A COMMISSION REPORT

The States and Distressed Communities:

The Final Report

ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS

Washington, D.C. 20575 • November 1985

A-101

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November 1985

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PREFACE

The problems facing communities have long been a concern of the Advisory Commission on Intergovernmental Relations. Since 1961, the Commission has issued reports on the fiscal and economic development problems of urban and rural areas.

In 1979, the Department of Housing and Urban Development asked ACIR and the National Academy of Public Administration to look at the role of the states in shaping community conditions, with a focus on the role of state aid to distressed communities.

This report should be viewed as a valuable snapshot of the four-year period 1980-83. To maximize an understanding of its content, the reader should keep in mind that in the intervening two years the country has experienced some rather dramatic changes, both economical and demographic.

The surveys for the report began during a period of double-digit inflation, and proceeded through two major (in rapid succession) recessions. While the data did partially encompass the recovery year of 1983, the full effects of the recovery would undoubtedly have been much more pronounced by the end of 1984 -- a year in which GNP rose at the fastest rate since 1952, and inflation rose at the slowest pace since 1967.

For demographic data it was necessary to rely on the population trends revealed in the 1970 and 1980 censuses. Thus, the report notes significant migration from the Northeast and Midwest to the South and West, and a decline in central city population. Mid-decade data just released by the Census Bureau shows a slowing, and partial reversal, of those trends. Cities such as Boston, New York, Philadelphia, and Chicago have gained population, concomitant with a regional economic upswing. "The 70s were a horrible period for the Northeast, when they lost a lot of jobs and the people went with them," said the Census Bureau's Donald Starsinic. "Now it looks as though it's infinitely better." Conversely, the sharply declining domestic oil industry has curtailed the economic boom in some sections of the country. As Rutgers University economist George Sternlieb said, "a little frost has fallen on the Sun Belt."

Though few could have predicted it at the time, surveying for this report commenced at the dawning of what many would consider a new period of American federalism. 1979 generally marks the year of the national government's retrenchment in providing grants-in-aid to state and local governments. The trend has accelerated during the Reagan Presidency as declining resources for discretionary domestic spending have engendered an era of "De Facto New Federalism" -- increasing fiscal restraint in Washington and remarkable resilience in states and localities. As a result, there has come the growing realization among state and local officials that the ability of the federal government to provide ever expanding aid to localities (either directly or through the states) has been seriously diminished -- at least for the immediate future. Had a survey been conducted in 1985, this change in orientation and expectations might have significantly altered responses.

Despite these rapidly changing conditions, we feel that the Commission's recommendations offer a valuable guide to state officials in endeavoring to enhance the economic vitality of their communities.

Robert B. Hawkins, Jr.
Chairman

ACKNOWLEDGMENTS

The final report was completed with the assistance of a number of people. The project was done under the general direction of former Executive Director S. Kenneth Howard, and former Assistant Director of Implementation Carl Stenberg. The project director was Edward M. Humberger who was responsible for the design and implementation of the project. William G. Colman served as senior consultant with primary responsibility for the state legislative drafting materials and Chapter 7. Project staff responsible for other chapters were: Jerold Fensterman, Edward Humberger, Mark Matulef, and Susan Szaniszlo. Major research support was provided by Dorothy Bacskai, Martha Davidson, Perry Ochacher and Jane Roberts. Secretarial and production assistance were provided by Elizabeth Bunn, Karen Kirkwood, and Harolyn Nathan. Other ACIR support staff also contributed valuable assistance.

The quality of the report benefited substantially from comments by a national advisory panel, state and local government public interest groups, and a number of other analysts of distressed community issues. These advisors included: Enid Beaumont, Norman Beckman, Renee Berger, Linda Church-Ciocci, Richard Geltman, Alan Gregerman, Susann Hiegel, Harold A. Hovey, Senator John F.. Kelly, Larry Malone, Mayor Thomas Moody, Mary Nenno, Senator David Nething, Wilson Riles, Larry Rudder, Steven Sager, James Solem, Francis Viscount, Thomas White, and Barry Zigas. More than 150 others responded to our survey and reviewed various drafts. Our sincere thanks go to all these participants.

Special thanks go to the project's grants manager, Audrey Scott, Special Assistant to the Assistant Secretary for Community Planning and Development at the U.S. Department of Housing and Urban Development.

Final responsibility for the report and its contents, of course, rests with the Commission and its staff.

John Shannon
Executive Director

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INTRODUCTION

HOW THE STUDY CAME ABOUT AND ITS BASIC STRUCTURE

In 1979, the Department of Housing and Urban Development (HUD) asked the Advisory Commission on Intergovernmental Relations (ACIR) and the National Academy of Public Administration (NAPA) to look at the role the states could play in shaping community conditions. At that time, the Carter Administration was interested in seeing how the states could help in implementing the National Urban Policy, with a particular focus on the role of state aid to distressed communities.

The object of the original project was to monitor what the 50 states were doing to aid distressed communities in five policy areas: housing, economic development, community development, state-local fiscal relations, and enhancing local self-help capabilities. With advice from a panel of experts, project researchers selected specific programs in each of the five areas that were considered to be good indicators of a state's commitment to assist distressed communities. In the first three policy areas -- housing, economic development, and community development -- the programs selected were those that helped communities meet specific needs related to their distress. In the other two areas, programs were chosen that relieved local governments of their financial burdens or provided them with the authority to respond to their own concerns. The following programs were used as indicators.

Housing

1) Single-Family Home Construction and Mortgage Finance
2) Multifamily Housing Construction and Long-Term Finance
3) Housing Rehabilitation Grants or Loans
4) Housing Rehabilitation Tax Incentives

Economic Development

5) Industrial or Commercial Site Development
6) Financial Aid for Industrial or Commercial Development
7) Customized Job Training
8) Small and Minority Business Development
9) Industrial Revenue Bonds

Community Development

10) Capital Improvements
11) Neighborhood Development

State-Local Fiscal Relations

12) State-Local General Revenue Sharing
13) Education Finance
14) State Assumption of Local Public Welfare
15) State Mandate Reimbursement
16) Improving Local Governments' Access to Credit Markets

Enhancing Local Self-Help Capabilities

17) Tax Increment Financing
18) Local Redevelopment Authorities
19) Local Sales or Income Taxes
20) Local Discretionary Authority

Each year from 1980 through 1983, ACIR surveyed the states to find out what actions they had taken related to each of these types of programs. The results of the 1980, 1981, and 1982 surveys have been presented in previous reports.

The objective of the project as originally defined in 1979 was to measure the capacity and willingness of state governments to take on the responsibility of assisting distressed communities. When the Reagan Administration in 1981 brought a stronger emphasis on the devolution of federal programs to state governments, the project's scope was revised and expanded. Four objectives were set for its final year:

1) reviewing the major issues in each of the five policy areas;

2) monitoring the activities and progress of all 50 states for each of the 20 types of programs, and providing an overview of the major trends;

3) developing a set of recommendations for consideration by the members of the Commission; and

4) developing a package of draft state legislation designed to address the major issues raised in the research.

How the Project Builds on Previous ACIR Studies

The problems facing distressed communities have long been a concern of the Commission. Since 1961, the Commission has issued reports on the fiscal and economic development problems of urban and rural areas. Five reports are of particular interest.

1. Fiscal Balance in the American Federal System (October 1967) focused on increased state and local government decisionmaking responsibilities in federal grant programs as well as expanded efforts to reduce fiscal disparities among local governments. The Commission recommended that state governments formulate long range plans and comprehensive policies for effective and coordinated resource development.

2. Urban and Rural America: Policies for Future Growth (July 1968) concluded that the economies of central cities and smaller urban areas were likely to grow less than those of other types of areas and that economic development policies for urban areas were not likely to be effective in nonmetropolitan areas. The report found that population migration patterns were resulting in pockets of poverty in both central cities and rural areas.

The Commission recommended that the national government formulate a National Urban Policy to assure that areas affected by migration patterns had

(1) opportunities for economic growth, (2) adequate standards of public service, and (3) incentives for industrial location.

3. In *Urban America and the Federal System* (October 1969) the Commission explored fiscal disparities and burdens for local governments, and state efforts to provide them with fiscal relief. The report concluded that the states bear some responsibility for the fiscal well-being of their subordinate localities, and that state governments can affect fiscal balance and economic development across localities by using their powers of coordination, revenue raising, and spending.

4. *City Financial Emergencies: The Intergovernmental Dimension* (July 1973) examined the inability of jurisdictions to meet their financial obligations and the basic service needs of their citizens. The Commission reaffirmed earlier recommendations, including (1) federal personal income tax sharing with states and major localities, (2) federal government assumption of all public welfare and medicaid costs, and (3) state government assumption of substantially all local costs of elementary and secondary education. The Commission also recommended that state governments assist local governments in managing debt and retirement systems, and that states take a direct role in managing local fiscal affairs in the event of a financial emergency. The Commission reviewed this same issue a decade later in *Bankruptcies, Defaults and Other Local Government Emergencies* (March 1985) and found no evidence that local governments generally are experiencing increased financial emergencies or that they are likely to do so in the future.

5. Finally, *Improving Urban America: A Challenge to Federalism* (September 1976) reviewed the problems facing American cities: (1) those affecting people, such as housing, transportation, pollution, crime, education, racial unrest; (2) financial problems, such as mandated expenditures and revenue restrictions; and (3) jurisdiction and power problems among governments, including limited economic development authority. This report codified Commission recommendations aimed at addressing these problems, including:

- enhancing local and metropolitan planning and development capacity;
- increasing state government's role in the securing of financial resources for capital improvements;
- relaxing limits on local debt and taxation;
- equalizing educational opportunities through state assumption of elementary and secondary education costs and distribution of financial aid to disadvantaged pupils and to communities unable to raise adequate revenues for education programs; and
- increasing state financial responsibility for housing, mass transit, and urban development programs.

Other ACIR reports have dealt with the potential role of states in aiding local communities in the areas of capital finance, industrial development bonding, tax capacity, and governmental organization. Thus, this four-year project on state aid to distressed communities is the continuation of a long-standing concern at ACIR with the problems of communities in need and intergovernmental responses to those needs.

Study Methodology and Implementation

For the final year of the project, the Commission established a two-tiered advisory process to ensure that the objectives, design, draft legislation, findings, and recommendations were accurate and reflected the concerns of state and local governments. The first level of this process was a review by a national advisory panel of seven members: two state legislators; two local elected officials; and three experts on fiscal issues, housing, and economic development. The members represented both major political parties as well as several regions of the country.

The second level of review entailed individual consultation and critics' sessions with over 25 state and local government public interest groups and research institutions in Washington, DC.

In carrying out the major part of the project -- monitoring state activities on 20 types of programs -- the Commission and the staff tried to ensure the reliability and validity of the data in three ways. (For a detailed overview of the methodology, see Appendix I.)

First, the state programs to be included in the study were clearly and precisely defined. Because the study sought to determine what actions states were taking on their own initiative to aid distressed communities, criteria for inclusion had to be established. A program was included if it was passed by a state legislature and signed into law before June 30, 1983. In addition, for programs in the housing, economic, and community development policy areas, the state also had to finance at least 50% of the program and target aid specifically to distressed people, places, or firms. Programs also had to demonstrate explicit mechanisms for targeting to distress. Targeting criteria were found primarily in the legislation, though in some cases targeting criteria emerged from adopted rules and regulations. State financial support was not a limiting criterion for programs in the categories of fiscal relations and enhancing local capabilities.

Secondly, rigorous procedures in carrying out the survey were followed to ensure data validity. ACIR staff members were trained in how to conduct the survey. A contact list of key state personnel responsible for each program was assembled for each state. A preliminary eligibility telephone interview was conducted, followed by a more detailed telephone interview based on a standard instrument tailored to each policy area. All data were then compiled, checked, and validated to ensure a high degree of accuracy. The result was a nonresponse rate less than 3%.

Third, as a check on data accuracy and completeness, the draft of the catalog of qualified state programs and their descriptions was sent to the planning director of each state to confirm their accuracy.

To supplement the survey data, project staff conducted secondary research on the major issues in each policy area. This research provided better understanding of the context in which states aid distressed communities.

The third major part of the project was preparing a draft package of state legislative materials that could serve as a tool kit for states seeking to aid their distressed communities. A preliminary set of issues was identified for each of the five policy areas to determine which types of legislation would be most useful. Both the national advisory panel and public interest groups were polled to determine the relevance and priority of the issues. Based on the results of the poll, the following 18 pieces of legislative drafting materials were newly prepared, substantially revised or updated, or reissued.

Housing

1. Housing Finance and Rehabilitation Agency*
2. Authorization for Consolidation of Local Housing Authorities*
3. Factory-Built Homes and Structures

Economic Development

4. State Economic Growth and Development Policy*
5. Comprehensive Employment Training, Placement and Relocation Assistance*
6. State Development Finance Authority*
7. State Land Assembly and State Development*

Community Development

8. Community Facilities Reconstruction Financing*
9. Neighborhood Improvement, Assistance, and Organization*
10. Enterprise Zones

Local Finance

11. Authorization for a Local Income Tax*
12. Authorization for a Local Sales Tax*
13. State Revenue Sharing*
14. State Mandates
15. Local Government Borrowing Supervision and Assistance*
16. State Assistance in Local User Charge Formulation and Administration*
17. Tax Increment Financing*
18. Metropolitan Tax Base Sharing*

Fifteen of these bills (marked with asterisks) were adopted in summary form for inclusion in the Council of State Governments' 1985 volume of Suggested State Legislation. In addition, the enterprise zone draft provides three previously published options, two by the Council of State Governments and one by the American Legislative Exchange Council.

Finally, based on the findings and conclusions of this study, the Commission adopted ten recommendations on December 8 and 9, 1983. They are contained in Chapter 7.

Limitations of this Study

It is important to point out what this study did not or could not try to do. First, the monitoring effort did not collect data on every state program. The programs selected for the survey were chosen only as indicators of a state's explicit commitment to aid distressed communities. These programs account for only a small percentage of state budgets. Education and welfare programs receive larger appropriations than the combined total of the housing, economic, and community development programs included in this survey. For more specific data on actual budgetary expenditures for targeted programs, four state budget case studies were completed and are reported in Appendix II. Furthermore, ACIR recognizes that state governments, by absorbing the costs of certain local government functions such as the courts, can indirectly move large numbers of dollars from the suburbs to the central cities and keep property taxes down.

ACIR is also aware of the limitations inherent in the data. The 20 selected programs are only a part of the range of programs available to a state to meet the problems of distressed communities. Choosing these 20 programs tends to reinforce a categorical way of thinking about distressed communities. As the findings and observations suggest, distressed communities exist in and result from large economic, political, demographic, and technological forces. Only a comprehensive approach aimed at underlying conditions in these communities can begin to correct the long-term effects of these problems.

Understandably, this project was constrained by time, scope, and resources. The data were gathered between 1980-83. The project was not designed to conduct a retrospective analysis of state actions, nor to forecast the future. Nor was it the project's objective to assess the relative merits of national or state government intervention. The report does, however, consider the range and diversity of approaches the states are using. Also, the project did not have the resources to evaluate the effectiveness of the various programs, although the value of such an analysis would be great.

Finally, the study considered the condition of the public physical infrastructure as an indicator of a local government's distress. A new state bill on community facilities reconstruction was also drafted for the legislative package. The Commission, however, did not deal with public physical infrastructure policy in this report because it was considered in greater detail in ACIR's, Financing Public Physical Infrastructure, A-96, 1984.

Organization of the Report

The full report on this project consists of three sets of materials: (1) this narrative volume presenting the results of the policy research and national survey, (2) a program catalog describing 776 state programs benefiting distressed communities, and (3) the 18 pieces of draft state legislation.

In the balance of this volume, Chapter 1 describes the context within which states will determine their actions toward distressed communities and looks specifically at the level of economic distress for people, places, and firms as well as for state and local governments. Chapters 2 through 6 present the research and survey findings for each of the five policy areas. The final chapter summarizes the project's findings and general observations and gives the Commissison's recommendations.

Chapter 1

STATES AND DISTRESSED COMMUNITIES: A CONTEXT

Economic distress can affect communities of all types and sizes, ranging from inner city neighborhoods to older suburban communities and rural towns. It disregards the boundaries of location and economic class.

Throughout the 1960s and 1970s, the notion was generally accepted that areawide economic distress was found predominantely in a few "pockets of poverty" such as central cities or Appalachia. With the stagnant economy of the mid 1970s, economic distress ceased to be an isolated phenomenon. It arose, and in many communities lingers persistently, occurring as the result of a complex array of economic, social, and political forces at the local, state, national and international levels. Monetary and fiscal policy, demographic change, technological innovation, international economic competition, trade and budget deficits, and changes in the composition of the national economy all combine to generate varying degrees of distress for communities across the country. Sometimes economic distress is the result of the natural, long-term evolution of a community's economy. Other times it is the immediate consequence of a plant closing or military base shutdown. In other instances, citizens and their communities fail to recognize adequately the growing national and international character of economic markets. Short-term business cycles may make these burdens heavier or lighter from time-to-time, but they are not the root causes.

This study measured distress during 1980-83, encompassing the worst national recession since the Great Depression. During this period, cyclical forces (like interest rates, inflation, and unemployment) combined with longer-term structural forces (like technological changes, population shifts, and decline in manufacturing) to heighten distress throughout the nation, whether considered in terms of individuals, firms or locations. For example, rates of business failure were up across all sizes of firms. State and local governments' revenue projections proved too high, and they had to scale back their spending while trying to provide acceptable levels of goods and services to their citizens. Their task was compounded by mounting national deficits and the fiscal necessity for the national government to pull back on many parts of its domestic spending.

These myriad forces combine to affect different communities in different ways. For example, at one time during 1983, the national unemployment rate was 8.4%, but at the same time it was over 30% in Youngstown, OH. In New Orleans, unemployment climbed to over 24% while in the District of Columbia it was just above 6%. It is important throughout this report to recognize the underlying forces at work, even though certain indicators or measurements may be skewed by economic conditions at the time of the study, and to note that the effects of distress, whatever they may be, are not spread uniformly across this nation's citizens, enterprises or locales.

States are the centerpiece of this study institutionally, but they too have been changing.1/ How states respond, both individually and collectively, to the challenges facing them, of which community distress is an outstanding example, will determine the future resilience, effectiveness and political balance in our federal system.2/ States need to provide firmer foundations for the kinds of productive partnerships between the state, local, and private sectors that American federalism will require in the years ahead.3/ Distressed communities will provide a crucible for testing both the will and capacity of these partnerships. Distressed communities, as a component of general state-local relations, will test the mettle of the states.

In summary, both the economy and the role of the states are evolving and changing. By focusing on distressed communities and their problems, this study enhances appreciation for the significance of these underlying trends.

Defining Distress

Cyclical and structural forces generate distress. The former are shorter term (two to five years) and relate to the swings in the business cycle. The latter are longer term (over five years) and reflect changes in the structure of the economy due to forces largely beyond the control of a state or local government.

One aspect of structural distress that is particularly pertinent to this project is called "market failure." In the case of distressed communities, market failure occurs when inefficiencies in the private marketplace, such as a lack of competition, or economic and social discrimination, combine to create "pockets," neighborhoods, or even whole cities where the economy stagnates or shrinks. Firms or developers are less likely to invest in market failure areas because the risk is perceived as being too high. Market failure can occur in communities whether or not there is a long-term shift in the structure of the economy. In fact, in the past, market failure even occurred during booming economic times. As economic conditions deteriorate, conditions in market failure areas became that much worse.

This report classifies economic distress in two ways: (1) community distress, which measures the relative economic and social conditions of people, the places where they live, and businesses, and (2) government distress, which measures the fiscal conditions of state and local governments in terms of revenues and expenditures in both the short and long terms.

Previous reports in this project have defined a "distressed community" as

> ...any areas (various types of general units of local government, including rural, urban and suburban places) which are declining or in need in relation to other areas in the state. 4/

For purposes of this final report, however, a more specific definition has been used:

> Distressed communities are those local government jurisdictions, and in some instances sub-areas of jurisdictions, which are in the bottom 25% of all jurisdictions of the same class throughout the state, based on the

most appropriate economic measure of distress for the same class of jurisdiction, e.g., poverty, unemployment or blight.

It is difficult, however, to be very precise about what a distressed community really is, particularly since conditions are different all across the country. As one very exhaustive study completed by the State of New York concluded: "No precise agreement exists as to what constitutes distress, nor is it clear how best to assess the relative problems and needs of urban and rural communities."5/

Ever since the problem of poverty and distress became a major national policy issue in the early 1960s, there have been attempts to define distress for people as well as for places and businesses. Subsection 600.7 of Section 701 of the Housing and Community Development Act of 1974, as amended, portrays distress as a relative measure:

> ...communities or places within a state or region which the state or areawide planning organization determine require greater attention and assistance than other communities or places within the state or region because of their relatively greater proportion of physical, social and economic problems.

This broad definition brought under consideration a range of variables affecting a local government, people or economic activity. Although a wide range of variables exists, most observers focus on four general categories:

1) Socioeconomic Measures: including per-capita income, poverty level and rate, welfare dependence, rate of violent crimes, and educational status.

3) Physical Measures: including the condition of the roads, bridges, and sewers, as well as housing stock.

3) Fiscal Measures: including the average operating surplus or deficit, the average short-term debt as a percentage of revenues, and dependence on intergovernmental aid.

4) Economic Development Measures: including population decline, levels of employment and unemployment, business dissolution and start-up rates, and levels of plant utilization.

These categories were used to generate data on several key dimensions of the context for community and government distress. One caveat is important, however: No attempt is made here to try to tackle the difficult task of sorting out what percentage of distress is due to structural or cyclical factors.

Dimensions of Community Distress

To operationalize the broad definition of distressed communities, the following specific measures were selected to gauge economic distress in this report.

1. Population Growth, Decline, and Composition

Population decline is a key measure of community distress. The United States population increased overall by 11.4% between 1970 and 1980, from 203.3 million to 226.5 million people. The greatest regional increases were in the South (20.9%) and West (19.8%), while the slowest rates of increase were in the Northeast (0.8%) and Midwest (3.8%) (see Table 1-1). Besides the District of Columbia, which lost 15.8% of its population, New York (-3.7%) and Rhode Island (-.03%) were the only states to lose population.6/

In the central cities, however, the picture is somewhat different. Between 1970 and 1980, the American population moved from the central cities to the suburbs and beyond. There was only a 0.2% increase in central-city populations, while the population of areas outside increased 18.2%.7/ In fact, between 1950 and 1980 the pecentage of the total population living in central cities declined from 58% to 40%.8/ The suburbs, on the other hand, have grown dramatically.

At the same time that the cities have lost population, their composition has also changed. As Table 1-2 shows, white population in the central cities during the 1970s dropped by 11.5% while black population increased 32.3% during the 1960s, and by 13% in the 1970s. Hispanics, Asians and other minority groups also migrated to the central cities during the 1970s.9/

2. Income and Poverty

The median family income in constant dollars declined for three years in a row between 1979 and 1982, but rose to slightly above the 1981 level in 1983.10/ Overall, 1983 median family income remained 8.6% below its 1979 peak of $26,885, due in large part to high rates of inflation followed by high rates of unemployment during the recession that began in 1981. The biggest drop in median family income in constant dollars between 1979 and 1983 occurred among Hispanics (-12.8%). Blacks in the North Central states experienced the greatest drop for any group in a region.

Poverty increased during this period. The number of persons below the poverty level rose from 25.3 million in 1979 to 35.3 million 1983, an increase of 39.5%.11/ (The federal Bureau of the Census defines poverty income as approximately $10,000 for a family of four in 1983.) The national poverty rate rose from 11.7% in 1979 to 15% 1982, its highest level since 1966. Poverty figures broken out by race and age show that poverty dropped between 1965 and 1975 in every category, and then began to increase again (Table 1-3). By 1982, poverty levels were either just as high as in 1965 or higher.

Poverty tends to be concentrated in the central cities. In 1975, 34.7% of all people in central-city neighborhoods were poor. This rose to 40.7% in 1980. For the White population in these neighborhoods, 29.8% were poor in 1970, rising to 32.9% in 1980. For Blacks, close to 40% were under the poverty line in 1970, rising to 47.1% in 1980.

Central cities are not the only places that may experience an increased poverty rate. For example, that rate for suburban areas outside the central city increased from 7.1% in 1970 to 8.9% in 1980.

Table 1-1

TOTAL POPULATION CHANGE, 1970-80
(rounded in thousands)

Region and State	1970	1980	Change 1970-80	
			No.	%
NEW ENGLAND				
Connecticut	3,032	3,108	76	2.5
Maine	994	1,125	131	13.1
Massachusetts	5,689	5,737	48	.8
New Hampshire	738	921	183	24.7
Rhode Island	950	947	-3	-.3
Vermont	445	511	66	14.9
Total	11,848	12,348	500	4.2
MID-ATLANTIC				
Delaware	548	595	47	8.6
Maryland	3,924	4,216	292	7.5
New Jersey	7,171	7,364	193	2.7
New York	18,241	17,557	-684	-3.7
Pennsylvania	11,801	11,867	66	.6
Total	41,685	41,600	-85	-.2
MIDWEST				
Illinois	11,110	11,418	308	2.8
Indiana	5,195	5,490	295	5.7
Iowa	2,825	2,913	88	3.1
Michigan	8,882	9,258	376	4.2
Minnesota	3,806	4,077	271	7.1
Ohio	10,657	10,797	140	1.3
Wisconsin	4,418	4,705	287	6.5
Total	46,893	48,660	1,767	3.8
SOUTH				
Alabama	3,444	3,890	446	13.0
Arkansas	1,923	2,286	363	18.9
Washington, DC	757	638	-119	-15.8
Florida	6,791	9,740	2,949	43.4
Georgia	4,588	5,464	876	19.1
Kentucky	3,221	3,661	440	13.7
Louisiana	3,645	4,204	559	15.3
Mississippi	2,217	2,521	304	13.7
North Carolina	5,084	5,874	790	15.5
Oklahoma	2,559	3,025	466	18.2
South Carolina	2,591	3,119	528	20.4
South (cont.)				
Tennessee	3,926	4,591	665	16.9
Texas	11,199	14,228	3,029	27.1
Virginia	4,651	5,346	695	14.9
West Virginia	1,744	1,950	206	11.8
Total	58,340	70,537	12,197	20.9
WEST				
Alaska	303	400	97	32.2
Arizona	1,775	2,718	943	53.1
California	19,971	23,669	3,698	18.5
Colorado	2,210	2,889	679	30.7
Hawaii	770	965	195	25.3
Idaho	713	944	231	32.4
Kansas	2,249	2,363	114	5.1
Missouri	4,678	4,917	239	5.1
Montana	694	787	93	13.4
Nebraska	1,485	1,570	85	5.7
Nevada	489	799	310	63.4
New Mexico	1,017	1,300	283	27.8
North Dakota	618	653	35	5.6
Oregon	2,092	2,633	541	25.8
South Dakota	666	690	24	3.6
Utah	1,059	1,461	402	38.0
Washington	3,413	4,130	717	21.0
Wyoming	332	471	139	41.8
Total	44,534	53,359	8,825	19.8
NORTHEAST	53,533	53,948	415	.8
MIDWEST	46,893	48,660	1,767	3.8
NORTHEAST & MIDWEST	100,426	102,609	2,183	2.2
SOUTH	58,340	70,537	12,197	20.9
WEST	44,534	53,359	8,825	19.8
SOUTH & WEST	102,874	123,896	21,022	20.4
U.S. TOTAL	203.300	226,505	23,205	11.4

SOURCE: ACIR staff calculations from U.S. Department of Commerce, Bureau of the Census, "Preliminary

Table 1-2

POPULATION BY METRO-NONMETRO RESIDENCE AND RACE, 1960-80

(in millions, except percent, as of April,
see also *Historical Statistics, Colonial Times to 1970*, series A 276-287)

	243 SMSA's 1/					318 SMSA's 2/				
		1970					1980			
			Percent distri-	Change 1960-70				Percent distri-	Change 1970-80	
Residence and Race	1960	Total	bution	No.	%	1970	Total	bution	No.	%
All Races	179.3*	203.3	100.0	23.9	13.3*	203.3	226.5	100.0	23.2	11.4
SMSA's	119.6	139.4	66.7	19.8	16.6	153.7	169.4	74.8	15.7	10.2
Central Cities	59.9	63.8	31.6	3.9	6.5	67.9	67.9	30.0	.1	.1
Outside Central Cities	59.6	75.6	37.0	16.0	26.8	85.8	101.5	44.8	15.6	18.2
Nonmetropolitan Areas	59.7	63.8	31.4	4.1	6.8	49.6	57.1	25.2	7.5	15.1
White	158.8	177.7	100.0	18.9	11.9	177.7	188.3	100.0	10.6	6.0
SMSA's	105.8	120.6	67.8	14.8	14.0	133.6	138.0	73.3	4.5	3.3
Central Cities	49.4	49.4	27.8	.0	.0	53.1	47.0	25.0	-6.1	-11.5
Outside Central Cities	56.4	71.1	40.0	14.7	26.1	80.5	91.0	48.3	10.6	13.1
Nonmetropolitan Areas	53.0	57.2	32.2	4.2	7.8	44.2	50.3	26.7	6.1	13.9
Black	18.9	22.6	100.0	3.7	19.7	22.6	26.5	100.0	3.9	17.3
SMSA's	12.7	16.8	74.3	4.0	31.6	17.9	21.5	81.1	3.6	20.2
Central Cities	9.9	13.1	58.2	3.2	32.3	13.5	15.3	57.8	1.8	13.0
Outside Central Cities	2.9	3.6	16.1	.7	24.1	4.3	6.2	23.3	1.8	42.7
Nonmetropolitan Areas	6.1	5.8	25.7	-.3	-5.3	4.7	5.0	18.9	.3	6.5
All Other Races	1.6	2.9	100.0	1.3	78.0	2.9	11.7	100.0	8.8	305.0
SMSA's	1.0	2.1	71.8	1.0	102.0	2.2	9.9	84.7	7.7	354.0
Central Cities	.6	1.2	42.5	.6	100.0	1.2	5.6	48.1	4.5	382.5
Outside Central Cities	.3	.8	29.3	.5	166.7	1.0	4.3	36.6	3.3	321.4
Nonmetropolitan Areas	.6	.8	28.2	.2	36.7	.7	1.8	15.3	1.1	153.7

1/ As defined in 1970 census publications.
2/ As defined by U.S. Office of Management and Budget, June 30, 1981.
* Totals include corrections and some annexations that are not included in data by race. See text.

Source: U.S. Bureau of the Census, U.S. Census of Population: 1960 and 1970, vol. 1: and 1980

Table 1-3

PERCENT IN POVERTY BY RACE AND AGE

Category	1965	1979	1980	1981	1982
Total	17.3	11.7	13.0	14.0	15.0
Youth	20.7	16.0	17.9	19.5	21.3
White	13.3	9.0	10.2	11.1	12.0
Youth	14.4	11.4	13.4	14.7	16.5
Black	41.8('66)	31.0	32.5	34.2	35.6
Youth	50.6('72)	40.8	42.1	44.9	47.3
Hispanic	22.8	21.8	25.7	26.5	29.9
Youth	27.8('73)	27.7	33.0	35.4	38.9

Source: U.S. Bureau of the Census, Statistical Abstract, 1982-83, Washington, DC, 1982.

Although their poverty rate is just about half the national average, suburban communities closer to the central city are beginning to experience the same set of problems as central cities. As the 1980 President's National Urban Policy Report pointed out, some older suburban communities face many of the same problems as do needy central cities, although the level of distress may not be as severe.12/

During the 1970s, rural areas experienced a high rate of population and economic growth. In spite of that growth, fully 44% of all rural communities were considered "needy" in 1979. In fact, 40% of all low income people in the country live in rural areas.13/ (HUD defines low income as 70% of state or areawide median income.) Clearly, increased economic growth in and of itself does not eliminate poverty.

Between 1980 and 1983, the percentage of families below the poverty level rose nationally and in all regions. Even as the recession abated between 1982 and 1983, poverty increased in all regions except the South, especially in the Midwest.

Most of the decline in poverty rates between the 1960 and 1975 can be attributed to increased levels of public assistance. Since 1975, however, the rate of poverty rose again to levels experienced in the early 1960s. The Census Bureau attributed the increase to two recessions, tightened standards of eligibility for public assistance, and a lower poverty threshold to qualify for that aid.14/

3. Employment and Unemployment

The percentage of the population actively engaged in full-time work has remained almost constant since 1978 when 63.2% of the population made up the labor force. The rate increased to 64% in 1982, and to 64.4% by September 1983. Apart from cyclical employment fluctuations, structural changes in employment have had a major impact on certain regions. Manufacturing employment decreased by 3.5% in the Midwest during the 1976-81 period, and increased by 18% in the West.15/

Between 1979 and 1983, the national unemployment rate ranged from 5.8% (in 1979) to 10.7% (in December 1982) and stood at 8.4% in November 1983. During that same period, the unemployment rate among Blacks was regularly more than twice that among Whites.

Unemployment in metropolitan areas continues to outpace the national rate. And here, too, as Table 1-4 shows, Black unemployment continues at more than twice the rate for Whites. The Bureau of Labor Statistics also found that Black youth unemployment went over 50% in 1981 for the first time since statistics were collected on this measure.

4. Public Physical Infrastructure

"Infrastructure" emerged as a national policy concern in 1981 with the publication of America in Ruins by the Council of State Planning Agencies.16/ This study estimated that 20% of all bridges in the country needed either major rehabilitation or reconstruction at a cost of $33 billion, that large cities would need $100 billion over 20 years to maintain their water systems, and that meeting 1986 water pollution control standards would cost $25 billion. The Congressional Research Service arrived at similarly large numbers.17/

To get a more specific picture of the problem, in 1983 the National League of Cities and the U.S. Conference of Mayors conducted a national Survey of 809 cities of all sizes. The survey found that the need for major improvements exceeded governmental resources.18/ Other analyses of the

Table 1-4

PERCENT UNEMPLOYED IN METROPOLITAN AREAS BY RACE

Category	1979	1980	1981	1982	1983*
National	5.8	7.0	7.5	9.5	10.8
Central Cities	7.1	8.4	8.9	11.1	12.4
Whites	5.5	6.6	6.9	8.7	10.0
Blacks	12.6	14.3	15.5	18.6	22.5
Total White	5.1	6.3	6.7	8.7	8.1
Total Black	12.3	14.3	15.5	18.9	19.0

*First quarter statistics.

Source: Bureau of Labor Statistics, U.S. Department of Labor, Washington, DC, 1983.

problem have suggested that the problem is severe but manageable when broken down into its component parts.19/ But a deteriorating physical plant is a particularly serious obstacle to development for distressed communities. Though no estimates of the extent or cost of the physical infrastructure problem in central cities are available, it is expected to be a far greater problem than in suburban areas. Even without these estimates, however, it is evident that local governments already experiencing fiscal problems find these higher costs a major deterrent to economic revitalization.

5. Private Sector Economic Activity

The major structural shifts occurring in the national economy lie at the core of many of the problems confronting distressed communities. As the drop in manufacturing employment would suggest, the process of disinvestment in the nation's productive capacity is continuing. The capital stock is aging, energy inefficient, and in need of replacement. Jobs are being exported to cheaper labor markets in the third world, and plants are being shut down.

Plant closings are perhaps the most visible sign of structural change in the economy. The chance of a manufacturing plant closing down during any seven conservative years of the 1970s was over 30% and no region of the country was immune; in fact, nearly half of all the jobs lost due to plant closings in the 1970s were in the Sunbelt.20/ This trend continued into the 1980s, with 619 plant closings in 1982 and 286 more closings in the first six months of 1983, for an 18-month total of 273,000 jobs lost, many of them permanently. Even the Sunbelt experienced many closings; the West had 30 closings (26,513 jobs) in the first half of 1983, and the Southwest closings (7,348 jobs).21/

When a large plant shuts down, the community in which it is located can suffer severe consequences. For example, the Massachusetts Department of Transportation estimated the costs of closing a large auto plant in an automotive-dependent community as follows, for a hypothetical community of 200,000 citizens, with employment of 94,000, and 50,000 of those in primary and secondary auto sectors (Table 1-5). Within two years after the plant closing, the community would lose 10% of its population, 20% of its jobs, 35% of its tax revenues, and 50% of new housing sales while the number of unemployed would rise by 200%.

Another measure of private-sector economic activity is business start-ups and failures. Although start-ups and failures reflect cyclical change, they do give some indication of the economy's volatility. Dun and Bradstreet reported in October 1983, that new business incorporations for 1983 were 11% above their 1982 rate, with 300,045 incorporations. As the same time, the business failure rate was also up sharply over 1982, with an average weekly failure of 598 firms in 1983 compared to 491 in 1982.22/

All five indicators display distress in many of the nation's communities that is both cyclical and structural in nature. Distress can arise anywhere -- in central cities, older suburbs and rural towns. Every region of the country experiences some degree of distress, and poor and minority persons are affected more severely than others.

The persistence and concentration of economic distress in cities have

Table 1-5

EFFECTS OF A PLANT CLOSING ON A HYPOTHETICAL COMMUNITY

A.	Before Closing - 1979	
	Population	200,000
	Total Employment	94,000
	Employment by Primary and Secondary Auto Sectors.	50,000
	Unemployment	6.6%
	Tax Revenues	$24 million
	New Housing Sales	1,000
B.	Two Years After Closing - 1981	
	Population	Down 10%
	Total Employment	Down 20%
	Employment by Primary and Secondary Auto Sectors.	Down 40%
	Unemployment	Up 200%
	Tax Revenues	Down 35%
	New Housing Sales	Down 50%

Source: George Byron and John O'Donnell, Facilities Planning and Regional Employment Assessment (Cambridge, MA: Department of Transportation, Transportation Systems Center), 1981.

led urbanologists to suggest that the economic functions of the city are changing.23/ The city in the early 1900s was a city of goods production in which large numbers of jobs were available for relatively unskilled workers. City poor during the 1980s are dependent on transfer payments and welfare. For the rich, however, the city was once one of manufacturing and production; now it has become a city of information processing, corporate headquarters, and consumption. In effect, the historic linkage between manufacturing activity and urban places has been severed, with major consequences for the people and businesses dependent on that productive activity.

Dimensions of Local Government Distress

A local government must have sound finances if it is to obtain and maintain a marketable bond rating, meet citizens' needs, and support local industry. In the last five years, the fiscal position of many local governments has eroded substantially. Whether their fiscal standing is measured in the short or long term, mounting fiscal pressures confront local governments of all sizes in every part of the country.

In 1978, the House Committee on Banking, Finance and Urban Affairs confirmed that city fiscal problems were greatest in northeastern cities of all sizes, and especially acute in large cities in the Northeast and Midwest. Even large and medium-sized cities in the South were experiencing difficulties.24/

In 1981, the Joint Economic Committee (JEC) of Congress released the results of a survey showing that distress had spread to a large number of cities in all parts of the country. These findings included the following:

1. For all cities with populations of 10,000 or more, the average increase in both revenues and expenditures was below the rate of inflation in 1979 and 1980.

2. More than 50% of these cities reported operating deficits in both 1979 and 1980.

3. In 1980, over 70% of the largest cities experienced deficits, and by 1981 all but four anticipated deficits.

4. Revenue trends included a reduction in federal aid, reduced growth in state aid, and increases in user fees to finance government activities.

5. Cities increased capital outlays by an average of 19.4%, to meet their physical infrastructure needs.25/

The committee summarized the fiscal outlook for cities as "bleak."

By January 1982, the JEC had completed yet another survey, with 108 respondents, which found that city budgets were under "substantial and mounting pressure." The report noted that "perhaps the most disturbing finding of the report is that for 1982, cities are projecting virtually no growth in revenues."26/ In fact, for cities of all sizes, revenues were expected to increase only 1.3%; when accounting for inflation, this was really a decrease of 6%. At the same time, expenditures were expected to grow at an average rate of 7.8%, producing an obvious cash squeeze and deficits (see Table 1-6). Furthermore, 40% of the responding cities said operating outlays and debt service payments exceeded current revenues and receipts in 1981, with 59% projecting current deficits in 1982. The largest increase in the percentage of cities experiencing current deficits occurred in small cities.

Finally, the Bureau of the Census found that in the 1980 census, five of the ten poorest cities were in the Northeast. Newark, NJ, the only city with more than 30% of its population below the poverty line, was ranked as the poorest city; surprisingly, Atlanta came in second. By 1980, five Southern cities were among the ten poorest.27/

Four indicators were used in this study to assess local fiscal condition: budgetary and citizen distress, which are short-term measures; and dependence on intergovernmental aid plus structural distress, which are long-term measures.28/

1. Short-Term Distress

Budgetary distress is the extent of short-run difficulty a local government confronts in balancing its budget. Measures of budgetary distress

Table 1-6

CURRENT REVENUES AND EXPENDITURES PER CAPITA BY CITY SIZE

	1980 (Actual)	1981 (Actual)	1982*	Percent Change 1980-81	Percent Change 1981-82
Small Cities (n=110)					
Revenues	$291	$314	$317	7.8%	1.0%
Expenditures	$274	$297	$327	8.7%	9.8%
Medium Cities (n=65)					
Revenues	$340	$376	$381	9.4%	1.3%
Expenditures	$322	$352	$385	9.3%	9.5%
Large Cities (n=67)					
Revenues	$366	$398	$397	8.4%	0.1%
Expenditures	$359	$395	$416	10.0%	5.2%
Largest Cities (n=44)					
Revenues	$503	$547	$562	8.6%	2.8%
Expenditures	$497	$534	$677	7.5%	6.5%
ALL CITIES (n=286)					
Revenues	$353	$383	$388	8.5%	1.3%
Expenditures	$339	$369	$398	8.9%	7.8%

*Budgeted or anticipated amounts for Fiscal Year 1982.

Source: U.S. Congress, Joint Economic Committee, Trends in the Fiscal Condition of Cities (Washington, DC DC: U.S. Government Printing Office, 1982), p. 13.

include the current balance between revenues and expenditures (surplus or deficit), average short-term debt as a percentage of total revenues, and average debt service costs as a percentage of total revenues. The data in Table 1-7 for the early to mid-1970s show that cities in the Northeast scored the worst on all measures in both 1972 and 1977. They had the smallest budget surpluses, the highest degree of dependence on short-term debt, and the largest debt and debt service costs of all cities. Southern cities fared much better.

Citizen fiscal distress occurs when a local government is unable to provide a basic package of public services and to collect the revenues necessary to pay for them. The measures used to reveal this condition are tax burdens and service levels.29/ During the 1970s, the highest tax burdens were in the Northeast. Six cities nationally had a percapita tax rate over $1,000, four of which were in the Northeast (Hartford, New York, Boston, and Cambridge).

In terms of service delivery, a key measure of a city's distress is its municipal work force. During the late 1970s and early 1980s, cities laid off

Table 1-7

BUDGETARY FISCAL DISTRESS MEASURES

	All	Northeast	North Central	South	West
NUMBER OF CITIES	153	28	41	52	32
1. Average Current Account Surplus or Deficit as Percent of Budget (higher is better)					
1972.........	14.5	9.4	14.3	15.0	18.3
1977.........	13.7	0.1	14.9	17.8	17.2
2. Average Short-Term Debt as Percent of Total Revenues (lower is better)					
1972.........	17.3	31.6	21.7	11.4	8.6
1977.........	8.4	15.7	13.7	3.7	2.7
3. Average Debt Service Cost as Percent of Total Revenues (lower is better)					
1972..........	30.3	40.9	35.6	27.9	18.1
1977..........	19.6	25.7	25.5	16.1	12.6

Definitions:

1. Current Account Surplus as Percent of Budget: difference between total revenues and total expenditures expressed as percent of average of expenditures and revenues. Total expenditures include general expenditures, noncapital utility expenditures, long-term debt retired and city contributions to own retirement systems. Total revenues include general revenues (intergovernmental and own source) and utility revenues.

2. Short-Term Debt as Percent of Total Revenues: ratio of short-term debt outstanding at year-end to general revenues expressed as percent.

3. Debt Service Costs as Percent of Total Revenues: interest expense on short-term debt outstanding, and long-term debt retired as percent of general revenues.

Source: Katharine Bradbury, "Fiscal Distress in Large U.S. Cities," New England Economic Review (November/December 1982), pp. 33-43; also "Structural Distress in Cities, Causes and Consequences," New England Economic Review (January/February 1983), pp. 32-43.

workers as a way of cutting costs to balance their budgets. An average work force reduction of 34% occurred in the 1980s as a result of cutbacks in the public service employment program operated under the Comprehensive Employment Training Act (CETA). Total employment for all cities continued to decline in 1981, particularly in medium-sized and large cities. The part-time work force was reduced by an average of 14.8%.30/ The National League of Cities found the trend toward work force reductions continued into 1982, with 47% of the cities in their survey anticipating further cuts in fiscal year 1983. Particularly surprising was the finding that 56.6% of the cities reporting from the South reported reductions.31/ The Sunbelt was not immune to fiscal problems.

2. Long-Term Distress

For cities, intergovernmental grants-in-aid make up 83% of all the federal aid they receive, with General Revenue Sharing (GRS), Community Development Block Grants (CDBG), local public works, and employment training assistance the four largest programs.32/ Some analysts have noted that aid to state and local governments has increased at an average annual rate of 14.6%, rising from $3.23 billion in 1955 to $89.7 billion in 1980. A National League of Cities study shows, however, that after inflation, states and cities have experienced no real growth since FY 1973. In fact, during the 1972-80 period, the real annual growth rate of aid was -0.6% for states and only 0.57% for cities, while GRS declined by 8%, and CETA was replaced by the much smaller Job Training Partnership Act.33/

The other indicator of a local government's long-term financial prospects is called "structural distress," defined as the long-term imbalance between responsibilities and revenues. This imbalance results from an unfavorable combination of six factors: (1) size of the tax base; (2) amount of intergovernmental aid; (3) tax collections by overlying governments; (4) range of service responsibilities; (5) costs of local production; and (6) level of service needs. A survey of 153 large cities done during the 1970s, found that different factors accounted for structural distress in different regions.34/ In the West, the most frequent reason was legal limits on revenues, such as Proposition 13 in California. Distress in the Northeast resulted from relatively low revenue-raising capabilities, above average costs of government, and high levels of service responsibility. The South, on the other hand, had less distress because of relatively low service responsibilities and low overlying tax rates.

The long-term indebtedness of cities is also an important measure of a city's structural distress. A Department of Commerce analysis of 75 urban regions found that after 1979, long-term debt began to rise slowly, with an 8.3% rise in FY 1980, and a 5.8% increase in FY 1981 to $133.8 billion.35/ In addition, access to the bond market has been frustrated by high interest rates. In fiscal year 1981, for example, the Joint Economic Committee found 59 bond issues being delayed or cancelled.36/

Dimensions of State Government Distress

In addition to structural changes in the national economy, several cyclical factors affected the states' fiscal posture: (1) the taxpayer revolt,

(2) the recession, and (3) a reduction in federal aid. The impact of these forces began in 1978, but came to a head in 1982, the "year of the big revenue shortfall" when the most severe economic downturn since the 1930s reduced federal, state and local tax receipts, and forced public officials at all levels of government to make painful choices.37/ It was also the year when the "jaws" effect of rising federal defense spending and declining federal aid to state and local governments became apparent (see Graph 1-1).

The taxpayer revolt began in 1978. Between that year and 1981, state taxes rose by an annual average of only 0.5%, except in energy rich states like Wyoming and Alaska. Furthermore, federal antirecession aid declined between the 1975 and 1981 economic downturns. Such aid amounted to $16 billion during the 1975 slowdown; nothing comparable was provided during the much more severe 1981 recession. Federal aid to state and local governments has been cut since 1978, when federal aid per capita (adjusted for inflation) was at an all-time high $231. During 1979-80, it dropped to $218 and by 1982 had dropped again to $174.

Three indicators can help assess the fiscal condition of state governments: (1) year-end balances, (2) state actions to balance their budgets and (3) levels of intergovernmental aid.

States' "year-end balances" are not necessarily "surplus" funds. They are often planned to ensure an adequate cash flow, to act as a hedge against economic uncertainty, and as a reserve in case of natural disasters or other emergencies. The size of this unobligated balance as a percentage of total general fund expenditures is considered to be a key indicator of the fiscal condition of a state government. A 5% level, which is enough to keep a state government running about 13 working days, is considered reasonable by bond raters.38/

According to an annual survey conducted by the National Governors' Association with the National Association of State Budget Officers, combined year-end balances for all states dropped from $11.3 billion in FY 1980 to an estimated $0.3 billion in fiscal year 1983, but was expected to rebound to $1.3 billion in fiscal year 1984 (see Table 1-8). This table also shows that year-end balances as a percentage of current-year expenditures dropped from 9% in fiscal year 1980 to 0.2% in fiscal year 1983, but were projected to improve to 0.7% in FY 1984.

By 1982, 44 states were expecting to have a year-end balance below the 5% mark. In effect, the states used up their marginal balances during the period covered by this study.

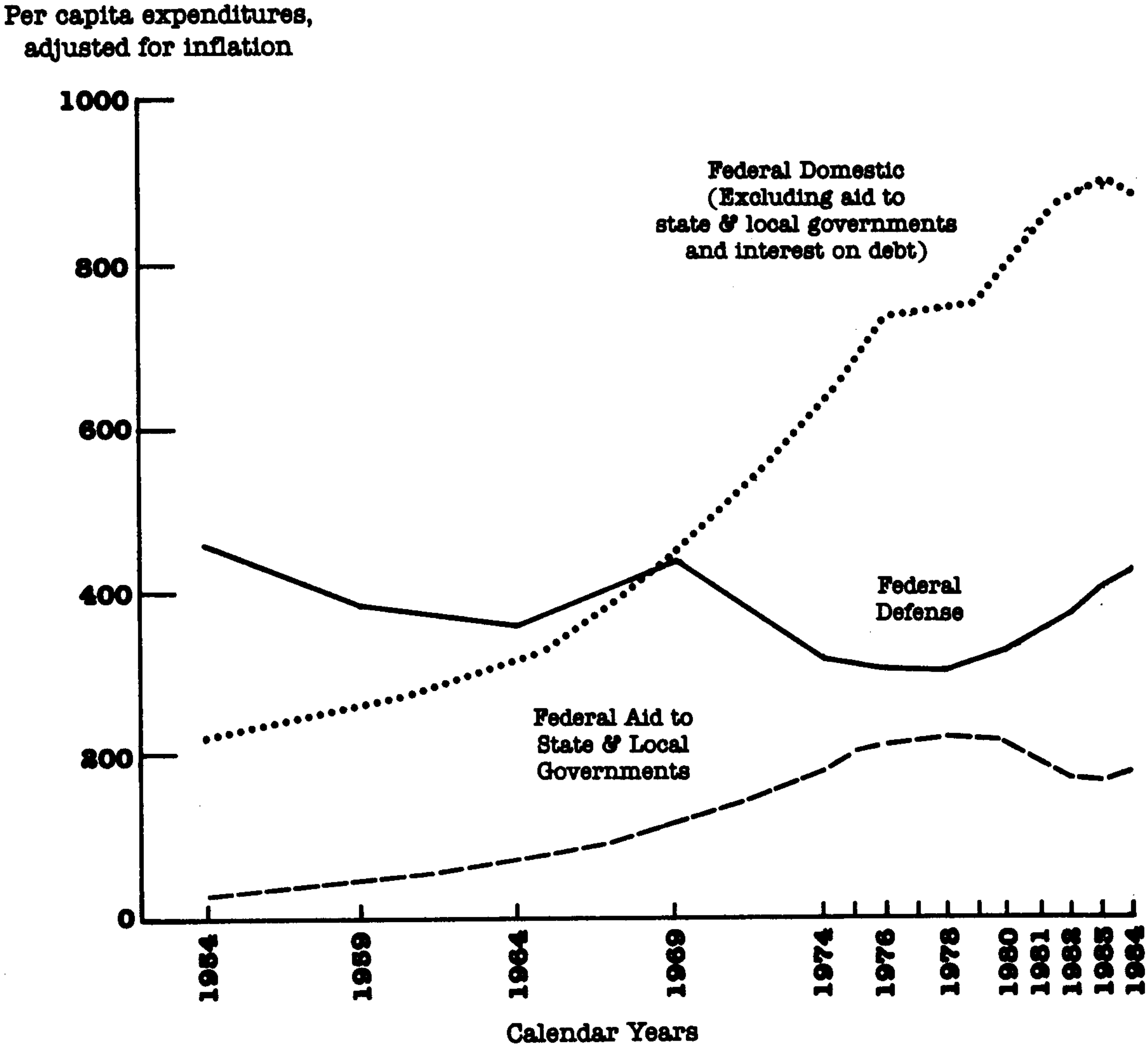
Several other dimensions of the state fiscal position are important to consider:

1. At the end of FY 1983, 19 states projected deficits in their general funds, and 12 others anticipated year-end balances of less than 1%.

2. Thirty-five states reduced their spending for FY 1983 below that year's proposed budget.

Graph 1-1

THE GROWING FEDERAL AID SQUEEZE AS DOMESTIC AND DEFENSE OUTLAYS INCREASE



Inflation adjustment by GNP Implicit Price Deflator 1972-100
Source: ACIR, Significant Features of Fiscal Federalism, 1984 Edition, Table 6 (based on U.S. Department of Commerce, National Income and Product Accounts).

Table 1-8

STATE GENERAL FUND SUMMARY, FISCAL YEARS 1980-84
(in billions)

	Actuals			Estimates	
	1980	1981	1982	1983	1984
Beginning Balance	$ 11.2	$ 11.8	$ 6.5	$ 4.5	$ 0.3
Revenues and Adjustments	126.1	141.2	153.8	160.8	174.7
Expenditures and Transfers	126.0	146.5	155.8	165.1	173.7
Ending Balance	11.3	6.5	4.5	0.3	1.3
Balance as Percent of Current-Year Expenditure	9.0%	4.5%	3.0%	0.2%	0.7%

Source: National Governors Association and National Association of State Budget Officers, Fiscal Survey of the States, 1980-81 (Washington, DC, 1981), p. 3.

3. Cutbacks due to recession induced revenue shortfalls, occurred in every state.

4. All regions of the country were affected, with at least two states in each region expecting an FY 1983 deficit.

5. Between FY 1978 and FY 1982, state taxes in 44 states fell as a percentage of personal income.39/

Clearly, the level of state fiscal distresss has increased dramatically between 1980 and 1983.

States have responded with a combination of cutbacks and new revenue raising measures. In 1982, 42 states used at least one type of budget balancing measure, and that number increased to 47 in 1983.

