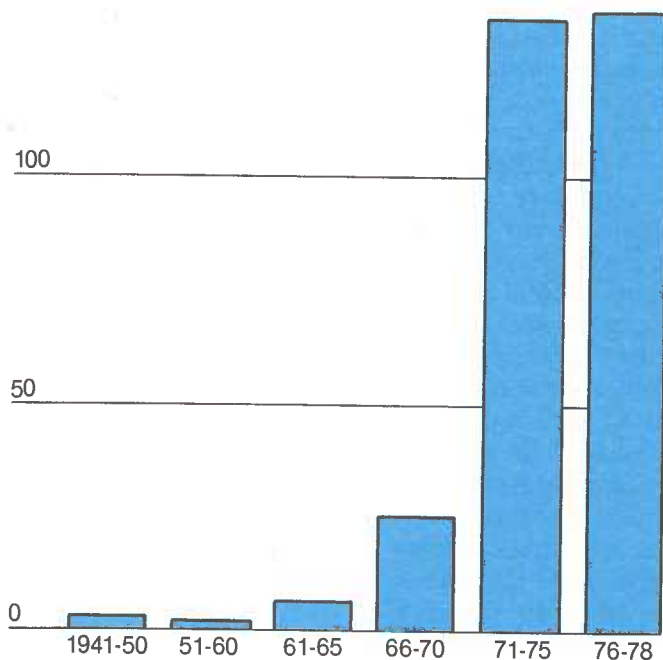
Major structural changes in local governments have occurred during the past two decades. Some changes merely extended longstanding trends. The number of independent school districts declined by more than half during the sixties, continuing a movement to consolidate small school districts. However, during the seventies the decline in the number of school districts slowed considerably. In the Northeast, the number of districts even increased slightly. The sixties and seventies saw a limited movement toward adoption of metropolitan-wide units of government through city-county consolidation.



Figure 4

### Federal Mandates Exploded in the Seventies

Number per year  
150



Source: Lovell, Catherine H., and others. "Federal and State Mandating on Local Governments: An Explanation of Issues and Impacts." Grad. Sch. of Admin., Univ. of Calif. (Riverside). 1979.

A less dramatic method of capturing some of the benefits of broad-based local government is the formation of special districts, which typically perform limited functions within a specially defined area. Both the number of special districts and their share of local government spending continue to grow. Counties also have been revitalized, taking responsibility for a larger portion of local expenditures.

Municipal governments remain the most prominent form of local government, although they have declined slightly in terms of their share of total local government spending. Township governments, once nearly withering away in some areas, have now acquired new duties and have found new funding sources; some townships are again becoming a vital part of the local government system.

State governments have also assumed larger roles in both financing and directly providing public services. A strong and continuing shift of duties from local to State levels of government occurred during the sixties. The trend has continued, but at a slower rate, as direct Federal aid to local governments has grown.

Other less dramatic but potentially significant changes have occurred in the way services are provided at the local level. Some services previously supplied by private firms have been taken over by municipal governments; public transportation and the operation of sanitary landfills are leading examples. Many cities, while retaining responsibility for the quality of services, are contracting for service delivery from other governments or private firms to reduce their costs. Further innovations in local service delivery are likely as local governments seek ways to cope with tightening budgets.

### Regional Agencies

The most dramatic structural change in recent years has been the creation of substate regional agencies. Their creation introduced a new layer of government that serves larger areas than traditional local governments.

Substate regional agencies are unique products of the sixties and seventies, most often resulting from the encouragement of Federal agencies. Although most substate agencies operate with sanction of State law, they seldom exercise full governmental powers. These agencies have considerable local planning and coordinating duties, but few have the right to tax or to provide direct services to the public. Most are in a position to influence local policies, either informally by persuasion and example or, more dramatically, by ruling on local applications for Federal funds.

### The Tax Limitation Movement

The movement to cut taxes, especially property taxes, and to put limits on State and local government spending is an issue of growing importance. Perhaps the best known measure of this type is California's Proposition 13. Although it was not

the first incidence of tax resistance in the United States, Proposition 13 was significant because it signaled a changing attitude toward the proper role and size of government.

The tax limitation movement continued for several reasons. High and steadily increasing property tax rates undoubtedly contributed to the success of Proposition 13 in California, where further increases in property taxes had been anticipated. In Massachusetts, where a similar proposition was recently approved, property taxes per capita are among the highest in the Nation.

Voters use such tax and expenditure limitations to express their displeasure with government in general. These antigovernment sentiments stem from the perception that government at all levels is too big and too costly. Many voters apparently believe that, with less government waste and greater efficiency, revenues can be cut with little effect on services.

Although the so-called tax rebellion has lost some of its urgency since 1978, the tax and spending limitation movement is by no means dead. Tax-limit initiatives were on the ballot in eight States in the November 1980 election, but only in Massachusetts and Missouri were they approved. Whether these results signify a weakening of the movement is uncertain. Even if voter perceptions of the value of public services and the efficiency of government improve, a moderate tax limitation movement is likely to continue.