Table 1-9 summarizes the nonpersonnel measures adopted or proposed by states for fiscal years 1982-84. Program cuts dominated state actions and delayed expenditures in FY 1982. There were even more cuts and delays in FY 1983, but revenue raising measures occurred in more than half the states in FY 1984..

The states also used a variety of personnel actions to help balance their budgets, as shown in Table 1-10. After rising for 35 years, the total

Table 1-9

STATES ADOPTING OR PROPOSING NONPERSONNEL BUDGET BALANCING MEASURES
(fiscal years)

Measure	1982	1983	1984
Across the Board Cuts	17	27	2
Selective Program Cuts	25	27	2
Reduced Recommendation Prior to Enactment	9	12	11
Permanent Revenue Increases	12	27	34
Temporary Revenue Increases	14	24	19
Capital Financing to Bonds	5	6	9
Move General Funds to Special Funds	8	17	21
Move General Funds to Other Government Entitites	1	3	3
Delayed Expenditures	13	15	6
Advanced Tax Dates	10	19	11

Source: National Governors Association and National Association of the State Budget Officers, Fiscal Survey of the States, 1982 and 1983 editions, (Washington, DC), pp. 11 and 34-37 respectively.

Table 1-10

NUMBER OF STATES ADOPTING OR PROPOSING PERSONNEL AUSTERITY MEASURES
(fiscal years)

	1982	1983	1984
Laid Off Personnel	20	22	12
Hiring Limits	37	42	27
Unpaid Furloughs	4	9	5
Restricted Travel:			
Out-of-State	24	32	18
In-State	16	23	12

Source: National Governers Association and National Association of State Budget Officers, Fiscal Survey of the States, 1982 and 1983 editions, (Washington, DC), pp. 12 and 38-41 respectively.

level of state employment began to decrease in mid-1981, with a further decrease in 1982 in 28 states. In 1982 and 1983, 33 states either froze or limited hiring new workers, and in 1984 employment continued to be limited through hiring reductions in 27 states.

On the revenue side, many states adjusted their tax rates. During 1981 and 1982, 27 states raised gas and motor fuel taxes, 16 hiked taxes on alcohol, and 11 raised cigarette taxes. The general sales tax was raised in 13 states and eight increased individual income taxes.40/ By 1983, permanent state tax increases were levied by 36 states and were up to a record $7.1 billion with another $2 billion in temporary increases.41/

The level of state aid to local governments as a percentage of state general expenditures remained nearly constant until 1981: 35.3% in 1957, rising to 36.8% in 1977, and dropping slightly to 36% in 1981. The total number of state dollars going to local governments has increased dramatically, however, from $7.4 billion in 1957 to $91.3 billion in 1981, with state aid still outpacing inflation (see Table 1-11).

Table 1-11

AMOUNTS AND INCREASES IN STATE AID TO LOCAL GOVERNMENTS
(in billions of dollars and percent)

	1981	1977	1972	1967	1962	1957
Amounts	$91.3	$61.1	$36.8	$19.1	$10.9	$ 7.4
Average Annual Percent Increase From Prior Period	10.6%	10.7%	14.0%	11.9%	8.1%	n.a.
Exhibit: Average Annual Rate of Inflation 1/	8.7%	7.0%	4.8%	2.3%	1.7%	n.a.

1/ Measured by change in the implicit GNP price deflator.

Source: The States and Intergovernmental Aids (1977), ACIR, A-59, p. 10, State Payments to Local Governments, Vol. 6, No. 3, of the Census of Governments, U.S. Census, p. 14; State Government Finances in 1981, U.S. Census, p. 10, adjusted for state intergovernmental expenditure to federal government, U.S. Economic Report of the President, February 1983, Table B-3.

Though the amounts have increased, the composition of state aid has changed only slightly since 1957. Education still has the largest claim, accounting for 63% of all state aid in 1981. The share going to public welfare decreased from a high of 19% in 1972 to 12% in 1981, while the amount for highways dropped from 15% in 1957 to 5% in 1981 (see Table 1-12).

State aid, however, is not as large a source of revenues for cities as these data suggest. In 1981, state aid accounted for only 32% of the revenue

Table 1-12

COMPOSITION OF STATE AID
(in percent and billions of dollars)

	1981		1977		1972		1967		1962		1957	
Purpose	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars
Education	63	57.2	61	37.0	58	21.2	62	11.9	59	6.5	57	4.2
Public Welfare	12	11.0	14	8.7	19	7.0	15	2.9	16	1.8	15	1.1
General Welfare	11	9.6	10	4.6	10	3.8	8	1.6	8	0.8	9	0.7
Highways	5	4.7	6	3.6	7	2.6	10	1.9	12	1.3	15	1.1
Other	10	8.7	9	5.4	6	2.2	5	0.9	4	0.5	5	0.3

Source: The States and Intergovernmental Aids (1977), ACIR, A-59, page 10, State Payments to Local Governments, V. 6, No. 3, of the Census of Governments, U.S. Census, page 14; State Government Finances in 1981, U.S. Census, page 10, adjusted for state intergovernmental expenditure to federal government.

base for cities, down from 39% in 1977 and well below the 61% average for all types of local governments (see Table 1-13).

Table 1-13

STATE AID AS PERCENT OF LOCAL OWN-SOURCE GENERAL REVENUE

Local Government	1981	1977	1972	1967	1962
Counties	63	63	68	63	59
Incorporated Municipalities	32	39	36	28	20
Townships	31	29	25	29	27
School Districts	120	95	76	72	63
Special Districts	10	12	6	7	4
All Localities	61	59	52	48	41

Source: 1962, 1967, 1972, and 1977 Census of Government, V. 4, Compendium of Government Finances; and 1980-81 Governmental Finances, Census of Governments, U.S. Census Bureau, U.S. Department of Commerce.

Data for the period 1980-83, however, show that state governments have been forced to cut local aid. Five states cut local aid across the board along with other programs, while 21 states cut local aid less than other programs. In some states, such as North Dakota, Idaho, and New Mexico, local aid was exempted from budget cuts. There were no cuts in eight states, while in Arkansas the local aid cuts were greater than the reductions in other programs.42/

In summary, the state fiscal picture which had been deteriorating since 1978, continued that trend throughout the period of this study to the point where year-end balances could no longer be counted on to balance the budget. Most states cut personnel and program expenditures and raised new taxes to balance their budgets. The willingness of taxpayers to tolerate additional tax hikes or program cuts is uncertain. Fiscal relations between states and local governments have also changed. Until 1981, states maintained a relatively constant level of aid, although cities got less of that aid than most other types of local governments. As the recession and reductions in federal aid to states took effect, most states reduced their aid to cities along with other program assistance in order to help balance their own budgets.

A recovering economy will improve the picture, but the results will be affected by the strength and duration of the recovery and by the still unknown political and fiscal effects of the tax and spending actions generated by the recession.

The National Response to Distressed Communities*

Until 1970, the national government responded to distressed community problems by designing specific categorical programs to address them. Not until 1970 was much attention given to the development of a comprehensive national urban policy, and such a policy was not articulated until 1978. The Reagan Administration, however, views the evolution of greater federal involvement in the cities as a shift in responsiblity that had grown well beyond the capability of the national government, and has sought to reduce substantially the federal role in favor of an increased role by state governments and the private sector.43/ In effect, since the economic distress of rural and urban communities became a national policy concern, there has been no consistent national policy response.

The first direct political association between cities and the national government came with the 1949 Housing Act. Then, urban renewal programs provided federal dollars directly to city agencies, bypassing state governments, for the first time.44/ By the end of the Eisenhower Administration, the cities were eager to have their own voice in the cabinet. President Kennedy attempted to give them one, but failed. Lyndon Johnson, however, succeeded in 1965, creating the Department of Housing and Urban Development (HUD).

HUD was only part of the Johnson Administration's accomplishments in this regard. Largely in response to the urban riots that occurred during 1964-68, President Johnson substantially increased the federal presence in cities. The Model Cities program, the centerpiece of the Great Society's urban agenda, sought to demonstrate new approaches to revitalizing central cities. By the time Congress passed the legislation, however, the funding was too little and spread too thinly to be very effective, due in large part to competition for dollars from the Vietnam War and other domestic programs.

The Nixon Administration started the process of developing a coherent national urban policy. In 1970, Congress passed the National Urban Growth Policy and Community Development Act. By 1972, however, President Nixon felt there was not a set of specifically "urban" problems which national policy could usefully and legitimately address, and he decided not to prepare a Congressionally mandated report on urban growth policy. Instead, he proposed special revenue sharing programs for transportation and urban aid.

The Ford Administration initially followed the Nixon lead. No major recommendations were made in the 1974 urban growth policy report. The emphasis was placed instead on national economic growth, New Federalism, and the private market. During the Ford Administration, however, Community Development Block Grant legislation was signed, Section 8 housing assistance for the poor became law, and federal operating subsidies for mass transit were authorized through the Urban Mass Transportation Administration. By 1976, President Ford had moved toward the concept of targeting federal dollars to meet the problems of distressed cities.

*The primary focus of this section is on the development of national urban policy because it has dominated the debate and literature about aid to distressed communities.

The Carter Administration took a different approach. In July 1978, the White House Conference on Balanced National Growth and Economic Development made several recommendations that provided a general framework for President Carter's approach to the problems of distressed communities.45/ These recommendations included calls for:

1) a strengthened national growth policy process to set goals and to evaluate the impact of those approaches;

2) greater state responsibility for the fiscal condition of urban government;

3) better targeting of federal and state assistance to needy cities;

4) renewed government help to provide employment opportunities, primarily in the private sector, targeted to high concentrations of the unemployed;

5) new efforts to develop the economy of distressed areas through incentives and inducements to attract and retain private businesses; and

6) fuller fiscal relief to cities by having welfare and Medicaid financing assumed by the national government and local public education costs assumed by state governments.

The 1980 National Urban Policy report to Congress built upon this framework by setting out five basic policies to:

1) foster strong urban economics and strengthen the economies of needy urban communities;

2) expand job opportunities and mobility for the long-term unemployed and disadvantaged in urban communities;

3) promote fiscal stability in urban communities;

4) expand opportunity for those disadvantaged by discrimination and poverty; and

5) encourage energy efficient, environmentally sound urban development patterns.46/

In effect, the Carter policy continued the trend toward decentralizing responsibility for urban problems to state and local governments as well as to community self-help groups, but recognized the need for a strong federal financial presence.

The President's Commission on a National Agenda for the Eighties once again shifted the focus of national urban policy by urging substantially reduced direct federal aid to distressed areas.47/ The commission's report on the cities argued that the national government should not target resources to "unproductive" areas, such as the Northeast and Midwest, but rather should reinforce private market forces that have been shifting economic growth to the Southwest. The commission felt that the national government should help people move to jobs rather than target jobs to where people live; that it should not attempt to reverse or impede structural economic forces, even though federal fiscal, monetary, and expenditure powers affect the accumulation and placement of private capital.

President Reagan's approach to urban policy was basically built on a similar set of assumptions. His economic recovery program was designed to stimulate the private economy and cut domestic programs, and the New Federalism's intent was to reduce the federal presence in state and local governments.

The President's urban policy, built on this framework, consisted of ten initiatives:

1. Streamlining Existing Programs. Continuing programs that have been successful in bettering people living in urban areas.

2. Deregulation. Reducing the burden on cities of federal regulations which suppress economic growth and impede efficient service provision by state and local governments.

3. Housing. Using housing vouchers to replace subsidies to address the lack of adequate family income and to shift the emphasis from production to use of existing housing stock; providing rental rehabilitation subsidies to improve rental property and encourage private investment; and making it easier for pension funds to be invested in housing.

4. Mass Transportation. Assisting local policymakers in planning to meet their transportation needs.

5. Economic Development. Creating enterprise zones, Community Development Block Grants and Urban Development Action Grants.

6. Private Sector Initiatives. Strengthening the role of the private sector in community services.

7. Job Training. Assisting economically disadvantaged people through the Job Corps and other programs for dislocated workers and youth.

8. Criminal Justice. Bail reform, sentencing reform, and victim and witness assistance.

9. Education. Shifting programs to the states in a single block grant.

10. Equal Housing Opportunity. Establishing community housing resource boards to advise the local housing industry on fair housing, and to conciliate more complaints through the fair housing assistance program.[48]

Overall, these initiatives seek to return responsibilities for urban development to state and local governments and the private sector.

Summary

Economic distress fits into no patterns in terms of community size, type or geographic region. Its effects can be seen in many different communities. The nation's communities, by the measures used in this study, were not much better off in 1983 than they were twenty years earlier. Poverty and unemployment were up, central cities were poorer, and while certain sectors of the economy were booming, the benefits rarely trickled down to the most distressed communities. There is no consistent national policy response. Federal aid was being substantially reduced, but the economy was emerging from one of the worst recessions in history. States, having enhanced their capacity to govern, were limited by fiscal realities and citizen expectations of an extraordinary order as they faced the question of what to do about aiding their distressed communities.

* * * * * * *

FOOTNOTES

[1] See Advisory Commission on Intergovernmental Relations (ACIR), The Question of State Government Capability, A-98 (Washington, DC: U.S. Government Printing Office, 1985).

[2] Ibid., p. 400.

[3] Ibid., p. 402.

[4] ACIR, The States and Distressed Communities, Reports for 1980, 1981, and 1982 (Washington, DC: U.S. Government Printing Office).

[5] New York State Department of State, "Assessing Conditions of Distress in New York State's Communities and Places," (Albany, NY, August 1979).

[6] Northeast/Midwest Institute, The State of the Region, 1983 (Washington, DC, 1983).

[7] U.S. Bureau of the Census, Statistical Abstract of the United States, 1982-83 (Washington, DC: U.S. Government Printing Office, 1982), p. 15.

[8] U.S. Bureau of the Census, Historical Statistics of the United States:

Colonial Times to 1970, Part 1 (Washington, DC: U.S. Government Printing Office, 1975), p. 39; *1982-83 Statistical Abstract*, p. 15.

9/ *1981 Statistical Abstract, op. cit*., p. 16.

10/ *Statistical Abstract: 1985*, p. 446.

11/ *Ibid*., p. 454.

12/ U.S. Department of Housing and Urban Development, *The President's 1980 National Urban Policy Report* (Washington, DC: U.S Government Printing Office, 1980), Chapter 7.

13/ *Ibid*., Chapter 8.

14/ U.S. Bureau of the Census, *Money Income and Poverty Status* (Washington, DC: U.S. Government Printing Office, 1983).

15/ Northeast/Midwest Institute, *op. cit*.; Council of Economic Advisors, "Economic Indicators," (Washington, DC, October, 1983).

16/ Council of State Planning Agencies, *America in Ruins* (Washington, DC, 1981).

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20/ Barry Bluestone and Bennett Harrison, *The Deindustrialization of America* (New York, NY: Basic Books, 1982).

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23/ George Sternlieb and James Hughes, "The Uncertain Future of the Central City," *Urban Affairs Quarterly*, June 1983, p. 456.

24/ U.S. House of Representatives, Committee on Banking, *City Needs and the Responsiveness of Federal Grant Programs* (Washington, DC: U.S. Government Printing Office, 1978).

25/ U.S. Congress, Joint Economic Committee, "Trends in the Fiscal Condition of Cities, 1979-81," (Washington, DC: U.S. Government Printing Office, 1981), pp. 3-8.

26/ U.S. Congress, Joint Economic Committee, "Trends in the Fiscal Condition of Cities, 1982," (Washington, DC: U.S. Government Printing Office, 1982), p. 1.

27/ U.S. Bureau of the Census, "Cities With a 1980 Population of 100,000 or More, Ranked by Persons' Poverty Rate, 1979," (Washington, DC, February 25, 1983).

28/ Katharine Bradbury, "Fiscal Distress in Large U.S. Cities," *New England Economic Review*, November/December 1982, pp. 33-43; also "Structural Distress in Cities, Causes and Consequences," *New England Economic Review*, January/February 1983, pp. 32-43.

29/ *Ibid*.

30/ Joint Economic Committee, 1982, *op. cit*.

31/ National League of Cities and U.S. Conference of Mayors, *op. cit*., 1983.

32/ Francis Viscount, "Illusory Growth in Federal Grants in Aid to Cities," (Washington, DC: National League of Cities, July 1981), p. 10.

33/ *Ibid*.

34/ Katharine Bradbury, *Ibid*.

35/ "Debt in 75 Urban Regions Rose 6% in '81, Study Says," *The Weekly Bond Buyer*, May 16, 1983, p. 104.

36/ Joint Economic Committee, 1982, *op. cit*., p. 6.

37/ John Shannon and Susannah Calkins, "Federal and State-Local Spenders Go Their Separate Ways," *Intergovernmental Perspective*, Winter 1983, (Washington, DC: U.S. Government Printing Office), pp. 23-29.

38/ National Governors' Association and National Association of State Budget Officers, *Fiscal Survey of the States, 1980-81* (Washington, DC, 1981), p. 3.

39/ National Conference of State Legislatures, "State Fiscal Conditions Entering 1983," (Denver, CO, 1983).

40/ Shannon and Calkins, *op. cit*.

41/ Bill Curry, "States' Taxes Up Record $7.1 Billion," *Oakland Tribune*, September 4, 1983, p. A-3.

42/ National Conference of State Legislatures, "State-Local Fiscal Relations," (Denver, CO, 1983).

43/ U.S. Department of Housing and Urban Development, The President's 1982 National Urban Policy Report (Washington, DC: U.S. Government Printing Office, 1982), pp. 45-57.

44/ Royce Hanson, The Evolution of National Urban Policy, 1970-1980: Lessons From the Past (Washington, DC: National Academy of Sciences, 1982), p. 1.

45/ Balanced National Growth and Economic Development, Final Report, Vol. 1, Summary, White House Conference Proceedings (Washington, DC: U.S. Government Printing Office, July 1978), pp. 4-6.

46/ 1980 National Urban Policy, op. cit.

47/ President's Commission on a National Agenda for the Eighties, A National Agenda for the Eighties (Washington, DC: U.S. Government Printing Office, 1980), pp. 64-72.

48/ 1982 National Urban Policy, op. cit., pp. 2-9.

Chapter 2

ASSISTED HOUSING POLICY

Government efforts to aid those who cannot find or afford adequate housing have undergone many changes over past decades. Since 1949, when Congress declared the goal of "a decent home" for every American, housing conditions have generally improved. Yet, several population groups and residents of some areas have not benefited from that progress. These needs present a challenge to state housing officials at a time when the national government is reducing its financial support for assisted housing.

This chapter reviews the factors influencing the supply and cost of and access to quality housing, and reports the results of the national survey of four program indicators reflecting a state's commitment to aid distressed communities.

Housing Need

Four groups of people have been identified as still being in need of decent, safe, sanitary and affordable housing: low and moderate-income households, households with elderly or disabled persons, minority households, and households or persons who are homeless or potentially homeless (Exhibit 2-1).

Exhibit 2-1

GROUPS WITH HIGH LEVELS OF NEED, 1983

Category	Examples
1. Low and Moderate-Income Households	Welfare Families; "Working Poor" Families; Single-Parent Families; Large, Poor Families; Elderly; Fixed Income or Single-Person Households
2. High-Cost Households	Frail Elderly Persons; Developmentally and Physically Disabled Persons
3. Minority Households	Blacks, Hispanics, and Native Americans; Migrant and Seasonal Workers
4. Homeless or Potentially Homeless Households and Persons	Unemployed Workers; Deinstitutionalized Persons; Disaster Victims; Chronically Homeless Persons

The groups make up a disproportionately large share of the people who live in distressed communities.

Each of these groups has a different housing problem. Those living in central cities and rural areas have a higher incidence of substandard housing. Low-income people are affected by high housing costs. For minorities, the homeless, disabled and the poor, there remain legal, attitudinal and credit barriers. The following sections discuss these needs, and the other factors with which state housing agencies must contend -- changing financial conditions, a contraction in the federal government's role in housing and local issues that affect such agencies.

Housing Affordability. Rising costs of housing are an important part of the problems faced by the groups with high levels of need. The increases have hit potential homeowners especially hard, but have also affected renters. The Department of Housing and Urban Development (HUD) has estimated that housing sales prices increased threefold while average household incomes doubled between 1960 and 1980.1/ As a result, a smaller proportion of Americans could afford to buy homes than at any time in the preceeding 30 years. Rents for housing not occupied by the owner have also increased; the rent component of the Consumer Price Index increased by 20.1% between 1960 and 1970, and by 74.0% between 1970 and 1980.2/

Unemployment rates between 8% and 10% in 1980-83 forced many households to fall behind on mortgage or rent payments, leading to foreclosures or evictions. The families of newly unemployed workers were joining the ranks of the homeless.

The increase in housing costs inspired many housing analysts to define housing deprivation as a problem of excessive cost rather than a problem of physically inadequate shelter. The President's Commission on Housing declared that America's housing problem was basically an income problem, and recommended a program of national housing vouchers and local deregulation to reduce the upward pressure of zoning and other codes on housing costs.3/ These efforts would replace the current policy emphasizing subsidies for construction. Various studies have linked the poorest housing conditions with the lowest income households.4/ Critics of this approach argue that the private sector alone cannot be relied upon to improve housing conditions, and that the market may require a visible hand to guide it toward assisting communities traditionally underserved by private financing and construction.5/

Several figures show the growing importance of high rents as a housing problem. In 1960, 5% of the 15.3 million occupied inadequate housing units could be characterized as overcrowded, 24% as burdened by high rents, and 71% as physically inadequate.6/ By 1973, of 16.8 million inadequate occupied units, 4% were overcrowded, 47% had high rents, and 49% were physically inadequate. Physical inadequacies were more prevalent in rural communities than in urban areas; high rents were more common in central cities. High rents were also a bigger problem for low-income households than for the population as a whole.

Over recent years, American households have increased the share of income they pay for housing. Moreover, certain population groups are paying a higher proportion of their income on housing than others. In 1970, the median proportion of household income spent on rent was 20%; by 1981, that proportion had increased to 27%.[7] Blacks and Hispanics paid 30% of their income on rent, while one-person households paid 31% of income toward rent at the median, one-person households over the age of 65 paid 38.1%, and female-headed households paid 35.8%.[8]

Black households are particularly affected by high rents. As a group, they include more female-headed households, have lower incomes than the population as a whole, and are more often renters than other groups of individuals.[9] Blacks housed in central cities were paying 33% of their income in 1983, while all others living in cities paid 31%.[10]

Because of the link between household income and physical housing conditions, lower income families, whether working or dependent on income assistance, may require financial support for housing as well as efforts to assure the physical adequacy of their shelter. Yet, the recent trend has been away from such help. National public assistance programs, like Aid to Families with Dependent Children, have reduced their "shelter allowances" while neglecting to establish minimum standards for the quality of housing occupied by welfare recipients.[11] By 1981, only ten states authorized a separate shelter allowance in their AFDC programs. The termination of new federal commitments of rental assistance in newly constructed and substantially rehabilitated multifamily housing poses problems for new families who in previous years would have qualified for rent subsidies.

Physical Housing Inadequacy. Figures for the United States as a whole show that the physical inadequacy of housing has been decreasing,[12] but national statistics fail to reveal the pockets of relatively greater inadequacy in particular areas and among certain population groups. In 1973, Cochran and Rucker reported that a significant gap existed between the quality of housing occupied by black households and other American households.[13] The 1980 census of housing reported that the incidence of the physical inadequacy of housing continues to be greatest among blacks in rural areas. The Census Bureau estimated that 50.1% of all housing units occupied by black households in nonmetropolitan areas were substandard, compared to 12.8% for all housing.

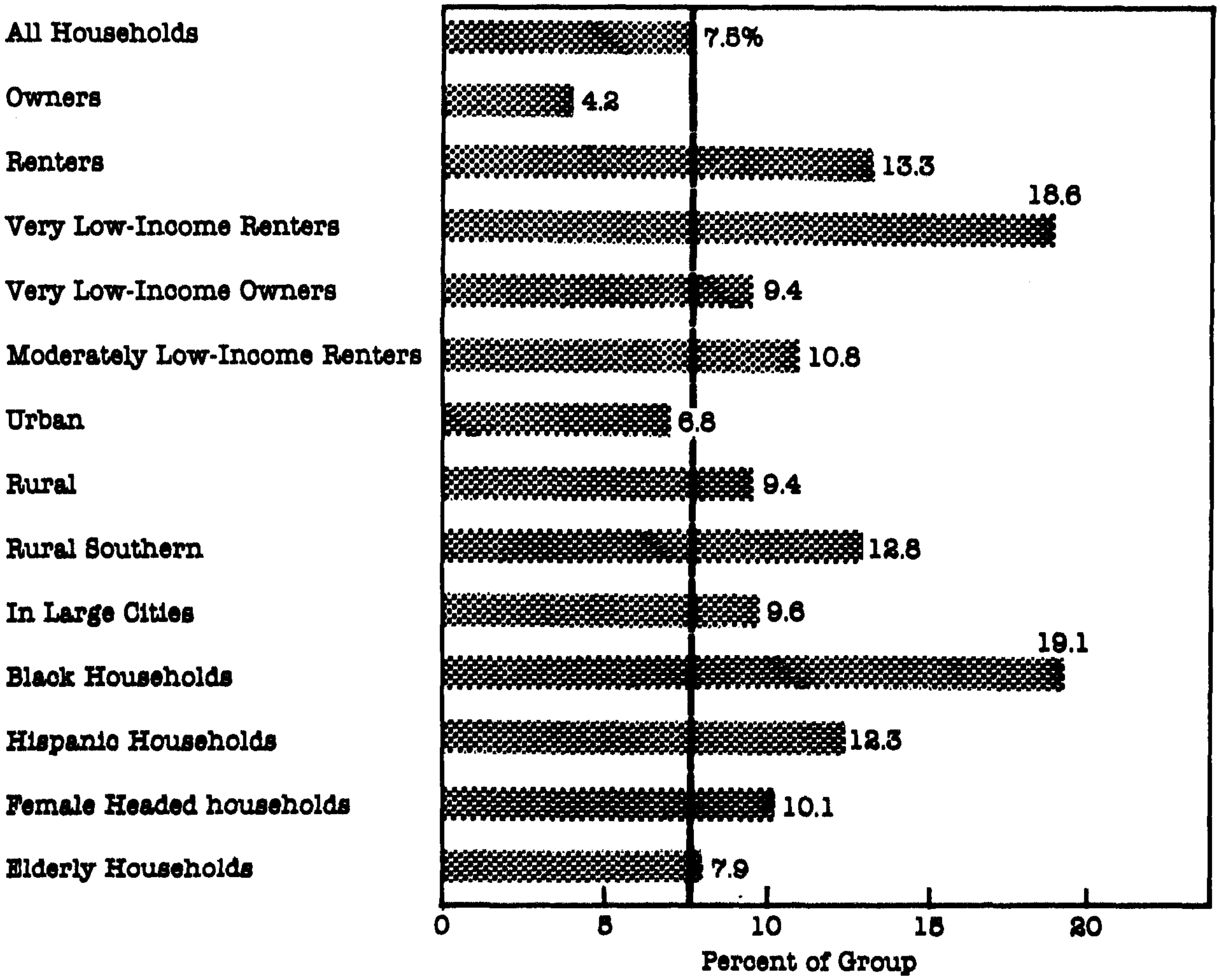
The need for housing rehabilitation varies from community to community and from group to group. The President's Commission on Housing presented statistics from the 1977 annual housing survey that reveal this disparity in physical housing conditions (Exhibit 2-2).[14] Black households and very low-income renters (renter households earning less than 50% of the statewide median income) experienced the highest incidence of physical inadequacy. Households in rural communities, female-headed households, elderly households, Hispanic households and renters overall are more likely than the average household to live in a house or apartment with physical deficiencies.

Physical housing conditions in central cities and nonmetropolitan (rural areas, townships) are worse than those for the nation overall (Table 2-1). Housing conditions are more likely to be worse for black households than for the nation's housing overall (Table 2-2). In 1981, more than 2 million occupied housing units had inadequate plumbing facilities, and over one-quarter of these units were occupied by black households.[15]

Exhibit 2-2

Incidence of Deficient Housing Among Various Housing Groups, 1977

Percentage of Units Judged to Be in Need of Rehabilitation, According to the Congressional Budget Office Definition.



Source: U.S. Department of Commerce, Bureau of the Census, and U.S. Department of Housing and Urban Development, Office of Policy Development and Research, Annual Housing Survey, 1977.

Table 2-1

PHYSICAL HOUSING INADEQUACY, 1981
(in thousands)

	Category of Units	Total 1981	Total 1970	Central City	Non-SMSA
A. Housing Stock	1. All Year-Round Units	89,610	67,699	26,537	
	2. All Year-Round Occupied Units	83,175	63,445	24,278	27,000
	3. Owner-Occupied Units	54,312	39,886	12,214	20,000
	4. Renter-Occupied Units	28,863	23,559	12,058	7,000
B. Age of Housing Stock	1. All Units Built 1939 or Prior	27,582 (33.2%)	27,458 (43.3%)	11,039 (45.5%)	NA
	2. Pre-1939 Owner-Occupied Units	13,988 (25.8%)	14,235 (35.7%)	4,385 (35.9%)	NA
	3. Pre-1939 Rental Units	10,900 (37.8%)	11,361 (48.2%)	5,674 (47.0%)	NA
C. Interior Wall and Ceiling Conditions	1. With Open Cracks or Holes:				
	a. Owner-Occupied Units	1,587 (2.9%)	NA	438 (3.6%)	687 (3.4%)
	b. Rental Units	3,050 (10.6%)	NA	1,542 (12.8%)	759 (10.8%)
	2. With Broken Plaster:				
	a. Owner-Occupied Units	1,059 (1.9%)	NA	362 (2.7%)	435 (2.2%)
	b. Rental Units	1,858 (6.4%)	NA	1,006 (8.3%)	431 (6.2%)
D. 1.5+ Persons Per Room	1. Owner-Occupied Units	362 (0.7%)	449 (1.1%)	110 (0.9%)	138 (0.7%)
	2. Rental Units	537 (1.9%)	780 (3.3%)	119 (1.0%)	128 (1.8%)
E. Interior Floor Per Room	1. With Holes in Floors:				
	a. Owner-Occupied Units	459 (0.8%)	NA	110 (0.9%)	241 (1.2%)
	b. Rental Units	1,102 (3.8%)	NA	521 (4.3%)	325 (1.6%)
F. Boarded Up Buildings On Same Street	1. All Occupied Units	4,344 (5.2%)	NA	2,184 (9.0%)	1,191 (4.4%)

Source: U.S. Department of Housing and Urban Development, 1981 Annual Survey of Housing, (Washington, DC: U.S. Government Printing Office, 1983).

Table 2-2

PHYSICAL HOUSING INADEQUACY AMONG BLACK HOUSEHOLDS, 1981

	Category of Units	Total 1981	Total 1970	Central City	Non-SMSA
A. Interior Wall and	1. With Cracks and Holes				
Ceiling Conditions	a. Owner-Occupied Units	309	NA	43	130
		(7.9%)		(2.2%)	(11.6%)
	b. Rental Units	1,098	NA	734	226
		21.5%)		(21.9%)	(27.4%)
	2. With Broken Plaster:				
	a. Owner-Occupied Units	203	NA	97	75
		(5.2%)		(5.0%)	(6.7%)
	b. Rental Units	648	NA	449	111
		(12.7%)		(13.4%)	(13.4%)
B. Interior Floor	1. With Holes:				
Conditions	a. Owner-Occupied Units	120	NA	39	63
		(3.1%)		(2.0%)	(5.6%)
	b. Rental Units	468	NA	275	118
		(9.2%)		(8.2%)	(14.3%)
C. 1.5+ Persons Per Room	1. Owner-Occupied Units	77	119	21	45
		(2.0%)		(1.1%)	(4.0%)
	2. Rental Units	136	309	86	36
		(2.7%)		(2.6%)	(4.4%)
D. Boarded Up Buildings	1. All Occupied Units	1,644	NA	1,137	255
On Same Street		(18.2%)		(21.6%)	(13.1%)

Source: U.S. Department of Housing and Urban Development, 1981 Annual Survey of Housing, (Washington, DC: U.S. Government Printing Office, 1983).

Access Barriers. Achievement of the goal of "a decent home in a suitable living environment" is threatened by a number of factors that make housing inaccessible to certain groups. The cost of housing is very high for the frail elderly or disabled persons. Legal, attitudinal and credit barriers often prevent minorities, the homeless, deinstitutionalized persons and very low-income households from having access to decent housing.

Race is a particularly significant factor in determining the quality and location of one's housing. As a group, Blacks are more likely to pay a higher price for housing than other racial groups. Black households are likely to pay a high premium for housing in communities in which Blacks have not traditionally resided, as a result of restricted housing and credit opportunities which limit the market availability of housing for that group and thus drive up the price.16/

The need for housing among low-income persons is, moreover, not static. By 1985, the Bureau of the Census predicts that there will be 34 million more persons between the ages of 25 and 35.17/ Estimating the poverty rate at 15% and average household size at slightly more than two persons, an additional 2.5 million new families in poverty can be expected by the year 1985, with an additional 2.3 million by 2000.18/

Furthermore, the composition of households is changing, resulting in more single-parent households and more elderly households. Also, homeless persons, deinstitutionalized persons, migrants and others needing housing will not disappear.

Market and Economic Factors

State housing agencies try to alleviate housing needs through a variety of means, which will be described in detail later in this chapter. A large part of their activity involves issuing tax-exempt bonds to raise money with which to subsidize low-interest loans from private lenders to developers or single-family home buyers. These loans make it possible for developers to undertake projects that would otherwise not be economically feasible, and for households to purchase homes they could not otherwise afford. The success of these financing efforts depends to a great extent on economic and market conditions.

Housing markets in general are sensitive to the rate of inflation. Periods of high inflation are usually accompanied by high interest rates, which translate into higher construction and rehabilitation finance costs and thus discourage investors from putting money into housing. Inflation stifles the housing industry as a whole and the assisted housing industry in particular.

Another problem facing state housing finance agencies (HFAs) is the lag between the time a bond issue is marketed and the time that bond proceeds can be made available to eligible borrowers. A drop in interest rates after a bond issue could effectively reduce or eliminate the difference in interest rates between subsidized loans and those available from conventional sources. If this happens, an HFA may not be able to attract any developers to its subsidized loans, and thus may be forced to call in its bonds and pay off its bondholders ahead of schedule. HFAs could also call in bonds if inflation put the brakes on the housing industry by making it too expensive for anyone to buy or build housing.

Housing finance agencies must not only attract borrowers for their loans but must also attract buyers for the bonds backed by revenues from those loans. To sell their bonds, agencies must compete with the bonds and notes sold by the U.S. Treasury. The rates of Treasury bills have fluctuated recently as the Federal Reserve Board grapples with competing demands to control inflation and stimulate growth by manipulating the money supply.

The size of the national debt affects interest rates as well. Fears of increased government borrowing to reduce annual deficits as well as government borrowing itself work to raise interest rates. During the spring and summer of 1983, the Federal Housing Administration and the Veterans Administration raised the allowable interest rates on federally insured mortgages to as high as 13.5%. Over the same period, bond, mortgage and Treasury bill rates increased gradually, but retreated several times also. Bond investors prefer stable markets.19/

If market interest rates remain high, state HFAs face higher borrowing costs also. As the cost of borrowing increases, the interest rates HFAs charge assisted housing buyers and developers also go up. Higher interest rates could raise the cost of assisted housing beyond the reach of low and moderate-income households.

Federal Policies

Although state and local housing agencies play leading roles in financing and operating housing programs, the federal government has since the 1930s defined the framework in which housing programs function. The nature of the federal government's role has undergone several changes over the years, as reflected in the highlights of federal legislation in Exhibit 2-3.20/

Multifamily Housing Programs. Until 1974, the federal government was heavily involved in subsidizing the construction of multifamily housing, both directly and indirectly through local housing agencies and other intermediaries. Through a variety of programs, the federal government provided subsidized loans, loan guarantees and direct subsidies. Different programs provided different types of aid to different classes of housing or for different groups in a community.

A shift in federal policy took place in 1974. Many programs providing particular kinds of aid to particular kinds of projects were terminated. This action largely eliminated the federal government's direct role in subsidizing housing construction -- as one analyst put it, getting the national government out of the real estate business.21/ Federal programs then had two main emphases: (1) to expand the stock of new and renovated housing indirectly, relying largely on state and local housing agencies, and (2) to make available housing more affordable to households that did not want to live in public housing projects or were not eligible for them, but nevertheless needed help in paying for safe and adequate housing.

The vehicle for this new federal approach was Section 8 of the Housing

Exhibit 2-3

HIGHLIGHTS OF THE FEDERAL ROLE IN ASSISTED HOUSING

1937 Creation of U.S. Public Housing Authority.

1949 Housing Act authorizing "urban redevelopment" (later termed "urban renewal").

1959 Housing Act authorizing the Section 202 rent subsidy program for older Americans.

1965 Housing Act authorizing the subsidization of interest rates for rental housing investments (eventually resulted in Section 221(d)(3) interest rate subsidy and Federal Housing Administration mortgage insurance program and the Section 236 home mortgage subsidy and insurance program).

1973 Moratorium on federally supported new housing construction.

1974 Authorization of Section 8 rent subsidy program.

1982 Termination of Section 8 reservations for new or substantially rehabilitated housing.

Act. Portions of the act provided an indirect spur for construction of new multifamily housing units and rehabilitation of dilapidated buildings. Under these portions, a state or local housing agency negotiated an agreement with a developer to build or renovate housing, and the federal government agreed to make direct payments to the developer to subsidize the rents of low-income tenants. The developer typically agreed to reserve 20% of the units for such tenants.

Under another portion of the Section 8 program, federal funds were used by local government agencies to pay subsidies to low-income households themselves. The households found accommodations in existing units, and the subsidy was equal to the difference between the rent and the amount the government calculated the household should be expected to pay for housing.

Another phase of federal policy toward multifamily housing aid began in 1981 with passage of the Omnibus Budget Reconciliation Act. That act terminated new commitments of Section 8 funds for construction and rehabilitation after 1982 (although subsidies continue to be paid to projects previously approved), and reversed the pattern of growth in federal spending on housing aid (see Table 2-3).[22] The result was to force local governments to rely more heavily on their own resources and on state funds for housing construction, or to cut back on efforts in this area. Some states adopted innovative approaches to help pick up the funding slack, as described in a later section of this chapter.

Table 2-3

HOUSING ASSISTANCE PROVIDED THROUGH HUD RENTAL ASSISTANCE PROGRAMS

	Actual								Estimated		
					1981		1982		1983		1984
	1977	1978	1979	1980	Original Law	Final Law*	Original Law	Final Law*	Administration Proposal	Law	Administration Proposal
Net Reservations** (thousands of units)											
S.8 New Construction and Substantial Rehabilitation	167	122	145	93	74	52	44	12	-7	6	10
S.8 Existing and Moderate Rehabilitation	162	135	125	76	110	102	74	98	21°	144	189°°
Public Housing New Construction	57	69	55	37	36	24	24	2	-40	-23	-15
TOTAL	388	326	325	206	220	178	142	112	-26	127	184
Percentage Distribution											
New Construction and Substantial Rehabilitation	52	55	61	63	50	43	48	12	†	†	†
Existing and Moderate Rehabilitation	48	45	39	37	50	57	52	88			
New Budget Authority (in billions of dollars)											
Subsidized Housing	$28.0	$31.5	$24.4	$26.7	$25.0	$19.8	$17.4	$13.3	$-2.4	$8.6	$0.5
Public Housing Operating Subsidies	$ 0.6	$ 0.7	$ 0.7	$ 0.8	$1.1	$1.1	$1.3	$1.4	$1.1	$1.4	$1.6

* Indicates changes in the program for that year were caused by legislation after initial appropriations were passed into law.

** Net Reservations are the number of incremental units to be assisted, they include units converted from units covered from one program to another but exclude (subtract) units whose funding is deobligated (rescinded).

° Composed of a rescission of 86,000 Section Existing units and an addition of 107,000 housing vouchers.

°° Net increment of 80,000 units, the balance is formal conversions, property disposition, etc.

† Not computed for negative new construction units, all incremental units are existing.

SOURCE: CBO unpublished figures, HUD budget documents, and unpublished figures.

The recent trend toward lower federal spending on housing aid was reversed in 1983, when Congress passed appropriations and authorization bills that resulted in $9.9 billion in new budget authority for fiscal year 1984 -- a modest increase over the $8.6 billion authorization for fiscal year 1983. The 1984 appropriations included money for 14,000 units of housing for the elderly and 5,000 units of low-rent public housing, and provided funds for an urban homesteading program that allowed low-income households to buy abandoned homes or multifamily buildings at low prices if they agree to rehabilitate the units.

Several new demonstration projects were authorized in 1983 under the Housing and Urban-Rural Recovery Act. They included the following:

° A Housing Voucher Demonstration Program. Similar to the portion of Section 8 that makes direct subsidy payments to households, this program is supposed to give families greater freedom of choice in selecting their housing. For fiscal year 1984, $242 million was authorized, enough to aid about 15,000 households.

° A Housing Development Grant Program. Modeled on the Urban Development Action Grant (UDAG) program, it will make grants to developers covering up to half the cost of rehabilitating or developing an apartment building if they agree to reserve 20% of the units for lower income households. Local or state governments apply on behalf of the developers in periodic national competitions. A total of $200 million was authorized for fiscal years 1984 and 1985, enough to aid projects totaling up to 10,000 units.

° Rental Rehabilitation Grants. Money to be distributed on a formula basis to cities and urban counties with large numbers of low-income renters and high levels of overcrowding in rental units, and to be used to rehabilitate buildings in low-income neighborhoods for rental to low-income families. Although rents were to be at market rates, renters would be eligible for housing vouchers and for Section 8 subsidies. Congress authorized $150 million per year in fiscal years 1984 and 1985.

The 1983 appropriations continued aid to rural areas, with $940 million allotted for loans to help build or renovate rental housing and $29 million to help families buy homes at low interest rates. These programs were administered by the Farmers' Home Administration.

Single-Family Housing Aid. The federal government's role in helping individual families purchase their own homes relies not on grants and loans, but on tax legislation. The single largest federal housing subsidy program is the provision in the tax code allowing homeowners to deduct mortgage interest payments and property tax payments from the income on which they pay federal income taxes.23/ In 1982, this provision accounted for $31.7 billion in lost federal revenue.

The other provision of the tax code that assists purchasers of single-family housing is the exemption from federal taxation of interest on mortgage revenue bonds (MRBs) issued by state and local government bodies. This has been a controversial form of aid, and in 1980 Congress passed the Mortgage Subsidy Bond Tax Act in an attempt to restrict its use.

Tax-exempt bonds are sold by government agencies, such as state housing agencies, and the proceeds are used to subsidize construction and long-term loans for multifamily housing and mortgage loans for single-family housing.

The 1980 restrictions were imposed to limit the total level of tax-exempt bonding and limit its uses.24/ For state or local MRBs to be exempt from federal taxation, the act required that (1) 20% of total available funds be set aside for loans in low-income areas; (2) mortgages be given only to first-time home buyers; (3) the purchase price of a home for which a mortgage is granted could not exceed a certain amount; and (4) tax-exempt bond issuers follow various financial reserve rules.

The act also limited the total amount of MRBs a state could issue in any year. The limit was set at $200 million, or the average of the previous three years' of bond issues, whichever was greater.

These restrictions and the bond ceiling substantially reduced the amount of mortgage revenue bond financing in recent years. Authority to issue tax-exempt mortgage revenue bonds expired at the end of 1983, but was renewed through 1987 by the Tax Reform Act of 1984, enacted in June 1984. Also, the renewal legislation allows states to trade part of their mortgage subsidy bond cap for the right to issue "mortgage credit certificates" (MCCs) which entitle home buyers to claim a nonrefundable credit on their income tax returns.25/

Local Issues

Local governments and their public housing finance agencies have been prominent in housing programs because they have had long histories in providing assisted housing and community development programs. Local officials also have access to community development block grants. Most local public housing finance agencies issue tax-exempt bonds like their state counterparts. Assisted housing programs may be more innovative in some localities than those at the state level, in part due to their long history and in part because local governments often combine housing and community development efforts. Local governments can also offer property tax incentives. Local officials may use CDBG funds to reduce mortgage interest rates, create revolving loan funds, and assist self-help rehabilitation efforts.

Local government is a critical partner for state housing agencies. Through local zoning ordinances, public hearings, legislative and executive action, localities can control where assisted housing will be built, and what level of services such housing will receive, such as water and sewer services and police and fire services. This control can either facilitate or inhibit the effectiveness of a state's assisted housing programs. Such a situation has led New Hampshire's HFA to negotiate with localities for the location of assisted housing developments. In New Hampshire town meetings, state officials discuss with local residents the various aspects of design, tenancy policy, development size, and community need. Many other states also coordinate housing programs with local governments -- financially, linking state-level bond proceeds with local tax incentives, and administration.26/

As indicated in a recent General Accounting Office (GAO) poll of local community development officials, local officials may prefer independence from both national and state government officials.27/ Local officials may prefer that national and state authorities grant or lend capital to local housing and community development programs, then let local officials take things from there.

Another local issue is the diversity of housing needs between communities. A state with a large number of people in rural areas will probably have to spend money for intensive advertising, hiring field representatives and providing more technical assistance and attention to rural community lenders. Similarly, a state with especially fastgrowing areas -- such as "boom towns" resulting from increases in energy production and mining -- may have to pay special attention to families moving to such areas in anticipation of jobs who need adequate homes.

Communities may also differ with respect to concentrations and types of particular groups with high levels of need. Solutions to the housing problems of migrant workers and Native American families are bound to be different from those of large single-parent families in the central city. Disabled and elderly persons require different kinds of residential facilities than do low-income families.

Rural communities have special problems as well. Rural households are at a disadvantage because they have few lending institutions. Most homeownership programs involve the state HFA purchase of loans originating in a financial institution. With respect to multifamily housing, states with rural public housing authorities (PHAs) holding jurisdiction over relatively small geographic areas may find their jurisdictions do not contain enough eligible households in substandard dwellings to make public housing construction feasible. Rural PHAs need to cover large enough areas of sparsely populated countryside and small towns in order to identify enough eligible households to occupy an assisted development.28/

Both innercity and rural communities often have heavy need for rehabilitation of existing housing, as the President's Commission on Housing has underscored. America's older industrial cities have an aging housing stock likely to require rehabilitation. Such needs have only recently been recognized in many states, including California. HFAs could include rehabilitation costs in homeownership and rental housing purchase assistance programs.

By way of summary, Exhibit 2-4 presents an overview of the major problems and pressures facing state housing financing agencies.

We turn now to a review of the state experience in addressing these problems and targeting assistance to distressed communities.

State Aid to Housing in Distressed Communities

The survey of state efforts to aid distressed communities studied four areas of assisted housing programming: aid for single-family construction and investment, aid for multifamily housing construction and investment, housing rehabilitation grants or loans, and housing rehabilitation tax incentives.

Exhibit 2-4

PROBLEMS AND RELATED PRESSURES FACED BY STATE HOUSING FINANCE AGENCIES

Problem	Pressure for Innovation
Federal Support Decline: cutbacks in direct housing subsidies and threatened cutbacks in tax exemptions providing indirect subsidization.	Pressure to Implement New Subsidies: pressures to appropriate general funds, extend property tax incentives and work with tax-exempt nonprofit housing associations.
Market Instability and Large Capital Requirements: undependability of mortgage revenue bonds in light of the high cost of providing housing development finance.	Pressure to Use Alternative Finance Sources: pressures to issue general obligation or non-tax-exempt revenue bonds, use public permanent funds, use public funds to leverage private dollars.
Skepticism of Local Governments and Local Housing Need Variation: local laws, attitudes and lending practices as barriers to assisted housing location; different needs of different local communities.	Pressure to Negotiate with and Rely on Community-Based Organizations: pressures to seek local approval and cooperation for location of new developments, to reform zoning and lending practice codes, to work with nonprofit community groups and plan more closely with local officials.
Inclusion of the Less Needy in Housing Programs: pressure to spread risk and existence of housing problems for all Americans (high costs) in light of limited housing assistance resources and varying degrees of need.	Pressure for Targeting, Analysis, and Priorities: pressure to determine the minimum service to middle income households to maintain solvency, to identify concentrations and degrees of need and to target resources to such concentrations.

The survey data showed the following:

1. Most state assisted housing efforts are executed by state housing finance agencies -- public finance corporations, usually independent of executive functions like civil service and public budgeting.

2. The most common source of housing program funding is the tax-exempt revenue bond.

3. States tend to operate programs similar to one another, and those programs usually entail some form of federal subsidy.

4. When housing program resources are targeted to distress, they do so more often on the basis of household income than geography.

Table 2-4 presents a summary of all these state programs as of 1983.

Single-Family Programs. Of the 49 states with single-family construction or mortgage subsidy programs, 47 had 55 programs targeted to distress in 1983 (Table 2-5). Fifty-one of those programs involve some type of income restriction. Seven of these single-family programs use geographic targeting beyond that required by federal regulations. State programs with less typical targeting provisions include the following:

- ° Connecticut's single-family mortgage purchase program, which allows participants to exceed income limits if they have been rejected twice for conventional mortgages.

- ° Nebraska's single-family program, which sets aside 20% of loan funds for households earning less than $15,000 annual income.

- ° California's Home Mortgage Purchase Program, which operates under an executive order sets aside 20% of loan funds for rural and remote areas.

Geographic targeting or commitment of single-family funds beyond national requirements was more common before the advent of the 1980 Ullman Act.

Multifamily Programs. State assisted multifamily programs are also targeted mostly to persons on the basis of income rather than geography. The Section 8 program, now discontinued, required developers to set aside units for low-income households, in exchange for federal guarantees of subsidies for tenants in those units. States beginning new developments with tax-exempt mortgage revenue bonds must now follow national regulations requiring 20% of the units built with money raised from the bonds to be set aside for low-income families, the so-called 80-20 program. Without the federal rent subsidy that had been provided under Section 8, housing developers must rely upon the subsidization of construction and permanent loan interest rates by housing finance agencies to support the existence of lower income tenants in their developments. It is too early to tell if the 80-20 program dissuades developers from undertaking assisted multifamily projects and whether developers are financially vulnerable without rent or operating subsidies.

Forty-three states had a total of 57 targeted multifamily programs in 1983 (Table 2-6). Twenty-nine of these programs relied largely on the Section 8 program; as of 1983 there were still subsidies in the pipeline. All but two of the programs were targeted to low and moderate-income tenants, through set-asides or income limits. Only five of these programs involved geographic targeting, while 27 involved targeting to population groups with high housing needs -- senior citizens, disabled persons, and Native Americans.

Because any one HFA usually approves only a handful of multifamily

Table 2-4

ASSISTED HOUSING PROGRAMS TARGETED TO DISTRESS, 1983

Regions and States	Single Family	Multi-family	Rehabilitation Grant or Loan	Rehabilitation Tax Incentive
New England	6/6*	6/6	4/6	2/6
Connecticut	x	x	x	x
Maine	x	x	x	
Massachusetts	x	x	x	x
New Hampshire	x	x	x	
Rhode Island	x	x		
Vermont	x	x		
Midwest	4/5	5/5	5/5	3/5
Delaware	x	x	x	
Maryland	x	x	x	
New Jersey	x	x	x	x
New York		x	x	x
Pennsylvania	x	x	x	x
Great Lakes	4/5	4/5	4/5	0/5
Illinois	x	x	x	
Indiana	x	x	x	
Michigan	x	x	x	
Ohio				
Wisconsin	x	x	x	
Plains	6/7	6/7	6/7	2/7
Iowa	x	x	x	x
Kansas				
Minnesota	x	x	x	
Missouri	x	x	x	
Nebraska	x	x	x	x
North Dakota	x	x	x	
South Dakota	x	x	x	
Southeast	12/12	9/12	2/12	1/12
Alabama	x			
Arkansas	x	x		
Southeast (cont.)				
Florida	x	x		
Georgia	x			
Kentucky	x	x		
Louisiana	x	x		
Mississippi	x			
North Carolina	x	x	x	
South Carolina	x	x		
Tennessee	x	x		
Virginia	x	x	x	x
West Virginia	x	x		
Southwest	4/4	3/4	2/4	0/4
Arizona	x			
New Mexico	x	x	x	
Oklahoma	x	x	x	
Texas	x	x		
Rocky Mountain	5/5	5/5	1/5	0/5
Colorado	x	x	x	
Idaho	x	x		
Montana	x	x		
Utah	x	x		
Wyoming	x	x		
Far West	6/6	4/6	2/6	1/6
Alaska	x	x		
California	x	x	x	
Hawaii	x			
Nevada	x	x		
Oregon	x	x	x	x
Washington	x			
TOTAL STATES	47	42	26	9

* x/y, where x = number of states with programs, and
y = number of states in the region.

Source: ACIR staff compilation.

Table 2-5

TARGETED SINGLE-FAMILY CONSTRUCTION AND MORTGAGE FINANCE PROGRAMS, BY STATE, 1983

		Year	1983	Targeting		
Region and State	Program Type	Enacted	Funding	Income	Geographic*	Other
New England						
Connecticut	MPP	1979	x	x		x
	Site Development Loan Program	1967	x	x	x	
	Down Payment Loan Program	1979	x	x	x	x
Maine	MPP	1969	x	x		
Massachusetts	MPP	1979	x	x		x
New Hampshire	MPP	1975	x	x		x
Rhode Island	MPP/FC	1973	x	x		x
Vermont	MPP	1971	x	x		
Mideast						
Delaware	MPP/FC	1979	x	x		
Maryland	MPP	1974	x	x		
	MPP	1976	x	x		
New Jersey	MPP	1977	x		x	
New York						
Pennsylvania	MPP	NA	x	x		
Great Lakes						
Illinois	MPP	1967	x	x		
Indiana	MPP	1980	x	x		
Michigan	MPP	1966	x	x		
Ohio						
Wisconsin	MPP	pre-1980	x	x		
Plains						
Iowa	MPP	1977	x	x		
Kansas						
Minnesota	MPP	1971	x	x		
	Downpayment Loan Program 1/	1980	x	x		x
	Indian Housing	NA	x	x	x	x
	MPP	NA	x	x	x	x
Missouri	MPP	1969	x	x		
Nebraska	MPP 2/	1978	x			x
North Dakota	MPP	1980	x	x		
South Dakota	MPP 3/	1973	x	x		

Table 2-5 (cont.)

Region and State	Program Type	Year Enacted	1983 Funding	Targeting Income	Targeting Geographic*	Targeting Other
Southeast						
Alabama	MPP	1980	x	x		
Arkansas	MPP	1978	x	x		
Florida	MPP	1982	x	x		
	Rural Site Development Loan Program	1974	x	x	x	
Georgia	MPP	1976	x	x		
Kentucky	MPP	1973	x	x		
Louisiana	MPP	1980	x	x		
Mississippi	MPP	1980	x	x		
North Carolina	MPP/FC	1976	x	x		
South Carolina	MPP	1977	x	x		
Tennessee	MPP	1973	x	x		
Virginia	MPP	1972	x	x		
West Virginia	MPP	1968	x	x		
	MPP Trust Fund	1982	x	x		
Southwest						
Arizona	MPP	1978	x	x	x	
New Mexico	MPP	1975	x	x		
Oklahoma	MPP	1976	x	x		
Texas	MPP	1979	x	x		
Mountain						
Colorado	MPP	1973	x	x		
Idaho	MPP	1972	x	x		
Montana	MPP	1975	x	x		
Utah	MPP	1975	x	x		
Wyoming	MPP·Trust Fund	1981	x		x	
	Forward Commitment	1975	x		x	
Far West						
Alaska	MPP 4/	1971	x	x		
California	MPP/FC	1977	x	x	x	
Hawaii	MPP	1979	x	x		
Nevada	MPP	1975	x	x		
Oregon	MPP	1973	x	x		
Washington	MPP	1983	x	x		

Table 2-5 (Cont.)

Key: MPP--Mortgage purchase program: agency purchases mortgages originated by private sector lenders.
FC--Forward Commitment mortgage purchase program with funds reserved for new single-family housing.

*Federal regulations require using tax-exempt bonds to set aside 20% of assistance to "areas of chronic economic distress." Targeting have exceeded federal regulations.

1/ Minnesota provides lower interest rate loans to the lowest quarter income participants in the mortgage purchase program. Low interest down payment loans are also available.

2/ Nebraska set aside 20% of its loans for households with income below $15,000. The normal 1983 income limit was $32,500.

3/ South Dakota's legislature repeated the single-family program income limit effective July 1983.

4/ Alaska has no income limit but offers mortgage interest rates on a sliding scale based on home buyer income.

Source: ACIR staff compilation based on interviews with state housing finance agency officials.

Table 2-6

TARGETED MULTIFAMILY HOUSING CONSTRUCTION AND PERMANENT FINANCE PROGRAMS, BY STATE, 1983

		Year	1983	Targeting		
Region and State	Program Type	Enacted	Funding	Income	Geographic	Other
New England						
Connecticut	Section 8*	1971	x	x		x
	Site Development	1967	x	x	x	
	Down Payment Assistance	1979	x	x	x	
Maine	Section 8*	1969	x	x		x
Massachusetts	Section 8*	1966	x	x		x
	Public Housing:					
	Disabled Persons	pre-1980	x	x		x
	Elderly Persons	pre-1980	x	x		x
	Family (low density)	pre-1980	x	x		
	Section 8 (direct construction and weatherization)	NA	x	x		x
New Hampshire	Section 8	1975	x	x		x
Rhode Island	Section 8 (direct and LTL)	1973	x	x		x
Vermont	Direct Loans	1974	x	x		x
Mideast						
Delaware	Section 8*	1968	x	x		
Maryland	Section 8	1975	x	x		
New Jersey	Section 8*	1967	x	x	x	
	Demonstration Grants to Local Government	NA	x	x		
New York	Section 8*	1960	x	x		
Pennsylvania	Section 8*	1959	x	x		x
Great Lakes						
Illinois	Section 8*	1967	x	x		
Indiana	Section 8	1980	x	x		
Michigan	Section 8*	1966	x	x		
	Equity Conversion	1983**		x		
	Moderate Rental	NA	x	x		
Ohio						
Wisconsin	Direct Loans	NA	NA	x	x	
Plains						
Iowa	Direct Loans	NA	NA	x		
Kansas						
Minnesota	Section 8*	1972	x	x		x
Missouri	Direct Loans	1969	x	x		x
Nebraska	Section 8	1978	x	x		x
North Dakota	Section 8	1980	x	x		x

Table 2-6 (Cont.)

Region and State	Program Type	Year Enacted	1983 Funding	Targeting		
				Income	Geographic	Other
Southeast						
Alabama	MPP	1980	x	x	x	
Arkansas	Section 8	1978		x		
Florida	Market Rate Loans (Section 8: Direct, LTL)	1982	x	x		
	Farmworker Housing	NA	NA			x
Georgia						
Kentucky	Direct Loans	NA		x		
Louisiana	Section 8	1981	NA	x		
Mississippi						
North Carolina	Section 8***	NA	x	x		x
South Carolina	Direct Loans	1977	x	x		x
Tennessee	Section 8	1977	x	x	x	x
Virginia	Direct Loans	1972	x	x		
West Virginia	Section 8*	1968	NA	x		
Southwest						
Arizona						
New Mexico	Loans to Lenders	1975	NA	x	x	
Oklahoma	Section 8 (FSCIC)	1976	NA	x		x
Texas	Section 8 (LTL)	1979	x	x		
Mountain						
Colorado	Section 8	1975	x	x		
	Grant and Loan Program	1970	x	x		
Idaho	Section 8	1972		x		x
Montana	Section 8	1975		x		x
Utah	Direct Loans	1975	x	x		x
Wyoming	Direct Loans	1975	x	x		
Far West						
Alaska	Senior Citizen Loan	1975	x			x
	Loan Fund	NA	NA	x		
	Rural Grant Fund	NA	NA	x	x	
California	Section 8 (80:20)	1975	x	x	x	x
Hawaii						
Nevada	Direct Loans	1975	x	x		x
Oregon	Section 8 (80:20)	1973	x	x		x
Washington						

Table 2-6 (Cont.)

Key: Section 8--Program entails federal rent subsidies and state level construction and permanent finance.

MPP--Mortgage purchase program. State agency purchases permanent loans originated by private sector lenders.

LTL--Loans-to-lenders program. Program entails state agency provision of funds to be loaned out by private sector lenders.

80:20--80:20 program. Program entails state agency finance of housing without rent subsidies and the setting aside of units for low-income tenants.

FSLIC--Federal Savings and Loan Insurance Corporation backed program. Program entails using FSLIC deposits to back housing development loans.

*Multifamily authority granted prior to Section 8 program.
**Program not in operation in 1983.
***State plans or non-Section 8, targeted multifamily housing program.

Source: ACIR staff compilation based on interviews with state housing finance agency officials.

projects in a given year, there is always a geographic targeting aspect to the location of multifamily developments. In most states an HFA will not approve a loan for a developer unless the loan application shows that demand exists in the area, that the location is acceptable to the local community, and that the site has adequate water, sewerage, and other public services.

In general, state HFAs serve low and moderate-income families, elderly persons and physically or developmentally disabled persons. A typical approach is for an HFA to issue a request for proposal (RFP) to local developers, expressing its interest in financing a development for families, elderly or disabled persons, or a mix thereof. The RFP may ask developers to submit plans providing for designs and facilities which meet the special housing needs of certain households -- for example, more bedrooms for large families, or ramps and elevators for physically disabled persons. Some notable targeting provisions in multifamily housing programs include:

- California's multifamily program, operating under the goal of a 40% set-aside for rural and remote areas.

- Idaho's multifamily program, extending priority to displaced workers and their families.

- Wisconsin's multifamily program, extending priority to areas characterized by a high concentration of low income, elderly households and substandard housing conditions.

Because state HFAs take a direct role in the approval and design of multifamily housing developments, assisted multifamily housing can be tailored to a community's needs.

Rehabilitation Grants and Loans. State rehabilitation efforts parallel their single-family and multifamily counterparts with respect to targeting. Most improvement loan programs for single-family homes set limits on an applicant's income, and most multifamily rehabilitation programs restrict funds to buildings with set-asides for low-income residents. Twenty-six states operated 55 targeted rehabilitation grant, loan, or acquisition and rehabilitation loan programs in 1983 (Table 2-7). Of these 55 programs, 11 were Section 8 "substantial rehabilitation" programs, and, as such, were subject to national regulations setting aside assistance for units occupied by low income or Section 8 eligible households. Three states included loans for acquisition and rehabilitation in their single-family mortgage subsidy programs.

Of the 55 state rehabilitation programs, 53 involved some form of income targeting, and 14 had some form of geographic targeting. Single-family acquisition and rehabilitation programs followed the federal requirement of a 20% set-aside for areas of chronic economic distress. Some notable rehabilitation targeting efforts included:

- Connecticut's Community Housing Development Corporations program limited the program's application to federally approved Neighborhood Housing Service areas.

- Colorado's Housing Development and Rehabilitation program provided a

Table 2-7

TARGETED HOUSING REHABILITATION GRANT AND LOAN PROGRAMS, BY STATE, 1983

Region and State	Program Type	Year Enacted	1983 Funding	Targeting		
				Income	Geographic	Other
New England						
Connecticut	Acquisition/Rehabilitation	pre-1983	x	x		
	Grants to Nonprofits	1981	NA	x		x
	NHS Grants	pre-1983	NA	x		x
	Homesteading	pre-1983	NA	x	x	
	Site Development	1967	x	x	x	
	Down Payment Assistance	1979	x	x	x	x
	Section 8*	1971	x	x		
Maine	SF Loans	1980	x	x		
Massachusetts	Public Housing:					
	Disabled Persons	pre-1980	x	x		x
	Family	pre-1980	x	x		x
	Elderly Persons	1958	x	x		x
	Family (Low Density)	pre-1980	x	x		
	Section 8*	1966	x	x		x
New Hampshire	Section 8	1975	x	x		
Rhode Island						
Vermont						
Mideast						
Delaware	Section 8*	1968	x	x		
Maryland	RLP	1977		x		x
	Home and Energy Loan Program	1983	x	x	x	
New Jersey	Section 8*	1967	x	x	x	
	Direct SF and Energy Improvement Loans	1978	x	x		
	MF Grants to Local Governments	NA	NA	x		
New York	Neighborhood/Rural Area Preservation Companies	1980	NA	x	x	
Pennsylvania	Section 8*	1959	x		x	
	Grants to Nonprofits	1949	x	x		

Table 2-7 (Cont.)

Region and State	Program Type	Year Enacted	1983 Funding	Targeting		
				Income	Geographic	Other
Great Lakes						
Illinois	Section 8*	1967	x	x		
Indiana	Section 8	1980	x	x		
Michigan	Home Improvement	1977	x	x		
	Neighborhood Improvement	1977	x	x		
	Community Improvement	1977	x	x	x	
	Acquisition/Rehabilitation	1983	NA	x		
	Moderate Rental	NA	NA	x		
Ohio						
Wisconsin	Direct Loans (SF)	pre-1980	x	x		
Plains						
Iowa	SF-RLP	1977	x	x		
Kansas						
Minnesota	SF-RLP	1974	x	x		
	Loans to Local Governments	1976	x	x		
	Indian Housing	NA	x	x	x	x
Missouri	Section 8*	1969	x	x		
	Direct Loans	1969	x	x		
	Weatherization Loans	1969	x	x		
Nebraska	Direct Loans (MF)	1982	x	x		
	Direct Loans (SF)	1982	x	x		
North Dakota	Direct Loans	1980	x	x		x
South Dakota	Section 8	1973	x	x		x
	Direct Loans and Acquisition/ Rehabilitation Loans	1978		x		
Southeast						
Alabama						
Arkansas						
Florida						
Georgia						
Kentucky						
Louisiana						
North Carolina	Loans to Local Governments	1980	x	x		x
South Carolina						
Tennessee						
Virginia	Acquisition/Rehabilitation (SP)	1972	x	x	x	
West Virginia						

Table 2-7 (Cont.)

Region and State	Program Type	Year Enacted	1983 Funding	Targeting		
				Income	Geographic	Other
Southwest						
Arizona						
New Mexico	Direct Loans (Elderly, SF)	NA			x	x
Oklahoma	SF-RLP	1976	x	x		
Texas						
Mountain						
Colorado	Grants and Direct Loans	1970	x	x	x	
Idaho						
Montana						
Utah						
Wyoming						
Far West						
Alaska						
California	Rural/Urban Site Development	pre-1982	x	x		
	Rural Land Purchase	pre-1983	x	x	x	
	Deferred Loan	1979	x	x	x	
	Farmworker Housing Grants	pre-1983	NA	x		x
	Elderly and Handicapped	pre-1983	NA	x		x
Hawaii						
Nevada						
Oregon	Section 8	1973	x	x		x
Washington						

Key:
SF--Single-family housing program.
MF--Multifamily housing program.
RLP--Rehabilitation loan purchase program. State agency purchase rehabilitation loans originated by private sector lenders.
Section 8--Program entails state-level funding of housing rehabilitation and federal rent subsidies.
NHS--Neighborhood Housing Service corporations. NHS corporations provide low interest rehabilitation loans within designated areas. Seed money was provided under a federal government program.

*Rehabilitation program authority was granted prior to the Section 8 program.

Source: ACIR staff compilation based on interviews with state housing finance agency officials.

50% earmark of funds for rural areas and 50% for urban areas.

- New York's Neighborhood and Rural Areas Preservation Companies program targets loans to communities where the majority of the population earns less than 90% of the state median income.

Rehabilitation Tax Incentives. The survey identified nine states in 1983 with 11 targeted rehabilitation tax incentive programs. The states were Connecticut, Iowa, Massachusetts, Nebraska, New Jersey, New York, Oregon, Pennsylvania, and Virginia. All 11 programs involved some form of local implementation, and all relaxed of local property taxes. A typical rehabilitation tax incentive program entailed the passage of state legislation enabling local governments to extend tax incentives such as abatements, exemptions or payments in lieu of taxes. A local government then would pass ordinances and designate geographical areas where tax incentives would be granted. Finally, a developer or owner would apply for tax incentives for rehabilitation or conversion, usually to a city council or designated land-use board.

A notable example of tax incentives for residential rehabilitation and conversion was the State of New York's J-51 program, which operated only in the City of New York. Until 1983, J-51 was targeted neither by income nor by geographic area within the city. The state legislature in that year limited J-51 to areas of the city with high concentrations of low-income households. Before this amendment was made, the program had been used extensively in tandem with the conversion of nonresidential buildings and lofts into apartments, cooperatives and condominiums for persons who would otherwise commute to jobs in New York from surrounding communities. Critics concluded that taxes foregone by the city have far outweighed taxes that the city can expect to collect for many years.29/ J-51 may also be used for residential rehabilitation, as in the example of the New York City Preservation Company's use of the tax incentives for assisted housing.

Other examples of targeted rehabilitation tax incentives included:

- Massachusetts's Urban Development Corporation Chapter 121A restricts tax incentives to developments which benefit low and moderate-income households.

- Nebraska's Community Improvement and Financing Law restricts application to residences that are deteriorated, fire hazards or tax delinquent.

- New Jersey's Tax Abatement Program restricts application to blighted areas defined as having a minimum of 25% of buildings 40 years or older and in violation of building codes.

Summary of Targeted State Programs. The types of assisted housing programs implemented by state level agencies are quite similar from state to state. Most states have single-family mortgage purchase programs, direct construction and permanent finance loan programs for multifamily housing, and rehabilitation programs which parallel single-family and multifamily programs.

Table 2-8 summarizes the implementation record for targeted assisted

Table 2-8

TARGETED HOUSING ASSISTANCE PROGRAMS BY STATES, IMPLEMENTED 1980-83

	Single Family				Multifamily				Rehabilitation Grants or Loans				Rehabilitation Tax Incentives			
Region and State	80	81	82	83	80	81	82	83	80	81	82	83	80	81	82	83
New England	6	6	6	6	6	6	6	6	4	4	4	4	2	2	2	2
	(8)	(8)	(8)	(8)	(13)	(13)	(13)	(13)	(14)	(14)	(14)	(14)	(2)	(2)	(2)	(2)
Connecticut	3	3	3	3	3	3	3	3	7	7	7	7	1	1	1	1
Maine	1	1	1	1	1	1	1	1	1	1	1	1				
Massachusetts	1	1	1	1	6	6	6	6	5	5	5	5	1	1	1	1
New Hampshire	1	1	1	1	1	1	1	1	1	1	1	1				
Rhode Island	1	1	1	1	1	1	1	1								
Vermont	1	1	1	1	1	1	1	1								
Mideast	4	4	4	4	5	5	5	5	5	5	5	5	3	3	3	3
	(5)	(5)	(5)	(5)	(6)	(6)	(6)	(6)	(9)	(9)	(9)	(10)	(4)	(4)	(4)	(4)
Delaware	1	1	1	1	1	1	1	1	1	1	1	1				
Maryland	2	2	2	2	1	1	1	1	1	1	1	2				
New Jersey	1	1	1	1	2	2	2	2	3	3	3	3	2	2	2	2
New York					1	1	1	1	2	2	2	2	1	1	1	1
Pennsylvania	1	1	1	1	1	1	1	1	2	2	2	2	1	1	1	1
Great Lakes	4	4	4	4	4	4	4	4	4	4	4	4	0	0	0	0
	(4)	(4)	(4)	(4)	(5)	(5)	(5)	(5)	(7)	(7)	(7)	(8)	(0)	(0)	(0)	(0)
Illinois	1	1	1	1	1	1	1	1	1	1	1	1				
Indiana	1	1	1	1	1	1	1	1	1	1	1	1				
Michigan	1	1	1	1	2	2	2	2	4	4	4	5				
Ohio																
Wisconsin	1	1	1	1	1	1	1	1	1	1	1	1				
Plains	6	6	6	6	6	6	6	6	5	5	6	6	2	2	2	2
	(8)	(8)	(8)	(8)	(6)	(6)	(6)	(6)	(10)	(10)	(12)	(12)	(3)	(3)	(3)	(3)
Iowa	1	1	1	1	1	1	1	1	1	1	1	1	2	2	2	2
Kansas																
Minnesota	3	3	3	3	1	1	1	1	3	3	3	3				
Missouri	1	1	1	1	1	1	1	1	3	3	3	3				
Nebraska	1	1	1	1	1	1	1	1			2	2	1	1	1	1
North Dakota	1	1	1	1	1	1	1	1	1	1	1	1				
South Dakota	1	1	1	1	1	1	1	1	2	2	2	2				
Southeast	12	12	12	12	9	10	10	9	2	2	2	2	1	1	1	1
	(12)	(12)	(12)	(12)	(9)	(10)	(11)	(10)	(2)	(2)	(2)	(2)	(1)	(1)	(1)	(1)
Alabama	1	1	1	1	1	1	1									
Florida	1	1	2	2	1	1	2	2								

Table 2-8 (Cont.)

Region and State	Single Family				Multifamily				Rehabilitation Grants or Loans				Rehabilitation Tax Incentives			
	80	81	82	83	80	81	82	83	80	81	82	83	80	81	82	83
Southeast (cont.)																
Georgia	1	1	1	1												
Kentucky	1	1	1	1	1	1	1	1								
Louisiana	1	1	1	1		1	1	1								
Mississippi	1	1	1	1												
North Carolina	1	1	1	1	1	1	1	1	1	1	1	1				
South Carolina	1	1	1	1	1	1	1	1								
Tennessee	1	1	1	1	1	1	1	1								
Virginia	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
West Virginia	1	1	2	2	1	1	1	1								
Southwest	4	4	4	4	3	3	3	3	2	2	2	2	0	0	0	0
	(4)	(4)	(4)	(4)	(3)	(3)	(3)	(3)	(2)	(2)	(2)	(2)	(0)	(0)	(0)	(0)
Arizona	1	1	1	1												
New Mexico	1	1	1	1	1	1	1	1	1	1	1	1				
Oklahoma	1	1	1	1	1	1	1	1	1	1	1	1				
Texas	1	1	1	1	1	1	1	1								
Mountain	5	5	5	5	5	5	5	5	2	2	2	2	0	0	0	0
	(5)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(2)	(2)	(2)	(2)	(0)	(0)	(0)	(0)
Colorado	1	1	1	1	2	2	2	2	1	1	1	1				
Idaho	1	1	1	1	1	1	1	1	1	1	1	1				
Montana	1	1	1	1	1	1	1	1								
Utah	1	1	1	1	1	1	1	1								
Wyoming	1	2	2	2	1	1	1	1								
Far West	5	5	5	6	4	4	4	4	2	2	2	2	1	1	1	1
	(5)	(5)	(5)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(1)	(1)	(1)	(1)
Alaska	1	1	1	1	3	3	3	3								
California	1	1	1	1	1	1	1	1	5	5	5	5				
Hawaii	1	1	1	1												
Nevada	1	1	1	1	1	1	1	1								
Oregon	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Washington				1												
TOTAL STATES	46	46	46	47	42	43	43	42	26	26	26	26	9	9	9	9
PROGRAMS	(51)	(52)	(54)	(55)	(55)	(56)	(57)	(56)	(53)	(53)	(53)	(55)	(11)	(11)	(11)	(11)

Key: x/(y): x = number of states in the region with programs; y = number of programs in the region.

housing programs in the 50 states. It reveals that a few programs on the books were not in operation during 1981 (the year the Ullman rules went into effect) and 1983 (a year of high interest rates and further confusion over future federal government policies concerning tax-exempt bonds). Table 2-8 shows also that most states had operational targeted single-family and multifamily housing programs over the past four years, that fewer states operated targeted housing rehabilitation grant or loan programs, and that only nine states implemented targeted housing rehabilitation tax incentives. For the most part, the same states that operated targeted housing assistance programs in 1980 also operated such programs in 1983.

Of the 55 state single-family assisted housing programs, 49 were mortgage purchase programs. In these programs, the state HFA purchases mortgages originated by conventional mortgage lenders at an interest rate below the current market rate. All 49 of these programs were funded between 1982 and 1983. Fifty-one programs were bond financed, and only five programs involved subsidies other than below-market mortgage interest rates.

Of the 57 targeted multifamily assisted housing programs, 29 were, or had been, Section 8 programs. Thirty-six involved direct construction loans or permanent loans to developers. At least 43 were financed in 1982 or 1983, nearly all by bonds. By July 1983, at least ten states had implemented or were expecting to implement an 80-20 direct loan program, and four states had implemented or planned loans-to-lenders programs. Only eight programs involved grants, and only five programs involved financial assistance for non-mortgage or construction component costs.

Of the 55 targeted rehabilitation programs, 11 were Section 8 programs; three were single-family mortgage purchase programs with rehabilitation components. Of the 55 rehabilitation programs, 22 assisted multifamily housing, 17 assisted single-family housing, and 15 assisted both. At least 15 states offered low interest loans or grants to nonprofit housing corporations or public authorities to carry out their own programs.

State Bonding Activity

A few states experienced problems selling their bond issues and were forced to call in bonds ahead of schedule (like Montana and Tennessee). The Weekly Bond Buyer anticipated many more bond calls in 1983 and 1984, however, if unfavorable economic conditions continued. Several state HFAs failed to issue bonds at all during 1982-83. Table 2-9 summarizes HFA bonding activity for single-family and multifamily housing in 1982 and 1983.30/

Innovations in State Housing Programs

In housing finance, permanent public funds (such as pension funds) have been used in three states: California, West Virginia, and Wyoming. The greatest barrier to the use of such funds for assisted housing investment is the below-market yield of such investment. Laws in many states require permanent state funds like these to invest only in projects yielding market rate returns. Even when state fund directors are not mandated to do so, they also have historically followed a tradition of seeking less risky investments.

Table 2-9

STATE HOUSING FINANCE AGENCY BONDING ACTIVITY, 1982 AND 1983
(in millions)

	Single-Family Programs (January-July)			Multifamily Programs (January-July)		
State	1983	1982		1983	1982	
Alabama	$100	$100		$ 67.5	$ 0	
Alaska	20	185				
		15	Home Improvement Loan	NA	0	
Arizona	NA	27.2		(no program)		
Arkansas	200	100		0	153	Section 8 Insured
California	0	345.3		35	46	Section 8 Insured
					107	Section 8
Colorado	149.0	66.1		13	134	Section 8 Insured
					32	Loans-to-Lenders
Connecticut	200	200		0	51.3	Section 8 Insured
Delaware	32.8	40		9.3	71.9	Section 8 Insured
Florida	0	215		91	50	Section 8 Insured
					31	Multifamily
Georgia	56.2	50		(no program)		
Hawaii	NA	60		(no program)		
Idaho	190	0		0	0	
Illinois	157	90		NA	225	Section 8
Indiana	200	75		2.45	9	Section 8 Insured
Iowa	NA	14.1		NA	18	Section 8 Insured
Kansas	(no program)			(no program)		
Kentucky	72.9	0		0	0	
Louisiana	NA	100		NA	74	Section 8 Insured
Maine	100	53.9		NA	23	Section 8 Insured
					4	Section 8 Insured
Maryland	138	152.5		NA	116	Section 8/FHA
Massachusetts	200	200		NA	101	Section 8
					18	Section 8 Insured
Michigan	200	30	Home Improvment Loan	NA	33	Section 8
Minnesota	110.9	116.9		60	48	Section 8
Mississippi	127.5	150.5		(no program)		
Missouri	145	100		66	7	FHA
					NA	FHA Nursing Home
Montana	200	55		0	1.9	Section 8 Insured

Table 2-9 (Cont.)

State	Single-Family Programs (January-July) 1983	1982		Multifamily Programs (January-July) 1983	1982	
Nebraska	39	126.7				
		9.8	Home Improvement Loan	4.2	3	Section 8 Insured
Nevada	60	60		19	2	FHA Insured
					3	PMI Insured
New Hamsphire	165	167.3		0	37	Section 8
New Jersey	266	275.2		89	6	Section 8 Insured
New Mexico	NA	98.7		NA	10	Section 8 Insured
New York	376	401		44	56	Section 8 Insured
				(1982-83)		
	(NY State Mortgage Authority)			(NY State Housing Finance Authority)		
North Carolina	186	0		52	52	Section 8 Insured
North Dakota	0	102		0	11	Loans to Lenders
					11.4	Direct Loans
Ohio	410	(no program)		(no program)		
Oklahoma	197	25	Home Improvement Loan	63	0	
Oregon	NA	125		46	65	G.O. Bonds
Pennsylvania	177	215		50	51	Section 8
					62	Section 8 Insured
Rhode Island	200	71.7		0	50	Section 8
South Carolina	99.8	82.3		0	30	Section 8
South Dakota	28	24.1		NA	14	Section 8
Tennessee	138.5	150		NA	0	
Texas	NA	100		40.8	70	Loans to Lenders
Utah	57.8	121.8		9.5	40	Section 8 Insured
Vermont	57.8	35		7.35	8	Section 8
Virginia	NA	226.1		61	44	Section 8
Washington	.9	(no program)		(no program)		
West Virginia	NA	25		NA	4	Rental Development
					2	Section 8
					22	Section 8 Insured
Wisconsin	NA	150		NA	77	Section 8
Wyoming	40	0		0	3	Section 8 Insured
		$5,135.8			$2,444.9658	

Sources: ACIR staff compilation based on telephone conversations with state housing officials; Council of State Housing Agencies, "1982 Survey of State Housing Finance Agencies" (Washington, DC: 1983).

Regardless of such barriers, real estate and mortgage investment by state pension funds is common.31/ Most state pension funds have mortgage investments, and some have invested significantly in mortgage-related areas -- for example, Michigan 48.6%, Missouri 43.1%, Montana 43.7%, and Colorado 34.9%. Thus, state pension funds are no strangers to mortgage investments.

In California, the public employees' pension fund agreed to commit $100 million for the purchase of single-family home mortgages.32/ Beyond that, the California Housing Finance Agency was expecting to work in tandem with the pension fund to purchase single-family home mortgages. CHFA would either act as a broker for the pension fund and manage its mortgage porfolio, or it would issue a mortgage-backed security to the pension fund, holding the mortgage titles as in its own mortgage purchase program. The latter alternative may provide an incentive for investment by smaller, local pension funds in the state. Neither of these proposals would allow, however, the purchase of below-market interest rate mortgages.

Several other state programs offer examples of innovations.

Use of Permanent Funds. Wyoming's State Mortgage Trust Fund/State Treasurer's Mortgage Purchase Program uses the Mineral Fund. Up to 6.5% of the portfolio is allowed for mortgage investments.

In West Virginia, the legislature made a one-time allocation of $5 million from the Workman's Compensation Trust Fund for the West Virginia Economic Development Authority to use in its mortgage subsidy program. The 1983 legislature, however, failed to approve legislation allowing regular allocations from this Fund for mortgage investments.

Use of General Funds. Florida appropriated general fund money to create the Revolving Land Acquisition and Site Development Trust Fund.

Minnesota's Housing Assistance Fund uses general funds to reduce interest rates and down payment costs for mortgage subsidy program participants with incomes in the lowest 25%.

In Alaska, the Senior Citizen Housing Development Fund uses general funds for senior citizen housing development grants.

Colorado's Housing Development and Rehabilitation program uses general funds for construction and rehabilitation grants and loans.

New Jersey's Multifamily Demonstration Program uses general funds to make grants to local governments and nonprofit developers for construction, rehabilitation, training and technical assistance.

By June 30, 1983, no states had gained experience with taxable revenue bonds, although some HFAs had used general obligation bonds.

Long Tenure Developments. Under Michigan's Equity Conversion Demonstration, homeowners in distressed areas may trade homes for stakes in new cooperative housing developments. Homes become part of Michigan State Housing Development Authority portfolio and may be sold in the Single-Family Program.

State Public Housing and Rent Subsidies. In Massachusetts, the Department of Communities and Renewal provides construction and rehabilitation finance for scattered site and higher density public housing, with an emphasis on small towns and rural areas. Maryland, Massachusetts and New York have legislated and implemented rent subsidy programs.

Homesteading and Adopt-a-House. Connecticut's Homesteading Program provides low interest loans to homesteaders in federally designated Neighborhood Housing Service areas.

Under Kentucky's Adopt-a-Neighborhood Program, the state HFA contracts with local neighborhood based organizations for the substantial rehabilitation of abandoned homes to spur communitywide revitalization efforts. The neighborhood based organization may receive private contributions.

Working with Community Based Developers. New York's Neighborhood and Rural Area Preservation Companies are nonprofit, locally based companies and associations in low income communities. They receive low interest loans and favorable tax status to support their rehabilitation efforts.

Partnerships with Communities. New Hampshire negotiates with local communities and sends its HFA officers to town meetings to seek approval for multifamily housing developments. State and local participants negotiate design, size and tenancy policy of developments. NHHFA prefers to use community based, nonprofit developers.

Aid to the Homeless. California's Department of Housing and Community Development and its HFA earmarked mainline program funds for victims of the Coalinga Earthquake and the Anaheim fire.

Component Cost Reduction. Connecticut and Florida offer low interest loans to reduce the costs of site development and land acquisition. Such loans are also available for down payments in Connecticut, while Minnesota offers down payment assistance and gives lower interest rates for lowest income single-family program participants.

Special Funds. California has a fund for migrants, American Indians and the elderly, while Alaska has funds for senior citizen housing and formation of local boards to oversee senior housing development.

Technical Assistance. In the area of technical assistance, New Jersey provides grants and management training to neighborhood housing corporations and associations. California operates a wide variety of technical assistance housing programs. They include:

1) migrant services program, providing assistance in housing development, placement and management to local housing authorities and community based organizations active in migrant worker family housing efforts;

2) California Indian assistance program for housing placement and development efforts benefiting Native Americans on and off reservations;

3) state and local surplus land program, providing information to devel-

opers and housing authorities concerning available public lands; and

4) rural development assistance program, assisting local housing authorities, developers, and community based organizations serving rural and remote areas.

The California Department of Housing and Community Development staffs these programs from offices throughout the state.

Targeting. Examples of targeting innovations have already been outlined. In addition, a number of states such as Colorado, Georgia, and Maine target assisted housing resources to rural communities.

Anti-Discrimination Laws. Several states have implemented statewide anti-redlining laws prohibiting lenders from refusing to make mortgage loans in certain neighborhoods, a practice known as "redlining."33/

California's Housing Financial Discrimination Act of 1977 provides that neighborhood location is not related to the creditworthiness of mortgage loans. Michigan's and Iowa's laws prohibit loan denial due to racial or ethnic characteristics of neighborhoods or age of the structure at hand; they provide penalties and guarantee the right of redress for victims of such bias.

Oregon's laws prohibit local moratoriums against housing development and allow the state to override local plans and regulations found inconsistent with the state's affordable housing objectives.

Massachusetts created a housing appeals committee which can overturn local development decisions if they are found to be prejudicial to the construction of low and moderate-income housing.

Connecticut, Illinois, New Jersey, and Virginia have also passed legislation designed to reduce local barriers to low and moderate housing location and finance.

Innovations in Local Housing Programs

Locally based institutions have also been active in innovative programs in other housing areas. Following are some examples:

Cooperative Housing. Instead of demolishing 211 duplexes and single-family houses in Rutherford County, TN, the public housing authority planned to sell its low-income housing development in Smyrna to a tenant cooperative for a below-market price. Rents would be kept within the $160-190 per month range. The cooperative would maintain lower costs by implementing a phased-in sweat equity rehabilitation program.34/

Pension Fund Use. New York City committed $50 million of police pension funds to the acquisition and rehabilitation of 4,000 to 5,000 multifamily housing units. The plan was for the pension fund to purchase loans originated by the New York City Community Preservation Corporation. The fund would receive a market rate return; rents would be contained through sweat equity, J-51 tax abatements and exemptions, and Section 8 rent supplements.35/

Emergency Family Shelter. Shelter, Inc., a nonprofit group, opened a 35-bed shelter for homeless families in Boston. The shelter was designed to serve entire families displaced by disasters, condominium conversions, domestic disputes and evictions. However, it is not designed to serve the chronically homeless. The Department of Public Welfare planned to subsidize 75% of first year costs, and 50% of costs in succeeding years. Ten other such shelters throughout Massachusetts are planned.36/

Summary

Monitoring state activities targeted to distressed communities has revealed great similarities among housing assistance programs. The typical state has empowered a housing finance agency to operate a subsidized mortgage program for buyers of single-family homes and a direct construction loan program for multifamily buildings based upon Section 8 (Table 2-10).

Table 2-10

STATES WITH STATE-ASSISTED HOUSING PROGRAMS TARGETED TO DISTRESS (July 1, 1983)

Programs	State Laws Enacted	At Least One Program Implemented	1983 Funding
Single-Family Construction	47*	47	47**
Multifamily Construction	43	42	33**
Rehabilitation Grants or Loans	26	26	25**
Rehabilitation Tax Incentives	9	9	9

*Does not include Washington's nonimplemented program nor New York's or Ohio's nontargeted programs.

**Information not available on six multifamily and one rehabilitation program.

Source: ACIR staff compilation.

The results of the survey reflect a recent decline in housing assistance targeted to distressed communities. One state housing finance agency (Arkansas) discontinued its multifamily effort after the discontinuation of federal Section 8 rent subsidies. Idaho, Kentucky, and Montana raised no funds for 1983 multifamily efforts.

This study identified 186 separate targeted housing programs. Almost all of them involved some form of income targeting -- income limits or set-asides of units to low or moderate-income households. Of these 186 programs, approximately 35 involved targeting to traditionally poorly housed minorities or geographic targeting which exceeded federal regulations. California, Florida, and Minnesota are the only states to target housing assistance to migrant workers and Native Americans. Most states with multifamily programs, however, designated developments for elderly or disabled persons. State housing development programs can be generally described as targeted to people rather than to places.

Several implications can be drawn from a look at state targeted housing programs in the broader context of housing policy. First, in 1983 the states could not fill the gap in assisted housing left by reduced federal aid. Second, the tax-exempt mortgage revenue bond is an inadequate source of financing for assisted housing programs. Third, most state HFAs, typically staffed by a handful of persons in the state capital, do not necessarily have the resources to determine state or local housing needs, negotiate the location of assisted housing throughout the state, encourage rural area participation in homeownership assistance programs, or provide needed technical and managerial assistance to nonprofit housing development associations and corporations. Fourth and finally, state housing assistance policy appears to be divided between the objective of improving housing for traditionally poorly housed population groups and the objective of addressing the overall housing affordability problem.

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FOOTNOTES

1/ U.S. Department of Housing and Urban Development, The President's National Urban Policy: 1980 (Washington, DC: U.S. Government Printing Office, 1980), p. 1.

2/ Council of Economic Advisors, Economic Report of the President (Washington, DC: U.S. Government Printing Office, February 1982), p. 291.

3/ Interim Report of Presidential Commission on Housing, 30 October 1981, p. 30. Voucher-like programs have an experimental precedent. Beginning in 1972, HUD conducted the Experimental Housing Allowance Program (EHAP) involving over 23,000 households in 12 cities nationwide. A primary finding was that the experiment did not produce a significant improvement in either the physical quality or supply of housing. EHAP did result in minor improvements in already standard housing and minor steps toward housing code compliance. HUD's own analysis found that EHAP neither eliminated the housing problems of the poor, nor affected household mobility from polarized, poorhousing neighborhoods. Other discussion of EHAP can be found in Marc Bendick, Jr., and James Zais, "Incomes and Housing: Lessons from Experiments with Housing Allowances" (Washington, DC: The Urban Institute, 1978) p. 7; Raymond Struyk and Marc Bendick, Jr., "Housing Vouchers for the Poor," The Urban Institute Policy and Research Report, Winter 1980, pp. 1-5; and U.S. Department of Housing and Urban Development, Experimental Housing Allowance Program: A 1979 Report of Findings (Washington, DC: U.S. Government Printing Office, 1979), pp. 2-6, 33-40.

4/ Silver and Smith, p. 19.

5/ National League of Cities, Housing and Cities: Municipal Perspectives on the Report of the President's Commission on Housing, September 1982.

6/ Bernard J. Frieden and Arthur P. Solomon (with David Birch and John Pitkin) The Nation's Housing: 1975 to 1985 (Cambridge, MA: Joint Center for Urban Studies of Massachusetts Institute of Technology and Harvard University, 1977), pp. 39, 87, 89, 95-98.

7/ U.S. Department of Housing and Urban Development, 1981 Annual Survey of Housing, Financial Characteristics of the Housing Inventory for United States and Regions, Part C (Washington, DC: U.S. Government Printing Office, 1983), p. 231.

8/ George Sternlieb and James Hughes, "Overview," America's Housing: Prospects and Problems, George Sternlieb, ed. (New Brunswick, NJ: Rutgers the State University of New Jersey, 1980), p. 84.

9/ Raymond Zelder, "Poverty, Housing and Market Processes," Housing the Poor, Donald Reeb and James T. Kirk, eds. (New York: Praeger Publishers, 1973), pp. 29, 226.

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11/ John Weicher, Federal Housing Policies and Programs (Washington, DC: American Enterprise Institute, 1980), p. 14.

12/ Mary K. Nenno, "What Is the Future for Federal Housing Assistance," (Washington, DC: n.p., May 20, 1983), n.p.

13/ Clay Cochran and George Rucker, "Every American Family Housing Need and Non-Response," Housing the Poor, Donald Reeb and James Kirk, eds. (New York: Praeger Publishers, 1973), p. 164.

14/ Interim Report of President's Commission on Housing, 30 October 1981, p. 17.

15/ U.S. Department of Housing and Urban Development, 1981 Annual Survey of Housing (Washington, DC: U.S. Government Printing Office, 1983); U.S. Department of Commerce, Bureau of Census, 1980 Census of Housing, Part A, General Housing Characteristics (Washington, DC: U.S. Government Printing Office, 1981), Tables A-1 and A-7, pp. 4 and 37.

16/ Raymond Struyk, Urban Homeownership: The Economic Determinants (Lexington, MA: Lexington Books, 1976), pp. 122-25.

17/ U.S. Department of Commerce, Bureau of the Census, 1980 United States Statistical Abstract (Washington, DC: U.S. Government Printing Office, 1981), p. 6.

18/ The Bureau of the Census reported a national poverty rate of 15% in Summer 1983; there were 34 million persons reported below the poverty level -- between $9,000 and $10,000 for a family of four persons.

19/ George Peterson with Brian Cooper, Tax Exempt Financing of Housing Investment (Washington, DC: The Urban Institute, 1979), p. 1.

20/ U.S. Congress, The Library of Congress Congressional Research Service, Housing Assistance to Low- and Moderate-Income Households, Issue Brief No. IB79058, 17 September 1981.

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22/ Raymond Struyk, Neil Mayer, and John A. Tuccillo, Federal Housing Policy at President Reagan's Midterm (Washington, DC: The Urban Institute, 1983), p. 62.

23/ John Weicher, Housing: Federal Policies and Programs (Washington, DC: American Enterprise Institute for Public Policy Research, 1980), p. 141.

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28/ Interview with Diane Sternberg, Housing Assistance Council, Washington, DC, August 1983.

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32/ Interview with Marcie Mills, California Housing Finance Agency, September 1983.

33/ Joe Darden, "State Anti-Redlining Laws: A Comparative Analysis," State Government, March/April 1983, pp. 14-20; and John Sidor, "Affordable Housing--The State's Role," Journal of Housing, May/June 1982.

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Chapter 3

ECONOMIC DEVELOPMENT

The recession of the early 1980s helped focus attention on economic conditions in the states. In California, generally considered to have a diversified and stable economy, more than 1,200 plants closed between January 1980 and 1983, displacing more than 105,000 workers.1/ Around the country, many other plants closed, many of them obsolete and victims of competition from firms in other countries. According to 1982 figures from the Bureau of National Affairs, Ohio had 58 plant closings idling 18,000 workers, while Alabama experienced 11 closings for a loss of 5,400 jobs, and Texas had 12 closings in which 5,480 employees were laid off.2/

While such closings are dramatic, they respresent but part of the challenge states face in economic development. States also are trying to attract new firms, keep existing firms and help them expand, encourage firms to increase exports, and put the unemployed back to work. Some states have also focused on meeting the development needs of distressed communities.

These challenges have raised economic development to a high priority for officials in many states. Three surveys of state officials and governors in 1982 and 1983 found that economic development ranked first or second on their lists of priorities.3/ A similar survey in 1976 had placed economic development sixth on officials' list. Reflecting this increased emphasis, Neal Peirce, a journalist who specializes in state and local government issues, commented that "economic development is essential to and inseparable from the successful governance of states.... Such efforts should be related to and coordinated with virtually every other type of state activity."4/

We have already noted one of the reasons for the increased attention given to economic development by states: major shifts are occurring in the structure of the national economy that alter the locational advantages of regions and communities for various industries and types of economic activity. Accompanying this transformation is a movement away from labor-intensive industry to capital-intensive enterprises, often resulting in permanent loss of certain types of jobs.

A second reason is the Reagan Administration's efforts to reduce the national government's role in economic development, and to devolve that responsibility to state and local governments as well as to the private market. Some states are capable of handling the newly expanded role, while others now find it necessary to increase their capacity in this area.

Finally, the second recession in five years, combined with fiscal stress at both state and local levels, increased competition among states and localities to attract new private investment and jobs.

Combined, these factors have meant an increased need for the economic development function for many state and local governments.5/

State economic development efforts are focusing on three objectives:

1) to generate and sustain a sufficient number of long-term, quality jobs for all job seekers;

2) to generate and sustain economic growth through business development and ensure the equitable distribution of the benefits of that growth; and

3) to promote and support the revitalization and stability of local economies to ensure the stability of the state's economy.

States have pursued a variety of programs to meet these objectives. The most visible development programs for most states have been industrial recruitment programs, which often combine three types of policies: site development, customized job training, and a basket of tax incentives. But the three broad objectives above require a state role that deals with more than just business location decisions.

Nowhere is this more clear than in the kinds of assistance states provide to distressed communities. In the past, states have left such assistance largely to the federal government. Programs administered by the Economic Development Administration (EDA), the Department of Housing and Urban Development (HUD), or the Community Services Administration (CSA) have directed grants, loans, and technical assistance to urban and rural communities, as well as firms. That role has now shifted dramatically, and distressed communities are finding that they must increasingly rely on state and local government or private market assistance.

This report has used five types of state economic development programs from among the many types of state help to serve as indicators of a state's commitment to help distressed communities:

1) commercial or industrial site development;
2) financial aid for industrial or commercial development, including enterprise zones;
3) customized job training;
4) small and minority business development; and
5) industrial revenue bonds.

Each of these indicators will be considered in some detail later.

This chapter examines, first, a range of policy issues that states are confronting in the economic development field, and then reviews the types of strategies and programs that states are using to deal with these concerns. Finally, it reviews the record of state aid to distressed communities for the five types of program indicators.

Economic Development Policy Issues

The devolution of the national government's responsibilities to state and local governments, the structural transformation of the national economic base, and cyclical economic forces all have changed the face of state economic development. As a result, four major issues have emerged as central to the state agenda:

1) job development;
2) business development;
3) capital markets failure; and,
4) targeting.

Job Development

Macro-economic forces have resulted in the displacement of millions of workers over the past 20 years. Basic industries such as steel and autos have had to lay off many workers. Many large corporations move to cheaper labor markets or substitute machines for labor. These moves cause serious unemployment. Detroit, for example has lost an estimated 300,000 jobs since the mid-1970s due to the decline in the American auto industry.6/ These jobs are not likely to come back. Displaced workers either have to be retrained for new jobs, start their own businesses, or become "structurally unemployed."

For state and local governments, high concentrations of structurally unemployed people mean not only lost tax revenues and increased spending for unemployment or welfare benefits, but also high social and personal costs (like increased crime, drug use, and mental illness).

Although discussions have occurred about encouraging the unemployed to move to areas where jobs are more abundant,7/ most workers have strong ties where they now live. Because unemployment is a national phenomenon, moreover, few areas have job surpluses, and those high-growth industries that are hiring large numbers of workers generally require specialized skills.

State human resource and development programs, therefore, must try to deal with the needs of several groups particularly affected by the combination of structural and cyclical unemployment:

1) displaced workers, who need retraining or entrepreneurial training;
2) minorities and minority youths, who need training and access to jobs on a nondiscriminatory basis; and
3) the underemployed and unemployed, who need either training or placement services.

In spite of some national encouragement, the high-need populations usually do not move. Furthermore, state human resource programs generally do not link job development activities with overall economic development strategies. Customized job training, as we shall see below, is one way to link jobs to development projects and businesses. Targeting job development activities to and coordinating them with business development can help create more long-term, quality jobs and reduce both the economic and social costs of unemployment.

Business Development

The economic transformation, federal program reductions, and the recession have not only affected the types of businesses that survive, but have also affected survival rates. Consequently, the state role in business development is shifting.

Early state activities focused on bringing new industries into the state, or what has been called "smokestack chasing." More recently states have added "high tech chasing" to their agenda as they seek high-growth, "clean" industry. Nonetheless, in recent years the economic wisdom of trying to recruit industries has been called into question. There is mounting evidence that only a small fraction of employment gains are due to corporate moves between states, and that "beggar thy neighbor" competition between states is far more costly than beneficial.8/

Extensive research shows, moreover, that states can do little to influence firms in the early stages of decisions about where to locate facilities -- decisions that generally take a year or more to make. By the time state and local governments are aware of a location decision, it is generally two-thirds completed, and they are put in the position of bidding down other state or local governments by giving a more profitable basket of incentives that risks undermining the tax base of the community.9/

Politically, a state cannot afford not to bid, no matter how costly. Long-term costs, however, may easily outweigh short-term benefits. As Neal Peirce has noted,10/

> States have become so busy offering tax incentives to firms that the process may have become clearly counterproductive.... In some states, tax abatement programs have led to serious erosion of the tax base, a policy which can lead to inadequate schools and services -- some of the most important drawing cards for industry in the first place. No state seems to have broken this vicious cycle.

Thus, by giving away economic benefits firms do not even consider until the end of a decision process, governments may erode their capacity to provide those things industry does look for much earlier in choosing a location.

Although industrial recruitment remains an important part of state business development efforts, the focus of business development has begun to shift toward keeping or expanding businesses already in the state. The Urban Institute has found that an increasing number of states have expanded their incentive programs to cover in-state businesses, and they have established new financial and technical assistance programs to help.11/

Capital Market Failure

For a state to engage in any business development activities to generate jobs, there must be adequate capital in the market, and to be successful, that capital must be available to all sizes of firms. There is plenty of capital available nationally. Some estimates say that there is $3 trillion available in private investment pools, $1 trillion in public pension funds (by 1990), and $7 billion in venture capital. The real problem -- especially for small and minority firms -- is in getting access to these resources.

This leads to a consideration of private "market failure" as it relates to distressed communities, where vigorous economic activity has ceased.12/ In seeking to explain market failure, several analysts have looked at the way in which capital gets allocated to firms. This process can be seen as one where businesses compete for funds. Lenders evaluate how risky a venture is, and what rate of return can be expected. Based on this evaluation, firms will or will not get access to capital. The cost of capital will be lower to those with lower risk and higher returns, while higher cost capital, or none at all, will go to those with higher risks and uncertain returns.

A consequence of this capital allocation process is that little capital goes to businesses or projects in distressed communities, because lenders view them as too risky and do not believe that the rate of return will compensate for the risk.

This private decision is made even though a firm or project may provide benefits to the public, such as hiring the unemployed. What this means for state economic development is that businesses, jobs, and income will not be generated in those communities or neighborhoods that need them most. Analysts have identified seven major barriers that state development effort must overcome if they are to induce investment in distressed areas.

1. Risks are not widely enough shared and pooled to achieve the proper amount of investment in economic development.

2. Costs of information for completing transactions are high.

3. Competition is lacking among financial institutions.

4. Financial institutions discriminate against certain types of borrowers, namely minorities, women, community based organizations, employee stock ownership plans, and cooperatives.

5. Government regulations and tax policies have unintended side effects.

6. The odds are stacked against young, small businesses.

7. Too little capital is placed in the hands of low-income entrepreneurs and community based organizations.

State efforts to deal with these problems can involve grants, loans, loan guarantees, bonds, deregulation, creating public development finance institutions, or using public powers to create sheltered markets for firms traditionally excluded from the private market.

Targeting

The idea of using public policies to direct assistance to people, places, or firms in distress or need has been a controversial issue for some time. Most states target little or none of their economic development funds. In fact, the idea of public intervention to guide private development seems foreign to some officials. As one official put it: "Industry goes where it wishes, based on its own criteria." Yet national, state, and local policies affect the behavior of private businesses in many ways -- by locating public facilities or highways in certain places or by writing tax codes and regulatory laws in certain ways. Thus, targeting is a far more complex issue than it seems at first glance.

The issue here is not the mechanics of targeting but rather its political desirability. This debate centers on the question of which goals state economic development policy should maximize: (1) economic growth, which largely benefits firms or places already in the mainstream, or (2) economic revitalization which enables failed markets to succeed and opens up opportunities for disadvantaged entrepreneurs to enter the mainstream.

Many participants in the targeting debate see it as a "zero-sum game"; they assume that there are "winners" and "losers" in life, and that targeting penalizes the winners. Advocates of targeting see it either as an integral part of the public sector's responsibility or a feasible way for states to move beyond the dilemma of competing with other states for business. These advocates suggest that private markets work imperfectly for certain firms, people, and places, that there is already a wide range of public intervention into private markets, and so the issue is really how to use targeting to more equitably distribute the benefits of economic growth and open up opportunities for fuller participation in the economic system. In fact, some argue that targeting is the only way to encourage business development -- in effect to create more winners -- and to stimulate the process of economic revitalization.

Opponents of targeting argue that rewarding the "losers" is inappropriate public tampering with private market forces; if the state must act, it should do so to eliminate any further barriers to economic growth. The benefits of that growth will then go to the greatest number of citizens.

Aside from philosophical questions, targeting also presents certain practical difficulties. Among the issues cited by state development officials are the following:13/

1. Constitutional Problems. In some states it is illegal to give preferential treatment to firms on certain taxes. Some court opinions have argued that public assistance to one firm over another in the same business constitutes a violation of fair market practices.

2. Local Government Backlash. Local officials may fear that designating the locality as "distressed" could create a negative image that would discourage investment.

3. People versus Places. If it is people that programs are trying to benefit, then the targeting of resources to places will miss them if they move.

4. Costs versus Benefits. Targeting resources to "losers" may not generate the rate of return expected by the taxpayers, creating problems of accountability for the use of public funds.

5. Criteria and Data. It is difficult to select criteria that meet fairness standards, and often the data needed to determine eligibility are not available.

On the other hand, the allocation of resources to areas, people, or firms in need can have significant advantages for a state if effectively administered. Targeting resources in a coordinated way can begin to improve economic conditions relatively quickly. For example, state procurement policy with set-asides for small business creates an immediate market, giving them a fighting chance to survive. Or a public facility built in a deteriorating neighborhood can serve as an anchor for revitalizing the area.

Second, targeted development strategies can reduce economic and social costs by putting the unemployed back to work and reducing the need for welfare subsidies. Third, the quality of life for every citizen is improved when failed markets begin to be active participants in the economy.

Despite the lack of consensus on the targeting issue, it is clear that the issue of state intervention in the marketplace to achieve economic revitalization and stability is far more complex than the "winner" versus "loser" dichotomy would suggest.

State Organization and Programs

States have substantial powers relative to local communities. They administer federal funds for roads, public sanitation, ports, and other facilities. They provide more direct aid to local governments than does the national government. Furthermore, state governments have broad powers to shape the future of cities, towns and counties, including powers to alter boundaries, set rules for annexations, shift authority for certain functions from one level of government to another, determine local taxing authority, and mandate local governments to bear certain responsibilities. States can fund agencies to finance new jobs, business development, and housing, and they can provide technical assistance to local governments.

More specifically, states also have substantial tax, regulatory, and expenditure powers (Exhibit 3-1). If used in a coordinated and planned manner, these powers can have a major impact on a state's economic development needs.

State actions are, nonetheless, constrained by several factors that force them to move cautiously. These factors include the following:

- political traditions resulting in weak state governments,
- national and international economic conditions affecting capital markets,
- skepticism on the part of the public and legislatures toward public economic planning,
- negative perceptions about business climates,
- lack of gubernatorial control over the development budget, and
- insufficient resources (in staff, expertise, and money) to provide a range of development assistance to local governments.

The most important factors are those related to what the governor and legislature are willing to do. Effective state action in economic development requires a strong commitment from the governor and a positive attitude on the part of the legislature. As a report from the Council of State Community

Exhibit 3-1

STATE POWERS AFFECTING ECONOMIC DEVELOPMENT

I. Tax Powers
   1. All state tax laws, particularly corporate, and personal income, sales, and property taxes.
   2. Tax abatements, credits, incentives, and exemptions.
   3. Authorization of local governments to raise nonproperty tax revenues (e.g., payroll, commuter).
   4. Authorization of tax base sharing or relaxing municipal annexation laws.