This movement has implications for the ways local governments deliver services. Coping with tax or spending limits clearly requires that the growth of some services and the cost of delivering others must be held down. While budgetary pressures already have led to many structural changes, the tax limitation movement may further alter the traditional way governments do things. Likely changes include consolidation, voluntary cooperation between local governments, and contracting with the private sector to provide services.

Tax limits and the widely held belief that the property tax is inequitable have also affected the revenue raising efforts of local governments. Property taxes dropped from 69 percent of locally raised general revenues in 1960 to 53 percent in 1979 (fig. 3). Local officials are relying increasingly on income and sales taxes and user fees to raise needed revenues. The trend towards diversification of local

revenue sources likely will continue, but the property tax is apt to remain the largest single source of local revenue available to local governments.

## Pervasive Aspect of Inflation

State and local governments have had to adjust to the effects of a rapid rate of inflation. Not only must local governments pay higher prices for materials, equipment, and supplies, but the wages of public employees also rise in response to general price increases.

The effects of inflation have been more severe on local governments than on the general public. The consumer price index, which measures increases in the prices of consumer goods, rose 145 percent between 1960 and 1979, but prices of labor and materials that State and local governments typically purchase rose by more than 200 percent.

How well local governments are able to cope with inflation depends on the responsiveness of revenue sources to price-level increases, the bargaining strength of public employees, and the flexibility of officials regarding the methods used to produce public services. Many local governments have found that expenditures have increased more rapidly than revenues.

Local revenues, based largely on property taxes and user charges, do not automatically rise with the price level. Revenues increase only when rates are increased or when the value of taxable property is reassessed. As both actions are politically unpopular, local revenue growth often lags behind inflation. Sales and income taxes usually rise with inflation, but these revenues comprise only a small share of local revenues.

The enormous increase in Federal and State aid to local governments over the past decade undoubtedly made coping with the effects of inflation easier for local officials. Even with this help, many local governments had to raise tax rates, levy new taxes, and increase user charges to finance the level of public services provided during the seventies. Even with increases in revenues and relatively

low wage increases for public employees, many local officials are faced with the problem of cutting back public services to keep their budgets balanced. Continued inflation, combined with voter resistance to tax increases, will likely force more local governments to make difficult cuts in public services.

## Issues Affecting Rural Areas

Despite their many similarities, urban and rural areas are distinct in several important respects. These differences, combined with the recent population reversal, have created a unique set of problems for rural governments.

Nonmetro America, by definition, is not highly urbanized. Nearly half of all nonmetro residents live inside municipal boundaries, but these municipalities are small and less densely populated than large urban centers. Rural communities have a smaller share of the Nation's wealth than of the Nation's population. These factors strongly affect the ability of rural governments to provide desired public services.

Rural areas now face challenges unlike those encountered earlier in this century. Many rural communities, previously resigned to a continued migration of their population to urban areas, are now experiencing persistent, large-scale immigration.

This population reversal has made new and increased demands for local public services. In boomtowns created by large-scale energy developments or new industrial plants, growth in local government revenues often lags far behind the need for expanded public services.

Even modest population growth can represent a radical change for places accustomed to decline. The problem of extending existing services to a growing population will likely be compounded by new residents' demands for an expansion of services to the level available in more urbanized areas. Coupled with Federal and State mandates that local governments upgrade the quality of services, such as water and waste treatment, these population shifts have radically altered the fiscal environment in many rural communities.

## Rural Government Expenditures

Some of the effects of recent nonmetro population growth are reflected in the finances of local governments. During the sixties, local government expenditures per capita grew faster in metro than



in nonmetro areas. As increasing numbers of people began moving back into nonmetro areas in the seventies, expenditures per capita rose at a faster rate in nonmetro areas. Nonetheless, the level of per capita government spending in nonmetro areas remains lower than that in metro areas.

Public employment trends are similar. Local government employment grew more rapidly in metro areas during the sixties. During the seventies, however, public employment grew less rapidly in metro areas but nonmetro areas continued to expand public employment at a similar rate as in the previous decade. Thus, by 1977, nonmetro government employment per capita was nearly that of metro governments. Growth in population, demands of new residents, imposition of Federal and State mandates, and increasing availability of inter-governmental aid have encouraged rural governments to increase their level of public services.

The pattern of expenditures by local governments has changed slowly over time as basic demographic and social changes occurred. For example,

the postwar baby boom increased the relative importance of education expenditures in both metro and nonmetro areas. Although educational expenditures have not continued to grow at their previous rate, education remains the largest single expenditure item in local government budgets. Local expenditures on health care services and facilities have increased as the population has grown older. An increasing rate of household formation and greater concern over crime has led to rising expenditures for fire and police protection.

One area in which nonmetro government expenditures do not mirror the national trend is in the growth of public welfare. Although increasing, nonmetro expenditures for public welfare programs have not kept pace with the overall growth of rural government spending.