II. Regulatory Powers
   1. Laws of land use and the environment.
   2. Water and sewer laws.
   3. Bank charters.
   4. Streamlining the permitting process.

III. Expenditure Powers
   1. Development programs.
   2. State construction and siting.
   3. New public finance institutions or mechanisms.
   4. State procurements.

Affairs Agencies put it, "states retain...the capacity to act across broad fronts.... Often they simply lack the political will to act aggressively."14/

Strategies for State Action

Even when the governor and legislature are strongly committed, the question remains as to what the state government's role ought to be in economic development. In defining what role a state will play, the first step for state officials is to assess development needs. Then they should develop and evaluate alternative state policy and strategic plans. The third step is to decide how active a role the state wishes to play, and adopt a plan consistent with this basic decision.

The state can play a residual role, defined as "gap filling." The state meets emergencies as they arise, but basically relies on private market forces. A residual role involves no targeted assistance and little funding activity. The state nevertheless works to reduce barriers to private market activity through deregulation.

A facilitative role would commit a state government to sustain existing programs, and to aid or expand private market actions to address a state's development needs, using some targeting. Public-private partnerships, and even enterprise zones, are examples.

An active role would involve a broad range of new program initiatives, experimentation, additional funding, new financial institutions in the public market, and a coordinated program of targeted resources.

Depending on the role it has adopted, a state could implement its economic development strategy through fiscal, regulatory, or spending initiatives, or a combination of these. The results -- as measured by job development, business development, community revitalization, and economic growth and stability depend on the role selected and on the effectiveness of the programs.

Central to effective state action is a carefully developed long-term plan that focuses not only on overall economic growth objectives for the state, but also on the specific needs of communities and economic sectors. Ohio, for example, recently completed a state strategic plan, while Massachusetts has created the Governor's Commission on Mature Industries.

Program Implementation Initiatives

As Exhibit 3-2 shows, states can choose from a sizable tool kit of fiscal, regulatory, and expenditure initiatives. The particular alternatives a state selects depends on the degree of intervention it wishes to use.

State-Local Relations

State and local governments must forge a strong relationship in meeting their economic development objectives. As noted in a later chapter, a state can enhance a local government's capacity to handle its own problems by granting it local taxing authority, improving its access to credit markets, providing local development powers, and giving it local discretionary authority. In addition, states can strengthen their relationship with local governments in any or all of the ways presented in Exhibit 3-3.

Organization of State Economic Development Actions

Every state has some kind of an office of economic development, although titles, responsibilities, funding, and staffing patterns vary from state to state. Departments of economic development, commerce or community affairs are typically the primary agency.

Of 44 states responding to a 1983 survey conducted by the Council of State Governments, 12 had established their economic development agencies prior to 1960, 11 did so during the 1960s, 13 started agencies in the 1970s, and eight more acted in 1980-83. Some states, however, already had departments but reorganized to increase their emphasis on economic development. In 30 states, the economic development agency is organized as a state department with one director, although ten of these states have advisory groups.15/

State agency budgets for economic development programs ranged in FY 1983 from $279 million in Ohio to $900,000 in South Dakota, with four states besides Ohio (Michigan, Kentucky, Illinois, and North Carolina) having agency budgets over $200 million.

Exhibit 3-2

STATE PROGRAM IMPLEMENTATION INITIATIVES IN ECONOMIC DEVELOPMENT

I. Fiscal Initiatives
   1. State Tax Structure Revisions
      a. General sales tax.
      b. Graduated personal income tax.
      c. Reduction of interstate and interlocal tax disparities.
   2. State Fiscal Policies to Aid Needy Governments
      a. State revenue sharing or tax sharing programs.
      b. Education finance reform.
      c. State assumption of local social service costs.
      d. Reimbursement of local governments for local expenditures required by the state.
      e. Enabling statute permitting metropolitan revenue and tax base sharing programs.

II. Regulatory Initiatives
   1. Banking
      a. Elimination of usury ceilings on commercial lending.
      b. Limitation of commercial bank reserve requirements.
      c. Revision of chartering and branching regulations for commercial banks.
   2. Insurance
      a. Regulation of insurance rates and territories to ensure equitable coverage.
      b. Investigation of discriminatory practices in insurance industry.
   3. Environment, Air Quality, and Land Use
   4. Licensing, Regulation and Permitting
      a. One-stop permitting program.
      b. Office of business advocacy.
      c. Forms management/paperwork reduction program.

III. Expenditure Initiatives
   1. State Procurement Policy
      a. Procurement set-asides for small and minority business.
      b. Procurement set-asides for firms located in economically lagging jurisdictions.
   2. State Facilities Siting Policy
   3. State Credit Policy
   4. Investment of State Pension Funds
   5. Development Grants:
      a. Infrastructure development policy.
      b. Placing improvements to facilitate economic development.

IV. Financial Aid Initiatives
   1. Grants
   2. Loans, Loan Guarantees, and Revolving Loan Funds
   3. Interest Subsidies
   4. Bonds
   5. Equity and Near-Equity Financing
   6. Tax Incentives, Credits and Abatements
   7. Business Site Development Assistance
   8. Customized Job Training
   9. Public Sector Development Finance Institutions

V. Nonfinancial Aid Initiatives
   1. Technical Assistance
   2. Public Relations, Marketing Assistance
   3. Export Development
   4. Information and Referral

Source: Council of State Community Affairs Agencies, *Economic Development: The States' Perspective* (Washington, DC, 1981).

Exhibit 3-3

STATE ROLES TO AID LOCAL GOVERNMENTS IN ECONOMIC DEVELOPMENT

I. Technical Assistance Role
   1. Preparing comprehensive investment plans.
   2. Building local government capacity.
   3. Helping establish local development organizations.
   4. Giving aid in long-range planning.

II. Broker Mediator Role
   1. Aiding in obtaining federal grants.
   2. Aiding in interlocal agreements.
   3. Assisting in private-public joint ventures or negotiated investment strategies.
   4. Facilitating public-private-labor-community partnerships.

III. Advocate Role
   1. Expediting grant packages.
   2. Passing laws.

IV. Research and Development Role
   1. Conducting long-range development research.
   2. Evaluating program impacts.
   3. Experimentation and innovation.

Source: The Urban Institute, Directory of Incentives for Business and Economic Development (Washington, DC, 1983).

Program Activities

State agencies engage in a broad range of activities, with an emphasis on industrial development, including site selection, industrial parks and plants, and financial assistance. Other activities include:

1) information, technical, and labor services;
2) industrial development bonds;
3) industrial finance authorities;
4) financial and technical assistance for small, minority, or community based enterprises;
5) job training and placement programs;
6) international trade promotion;
7) export development;
8) encouraging foreign investment;
9) neighborhood economic development;
10) tourism; and
11) targeting assistance to places, people, and firms in need.

This list suggests that the scope of state economic development is quite broad, although the scale of funding of these programs is quite low compared to other state programs.16/ Targeted state programs for distressed communities, however, are much narrower in scope and even less well funded.

State Aid to Distressed Communities

This section discusses the previously identified indicators of state efforts to aid distressed communities.

Industrial and Commercial Site Development

Industrial and commercial site development involves physical improvements to specific sites, either to attract new firms or to help existing ones expand. A firm considering a new location considers many factors, such as the condition of infrastructure and quality of the local work force; the actual site is not always a primary consideration, but it is a factor.

Firms seeking to expand at their current site, particularly in older urban areas, usually need land assembly assistance, plant construction or rehabilitation, and other services. Firms locating or expanding in high-growth areas, as in the Southwest, may use the existing sanitation facilities beyond their present capacity. Major new facilities are often required to accommodate needs.

Site development is particularly critical in directing new private industrial investment and jobs to distressed places. State development agencies usually have industrial specialists to help out-of-state firms identify suitable sites.17/ Some states, such as Alabama, assist firms by identifying communities where their basic industrial location needs are already met.

Site development assistance generally is not targeted to distressed areas, however. Among the reasons often cited for the lack of distress targeting are the poor physical infrastructure, poor locations, crime, physical deterioration, and the cost of rehabilitation.

Targeted assistance in older industrial cities can assist business by assembling scarce land parcels large enough to accommodate a major facility. The most popular mechanism for targeted land assembly is the creation of urban industrial parks. Land banking is a way to minimize real estate speculation and allow states and cities to capture the increased land value. In distressed rural communities, the availability of land is much less a problem than is the availability of the necessary water and sewer facilities, plus access to major transportation routes.

Existing buildings sometimes can be rehabilitated or converted to new uses to accommodate specific firms seeking to expand on site or wishing to move to the site. A second approach is to rehabilitate buildings on a speculative or "incubator" basis, without prior commitments from firms to rent or purchase. The buildings can be constructed to minimize the need for modifications. Firms can lease them for limited periods of time, thereby reducing their start-up costs, and enabling them to test their market strength without a full-scale commitment. When used this way, site development is a critical part of a comprehensive approach to local redevelopment for distressed areas.

In this study, state industrial and commercial site development programs are defined as:

> Those program activities funded primarily by the state which develop or redevelop land, or make physical improvements to or for industrial or commercial sites for the purposes of attracting new private investment or enabling existing firms to expand.

This definition distinguishes site development from two other indicators: (1) financial aid for industrial or commercial development, and (2) capital improvements. As will be noted later, financial aid for industrial or commercial development involves physical site improvements. The capital improvements indicator involves physical improvements which primarily benefit an entire community, as in the case of a new pollution control system, rather than improvements to accommodate a specific firm.

The survey in 1983 found targeted site development activity in only eight states, up from three states with programs that met the criteria in 1980. The greatest period of new program growth occurred during 1982 (see Table 3-1). Seven of the nine programs in 1983 were located in the Northeast and Midwest, and the increase in the number of programs since 1980 is attributable to those same regions. Only one state, Pennsylvania, has more than one targeted program.

The primary purpose for one-third of the programs was to establish and develop urban industrial parks, while the purpose of another third was to acquire property and redevelop blighted urban areas. Three programs did not designate an urban emphasis. Vermont's Industrial Park and Speculative Buildings program has a well developed purpose statement typical of the intent of most programs:18/

> To alleviate and prevent unemployment and underemployment, and raise per-capita income within the state; to develop increased industry and to promote the general welfare of all citizens; to provide low-interest loans to local development corporations to purchase land for industrial parks for park planning and development, and erection of speculative shell buildings.

Every state's site development program was targeted to distressed places using either unemployment or criteria related to economic distress and blight. New Jersey's Community Development Bond Act of 1982 is targeted to "urban impact cities" using (1) high unemployment, (2) a low level of new capital investment, (3) a deteriorating tax base, and (4) depressed working and living conditions. This formula is quantifiable and is used for targeting a variety of economic development programs.

Site development programs are generally funded in one of two ways: (1) a one-time appropriation establishes a revolving loan fund, or (2) general obligation bonds are issued for acquiring property and construction. The level of such financial activity is not very high, ranging from $1 million in 1983 for Pennsylvania's Site Development Act to $17.5 million in general obligation bonds for the Massachusetts Community Development Action Grant program.

There is no single pattern for how site development programs work.

Table 3-1

TARGETED INDUSTRIAL AND COMMERCIAL SITE DEVELOPMENT PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983
New England	2(2)	2(2)	3(3)	3(3)
Connecticut	1	1	1	1
Maine				
Massachusetts			1	1
New Hampshire				
Rhode Island				
Vermont	1	1	1	1
Mideast	1(2)	1(2)	2(3)	2(3)
Delaware				
Maryland				
New Jersey			1	1
New York				
Pennsylvania	2	2	2	2
Great Lakes	0(0)	0(0)	0(0)	0(0)
Illinois				
Indiana				
Michigan		1	1	1
Ohio				
Wisconsin				
Plains	0(0)	0(0)	0(0)	1(1)
Iowa				
Kansas				
Minnesota				
Missouri				
Nebraska				
North Dakota				
South Dakota				
Southeast	0(0)	0(0)	0(0)	0(0)
Alabama				
Arkansas				
Florida				
Southeast (cont.)				
Georgia				
Kentucky				
Louisiana				
Mississippi				
North Carolina				
South Carolina				
Tennessee				
Virginia				
Southwest	0(0)	0(0)	0(0)	0(0)
Arizona				
New Mexico				
Oklahoma				
Texas				
Mountain	0(0)	0(0)	0(0)	0(0)
Colorado				
Idaho				
Montana				
Utah				
Wyoming				
Far West	0(0)	0(0)	1(1)	1(1)
Alaska				
California				
Hawaii				
Nevada				
Oregon				
Washington			1	1
Total States (Programs)	3(4)	4(5)	7(8)	8(9)

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.

Source: ACIR staff compilation based on interviews with state officials.

MICHIGAN'S URBAN LAND ASSEMBLY LOAN PROGRAM

Created in 1981, the Urban Land Assembly Fund is directed toward revitalizing the economic base of municipalities experiencing distress and decline. The fund, administered by the Department of Commerce, provides loans for the purpose of acquiring land for economic development, including industrial and downtown commercial projects. When the land is sold or leased to developers, the municipality repays the loan, thus making funds available for other projects.

Funds can be used not only to acquire land but also for demolition, relocation, and site improvements. Projects must be at least ten acres in size, though smaller sites will be considered if the Department of Commerce judges them to be "critical" or if they are located in a downtown development authority district.

No loan to a single municipality can exceed 50% of the assets of the fund in a given fiscal year.

Typically, however, state agencies make loans available to industrial development agencies, nonprofit local development corporations, or municipalities. The recipients use the funds to acquire and assemble land, to rehabilitate or construct buildings, and to make public works improvements, often for specified industrial parks. Michigan's Urban Land Assembly Loan Program is a good example of how this type of program works.

The Community Development Action Grant program in Massachusetts is an innovative approach to site development, based on the principles of the federal Urban Development Action Grant program (UDAG).

None of the eight states had conducted a program evaluation, although five programs had developed criteria for measuring their impact. The most frequently cited criteria were the number of jobs created, improved economic conditions in the area, and the number of firms retained, expanding, or moving to the area.

The experience of the states with targeted site development programs has led key agency personnel to make these recommendations to other states:[19]

1. Be sure that there is sufficient funding to finance the program -- at least $5 to $10 million over two or three years.

2. The state's role should be clearly defined. The specific role taken depends on the size of the state; the smaller the state the more direct the role it should have.

3. There is substantial value in using the leveraging principle to attract private investment.

In sum, there is very little targeted state activity in site development, although activity increased significantly since 1980. It appears that

MASSACHUSETTS COMMUNITY DEVELOPMENT ACTION GRANT PROGRAM

In 1981, the Department of Community Affairs realized that the number of qualified applications for the UDAG federal program was far greater than could be funded. Fearing that UDAG might be terminated or its funds reduced, and realizing that state funds for economic development might be limited, state officials moved to offer alternative approaches.

The Department proposed creating a state-funded Community Development Action Grant (CDAG) program to provide public funds for physical infrastructure improvements that would help attract private investment and business development. The program, passed by the legislature in 1982, provides $17.5 million from general obligation bonds. A total of $10 million was available in the first round of applications; $2.5 million is the maximum grant for any single project.

The CDAG program requires a public-private partnership to revitalize distressed areas. As in the national UDAG program, Massachusetts insists that public funds leverage private investment. Unlike the UDAG program, however, CDAG funds may only be used for publicly owned improvements such as access roads, water and sewer construction, or parking facilities.

All 351 cities and towns in the state are eligible to apply for CDAG, although the project must be sited in an economically distressed area. During the first round of applications, 27 communities submitted proposals. Fifteen were funded, with an average of $667,000 per project. Newbury's CDAG grant is being used to develop a site so that Samuel Cabot, Inc., a Chelsea-based paint and stain manufacturer, can move to the city. Leominster received a $650,000 grant that leveraged more than $6 million in private investment by two established firms.

this type of economic development activity is more suited to older, industrialized cities, although its full potential for aiding distressed communities has yet to be determined.

Financial Aid for Industrial and Commercial Development

Nearly every state engages in financial activity to improve its business development prospects aimed at job creation and ensuring long-term growth. As noted earlier, a traditional approach has been called "smokestack chasing," though recently states have expanded their focus to "high tech chasing." The drawbacks of several typical forms of financial aid to firms, such as tax rebates, have already been discussed, as has the unwillingness by many lenders to finance investments in highly distressed areas. A central problem for state economic development programs is to correct the inefficiencies of private capital markets, and to ensure that enough development capital is available in distressed areas.

In this study, targeted financial aid for industrial and commercial development is defined as:

> Any state-financed program that provides financial assistance to a business enterprise which locates, stays, expands, or starts up in a distressed area.

Such financial assistance is generally provided directly to a firm through a state department of development, a state-authorized development finance agency, a private nonprofit community development finance corporation, or through tax policies. Since 1981, enterprise zones have emerged as a geographically targeted instrument for directing certain types of development finance to distressed areas, and they will be discussed in more detail later in this section. There is also a broad range of financial assistance available through various institutions, from bonds and grants to loans and equity participation by the state.

Every state has some type of economic development agency. In larger states, or where the problems are particularly severe, a number of institutions have been created to address development finance issues. For example, Massachusetts has a governor's development cabinet consisting of the secretaries of key agencies concerned with aiding communities, as well as (1) the Industrial Finance Agency which handles traditional industrial development activities and an array of innovative programs, (2) the Community Development Finance Corporation providing financial assistance to community based development corporations and their ventures, and (3) the Technical Development Corporation that looks for growth-oriented investments.

However simple or complex a state's institutional arrangement is, an overall economic development plan for financing state aid for business development, particularly in distressed areas, is essential. The plan would consider the dimensions of the development finance problem, determine what level of state intervention is appropriate, and then use the most appropriate finance tools.

Available tools include four major kinds of financial aid -- grants, loans, interest subsidies, and equity financing -- plus a variety of tax incentives, including credits, abatements, and exemptions. Each is described in Exhibit 3-4. Nonfinancial assistance or physical improvements are not considered in this section.

In 1983, 22 states had a total of 36 targeted financial aid programs, not including enterprise zones, which are considered below (see Table 3-2). The number of states engaged in targeted assistance strategies nearly doubled in the 1980-83 years, reflecting an increased concern with the problems of business development in distressed communities.

The primary purpose of nearly every financial assistance program is to stimulate industrial and business development in distressed areas, particularly urban areas. Pennsylvania's Industrial Development Authority Act provides a well developed and representative statement of purpose:20/

> To alleviate unemployment with its resulting spread of indigency and economic stagnation by the promotion

Exhibit 3-4

STATE FINANCIAL AID AND TAX INCENTIVES FOR BUSINESS DEVELOPMENT

I. FINANCIAL AID

A. Grants

Grants provide direct transfers of state financial resources to recipient firms. Firms generally prefer grants because they need not be paid back. For the same reason, however, grants are expensive to states, and are seldom offered by state development programs.

B. Loans

Loans permit firms to borrow money directly from the state government or its agents, such as economic development corporations and financial authorities. Rates of interest on direct loans from states may be either at or below the prevailing market rate from commercial lending sources. Loans with market rates of interest are useful primarily to firms unable to secure financing from commercial lenders, thus providing the firm access to financial capital. New or small firms without established lines of credit or credit ratings and those engaged in highly speculative ventures find state loan programs particularly advantageous.

For many firms, however, direct loans are not useful unless they are subsidized or are soft loans with interest rates below prevailing market rates. Often, firms applying for subsidized state loans must demonstrate that financing is not available from conventional sources or is available only at rates at which the projects become unprofitable.

A number of states now administer loan programs through revolving loan funds (RLFs) capitalized by nonrecurrent legislative appropriations, federal funds, and private capital. The principal of RLFs is continuously recycled as repayments of outstanding loans return to the fund and are subsequently used to make loans to other businesses. Interest payments are often used to pay administrative costs of RLFs. One obvious advantage of the revolving loan mechanism is that it provides a self-renewing pool of funds for loans to businesses. Once established, revolving loan funds are not subject to the uncertainty of state legislative appropriation processes. Therefore, funds available for business loans in a given fiscal year can be estimated with relative precision.

C. Interest Subsidies

Exhibit 3-4 (Cont.)

State subsidies on rates of interest for loans from commercial lending institutions reduce the cost of borrowing to businesses.

(1) Direct Subsidies. Although they seldom do so, states can reduce interest rates to borrowers by paying direct subsidies to lenders. Alternatively, states can indirectly subsidize interest rates by depositing state reserves in financial institutions that agree to make commercial loans to specific classes of borrowers at reduced interest rates.

(2) Loan Guarantees. The state guarantees a loan by agreeing to compensate the lender for some portion or all of the outstanding principal and interest on the loan if the borrower defaults. Loan guarantees are a means of making commercial loans available to high-risk enterprises, as well as new and small firms.

(3) Industrial Revenue Bonds. The financial incentive used most extensively by states is industrial revenue bonds (IRBs), authorized and issued by a public agency or authority to provide financing for acquisition of fixed assets in approved industrial projects.

(4) General Obligation Bonds. A less common type of bond is the general obligation (GO) bond. These differ from industrial revenue bonds in that they are backed by the full faith and credit of the issuing government, which assumes the risk associated with the bond issue. If a firm defaults on repayments of GO the issuing government or its agency compensates holders of the bonds.

(5) Umbrella Bonds. General revenue bonds are issued to provide financing for industrial projects for a number of firms when an individual project is so small that the fixed costs of issuing the bond are prohibitive relative to the required capital, or when a firm does not have an adequate credit rating to qualify for an IRB.

D. Equity and Near-Equity Financing

Most forms of financial incentives provide debt capital financing to firms, with the borrower assuming the obligation to repay the loan on a relatively fixed schedule regardless of the financial status of the firm. Equity financing provides financial capital to firms with a variable rather than fixed pay-back obligation. The timing and size of payments are a function of the financial conditions of the firm, rather than the conditions of the award, with repayment based on future income or profitability of the firm. Firms receiving equity investments need make no payments until they generate profits.

Exhibit 3-4 (Cont.)

There are three basic financing mechanisms for transferring equity capital to a firm: common and preferred stock, and convertible debt. Both forms of stock purchase generally mandate a payback to the investing government or agency of a prorated percentage of the firm's earnings, with preferred stock taking precedence and the common stock carrying voting rights. With each, the obligation to the government or its agency may be subordinated to other investments capitalizing the firm. Convertible debt allows the government investor to straddle equity and debt instruments by permitting the conversion of loans or bonds to common stock, trading the probability of full repayment for a share of the potentially greater returns.

Royalty agreements, another equity-like financing tool, are similar to stock purchases, but repayment is a fixed percentage of the returns from the sale of the firm's product once it is marketed.

Warrants are a further example of the equity participation. They are contracts giving the holder the option to purchase a certain number of a company's shares at a fixed price for a certain period of time, and are most frequently "sweeteners" issued by a company as part of a package with a bond, debenture, or note. In exchange for this sweetener, the state provides the accompanying debt financing at terms favorable to the borrowing company.

II. TAX INCENTIVES

Depending on the state, the type of firm, and its financial status, a firm is potentially subject to business income taxes; property taxes on land and structures and, in some states, on equipment and inventories; sales and use taxes; excise taxes; license fees; and payroll taxes. Abatements, exemptions, and moratoriums on any of these taxes are financial incentives to firms.

To benefit from deductions or credits against its business income tax liability, a firm usually must be of a particular type or be in specified industries, make an eligible type of capital investment, or hire particular types or numbers of workers. Some states also offer tax credits for purchase of goods produced within the state and accelerated depreciation allowances for eligible investments. Any form of concession on business income taxes is an incentive only to firms making taxable profits. Abatement or exemption from sales taxes is a common state tax incentive. Property tax abatement on land, buildings, equipment, inventories, and goods in transit are a third type of tax incentive frequently offered by states.

Table 3-2

TARGETED FINANCIAL AID PROGRAMS FOR INDUSTRIAL AND COMMERCIAL DEVELOPMENT BY STATE, 1980-83*

Region and State	1980	1981	1982	1983
New England	3(8)	3(8)	3(8)	3(8)
Connecticut	3	3	3	3
Maine				
Massachusetts	4	4	4	4
New Hampshire				
Rhode Island				
Vermont	1	1	1	1
Mideast	3(8)	3(9)	3(10)	3(10)
Delaware				
Maryland				
New Jersey**	5	5	5	5
New York**	1	2	3	3
Pennsylvania	2	2	2	2
Great Lakes	3(3)	3(3)	5(5)	5(6)
Illinois	1	1	1	2
Indiana	1	1	1	1
Michigan			1	1
Ohio	1	1	1	1
Wisconsin			1	1
Plains	1(1)	1(1)	2(2)	3(3)
Iowa	1	1	1	1
Kansas				
Minnesota				1
Missouri				
Nebraska			1	1
North Dakota				
South Dakota				
Southeast	0(0)	0(0)	0(0)	0(0)
Alabama				
Arkansas				
Florida				
Southeast (cont.)				
Georgia				
Kentucky				
Louisiana				
Mississippi				
North Carolina				
South Carolina				
Tennessee				
Virginia				
West Virginia				
Southwest	1(1)	1(1)	1(1)	1(1)
Arizona				
New Mexico				
Oklahoma				
Texas	1	1	1	1
Mountain	0(0)	0(0)	0(0)	0(0)
Colorado				
Idaho				
Montana				
Utah				
Wyoming				
Far West	1(1)	3(5)	3(5)	3(5)
Alaska	1	1	1	1
California		1	1	1
Hawaii				
Nevada				
Oregon				
Washington		3	3	3
Total States (Programs)	12(22)	14(27)	17(31)	18(33)

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.

* Programs in this table do not include enterprise zones.

** The New York-New Jersey Port Authority has a bi-state aid program; it is recorded under New York.

Source: ACIR staff compilation based on interviews with state officials.

> development of industry and manufacturing enterprises in those areas in which conditions of critical unemployment currently or may from time to time exist.

Besides high unemployment, other measures of distress include "blight," status as a "critical economic area," and eligibility for federal UDAG aid.

States use four types of targeted programs for business development: financial aid, tax incentives, community development finance corporations, and plant closing assistance. These are often used in combination as part of an overall strategy.

Financial Assistance. Twenty of the 22 states that in 1983 provided financial aid for industrial and commercial development gave some kind of loan, loan guarantee, or revolving loan fund assistance. New Jersey's Local Development Financing Fund Act is a good example of the maximum use of the loan power.

NEW JERSEY'S LOCAL DEVELOPMENT FINANCING FUND ACT

This act establishes a state urban development action grant program, with a revolving loan fund which can be used by business in distressed areas sponsored by municipalities. The public fund can be used to leverage private dollars for development projects "where it would not otherwise occur;" 80% of the state funds are placed in a revolving loan fund. Businesses are eligible for loans, loan guarantees, state equity participation, and grants. Private funds are leveraged at a 3:1 ratio.

Bonds are used in five states, while working capital loans are available in four states. Grant assistance is available only in Vermont under its Economic Development Grant Program.

Tax Incentives. Tax incentives are used by less than half of the 22 states. They include income tax credits, employment tax credits, and exemptions on property taxes for certain areas and for equipment. Many of the specific tax incentives used will be reviewed in the enterprise zone section of this chapter. An innovative use of tax policy is New York's High Risk Targeted Investment Fund, administered by the Urban Development Corporation (UDC). This act allows UDC to take title to real estate, avoiding the construction sales tax. The Urban Development Corporation, however, then makes a public purpose payment to the state in lieu of the sales tax, and it is used specifically for public improvements related directly to the real estate project. The private firm involved in the project then buys the project back.

Community Development Finance Corporations. Community development finance corporations (CDFCs) have been started in four states, growing out of a program Massachusetts began in 1975. Community development finance authorities or corporations are either nonprofit or for-profit corporations which are initially financed by general obligation bonds. The proceeds of these bonds are used to take equity positions in ventures initiated by community based development corporations (CDC). These ventures are usually high risk deals in distressed neighborhoods. CDFCs create a public sector capital market aimed at directly addressing the market failure problem.

MASSACHUSETTS COMMUNITY DEVELOPMENT FINANCE CORPORATION

CDFC offers three investment programs:

1. The Venture Capital Investment Program creates a three-way partnership between CDFC, a business, and a CDC. Investments are selected not only for soundness of the business plan of the company but also for the potential community benefits. CDFC investments are structured as debt (interest-bearing loans at negotiable rates and terms) and as equity (the purchase of common stock). In most situations, CDFC seeks an equity position in the company which is shared with the participating CDC. Every attempt is made to leverage the participation of other public and private funding sources, and CDFC will often subordinate its interest to other lenders to bring about such participation.

2. The Community Development Investment Program offers flexible, short to medium-term financing to CDC-sponsored housing and commercial/ industrial real estate projects. CDFC may lend or otherwise invest up to 20% or $250,000, whichever is less, to CDCs in Massachusetts to be used as front-end financing for essential, project-specific and recoverable development expenses incurred prior to full project financing, as a source of CDC "equity" where such a need exists. CDFC funds are intended to complement and leverage other public and private sources of construction and permanent financing, not to replace them.

3. Small Business Loan Guarantee Program was created to make commercial credit more available to small businesses located in CDC target areas. It is a streamlined program designed to minimize processing time and administrative costs. CDFC may guarantee up to 50%, not to exceed $25,000, of a loan made to an eligible small business by a participating financial institution, when such a guarantee is requested by an eligible CDC.

Plant Closing Assistance. A final approach to assisting businesses in distressed communities is to provide economic adjustment assistance to communities expecting or responding to a plant closing. California has pioneered in this area, using existing state financial and technical assistance resources to help businesses, employees, and communities make the transition.

Only one state was conducting a program evaluation of financial assistance programs as of 1983; Massachusetts' five-year review of the CDFC program focused on internal management issues. At least half of the 22 states, however, have developed criteria by which program impact could be assessed. These criteria include primarily the number of jobs created or retained, a

CALIFORNIA'S ECONOMIC ADJUSTMENT TEAM

In response to approximately 1,200 plant closings, throwing more than 105,000 persons out of work, Governor Jerry Brown in 1981 created the California Economic Adjustment Team (CEAT) to help communities either anticipate and avert plant closings, or to ease the transition where closings had already occurred. The CEAT idea was enacted into law in 1982.

In selecting communities for state aid, the team directs its efforts to those with large numbers of displaced workers, where economic conditions are such that the recently unemployed cannot be easily absorbed and the community's ability to respond effectively is limited.

When a plant closes or a closing is anticipated, a community may obtain assistance by having community leaders, employers, and unions draft an economic action program and submit it to the team. In addition, the team itself may find out about a closing and seek out community leaders to develop an economic action plan.

CEAT marshals state resources, such as by setting up workshops on economic adjustment, targeting retraining programs to displaced workers, and, in some cases, helping employees buy the business that is closing. Local initiative is essential; the assistance package is tailored to local circumstances .

In Weed, when the International Paper mill was closing, CEAT provided counseling and training assistance to management, union, and community representatives on the feasibility of a worker buy-out. In Salinas, CEAT assisted the Spreckel's Ethanol Conversion project to see how the sugar mill could produce ethanol fuel for use by city vehicles. Community response committees were created in Fremont, San Jose, Modesto, and Milpitas to respond to possible automotive plant closings. The Masonite Corporation was aided in developing an energy-saving program, including a cogeneration project, to reduce operating costs and therefore avert a possible 1983 closing.

substantial increase in state and local tax revenues, and private dollars leveraged.

Program administrators offered the following recommendations for designing future programs:21/

1. The finance agency must be independent from the state to be able to act effectively in financing deals.

2. There should be well defined measures of public benefit.

3. The programs must have the backing of the governor, be sufficiently staffed and funded at the start, and have the tax incentives and financial assistance necessary to attract private investment.

4. There should be a public-private leveraging requirement.

5. Criteria for loans should be clearly spelled out.

6. All development program elements, like technical assistance, should be under one roof.

State Enterprise Zone Programs

The Reagan Administration has advanced the enterprise zone concept as its primary approach to attracting private capital to distressed communities. In his statement accompanying the introduction of the Enterprise Zone Tax Act of 1982 on March 23, 1982, the President said:22/

> The enterprise zone is based on utilizing the market to solve urban problems, relying primarily on private sector institutions. The idea is to create a productive free market environment in economically depressed areas by reducing taxes, regulations and other government burdens on economic activity.

Enterprise zones, as originally proposed by the Heritage Foundation in 1980,23/ are supposed to revitalize the cities by

> encouraging entrepreneurs to take the risk of setting up a business by removing unnecessary obstacles and reducing taxes. It seeks to establish an entrepreneurial climate in the neighborhoods, rather than embark on a policy of selecting particular firms which would then receive government aid.

Blaming urban economic distress primarily on the failure of past "centrally planned" federal programs such as Model Cities, conservative proponents of urban enterprise zones argue that, once unleashed, the "invisible hand" of the free enterprise system will result in economic growth and the eventual revitalization of urban economies. Proponents emphasize the importance of creating new small businesses in the zones, because such firms have been found to create two-thirds of all new jobs in the country.24/

The administration plan would be a three-year experiment, with up to 25 zones designated each year, for a total of 75 zones. HUD would administer the experiment, for which 2,000 large cities would be eligible; rural areas and Indian reservations would also be eligible to apply. The primary tools used to stimulate private investment would be tax incentives and regulatory relief. Early statements of the concept called for adding other incentives to business formation, such as suspension of minimum wages for youths, creating free trade zones to allow products to be assembled for export without taxation, and eliminating local rent control laws. These additional measures, however, are not part of the federal bill, nor of any of the state laws passed so far.

The concept is controversial. Not all advocates of economic revitalization think the approach will work without providing small firms access to the capital and markets they need.25/ Small firms often cannot take advantage of tax credits and large firms create more jobs than do small firms taken together. A targeted development finance program combining site development, financial and technical assistance, and other development resources in a strategy of "bargained development" or partnerships involving public, private, labor, and community sectors has been proposed as a practical alternative.

While the federal bill on enterprise zones languished in Congress in 1981-83, 19 states passed their own enterprise zone bills (see Table 3-3), though only a handful of these were implemented by 1983. One-third of the states with bills are in the Southeast, more than double the total in any other region. This stands in sharp contrast with other types of targeted economic assistance programs, which are used less in the South than elsewhere.

All state bills have fairly uniform purposes and targeting criteria. Their primary purpose is to stimulate business and industrial growth in depressed areas through tax incentives and other assistance to business, thereby creating jobs. Targeting is always to economically distressed areas, as measured by high rates of unemployment, welfare, poverty, and physical deterioration.

But that is where uniformity ends. Each program offers different incentives and has a different system for program implementation. Every program uses tax incentives: some are use or sales tax exemptions, while others are investment or employment tax credits.

Only the Connecticut program has been evaluated by the U.S. Department of Housing and Urban Development. The results have not yet been released. Other programs have set state evaluation criteria, including job creation and retention, and new or expanded business in the zone.

State enterprise zone staff made a number of recommendations for other states in designing these programs:26/

1. Limit the number of zones in the program to increase the resources targeted to each.
2. Look at the development goals you want to meet, and tailor your tax and other incentives accordingly.
3. Do not provide incentives to businesses before the jobs are created.
4. Provide a plan, obtain support from the Governor, and coordinate other development resources available for the zones.
5. Have the state legislature consider the amount of forgone revenues the program will involve and set a ceiling.

The enterprise zone initiative is only an experiment. Without the federal program, limited resources have been committed to the programs, and there is insufficient experience to determine how effective this approach may be. The concept to date, however, has heightened awareness of the need to target resources to distressed communities.

Customized Job Training

Government efforts related to economic development include not only

Table 3-3

STATE ENTERPRISE ZONE PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983
New England	0(0)	0(0)	1(2)	2(3)
Connecticut			2	2
Maine				
Massachusetts				
New Hampshire				
Rhode Island				1
Vermont				
Mideast	0(0)	0(0)	1(1)	2(2)
Delaware				
Maryland			1	1
New Jersey				
New York				
Pennsylvania				1
Great Lakes	0(0)	1(1)	2(2)	3(3)
Illinois			1	1
Indiana				1
Michigan				
Ohio		1	1	1
Wisconsin				
Plains	0(0)	0(0)	2(2)	3(3)
Iowa				
Kansas			1	1
Minnesota				1
Missouri			1	1
Nebraska				
North Dakota				
South Dakota				
Southeast	0(0)	0(0)	4(5)	7(8)
Alabama				
Arkansas				1
Florida			2	2
Southeast (cont.)				
Georgia				1
Kentucky			1	1
Louisiana		1	1	1
Mississippi				1
North Carolina				
South Carolina				
Tennessee*				
Virginia			1	1
West Virginia				
Southwest	0(0)	0(0)	1(1)	2(2)
Arizona				
New Mexico				
Oklahoma			1	1
Texas				1
Mountain	0(0)	0(0)	0(0)	0(0)
Colorado				
Idaho				
Montana				
Utah				
Wyoming				
Far West	0(0)	0(0)	0(0)	0(0)
Alaska				
California*				
Hawaii				
Nevada				
Oregon				
Washington				
Total States (Programs)	0(0)	2(2)	11(12)	19(21)*

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.
* California and Tennessee legislatures passed enterprise zone laws in 1984.

Source: ACIR staff compilation based on interviews with state officials those designed to encourage business activity but also those aimed at combating unemployment in various ways. The federal government first became involved in programs to alleviate unemployment during the Great Depresssion of the 1930s, when the Public Works Administration and later the Works Progress Administration directly created thousands of jobs with federal subsidies. More recently, the now discontinued public service employment component of the Comprehensive Employment and Training Act (CETA) provided federal funds to state and local governments to subsidize positions in government agencies and nonprofit organizations.

These programs were intended to reduce umemployment during periods of economic downturn. They were temporary and were aimed at areas with especially high unemployment.

Since the 1960s, other government efforts have been made to alleviate long-term or "structural" unemployment. Such programs focus on categories of people who are likely to have poor employment prospects even in a robust economy. They attempt to provide such people with the skills and work experience they need to find and hold jobs.

Since 1982, the primary vehicle for direct federal efforts against unemployment has been the Job Training Partnership Act (JTPA). Compared with its predecessor, CETA, the current program gives far greater responsibility for planning and coordinating training programs to state governments, and involves private business representatives to a greater degree. JTPA makes no provision for federally subsidized public service jobs, and reduces the federal government's role to one of setting goals.

Under JTPA, the governors, with the assistance of state coordinating councils, divide their states into service delivery areas (SDAs). Within each SDA, a private industry council (PIC) is named, with a majority of members from the private sector. Working in conjunction with government officials of the localities covered in the SDA, the PIC sets policies and oversees program operations.

Because of their expanded role under JTPA, the states are now the focus of activity for employment and training programs. Virtually all states have two kinds of interrelated human resource programs: training tailored to the needs of specific industries or firms, and programs that collect and analyze data on the state's work force.

Tailored training programs are often called "customized job training" (CJT). The basic idea behind them is to link the labor force with business development needs. The tendency in the past has been to tailor training programs to particular firms with few stipulations. But because of its targeted focus, CJT permits states to aid distressed communities by directing this aid to firms locating in distressed areas or to firms hiring the unemployed.

For purposes of this report, the latter rather than the former represents real targeting. A targeted customized job training program is one where the state government prepares labor pools to meet the specialized needs of new or or expanding industries, with the objective of encouraging firms to locate or expand in distressed areas of the state.

CJT programs do not create new jobs; they simply link workers to existing jobs. Also, there is a tendency not to develop CJT programs as part of an overall economic development strategy, particularly for distressed areas. Furthermore, the existance of a CJT program in and of itself does not guarantee coordination between the human resource agency, the state vocational education system, or development finance agencies seeking to develop business. States need to recognize the inherent linkage between these agencies, and plan and implement programs accordingly, if they are to reduce program overlap and increase effectiveness.

Objections to targeting CJT programs to distressed people or places, but rather than to firms have been that the states cannot afford it and that the economy is such that they must provide this aid to any industry asking for it regardless of where they locate or who they will hire. This dual objection is raised, however, in the face of economic evidence to the contrary. The Brookings Institution recently published a study showing that the national unemployment rate could be cut by about 0.6%, or 500,000 jobs, with no increase in inflation, if subsidies were targeted to workers in markets where there is greatest unemployment.27

The target audiences for CJT programs include not only the long-term unemployed, but also dislocated workers, minorities, women, low-income people, unemployed youths, and displaced homemakers. If job training programs can be targeted to these specific groups, the economic and social benefits from employing previously unemployed people and reducing the state's unemployment and welfare burden may outweigh the costs of the programs themselves.

One important caveat must be acknowledged. Even if CJT programs were targeted to the unemployed, there is no guarantee that the jobs people will get are high quality or long term, offering opportunities for advancement.

Only 11 states had targeted customized job training programs in 1983, an increase of six states since 1980 (see Table 3-4). The most programs, four, are found in Plains states. Every other region except the Southeast has at least one qualifying program.

Two programs are particularly good examples of how such a program can work: the Massachusetts Bay State Skills Corporation and California's Worksite Education Training Act.

Small and Minority Businesses

Capital market failure has already been noted as a major problem facing distressed communities. While access to capital is a problem for larger firms in areas considered by lenders to be too risky for investment, it is even more difficult for smaller firms which experience a high rate of failure in their early years.

Nonetheless, independently owned firms with fewer than 100 employees are essential to the economic health and stability of distressed communities.28/ They not only serve the industrial sector as suppliers and subcontractors, but also comprise the retail and commercial backbone of a community. Furthermore, small enterprises provide opportunities for entrepreneurs to enter into the

Table 3-4

TARGETED CUSTOMIZED JOB TRAINING PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983
New England	0(0)	1(1)	1(1)	1(1)
Connecticut				
Maine				
Massachusetts		1	1	1
New Hampshire				
Rhode Island				
Vermont				
Mideast	0(0)	0(0)	0(0)	2(2)
Delaware				1
Maryland				
New Jersey				
New York				
Pennsylvania				1
Great Lakes	1(1)	1(1)	1(1)	1(1)
Illinois				
Indiana				
Michigan				
Ohio	1	1	1	1
Wisconsin				
Plains	2(2)	2(2)	3(3)	4(4)
Iowa				1
Kansas			1	1
Minnesota	1	1	1	1
Missouri				
Nebraska				
North Dokato	1	1	1	1
South Dakota				
Southeast	0(0)	0(0)	0(0)	0(0)
Alabama				
Arkansas				
Florida				
Southeast (cont.)				
Georgia				
Kentucky				
Louisiana				
Mississippi				
North Carolina				
South Carolina				
Tennessee				
West Virginia				
Southwest	1(1)	1(1)	1(1)	1(1)
Arizona				
New Mexico				
Oklahoma	1	1	1	1
Texas				
Mountain	0(0)	0(0)	1(1)	1(1)
Colorado				
Idaho			1	1
Montana				
Utah				
Wyoming				
Far West	1(1)	1(1)	1(1)	2(2)
Alaska				
California	1	1	1	1
Hawaii				
Nevada				
Oregon				
Washington				1
Total States (Programs)	5(5)	6(6)	8(8)	12(12)

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.

Source: ACIR staff compilation based on interviews with state officials.

TWO INNOVATIVE PROGRAMS: MASSACHUSETTS AND CALIFORNIA

Bay State Skills Corporation

Established by the Massachusetts legislature in 1981, this quasi-public corporation seeks to turn out trained workers needed in the state's high-growth industries, including high-tech firms, machine trades, health-related firms, and clerical work.

BSSC provides grants to educational and training institutions, which must receive matching grants from the private sector. Business and industry not only make a financial commitment to the program but also are involved in planning and help in designing curriculum and providing teachers.

The corporation makes a special effort to meet the training needs of welfare recipients, workers dislocated by plant closings, unemployed youths, and former public employees laid off after state voters approved an initiative limiting local property taxes. A firm that participates in a training program targeted to one of these groups must match only 20% of the BSSC grant, compared to 100% for an untargeted program.

California's Worksite Education and Training Act

CWETA trained people for specific, existing jobs in participating firms from its start in 1979 until the new governor vetoed the fiscal year 1983 appropriation. Employers participated in the design and operation of entry-level programs and upgrade programs. The training was similar to apprenticeships: participants received on-the-job training by day and classroom training after hours.

CWETA programs have trained workers for nursing, machine trades, and the electronics and aerospace industries, all of which had shortages of trained workers. Of those who completed the training, 82% found jobs. The program was targeted to displaced workers, minorities, youths, the underskilled, the economically disadvantaged, and Vietnam veterans.

private market system. Enterprise development and commercial revitalization efforts, in the context of a comprehensive state economic development plan, can create jobs, provide stability to the local economy, and anchor economic revitalization in distressed areas.

Researchers have pointed to three areas where small enterprises benefit the economy: job generation, innovation and invention, and distressed area development.29/ The actual number of jobs that small firms generate has been the subject of some controversy in the past few years, but it is known that individual companies (not subsidiaries or franchises) with fewer than 20 employees account for nearly 90% of all companies, employ about 20% of the labor force, and account for 17.8% of all payrolls. In addition:

1. Small businesses contribute somewhat more than their share of baseline employment to net new jobs created. Small establishments create a very large share of the new jobs generated in the economy.

2. New and small businesses are more likely to die than older and larger enterprises.

3. Small businesses provide a larger share of net new jobs in slowly growing regions than in rapidly growing regions.

Second, new and small businesses are considered to be major sources of innovation. One study found that 23% of all innovating institutions were firms employing fewer than 100 employees, and these firms produced four times as many innovations per research and development dollar as firms with 1,000 to 10,000 employees, and 24 times as many as firms with over 10,000 employees.

Third, small and minority-owned firms play a significant role in generating jobs in distressed areas. Construction, manufacturing, and producer services are sectors which have a high rate of return, suggesting the potential for growth and profit. Only a few of these firms, however, are minority-owned.

For purposes of this report, a small business program was defined as one aimed at firms of fewer than 100 employees in distressed areas where the firms have been denied access to conventional financing. A minority business program qualified for inclusion in this study if it assisted firms anywhere in the state in which at least 51% of the stock was owned by minorities.

There are four major barriers to the success of small and minority-owned firms in general, and particularly in distressed areas: lack of equity capital, lack of debt capital, lack of access to knowledge and technical assistance, and discrimination. Some of these problems originate in the private marketplace, and some are created by federal or state policies.

Equity Capital. For small firms, equity capital is critical during the first 3-5 years, although the money needs are different at the various stages of development.[30] In the start-up phase, entrepreneurs need enough venture capital to get the enterprise off the ground. That capital usually comes from the owner's own sources, family, or other investors. Once the enterprise reaches the product design and implementation stage, it needs a substantial injection of cash which comes either from the same sources or from research or grant funds. Finally, once the firm has stabilized, it will need equity capital again when it decides to expand.

There is plenty of venture capital available, at a price, although these capital markets are rarely open to small or minority enterprises, because they are considered too risky. The lack of equity capital in the very early stages is one of the primary reasons for the high rate of small business failures, estimated at over 90% in the first five years.

Debt Capital. Securing long-term debt financing is often directly related to low levels or lack of equity financing. In fact, the lack of equity investments is cited in a survey of bank loan officers as a frequent reason for refusing a loan. Other problems small firms experience include:[31]

1. Loan Classification Procedures. Some studies have found that because certain types of loans are classified by bank inspectors as requiring an increase in reserves and expensive biweekly reports, the cost of small business lending is made unnecessarily expensive.

2. Tax Disincentives. The costs of bad debts cannot be written off immediately.

3. Transaction Costs. The costs of processing and servicing a loan do not increase proportionately with the size of the loan, and therefore banks try to concentrate on larger, lower-cost loans.

4. Regulation of Financial Institutions. All financial institutions are heavily regulated at both the state and the federal level. These regulations often govern the type of loans and investments that the institutions are allowed to make.

Access to Knowledge and Technical Assistance. Knowledge about new technologies, market opportunities, locational costs, and state and federal tax and regulatory policies is critical to a new firm, but acquiring such information is very expensive. Financial, managerial and legal expertise is also expensive and sometimes not available when it is needed by the firm. In fact, after capital problems, management is the biggest reason for small business failures.

Discrimination. For a variety of social and economic reasons, lenders tend to view minority-owned firms as riskier investments than firms owned by Whites. Inexperienced management and lack of access to capital, markets, and support services all contribute to the low level of minority business formation and the high rate of failure.

Federal assistance to small firms has been offered primarily through the Small Business Administration (SBA) and the Department of Commerce. Since 1953, SBA has offered more than $25 billion in loans and loan guarantees to entrepreneurs who have been denied credit from traditional sources, have low incomes, are located in areas with high unemployment, or meet other criteria of need.32/ Programs of the Small Business Investment Company (SBIC) and Minority Enterprise Small Business Investment Company (MESBIC) also make equity and venture capital available to socially and economically disadvantaged enterprises. SBA also provides project grants, the Small Business Research Innovation Program and set-asides, Section 8(a) set-asides for minority-owned firms, and technical assistance.

The Department of Commerce's Minority Business Development Agency (MBDA) offers project grants, business counseling, and management assistance to businesses owned and operated by minorities. Commerce, SBA and the Department of Housing and Urban Development are also cosponsors of the Small Business Economic Revitalization Program. Twenty-six participating states have established public-private small business economic revitalization corporations to aid small businesses with expansion financing and to stimulate job creation. Federal funding is matched by the state.

Federal programs have sought to address the capital, market access, and technical knowledge problems of small firms. These firms still lack equity capital, however, and federal resources are too small to reach all small firms in need of help. The states have an opportunity to play an active role.

A few states have done so by establishing direct loan programs, revolving loan funds, statewide certified development corporations, and technical assistance. Minnesota, for example, provides supplemental funding through its Development Loan Fund in packages where the owner's equity is not enough to match the available private funding. Colorado has a linked deposit program where the state treasurer can deposit state funds in different regions of the state at different rates to encourage investments in those regions.

The opportunities for an expanded state role, however, are substantial. The National Conference of State Legislatures has made a number of recommendations for state action in four areas: government recognition of small business problems, access to capital, regulatory reform, and improving the competitive position of small business.33/

1. Government Recognition of Small Business Problems. The tendency of legislatures has been to focus on large corporations; they need to be aware of the economic importance of small firms and be more sensitive to their needs. Actions that can be taken include:
   a. creating a legislative small business committee;
   b. holding statewide small business conferences; and
   c. establishing offices of small business advocacy.

2. Access to Capital.
   a. Usury ceilings should be made more flexible.
   b. Tax reductions should be granted for investments made in small businesses.
   c. State assisted loan programs need to be created.
   d. Equity investments can be encouraged by removing barriers to state pension fund investments in small businesses; also, state-initiated venture capital funds should be considered.

3. Regulatory Reform. A review of state regulations and paperwork requirements of small businesses is needed; a one-stop licensing and permitting process can also reduce small business costs.

4. Improving the Competitive Position of Small Business.
   a. Prompt payment legislation is needed to require state agencies to pay their bills within 30 days.
   b. Small claims courts are needed to process disputes quickly.
   c. Reform of the inheritance tax laws can reduce a significant burden on the owners of small family businesses.
   d. Small business set-asides for state procurement and contracts, say 10%, provide a market for the products of small firms.

Absent from these recommendations is the encouragement of small business development in distressed areas and the formation of minority firms.

ACIR survey results in this category were divided into two parts: (1) targeted small business assistance and (2) minority business assistance. In the first part, only eight states have qualified programs, and the number of programs is too small to discern any pattern of regional activity. Only one of these eight programs has been started since 1980 (Table 3-5). Thus, whatever targeting states have done in this area occurred prior to the recent upsurge of interest in small business.

The main purpose of these targeted programs has been to provide loans, loan guarantees, and low-cost financing to small firms. The definition of "small," however, varies from state to state. Some states use the SBA definition of fewer than 500 employees and others use either a smaller number of employees or annual sales volume.

Maryland is the only state that has created a Small Business Development Finance Authority. Passed in 1978, the authority makes short and long-term loans, provides loan guarantees, and leverages private lending institution financing at a 3:1 ratio.

Hawaii's Capital Loan Program, passed in 1963, targets assistance to firms with fewer than 500 employees that are unable to get conventional financing. These firms must create jobs, be engaged in "clean" industry, and meet the goals of the Hawaii State Plan. Firms can get 7.5% loans for a maximum of 20 years for up to 90% of the deal. Commercial banks participate in the program by submitting the loan package to the Department of Planning and Economic Development for approval. In 1982, the program was responsible for creating or maintaining 648 jobs, leveraging $26.6 million in private financing on $11.9 million in state funds.

State minority business assistance is more widely available than small business programs. As Table 3-6 shows, 26 states had programs providing some type of assistance to minority-owned and controlled firms by 1983, although the level of financial activity in most programs is negligible. Over half of the state aid programs are found in two regions, the Southwest and the Great Lakes. All but six of the programs existing in 1983 were begun before 1983, and all but eight were begun before 1980.

The primary purpose of nearly every minority business assistance program is to provide management technical assistance, education and training, and loan packaging assistance. In addition, ten states provide state procurement set-asides, and several states provide oversight and monitoring of the procurement process to increase minority participation. Ohio and Illinois are among the states that have set definitive guidelines for all state agencies, requiring 10% to 15% of all state procurement and contracts to go to minority-owned and minority-operated firms.

Other state agencies have created revolving loan funds; provided bonding assistance, access to working capital, loans, and loan guarantees; and have established bidders lists for minority firms. Minority business directories, public relations efforts, and state marketing of minority firm capabilities are also provided in eight states.

Ohio's Minority Business Financing Commission was created in 1981 to provide financial and technical assistance to firms owned and controlled by "socially or economically disadvantaged persons." The commission created a

Table 3-5

TARGETED SMALL BUSINESS DEVELOPMENT PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983
New England	1(1)	1(1)	1(1)	1(1)
Connecticut	1	1	1	1
Maine				
Massachusetts				
New Hampshire				
Rhode Island				
Vermont				
Mideast	2(3)	2(3)	2(3)	2(3)
Delaware				
Maryland	1	1	1	1
New Jersey				
New York				
Pennsylvania	2	2	2	2
Great Lakes	0(0)	0(0)	0(0)	0(0)
Illinois				
Indiana				
Michigan				
Ohio				
Wisconsin				
Plains	1(2)	2(3)	2(3)	2(3)
Iowa				
Kansas				
Minnesota	2	2	2	2
Missouri		1	1	1
Nebraska				
North Dakota				
South Dakota				
Southeast	0(0)	0(0)	0(0)	0(0)
Alabama				
Arkansas				
Florida				
Georgia				
Kentucky				
Louisiana				
Mississippi				
North Carolina				
South Carolina				
Tennessee				
Virginia				
West Virginia				
Southwest	1(1)	1(1)	1(1)	1(1)
Arizona				
New Mexico				
Oklahoma				
Texas	1	1	1	1
Mountain	0(0)	0(0)	0(0)	0(0)
Colorado				
Idaho				
Montana				
Utah				
Wyoming				
Far West	2(2)	2(2)	2(2)	2(2)
Alaska				
California	1	1	1	1
Hawaii	1	1	1	1
Nevada				
Oregon				
Washington				
Total States (Programs)	7(9)	8(10)	8(10)	8(10)

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.

Source: ACIR staff compilation based on interviews with state officials.

Table 3-6

TARGETED MINORITY AND DISADVANTAGED PERSON OWNED BUSINESS DEVELOPMENT PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983
New England	2(2)	2(2)	2(2)	3(3)
Connecticut	1	1	1	1
Maine				
Massachusetts				1
New Hampshire				
Rhode Island	1	1	1	1
Vermont				
Mideast	2(3)	2(3)	2(3)	3(4)
Delaware				
Maryland	2	2	2	2
New Jersey				
New York				1
Pennsylvania	1	1	1	1
Great Lakes	5(5)	5(5)	5(6)	5(7)
Illinois	1	1	2	2
Indiana	1	1	1	1
Michigan	1	1	1	1
Ohio	1	1	1	1
Wisconsin	1	1	1	2
Plains	3(5)	3(5)	3(5)	3(5)
Iowa				
Kansas	2	2	2	2
Minnesota	2	2	2	2
Missouri				
Nebraska				
North Dakota	1	1	1	1
South Dakota				
Southeast	8(0)	8(0)	9(10)	10(12)
Alabama	1	1	1	1
Arkansas	1	1	1	1
Florida				2
Southeast (cont.)				
Georgia				
Kentucky	1	1	1	1
Louisiana			1	1
Mississippi				
North Carolina	1	1	1	1
South Carolina	1	1	1	1
Tennessee	1	1	1	1
Virginia	1	1	1	1
West Virginia	2	2	2	2
Southwest	1(1)	1(1)	1(1)	1(1)
Arizona				
New Mexico				
Oklahoma				
Texas	1	1	1	1
Mountain	0(0)	0(0)	0(0)	0(0)
Colorado				
Idaho				
Montana				
Utah				
Wyoming				
Far West	0(0)	0(0)	0(0)	0(1)
Alaska				
California				
Hawaii				
Nevada				
Oregon				
Washington				1
Total States (Programs)	21(25)	21(25)	22(27)	26(33)

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.

Source: ACIR staff compilation based on interviews with state officials.

15% procurement and contracts set-aside, established a minority bidders list, allows minority firms to bid at a small percentage higher than other bidders, and provides performance bonding insurance for firms qualifying to receive state contracts.

Advice from current state administrators, contacted by ACIR, urges other states considering the creation of minority business assistance programs to provide sufficient funding for the programs and adequate support services; to obtain the support of the governor, the legislature and the business community; and to focus the program on job creation or retention and on growth oriented businesses.

Industrial Revenue Bonds

Industrial revenue bonds (IRBs) are development finance tools authorized by state and local governments to provide financing at low interest rates for firms that seek to acquire fixed assets in approved industrial projects. Interest earned on the bonds is not subject to federal income tax, although not all states exempt such interest from state taxation.

IRBs are not backed by the full faith and credit of the state, so the risk is assumed by the investors. IRBs are paid solely from the revenues of the project itself. This increases the risk to the investor, although the private firms undertaking the projects benefit because the federal tax break reduces their costs of borrowing.

IRBs are a particularly valuable tool in a state's economic development kit because, in addition to low interest rates, firms purchasing facilities with funds from this source can get federal investment tax credits and can depreciate the cost of the facilities at an accelerated rate.34/ If IRBs were targeted to distressed areas in any significant amounts, the benefits from private investment, jobs and economic revitalization could be substantial.

The structure for IRB financing varies from state to state, but generally includes a loan, lease, or installment sale. Loan transactions were used in 35 states in 1982. The preferred method is for the bond issuer to lend the bond proceeds to a company for acquisition of land, buildings, or equipment, and the company signs an agreement to pay the principal and interest on the bond. Alternatively, lease arrangements may be used if the user of the facility is tax exempt. In that case, a company might construct a building for a city, lease it from the city, and buy it when the bond has been retired. Finally, under an installment sales agreement, the issuing government constructs the facility with bond proceeds and sells it to the company; then the company signs an installment sales agreement spelling out the final disposition of the building.35/

Tax-exempt IRBs were first used in southern states in the 1930s to promote industry in rural areas. By the 1960s, their use spread to the North and Midwest, and large corporations began to use this tool for major capital expansions. By 1968, 40 states had authorized use of IRBs, and the total amount of issues increased from $100 million in 1960 to $1.8 billion in 1968.

This heavy use of IRBs by corporations and the resulting losses in

FINANCIAL BENEFITS OF AN IRB

Typically the interest rate on a tax-exempt IRB ranges from 65% to 80% of the commercial bond rate. If, for example, the interest rate differential between taxable and tax-exempt bond issue is three percentage points, the savings to the company financed by a $10 million IRB is approximately $300,000 in the first year.

federal tax revenues led Congress in 1968 to impose several restrictions on the types of projects eligible for federal tax exemption. The Revenue Expenditure and Control Act of 1968 attempted to allow tax exemption only for IRBs that finance approved quasi-public services or facilities (airports, convention centers, parking garages, pollution control, sports stadiums) and involve public capital expenditure of $10 million or less.

However, throughout the 1970s, state legislatures responded by relaxing restrictions on use of the bonds, particularly those involving less than $10 million. By the 1980s, nearly all states issued IRBs for all types of projects, from grocery stores and shopping centers to private clubs.

An Internal Revenue Service ruling in 1981 attempted to restrict the tax advantages of IRB financing. In response, Congress passed the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), overturning that ruling and making several changes in the rules for IRBs. The act eliminated tax exemption on small-issue bonds (those of less than $10 million) after December 31, 1986, but allowed states to pool several small bonds and issue them as "umbrella" bonds. Small issue bonds can no longer be used if more than 25% of the proceeds are used for retail food or beverage services, certain recreational or entertainment facilities, automotive sales or service facilities.

The Tax Reform Act of 1984 further limited issuance of IRB's by imposing a state cap on annual issues of "private activity bonds" of the greater of $200 million or $150 per capita. Several other restrictions were also imposed. Authority to issue bonds to finance manufacturing facilities was extended through 1988; for others the expiration date remains December 31, 1986.

State laws determine whether a local political subdivision can issue bonds, and for what purposes.36/ All 50 states authorize IRB financing of one type or another, but the purposes vary widely. They include:

1) land purchase and site development;
2) construction of new buildings;
3) purchase of existing buildings;
4) purchase of new or used equipment;
5) expansion or improvement of existing plants; and
6) cost of bond counsel, underwriting, and printing bonds.

But while most state IRB issues share a number of features, there are three key differences among state programs:37/

1. Some states permit a local issuing authority to issue bonds for projects outside its own boundaries.
2. Some states exempt IRB-financed facilities from property taxes as an additional incentive.
3. The repayment schedule varies from state to state, up to a maximum of 40 years.

For purposes of this report, IRB programs qualified for inclusion in the survey if they were targeted to distressed areas.

The primary concern about IRBs is their rapid growth during recent years, from $4.9 billion in 1975 to $41.6 billion in 1982. Critics argue that IRBs drain tax revenues from the Treasury, give an unfair competitive edge to some corporations that could get conventional financing, and hurt the market for traditional municipal bonds by reducing the availability of capital.38/ The rapid growth has also raised questions about how many new jobs they have actually created, at what cost, for what purposes, and with what impact on interstate and interlocal competition for jobs.39/

The second major policy issue relates directly to targeting such aid to distressed communities. One study estimated that 95% of all issuances were untargeted.40/ Billions of dollars of IRBs represent a major pool of capital which, if directed to economically distressed areas, could have a significant impact. Both Presidents Carter and Reagan tried to target IRBs. In 1978, Carter proposed that IRBs be used to finance industrial parks and plants in distressed areas or lose their tax exempt status. Congress ignored the proposal. In 1981, Reagan unsuccessfully tried to link IRBs to his enterprise zone proposal.41/ Targeting IRBs to distressed areas remains an unresolved issue.

The survey found that only 11 states targeted their IRBs to distressed areas. As Table 3-7 shows, there has been little increase in the number of qualifying states since 1980. Of the 11 state programs, only two were initiated after 1980, while Oregon's program, which began in 1975, was terminated in 1981.

The purposes of these programs are similar to most programs aimed at benefiting distressed communities, including the prevention of job loss, and promoting commercial and other development projects in blighted areas. The New Jersey Economic Development Authority's legislative purpose is fairly typical:42/

> To provide for the construction, acquisition, financing, selling, leasing of industrial manufacturing, commercial, and other employment generating facilities.

Nearly every one of the programs is targeted to distressed urban areas, or communities facing plant closings or extended periods of high unemployment.

The level of financial activity varied widely among states reporting targeted IRB programs. Two states had no funding in 1983, one had $2.7 million, another had $250 million. Illinois provided $1 billion in authority, including $100 million designated for enterprise zones.

Table 3-7

TARGETED INDUSTRIAL REVENUE BOND PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983	Region and State	1980	1981	1982	1983
New England	3(3)	3(3)	3(3)	3(3)	Southeast (cont.)				
Connecticut	1	1	1	1	Georgia				
Maine					Kentucky				
Massachusetts	1	1	1	1	Louisiana				
New Hampshire	1	1	1	1	Mississippi				
Rhode Island					North Carolina				
Vermont					South Carolina				
Mideast	1(1)	1(1)	1(1)	1(1)	Tennessee				
Delaware					Virginia				
Maryland					West Virginia				
New Jersey	1	1	1	1	Southwest	0(0)	1(1)	1(1)	1(1)
New York					Arizona				
Pennsylvania					New Mexico				
Great Lakes	2(2)	2(2)	2(2)	2(2)	Oklahoma				
Indiana					Texas		1	1	1
Illinois	1	1	1	1	Mountain	0(0)	0(0)	0(0)	0(0)
Michigan					Colorado				
Ohio					Idaho				
Wisconsin*	1	1	1	1	Montana				
Plains	1(1)	1(1)	1(1)	1(1)	Utah				
Iowa					Wyoming				
Kansas					Far West	2(2)	2(2)	2(2)	2(2)
Minnesota					Alaska				
Missouri***	1	1	1	1	California	1	1	1	1
Nebraska					Hawaii				
North Dakota					Nevada				
South Dakota					Oregon**	1	1	1	1
Southeast	1(1)	1(1)	1(1)	1(1)	Washington				
Alabama									
Arkansas					Total States				
Florida	1	1	1	1	(Programs)	10(10)	11(11)	11(11)	11(11)

Key: X(Y): X = number of states in the region with programs; Y = number of programs in the region.
* No bonds were issued in Wisconsin in 1983. ** No bonds were issued in Oregon in 1982 and 1983.
*** Missouri's program is currently inactive.

Source: ACIR staff compilation based on interviews with state officials.

Two of the states with targeted IRB programs (Oregon and Wisconsin) have completed evaluations; Oregon terminated its program in December 1981.

Some of the comments of IRB program administrators may provide insight into how best to design such a program to have maximum impact:43/

1) have a stringent and limited definition of eligible uses,
2) have a tough state-level review as well as public hearings,
3) include a relocation clause to prohibit a firm from moving from one state to another,
4) have "intent" legislation targeting IRBs to distressed areas and adhere to it,
5) consider the cost per job created and the number of jobs created,
6) have a formal municipal role to avoid problems of IRBs drawing money away from downtown development, and
7) smaller states should administer the program directly.

CALIFORNIA'S INDUSTRIAL DEVELOPMENT FINANCING ACT

The Hysol-Grafil company is a manufacturer of carbon and graphite fibers which replace aluminum in airplanes. The company received an $8 million bond to create 65 jobs. The Company agreed to use the Private Industry Council to screen and train applicants and located in an economically distressed area. Without the IRB, the company said it would have gone to another state.

In sum, IRBs remain a largely untapped resource for distressed communities, despite the rapid increase in their use and growing resistance.

Summary

The record of state aid to distressed communities in economic development can be improved. In four of the indicators, only a handful of states are active. Only in targeting to businesses owned by minorities or the disadvantaged, among all the economic development indicators, are at least half of the states active. States providing the most and innovative program strategies tend to be located in areas experiencing the greatest difficulties -- New England, California, Michigan, New Jersey, and Massachusetts.

Targeted economic development assistance to distressed communities is essential if any state is to stabilize its long-term growth and reduce a costly drain on its general fund. The most effective way to target that aid is to systematically develop a state policy to do so, to strategically link related state programs to this goal, to increase funding and to establish the administrative mechanisms needed to achieve the desired results.

* * * * * * *

FOOTNOTES

[1] Edward Humberger, "States Investing in Distressed Areas to Create Jobs," Intergovernmental Perspective, Winter 1983, pp. 36-37.

[2] Bureau of National Affairs, "BNA's Labor Economic Report, First Half, 1983," October 1983, Washington, DC, p. 40.

[3] Thad L. Beyle, "Issues Facing the States and Governors, 1982," State Government, Vol. 56, No. 2, 1983, pp. 65-68; Erik B. Herzik, "Governors and Issues: A Typology of Concerns," State Government, Vol. 56, No. 2, 1983, pp. 58-64; and, Harold Hovey, State Policy Reports, 1983.

[4] Neal Peirce, Economic Development, Challenge for the 1980s (Washington, DC: Council of State Planning Agencies), p. 1.

[5] Terry Buss, Steven Redburn, and Larry Ledebur, "Symposium on Economic Revitalization of America," Policy Studies Review, Vol. II, May 1983, pp. 663-65.

[6] Jack Russell and Dan Luria, Rational Reindustrialization (Detroit: Widgetripper Press, 1981).

[7] President's Commission on a National Agenda for the Eighties, A National Agenda for the Eighties (Washington, DC: U.S. Government Printing Office, 1980).

[8] Peirce, op. cit.; Buss, Redburn, and Ledebur, op. cit.; Roger Vaughan, State Taxation and Economic Development (Washington, DC: Council of State Planning Agencies, 1979).

[9] Edward Humberger, Business Location Decisions and Cities (Washington, DC: Public Technology, Inc., 1982); Roger Schmenner, Business Location Decision Making (Englewood Cliffs, NJ: Prentice-Hall, Inc., 1982).

[10] Peirce, op. cit., p. 2.

[11] Humberger, 1982, op. cit.

[12] This section is based on Michael Barker, ed., Financing State and Local Economic Development (Durham, NC: Duke Press Policy Studies, 1983).

[13] Peirce, op. cit.; Council of State Community Affairs Agencies, Economic Development: The States' Perspective (Washington, DC: COSCAA, 1981).

[14] COSCAA, op. cit.; see also Public Technology, Inc., State Role in Urban Economic Development (Washington, DC: PTI, 1980).

[15] Council of State Governments, Economic Development: A Survey of State Activities (Lexington, KY: COSG, 1983).

[16] Ibid.

17/ Adapted from Council of State Community Affairs Agencies, op. cit.; Edward Humberger, Public Technology, Inc., op. cit.

18/ Title 10, Chapter 211, p. 37, Vermont Statutes Annotated, 1984.

19/ Recommendations from conversations with state officials administering programs.

20/ Title 73, Chapter 302, p. 167, Purdon's Penna. Statutes Annotated, 1971.

21/ Recommendations from conversations with state officials administering programs.

22/ President Ronald Reagan, "Transmittal Letter to Congress: The Enterprise Zone Tax Act of 1982," March 23, 1982.

23/ Stuart Butler, Enterprise Zones: Pioneering in the Inner City (Washington, DC: The Heritage Foundation, 1980), p. 33. For a full discussion of the original concept, see Stuart Butler, Enterprise Zones: Greenlining the Inner Cities (New York: Universe Books, 1981); Charlotte Brekinridge, "Enterprise Zones as a Concept" (Washington, DC: Congressional Research Service, March 26, 1981).

24/ David Birch, The Job Generation Process (Cambridge, MA: Massachusetts Institute of Technology, 1979), p. 43.

25/ For a fuller examination of the issues raised by this concept, see Edward Humberger, "The Enterprise Zone Fallacy," Journal of Community Action, September/October 1981, pp. 20-28.

26/ Recommendations from conversations with state officials administering programs.

27/ Martin Neil Baily, ed., Workers, Jobs, and Inflation (Washington, DC: The Brookings Institution, September 1982).

28/ The U.S. Small Business Administration defines a "small" firm as one having fewer than 500 employees; the 100-employee criterion was chosen since it more accurately represents the size of firm responsible for the greatest number of jobs created.

29/ This section is based on Roger Vaughan, Small and New Business Development: An Action Guide for State Governments, Coalition of Northeastern Governors, May 1983. See also Michael Kieschnick, Venture Capital and Urban Development (Washington, DC: Council of State Planning Agencies, 1979).

30/ Karl Vesper, Entrepreneurship and National Policy, Heller Institute for Small Business Policy Papers, 1983.

31/ Vaughan, op. cit., pp. 15-16.

32/ Northeast/Midwest Institute, The 1983 Guide to Government Resources for

Economic Development (Washington, DC: NMI, 1983).

33/ National Conference of State Legislatures, "Recommendations to Assist Small Businesses," Denver, CO, August 8, 1983; also Roger Vaughan, State Tax Policy and the Development of Small and New Businesses (Washington, DC: Coalition of Northeastern Governors, May 1983).

34/ Council of State Community Affairs Agencies, op. cit.

35/ For a detailed look at IRBs, see The Urban Institute, State Incentives for Business and Economic Development (Washington, DC, 1983), pp. 23-24.

36/ The Tax Reform Act of 1984 provisions impose a state cap on the volume of issues necessitated allocation of the cap between state and local governments and among local governments. The law allows states to establish their own allocation formulas if they wish.

37/ Urban Institute, op. cit., pp. 26, 28.

38/ "Remarks of U.S. Representative J.J. Pickle on the Introduction of The Industrial Development Bond Limitation Act," Congressional Record, February 24, 1983.

39/ "As Washington Talks Tough, IRBs Flourish," Weekly Bond Buyer, April 25, 1983, p. 3.

40/ Wisconsin, Legislative Audit Bureau, "IRBs, An Evaluation," (Madison, WI, May 29, 1981).

41/ Urban Institute, op. cit.

42/ Title 34: 1B-1, p. 24, N.J. Statutes Annotated, 1985 Cumulative Annual Pocket Part.

43/ Comments from conversations with state officials administering programs.

Chapter 4

COMMUNITY DEVELOPMENT

For distressed areas to revive, it is not enough for a state or local government to try to attract new firms and encourage expansion of existing ones with the economic development approaches described in the previous chapter. Another element needed is community development.

Community development takes in two aspects of what makes a locality attractive to business and to residents. One is infrastructure -- the physical facilities vital to a community's ability to support industry and to meet the basic service needs of its citizens. The other is organization -- the capacity of community residents to help themselves. Community based organizations have been formed in most localities to help supply housing, revitalize neighborhoods and spur many other public improvements essential to a healthy community.

The public physical infrastructure is a hidden crisis for distressed places, hidden until a bridge collapses or a water main breaks. By the late 1970s and early 1980s, evidence had mounted that the investment needed to rebuild the physical infrastructure could no longer be avoided. The examples abounded:

- ° Cleveland, a city that filed for bankruptcy in 1978, needs to rebuild or resurface 30% of its streets, and invest $1 billion in other public works.1/

- ° In July 1982, 300,000 residents of Jersey City, NJ, went without drinking water for three days, following rupture of an 80-year-old aqueduct, the fourth major water line break in Jersey City in 18 months.2/

Without a sound physical infrastructure, no community can meet the basic service needs of its residents and industry. The availability and condition of public facilities is also a critical factor for business development.3/ An inadequate capital plant may hinder, if not cripple, economic recovery and revitalization at the local level, particularly in a distressed area.

In addition to the physical infrastructure problems facing distressed communities, community based organizations are also experiencing problems in meeting the communities' development needs.

> Low-income [housing] projects are becoming moderate-income projects as interest rates, land costs, and development costs rise with inflation.... The scarcity of administrative and redevelopment project funding inevitably forces nonprofit developers to recoup their expenses through mortgage loans arranged for the projects. Low-income people are hurt most by the process.... If we are able to survive ... by necessity the bottom line

> will become the only ruling force in making development decisions. In any case, this will mean that the real needs and concerns of a neighborhood and its residents will be pushed aside.4/

Community based organizations (CBOs) typically operate in low-income communities that have experienced market failure. In such neighborhoods, CBOs have been particularly pivotal in carrying out community development activities that traditional public and private actors could not or would not tackle. CBOs that once received federal funding are now facing serious problems trying to survive the new economic realities.

Policy Issues

Two major issues in national domestic policy have affected the field of community development over the past few years: (1) President Reagan's economic program, and (2) the structural and cyclical forces changing the national economy.

The President's economic program includes two main aspects. The first is a set of principles guiding the formulation of policy, namely supply side economics, an increased reliance on the private sector in meeting local needs, and the reduction of the size and scope of federal government activity achieved by shifting federal programs and responsibilities to the states.

The second part involves the actual program changes resulting from the Omnibus Budget Reconciliation Act of 1981. This act created seven new block grants and modified two existing ones by consolidating 77 previous categorical grants or programs. The act also effectively reduced funding by up to 25% in several of the new block grants. To estimate the real effects of these cuts is beyond the scope of this study. To do so properly requires an examination of the size and direction of the funding changes, the ways in which state and local governments adapted to them, and the impacts of both the federal cuts and the related adjustments of states and local governments and groups.

Table 4-1 presents changes in budget authority for a number of major federal programs that have community development impacts.5/ In the area of physical infrastructure in particular, programs of two agencies are important: the Economic Development Administration (EDA) and the Environmental Protection Agency (EPA).

EDA encourages private investment and development in distressed areas by providing loans, grants and technical assistance for public works improvements. In early 1981, the administration proposed terminating the agency to save $625 million.6/ The agency was reauthorized for one year, however, with a reduction of $189 million in its budget. For fiscal year 1982 the budget was reduced another 54% to $198.5 million, and was funded at that level in the following year as well.

EPA helps cities meet their public sanitation construction needs through the $3.9 billion wastewater treatment construction program. This program has been particularly critical for Sunbelt cities seeking to expand. It was increased by 50% in 1981.

Table 4-1

CHANGE IN BUDGET AUTHORITY OF FEDERAL GRANT PROGRAMS AFFECTING COMMUNITY DEVELOPMENT

	1982 Budget Authority	
Program	Millions of Dollars	Percentage Change from CBO Baseline*
Community Services Block Grant	$ 348	-41%
Community Development Block Grant	3,456	-13
CETA Training	3,037	-46
CETA Public Service Employment	0	-100
Job Training Partnership Act	2,833†	+100
Mass Transit	3,495	-31
Urban Development Action Grant	440	-35
Wastewater Treatment	2,400	+50

*This compares supplemental appropriations made after the reconciliation against a Congressional Budget Office baseline, an estimate of the level of spending that would have been needed in FY 1982 if the federal government's policies had not changed from the previous year, except for spending increases to reflect inflation.

†This figure represents the President's FY 1984 budget request for programs funded under Titles II-A, II-B, and III of the act. They are included to provide contrast to the administration's cuts in CETA.

Source: Nathan, et al, The Consequences of Cuts, pp. 20-21.

In neighborhood revitalization, a number of important development programs have been supported by the Department of Housing and Urban Development (HUD), the Economic Development Administration (EDA), the Community Services Administration (CSA), and the National Consumer Cooperative Bank (NCCB). The largest urban revitalization programs administered by HUD are the Community Development Block Grant (CDBG) and the Urban Development Action Grant (UDAG). CDBG was reduced $238.6 million for fiscal year 1982, to a new total of $3.46 billion. In 1983, $4.45 billion was authorized for this program, with budget authorization estimates for 1984-87 falling back to $3.46 billion annually. At the same time, regulations were promulgated to de-emphasize the special focus of past administrations on low and moderate-income projects.

The UDAG program was originally scheduled for merger with the CDBG program, but was reduced from $675 million to $440 million instead.

Capital Improvements Policy Issues*

The major capital improvements issue is the condition of the public physical infrastructure. This section analyzes the national scope of the issue, discusses its affects on states and how states are responding, and considers two state innovations -- the infrastructure bank concept and the adaptive reuse of existing facilities.

The walls of this nation are crumbling, according to several recent reports. Not just the walls; the roads, bridges, water and sewer systems, trains, and buses are all "wearing out faster than they are being replaced."7/

In northeastern and midwestern cities, the infrastructure problem is one of maintenance -- that is, not keeping up with the aging process. In cities in the southwest, infrastructure is a problem because growth has been outpacing local capacity. An inadequate or decaying physical plant is particularly troubling for communities in distress; the absence of good roads, bridges, and public sanitation makes it more difficult to revitalize their economies.

In 1981, the Council of State Planning Agencies documented the scope of the problem in America in Ruins:8/

1. Twenty percent of all bridges in the country need either major rehabilitation or reconstruction, at an estimated cost of $33 billion. Federal allocations ran at about 5% of that need.

2. Urban areas with more than 50,000 population will require close to $100 billion over 20 years to maintain their water systems. Thirty-three percent of communities surveyed by the Department of Commerce were operating water treatment facilities at or above 70% of full capacity, meaning these communities are unable to accommodate additional industry.

3. Meeting water pollution control standards will cost $25 billion in the next five years.

4. At least 1,300, and as many as 3,000, of the nation's jails must be either totally rebuilt or substantially renovated in this decade.

The Congressional Budget Office has made similar estimates of the costs of repairing, rehabilitating, and replacing infrastructure between 1983 and 1990 under current policy: $17.3 billion for highways, $3.3 billion for

*ACIR has dealt with the general public physical infrastructure problem as part of another project, the results of which are available upon request. See Advisory Commission on Intergovernmental Relations, Financing Public Physical Infrastructure, A-96 (Washington, DC: U.S. Government Printing Office, 1984).

public transit, $500 million for wastewater treatment, $1.8 billion for water resources, $700 million for air traffic control, $500 million for airports, and $4.1 billion for municipal water supply.9/ The Federal Highway Administration found that, as of 1981, 29% of all federally aided bridges needed substantial maintenance or repair (Table 4-2). While these are only estimates, they are indicative of the seriousness of the physical infrastructure situation, particularly in transportation systems.

Table 4-2

U.S. HIGHWAY BRIDGE CONDITIONS, DECEMBER 31, 1981

	Federal-Aid	Off System
Number of Bridges Inventoried	259,950	297,566
Structurally Deficient*†	27,354	99,301
Functionally Obsolete*	40,342	81,530
Bridges That Are, or Should Be Load-Posted	27,100	122,800
Bridges Closed to All Traffic (temporarily or permanently)	316	3,100
Total Number of Bridges Funded Under the Bridge Program	5,664	2,995
Number of Replaced or Rehabilitated Bridges Now Open to Traffic	2,270	832

*The total number of deficient bridges (structurally deficient and functionally obsolete) reflects the Federal Highway Administration's interpretation of the states' inventory data pertinent to this program, and need not necessarily agree with the states' records for these two categories.

†A structurally deficient bridge is one that is restricted to light vehicles only, closed, or in need of immediate rehabilitation to keep it open; a functionally obsolete bridge is one on which the deck geometry, load carrying capacity, clearance or approach roadway alignment can no longer safely service the system of which it is a part.

Source: Federal Highway Administration, 1981.

To get a more detailed picture of the problem, the National League of Cities and the U.S. Conference of Mayors in 1983 completed a national survey of 809 cities of all sizes in every region in the country.10/ Thirty-six percent of the respondents were central cities, 35.5% were suburbs, and 26% were nonmetropolitan cities. Respondents were asked to describe the condition of 19 types of public facilities, ranging from parks and water storage to solid waste disposal, docks and wharves.

Among the survey's findings was that the physical infrastructure of the nation's communities is a national issue, with differences in capital investment needs among the regions, but with no region escaping the problem. For ten of the 19 facility types surveyed, at least 30% of the respondents indicated the need for major repair or replacement, including streets and roads (70.4%), sidewalks and curbs (69.9%), and storm water collection or drainage (67.4%).

Most cities said they could finance such items as public buildings, sidewalks and curbs, and water distribution. In eight of the 19 categories, however, majorities of the respondents said they required some state or national assistance for items such as streets and roads (62%), wastewater treatment (54.5%), and bridges and overpasses (54.4%).

Total public investment in such capital projects declined in nine of the years from 1967 to 1977. State and local net investment fell eight times between 1968 and 1977. Even more telling, public works expenditures as a percent of GNP fell from 4.1% in 1965 to 2.3% in 1977.11/ State and local governments are seeing that they can no longer afford to defer maintenance and repair projects, and yet their fiscal capacity to meet these needs is more thinly stretched now than at any time since the Great Depression.

None of the studies on this subject estimates the cost of the physical plant problem for distressed communities per se. It is logical to expect, however, that neglect and disinvestment there would be more severe than in this nation at large. As Choate and Walter note:12/

> A large and growing number of communities are now hamstrung in their economic revitalization efforts because their basic public facilities -- their streets, roads, water systems and sewerage treatment plants -- are either too limited, obsolete or worn out to sustain a modernized industrial economy.

The problems of communities facing this situation are multifaceted. New businesses are less likely to locate in them, and the chances are increasing that firms already located in such communities will leave.13/ This reduces the number of jobs, thereby reinforcing the disinvestment process.

A longstanding debate exists concerning the targeting of public works aid to distressed areas. One side argues that numerous market forces -- such as the cost of labor, availability of energy and efficacy of the transportation system -- determine the economic health of an area, and are difficult to reverse.

Another view suggests that inefficiencies in the marketplace are responsible for the decline of some areas while at the same time others prosper. The "redlining" of certain neighborhoods by some financial institutions is one commonly cited example of distortions in the market that contribute to selective decline. Federal and state incentives favoring new construction over rehabilitation of existing buildings are other examples of market distortion.14/ But no matter which argument is more nearly correct, these distortions have penalized particular areas, and might be reversed through the targeting of essential resources.

While this debate is far from settled, there are many mechanisms that states are using for financing and targeting assistance to such areas. Exhibit 4-1 lists ten.

Capital Improvements Innovations

The Infrastructure Bank. Governor Thomas Kean of New Jersey proposed a novel approach to funding capital improvements, specifically roads, bridges, water supply, and wastewater treatment systems.15/ His New Jersey Infrastructure Bank proposal was designed to maximize state use of federal funds, capture a reliable and continuing source of money, and decrease reliance on general obligations for these expenses. These provisions were aimed at preserving the state's financial health, including its AAA bond rating.

This proposal, however, engendered opposition. As explained by state officials, it was rejected by the legislature. But, the concept is an innovation in the role states can play in addressing a major problem for distressed communities and, thus, is worth exploring in more detail. In general, the bank would look something like the following:

1. It would be a nonprofit institution located in the state's offices and would have power to issue bonds, notes and other obligations which would represent neither a debt nor a liability of the state itself.

2. It would receive any state or federal funds the final plan agrees should be included.

3. It would provide low or no-interest loans, and perhaps grants, to communities for approved infrastructure projects. Repayments would go into a revolving loan pool for other projects.

New Jersey had 237 projects in 1983 eligible for federal EPA wastewater treatment grants, totalling $2.4 billion. The state had authorized $385 million for FY 1982 to FY 1985 to match funds expected from Congress to meet these federally mandated goals. However, this federal grant level plus state money is enough to fund only 13 of the 237 projects. The revolving fund of the bank would allow the state to start construction on every project within ten years. Were that the case, the state could save money on inflationary increases in construction costs over time, mitigate expected increases in user charges, reduce pressures on the state to increase its issuance of general obligation bonds, fund many more projects than could be funded otherwise and, for that reason, create numerous additional construction jobs while spurring development in local economies.

The most controversial point of the bill, largely responsible for its rejection, concerned the source of funds to capitalize the bank. Governor Kean's original proposal called for the state to assume responsibility for some federal programs. Federal wastewater construction grants, for example, intend-

Exhibit

STATE FINANCIAL

1. Reshaping Capital Budgets to Emphasize Repair and Rehabilitation. Shift the ratio in a capital budget to greater emphasis on preservation of facilities. Require life-cycle costing, where the full costs of maintenance are included in all funding proposals.

2. Creating Independent Authorities, Especially for Water and Sewer Systems. This takes these systems out of normal budget competition and reduces the ability to defer maintenance by shifting the funds elsewhere. An Urban Institute study has shown that systems so managed are generally superior to those left in the budget.

3. Bond Guarantees. A state can adopt a bond program or create a lending authority to provide access to credit and lower interest costs for long-term debt issued by local governments.

4. State Authorities and Bond Pooling. A state can create an authority to supervise local capital operations and create state bond banks that issue debt on behalf of localities. The state can set priorities for projects throughout the state, as New Jersey has proposed for an infrastructure bank. Or the state can issue bonds and loan out the money to smaller districts which either cannot go out on the market or cannot afford to, as in Texas.

5. Private-Sector Initiatives. Private industry benefits from public capital facilities. Through cooperative efforts, uses of the tax system, or some other mechanism, the value to private industry can be captured and an appropriate fee levied on a portion of that value.

6. Leasing. Sale-leaseback arrangements can be made, where a private concern purchases a facility from a local government, thereby buying

ed for specific local projects would go instead to the state and then back to those projects, depending on their position in the project priority list, as loans. Some suggested that this was necessary and prudent, since the state could better decide which projects were of a higher priority and could use the revolving loans to fund them all rather than just a few. Others contended that this would be inequitable: one town's grant money would become another's loan money, and the original town might never receive any funds. Further, even an interest-free loan may prove especially difficult for a distressed community to pay back.

Adaptive Reuse of Facilities. Housing, factories and other facilities in some areas of older cities have been abandoned. This abandonment is a sign of poverty, outmigration, loss of employment, and a general drop in the tax base that leads to accelerated neighborhood and urban decline. Combating abandonment can help create a more livable and economically viable neighbor-

4-1

TARGETING MECHANISMS

the depreciation advantage of capital ownership the government cannot use. The government primarily gains cash, which it can put into capital repairs or construction.

7. Dedicated Taxes. A specific portion of a tax increase on, say, sales, gas or income can be dedicated to capital improvement budgets.

8. Special Assessment and Tax Increment Districts. These try to wrest additional funds for capital improvements from those who benefit most from a particular service or capital project.

9. Maintenance and Rehabilitation Incentives. To encourage local governments to cooperate with a statewide capital construction plan, the state can provide aid for local operating and maintenance costs.

10. Targeted Hiring Arrangements. A city or state can develop an agreement with any firm to which public dollars or assistance are going to provide jobs to local residents. In Portland, OR, the agreement is that the firm will use the local employment office as its first referal agency for entry level positions for five years. Boston has a policy, affirmed by a Supreme Court decision, requiring hiring a specified percentage of women and minority workers in any construction project receiving city money.

Source: Drawn from George Peterson and Mary John Miller, Financing Public Infrastructure: Policy Options (Washington, DC: Public Technology, 1981), pp. 40-57, passim; and ACIR, Financing Public Physical Infrastructure, A-96 (Washington, DC: U.S. Government Printing Office, 1984).

hood for the remaining residents. These considerations have led to the idea of finding new uses for abandoned facilities.

Because the cost of new construction is escalating, rehabilitation and reuse are often less expensive. Moreover, in some cases 16/

> ... maintaining and upgrading old buildings can leverage more private investment and subsequent redevelopment than a comparable public investment in clearance and new construction.

Adaptive reuse entails the renovation of unused real estate and can become a valuable strategy for any city or town with such holdings. It is especially appropriate for larger and older cities that have lost large numbers of households.

Property to be reused may include residential or industrial buildings, but also cleared land and properties that become municipal property through military base closings, abandonment of railroad spurs and rights of way, and school closings. When such property is in a strategic location within a neighborhood, its renovation can be the mortar for neighborhood revitalization.

In their handbook on adaptive reuse, Burchell and Listokin list seven different forms this physical reconstruction may take:17/

> ...residential or nonresidential conversion; augmented or intensified public services; transportation system upgrading; neighborhood parking development; active/passive recreation improvements; interior lot annexations and urban gardening plots; or municipal land banking.

As this list implies, the objective of adaptive reuse is not merely the rehabilitation of buildings:18/

> Rather, it is the conversion of these structures into sufficiently unique economic entities that secure a potential to succeed in the future where reinstitution of uses similar to those of the past would be likely to fail.

There are roadblocks to adaptive reuse. Those who prefer new development, argue that older cities and neighborhoods with significant abandonment are poor investments. Local development plans and policies have often supported this belief, giving preference to new construction in a city's vacant outskirts

SUCCESSFUL EXAMPLES OF ADAPTIVE REUSE

FITCHBURG, MA: A seven-story downtown building had six of its floors closed off, having failed for lack of demand in an attempt to modernize some of it for office.space. Using funds received from the Massachusetts Housing Finance Agency, the upper six floors were successfully transformed into 70 housing units, 24 leased to the Fitchburg Housing Authority and 46 rented to moderate-income persons.20/

BROOME COUNTY, NY: The county established an industrial incubator using a 30-year-old, 27,000-square-foot facility. The incubator, in this case part of a broader industrial development strategy, is a place where small businesses can get started with inexpensive rent, flexible space and shared services. This building went through some exterior improvements and the inside was substantially rebuilt in order to provide spaces appropriate for different types of businesses. Tenants included a design-drafting firm, a chemicals packaging company, a small manufacturer spinning off from the parent company, and a minority-owned precision electronic component and assembly subcontractor. The project required that companies reaching a certain level of development must vacate and make room for another firm.21/

which, at the same time, erodes some incentives for renovating older structures closer in. Overly strict building codes, too, can make many substantial rehabilitation projects uneconomical. Modifying code provisions that go beyond essential protection of the public's health and safety could expand the rehabilitation opportunities. State and federal policies also should be reexamined to avoid tipping the balance in favor of new construction.

Policies intending to favor adaptive reuse, if not carefully prepared, may inadvertently create disincentives to unsubsidized renovation,19/

> ... rewarding those property owners who have done the least to maintain and improve their properties, and failing to reward owners who have maintained their properties all along.

Although the more conscientious owners would benefit to the extent that such reuse would revitalize the community and increase their property values, care should be taken to guard against this reverse incentive.

Neighborhood Development Policy Issues

In many cities, some neighborhoods have been in decline for decades. Federally subsidized suburban housing construction lured many middle income families to move from the central cities, depriving those cities of a large part of their tax base. Many firms also left for the suburbs, further eroding the urban tax base. As a result, municipal services suffered from lack of revenues. And the credit policies of financial institutions were used to steer people away from declining communities (a practice often known as redlining).

Community organizations, often created in response to neighborhood development issues, have long served as valuable mediating structures between individuals and large-scale institutions. Throughout history, religious institutions and civic associations have been focal points for providing services. In recent times, newer types of organizations, broadly known as community-based organizations, have taken their place alongside these older groups. CBOs not only provide services but also engage in development activities such as commercial revitalization.

Recent interest in neighborhoods began in the early 1970s with a series of conferences on neighborhoods. Some focused on the positive nature and broad capacities of neighborhoods. One held in 1972 focused on the particularly difficult problem of redlining. The conferences produced a greater sense of unity and common purpose among groups across the country. These groups lobbied hard to get the Home Mortgage Disclosure Act passed by Congress in 1975.22/ In 1977, President Carter established the National Commission on Neighborhoods, the first attempt to approach a wide range of issues from a neighborhood viewpoint at the chief executive's level. In 1978, Congress enacted the Neighborhood Self-Help Act.

Interest in neighborhood development has remained high, even in the face of funding cuts. But the discussion expanded in the early 1980s to include alternatives to federal funding of neighborhood ventures. These new policy directions included privatization, public-private partnerships, and volunteerism. The following section reviews the current status of these approaches to neighborhood development.

Community-Based Development. There is no census of the number of community-based development groups across the country, although rough estimates run in the thousands. These groups engage in a wide variety of development activities such as building and rehabilitating housing, providing commercial goods and services, creating jobs and businesses, training workers, and conducting energy conservation projects.

There are three different types of CBOs:

1) neighborhood advocacy groups (NAG), which generally have histories of defending or promoting the interests of the neighborhood in the larger political arena;

2) social service organizations (SSO), which have provided direct services under a variety of public programs; and

3) economic development organizations (EDO), which have their primary experience in housing and community development activities.23/

Many studies have documented that each of these types of CBOs can and do offer various types of high quality services.24/

An Urban Institute study looked at the factors needed for growth of community based organizations. It identified funding support and technical assistance as two essential elements.25/

> In general, financial support that allows flexible use of the money, insures neighborhood development organizations against future cutbacks, meets such special needs as "upfront" funding for planning and early implementation stages of projects, is particularly useful to neighborhood organizations.

The study concluded that such support "is particularly scarce."

The study identified nine types of technical assistance that can be provided:

1) proposal writing;
2) project packaging;
3) specialized professional services;
4) legal assistance;
5) accounting;
6) assistance in relating to outsiders, especially funding sources;
7) defining internal roles;
8) organizational design; and
9) multipurpose project counseling.26/

Not only are these aids important, but so is the timing of the assistance.

Some types of assistance are needed early. Other types are project-specific. Still others require advanced organizational maturity.

Moving beyond their general needs, the actual condition of these groups appears to be less than optimal. The economic pressures of recent years have hurt CBOs. It appears that at the very time when interest in, and the need for neighborhood organizations is on the rise, these groups have substantially fewer resources with which to work.

Several studies suggest that:27/

1. Many CBOs are closing down while others are laying off substantial numbers of people.
2. Due to diminished funding, CBOs must look for alternative funding and staffing.
3. CBOs are forced to rely increasingly on volunteers.
4. CBOs must move toward self-sufficiency through profit-making ventures.

One study identifies a transformation occurring in the field.28/ Of the three types of organizations, the economic development groups are more likely to succeed than the political advocacy and social service groups.

But the changes now taking place have their costs. First, neighborhoods have lost valuable advocates and services. Second, some CBOs are losing their linkage to the communities they are created to serve. A concern about this loss is that some CBOs may no longer be "of" the neighborhood and committed to providing benefits to low and moderate-income people; instead they may become like other organizations "in" the neighborhood, providing services that they, not the neighborhood, find most valuable.

Moreover, as an organization's dependence on profit increases, the types of projects it works on may tend to shift. "To the extent that low and moderate-income benefit is not sufficiently profitable, that goal is sacrificed in the name of organizational survival."29/ High risk, low payback deals, the kind on which these groups cut their teeth and earned acceptance in the community in the 1960s and 1970s, are sometimes sacrificed for lower risk, higher payback projects.

It is important to emphasize that some CBOs are succeeding in the current environment while continuing to serve distressed neighborhoods. The transformation discussed above is not occurring universally. The development activities within some neighborhood organizations appear to be providing revenues to support traditional service and advocacy activities. Moreover, it is a point of lively debate as to whether groups unable to exist in the marketplace should be subsidized in order to continue their work.

Voluntary and Private Development. Since coming into office, President Reagan has spoken often about the need for communities to increase their self reliance. Two approaches the administration supports are (1) increased volunteerism and (2) privatization -- that is, use of private firms to deliver some services that had been delivered by government. The latter has been the subject of a report by President Reagan's Task Force on Private Sector Initiatives, Investing in America, as well as many other studies and conferences.30/

1. Volunteerism. Volunteers have always played an essential role in community based organizations. In some instances, volunteers have brought sophisticated and relevant skills to CBOs. Yet, the more complex the activity in which the organization is involved and the greater its responsibility, the greater are the demands for specialized skills. Volunteers may have those skills, but they are not staff. Volunteers may be a necessary ingredient for successful CBOs, but they are not sufficient alone.

2. Privatization. The private sector is becoming increasingly involved in community development activities.31/ Investing in America goes beyond that fact to analyze what private resources are available for economic and community development and how to tap those resources.32/ However, privatization and partnerships have limits. Just because profit is the bottom line in the private sector does not necessarily make privatization a more efficient and economical model.

   For example, the Massachusetts Taxpayers Foundation found that the state's human service agencies were spending over $300 million a year buying services from private providers over which the state maintained little effective programmatic or fiscal control. The report goes on to say that 33/

   > [T]he larger the role of providers, the less control the state can exert over them; the less control the state exerts, the larger the providers' role in the system becomes....

A number of studies, such as John Hanrahan's Government by Contract, document numerous cases of waste and abuse by private contractors.34/ Hanrahan provides descriptions of some of the more blatant private misuses of public funds and public interest. He cites examples of officials who regularly move back and forth between public agencies and industry; regulations that are written to benefit the regulated industries; and public agencies that are so closely tied to industry that they are virtually "captured" by private firms. While Hanrahan was primarily concerned with the frequency of such abuses at the national level, he was nevertheless convinced that similar problems were pervasive in private-public arrangements at the local level as well.

Survey Results

The survey of the states used for this report was designed to look for state programs targeted to distressed communities that helped to improve their physical plant or furthered the capacity of communities to help themselves. Table 4-3 presents the results of the survey.

Capital Improvements

The capital improvements indicator is divided into three categories: (1) basic construction, expansion, or renovation of core public capital facilities; (2) natural resource development impact aid; and (3) a set of related programs. Most of the state programs in this indicator fall under the first two categories.

Core Construction Programs. In 1983, 13 states had 14 construction programs. They were in virtually every region of the country, with three states each in the Southeast and Plains states.

Most of these programs are simply for the construction or expansion of water, sewer, or solid waste systems. In South Dakota, the State Water Resources Management Act provided grants to rural water systems or small water development projects. Pennsylvania's Community Facilities program provided grants for needed public facilities to strengthen the income producing capability, improve the health and safety, and alleviate financial hardship of selected communities.

Several of the water programs were aimed at construction or expansion of facilities, but could also be used to respond to immediate threats to the public health and safety arising from pollution or other emergencies. Idaho's Environmental Protection and Health Act of 1972 was funding projects to prevent and control water pollution. The Water Storage and Control Facilities program in Oklahoma provided for the acquisition, development, and utilization of storage and control facilities of the state's water and sewage, but only provided grants when the health, welfare, and property of the community were in imminent peril. Maine's Small Community program provided money to small communities that could not get federal EPA grants for sewers or discharge problems, especially where such problems threatened the economy and the ecology. One program in Maine, for example, had been used to open up clam flats and shell fish areas previously closed because of sewage discharges.

Alaska had two programs, the Rural Development Assistance program and the Bulk Fuel program, which provided aid for rural towns and villages. The first program was for constructing basic facilities and diversifying local rural economies. The second helped areas far from fuel supplies to build bulk fuel storage facilities to reduce the costs and uncertainties of deliveries. Both were targeted to small communities lacking essential facilities. The funds for each program came from the state's general fund.

A unique core construction program was the West Virginia Hardship Grant. Through this program the state made grants to communities that had previously received federal EPA grants for ecological distress, but had an average percapita monthly sewer bill above a set level ($19.75). These grants were subsidies designed to get the monthly bill below that amount or as close to it as funding permitted.

The funding mechanisms for these programs were fairly standard. Eight were funded solely out of state general appropriations, and three operated on bond proceeds or a mix of general appropriations and bond revenues. The other two programs were funded from special taxes. Pennsylvania dedicated a tax on horse and harness racing that, combined with general funds, provided about $6 million annually for its program. Idaho used $2.3 million of dedicated state taxes on inheritance, tobacco and cigarettes.

Few of these programs were new. Most started up before 1980, and had been in place for ten or more years.

The interviewees recommended that others considering implementing similar programs should:

1) set specific criteria to evaluate an applicant's problems so the money would go to those with a demonstrated need;
2) have a centralized plan and stick to it to determine project feasibility and need;
3) make sure there is adequate staff capacity at the state level to handle the deluge of requests and needs;
4) design the funding cycle to coincide with the annual construction season; and
5) streamline all paperwork so that a part-time local official lacking adequate staff support can complete it.

Energy Impact Programs. Energy impact programs aid areas where the rate of development outpaces local capabilities or where communities are experiencing the boom-bust cycle of energy development. Eight states had nine programs to aid such communities. These programs were found in four of the eight regions of the nation, but were most plentiful in the Rocky Mountain states.

Most of the programs funded general public capital facilities to meet needs resulting from increased demand for energy. A few of the programs provided aid specifically for the expansion and improvement of municipal services.

ENERGY DEVELOPMENT IMPACT PROGRAMS

NEW MEXICO'S Community Assistance Council provided aid for general physical improvements and included technical assistance to local governments faced with high resource development impacts. MINNESOTA'S Iron Range Resource Rehabilitation Board targeted its aid to mining areas to help diversify their industrial bases, hoping to avert the boom-bust cycles so familiar in the mining industry. NEBRASKA'S program required electric utilities to provide aid to school systems affected by rapidly expanding enrollments due to power plant construction.

The programs were nearly uniform in their targeting requirements. Most provided aid to those communities where the mining impacts were direct. Two others were aimed at areas where resource development had ceased, to help them deal with industry decline and to diversify their economic base.

Most of the states raised funds for these programs through special severance taxes. Three states funded their programs through their federal mineral lease funds. New Mexico raised revenue through the sale of severance tax anticipation bonds.

Only one program, in Kentucky, started during the 1980-83 period. All of the rest were initiated during the 1970s. Administrators of these programs offered the following advice to colleagues:

1) try to keep the procedures simple;

2) insist on substantial local effort;

3) develop clear eligibility requirements for targeting, but retain flexibility "so that the process does not become one of administering instead of decisionmaking"; and

4) have a long-term plan.

Other Programs. Five states, primarily in the Mideast and New England, offered ten other programs targeting capital improvements to distressed areas.

Three states offered such programs to support local community economic development initiatives. The Massachusetts Heritage Parks program was designed to bring new and improved parks to downtown parts of distressed cities. These parks are cooperative ventures between certain cities and the state. They highlight a city's history and stimulate private investment in those areas. For example, Lawrence has a park with the theme "The City of Workers." Heritage Parks are funded through bond revenues.

Hawaii created the Community Development Authority to centralize planning and implemention of community development projects in underused, underdeveloped and blighted areas. The plans for its first project included the development of capital facilities in a depressed section of Oahu, including private mixed-use buildings and housing for low and moderate-income people. Operating funds come from general appropriations, while money for capital improvements ($5.5 million in 1983) comes from bond sales. Much of the housing costs come from private interests, a requirement of the project.

New Jersey was operating two programs: (1) the Depressed Rural Centers Aid Act, which provided funds to depressed, small, rural areas for maintenance of adequate municipal services, and (2) the State Municipal Aid program, which did the same for cities rated as distressed on five strict criteria.

All these programs began before 1980. Another effort, the Vermont Futures program, was providing up to 18 weeks of employment for qualified residents to work on projects that would maintain and improve the state's capital facilities. This program, using $5.3 million from a five-year bond, is noteworthy because it aimed to retain Vermont's labor force without creating any new bureaucracy.

Officials in these programs made the following recommendations to other states considering such assistance:

1) try to use existing state structures and employees rather than create new ones;
2) define eligibility criteria sharply and well;
3) obtain the cooperation of localities; and
4) commit enough funds to programs to cover their creation, operation and capital maintenance.

Two final observations need to be made. First, only four of the programs have undergone some evaluation. Second, few new programs have been implemented during the life of this study (Table 4-4). In 1980, 23 states had 29 pro-

Table 4-4

TARGETED CAPITAL IMPROVEMENT PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983
New England	1(1)	2(2)	2(2)	3(3)
Connecticut				
Maine		1	1	1
Massachusetts	1	1	1	1
New Hampshire				
Rhode Island				
Vermont				1
Mideast	2(4)	2(4)	2(5)	2(5)
Delaware				
Maryland				
New Jersey	2	2	2	2
New York				
Pennsylvania	2	2	3	3
Great Lakes	0(0)	0(0)	0(0)	0(0)
Illinois				
Indiana				
Michigan				
Ohio				
Wisconsin				
Plains	5(6)	5(6)	5(6)	6(7)
Iowa				1
Kansas	1	1	1	1
Minnesota	1	1	1	1
Missouri				
Nebraska	1	1	1	1
North Dakota	1	1	1	1
South Dakota	2	2	2	2
Southeast	4(5)	4(5)	4(5)	4(5)
Alabama				
Arkansas				
Florida	1	1	1	1
Southeast (cont.)				
Georgia				
Kentucky	1	1	1	1
Louisiana	1	1	1	1
Mississippi				
North Carolina				
South Carolina				
Tennessee				
Virginia				
West Virginia	2	2	2	2
Southwest	3(3)	3(3)	3(3)	3(3)
Arizona				
New Mexico	1	1	1	1
Oklahoma	1	1	1	1
Texas	1	1	1	1
Mountain	5(6)	5(6)	5(6)	5(6)
Colorado	1	1	1	1
Idaho	1	1	1	1
Montana	1	1	1	1
Utah	1	1	1	1
Wyoming	2	2	2	2
Far West	3(4)	3(4)	3(4)	3(4)
Alaska	2	2	2	2
California				
Hawaii	1	1	1	1
Nevada				
Oregon				
Washington	1	1	1	1
Total State (Programs)	23(29)	24(30)	24(31)	26(33)

KEY: x(y): x = number of states with programs in the region; y = number of programs in the region.

SOURCE: ACIR staff compilation based on interviews with state officials.

grams. By 1983, three more states had added four new programs. In all, about half the states offered at least one of the three kinds of targeted assistance.

Neighborhood Development

In the neighborhood development indicator, the survey found 18 programs in 14 states (Table 4-5). Only one dominant form showed up -- five states offered neighborhood assistance programs (NAP). NAPs provide tax incentives to businesses that contribute money directly to community-based organizations. Several of these states allowed up to a 50% credit for such contributions. Annual limits on the total amount of credits the states allowed varied from $1 million in Indiana to nearly $9 million in Missouri. Pennsylvania allowed credits up to 70% of the amount of the contribution, with a cap on annual credits throughout the state of $8.75 million. Delaware permitted an unlimited number of firms to take a 100% tax deduction -- up to $50,000 per year contribution per firm.

Each of these states targeted aid to distressed areas. Measures of distress included a mixture of the relative level of unemployment, quality of housing stock, and size of the tax base. Only two of these programs began since 1980. Advice received about starting a NAP program included the following points:

1) use the money either as a grant or a low-interest loan;

2) consider the cost of administration; tax credits are easy to extend, yet "no one knows the cost to run this kind of program";

3) promote the program to achieve substantial participation; and

4) be prepared to commit funds to community development corporations (CDCs) for three to five years. They often need help for that much time if they are to succeed.