## **Rural Government Revenues**

Expenditure growth has been accompanied by growth in revenues from various sources. Not only are local governments raising more revenue, but the degree to which local governments depend on these various sources is also changing. Nonmetro governments relied less on property taxes and received a larger proportion of revenues as State aid during the last two decades than did local governments in metro areas. By 1977, State aid and Federal funds passed through the State replaced the property tax as the leading source of revenues in nonmetro areas. Both user fees and utility charges have been consistently more important revenue sources in nonmetro than in metro areas. User fees in particular have grown in importance. In contrast, direct Federal aid has consistently been more important to local governments in metro than in nonmetro areas. The same is true of local sales and income taxes, although their importance has increased in both metro and nonmetro areas.

## **Rural Government Debt**

Local governments have long supplemented current revenue flows and spread out payments for large capital purchases by issuing a variety of debt instruments. Debt levels of local governments have increased over the past two decades despite the availability of Federal and State construction grants.

Local governments in nonmetro America increased their long-term debt per capita nearly 150 percent between 1962 and 1977. Personal incomes grew more rapidly, however, and debt burden (long-term debt as a percentage of personal income) actually declined over this period. Per capita indebtedness remained lower for nonmetro than for metro governments.

Local governments' short-term debt per capita nearly tripled in nonmetro areas during the sixties. Use of short-term borrowing as a financing tool dropped dramatically, however, in the wake of New York City's widely reported fiscal problems in 1975. Because of more stringent accounting procedures and information disclosure requirements for the sale of municipal bonds, short-term financing will probably increase less rapidly than during the sixties and early seventies.

## **Federal and State Aid to Rural Areas**

Federal and State assistance to local governments has increased steadily over the last two decades. Aid to nonmetro areas actually grew faster than aid to metro areas during the seventies. By 1977, more than 47 percent of the general revenues of local governments in nonmetro areas came from the State and Federal governments.

Increased aid to small rural places resulted from their increased eligibility for aid programs. Some new programs are designed specifically for smaller communities. Other programs that provide funds to all sizes of governments earmark more funds for small places than previously. The General Revenue Sharing program guarantees funds to general purpose governments, thus providing Federal assistance to small places that previously had not received Federal funds. The Community Development Block Grant program has replaced several categorical grant programs used mainly by large cities. This program, administered by the U.S. Department of Housing and Urban Development, reserves a substantial share of funds for smaller cities.

Economic and community development programs at both Federal and State levels have become more prominent, as have programs to help smaller cities contribute to cleaning up the Nation's water. A few of the newer programs are intended to help communities anticipate and manage the



**Federal and State aid as a percentage of city revenues**

City population	Year			
	1962	1967	1972	1977
	Percent			
0-2,499 .....	2	2	1	13
	14	12	20	16
2,500-9,999 .....	2	2	5	10
	11	11	12	12
10,000-99,999 .....	3	4	6	10
	12	13	14	15
100,000-999,999 .....	6	7	13	18
	14	15	17	16
1,000,000 and over .....	2	4	5	9
	19	26	32	30
	Federal aid		State aid	

effects of growth of nearby energy extractive industries. The U.S. Departments of Agriculture, Commerce, and Energy sponsor such programs.

Assistance to smaller communities has involved more than financial aid, however. The management capabilities of local governments are critical to the success of local programs and policies. Various Federal and State actions have assisted small communities in improving the management expertise of local officials. One approach has been to encourage the use of a circuit-riding manager to provide administrative services to several rural communities on a shared-cost basis.

The U.S. Departments of Agriculture and Transportation, the National Science Foundation, and other institutions have begun efforts to share the fruits of recent scientific and technological developments with local governments. Enactment of the Technology Innovation Act of 1980 established a Federal commitment to transfer technology to local areas.

## Prospects for the Eighties

The eighties may be a difficult time of adjustment for many local governments. Slow growth of the U.S. economy over the next few years would retard growth in local revenues. Without a dramatic decline in the rate of inflation, local governments will continue to face rapidly rising costs for public services. Tight budgets and changed spending priorities of the Federal and State governments will likely limit the amount of financial assistance available to local governments from these sources.

Several courses of action can be pursued by local officials as they attempt to cope with tightening budgets. One alternative is to increase revenues through new and higher taxes. Given the current mood of the country towards tax increases—at all levels of government—the prospect of any sizable increase in tax revenue appears unlikely.

A second alternative is to increase reliance on user fees. Such an approach is particularly applicable to those services whose users are readily identifiable.

A third alternative is to pursue greater efficiency through innovative arrangements for local service delivery, improvement of management capabilities, and aggressive reviews of program performance and priorities. Cooperative agreements among governments and contracts with the private sector to provide public services are two techniques used increasingly to employ available funds more effectively.

At best, local officials in many areas will likely be hard pressed to serve the needs of their growing populations. Many may have to make painful choices regarding both the quantity and the quality of public services to be provided by local governments serving rural America. □