The other programs in this indicator were of several types. One provided aid to CDCs and community redevelopment corporations (CRCs). Ohio's Community Redevelopment Corporations Act empowered cities and villages to extend tax abatements to CRCs active in blighted areas. An example is a deal between the City of Columbus and Nationwide Insurance. Nationwide built a $35 million headquarters in Columbus and refunded to the city the amount of property taxes rebated with the stipulation that the money be used for improving local public facilities.

Minnesota created a Community Development Grant program with $180,000 (half for administration, half for venture financing) from the general fund for grants to CDCs for community improvement projects. This was targeted to communities in which at least 10% of the population had low incomes. Forty percent of the board members were required to be low-income people. This program also provided technical assistance to the CDCs.

The California Housing Advisory Service, with $200,000 from 1983 general funds, provided grants, training, and technical assistance to local nonprofit organizations that helped individuals rehabilitate their own homes. To re-

Table 4-5

TARGETED NEIGHBORHOOD DEVELOPMENT PROGRAMS BY STATE, 1980-83

Region and State	1980	1981	1982	1983	Region and State	1980	1981	1982	1983
New England	2(4)	2(4)	2(4)	2(4)	Southeast (cont.)				
Connecticut	1	1	1	1	Georgia				
Maine					Kentucky			1	1
Massachusetts	3	3	3	3	Louisiana				
New Hampshire					Mississippi				
Rhode Island					North Carolina				
Vermont					South Carolina				
Mideast	3(5)	4(6)	4(6)	4(6)	Tennessee				
Delaware	1	1	1	1	Virginia				
Maryland		1	1	1	West Virginia				
New Jersey	3	3	3	3	Southwest	0(0)	0(0)	0(0)	0(0)
New York					Arizona				
Pennsylvania	1	1	1	1	New Mexico				
Great Lakes	2(2)	2(2)	3(3)	3(3)	Oklahoma				
Illinois					Texas				
Indiana	1	1	1	1	Mountain	0(0)	0(0)	0(0)	0(0)
Michigan			1	1	Colorado				
Ohio	1	1	1	1	Idaho				
Wisconsin					Montana				
Plains	2(2)	2(2)	2(2)	2(2)	Utah				
Iowa					Wyoming				
Kansas					Far West	1(1)	1(1)	1(1)	1(1)
Minnesota	1	1	1	1	Alaska				
Missouri	1	1	1	1	California	1	1	1	1
Nebraska					Hawaii				
North Dakota					Nevada				
South Dakota					Oregon				
Southeast	1(1)	1(1)	2(2)	2(2)	Washington				
Alabama									
Arkansas					Total States				
Florida	1	1	1	1	(Programs)	11(15)	12(16)	14(18)	14(18)

KEY: x(y): x = number of states in the region with programs; y = number of programs in the region.

SOURCE: ACIR staff compilation based on interviews with state officials.

THE MASSACHUSETTS
COMMUNITY ECONOMIC DEVELOPMENT ASSISTANCE CORPORATION

In MASSACHUSETTS, the Community Economic Development Assistance Corporation (CEDAC) provided technical assistance -- organization building, planning, business counseling, evaluation, and training -- to small businesses and community-based housing organizations that received state financial assistance from one of the state's other development programs. CEDAC had $340,000 from general funds and contracts with other agencies. Recipient organizations were limited to those in communities where the median family income is 85% of the Boston SMSA or less.

ceive aid, these organizations had to serve low to moderate-income people and be in areas other than those designated for federal entitlements. Between 1979 and 1983 this program spent $1.1 million through nine organizations to train nearly 10,000 people. The program resulted in the production or rehabilitation of 2,140 housing units.

The Connecticut Department of Housing provided grants for housing, neighborhood capital improvements, commercial improvements and mixed use projects through its Neighborhood Preservation program. The state provided one-third of project costs, with the rest coming from combined federal and local funds (which could include CDBG money). The $1 million state share came from general obligation bonds and was targeted to areas that met the distress criteria for federal block grant entitlements.

The National Trust for Historic Preservation established the federally funded Main Street Center, which provided organizational and architectural aid to merchants for commercial strip revitalization. Pennsylvania matched the funds for this distress targeted program at a rate greater than dollar-for-dollar.

Other states considering this type of neighborhood assistance were advised by survey respondents to:

1) design a means to verify tax abatements;
2) plan for expanded administrative demands;
3) draw on existing nonprofit organizations in determining needs and making plans; and
4) provide sufficient funding for two or more years.

As with capital improvements, few programs in this category were new, and only three programs had been evaluated.

Summary

State community development assistance to distressed places has not increased dramatically since 1980 when the "infrastructure crisis" was first discovered and when neighborhood groups began to experience budget reductions. In fact, there is minimal targeted state aid in either indicator. Some analysts would suggest that such aid ought to be increased if distressed communities are to be able to help themselves through difficult economic times. Others would suggest the need for greater private-sector involvement. In either case, the states have an opportunity to play a significantly increased role in targeting community development assistance to those in greatest need as part of an overall state plan to aid distressed communities.

* * * * * * *

FOOTNOTES

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[3] U.S. Department of Commerce, *Industrial Location Determinants, 1971-1975* (Washington, DC: U.S. Government Printing Office, 1975).

[4] Rick Cohen and Miriam Kohler, *Neighborhood Development Organizations After the Federal Funding Cutbacks: Current Conditions and Future Directions* (Washington, DC: U.S. Department of Housing and Urban Development, 1983), pp. 86-87.

[5] Richard P. Nathan, Fred C. Doolittle, and Associates, *The Consequences of Cuts: The Effects of the Reagan Domestic Program on State and Local Governments* (Princeton, NJ: Princeton Urban and Regional Research Center, 1983), pp. 20-21.

[6] This and the following four paragraphs begin with, but update: Edward Humberger, *Urban Policy and the Reagan Revolution* (Washington, DC: The Resource Group for Community Development, September 1982), pp. 38-41, passim.

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[8] *Ibid.*, pp. 2-3.

[9] Congressional Budget Office, *Public Works Infrastructure: Policy Considerations for the 1980s* (Washington, DC: U.S. Government Printing Office, 1983), p. 9.

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[12] *Ibid.*, p. 15.

[13] *Ibid.*, p. 17.

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[20] Gene Bunnell, Removing Obstacles to Building Reuse and Community Conservation at the Local Level (Boston, MA: Massachusetts Executive Office of Communities and Development, 1980), p. 41.

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[23] Roger S. Ahlbrandt, Jr., and Howard J. Sumka, Neighborhood Organizations and the Coproduction of Public Services (unpublished).

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28/ Sue A. Marshall and Neil S. Mayer, Neighborhood Organizations and Community Development (Washington, DC: Urban Institute, 1983), p. 8.

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30/ Including The President's Task Force on Private Sector Initiatives, Investing In America (Washington, DC: U.S. Government Printing Office, 1982); E.S. Savas, Privatizing The Public Sector; R.W. Poole, Jr., Cutting Back City Hall (New York, NY: Universe Books, 1982); and J.T. Bennett and M. Johnson, Better Government at Half the Price (Naperville, IL: Caroline House, 1981); The Financial Capacity Sharing Program, Office of Policy Development and Research at HUD, has sponsored an ongoing series of conferences which provide local government officials with information on public-private service alternatives. Privatization was also a topic on the agenda of the 1983 annual meetings of the National Assistance Management Association, National Association of Counties, and American Society for Public Administration. See for example: C.W. Lewis and J. Tenzer, "Paying the Piper," (Storrs, CT: Institute of Public Service, University of Connecticut, Winter 1983); R.W. Poole, Jr., "Municipal Services and the Privatization Option," The Heritage Foundation Backgrounder (Washington, DC: Heritage Foundation, January 11, 1983); and Urban Data Service Report, "Alternative Approaches for Delivering Public Services," (Washington, DC: International City Manager's Association, Vol. 14, No. 10, October 1982).

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Chapter 5

STATE-LOCAL FISCAL RELATIONS

Besides offering aid in the ways described in previous chapters, state governments can have a significant effect on the degree of fiscal pressure felt by local governments. State governments can either add to a local government's fiscal pressures by mandating programs or imposing revenue collection limitations, or they can relieve those pressures by instituting policies and programs that enable local governments to determine and meet their own needs.

This report concentrates on five indicators of a state's commitment to relieve local fiscal pressures:

1) state-local general revenue sharing;
2) finance of local public primary and secondary schools;
3) assumption of local public welfare costs;
4) reimbursement for state mandated programs; and
5) improving local governments' access to credit markets.

These efforts can provide relief for local governments in one or more of the following ways:

- Local Government Fiscal Relief programs involve state actions that either directly allocate funds to local governments or remove from local governments the fiscal responsibility for providing certain services.

- Redistributive or Equity-Based Policies are aimed specifically at directing funds to communities on the basis of need.

- Local Government Fiscal Empowerment policies enhance the ability of local governments to generate their own revenues, and state actions to support the financing of local capital projects.

The third category of efforts, local government fiscal empowerment, is treated in Chapter 6.

Considerations of equity are central to the discussion of state-local fiscal relations. The degree of fiscal distress faced by a particular government depends on its access to taxable wealth, economic well-being, and concentration of persons eligible for public welfare or special education programs. Equity in fiscal relations implies the reallocation of public resources from communities with relatively greater wealth and lower need to communities with relatively less wealth and higher need, so that all localities can provide similar levels of public services without undue fiscal burdens. This concept, however, raises several issues.

This chapter, first, reviews the policy issues affecting state-local fiscal relations, such as limits on revenue collection, strengthening the property tax, redistributive policy, and the use of targeting in redistribution formulas. Then, the policy issues specific to each of the five indicators are considered in relation to the ACIR survey findings.

In reading this chapter, two points should be kept in mind. First, the programs identified in this chapter are not directly targeted to distressed communities. These programs are statewide in nature, providing fiscal relief or empowerment to all localities. Nevertheless, they are of special importance to distressed communities because those communities are likely to face serious fiscal problems. They stand to gain most through policies that relieve localities of fiscal responsibilities, enhance revenue collection powers and redistribute public financial resources.1/

Second, two of the program indicators -- education finance and welfare reform -- make up a large share of most state budgets and can have a far greater budgetary impact on distressed communities than most of the other programs considered in this study. Therefore, it is important to keep the relative magnitude of these programs in perspective.

Policy Issues

Three policy issues affect the character of state-local fiscal relations: national policies, the importance of state aid to local governments, and state imposition of revenue limits.

National Policies

Federal government policies affect state and local finances in several ways. For example, federal fiscal policy affects the level of spending for public education and welfare. In addition, the new federal education block grants have changed the manner in which federal funds are distributed for certain education programs. Federal rules also determine minimum state shares in the Medicaid and Aid to Families with Dependent Children (AFDC) programs.

Implementation of the Reagan Administration's New Federalism proposal would have resulted in state and local assumption of all AFDC costs and federal assumption of all Medicaid costs. At present, almost no local governments pay into the Medicaid system, whereas several states require local government contributions to AFDC.

Finally, state-local fiscal relations are affected when certain policy issues are elevated to the national level. With the release of the report of the President's Commission on Excellence in Education, a national debate on public education programs and finance was initiated. Public pressures have been brought to bear on state government and local school districts to implement such innovations as merit pay for teachers and longer school hours, which would undoubtedly result in higher costs.

State Aid to Local Governments

State aid to local governments as a share of total state general spending varies from state to state.2/ Local government aid accounted for over 40% of total general expenditures in six states in 1981; between 30% and 40% in another 19 states, and between 20% and 30% in another 19 states (see Table 5-1).

Table 5-1

STATE AID TO LOCAL GOVERNMENTS AS A PERCENTAGE OF TOTAL STATE GENERAL SPENDING, 1981

Under 20% (5 states)	
Hawaii	1.4
New Hampshire	18.4
Rhode Island*	15.9
South Dakota	19.2
Vermont	15.2

20.1-25% (4 states)	
Connecticut*	23.0
Delaware	22.0
Maine	24.6
Montana	24.4

25.1-30% (15 states)	
Alabama	28.9
Alaska	25.3
Kansas	27.8
Kentucky	25.4
Louisiana	29.6
Massachusetts	28.0
Missouri	29.5
North Dakota*	26.5
Oklahoma	28.5
Oregon	28.2
South Carolina	27.2
Tennessee	26.9
Utah	29.2
Virginia**	28.3
West Virginia	25.6

30.1-35% (13 states)	
Arkansas	30.9
Georgia	33.4
Idaho	32.9
Illinois*	31.9
Maryland	32.6
Michigan*	34.1
Mississippi	35.0
Nebraska*	31.9
New Mexico	34.1
Nevada*	31.2
Pennsylvania*	32.1
Texas	32.2
Washington	30.7

35.1-40% (6 states)	
Colorado**	38.2
Indiana	40.0
Iowa	37.4
North Carolina*	39.1
Ohio*	35.9
Wyoming	38.2

Over 40.1% (6 states)	
California**	47.2
Florida	41.6
Minnesota**	42.7
New Jersey**	42.1
New York**	46.6
Wisconsin**	45.9

*Welfare accounts for 1-10% of state aid.
**Welfare accounts for more than 10% of state aid.

Source: Steven Gold, "State-Local Fiscal Relations in the Early 1980s," (Washington, DC: The Urban Institute, 1983), p. 12.

Of the states that spend the greatest proportion of their expenditures on local aid (California, Florida, Minnesota, New Jersey, New York, and Wisconsin), all but one spend more than 10% of that aid on public welfare. In all states, except Hawaii (where the state pays all education expenses itself), the largest share of state aid to local governments is for public education (Table 5-2). Out of a sample of 35 states, 20 allocated 75% or more of their local aid to schools. State support for highways has historically taken the second largest share of state aid to local governments. In some states, general support (including revenue sharing) constitutes the second greatest component of local aid.3/

Table 5-2

COMPOSITION OF STATE AID TO LOCAL GOVERNMENTS, 1983
(percent of total)

State	Local Schools	Highways	General Support	Other
Alabama*	82.2	12.9	5.0	.0
Arkansas*	79.8	11.2	8.8	0.2
California	57.6	3.3	10.4	28.7
Delaware	99.2	.8	.0	.0
Florida	71.7	6.3	22.0	NA
Georgia	82.8	2.5	.4	14.3
Hawaii	.0	.0	100.0	.0
Idaho	79.8	9.8	8.0	.2
Illinois	64.1	8.3	19.1	8.5
Iowa	59.7	18.5	21.6	.2
Kentucky	86.7	4.6	7.8	.9
Louisiana	75.5	3.3	16.5	4.7
Maine	78.0	4.1	11.3	6.6
Maryland	66.7	11.0	5.4	16.9
Massachusetts	52.6	2.1	32.3	12.9
Michigan	40.3	10.9	22.2	26.6
Missouri	76.0	5.4		18.6
Montana	75.6	2.8	8.6	13.1
Nevada	63.9	5.0	31.1	NA
New Hampshire	24.5	12.2	54.1	9.2
New Jersey	82.9	2.9	13.9	.3
New York*	58.9	2.1	13.6	25.4
North Carolina	76.1	2.2	4.7	17.0
North Dakota	69.6	10.9	17.7	1.8
Ohio	67.8	13.4	12.1	6.6
Oklahoma*	79.9	12.2	2.5	5.3
Oregon	71.9	10.4	17.7†	NA
Pennsylvania	93.2	5.3	.0	1.6
South Carolina	84.6	1.9	12.7	.8
Tennessee	74.4	12.2	10.6	2.8
Texas	88.8	.2	.0	11.1
Utah	83.5	4.8	.0	11.8
Vermont	81.8	10.7	1.7	5.8
Virginia	85.7	5.0	9.3	NA
West Virginia	92.1	.0	.0	7.9
Wisconsin	42.9	5.5	35.6	15.9

*1982 data.
†General support and "other" combined.

Source: Steven Gold, "State-Local Fiscal Relations in the Early 1980s," (Washington, DC: The Urban Institute, 1983), p. 15.

In 1981, the states paid an average of 58% of state and local government general expenditures. State general expenditures accounted for 61.5% of state-local highway expenditures, 83.7% of public welfare expenditures, and 52% of public education expenditures.4/

State Imposition of Revenue Limits

Another policy issue affecting local fiscal capacity is the imposition by states of limits on local powers to raise revenues. State "lid laws" can restrict local tax rates, tax levies, expenditures or debt actions, thereby constraining the ability of local governments to meet their fiscal obligations.

These limits have been justified by state officials as protecting local taxpayers and making local officials more fiscally responsible. Yet, such restrictions can become oppressive when coupled with state mandates for local public expenditures, which are discussed later in this chapter.

Of the 50 states, only five have not imposed fiscal restrictions on local governments (see Table 5-3).5/ Tennessee, South Dakota and Virginia have not imposed direct revenue limits but have passed "full disclosure laws," requiring local governments to disclose the effect of property reassessment on property taxes. State laws providing for the reimbursement of the costs of mandated programs and allowing local sales, income and use taxes would alleviate some fiscal burdens imposed by state restrictions on revenues collected from local property taxes.

The property tax remains the major source of local revenue. Policies that enhance the ability of local governments to tap this revenue source are of critical interest to local officials. Specific property tax policy enhancements include the following:

1) reducing the level of tax abatements granted for certain types of public and private property;
2) allowing governments to increase property tax rates without harming the poor by providing "circuit breaker relief," in the form of individual tax abatements for low-income households; and
3) relaxing restrictions on property taxes.

State restrictions on local property taxes have significantly reduced local governments' abilities to pay for basic services. For example, California's Proposition 13 and Massachusetts' Proposition 2-1/2, have resulted in significant cutbacks in public education spending.

Indicators

State-Local Revenue Sharing

A number of states allocate a portion of their collected revenue to counties or municipalities and allow local officials to decide how to use this money. The state legislature determines the amount to be allocated and devises a distribution formula that uses such characteristics as population, taxes raised and per-capita income. Revenue sharing funds can come from specific sources (such as state income or sales taxes, and excises like

Table 5-3

RESTRICTIONS ON STATE AND LOCAL GOVERNMENT TAX AND EXPENDITURE POWERS, JANUARY 1, 1983

		State-Imposed Limits on Local Governments						
State	Overall† Property Tax Rate Limit	Specific† Property Tax Rate Limit	Property Tax Rate Limit	General Revenue Limit	General Expenditure Limit	Limits on Assessment Increases	Full Disclosure	Limits on State Governments
TOTAL	14	29	20	5	8	6	10	20
Alabama	CMS***	CMS*						
Alaska	CMS**		CM**					Const.***
Arizona	CMS***		CM***		CMS***	CMS***		Const.***
Arkansas		CMS*	CMS***††					
California	CMS***				CMS***	CMS***		Const.***
Colorado		CS*	CM*		S**		CMS***	Stat.**
Connecticut								
Delaware		CS**	C***††					Const.***
Washington, DC								
Florida		CMS*	CMS***			CMS**	CMS**	
Georgia		S*						
Hawaii						C**	C**	Const.***
Idaho	CMS***	CMS*	CMS***					Stat.***
Illinois		CMS*						
Indiana			CMS***					
Iowa		CMS*			S**	CMS**		
Kansas		CM*	CM**		S**			
Kentucky	CMS*						CMS***	
Louisiana		CMS**	CMS***††					Stat.***
Maine								
Maryland						CM**	CM**	
Massachusetts	CMS***		CMS***					
Michigan	CS*	M*	CMS***				CMS***	Const.**
Minnesota		CMS**		CM**	S**			
Mississippi		CMS**	CMS***					
Missouri		CMS*		CMS***				Const.***
Montana		CMS*					CMS**	Stat.***
Nebraska		CMS*		CMS***				Stat.***
Nevada	CMS*			CM**				
New Hampshire								

Table 5-3 (cont.)

State	Overall† Property Tax Rate Limit	State-Imposed Limits on Local Governments Specific† Property Tax Rate Limit	Property Tax Rate Limit	General Revenue Limit	General Expenditure Limit	Limits on Assessment Increases	Full Disclosure	Limits on State Governments
New Jersey			C**		MS**			Stat.**
New Mexico	CMS*	CMS**	CMS***			CMS**		
New York		CMS*						
North Carolina		CM**						
Ohio	CMS*		CMS**					
Oklahoma	CMS*	CMS*						
Oregon			CMS*			CMS***		Stat.***
Pennsylvania		CMS*						
Rhode Island								Stat.**
South Carolina			°					Stat.***
South Dakota		CMS*						
Tennessee							CMS***	Const.***
Texas		CMS**					CMS***	Const.***
Utah		CMS*						Stat.***
Vermont								
Virginia							CM*	
Washington	CMS**	CMS**	CMS**	S**				Stat.**
West Virginia	CMS*	CMS*						
Wisconsin		CMS*	CM**		S**			
Wyoming		CMS*						

C - County M - Municipal S - School District * - Enacted before 1970
** - 1970 to 1977 *** - 1978 and after Const. - Constitutional Stat. - Statutory

†Overall limits refer to limits on the aggregate tax rate of all local government. Specific rate limits refer to limits on individual types of local governments or limits on narrowly defined services (excluding debt).
††Limits follow reassessment.
°Limit followed transition to a classified property tax.

Source: ACIR staff calculations.

tobacco or alcohol taxes), or they may be appropriated from general funds much like federal revenue sharing.

What differentiates revenue sharing from other forms of aid to local governments is that revenue sharing funds are not earmarked for specific functions. The definition of state-local revenue sharing excludes categorical aid, payments to school districts and special districts, and piggyback taxes that involve a local option to tax or to determine the local tax rate.

The key feature of state-local revenue sharing programs is the distribution formula. These formulas can be either equalizing or nonequalizing. Equalizing formulas allocate funds on the basis of indicators of need, whereas nonequalizing formulas allocate funds on the basis of revenue source. Nonequalizing programs can include the following factors in the distribution formula:

1) source of origin, (also "return to origin") in which revenues from such levies as the state sales and use taxes are returned to the local community of origin; and

2) local compensation, in which the state pays localities a sum in exchange for revenues foregone for tax-exempt property.

Programs considered equalizing pay proportionally more to areas with greater fiscal need than they pay to less needy areas.

ACIR's report The State of State-Local Revenue Sharing defines equalizing revenue sharing as "that which counteracts inequality in local financing abilities by providing relatively more aid to places lacking tax capacity."6/ Revenue sharing does not precisely equalize, although the term "equalizing" is applied to a range of redistributive formulas.

Actually, revenue sharing programs might not result in equalization of spending levels. In theory, some communities could achieve higher-than-equal spending levels because of revenue sharing. Equalizing formulas could increase payments in relation to the following factors:

1) population, such as local population or income per capita;
2) tax capacity, such as the inverse of local tax capacity;
3) tax effort, such as the proportion of taxes collected to tax capacity; and,
4) other need measures, such as population density or number of households receiving public assistance.

Including factors like per-capita income or the inverse of local tax capacity may have a greater equalizing effect than including a factor like population. Revenue sharing can address issues of local fiscal need.

Several of the measures commonly used as indicators of local need may not accurately reflect the community's true circumstances. Such indicators include the following:

1. Population or Per-Capita Measures. Some formulas are based on the

notion that areas with large populations have greater relative needs. While this may be true for some large urban centers, the converse is often true for sparsely populated areas that have higher per-capita costs for services. Population measures are considered slightly equalizing, nevertheless, to the extent that funds would flow from wealthier communities to less affluent areas.

2. Tax Rate. A high property tax rate is considered an indication of low fiscal capacity. A community may have a limited tax base, requiring it to tax itself at a high rate to obtain an adequate revenue yield. On the other hand, a high tax rate may indicate the desire of a wealthy community to provide higher-than-average levels of public services. Thus, a revenue sharing formula that rewards areas with high tax rates may help wealthy communities as well as needy ones.

3. Tax Yields. Local tax yields also are double-edged swords as indicators of local need for fiscal relief. A high level of tax revenues may indicate that a community faces particularly high costs of providing services, such as infrastructure replacement or renovation in older cities. Or it may reflect the ability of wealthier communities to tax themselves at a relatively low rate and still attain ample revenues. Conversely, low revenue receipts may indicate either an inability or an unwillingness to tax at the rate necessary to yield revenue adequate to pay for public services.

Measures of tax capacity seem to provide the strongest basis for state-local revenue sharing based on need. They directly address the issue of relative ability of governments to generate revenues.7/

Equalizing factors in state-local revenue sharing formulas are counterparts of criteria used to target other forms of aid to distressed communities. Fiscal relief is a technique for providing aid to fiscally pressed or distressed communities. Even when aid is distributed on the basis of factors other than need, as with return-to-origin or tax exemption compensation, funds are allocated to local communities providing some measure of fiscal relief. Furthermore, nonequalizing distribution formulas are not necessarily unfair when they favor wealthier communties. They are designed to meet other goals, as well, such as property tax relief. The effect of both nonequalizing and equalizing revenue sharing programs is to provide local fiscal relief, thereby allowing a local government to use its funds for other high-priority projects.

Not all types of equalization aid provide the same degree of assistance to distressed communities. As noted above, formulas based on tax rates or tax collections may direct aid to wealthier communities, rather than to poorer ones. Formulas distributing funds on a population or per-capita basis are considered only slightly equalizing, providing the weakest degree of assistance to distressed areas. The use of other indicators of fiscal need, such as tax capacity, more explicitly targets aid to distressed communities.

Alternatives to state revenue sharing for providing local fiscal relief include the following:

Table 5-4

STATE-LOCAL REVENUE SHARING: STATES WITH EQUALIZING PROGRAMS AND TOTAL STATE REVENUE SHARING OUTLAYS BY STATE, 1980-82

	Programs Providing Equalized Revenue Sharing To			Total Revenue Sharing (in thousands)		
State	Counties	Municipalities	Towns	1980	1981	1982
Alabama	2	2		$ NA	$ 52,839	$ 57,826
Alaska	2	3		36,378	114,134	149,507
Arizona	1	2		244,944	293,821	294,349
Arkansas		2		36,903	41,701	40,493
California	1	2		395,566	537,182	474,350
Colorado				16,919	17,693	17,964
Connecticut				NA	108,701	90,679
Delaware						
Florida	2	3		NA	296,822	311,429
Georgia		4		NA	16,117	16,117
Hawaii	1	1		18,223	18,243	18,273
Idaho	1	2		36,194	26,417	23,169
Illinois	2	2		435,456	435,998	414,877
Indiana	1	3		NA	424,973	448,990
Iowa	1	2		115,783	121,820	129,370
Kansas	2	1		41,500	41,500	45,346
Kentucky				NA	1,468	1,760
Lousiana	2	1		171,415	210,616	223,285
Maine		1		NA	24,179	24,469
Maryland	2	2		NA	58,791	53,293
Massachusetts		1	1	NA	175,861	378,565
Michigan		3	4	NA	546,346	535,232
Minnesota	2	3	2	383,596	467,204	494,754
Mississippi		1		NA	132,095	145,432
Missouri				7,374	6,901	6,449
Montana				15,269	15,459	24,465
Nebraska	3	2		NA	122,839	123,932
Nevada	4	2		16,237	16,256	158,577
New Hamsphire		3	3	NA	37,519	42,731

1) authorizing local taxes in addition to the property tax, such as local sales and income taxes;
2) authorizing coordinated revenue raising mechanisms below the state level, such as tax base sharing (as practiced in Minneapolis-St. Paul) and interlocal revenue sharing (as practiced by counties in many states for their cities, towns, and unincorporated communities);
3) strengthening the ability of local governments to use the property tax for such purposes as circuit-breaker relief for low-income households; and
4) relaxation or elimination of state imposed property tax limits.

Table 5-4 (cont.)

	Programs Providing Equalized Revenue Sharing To			Total Revenue Sharing (in thousands)		
State	Counties	Municipalities	Towns	1980	1981	1982
New Jersey		3	1	NA	1,043,881	1,165,078
New Mexico		1		116,143	132,588	174,794
New York	1	2	1	NA	1,099,621	912,861
North Carolina	1	1		NA	115,431	134,001
North Dakota	2	1		29,344	35,786	39,628
Ohio		2		328,327	351,078	361,923
Oklahoma	2	1		9,803	9,482	12,108
Oregon	2	2		59,132	60,668	194,192
Pennsylvania		1		NA	41,880	60,450
Rhode Island		1	1	NA	15,774	16,676
South Carolina	4	3		NA	91,678	90,566
South Dakota		1	1	24,901	45,743	46,081
Tennessee		3		NA	103,374	117,392
Texas				24,995	31,576	39,781
Utah	1	1		1,920	1,930	1,000
Vermont				NA	128	173
Virginia	2	2	1	NA	22,497	22,354
Washington	3	3		51,835	60,799	62,601
West Virginia	2	1		NA	16,670	13,823
Wisconsin	2	2		NA	766,208	758,982
Wyoming	1	1		86,143	109,904	128,600
Total States	28	42	9			
(Programs)	(51)	(80)	(15)			

Source: ACIR interviews with state officials; Center for Governmental Research, Inc., State Revenue Sharing; U.S. Department of Commerce, Bureau of the Census, state revenue sharing worksheets for 1982.

The creation of separate programs along these lines could complement the creation of equalizing state-local revenue sharing programs.

Survey Findings. For the ACIR survey of state officials, revenue sharing was defined as state-local aid not specified for particular local programs; that is, it would not include, for example, aid for local police districts financed through redistributed liquor taxes. The catalogue of state programs published as part of this study (ACIR Report M-140) contains the list of revenue sharing programs in each state which are characterized by distribution formulas containing "need" factors. "Need" factors were broadly defined as population, per-capita income, tax effort, or other factors such as the inverse of property wealth. Programs returning revenues to the place of origin were not included. Because the Bureau of the Census does not distinguish between equalizing and nonequalizing state-local revenue sharing, the data concerning state total revenue sharing payments for the years 1979-82 combine both kinds of revenue sharing programs in Table 5-4.

This report contains three types of state-local revenue sharing data: (1) identification of states with revenue sharing programs, (2) identification of programs which have equalizing distribution formulas, and (3) the total state-local revenue sharing payments for the years 1979 through 1982.

In 1982, 49 states operated general state-local revenue sharing programs, 41 of which had equalizing distribution formulas. Local population size is a factor in the revenue sharing programs of every state. Four states distribute aid on the basis of specialized population characteristics; e.g., average daily school attendance in Nebraska. Six states consider per capita income in their revenue sharing programs. A handful of states use factors considered more equalizing than population. For example, Louisiana considers revenue need, New Hampshire and New Jersey count equalized property valuation, and New Jersey factors in equalized tax rates.

State-local revenue sharing programs are financed from a variety of sources. Alcohol and tobacco taxes, motor vehicle license fees, income taxes, sales and excise taxes, and the state general fund are common sources of revenue sharing funds. Of all the revenue sharing programs operating from 1981 to 1982, 33 increased aid to local governments, 15 decreased payments, and one state provided the same level of funding for both years.

The regional distribution of state revenue sharing programs is reported in Table 5-5. This table reveals that most states in each region were using

Table 5-5

STATE-LOCAL REVENUE SHARING PROGRAMS BY REGION, 1982

State-Local Revenue Sharing Programs (N=49)*	Northeast (11)	South (13)*	Midwest (12)	West (13)
Programs with Equalizing Formulas (42)	8 .	12	11	11
Increases in Programs with Equalizing Formulas 1980-82 (32)	6	9	8	9

*Delaware had no revenue sharing program meeting the definition used in this study.

Source: ACIR staff compilation based on interviews with state officials; Center for Governmental Research, Inc., State Revenue Sharing; U.S. Department of Commerce, Bureau of the Census, state revenue sharing worksheets for 1982.

equalizing formulas and have increased state-local revenue sharing. Of the five states that spent the most on local revenue sharing, two were in the East -- New Jersey and New York, and three were in the Midwest region -- Michigan, Minnesota and Wisconsin.

Public Education Finance

Local school districts have the primary responsibility for providing local public elementary and secondary education, but state governments and the federal government also play important roles. States provide funds for both elementary and secondary schools, as well as for higher education, and can work effectively to equalize public education expenditures per pupil. In fact, state constitutions and court decisions have accelerated this equalizing role. Before 1982, federal aid to education was designed largely to supplement local school budgets in an equalizing fashion through a series of categorical grants for programs like compensatory education and desegregation. The current federal education block grants equalize moderately among states without respect to special programs or allocations among local school districts.

Because the ability of school districts to raise revenues locally is usually tied to the local property tax, districts with low property wealth must tax themselves at a higher rate than wealthier districts to attain the same level of education finance, if left to their own devices. State aid to public education relieves the fiscal pressures on less wealthy school districts.

Education finance reform refers to those policies and aid distribution formulas designed to alter the manner in which educational funds are distributed. The term "reform" should be used with caution, however, because of both conceptual and situational complexities.

Reform policies seek, in general, to address one or more of the following goals:

1. Expenditure Equalization. The traditional reliance of educational spending on the local property tax creates wide variations in per-pupil expenditures. Differences in both tax rates and property tax bases affect these local expenditures. Expenditure equalization, as an equity goal, implies the achievement of substantially equivalent per-pupil spending levels in all school districts.

2. Compensatory Education. Programs for disabled or otherwise disadvantaged children cost more than mainstream education programs. Such additional expenditures are usually considered legitimate and necessary for these children to participate in the public school system and achieve the same level of education as their counterparts who are not disadvantaged. Although special education for the physically disabled is the most common form of compensatory education provided by the states, additional types of aid (for the culturally and economically disadvantaged) also may be provided in state education funding based on need.

3. Wealth Neutrality. The most sophisticated of education finance equity concepts, wealth neutrality requires that education expendi-

Table 5-6

STATE EDUCATION FINANCE: COMPENSATION FOR NEED BY STATE, 1982

	State Aid to Education Compensates for...					
State	Grade Level Differences	Exceptional Education Programs	Compensatory Education Programs	Bilingual Education	Density/ Sparsity/ Small Schools	Declining Enrollment
Alabama	x	x				x
Alaska	x	x		x	x	x
Arizona	x	x		x	x	x
Arkansas	x	x			x	x
California		x	x	x	x	x
Colorado		x		x	x	x
Connecticut		x	x	x	x	x
Delaware	x	x	x			
Florida	x	x	x	x	x	x
Georgia	x	x	x		x	
Hawaii						
Idaho	x	x			x	x
Illinois	x	x	x	x		x
Indiana		x				x
Iowa		x			x	x
Kansas		x		x	x	x
Kentucky		x			x	x
Louisiana	x	x		x	x	
Maine	x	x			x	
Maryland		x	x		x	
Massachusetts		x	x	x		
Michigan		x	x	x		x
Minnesota	x	x	x	x	x	x
Mississippi	x	x				x
Missouri		x	x			x
Montana	x	x			x	x
Nebraska	x	x	x		x	x
Nevada	x	x			x	x
New Hampshire	x	x				x

tures not be related to the wealth of a child's community. Simple wealth neutrality is where low-wealth districts pay the same amount per pupil as high-wealth districts. Conditional wealth neutrality allows spending differences so long as they are attributed to "exceptional characteristics" such as the tax rate.

Equalization may not, however, be the best choice of goals for education finance. First, the relationship between spending and achievement has not been firmly established. Second, and more importantly, there may be legitimate reasons for allowing and encouraging different levels of education expendi-

Table 5-6 (cont.)

	State Aid to Education Compensates for...					
State	Grade Level Differences	Exceptional Education Programs	Compensatory Education Programs	Bilingual Education	Density/ Sparsity/ Small Schools	Declining Enrollment
New Jersey		x	x	x		
New Mexico	x	x		x	x	
New York	x	x	x	x		x
North Carolina	x	x	x		x	
North Dakota	x	x			x	
Ohio		x	x		x	x
Oklahoma	x				x	x
Oregon	x	x	x		x	x
Pennsylvania	x	x	x		x	x
Rhode Island		x	x	x		
South Carolina	x	x				
South Dakota	x	x			x	
Tennessee	x	x				
Texas	x	x	x	x	x	
Utah		x	x	x	x	
Vermont	x	x				
Virginia		x				x
Washington		x	x	x	x	x
West Virginia		x				
Wisconsin		x		x		
Wyoming		x			x	x

Source: Kent McGuire and Patty Flakus, "School Finance at a Sixth Glance," Education Finance Center, Education Commission of the States, Denver, CO; Roger Gaunt, Virginia Department of Education, correspondence with ACIR staff, July 1984; and, Lon Sprecher, Wisconsin Department of Administration, correspondence with ACIR staff, July 1984.

tures among school districts. Spending for compensatory education is contrary to simple expenditure equalization, but may be justified. Compensatory education finance can take into consideration grade-level differences between districts, economic disadvantage, the concentration of students for whom English is the second language, declining enrollment, and higher costs associated with providing education services in urban or rural areas. Compensation for need, by state, is shown in Table 5-6.

With respect to wealth neutrality, it should be emphasized that "simple" wealth neutrality does not imply that every district should spend the same amount per pupil, but that districts in one income class spend, on average, the same amount as districts in other income classes.8/

Another major policy issue associated with education finance concerns the inherent conflict among the various equity concepts. Compensation to a poor community necessarily means unequal expenditure rates. The choice between "simple" and "conditional" wealth neutrality as a goal determines what policies would achieve either goal. The following education finance mechanisms would achieve different policy goals:

1. Foundation Plan. This would provide a guaranteed minimum level of per-pupil support. Some reforms involve significant increases in the foundation level.

2. District Power Equalizing. Also known as guaranteed yield, this system would provide that a given local tax rate would yield a certain level of education funding. If a local district's revenues fell short of this level, state funds would make up the difference.

3. Full State Funding. The state would assume all responsibility for education finance (or some major segment of it like school construction or teacher salaries). This may remove some local autonomy concerning the administration and substance of public education, but it provides for state control over education aid distribution.

4. Vouchers. While never implemented on a statewide basis, this system would involve the distribution of education vouchers for each school-age child, redeemable at any public or private school.

Vouchers are designed to provide parents with the choice of enrolling their children in any school, and would have the effect of linking state expenditure to school enrollment. District power equalizing is designed to achieve conditional wealth neutrality by allowing spending variations related to a district's tax rate choice.

Educational finance policy is also affected by legal decisions. In the landmark case Serrano v. Priest, the California Supreme Court ruled that disparities in education spending related to wealth were unconstitutional. The court left ambiguous, however, whether simple or conditional wealth neutrality would be required. Unless district wealth characteristics are identical, both concepts cannot be satisfied. In California, the state supreme court intended to allow local choice; one or the other definition of wealth neutrality would have to be chosen. Conditional neutrality would require that districts making the same tax effort receive the same amount of funds. Simple wealth neutrality would require that average expenditures per child be the same in property-poor districts as in other districts. The adoption of an education finance policy designed to satisfy simple wealth neutrality would go further toward the separation of education spending from community wealth.

Finally, the national policy debate on educational excellence and federal education finance policy has influenced state education finance policy.9/ Public pressures have been brought to bear on state officials since the release of the report of the President's Commission on Excellence in Education in 1983. The governors of Virginia and Tennessee have proposed reforming school curricula and implementing merit pay systems for teachers. This represents a commitment to greater spending for public education, which is already the most significant component in state aid to local governments. Public groups have brought pressures to bear on the State Board of Regents of New York to increase school aid in general, to implement an aid distribution program providing for greater equalization, and to fund stiffer science, mathematics, and foreign language requirements, as well as to provide more in-service teacher training. In Florida, the governor has persuaded the legislature to raise $233 million in new taxes to pay for several changes in the schools. These include longer school hours, more required credits for high school graduation, merit pay for teachers, and the continuation of students who fail the high school literacy test.

With respect to federal aid to education the education block grant has resulted in changes in how public school systems spend their federal dollars. Critics of block grants for education, like the Council of Great City Schools and the American Association of School Administrators, assert that with the advent of the federal education block grants, federal support of desegregation efforts has fallen off as has the amount of aid received by urban school districts.[10] The losses in Buffalo, Cleveland, St. Louis, and Seattle have been reported at 85% since the block grant went into effect. The block grant gives states the authority to reallocate federal funds to local districts. Reallocation formulas vary widely, from those favoring enrollment to those favoring "high cost" factors. The grant has encouraged expanding libraries and acquiring computers, but is also reported as contributing to expenditure inequality.

As a final note, the Education Commission on the States has identified those states that have undergone school finance reform. States that have voluntarily modified their education finance structures or that have been ordered by the courts to implement changes, as well as states changing the level of support, are shown in Figure 5-1.

Figure 5-1

STATES CHANGING EDUCATION FINANCE STRUCTURE OR SUPPORT LEVEL

1. States That Have Modified Finance Structure

Arizona
California
Colorado
Connecticut
Florida
Illinois
Indiana
Iowa
Kansas
Maine
Massachusetts
Michigan
Minnesota
Missouri
Montana
New Jersey
New Mexico
Ohio
Oklahoma (1980s)
Pennsylvania
Rhode Island
South Carolina
Tennessee
Texas
Utah
Virginia
Washington
West Virginia (1983-84)
Wisconsin
Wyoming (1983)

2. States That Have Changed Level of Support

Alaska
Delaware
Maryland
New York
North Dakota
Oregon
Vermont

Table 5-7

ESTIMATED REVENUE RECEIPTS FOR ELEMENTARY AND SECONDARY EDUCATION BY GOVERNMENT SOURCE AND STATE, SCHOOL YEARS 1980-81, 1982-83

	School Year 1980-81			School Year 1982-83		
State	Federal Share	State Share of State-Local Cost	State Receipts	Federal Share	State Share of State-Local Cost	State Receipts
Alabama	12.0%	79.7%	$ 845M	15.1%	75.4%	$ 736M
Alaska	13.1	80.1	325	5.7	83.1	469
Arizona	12.0	46.2	495	11.4	51.6	640
Arkansas	14.6	63.3	425	13.3	62.7	506
California	10.6	84.3	7798	5.3	90.6	8190
Colorado	6.1	36.5	606	5.4	39.0	668
Connecticut	5.8	43.6	525	4.9	38.3	660
Delaware	12.6	75.4	210	11.2	76.1	244
Florida	8.7	63.5	2000	7.1	66.7	2600
Georgia	12.9	63.5	1138	10.2	61.9	1358
Hawaii	12.3	97.1	378	9.1	99.6	458
Idaho	8.4	67.2	235	6.9	67.3	289
Illinois	9.7	45.1	2262	8.5	41.6	2327
Indiana	5.5	63.1	1322	6.3	62.6	1563
Iowa	7.4	46.5	619	7.3	45.4	635
Kansas	6.8	48.9	504	10.0	46.7	606
Kentucky	11.7	79.8	935	10.7	79.0	1054
Lousisiana	14.9	64.9	851	9.4	61.7	1072
Maine	9.1	53.7	233	10.1	55.2	275
Maryland	7.6	43.0	844	5.3	42.7	956
Massachusetts	7.0	41.6	1263	4.8	41.4	1141
Michigan	8.0	38.9	1750	8.1	39.3	2067
Minnesota	6.4	58.4	1234	4.8	51.3	1182
Mississippi	24.1	69.9	456	33.0	69.2	528
Missouri	10.1	41.1	678	8.1	43.1	858
Montana	9.0	53.1	198	8.4	51.7	231
Nebraska	7.9	26.5	158	7.1	30.1	190

As of July 31, 1983, reform legislation was passed in Georgia and South Dakota but had not been implemented, and Arkansas was under a court order to change its finance system but had not implemented the provisions of the ruling.11/ Hawaii is not on the list because it has a record of nearly equal spending per pupil between localities.

Survey Findings. State aid in public education finance can take several forms: (1) passage of reform legislation; (2) maintenance or improvements in the reduction of spending disparities; (3) increased state spending; (4) increases in the state share of total education finances; and (5) state replacement of reduced federal aid.

Table 5-7 (cont.)

	School Year 1980-81			School Year 1982-83		
State	Federal Share	State Share of State-Local Cost	State Receipts	Federal Share	State Share of State-Local Cost	State Receipts
Nevada	7.8	56.1	154	7.8	65.6	217
New Hampshire	4.6	7.0	25	3.9	7.2	28
New Jersey	3.6	40.9	1631	3.5	41.5	1948
New Mexico	13.4	78.2	453	10.2	86.7	646
New York	4.9	44.2	3955	4.0	43.7	4492
North Carolina	13.4	67.0	1465	16.1	73.3	1623
North Dakota	7.9	49.4	115	7.3	55.6	176
Ohio	8.2	44.2	1711	5.0	42.8	2136
Oklahoma	11.5	67.0	825	10.3	67.1	1037
Oregon	9.7	39.8	480	8.8	40.4	602
Pennsylvania	8.5	49.2	2531	7.5	48.8	2850
Rhode Island	5.9	41.2	159	4.7	38.8	174
South Carolina	14.4	68.6	711	13.7	66.1	2136
South Dakota	12.6	30.9	77	8.2	30.3	95
Tennessee	15.0	56.9	749	13.0	54.3	883
Texas	10.4	56.6	3246	10.0	56.3	4159
Utah	7.6	58.4	384	5.2	59.3	480
Vermont	6.1	28.8	59	6.8	37.8	161
Virginia	9.5	45.2	954	6.7	44.5	1116
Washington	8.6	81.9	1407	5.4	79.5	1682
West Virginia	11.3	68.9	499	9.0	68.6	606
Wisconsin	6.3	39.2	844	5.3	39.5	979
Wyoming	6.7	30.6	79	4.0	36.1	130

Source: ACIR staff compilation from National Education Association, Estimates of School Statistics, 1982-83 (Washington, DC: 1983).

State expenditures for education increased in 47 states from 1980-81 to 1982-83 (Table 5-7). Federal expenditures increased over that same period in 24 states. Overall, federal expenditures for the 50 states declined during that period from $8.9 billion to $8.7 billion a difference of $238 million. For the school years 1980 to 1983, the federal share of public education increased in seven states; the state share increased in 24. Local and other shares increased in 32 states. Nationwide, state expenditures for public education increased from $50.8 billion to $58.4 billion. The average state share of state and local costs declined slightly from 54.6% to 54.3%.

Another measure of state performance in public education spending is per-pupil spending disparity. Spending disparity is estimated here by what is known as the "95:5" ratio -- that is, the ratio between the amount spent per-pupil by school districts in the 95th percentile (i.e., high-spending districts) and the amount spent by districts in the 5th percentile (low-spending districts).12/ Of the 50 states, 18 are reported to have improved their spending disparity records from the 1976-77 to the 1982-83 school years on the basis of 95:5 calculations (Table 5-8). Despite heavy property tax losses due to Proposition 13, California was one of the states reporting an improvement: spending ratios dropped from 1.54 to 1.48, suggesting some compliance with the Serrano court decision. Table 5-9 shows the variation in per-pupil spending disparity for all states.

Finally, the regional differences and similarities in state education finance performance are presented in Table 5-10. For the 50 states, 95:5 performance seems evenly distributed, but the state share of state-local receipts is more unevenly distributed. Regionally, the 95:5 measure reveals different performances in spending disparity, with the Northeast and South experiencing greater disparity than midwestern states. Of the five states spending the most on public education, one is in the West (California), two in the South (Florida and Texas), and two in the Northeast (New York and Pennsylvania).

Assumption of Local Public Welfare

Public welfare programs consume a significant portion of state budgets. The two largest programs -- Medicaid and Aid to Families with Dependent Children (AFDC) -- operate under federal legislation but involve both federal and state governments in their administration and funding. Some states mandate that local governments provide part of the state share of funding for these programs. These states can help alleviate local fiscal distress by reducing or eliminating the share that local governments are required to contribute.

Several states also operate their own general assistance programs that receive no federal funds. Local governments pay part of the bill in some of these states.13/

Although local governments have a role in funding Medicaid and AFDC in some states, they generally have little or no authority to set rules for eligibility and levels of benefits. Each state has the power to set these rules, within guidelines established at the federal level. Before 1981, these guidelines allowed almost total discretion to states, but the reconciliation act passed in that year imposed several restrictions. These included tighter limits on what sources of income are counted to determine whether a person is eligible, and other restrictions on eligibility. Federal rules give states the option of making AFDC payments to households in which both parents are present but the father is unemployed; about half the states do so.

The federal government's share of a state's Medicaid and AFDC costs varies with the state's per-capita income; poorer states receive a larger proportion of total costs from the federal government than do richer states. A state has the option of gaining a larger federal share of AFDC costs if it increases state outlays for all public welfare programs.

Most states administer public welfare programs from state offices. A

Table 5-8

WITHIN-STATE DISPARITIES IN CORE EDUCATION EXPENDITURES MEASURED BY RATIO OF EXPENDITURES AT 95TH AND 5TH PERCENTILES, SCHOOL YEARS 1976-77, 1978-79, 1982-83

Region and State	1976-77	1978-79	1982-83
New England			
Connecticut	1.83	1.75	1.73
Maine	1.60	1.60	1.64
Massachusetts	2.24	1.81	1.96
New Hampshire	1.57	1.64	1.96
Rhode Island	1.53	1.61	1.56
Vermont	1.77	1.92	2.20
Mideast			
Delaware	2.01	1.49	1.64
Maryland	1.64	1.79	1.61
New Jersey	1.70	1.72	1.75
New York	1.83	1.90	1.90
Pennsylvania	1.71	1.82	1.93
Great Lakes			
Illinois	1.62	1.61	1.91
Indiana	1.63	1.69	1.64
Michigan	1.78	1.73	1.74
Ohio	1.94	2.04	1.95
Wisconsin	1.55	1.70	1.71
Plains			
Iowa	1.28	1.24	1.29
Kansas	1.54	1.51	1.64
Minnesota	1.91	1.51	1.58
Missouri	1.93	1.70	1.81
Nebraska	1.67	1.59	1.45
North Dakota	1.61	1.49	1.52
South Dakota	1.93	1.60	1.61
Southeast			
Alabama	1.49	1.41	1.49
Southeast (cont.)			
Arkansas	1.80	1.85	1.88
Florida	1.41	1.41	1.40
Georgia	1.88	2.07	2.01
Kentucky	1.82	1.75	1.51
Louisiana	1.45	1.44	1.53
Mississippi	1.67	1.56	1.52
North Carolina	1.42	1.42	1.38
South Carolina	1.64	1.67	1.76
Tennessee	1.89	1.87	1.89
Virginia	1.82	1.83	1.82
West Virginia	1.28	1.27	1.32
Southwest			
Arizona	1.43	NA	1.78
New Mexico	1.48	1.38	1.38
Oklahoma	1.55	1.55	1.70
Texas	1.66	1.69	1.30
Mountain			
Colorado	1.66	1.67	1.67
Idaho	1.50	1.54	1.56
Montana	NA	NA	2.18
Utah	130	1.42	1.38
Wyoming	1.51	1.57	1.55
Far West			
Alaska	1.77	2.64	2.80
California	1.54	1.58	1.48
Hawaii	1.00	1.00	1.00
Nevada	1.14	1.23	1.11
Oregon	1.40	1.42	1.46
Washington	1.78	1.84	1.69

Rank: 100 = No disparity between 95th and 5th percentile expenditures per pupil; the higher the ratio, the higher the disparity.

Key: NA -- not available.

Source: ACIR staff compilation from U.S. Department of Education, National Center for Education Statistics unpublished tabulations of public education expenditures for local school districts.

Table 5-9

SUMMARY OF PER-PUPIL SPENDING DISPARITIES, 1982-83

95:5 Ratio in 1982-83	Number of States
1.00 - 1.24	2
1.25 - 1.49	11
1.50 - 1.74	19
1.75 - 1.99	14
2.00+	4

Source: ACIR staff compilation from U.S. Department of Education, National Center for Education Statistics unpublished tabulations.

Table 5-10

STATE FINANCE OF LOCAL EDUCATION BY REGION, 1982-83

Measure	Northeast (10)	South (14)	Midwest (12)	West (13)
1. 95:5 Ratio				
1.00 - 1.24 (2)	0	0	0	2
1.25 - 1.49 (11)	0	5	2	4
1.50 - 1.74 (19)	5	3	7	4
1.75 - 1.99 (14)	5	5	3	1
2.00+ (4)	1	1	0	2
2. State Share of State-Local Receipts				
80%+ (4)	0	0	0	4
70 - 79.9% (5)	1	3	0	1
60 - 69.9% (11)	0	8	1	2
50 - 59.9% (8)	1	2	2	3
40 - 49.9% (12)	5	1	5	1
0 - 39.9% (10)	4	0	4	2

Source: ACIR staff compilation.

few states, like New Jersey, administer public welfare programs at the county level. Essex County, NJ, is currently transferring public welfare administration responsibilities from county offices to offices managed by community based, nonprofit organizations.

Survey Findings. States have assumed a greater share of state-local costs of AFDC as well as outlays for general public welfare. Table 5-11 shows state shares of state and local costs of public welfare, including AFDC, Medicaid, and general assistance. It also shows that the federal share of AFDC and Medicaid increased in 13 states between 1981 and 1983. Twenty-six states increased their share of state-local public welfare costs between 1981-82. Forty states assumed all state-local AFDC in 1982. Nationwide, state public welfare expenditures increased from $12.9 billion to $13.7 billion between 1981 and 1982.

In Medicaid, few local governments are required to contribute to program costs. Of the 49 states participating in the Medicaid program, 39 assumed all state and local costs in 1982. (Arizona administers its own independent health care assistance program.) Federal contributions increased in 33 states between 1981 and 1982, while state contributions increased in 38.

Table 5-11 also shows that 49 states operated general assistance programs in 1978 (the latest data available). Twenty-three of these states assumed all assistance payment costs; 11 states shared costs with local governments; and 15 states made no contribution to these programs.

The regional distribution of state public welfare efforts is shown in Table 5-12. The state share of AFDC and Medicaid can be characterized in all regions typically as 100% of state-local costs. More Western and Eastern states support general assistance than Southern or Midwestern states.

Table 5-13 shows those states requiring the greatest local involvement in paying for welfare programs.

State Reimbursement for Mandated Programs

State mandates include any constitutional, statutory or administrative action that limits or places requirements on local governments.14/ State officials generally justify such mandates with three arguments:

1. Mandated programs or services promote a desirable social or economic goal.

2. An activity or service is of sufficient statewide importance that the decision to provide the activity or service should not be left to the judgment of individual local jurisdictions.

3. The achievement of statewide uniformity in a program or service is deemed essential by the legislature or courts.

The local view of mandating is, not surprisingly, quite different. Local officials maintain that state mandates contravene the principle of political accountability. According to this principle, programmatic and financial decisions are best made by those directly accountable to the voters for those decisions. State mandates also are said to undercut financial responsibility because they absorb much needed revenues and diminish the control local officials' exercise over their budgets. Local government officials are especially critical of state laws pertaining to the salaries, job benefits, and working conditions of local government employees. These issues are of particular concern to officials of distressed communities.

Table 5-11

STATE ASSUMPTION OF LOCAL PUBLIC WELFARE COSTS BY STATES
(in percent)

			State Share of State-Local Share of Welfare Costs					
	Federal Share (FMAP)+		Public Welfare		AFDC	Medicaid		General Assistance
State	1980-81	1982-83	1981	1982	1983	1981	1982	1978
Alabama	71.32	71.23	94	96	100.0	100.0	100.0	100.0
Alaska	50.00	50.00	97	94	100.0	100.0	100.0	100.0
Arizona*	61.47	59.87	63	60	100.0	NA	NA	100.0
Arkansas	72.87	72.16	99	100	100.0	100.0	100.0	NA
California	50.00	50.00	99	98	89.2	100.0	100.0	0
Colorado	53.16	52.28	80	94	57.3	100.0	100.0	0
Connecticut	50.00	50.00	92	90	100.0	100.0	100.0	90.0
Delaware	50.00	50.00	100	99	100.0	100.0	100.0	100.0
Florida	58.94	57.92	85	89	100.0	87.8	89.9	100.0
Georgia	66.76	66.28	96	95	100.0	100.0	100.0	100.0
Hawaii	50.00	50.00	100	96	100.0	100.0	100.0	100.0
Idaho	65.70	65.43	91	85	100.0	100.0	100.0	100.0
Illinois	50.00	50.00	97	96	100.0	100.0	100.0	shared
Indiana	57.86	56.73	67	66	60.0	100.0	100.0	0
Iowa	56.57	55.35	80	83	100.0	100.0	86.5	0
Kansas	53.52	52.50	96	95	100.0	100.0	100.0	100.0
Kentucky	68.07	67.95	97	96	100.0	100.0	100.0	0
Lousiana	68.82	66.85	93	93	100.0	100.0	100.0	100.0
Maine	69.33	70.63	91	95	100.0	100.0	100.0	shared
Maryland	50.00	50.00	100	100	100.0	100.0	100.0	100.0
Massachusetts	51.75	53.56	97	96	100.0	100.0	100.0	100.0
Michigan	50.00	50.00	93	100	100.0	100.0	100.0	100.0
Minnesota	55.64	54.39	61	93	85.0	95.7	95.8	50.0
Mississippi	77.55	77.36	89	92	100.0	100.0	100.0	0
Missouri	60.36	60.38	100	99	100.0	100.0	100.0	100.0
Montana	64.28	65.34	55	72	75.0	100.0	100.0	shared
Nebraska	57.62	58.12	65	74	100.0	65.7	70.2	0
Nevada	50.00	50.00	81	80	100.0	100.0	100.0	0
New Hampshire	61.11	59.41	74	46	100.0	100.0	100.0	0
New Jersey	50.00	50.00	78	94	75.0	100.0	100.0	shared
New Mexico	69.03	67.19	93	93	100.0	100.0	100.0	100.0
New York	50.00	50.00	50	53	50.0	60.2	61.0	shared
North Carolina	67.64	67.81	46	44	50.0*+	78.5	81.5	0

Table 5-11 (cont.)

			State Share of State-Local Share of Welfare Costs					
	Federal Share (FMAP)+		Public Welfare		AFDC	Medicaid		General Assistance
State	1980-81	1982-83	1981	1982	1983	1981	1982	1978
North Dakota	61.77	62.11	75	80	75.0	89.1	86.7	0
Ohio	55.10	55.10	82	86	90.0	100.0	100.0	75.0°
Oklahoma	63.64	59.91	98	100	100.0	100.0	100.0	shared
Oregon	55.66	52.81	86	85	100.0	97.8	98.1	100.0
Pennsylvania	55.14	56.78	90	94	100.0	98.6	98.3	100.0
Rhode Island	57.81	57.77	99	99	100.0	100.0	100.0	100.0
South Carolina	70.97	70.77	95	98	100.0	100.0	100.0	shared
South Dakota	68.76	68.19	88	84	100.0	100.0	100.0	0
Tennessee	68.88	68.53	83	87	100.0	100.0	100.0	0
Texas	58.35	55.75	95	91	100.0	100.0	100.0	0
Utah	68.07	68.64	95	97	100.0	98.3	97.0	100.0
Vermont	68.40	68.59	100	99	100.0	100.0	100.0	100.0
Virginia	56.54	56.74	75	85	100.0	100.0	100.0	62.5
Washington	50.00	50.00	98	99	100.0	100.0	100.0	100.0
West Virginia	67.35	67.95	97	98	100.0	100.0	100.0	100.0
Wisconsin	57.95	58.02	70	87	100.0	100.0	100.0	0
Wyoming	50.00	50.00	100	96	100.0	100.0	100.0	100.0

+"Federal medical assistance payments" are the federal shares of state AFDC and Medicaid program finances. They are calculated several years in advance by the Department of Health and Human Services.

*Arizona does not participate in federal Medicaid program.

*+North Carolina pays at least 50% of the state-local share of AFDC.

°Ohio pays at least 75% of General Assistance.

Source: ACIR compilation from published and unpublished tables from U.S. Department of Health and Human Services; U.S. Department of Health and Human Services, Office of Family Assistance, Characteristics of State Plans for Aid to Families with Dependent Children: 1982 Edition; ACIR Significant Features....; and, unpublished tables from the American Public Welfare Association, Washington, DC.

Table 5-12

STATE ASSUMPTION OF LOCAL PUBLIC WELFARE BY REGION

Measure	Northeast (11)	South (14)	Midwest (12)	West (13)
1. State Share of State-Local AFDC (1983)				
100% (40)	9	13	8	10
90 - 99.9% (1)	0	0	1	0
80 - 89.9% (2)	0	0	1	1
0 - 79.9% (7)	2	1	2	2
2. State Share of State-Local Medicaid (1982)				
100% (39)	9	12	8	10
90 - 99.9% (4)	1	0	1	2
80 - 89.9% (4)	0	2	2	0
0 - 79.9% (2)	1	0	1	0
3. State Share of State-Local General Assistance (1978)				
100% (22)	6	5	3	8
1 - 99.9% (11)	4	3	3	1
0% (15)	1	5	6	3

Source: ACIR staff compilation.

Table 5-13

STATES REQUIRING LOCAL CONTRIBUTIONS IN MORE THAN ONE MAJOR WELFARE PROGRAM*

State	Highest Local Share, Category of Welfare
Colorado	AFDC, General
Indiana	AFDC, General
New York	AFDC, Medicaid
Nebraska	Medicaid, General
North Dakota	AFDC, General

*Among Medicaid, Aid to Families With Dependent Children, and General Assistance programs.

ACIR has identified the following five classes of state mandates:15/

1) rules of the game mandates, relating to the organization and operating procedures of local governments, such as:

   a) the form of government,
   b) the holding of local elections,
   c) the designation of public officers and their responsibilities,
   d) the requirement of "due process" with respect to the administration of justice and the tax law,
   e) state safeguards designed to protect the public from malfeasance by local public officeholders, and
   f) provisions of the criminal justice code that define crimes and mandate punishment;

2) spillover or service mandates, dealing with new programs or enrichment of existing local government programs including:

   a) education,
   b) health,
   c) hospitals,
   d) public welfare,
   e) environment, and
   f) transportation;

3) interlocal equity mandates, requiring localities to act or refrain from acting to avoid injury to or conflict with neighboring jurisdictions. Mandates of this type would include regulatory and supervisory state roles in such areas as:

   a) local land use regulations,
   b) tax assessment procedures and review, and
   c) environmental standards;

4) loss of local tax base mandates, wherein the state removes property or selected items from the local tax base such as:

   a) exemption of business inventories from the local property tax base, and
   b) exemption of food and medicine from the local sales tax; and

5) personnel mandates, including:

   a) personnel standards of those local employees who carry out state-aided programs, and
   b) personnel benefits where the state sets salary or wage levels, hours of employment, working conditions or retirement benefits.

Few issues cause more concern among local government officials than state mandates because they impose restrictions on local autonomy and budgets. Although state officials must have wide latitude in determining and implementing statewide policies and programs, substantial controversy remains over how far states should go in certain areas. For example, education, highways, welfare, health, and environmental protection are functions considered subject to broad statewide policy objectives because of their "spillover" effects.

In the past few years, nearly every state has taken at least one step toward establishing a policy to control mandates. At least half the states have undertaken mandate studies, while 15 others catalogue their mandates. Fully 80% of the states have adopted the use of the fiscal note process to measure the effects of proposed legislation on local governments. In some states this process also covers state administrative rules.

The experiences of the states in dealing with mandates are indicative of the benefits, as well as the difficulties, associated with developing and implementing a state mandates policy. In Georgia, for example, a 1981 study conducted by the Department of Community Affairs surveyed eight cities and eight counties to determine the "true costs" of 30 state mandates in six categories: personnel, local government organization and structure, tax exemptions, service, due process, and mandates by default. Two significant findings emerged from the study. First, counties are affected by mandates at a level ten times greater than cities, totaling about $5.5 million for counties, compared to $500,000 for cities in the surveyed jurisdictions. When measured as a percentage of local budgets, mandates represented 30% for the surveyed counties and only about 7.5% for the surveyed cities. Second, one of the highest costs to local governments is the state's restriction of local revenues through tax exemptions. In fact, most of the $250 million annual cost of mandates to Georgia's cities and counties is attributable to tax exemptions.

Fiscal notes estimate how much a local government will have to spend (or lose in revenues) to comply with a proposed state law, joint resolution or administrative action. These notes can serve as a brake on state legislative and administrative activity affecting local governments by providing information for both legislators and local representatives about the likely impact of state actions on localities before they are enacted.

Fiscal notes increase the degree of accountability. As states move toward reimbursement of local governments for mandated programs, fiscal notes become an essential part of any such procedure. The fiscal note provides a basis for estimating the cost of such reimbursement and actually can initiate the reimbursement process. Figure 5-2 lists the 42 states having provisions regarding local government fiscal notes.

Mandate reimbursement laws have proved beneficial, although not entirely successful. The success of a reimbursement program is dependent on several factors, including the fiscal condition of both state and local governments, what types of mandates are included, the method of determining costs, and the availability of relief for local governments if the reimbursement process is not effective.

Survey Findings. State-initiated mandates include any state constitutional, statutory or administrative action that places new fiscal or administrative requirements on local governments. The main issue raised by mandates is the extent to which these new costs imposed on local jurisdictions should be reimbursed by the state.

Figure 5-2

STATES WITH FISCAL NOTE PROVISIONS

Alabama
Arizona
Arkansas
California
Colorado
Connecticut
Florida
Georgia
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Lousiana
Massachusetts
Maryland
Michigan
Mississippi
Missouri
Montana
Nebraska
Nevada
New Hampshire
New Jersey
New Mexico
North Carolina
Ohio
Oregon
Pennsylvania
Rhode Island
South Carolina
South Dakota
Tennessee
Texas
Utah
Vermont
Virginia
Washington
West Virginia
Wisconsin
Wyoming

Source: Updated by ACIR staff from list in Council of State Governments, The Book of the States 1982-83, (Lexington, KY: Council of State Governments), April 1982.

Currently, only 12 states have either constitutional or statutory provisions for general reimbursement of state mandates. They are California, Colorado, Florida, Hawaii, Illinois, Massachusetts, Michigan, Missouri, Montana, Rhode Island, Tennessee, and Washington. Not included in this total are states that reimburse expenditures for or tax losses attached to individual programs.

There has not been a high level of state activity in the area of providing actual reimbursements in the past few years. Only four states have administrative mechanisms to do so. There has, however, been appreciable progress in the willingness of state officials to study reimbursement policy and to assess how mandates affect local budgets, policies, programs, and services.

The Colorado law, for example, may be more effective in eliminating hidden mandates than in guaranteeing state reimbursement. It requires the legislature to fund mandates for new or expanded programs or to provide a source of revenue for them. However, it also provides lawmakers the alternative of stating explicitly that added costs shall be borne by local property tax revenues subject to state and local revenue and spending limits.

The Colorado statute, nevertheless, fits into a pattern for mandate reimbursement provisions that has emerged in recent years. As in Missouri and Massachusetts, mandate reimbursement is tied to new limits on revenues and expenditures by the state itself. The limiting legislation, or constitutional amendment, prohibits the state not only from exceeding the limits but also from shifting the responsibility and the costs of new or added services to local governments.

A bill passed by the Connecticut legislature in 1983 stops short of actual reimbursement, but does define seven types of mandates and requires the state's fiscal analysis office to assess the first-year impact of bills and amendments on the finances of local governments. The measure also created a legislative interim study committee to review the feasibility of a pilot program for new or expanded mandates.

In Illinois, the 1981 State Mandates Act provided that certain types of state-mandated statutory or executive actions require state reimbursement of local costs, or else localities do not have to comply with the particular law or rule. The Illinois Community College Board, the Office of Education and the Department of Commerce and Community Affairs (DCCA) are responsible for administering the mandate law for colleges, school districts and local governments, respectively. The State Mandates Review Office in DCCA was created to implement the law. This office is responsible for developing fiscal notes for proposed legislation and for setting up a mandates advisory board and technical network of local officials. During 1981, 192 bills were reviewed. All bills found to have reimbursable mandates were defeated in the legislature that year and the following year as well.

A local government unit subject to a reimbursable mandate has 60 days to file a claim for reimbursement. The rate at which costs are to be reimbursed varies according to the type of mandate. Payments may be denied or reduced on unreasonable or excessive claims. Approved amounts then are forwarded to the comptroller for payment in three equal installments, using appropriated reimbursement funds. If the appropriation is insufficient to cover all approved claims, each claim is to be prorated, with differences between the amount approved and the actual program cost to be paid in the following year. This reimbursement claim process was not tested during the period of this study because, as noted above, all measures identified as reimbursable had been defeated. Likewise, several attempts to repeal the Illinois law were defeated.

The Massachusetts Division of Local Mandates was organized in 1983 within the Department of the State Auditor. The office was created to implement the mandate provisions of the Proposition 2-1/2 property tax limit law. This office has a two-fold responsibility:

1) monitoring and analyzing proposed and existing legislation, rules, and regulations imposing costs on towns and cities, and
2) determining what those costs are and whether the costs have been duly reimbursed by the state.

The division describes itself as a "municipal advocate on the state level" that will provide a variety of other services to local governments.16/ For example, the division is monitoring court decisions and federal activities to identify potential new costs to localities, and will express local concerns about those actions. The division maintains an information clearinghouse on mandates and also is prepared to render technical and management assistance, as well as long range financial planning services to jurisdictions. Finally, the division will be available to help localities in their dealings with other state agencies.

The new division launched its program during the latter part of 1983 with the issuance of reports on two measures awaiting action in the legislature. One required expansion of local polling place hours and the other dealt with labeling hazardous substances in the workplace. In the bill on polling place hours, the division surveyed 25 localities to assess the fiscal impact of expanding the voting hours and transmitted its findings to each member of the legislature. As a result of this report, the house amended the bill to provide reimbursement to those jurisdictions that would incur additional costs.

The second measure would have required local officials to maintain records about the manufacture, storage and use of toxic substances by local firms for 40 years. Upon completion of its review of the impact on cities and towns, the division recommended a local option provision and establishment of a central records repository as alternatives to mandatory local recordkeeping.

Improving Local Governments' Access to Credit

State efforts to improve local governments' access to credit market provide two kinds of benefits: local fiscal empowerment and local fiscal relief. Debt financing has become an increasingly important means of raising funds for local capital projects such as school buildings and water treatment plants. State governments can assist local governments efforts to fund capital projects by making local debt issues more marketable, by subsidizing local debt issues, or by issuing bonds for local governments and lending them the proceeds.

The Weekly Bond Buyer tracks local government debt financing increases. The contributions of state agencies and bond banks toward capital facility financing are outlined in Chapter 4.

One example of heavy local government reliance on debt financing is the case of public schools in Delaware. In fiscal year 1982, seven cents of every dollar spent in the public schools went to debt service. Of $231.9 million in state funds for public education, $18.3 million or 7.9% went to debt service. School facilities are constructed or renovated with 60% state funds and 40% local funds (special and vocational education schools are 100% state financed). The 40% local share is usually raised by issuing bonds that are amortized by taxing real property in the particular school district. District bond issues are limited to 10% of the assessed value of the district's real property. In 1981-82, district and state funding accounted for $25.1 million in principal and interest on debt.17/

State efforts to improve local governments' access to credit can take many forms. First, the state or its agent can mandate or provide optional municipal bond validation. If state officials review pending local bond issues and capital projects, potential bond investors are likely to feel more confident about buying the bonds. Second, the state or its agent can guarantee local bond issues by pledging its full faith and credit. Third, the state or its agent can provide debt subsidies by earmarking state aid for the repayment of local debt. Such action provides a mechanism for maintaining local credit standing. Fourth, a state agency or bond bank can act as a financial intermediary, issuing its own bonds and lending the proceeds to local governments, perhaps on a deferred basis. State institutions may lower borrowing costs by consolidating debt and by being able to borrow through the bond market more cheaply. Because states can pledge their full faith and credit, state bonds are less risky and so investors are willing to accept lower interest rates.

Bond validation is an approval process. Local authorities submit their proposed bond issues to a state court or other agency, which determines if the issue conforms to legal specifications. The validation of local bond issues can improve the security and marketability of local government securities. Validation procedures vary; they can involve rigorous analysis or merely routine registration of the fact that a community has borrowed funds. The validation process can reduce borrowing costs while providing legal and technical assistance to localities.18/

State guarantees of local debt take two general forms. First, the state can pledge its full faith and credit for the bond issue. Second, the state can guarantee that revenue shortfalls for repayment of debt will be paid by the state out of funds that would otherwise go directly to the local entity such as revenue sharing or school aid. In either case, the guarantee serves to assure bondholders that their investments are secure.

State subsidization of local debt service can involve earmarking a portion of local financial aid for debt service payments. This does not directly improve the marketability of local debt issues, but it helps local governments fulfill their debt obligation, maintain their credit standing, and pay off their debts.

State financial intermediaries take two major forms -- general purpose bond banks and special purpose financial intermediaries:

1. General Purpose Bond Banks pool local bond issues (often adding a state reserve fund to the pool) and then sell them on behalf of local governments or school districts. The larger issue and the state's own credit status permit borrowing at a lower cost than could be achieved by separate local government bond issues. General purpose bond banks may sell bonds on behalf of local governments rather than pooling issues. The state's higher credit rating would still reduce borrowing costs for local government.

2. Special Purpose Financial Intermediaries issue state bonds and then reloan the proceeds to local governments. The most common of these are state authorities that finance school building construction or other public facilities.

Other forms of state-local credit assistance include emergency financial assistance and technical assistance in financial management. Examples are the New York Financial Tracking System and the North Carolina Local Government Commission which monitor local financial affairs and provide advice on fiscal management.

Not all state efforts enhancing local credit access involve large outlays of state funds. Several state policies impose few or no costs on the state. For example, municipal bond validation requires only that an administrative mechanism for reviewing proposed bond issues be set up. State financial intermediaries may require relatively little spending other than for administrative costs. The use of state reserve funds constitutes a cost to the state, but these may be recaptured through bond proceeds and fees charged to participating local units.

These various fiscal assistance mechanisms do not all provide the same degree of assistance to local governments. Bond validation is the weakest form of assistance, and may do little to improve credit access. In fact, many state officials are unaware that bond validation laws even exist in their own states. Some bond validation programs are little more than rubber stamps. In contrast,

Table 5-14

PROGRAMS TO IMPROVE LOCAL GOVERNMENTS' ACCESS TO CREDIT MARKETS AND YEAR IN WHICH FIRST PROGRAM WAS ENACTED BY STATE, 1983

Region and State	Bond Validation (mandatory or optional)	Guarantee of Local Debt	Subsidization of Local Debt	State Financial Intermediary	Other
New England	2(2)	2(2)	3(3)	4(5)	0(0)
Connecticut			x(1) 1949	x(2) 1949	
Maine			x(1) NA	x(1) 1972	
Massachusetts	x(M) NA	x(1) 1980	x(1) 1948		
New Hampshire		x(1) 1979		x(1) 1977	
Rhode Island	x(M) 1956				
Vermont				x(1) 1969	
Mideast	2(2)	3(3)	2(2)	4(7)	2(2)
Delaware				x(1) 1971	
°Maryland			x(1) 1967	x(2) 1953	x(1) NA
New Jersey	x(M) NA	x(1) 1958			
***New York		x(1) 1975		x(1) 1970s	x(1) 1981
Pennsylvania	x(M) NA	x(1) 1947	x(1) 1947	x(3) 1947	
Great Lakes	4(4)	2(2)	1(1)	3(4)	1(1)
Illinois	x(0) NA		x(1) 1973		
Indiana		x(1) 1967			
*Michigan	x(M) 1943	x(1) NA		x(2) NA	x(1) 1980
Ohio	x(0) NA			x(1) 1968	
Wisconsin	x(0) NA			x(1) 1969	
Plains	4(4)	1(1)	0(0)	3(3)	0(0)
Iowa	x(0) 1962				
Kansas	x(M) NA			x(1) NA	
Minnesota		x(1) 1971		x(1) 1959	
Missouri	x(M) 1978				
Nebraska					
North Dakota	x(0) 1975			x(1) 1975	
South Dakota					
Southeast	9(9)	1(1)	0(0)	4(5)	1(1)
Alabama	x(0) 1953				
Arkansas					
Florida	x(0) NA			x(1) 1970	
Georgia	x(M) p-1980				
Kentucky	x(M) 1942				
Louisiana	x(M) NA				
Mississippi	x(0) NA				
North Carolina	x(M) 1931			x(1) 1931	
South Carolina					
Tennessee				x(2) 1978	
Virginia	x(0) 1958	x(1) NA		x(1) 1962	
†West Virginia	x(M) NA				x(1) 1983

Table 5-14 (cont.)

Region and State	Bond Validation (mandatory or optional)	Guarantee of Local Debt	Subsidization of Local Debt	State Financial Intermediary	Other
Southwest	4(4)	0(0)	0(0)	2(2)	1(1)
Arizona	x(0) 1943				
**New Mexico	x(M) p-1980				x(1) 1983
Oklahoma	x(M) NA			x(1) 1979	
Texas	x(M) NA			x(1) 1957	
Mountain	1(1)	1(1)	1(1)	2(2)	0(0)
Colorado					
Idaho					
Montana	x(M) 1975			x(1) 1983	
Utah		x(1) 1983	x(1) p-1983	x(1) p-1983	
Wyoming					
Far West					
Alaska		x(1) NA	x(1) 1976	x(1) 1975	
California	x(M) NA	x(1) NA		x(3) NA	
Hawaii					
Nevada	x(M) 1965			x(1) 1981	
Oregon				x(3) 1969	
Washington	x(0) NA				
Total States	29	12	8	26	5
(Programs)	(29)	(12)	(8)	(36)	(5)

Key: x -- state has a program; M -- mandatory; 0 -- optional;
(y) -- number of programs in a given state under a given category;
x/(y) -- x = number of states in the region with programs; y = number of programs in the region.

*Michigan provides funds to communities which suffer from "catastrophic economic events."

**New Mexico provides grants to local governments experiencing financial emergencies.

***New York provides financial projections for local governments and technical assistance.

†West Virginia's governor may issue bonds to pay off local government obligations.

°Maryland's Municipal Bond Bank issue bonds and loan the proceeds to local government unable to obtain credit on their own.

Source: ACIR staff compilation based on interviews with state officials and review of state legislation.

debt guarantees and financial intermediaries appear to significantly mitigate the principal barrier to local credit: investors' impressions that local governments are financially unstable and that their bonds represent poor investment risks.

Local credit access enhancement efforts are not necessarily targeted to distressed communities. As in the case of the other indicators examined in this study, credit access programs tend to be available to all localities. Nevertheless, such state efforts may only favor fiscally distressed communities indirectly, since such communities may need such assistance more than others. Granting priority or eligibility to distressed communities directly would require greater state level efforts such as selecting participating communities, monitoring fiscal conditions and determining local eligibility.

Survey Findings. State programs were identified that would improve a local government's access to credit or credit standing. These included bond validation provisions (both mandated and optional), debt guarantee or subsidization of local debt service, and state financial intermediaries (Table 5-14).

Debt service subsidization programs, when offered, are typically offered to all local governments for their debt financing. States commonly offer debt subsidization for specific capital projects, like school construction or water treatment plants. Debt guarantees may be general or project-specific. Some debt guarantee provisions involve the withholding of state financial aid in conjunction with guarantees of full faith and credit. State financial intermediaries are reported if they are bond banks, general purpose institutions, or project-specific finance institutions such as state water boards or hospital commissions.

Nearly every state provides local governments with credit enhancing options. There are 42 states with credit enhancing features for local governments and school districts. States with financial intermediaries often have more than one. For example, the Texas Department of Environmental Quality and Department of Water Resources issue bonds for sewage and water treatment facilities, respectively.

Twenty-nine states have bond validation programs. Thirteen are optional and 16 are mandatory.

In addition to the four categories of credit enhancement programs, there were other types of state efforts to improve local governments' fiscal wellbeing. For example, Maryland offered low-interest loans to local governments for waterway improvements. Michigan maintained a local government emergency loan program. The West Virginia legislature passed an appropriation for the Governor's Contingency Fund which could be used to provide emergency local government loans. New Mexico offered a countercylical grant to localities experiencing a 10% decline in revenues collected in the state-imposed gross business receipts tax.

Notable state efforts to improve local governments' access to credit include:

° WISCONSIN'S Point Source Water Pollution Abatement Program. The program has $650 million in bonding authority, of which $450 million was allocated for the biennium 1983-85. One-third or $150 million in bond proceeds will go to aiding pollution control efforts in Milwaukee, along with an additional $150 million in bonds passed by the legislature. Local governments pay the state back for loans extended through the Point Source program. EPA matching grants were available for between 40% and 50% of project costs.

- CONNECTICUT'S School Building Grant and Interest Subsidy Programs, and State Grant Commitment for School Construction. The state uses bond issues and general appropriations to provide grants to local school districts to cover up to 80% of the costs of school building construction. The subsidy may act as a means to guarantee local debt issuance.

- PENNSYLVANIA'S Debt Guarantee Program for School Building Finance. In the event of a local default on school project loans, the state may direct an equivalent amount of state aid to the Pennsylvania Public School Building Authority (PPSBA). School districts may borrow funds from the PPSBA for new school construction; the PBA becomes the owner of the new buildings and the local districts pay back the loans by leasing the new structures.

There are regional differences in the prevalence of certain local credit enhancing policies. All the Southwest states and most of the Great Lakes, Plains and Southeast states offer or impose bond validation. Few states pledge their full faith and credit to guarantee local bond issues; the Mideast region is the only one in which three states do so. Debt subsidization programs are also rarely offered, with five of the eight states providing the service from the New England and Mideast regions. State financial intermediaries are common in every region.

Summary

In 1982, 49 states operated general state-local revenue sharing programs, 41 of which had equalizing distribution formulas. These programs were funded from a variety of sources, including alcohol and tobacco taxes, motor vehicle license fees, taxes on income or sales, and the state general fund.

State aid to local education is provided by 49 states. Hawaii administers a state education system instead. The average state share of state and local public education costs declined slightly from 54.6% in 1980 to 54.3% in 1983. However, 18 states have reduced the disparities in school spending among local schools in the 1976-83 period.

Twenty-six states increased their share of state-local public welfare costs between 1981 and 1982. Thirty-nine states assumed all state and local Medicaid costs. Federal contributions to Medicaid programs increased in 33 states, while state contributions grew in 38 states.

In the area of state mandates, most states impose some on local government. A variety of mandate limiting laws have prevented some new financial responsibilities from being imposed on local governments. Forty-two states have some such laws (most commonly including fiscal notes). Only 12 states, however, have provisions to reimburse local governments for the costs of mandates, and only four states have administrative mechanisms to assess and process local claims. Nevertheless, there has been appreciable progress in the willingness of officials to address the issue of a mandate policy as witnessed by the growing number of states which are using fiscal notes, conducting studies, and developing mandate catalogues.

In state actions to improve local government access to credit, 42 states had at least one type of program, while 26 had enacted more than one credit-enhancing provision.

* * * * * * *

FOOTNOTES

1/ The selection of programs and policies in this policy area was not predicated upon targeting criteria, per se. State-local fiscal relief programs, redistributive policies, and fiscal empowerment may, nevertheless, benefit communities experiencing the kinds of distress as defined in the three previous chapters.

2/ Steven Gold, "State-Local Fiscal Relations in the Early 1980s," (Washington, DC: The Urban Institute, 1983), p. 12.

3/ Ibid., p. 15.

4/ Ibid., p. 14.

5/ U.S. Advisory Commission on Intergovernmental Relations, (ACIR), Significant Features of Fiscal Federalism, 1981-82 Edition, M-135 (Washington, DC: U.S. Government Printing Office, April 1983).

6/ ACIR, The State of State-Local Revenue Sharing, M-121 (Washington, DC: U.S. Government Printing Office, December 1980).

7/ ACIR, Tax Capacity of the Fifty States: Methodology and Estimates, M-134 (Washington, DC: U.S. Government Printing Office, March 1982).

8/ Lee S. Friedman and Michael Wiseman, "Understanding the Equity Consequences of School-Finance Reform," Harvard Educational Review, 2 May 1978, pp. 193-226.

9/ New York Times, "Education for a Transformed World," September 25, 1983, Sec. 4, p. 18.

10/ Washington Post, September 18, 1983.

11/ Letter from John Augenblick, Director of Education Finance Center, Education Commission for the States, to ACIR staff, July 29, 1983.

12/ Ratios were calculated from data on state primary and secondary education by school district provided by the U.S. Department of Education's National Center for Education Statistics.

13/ Michael C. Barth, et. al., Toward an Effective Income Support System: Problems, Prospects, and Choices (Madison, WI: Institute for Research on Poverty, University of Wisconsin-Madison, 1974).

14/ ACIR, State Mandating of Local Expenditures: In Brief, B-2 (Washington, DC: U.S. Government Printing Office, August 1978).

15/ Ibid.

16/ Massachusetts Department of the State Auditor, fact sheet, "Role and Responsibilities of the Division of Local Mandates," 1983.

17/ Delaware Board of Education and Department of Instruction, "State of Delaware Report on Educational Statistics 1981-82," October 1982.

18/ Jack F. Haley, Jr., A Study of State-Imposed Municipal Bond Validation Requirements (Washington, DC: Government Finance Research Center of the Municipal Finance Officers Association, November 1979), pp. 4-6.

Chapter 6

ENHANCING LOCAL SELF-HELP CAPABILITIES

President Harry S. Truman used to say, "The buck stops here," referring to the White House. Yet many local government officials believe that for many problems the buck stops with them. In cities and counties across the nation the effects of distressed people, communities, and businesses are seen and felt daily. Local administrators and elected officials directly bear the responsibility for dealing with urban and rural blight, yet many lack the authority to act effectively.

In the past, the federal and state governments helped meet local needs with substantial amounts of financial aid. In the 1980s, as federal aid in particular began to decline, renewed emphasis was placed upon empowering local governments to help themselves. Local officials need and want greater control over their communities' destinies. That control includes structural and functional self-determination, as well as the ability to raise or increase revenues from their own sources. Only through powers granted by the state or contained in the state constitution can communities make decisions and take actions in a manner befitting their special needs, rather than relying on the state or federal government to do so.

The federal system is built upon the concept of diversity. What may be desirable or needed in one community may not be in another. Residents in a retirement community are likely to care a great deal about health care, while those in a community with large numbers of children will emphasize schools and child care.

Whatever the special local circumstance may be, a state boiler-plate formula cannot always meet everyone's needs. Even if that were possible, state resource limits prevent such comprehensive coverage. Communities often need and want leeway to meet their special needs in their own way — in other words, to be able to help themselves.

Policy Issues

This chapter discusses three policy issues for local governments:

1. Decreasing Revenues. Fiscal constraints at all levels of government are causing a heavier burden on local governments to find new sources of local revenue.

2. Increasing Responsibilities. Shifts in responsibility to local government for services are increasing demands on local resources.

3. Empowerment to Help Themselves. Local governments require state constitutional authority in order to rely less on the state and federal governments and more on themselves.

Over the past 25 years, state and local governments have come to rely heavily on intergovernmental grants. Federal funds as a portion of local government revenue increased from 2.5% in 1955 to 16.3% in 1980; state funds were equivalent to 40.6% of local revenues in 1955 and 62.5% in 1980.1/ Economic events of the early 1980s, however, threatened the dependability of those revenue sources for local governments. Federal deficits and state revenue shortfalls caused reductions in most program areas and total elimination in others. Federal and state aid to local governments dropped during the four-year period of this study.2/ At the same time, local governments' ability to raise revenues through the property tax, the largest source of local money, was reduced by tax limitation initiatives beginning with California's Proposition 13, progressing to Massachusetts' Proposition 2-1/2, and continuing with an even more serious initiative in Texas. In fiscal 1980-81, property taxes generated 41% of local own-source revenue, a sharp drop from 55% ten years earlier.3/

The demand for services at the local level, however, did not decrease. Counties or cities with responsibilities for delivering welfare or health care services found that the number of indigents in need of aid increased because of funding cutbacks and changes in priorities at the federal and state levels. Changes in AFDC and Medicaid eligibility, for instance, made many former recipients ineligible for those federal and state-funded programs. In many cases, local governments had to meet the needs of these "working poor" for health and other services. For instance, Harris County, TX, experienced a 12% increase in indigent outpatient care in 1982. Well over two-thirds of the county hospital's $150 million budget went to provide charity care.4/ Like Harris County, most local human services agencies, hospitals and nonprofit organizations must pick up the increased caseload and carry it with their own resources. In 22 states, local governments cover more than half of their expenditures for health and hospitals from their own revenue sources.5/

For public welfare expenditures, there is a greater reliance on state funds. In South Dakota, for example, 88.3% of total state and local own-source spending on welfare comes from the state; in Texas, 94.9% comes from the state; in Michigan, 92.6%; in Georgia, 95.9%; in California, 99.5%; and in Massachusetts, 96.6%.6/ The lowest state shares are in North Carolina (46.1%), New York (50.0%), and Montana (55.1%).

Decreasing state funds for welfare and social services -- a result largely of the federal reductions flowing from the 1981 reconciliation act and the depressed economy -- forced local governments either to replace the funds or to deny the services. The United Way of Texas documented the effects of such decisions made in fiscal year 1982. Programs for community care of the aged and disabled in Houston lost $2,378,615 in fiscal year 1982, while during the same period cuts for child care services in Dallas totalled $764,696.7/

Many local governments relied heavily on workers whose salaries were subsidized by the Comprehensive Employment and Training Act (CETA), including workers providing, health and human services. This subsidy ended in October 1982, compounding local governments' fiscal pressures. San Antonio, for example, lost $139 million in CETA funds that had been used for the employment and training of human services workers.8/

Political forces have also caused increasing pressures on localities to provide services. Ronald Reagan, both as candidate and as President, called for less federal involvement in domestic issues and for returning power and responsibility to the state and local levels. In early 1981, he said,9/

> We need to provide for greater authority and responsibility in the states, counties, cities, and towns -- to return government to those closest to the people most affected.

Although the federal government may indirectly expand local authority by reducing regulatory influence, only the states may directly extend to local governments the power to plan, develop, and carry out local prerogatives. States have great leeway in determining how much authority to grant to local governments. The powers granted may range from virtually none -- keeping all responsibility at the state level -- to a great many -- allowing broad local home rule. Thus, the state ultimately deals with distress within its local communities either by taking full responsibility or by delegating at least some of that task.

Even if a state does not directly administer a program itself, it may exert substantial influence on local programs through financial aids that may include revenue sharing, grants, loans, or loan guarantees. These forms of state aid are not universally available nor are they without controversy. Court contests over equity in state-local revenue sharing formulas, for example, have developed in at least one state where counties contested the simple population-based formula for distribution to municipalities versus a more complex formula for the county share.10/ Direct grants or loans become more difficult for states to give when facing their own revenue shortfalls, and in several states it is unconstitutional either to loan state funds or to extend credit. Therefore, state grants and loans alone are rarely sufficient in an era in which pressure is increasing on local governments to provide for the general welfare of their residents.

An alternative to direct fiscal aid is to allow local governments to help themselves through enabling, or permissive, legislation. Programs generally considered under this category of self-help include local home rule; statutory authority for local-option sales and income taxes; and access to various other financial tools, such as tax increment financing, investment of idle cash, bonding, and user fees. State technical assistance in financial management and other areas of responsibility can also be important additions to the granting of broader authority.

The federal government continues to fund several programs directly assisting local governments. These include Community Development Block Grants (CDBG), Urban Development Action Grants (UDAG), and General Revenue Sharing (GRS). Nevertheless, under the Reagan Administration, states have gained a major role in administering CDBG to small communities and also now administer several former federal-local health and welfare programs through the new block grants to the states. Thus, even in predominantly federal-to-local funding programs, states are being given a greater role.

A review of what states can do to enhance local capabilities, and what they have done since 1980 in those areas with which this study is concerned,

Table 6-1

ENHANCING LOCAL SELF-HELP CAPABILITIES, 1980-83

Region and State	Tax Increment Financing				Local Redevelopment Authority				Local Taxing Authority			
	80	81	82	83	80	81	82	83	80	81	82	83
New England	2	3	3	3	6	6	6	6	0	0	0	0
Connecticut	x	x	x	x	x	x	x	x				
Maine	x	x	x	x	x	x	x	x				
Massachusetts					x	x	x	x				
New Hampshire		x	x	x	x	x	x	x				
Rhode Island				†	x	x	x	x				
Vermont					x	x	x	x				
Mideast	1	1	1	2	5	5	5	5	5	5	5	5
Delaware					x	x	x	x	x	x	x	x
Maryland	x	x	x	x	x	x	x	x	x	x	x	x
New Jersey				*	x	x	x	x	**	**	**	**
New York				x	x	x	x	x	x	x	x	x
Pennsylvania					x	x	x	x	x	x	x	x
Great Lakes	5	5	5	5	5	5	5	5	5	5	5	5
Illinois	x	x	x	x	x	x	x	x	x	x	x	x
Indiana	x	x	x	x	x	x	x	x	x	x	x	x
Michigan	-	x	x	x	x	x	x	x	x	x	x	x
Ohio	x	x	x	x	x	x	x	x	x	x	x	x
Wisconsin	x	x	x	x	x	x	x	x	x	x	x	x
Plains	4	5	7	7	7	7	7	7	5	5	5	6
Iowa	x	x	x	x	x	x	x	x	-	-	-	-
Kansas	x	x	x	x	x	x	x	x	x	x	x	x
Minnesota			x	x	x	x	x	x				**
Missouri			x	x	x	x	x	x	x	x	x	x
Nebraska		x	x	x	x	x	x	x	x	x	x	x
North Dakota	x	x	x	x	x	x	x	x	x	x	x	x
South Dakota	x	x	x	x	x	x	x	x				
Southeast	1	3	4	4	12	12	12	12	8	8	8	8
Alabama					x	x	x	x	x	x	x	x
Arkansas		x	x	x	x	x	x	x	x	x	x	x
Florida			x	x	x	x	x	x				
Georgia				*	x	x	x	x	x	x	x	x
Kentucky					x	x	x	x	x	x	x	x
Louisiana					x	x	x	x	x	x	x	x

may give some indication of states ability and willingness to pick up new responsibilities. This review may also provide insight into what local governments have done with additional authority.

Survey Results

This study employs four variables or "indicators" to measure the degree to which states enhance local self-help capabilities. The four indicators are:

Table 6-1 (cont.)

	Tax Increment Financing				Local Redevelopment Authority				Local Taxing Authority			
Region and State	80	81	82	83	80	81	82	83	80	81	82	83
Southeast (cont.)												
Mississippi					x	x	x	x				
North Carolina				*	x	x	x	x	x	x	x	x
South Carolina		x	x	x	x	x	x	x				
Tennessee	x	x	x	x	x	x	x	x	x	x	x	x
Virginia					x	x	x	x	x	x	x	x
West Virginia					x	x	x	x				
Southwest	1	2	2	2	4	4	4	4	3	3	3	3
Arizona					x	x	x	x	x	x	x	x
New Mexico	x	x	x	x	x	x	x	x	x	x	x	x
Oklahoma					x	x	x	x				
Texas		x	x	x	x	x	x	x	x	x	x	x
Mountain	2	3	3	4	4	4	4	4	3	3	3	3
Colorado		x	x	x	x	x	x	x	x	x	x	x
Idaho					x	x	x	x				
Montana	x	x	x	x	x	x	x	x				
Utah	x	x	x	x	x	x	x	x	x	x	x	x
Wyoming				x					x	x	x	x
Far West	4	4	4	4	6	6	6	6	4	4	4	4
Alaska	x	x	x	x	x	x	x	x	x	x	x	x
California	x	x	x	x	x	x	x	x	x	x	x	x
Hawaii					x	x	x	x				
Nevada	x	x	x	x	x	x	x	x	x	x	x	x
Oregon	x	x	x	x	x	x	x	x				
Washington				*	x	x	x	x	x	x	x	x
TOTAL STATES	20	26	29	31	49	49	49	49	33	33	33	34

Key: *Legislation introduced in 1983. x = State authorized local powers.
**Limited authority. Details available in tables on local sales and income tax authority.
†State granted local authority in 1984.

Source: ACIR staff compilation.

1) authority to use tax increment financing;
2) ability to create redevelopment authorities;
3) authority to levy sales and income taxes; and
4) degree of local discretionary authority.

Although the first two of these indicators are targeted to distressed areas, the other two are not. Nevertheless, discretionary authority and the local tax options, were chosen as indicators of self help because they allow a broader range of local options in dealing with distress.

The national discussion about increased local responsibility does not appear to have affected state actions geared toward enhancing local capabilities (Table 6-1). Almost no change has occurred since 1980 with regard to two of the three indicators followed in the annual surveys (local discretionary authority was not measured each year). By and large, those states that did grant one or the other of these two powers in 1980 continued to grant them in 1983; those that did not, still do not. In the other annually surveyed indicator, however, the number of states allowing local governments to use tax increment financing increased from 20 to 31, and the issue was considered in 11 other state legislatures during 1983. In some instances bills were introduced for the first time.

With respect to local sales and income taxes, it should be noted that, although no additional states granted such powers over the four years of this study, several states in 1983 authorized rate increases or amended rules on what types of local governments can levy the taxes.

Tax Increment Financing

Tax increment financing (TIF) is a tool used by local governments to finance redevelopment that is designed to increase future fiscal capacity by strengthening the local tax base.

This financing device works in the following manner. A state designates an economically depressed geographical area as a TIF district. Property in the district might be taxed by a single jurisdiction, such as a city, or by several jurisdictions, including an overlying county and special districts. Once the area is designated, the jurisdictions that levy property taxes in the district freeze their assessments of the value of its land and buildings, usually for a specified number of years. A private developer begins construction or renovation work -- often with the help of public funds raised by a government bond issue -- and the market value of property in the district presumably goes up.

As property values rise, the developer makes payments into a special fund that is used to help pay off the bond issue. The amount of the payments is equal to the difference between the property tax revenues that local jurisdictions are collecting under the "frozen" assessments and the amount the jurisdictions would collect if their assessments reflected rising market values. After public bonds have been paid off, jurisdictions may raise their assessments for general fund purposes above the "frozen" level, and discontinue the special tax increment funding procedure.

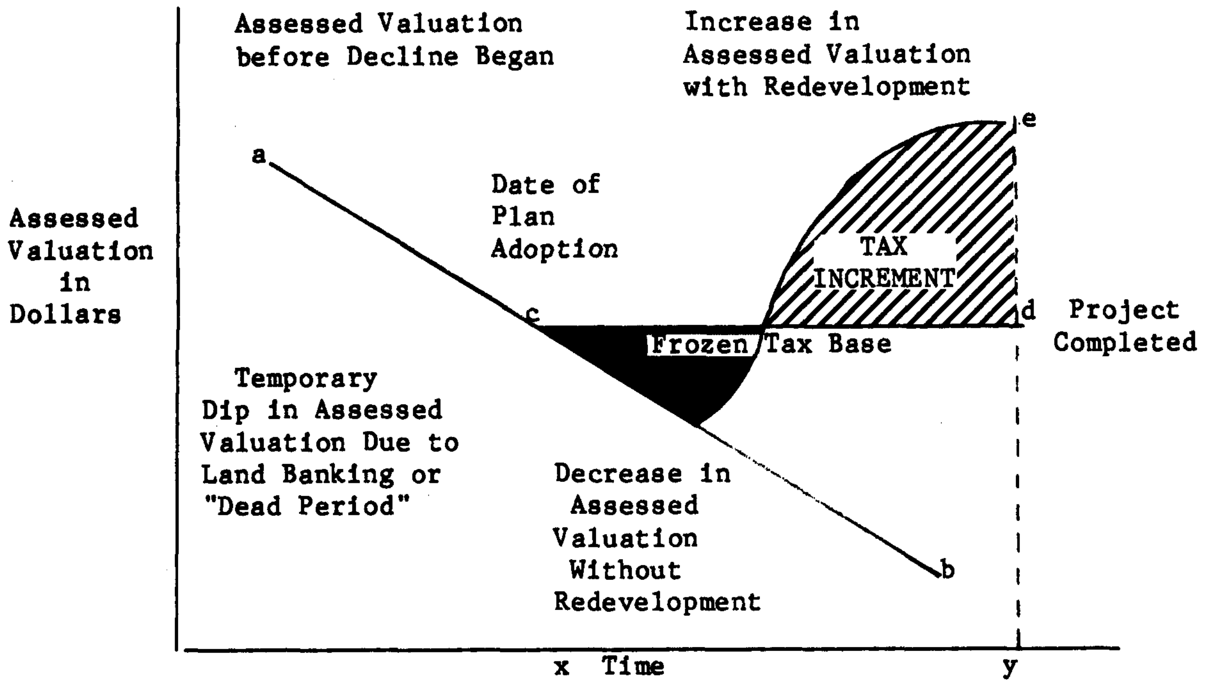
This arrangement is typical, although in some states the public costs of redevelopment are financed on a "pay-as-you-go" basis rather than from proceeds of a bond issue.

Tax increment financing is viewed as a "self-help" tool for localities because it relies on local property tax revenues and is administered and monitored almost entirely by local government officials.

Graph 6-1 shows graphically how tax increment financing works. Line ab

Graph 6-1

TAX INCREMENT FINANCING



Source: ACIR staff composite adapted from Florida Department of Veteran and Community Affairs, and Richard G. Mitchell. 11/

demonstrates how the assessed valuation of a slum or blighted area would drop over time without redevelopment. Such deterioration is a common and serious problem in many older urban areas, and often is exacerbated by owners who simply abandon their property when the taxes they pay neutralize any profits they might make. Under tax increment financing, a redevelopment plan for a designated slum or blighted area is adopted at, say, time x. The assessed valuation of the project area is determined by the most recent assessment made prior to the effective date of the ordinance adopting the plan. From that point on, that assessed value (represented on the graph as line cd) serves as a reference point from which to determine the tax increment. As redevelopment proceeds, the actual assessed valuation within the project area may drop temporarily but then will begin to rise, as indicated by line ce. The ad valorem taxes generated by this increase in assessed valuation over the reference valuation (that is, the difference at any given time between lines ce and cd) are known as the tax increments, and go into the special redevelopment trust fund that is used either to repay bond holders or to fund development on a pay-as-you-go basis.

The dip in line ce before it begins to rise reflects the initial decrease in tax revenues that occurs between designating and developing a TIF district. Once an area is designated a TIF district, it is often cleared of any buildings (or tenants) in preparation for redevelopment; thus, tax revenue decreases.

The land often sits idle for several years until enough capital is accumulated to float bonds. This period, because it represents a period of foregone tax revenues, should be kept as short as possible.

Some states loan or grant money up front to secure the financing and get redevelopment rolling to avoid this loss. Communities then reimburse the state as a part of their overall plan. For example, the State of Utah is permitted to loan a local redevelopment agency funds until the increment begins to accrue. Utah also may aid a tax increment district through legislative appropriations if the state wants a building in the redevelopment area. Colorado allows severance tax money to be added to the increment reserve fund (set by law at 15% of the annual total) to enable eligible cities to improve their bond ratings, and also will capitalize the fund up front through grants to its cities that need not be paid back if the balance of funds is used for other economic development projects after the TIF district development is complete. State participation as in these examples has been crucial in cases.

Information from interviews and the literature indicates mixed attitudes on the use of tax increment financing, with the scales tipped toward acceptance. Most state and local officials consider the need for economic revitalization greater than the controversies surrounding TIF. Rather than avoid this method for financing urban renewal, states have developed or revised statutes that address and control those concerns.

States recently active in encouraging the use of TIF have compiled some of the most convincing arguments for using it, including the following:12/

1. Under TIF, the bond proceeds are totally controlled by the locality.
2. TIF is more efficient than tax abatements, requiring the developer to pay full taxation.
3. TIF represents no commitment of state dollars.

Furthermore, no cases of loan default under TIF were uncovered in the course of this research.

This redevelopment financing tool has not been without controversy, however. Three major criticisms have been directed toward it:

1. TIF is geared toward large-scale development and is of little use to small firms in distressed communities.
2. It is a loan of public credit to aid private entities.
3. It is used for areas that might have developed with private funds anyway.

Other criticisms include:

1. TIF has been abused by funding projects that are only indirectly related to promoting development.

2. There has not always been a definite time-frame for payoff, the debt being financed indefinitely.

3. Tax increment financing may allow the redevelopment area to capture

property tax revenues, but it steals them from other taxing jurisdictions within the municipality for as long as the debt is incurred (school districts, for example).

It appears that most of these criticisms have been met and overcome. Small and medium-sized cities have shown an interest in using TIF to upgrade blighted areas; it is no longer seen as only a "big city" program. In Wisconsin, villages as small as 300 in population have used it; in Montana, city-county consortia are formed to increase the size of redevelopment areas.

State controls over TIF practices have become fairly well developed and, in some cases, are stringent. Controls concern the kind of area that can qualify, how the money can be used, and how long the debt can be carried.

The tax "stealing" issue can be overcome and an understanding can usually be reached if two conditions are met. First, proper care should be taken to fully inform the various entities affected by a proposed tax increment district. A taxing district can be informed about how it will ultimately benefit from an increased tax base over one that may not have existed without redevelopment. Second, compromises can often be reached so that certain taxing districts gain some of the increment during development.

In recent Florida litigation, TIF was alleged to be an unconstitutional pledge of ad valorem taxes because its use does not require voter approval of the bonds. Arizona, Kentucky, and Texas were also involved in court cases over the constitutionality of TIF. The Florida Supreme Court upheld the constitutionality of tax increment financing,[13] and the issue in Texas was resolved when the voters approved a constitutional amendment.[14]

The most recent problems confronting tax increment financing do not involve any of these controversies. Its biggest enemies have been lower levels of inflation and the adoption in many states of property tax lids. Projects funded by tax increment financing are helped if inflation increases property values substantially between a project's start and its completion because that change in value sustains financing. Ceilings on property tax rates limit a project's expected revenue generating capacity.

Taxpayer opposition can hinder implementing TIF even in states where it has become law. Dealing with misunderstandings among local officials and taxpayers is crucial to successfully legislating and implementing tax increment financing. Many of the fears over tax losses or concerns over the purposes of a TIF district can be allayed if TIF, its uses, its advantages and disadvantages, and the ultimate gain for the community are clearly outlined in the beginning. Nebraska and Missouri have prepared publications on the uses and benefits of TIF for this purpose, and other states have expressed interest in helping communities implement TIF. Publications and state technical assistance may enable local governments to help themselves in this way more quickly and more knowledgeably.

Part of the taxpayers' aversion to TIF stems from misunderstanding the bonding process. Tax increment financing most typically entails issuing revenue bonds to raise sufficient funds for the redevelopment project. Revenue bonds are often used for long-term governmental projects, and are not necessarily connected with a tax increment district. Unlike general obligation bonds, revenue bonds do not pledge the full faith and credit of a government, and they rarely require voter approval. Revenue bonds, whether used for tax increment districts or for other purposes, use the revenues generated by a project to pay the bonds' principal and interest; they include an element of self help.

In most cases, tax increment funds are used to leverage other resources into a larger pool of money. The bond market experience in California, for instance, has been that each $1 of tax increment will support from $7 to $10 in bonds. Thus, a $100,000 increment will leverage from $700,000 to $1 million in bonds.15/ Most communities use TIF in conjunction with other money, usually CDBG and UDAG funds, so that the total amount of money made available for community improvement is a considerable sum.16/

Most states limit the length of bond indebtedness to between ten and 20 years, although a few allow as long as 30 years. A New Hampshire official warned against such a long commitment, saying, "Politically there has to be a fast payoff in order to handle other taxing districts' pressure."17/ A Tennessee official, recommending no more than a ten-year debt, but preferring a three to five-year one, said, "If you float long-term debt, you limit the ability of taxing districts to feel the full benefit of redevelopment."18/

Some states also allow TIF to be used on a pay-as-you-go basis, spending only the amount of money that is in the fund at a given time. New Mexico allows only this method; communities in that state are unable to issue bonds because all taxing jurisdictions have to approve expenditures annually.

In considering using TIF, government officials must know the market potential of the proposed district. The January 1983, Center City Report emphasized the importance of a market analysis early in considering TIF:19/

> If you don't have a market for development, then you won't have sufficient potential private investment to get the TIF cycle started. In practical terms, the whole TIF experience is predicated on market potential. When market conditions are so poor that investors won't invest and developers won't develop, then there simply will be no tax increment.

Equally important is knowing the costs and assets as a district develops. Butte-Silver Bow, MT, has set up a mechanism for tax increment management. Once the tax records of that locality are placed on the local government's computer system, the tax increment program will be incorporated. This will eliminate revenue unknowns -- an important factor for taxing districts.

Peat, Marwick, Mitchell & Co., in evaluating the Albuquerque Center, noted that economic analyses of the tax increment financing are hard to do. The report went on to say, however,20/

> If one believes that redevelopment of any area of the city is in the long range best interest of all governmental units, then the tax increment program is a ve-

> hicle through which all governmental units can participate.

Agreement among all affected taxing jurisdictions is crucial for the success of TIF, not only financially, but in terms of taxpayer support and understanding. If it is absolutely impossible for all taxing districts to give up their full increment, some states have written into their legislation that a one-time payment, or a percentage of each year's increment, be paid each taxing authority affected by the TIF district. In this way, cooperation has been more easily achieved.

In addition to the obvious increases in assessed property valuations, redevelopment projects should gain additional revenues from sales taxes, business licenses, and other revenue sources that reflect restored economic vitality in an area.21/ Although in some states these additional sources of revenue also revert to the TIF pool, in most they do not. They are usually considered immediate gains for the local jurisdictions within whose boundaries the TIF districts lie. A community also stands to benefit from decreasing crime and health risks commonly associated with blighted areas.

Richard Mitchell, in the Journal of Housing, states,22/

> Another...way to look at the use of tax increment and the possible inference that it represents a form of subsidy is to recognize that if government does not utilize the powers and skills it has at its disposal to arrest and reverse the spread of blight and deterioration, it is, by lack of act, adding onto every tax bill a charge for this neglect, which is the product of decreased valuation and demand for increased governmental fire, police, health and welfare services.

Unfortunately, thorough evaluations of TIF programs have been rare. A North Dakota official said that TIF is "very permissive legislation and perhaps, therefore, very permissively administered without evaluation or definition of impact."23/ The evaluation process is one where the states can be helpful to local governments, either directly through technical assistance, or by providing published guides, or by sponsoring third-party evaluations. Impact is measured through cost-benefit analysis in Ohio if a community goes to the state for technical assistance. The Arkansas legislature requires that the Arkansas Public Service Commission present an impact report at the beginning of each biennium. Private third-party evaluations have been completed in California, Colorado, Iowa, New Mexico, and Montana. States could help by compiling and sharing comparative information about programs, as has been done in Illinois.

Analysis of 1983 tax increment data reveals a continuing interest in this redevelopment financing tool. As of December 1983, 30 states authorized TIF. In 1984 Rhode Island enacted TIF authorization. Also, TIF was actively considered in several state legislatures during their 1983 sessions. Much legislative activity involved amending current TIF legislation to deal with problems experienced in implementation (Texas, Florida, Indiana, Maryland, Nevada, and Utah). Two states tried again to pass TIF legislation, but failed (Massachu-

Table 6-2

AUTHORITY TO USE TAX INCREMENT FINANCING BY STATE, 1980-83

Region and State	80	81	82	83	Comments
New England					
Connecticut	x	x	x	x	
Maine	x	x	x	x	
Massachusetts					Legislation reintroduced 1983.
New Hampshire		x	x	x	
Rhode Island					Authority enacted in 1984.
Vermont					
Mideast					
Delaware					
Maryland	x	x	x	x	Not implemented.
New Jersey					Authority under active consideration.
New York				x	Authority approved in 1983 referendum.
Pennsylvania					
Great Lakes					
Illinois	x	x	x	x	
Indiana	x	x	x	x	Not implemented.
Michigan	x	x	x	x	
Ohio	x	x	x	x	
Wisconsin	x	x	x	x	
Plains					
Iowa	x	x	x	x	
Kansas	x	x	x	x	
Minnesota			x	x	
Missouri			x	x	
Nebraska		x	x	x	
North Dakota	x	x	x	x	
South Dakota	x	x	x	x	
Southeast					
Alabama					
Arkansas		x	x	x	Awaiting court constitutionality test.
Florida			x	x	
Georgia					Authority under active consideration.
Kentucky					

setts and Washington), and first-time legislation was defeated in Georgia and North Carolina.

As Table 6-2 illustrates, the most active regions remain the Plains and Great Lakes states, all authorizing the use of TIF. Four of the five Mountain states and four of the six Far West states authorized TIF. Between 1981 and 1983, 11 states passed legislation authorizing TIF, representing six of the eight regions depicted in Table 6-2.

Attempts to pass legislation were made in two additional Southeastern states in 1983, and this region may experience greater activity as economic

Table 6-2 (cont.)

Region and State	80	81	82	83	Comments
Southeast (cont.)					
Louisiana					
Mississippi					
North Carolina					Legislation introduced in 1983.
South Carolina		x	x	x	Awaiting court constitutionality test.
Tennessee	x	x	x	x	
Virginia					
West Virginia					
Southwest					
Arizona					
New Mexico	x	x	x	x	
Oklahoma					
Texas		x	x	x	
Mountain					
Colorado		x	x	x	
Idaho					
Montana	x	x	x	x	
Utah	x	x	x	x	
Wyoming				x	
Far West					
Alaska	x	x	x	x	
California	x	x	x	x	
Hawaii					
Nevada	x	x	x	x	
Oregon	x	x	x	x	
Washington					Authority under active consideration.
TOTAL STATES	20	26	29	31	

Key: x = state authorizes local use of tax increment financing.

Source: ACIR staff compilation based on interviews with state officials.

growth continues in that part of the country. According to authorities in both Georgia and North Carolina, legislation stood a good chance of passing in the future. Georgia's bill was lost due to an error in the language, and North Carolina's law was defeated largely as a result of a lack of understanding about how TIF works.

In the Mideast, only Maryland authorizes TIF. Even for Maryland, implementation is a problem because of a triennial tax assessment law, making it difficult to estimate and use the annual increments. The tax increment process cannot afford a three-year lag. Unlike a one-time "dead" period that ends once clearing and construction begins, assessing only once every three years impedes planning and does not allow for timely collection and use of tax revenues.

Because interest is high, both in states now using it and in others contemplating it, ACIR has developed draft legislation that attempts to compile the strongest points from various state statutes.

In those states that use TIF, support runs fairly high from most sectors, and examples abound of benefits gained from its use. Uses vary, including

DOWNTOWN COMMERCIAL DEVELOPMENT -- FOR RESIDENTS OR TOURISTS

Sparks, NV, revitalized its downtown for residents, as well as promoted tourism, by emphasizing its railroad heritage as an added enticement to visit the casinos there. The Town Center Project includes the Lillard Train Depot Park, the old depot, railroad equipment, and a railroad museum. The project included the constructing of many moderate-income multiunit housing structures, hoping to achieve "an attractive living area for downtown employees who can walk to work if they desire." 24/

Nashville, Tennessee's 6.5 acre Riverfront Park, located on the Cumberland River site of the original Fort Nashborough, is a combination of commercial and esthetic redevelopment of an old warehousing area, as well as historic preservation of an era. Twenty-three private businesses participated in the Nashville redevelopment plan. One resident said, at its grand opening in July 1983, "This is where the city of Nashville began, and we've sort of come full circle back to the banks of the river." 25/

DISTRESS FROM A NATURAL DISASTER

Xenia, OH, was able to rebuild a major portion of its downtown area after one of the country's worst tornado disasters. Xenia Towne Square, a 99,000 square-foot shopping center situated in the heart of the downtown area, was designed to accommodate 35 retail and service stores, and local officials hoped it would reestablish downtown Xenia as the commercial center for the surrounding market area. The plan was based on the concept that the city would clear, assemble and prepare the area for redevelopment, stimulating private sector investment. The Office of Local Government Services in the Ohio Department of Economic and Community Development received an award for the state assistance which helped make the project a reality. 26/

Canton, IL, the first tax increment project in that state, also started because a tornado had devastated much of the downtown area. A public/private effort between Fulton Square Development Corporation and the City of Canton, the downtown redevelopment project included two large commercial buildings, several small retail stores, street improvements and public parking.

Redevelopment Authority

Forty-nine states enable their local jurisdictions to create local redelopment or renewal agencies. Redevelopment authority is usually encompassed in a state's urban renewal law. It assigns administrative responsibility for accepting intergovernmental grants and loans, bonding, planning, and powers of eminent domain, to an independent, or semi-independent governing body. This body is either the local legislative council or an entity appointed by the council. Redevelopment authority first appeared as amendments to public housing legislation in the 1930s. Its popularity grew throughout the 1950s. The Model Cities Program of the 1960s broadened the use of redevelopment agencies (RDAs) still further, and strengthened their influence.

RDAs, however, did not maintain their strong positions during the 1970s as federal programs shifted. They were reported to be the lead administrative agency for community development in only 9% of communities in a 1978 survey conducted by the National Association of Housing and Redevelopment Officials. "Only in the performance of land acquisition and clearance (21%) and housing rehabilitation (15%) activities did they have significantly greater responsibility.... 37 of the 80 cities with renewal experience [had totally] phased out their authorities [by 1978]."30/ This change was attributed in great part to the shift from the federal categorical programs previously administered by the RDAs, into the Community Development Block Grant awarded directly to local governments. "Almost by definition, the block grant mechanism has shifted the formal responsibility for local development activity from independent agencies, chiefly redevelopment authorities, to elected officials."31/ The association found that "[community development] program directors reported directly to the mayor in 35% of the sample cities; to the city council in 11%; and to a city manager, presumably representing the mayor or functioning as the chief elected official, in 36%."32/ The survey detected a shift of day-to-day operational responsibility for the programs from RDAs to local government departments or agencies with the greatest experience in those functions. Planning departments took on the most increased program responsibility.

Today, RDAs appear to be coming to life again, most often as downtown redevelopers pursuing commercial and economic development benefits. Some of the new RDAs have been converted from older versions by amending the original legislation; some are spinoffs without formal amendment; and some are the products of completely separate legislation. The change has come at least partly because attitudes have changed, favoring innercity redevelopment to compete with the growth of suburbia and outlying shopping malls, and moving beyond the exclusive use of federal funds for urban renewal. The decreasing availability of those funds in the 1980s and the greater importance attached to private-sector involvement have caused many states to reevaluate investment strategies for saving or renewing the vitality of their urban centers.

According to a 1980 report prepared by the Council of State Community Affairs Agencies, 14 states had prepared or adopted state "investment strategies" or "community conservation plans" for the revitalization of downtowns and central city areas. Such policies, the report asserts,33/

> bolster local efforts as state resources are targeted for commercial revitalization...in downtown areas, as well as

REDEVELOPMENT AUTHORITIES WORK IN LARGE AND SMALL COMMUNITIES

In response to the opening of a large suburban mall, Grand Junction, CO, created one of the first downtown development authorities in Colorado to assist in the redevelopment of the downtown area. A market analysis and feasibility study for commercial, housing, retailing, and professional services was prepared, and hotel-retail, office-retail, and housing units for the elderly are planned.

Louisville Central Area, Inc., developed a long-term strategy for downtown development, identified current and potential development projects and completed a ground water survey to identify mechanisms that can prevent flooding from the Ohio River. Accomplishments include developing a $100 million Galleria Project, a six-block enclosed mall that includes offices, retail space, hotel and apartments.

Although a mall was built adjacent to the downtown area, the Rutland, VT, local development corporation organized the conversion of an old opera house, renovation of alleyways and restoration of facades into a central business district that provides "active retail competition." New public transit routes and two new large parking garages have increased accessibility to the downtown area, completing the success of this project.

Downtown activity, presently being organized by a downtown development corporation in Sisterville, WV, with support from the state historic preservation office, will comprehensively revitalize the downtown according to an historic theme. This project is the first in the state to be funded by the State Development Plan and Investment Program. The downtown development corporation has, in addition, set up a revolving loan fund financed by the businesses to aid the redevelopment. 34/

providing authorization for innovative financing techniques such as tax increment financing. An additional nine states reported state economic development policies, community development plans, or historic preservation policies that directly encourage downtown revitalization and provide local officials with tools needed to implement and package projects.

Some states, then, strongly supported local RDAs, but past tradition depended on federal money to catalyze viable programs. With the loss of that catalyst, however, many RDAs may not enjoy state support beyond enabling legislation. In many instances RDAs remain closely aligned with local governments, a legacy of the 1970s. Where RDAs administer tax increment financing, for example, they are supported by the local governments or, quite commonly, the local government serves as the RDA.

Sales and Income Taxing Authority

Although local sales and income taxing authority are not specifically targeted to distress, they were chosen as indicators of self-help in this study because their use allows localities a broader range of options in raising own-source revenue. Authority to levy local sales and income taxes not only allows communities to deal more directly with their own problems but also provides relief from heavy reliance on the property tax. California's Proposition 13 started a nationwide drive to limit the revenues generated by property taxes. As a result, the movement also limited local governments' ability to deliver services and to rely on own-source revenues to pay for those services.

Without local tax revenues as an adequate source of support, local governments are more dependent on state and federal resources. Subsequently, state and federal influence in local decisionmaking grows. It was apparent by 1981, however, that state and federal resources were limited. The growing federal deficit and the New Federalism philosophy of increasing local responsibility closed many "doors" previously open to local governments for federal funds. The states experienced revenue shortfalls, particularly of sales and income taxes, due to the deteriorating economy. Even the mainstay of local revenue, the property tax, fell from nearly 84% of total 1972 tax collections to 76% in 1981.35/ With state and federal funds diminishing as a revenue source for local governments, and limits being placed on the property tax, the need to broaden local options for own-source revenue became even greater.

Local governments generally have the power to tax only to the extent that state governments allow. Experiencing fiscal stress, many localities are more frequently calling upon their states to grant them greater flexibility in raising revenue.36/

Local general sales taxes, as used in this report, are usually levied on the sale of all goods -- with the exception of food and medicine in certain states -- and some services. As a general rule, the local tax is "piggybacked" onto a state sales tax and thereafter redistributed to the locality in which the sale occurred. Collections from local sales taxes grew substantially in the decade between 1972 and 1982, growing from 7.4% to 10.2% of total local revenues.37/ In three states, the tax is locally administered, including Alaska, the only state without a state sales tax that allows local sales taxes.38/ The most common local sales tax rate is 1%, though other rates are often permitted.

In addition to general sales taxes on which the greatest funding burden remains, many states allow local governments the option of levying taxes on motel and hotel rooms, motor fuel, utilities, cigarettes, and vehicle licenses. These "nongeneral" sales taxes are usually earmarked for specific purposes. Hotel, beverage, and cigarette taxes are commonly set aside for the promotion of tourism; motor fuel and vehicle license taxes for roads; and sales taxes for developing and maintaining public transportation.

The ability to levy these taxes may affect how local governments deal with distressed areas and businesses (building roads or fostering economic development) or people (developing mass transit or spurring job creation). In Atlantic City, NJ, for example, part of a 9% luxury tax is dedicated for low-income housing and a convention center. The occupancy tax on hotels and motels is not always earmarked for tourism, and can be a significant source of revenue to local governments. For instance, in Lafayette, WI, where revenues from an occupancy tax go into the local general operating fund, revenues in 1981 were $35,176. Local property tax revenue for that year was $39,410.39/

Local income taxes vary among those states that allow their use. In some instances, they are piggybacked on a state income tax, while in others they are locally administered. Some localities levy them only on persons who earn incomes within that community; others tax income of all residents, regardless of where it was earned. Michigan cities have authority to levy a tax both on residents -- at a rate of 1% to 3% -- and nonresidents -- at a rate of 0.5% to 1.5%, depending on the size of the city.40/ New York City cannot tax nonresidents unless it also taxes residents.

Some states allow localities to levy an occupation or license tax, generally serving the same purpose as an income tax. In Kentucky it is unconstitutional to levy an income tax, but an occupation tax is permissible. Newark, NJ, levies a business payroll tax; businesses, rather than individuals, pay taxes based on the income of their employees. Businesses may pass these costs on to consumers, resulting in higher prices.

Table 6-3 provides descriptions of local uses of sales taxing authority, and Table 6-4 provides descriptions of local uses of income taxing authority. Under the eight region breakdown of states used in this report, all regions but New England authorize local governments to levy sales or use taxes. Half of the Southeastern states and more than half of the Mideast, Great Lakes, Plains, Mountain, and Far West states authorize local sales taxes. All Southwestern states authorize local sales taxes.

In sharp contrast to the widespread use of local sales taxes, the only states authorizing local income taxes are in the Mideast, Great Lakes, Plains, and Southwest.

Three regions, the Southwest, Rocky Mountain, and Far West, use the sales tax exclusively for local own-source revenue. Those states indicated as authorizing local option taxes do so on a statewide basis. Some states, however, authorize only certain cities to levy a local option tax, such as Newark, NJ, and New York City. These states were not counted in the totals for Table 6-3, but are referenced in the legend. States in which local tax limits have been changed within the past year include Missouri, New Mexico, North Carolina, Oklahoma, South Dakota, Tennessee, and Utah.

According to a survey of the National Conference of State Legislatures (NCSL), cities levying an income tax tend to rely on it more heavily than do cities levying a sales tax. Tulsa and Oklahoma City are the only cities to obtain greater than 60% of their revenue from sales taxes, while six cities (Cincinnati, Columbus, Cleveland, Louisville, Philadelphia, and Toledo) derive greater than 60% of their revenue from the income tax.41/

These benefits notwithstanding, local taxes are politically vulnerable. In many states where local option taxes are authorized, not all qualified local governments actually use them. In a few states -- Wisconsin, Georgia, and North Dakota -- none do. Every respondent, when asked why local governments authorized to levy the taxes do not do so, answered either that they do not need the revenue (rather hard to believe) or that they cannot sell it to the

Table 6-3

USE OF LOCAL SALES TAXES, October 1983

State and Type of Government	Tax Rates Employed	Tax Rate Limit	Jurisdictions Levying Tax	
			Number	Percent
Alabama				
County	0.5-3.0	None	41	16
Municipal	0.5-3.0	None	310	71
Alaska				
Borough	1.0-4.0	6.0	7	88
Municipal	1.0-5.0	6.0	92	65
Arizona				
Municipal	1.0-2.0	None	70	92
Arkansas				
County	1.0	2.0	11	15
Municipal	1.0	2.0	32	7
California				
County	1.25	1.25	58	100
Municipal	1.0	0.85-1.0	434	100
Transit District†	0.5	0.5	5	NA
Colorado*				
County	0.25-2.0	Total state, county, and city tax may not exceed 7.0%.	27	44
Municipal	1.0-4.0		170	64
Transit District†	0.6	0.6	1	NA
Georgia				
County	1.0	1.0	128	81
Transit District†	1.0	1.0	1	NA
Illinois				
County	1.0	1.0	102	100
Municipal	0.5-1.0	1.0	1253	98
Transit District†	0.25-1.0	1.0	2	NA
Kansas				
County	0.5-1.0	1.0	51	49
Municipal	0.5-1.0	1.0	83	13
Louisiana				
Parish	1.0-2.0	Combined local tax of 3% unless authorized.	63	100
Municipal	0.3-3.5		161	53
School District	0.5-3.0		58	88
Minnesota*				
Municipal	1.0	1.0	2	<1.0
Missouri*				
County	0.375-0.5	1.0% except 3.0% in St. Louis.	70	61
Municipal	0.5-1.0	1.0	360	39
Nebraska				
Municipal	1.0-1.5	1.5	12	2

Authorized but locally unenacted sales taxes are found in Florida (counties and municipalities), Idaho (resort communities under 10,000 pop.), Kentucky (transit districts), North Dakota (municipalities), and Wiconsin (counties).

*For these states, see notes at end of table.

Table 6-3 (cont.)

Voter Approval Required	Revenue Redistribution	State and Type of Government
		Alabama
No	None	County
No	None	Municipal
		Alaska
Yes	None	Borough
No	None	Municipal
		Arizona
No	None	Municipal
		Arkansas
Yes	None	County
Yes	None	Municipal
		California
No	0.25% of the county tax is used for streets and highways.	County
No	None	Municipal
Yes	None	TD
		Colorado
Yes	None	County
Yes	None	Municipal
Yes	None	TD
		Georgia
Yes	Must be used for property tax relief.	County
No	None	TD
		Illinois
No	None	County
No	None	Municipal
No	None	TD
		Kansas
Yes	None	County
Yes	None	Municipal
		Louisiana
Yes	None	Parish
Yes	None	Municipal
Yes	None	SD
		Minnesota
Yes	The City of Rochester must allocate revenue for flood control.	Municipal
		Missouri
Yes	Portions of county sales tax may be used for property tax relief.	County
Yes	None	Municipal
		Nebraska
Yes	None	Municipal

†Transit tax is in addition to county and municipal taxes and is dedicated for public transportation purposes.

Table 6-3 (cont.)

State and Type of Government	Tax Rates Employed	Tax Rate Limit	Jurisdictions Levying Tax	
			Number	Percent
Nevada*				
County (mandatory)	3.75	3.75	16	100
County (optional)	0.25	0.25	1	6
New Jersey*	8.0-14.0	8.0-14.0	NA	NA
New Mexico*				
County	0.25	0.25	10	30
Municipal	0.25-0.75	0.75	98	100
New York*				
County	1.0-3.0	Combined city and county tax	51	89
Municipal	1.0-3.0	of 3.0%.	29	5
Transit District†	0.5	0.5	1	NA
North Carolina*				
County	1.0	1.0	100	100
County	0.5	0.5	96	96
Ohio				
County	0.5-1.0	1.0	59	67
Transit District†	0.5-1.0	1.5	3	NA
Oklahoma*				
Municipal	1.0-4.0	None	427	73
South Dakota				
Municipal	1.0-2.0	2.0	74	24
Tennessee				
County	1.0-2.25	Maximum combined rate of 2.25% with county taking precedence.	94	100
Municipal	0.25-2.25		16	5
Texas				
Municipal	1.0	1.0	1117	100
Transit District†	0.5-1.0	1.0	3	NA
Utah*				
County	0.75-.875	Maximum combined rate of 0.875%	29	100
Municipal	0.75-.875	with city taking precedence.	219	98
Virginia*				
County (does not overlap muni.)	1.0	1.0	95	100
Municipal	1.0	1.0	41	100
Washington*				
County	0.5-1.0	1.0	39	100
Municipal	0.5-1.0	1.0	273	100
Wyoming				
County	1.0	1.0	15	65

Source: ACIR staff compilations from Sales Taxation: State and Local
Johns Hopkins University Press, 1983; and State Tax Reporter,

Table 6-3 (cont.)

Voter Approval Required	Revenue Redistribution	State and Type of Government
		Nevada
No	Dedicated to local government purposes.	County
Yes	Dedicated for mass transit and tourist promotion purposes.	County
No	Used for local redevelopment; low-income housing; and convention center.	New Jersey
		New Mexico
Yes	County portion dedicated for county fire districts or indigent hospital patients.	County
No	None	Municipal
		New York
No	Not mandated by state but counties share revenue with cities.	County
No		Municipal
No	None	TD
		N. Carolina
No	Apportioned with cities on basis of population or property tax levy.	County
No		County
		Ohio
No*	None	County
Yes	None	TD
		Oklahoma
Yes	None	Municipal
		S. Dakota
Yes	None	Municipal
		Tennessee
Yes	One-half of county portion must go for local school purposes.	County
Yes	None	Municipal
		Texas
Yes	None	Municipal
Yes	None	TD
		Utah
No	None	County
No	None	Municipal
		Virginia
No	County portion divided with towns on basis of school age population.	County
No	None	Municipal
		Washington
No	None	County
No	None	Municipal
		Wyoming
Yes	Divided between counties, cities, and towns based on population.	County

Structure and Administration, John E. Due and John L. Mikesell, Commerce Clearing House.

Table 6-3 (cont.)

Notes:

Colorado -- Temporary state and local sales tax limit is raised to 7.5% until July 1984 when the state sales tax dcreases from 3.5% to 3.0%.

Minnesota -- In 1981, the state prohibited other localities from adopting a sales tax unless specifically authorized by the state.

Missouri -- St. Louis County and the cities of Carterville, Columbia, Excelsior Springs, Toplin, Kansas City, O'Fallon, Perryville, St. Louis, St. Peters, and St. Roberts levy a 0.5% public transit tax in lieu of creating a transit district.

New Jersey -- In legal terms, this is a state gross revenue tax on casinos. However it is dedicated largely for purposes of improving local communities. Consequently, it is classified here as a source of local revenue. The tax rate applicable in any given year varies according to how many casinos are operating, and there is an added 2.0% penalty for casinos that do not make real property reinvestments or improvements in their local community.

North Carolina -- Voter approval for sales tax adoption is optional. Counties can enact a one cent sales tax and an additional 1/2 cent sales tax -- the overall tax rate limit for counties is therefore 1.5 cents.

New York -- Maximum combined local rate is 3.5% for the Metropolitan Communities Transportation District (MCTD) comprised of the City of New York and the Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester Counties and 3.0% elsewhere. An exception for the Cities of Yonkers and New York the combined local rate is 4.5%.

Nevada -- In 1981 the state made the 3.75% county sales tax mandatory, which in practice raises the state rate and dedicates the tax for local government purposes. Also in 1981 counties were authorized to levy an optional transit tax. Only Washoe County has a 0.25% tax.

Ohio -- Voter approval not required unless voters petition.

Oklahoma -- Effective January 1984, counties with populations of 300,000 or less are authorized to levy a sales tax not over 2%, with voter approval.

Utah -- Davis, Salt Lake, and Weber Counties and Park City have enacted an additional 0.25% transit tax in lieu of creating a transit district. (Cities use of the transit tax requires voter approval.) Local tax limits will increase to 1.0% in 1987. Also, resort communities, defined as having a transient population higher than the permanent population, may levy an additional 1.0%.

Washington -- If the county in which the city is located imposes a tax, the rate for the city may not exceed 0.425%. For counties and cities to adopt the second 0.5%, voter approval is required. A local transit tax is levied by 99 cities, six unincorporated county areas, and nine unincorporated Public Transportation Benefit Areas (PTBA). The rates authorized are 0.1%, 0.2%, or 0.3% except for King County area which is allowed a 0.6% rate.

Table 6-4

Use of Individual Local Income and Wage Taxes, October 1983

State and Type of Government	Tax Rates Employed	Tax Rate Limit	Tax Base	Type of Tax	Jurisdications Levying Tax		Voter Approval Required
					Number	Percent	
Alabama							
Municipal	1.0-2.0	None	Wages Only	Flat Rate	8	2	No
Delaware							
Municipal	1.25	1.25	Wages Only	Flat Rate	1	2	No
Indiana							
County	0.5-1.0	1.0	State Taxable Income	Flat Rate	38	42	No
Iowa							
School District	3.5-16.0	Determined by Comptroller	State Taxable Income	Surtax	44	10	Yes
Kentucky							
County	0.1-2.7	None		Flat	9	8	No
Municipal	0.25-2.7	None	Wages Only	Rate	60	14	No
Maryland							
County	20.0-50.0 of State Tax Liability*	50.0	State Taxable Income	Surtax	24	100	No
Michigan							
Municipal	1.0-3.0	1.0-3.0	State Taxable Income	Surtax	16	3	No
Missouri							
Municipal	1.0	1.0	Wages Only	Flat Rate	2	<1	Yes
New York							
Municipal	0.4-2.0	1.0; Surtax Must Be Approved by Legislature	State Taxable Income	Graduated	1	<1	No
Ohio							
Municipal	0.25-2.5	None	State Taxable Income	Flat Rate	459	48	No
Pennsylvania							
Municipal	0.25-4.96	1.0	Wages Only	Flat Rate	2220 est.	86	No

Note: Arkansas authorizes municipalities and Georgia authorizes counties and municipalities to impose a local tax, but no local governments have enacted same.

*Counties are required to distribute to municipalities 8.5% of the county taxes paid by residents of those municipalities.

Source: ACIR staff compilations based on Commerce Clearing House, State Tax Reporter, State Revenue Departments, and interviews between U.S. Advisory Commission on Intergovernmental Relations staff and state officials.

voters. The NCSL study confirms the latter; the requirement for voter approval reduces the possibility that a tax will be adopted. However, this study concluded that "barriers to adoption of a sales tax tend to weaken over time, perhaps because of increased fiscal stress or because it takes a certain amount of time to overcome inertia."42/ The data from the 1983 States and Distressed Communities survey indicate an increase in voter approval of local sales taxes. In Arkansas, for instance, over half of both cities and counties have opted for the sales tax in the past year. Likewise, Kansas reported 1983 as the biggest year for voter approval of a local sales tax. Further, the State of Nevada has mandated a local sales tax.

Local inhibitions about imposing an income tax are more difficult to overcome.43/ Maryland mandated all counties and the City of Baltimore to use a local income tax at a rate of at least 20% of the state income tax, and authorized these localities to raise their rates as high as 50% of the state amount.

Limitations in some state laws make it more difficult to levy local option taxes. Wisconsin county governments must enact the tax law, but are entitled to none of the proceeds, which go instead to cities, villages, and towns within the county.44/ In Georgia, cities and counties may levy either a sales or an income tax, but not both.

In recommending that states allow their local governments to levy sales or income taxes or both, ACIR lists five criteria to be considered. The state should:

1) provide a uniform local tax base which conforms to that of the state if the state imposes the tax;
2) collect and administer the tax;
3) encourage widespread or universal coverage of the tax;45/
4) allow local flexibility in setting rates subject to state limits; and
5) take steps to reduce local fiscal disparities both by means of state aid and redistributing local revenues.

The failure in Indiana to pass a local option income tax in the 1983 legislative session has been attributed to several factors. Legislators were reluctant to authorize another tax so soon after state tax hikes. Legislators were unconvinced of pressing needs at the local level. Local officials were unwilling to propose a local tax before the 1984 elections.

It appears that passing local option taxes is difficult largely because of general voter opposition to taxes. Their revenue-generating capacity is often inadequately persuasive to voters; many communities, particularly counties and small cities, would have limited returns from such a tax. States, however, can institute or increase taxes without direct voter approval, and can redistribute the revenues on an equalizing basis to benefit, among others, small communities better than separate local taxes would. Florida, for instance, uses a sales tax distribution formula that includes a special portion targeted to counties under relatively great fiscal stress.

States can create or increase taxes whether or not local governments are given taxing authority. They can levy and redistribute in the interest of broad-based local revenue support. The local option tax simply increases local self-help capacities, if the need and the spirit are present. Without taking basic responsibility away from the state, this would grant flexibility to local governments.

Local Revenue Diversification

Even when local governments have the legal authority to levy sales or income taxes and to use such devices as tax increment financing, they often must seek additional ways to increase the amount of revenues they raise for their own use. In some cases additional revenue sources are needed because local political conditions make it impossible for a government to impose new taxes; in other cases, local fiscal conditions force the government to leave no stone unturned in seeking revenues.

As early as 1961, ACIR recommended the removal of constitutional and statutory prohibitions against investment of state and local funds.46/ There is now an even greater need for this. Most local governments do not have "extra" cash, but many follow the practice of "encumbering" funds -- that is, carrying them on the books as obligated for expenditure at a future date -- when a personnel slot stays open for a period or when supplies are ordered but not yet delivered. The amount of encumbered funds on the books at a given time can be substantial. The temporary investment of such "idle" funds can reap significant amounts of revenue for local treasuries.

Local governments are now eligible in many states to purchase high-yielding certificates of deposit, to open "Super NOW" accounts, and to invest their pension funds in authorized fiduciary investments. Small governments with relatively little cash available for investment can increase their gains by pooling their funds with other governments. Such pools must be authorized by state governments, and, in many cases, are run as a service by the states.

The Massachusetts Municipal Depository Trust, for instance, allowed Pepprill, MA (with a population of 8,300), to earn $196,000 in 1982.47/ In Florida, the Local Government Surplus Funds Trust fund balance on November 30, 1982, was over $1 billion. Seventy-two municipalities made up 22.4% of the fund, with 45 of those having populations less than 10,000, and only 11 greater than 30,000.48/

North Carolina's Cash Management Trust Fund is unique among state trust funds in that it was established as an open-ended investment company and registered with the Securities and Exchange Commission. One hundred counties and 480 cities are eligible to participate. As of April, 1983, 243 local governments were in the account with a total of $86 million. North Carolina officials felt that, in addition to bringing increased funds to their localities, it has made banks seek public funds more actively -- an example of the marketplace at work for the public sector.49/

In recent years the public has increasingly accepted user fees as an alternative to new or increased taxes in order to maintain or expand services. This form of local finance is used for services ranging from libraries to hospitals and from sewers to golf courses. According to William G. Colman,

> Basic economic objectives underlying user-based financing are efficiency, improvement in resource allocation, conservation encouragement, and equity improvements between (a) users and nonusers of particular services largely or partly individual (in contrast to community) in benefit..., (b) residents and nonresidents in use of costly facilities (e.g., museums, zoos), and (c) taxpaying and tax exempt organizations in use of "household" services (e.g., water, sewer, solid waste collection).50/

In 1974, ACIR concluded that "user charges constitute an effective method for diversifying local revenue structures when specific beneficiaries of particular government services can be readily or approximately identified."51/ The Commission recommended that states (1) authorize and encourage local governments to adjust fees and charges annually to reflect at least changes in financial costs, and (2) provide technical assistance and consultation as to appropriate areas, methods, and rates of charges. Because user charges could make it difficult for those with low incomes to enjoy museums, libraries, and other facilities, a "circuit breaker" should be incorporated into the fee structure. Persons with incomes below a certain minimum, who are above a certain age, or who have physical disabilities would be charged lower fees or none at all.

State governments can play three important roles in helping local governments increase revenues through investments and user fees. First, states can authorize these practices and set ground rules for their use. Second, states can provide information and technical assistance to local governments interested in these methods. Third, states can directly or indirectly manage trust funds that pool investments of several local governments.

Local Discretionary Authority

Local discretionary authority is defined as the power of a local government to conduct its own affairs, including the power to determine its own organization, the functions it performs, its taxing and borrowing authority, and the numbers and employment conditions of its personnel.52/ States tightly controlled local governments until the post-Civil War period. According to an ACIR report, initial constitutional efforts to expand local discretionary authority were designed to prevent legislative abuses of local governments. Starting with passage of the 1875 Missouri Constitution, state constitutions or statutes gave certain types of local units authority to draft, adopt and amend a charter, and to supersede special laws and certain general laws. Initially such grants of authority took the form of a provision establishing an "imperium in imperio" -- a state within a state -- wherein local governments were given a general grant of power such as "local affairs," or local powers were enumerated and removed from the competence and authority of the state legislature.53/

Given the decentralist thrust of recent federalism proposals, local governments would be strengthened by having the broadest possible base of discretion, and the authority to use it. Yet, many local governments are still bound by "Dillon's Rule," under which cities or counties can perform particular functions for their citizens only where they have obtained an express or a clearly implied authorization from their state legislatures.54/

ACIR has recommended that states grant to all general-purpose local governments all functional, structural and fiscal powers not expressly reserved, preempted or restricted by the state constitution or legislation. In 1962, when these recommendations were first made, the Commission adopted:

> ...the devolution of powers approach, permitting a broad, unambiguous grant of power while at the same time stipulating the right of affirmative reservation, preemption, and restriction by the state legislature to forestall problems arising from a lack of responsibility or prudence or from placing local interests above the broader substate regional or statewide interest. It firmly established the ultimate authority of states over local governments, even while recognizing that (1) local governments should have the freedom to experiment with solutions to servicing problems and to adapt to changing conditions without wasting time seeking permission from the state legislature; (2) local governments, being closest to the citizens, are more knowledgeable about local conditions and can respond more quickly and better to local problems than the legislature; (3) the diversity among local areas requires a flexible state approach to local governments; and (4) broad local discretion frees state legislatures from the burden of acting on a myriad of local matters, allowing them to concentrate on truly state concerns.55/

In 1980, the Commission expanded its recommendations to include a statement that any such constitutional amendment have a "self-executing" provision, stipulate that the grant of local discretionary authority be interpreted liberally by the courts, limit special legislation if local governments have discretionary authority already, require a "code of restriction" specifying those powers expressly reserved to or preempted by the state legislature, and require adoption and maintenance of a local government code consolidating all statutes applicable to local governments.56/

In some states, structural, functional, and fiscal authority is granted to one form of local government but not another -- for example, municipalities but not counties. In others, such authority is broadbased.

The importance to local officials of local discretionary authority, known in its broadest form as home rule, can be captured in the following quote from Texas, a state with strong municipal home rule:

> ... home rule cities have the inherent authority to do anything which qualifies as a 'public purpose' and is not contrary to the constitution or laws of the state. From the city attorney's vantage point, this means that the presumption will be in favor of ordinances and other acts

> of a home rule city whenever the city is a party to a law suit. From the city council's viewpoint, it means that a new program can be initiated to solve problems whenever they occur.
>
> Home rule is also an important instrument of decentralization. It assumes that governmental problems should be settled at the lowest possible level of government closest to the people, and that the undue concentration of powers in higher levels of government should be curtailed.57/

Home rule is not without controversy at the local level, however. Residents of Rockford, IL, recently voted to abandon home rule, as have two other communities in that state. These moves were a byproduct of voter opposition to local taxes. Opponents to Rockford's home rule argued successfully for statutory restrictions on local taxing powers, with voters having the power through referenda to approve or disapprove any new taxes.

According to a study by Thomas Kelty and James Banovetz, however, home rule authority has rarely been used to levy taxes. Rather, it is more commonly used to "facilitate the sale of local bonds and reduce the overall cost of debt to local taxpayers."58/ In fact, as their study shows, the loss of home rule power actually resulted in an increase in property taxes and a $9 million reduction in the city's budget, putting restraints on the city's economic development program.

Home rule powers recently have fallen under the shadow of a 1982 court decision, Community Communications Company, Inc. v. City of Boulder,59/ which denied local governments immunity from federal antitrust laws if their actions restrain or displace competition -- unless such actions are specifically empowered by state law. As local government participation in redevelopment activity increases, it crosses into private sector "territory." Using tax increment financing and tax incentives, and leveraging CDBG and UDAG funds, are vulnerable activities because they may cross the emerging antitrust line. States that authorize local governments to levy sales or income taxes, and to use other financial tools and means of revenue diversification, are helping those governments progress from dependence to self-help and independence. Under Boulder, each state legislature determines how to share state immunity from national antitrust policy with its local governments. Subsequently, Congress removed the threat of financial damages against guilty local governments (after some major awards had been made), and the Supreme Court relaxed the criteria for judging these cases so that local governments acting upon the clear intent of state laws are immune.60/ Nevertheless, states still need to act to protect their local units; broad home rule powers are not enough to sustain local activities that may have anticompetitive effects. Until this dilemma is resolved, home rule powers are in doubt.

Of the four areas -- structure, functions, personnel, and fiscal -- fiscal independence has traditionally been found to be the most important. Before Boulder, an ACIR study found that the area in which cities possess the least amount of discretionary authority is in finance.61/ Counties have even fewer powers overall. Yet, the Commission emphasized,

> regardless of the amount of discretionary authority granted by the state constitution or statutes.... The key determinant of the ability of a local government to exercise fully the grant of powers is adequate finance.62/

Table 6-5 shows the results of an ACIR survey on local discretionary authority within the 50 states. The table offers an index of discretionary authority in 76 functional areas -- for example, licensing, welfare, planning, police services, and schools -- and in finance. Discretion is measured on a scale of 1.00 to 5.00, with 1.00 indicating the highest degree of local discretion, and 5.00 the lowest. The index was derived from data collected through legal research and a survey of 119 governors, attorneys general, departments of community affairs, legislative research offices, muncipal leagues, and county associations. ACIR found that 37 states extended functional discretion and 13 states extended financial discretion to cities at the 1.00 to 2.49 level, inclusive. Fewer states extended functional or financial discretion to counties or towns. The above 37 states represent all of the eight regions depicted in Table 6-5.

Summary

If local governments are to meet the increased demands being put on them in the 1980s, states must enhance these localities' abilities to help themselves. While state governments remain the driving force behind many programs dealing with distress, there are areas where greater flexibility would allow local governments to go beyond a certain state-provided base in their delivery of services.

Granting authority for the use of tax increment financing and sales and income taxes decreases local financial dependence upon already strained state treasuries. Allowing broader authority for revenue diversification, including charging for services, and borrowing and investing to meet local needs, further strengthens the financial base of local government. Finally, granting local discretionary authority for structural, functional and personnel decisions frees the legislature from considering a myriad of local legislation in each session.

* * * * * * *

FOOTNOTES

1/ U.S. Advisory Commission on Intergovernmental Relations (ACIR), Significant Features of Fiscal Federalism, 1981-82 Edition, M-135 (Washington, DC: U.S. Government Printing Office, April 1983), p. 67.

2/ Ibid.

3/ John L. Mikesell, C. Kurt Zorn, and Scott S. Lloyd, Indiana University, "Broad-Based Sources for Local Revenue Diversification: Income and General Sales Taxation," prepared for the 76th Annual Conference on Taxation, National Tax Association-Tax Institute of America, Seattle, WA, 4 October 1983, p. 2 (mimeographed).

4/ National Association of Counties, "Counties pay billions for health

Table 6-5

INDEX OF LOCAL GOVERNMENT DISCRETIONARY AUTHORITY BY STATE, 1981*

Region and State	Index of Cities		Index of Counties		Index of Towns	
	Functional Areas	Finance	Functional Areas	Finance	Functional Areas	Finance
New England						
Connecticut	1.00	2.00	***	***	1.00	3.50
Maine	1.00	1.50	4.00	3.50	1.50	2.00
Massachusetts	2.00	5.00	5.00	5.00	2.00	5.00
New Hampshire	1.50	4.00	4.00	5.00	1.75	4.00
Rhode Island	2.00	5.00	***	***	2.00	5.00
Vermont	2.00	5.00	5.00	5.00	3.00	3.00
Mideast						
Delaware	2.00	3.00	2.00	2.00	2.00	3.00
Maryland	1.50	2.25	2.33	3.20	****	****
New Jersey	2.00	4.00	3.50	4.50	2.00	4.00
New York	3.00	4.00	3.00	4.00	3.00	3.75
Pennsylvania	2.00	2.50	2.00	2.00	****	****
Great Lakes						
Illinois	2.00	1.50	3.30	2.80	2.00	1.50
Indiana	2.50	4.00	3.50	4.00	2.50	4.00
Michigan	1.00	2.00	3.50	3.50	****	****
Ohio	1.50	2.50	4.00	4.00	****	****
Wisconsin	2.00	3.00	3.00	3.00	5.00	4.00
Plains						
Iowa	1.90	4.50	2.50	4.50	****	****
Kansas	1.00	3.00	2.50	3.00	****	****
Minnesota	1.00	4.00	3.00	3.00	****	****
Missouri	1.00	3.00	5.00	5.00	****	****
Nebraska	2.00	3.50	4.00	5.00	****	****
North Dakota	1.50	3.50	3.00	4.00	****	****
South Dakota	4.00	3.00	3.00	5.00	3.00	5.00
Southeast						
Alabama	2.50	2.00	4.00	4.75	3.00	2.00
Arkansas	3.00	3.00	3.00	3.00	4.00	3.00
Florida	1.30	4.50	1.30	4.50	****	****
Georgia	1.00	3.00	5.00	3.00	****	****
Kentucky	3.50	2.60	3.50	2.60	****	****
Louisiana	1.50	3.00	2.00	3.50	1.50	3.00
Mississippi	2.00	4.00	4.00	4.00	2.00	4.00
North Carolina	1.00	2.50	1.25	2.50	1.00	2.50
South Carolina	2.00	2.00	3.00	2.00	2.00	2.00
Tennessee	3.00	3.00	3.00	5.00	3.00	3.00

Table 6-5 (cont.)

Region and State	Index of Cities		Index of Counties		Index of Towns	
	Functional Areas	Finance	Functional Areas	Finance	Functional Areas	Finance
Southeast (cont.)						
Virginia	1.50	2.00	2.50	3.00	2.50	3.00
West Virginia	2.00	5.00	3.00	5.00	3.00	5.00
Southwest						
Arizona	2.00	1.75	4.00	4.00	2.00	1.75
New Mexico	5.00	3.00	3.00	3.00	****	****
Oklahoma	1.50	2.50	3.50	3.50	2.50	3.50
Texas	1.20	1.50	4.80	4.50	2.50	4.00
Mountain						
Colorado	3.00	3.50	5.00	4.50	3.00	3.50
Idaho	2.00	5.00	3.00	5.00	****	****
Montana	2.00	5.00	2.00	4.00	2.00	5.00
Utah	2.00	3.50	3.00	3.00	2.00	3.50
Wyoming	3.00	3.00	4.00	3.00	3.00	3.00
Far West						
Alaska	2.00	2.00	2.00	2.00	****	****
California	2.00	2.00	3.00	3.00	****	****
Hawaii	**	**	3.20	4.00	****	****
Nevada	3.50	4.00	4.00	4.00	4.00	4.00
Oregon	1.50	2.00	1.50	2.00	****	****
Washington	2.50	3.50	2.80	4.00	****	****
U.S. (unweighted average)	3.02	3.16	3.24	3.69	2.43	3.41

Scale: 1 to 5, with 1 indicating the greatest degree of freedom from state control and 5 indicating the smallest degree of freedom.

Key: *These indices are based on a 1981 ACIR survey and staff calculations. It remains the most current study of local discretionary authority.

**There are only four local governments in Hawaii: County of Hawaii, County of Kauai, County of Maui, and City of Honolulu.

***There are no organized county governments in Connecticut or Rhode Island.

****There are no organized town governments in Alaska, California, Florida, Georgia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Maryland, Michigan, Minnesota, Missouri, Nebraska, New Mexico, North Dakota, Ohio, Oregon, Pennsylvania or Washington.

Source: ACIR, Measuring Local Discretionary Authority, M-131, November 1981.

care," County News, Vol. 15, No. 13, 4 July 1983, p. 11.

5/ ACIR, op. cit., p. 24.

6/ ACIR, op. cit., pp. 24, 139. Public welfare includes cash assistance to persons based on need, vendor payments, and intergovernmental or other direct expenditures for welfare. It excludes pensions and other benefits not contingent upon need, and services provided directly by government through its hospitals and health agencies.

7/ United Way of Texas, Report on the Impact of Federal Budget Cuts on Health and Human Services Program in Major Texas Communities (Austin, TX: United Way, March 1983).

8/ Ibid.

9/ Statement on signing Executive Order 12303, April 8, 1981, from Weekly Compilation of Presidential Documents, Vol. 17, No. 15, p. 412.

10/ Memphis/Shelby County v. Tennessee.

11/ Florida Department of Veteran and Community Affairs, Division of Local Resource Management, Using Tax Increment Financing for Community Revitalization, Community Program Development Management Series, No. 22, February 1982, pp. 4-5; and Richard G. Mitchell, "Tax increment financing for redevelopment: is it as bad as it critics say? Is it as good as its proponents claim?," Journal of Housing Vol. 5, No. 77, May 1977, pp. 226-29.

12/ Massachusetts Executive Office of Communities and Development, Division of Community Services, "Executive Summary of Tax Increment Financing," Massachusetts House Bills 3392 and 5649, April 1983 (Boston, MA).

13/ The constitutionality of the statute itself could be challenged, but where the legislature has declared a program to be a valid public purpose, the court will not disturb that determination unless clearly unwarranted. Grubstein v. Urban Renewal Agency of the City of Tampa, 115 So.2d 745 (Fla., 1959). From Florida Department of Veteran and Community Affairs, Using Tax Increment Financing for Community Revitalization, p. 39.

14/ Approved November, 1981. Texas Revised Civil Statutes Annals, Article 1066e.

15/ Mitchell, op. cit.

16/ The Ohio law is an exception in its requirement that the land to be improved under this legislation must be acquired by a municipality with its own funds and held in fee title by the municipality. It is also unique in requiring public ownership of the land even after redevelopment, but the arrangement seems to work quite well there. The benefit to the developer is that no land need be purchased or prepared; the eventual benefit to the municipality, besides the redevelopment itself, is the rental of air space and increase in property tax base. An Ohio municipality interested in encouraging urban redevelopment can lease its land to developers for any purpose. The land is then exempt from real property taxation for up to 30 years. This is not tax abatement, however, as owners of redevelopment structures located on the land must make annual service payments equal to the tax that would be charged if the improvements were not exempt. These monies are then redistributed back to the municipality in which the improvements were made. Xenia, for instance, used in the chapter as an example of rebuilding after a disaster, recouped the entire amount of increased real property taxes generated by the improvements to the property in the Towne Square area.

17/ Staff interview, New Hampshire Office of State Planning, July 1983.

18/ Staff interview, Office of Intergovernmental Affairs, Mayor's Office, Nashville, July 1983.

19/ International Downtown Executives Assocation, Center City Report, January 1983, p. 5.

20/ Peat, Marwick, Mitchell & Co., report to Albuquerque Center, Inc., December 1980.

21/ Huddleston, Jack R., "A Comparison of State Tax Increment Financing Laws," State Government, Vol. 55, No. 1, 1982.

22/ Mitchell, op. cit., p. 126.

23/ Staff interview, North Dakota Department of Business and Economic Development, June 1983.

24/ Nevada State Journal, 20 November 1977.

25/ The Tennessean (Nashville), 11 July 1983, p. 12.

26/ The Ohio Developer, Winter 1980, p. 46.

27/ City of Cokato, MN, "Development District Program/Tax Increment Finance Plan," June 1981.

28/ Walter Trimble, Gahanna Dispatch (OH), April 1978.

29/ Dodge Center, MN, "Dodge Center Housing Development and Tax Increment Finance Plan," 1979.

30/ William Witte, "Community Development's Third Year: A Report on Trends and Findings of NAHRO's CD Monitoring Project," Journal of Housing, February 1978, pp. 70-3.

31/ Ibid.

32/ Ibid.

33/ Council of State Community Affairs Agencies (COSCAA), Downtown Revitalization: A Compendium of State Activities (Washington, DC: International Downtown Executives Association), 1980.

34/ COSCAA, op. cit.

35/ ACIR, op. cit., M-135, p. 42.

36/ Steven D. Gold, "Local Sales and Income Taxes: How Much are they Used? Should they be more Widespread?," National Conference of State Legislatures Finance Paper No. 24, July 1982, p. 3.

37/ ACIR, op. cit., M-135, p. 33.

38/ The Wisconsin Taxpayer, Vol. 51, No. 5, May 1983, p. 1.

39/ Ibid., p. 8.

40/ Michigan State Acts 5.3194 (1) et seq.

41/ Gold, op. cit., p. 10.

42/ Ibid., p. 17.

43/ Ibid.

44/ Wisconsin Taxpayer, p. 4.

45/ ACIR, op. cit., A-47, October 1974.

46/ ACIR, Investment of Idle Cash Balances by State and Local Governments, A-3 (Washington, DC: U.S. Government Printing Office, January 1961).

47/ Hamilton Brown, "Savings Alternatives Make Most of Idle Cash," National Community Reporter, No. 32, June 1983, p. 6.

48/ Florida Advisory Council on Intergovernmental Relations, "Florida Local Government Investment Pool," Florida ACIR Working Papers: Aspects of Fiscal Capacity (Tallahassee, FL: FACIR), 83-1, January, 1983.

49/ Staff interview, May 1983.

50/ William G. Colman, Potomac, MD, "Policy and Administrative Challenges in Expanding the Role of User Charges in Financing State and Local Government," March 1983 (working paper).

51/ ACIR, Local Revenue Diversification: Income, Sales Taxes and User Charges, A-47 (Washington, DC: U.S. Government Printing Office, October 1974), p. 7.

52/ ACIR, Measuring Local Discretionary Authority, M-131 (Washington, DC: U.S. Government Printing Office, November 1981), p. 1.

53/ Ibid., p. 5.

54/ Ibid., pp. 16-17, 20-21, 60.

55/ Ibid., p. 9.

56/ ACIR, State and Local Roles in the Federal System, A-88 (Washington, DC: U.S. Government Printing Office, 1982), p. 449.

57/ ACIR, op. cit., M-131, p. 28.

58/ Kelty, Thomas W. and James M. Banovetz, "The Use (and Misuse?) of Illinois Home Rule," Illinois Municipal Review, May 1983.

59/ 455 U.S. 40 (1982).

60/ "Conclusions and Recommendations Concerning Municipal Antitrust Liability," A Report to the U.S. Advisory Commission on Intergovernmental Relations, December 1983 (staff working paper). See also Local Government Antitrust Act of 1984 (PL 98-544), October 24, 1984 , nd Supreme Court case Town of Hallie v. City of Eau Claire (March 27, 1985).

61/ ACIR, op. cit., M-131, p. 6.

62/ Ibid., p. 16.

Chapter 7

FINDINGS, GENERAL OBSERVATIONS, AND RECOMMENDATIONS

This chapter summarizes the specific findings of the preceding chapters, and presents general observations based upon the data collected by the state monitoring effort.

Summary Of Findings

National Context for States and Distressed Communities

Distress can be divided into (1) community distress, which involves the economic and social conditions of people, places, and businesses, and (2) government distress, which defines the fiscal condition of state and local governments in terms of revenues and expenditures.

Economic distress affects the unemployed and the working poor, as well as small and large businesses. Distress also affects innercity neighborhoods, older suburban communities, and rural towns. State and local governments in every region of the country are also experiencing fiscal distress as revenues are hard pressed to keep up with increasing demands for services.

Distress is not an isolated phenomenon. Its existence and persistence in our nation's communities occurs in the context of the national and international economies. It is the result of a complex array of economic, social and political factors that are difficult to separate. Demographics, technological changes, international economic competition, trade and budget deficits, as well as changes in the structure and composition of the national economy all combine to produce distress in certain communities and states, but not in others. Given the complexity of the subject, this study sought only to describe the major dimensions of community and government distress.

In terms of the national context, the Commission found:

1. Economic forces generate distress for communities and local governments. Community and government distress is the result of two kinds of economic forces. One is structural and long-term, the result of forces largely beyond the control of state and local governments, while the other is cyclical and short-term. Structural and cyclical forces combine to generate different degrees of distress for different communities and state and local governments, including plant closings, long-term unemployment, and physical deterioration. Despite some variation in degree from place to place, nearly every state government and large municipality experienced fiscal distress in 1979-83.

2. Inefficiencies and distortions in the private market create market failure for certain communities. To a great extent, community distress results from market failure caused by inefficiencies or distortions in the market system due to such things as the lack of competition among finan-

Table 7-1

Summary of Indicators of State Government Efforts to

Policy Areas and Indicators	Number of States with Programs	New England	Mid-East	Great Lakes	Plains
Assisted Housing					
1. Single-Family Housing Construction	47	CT ME MA NH RI VT	DE MD NJ PA	IL IN MI WI	IA MN MO NE ND SD
2. Multifamily Housing Construction	43	CT ME MA NH RI VT	DE MD NJ NY PA	IL IN MI WI	IA MN MO NE ND SD
3. Housing Rehabilitation, Create/Lease	26	CT ME MA NH	DE MD NJ NY PA	IL IN MI WI	IA MN MO NE ND SD
4. Housing Rehabilitation, Tax Incentives	9	CT MA	NJ NY PA		IA NE
Economic Development					
5. Industrial/Commercial Site Development	8	CT MA VT	NJ PA	MI	IA
6. Financial Aid for Industrial and Commercial Development	21	CT ME MA NH VT	NJ NY PA	IL IN MI OH WI	IA MN NE
7. Customized Job Training	12	MA	DE PA	OH	IA KS MN ND
8. Small and Minority Business	29	CT MA RI	MD NY PA	IL IN MI OH WI	KS MN MO ND
9. Industrial Revenue Bonds	11	CT MA NH	NJ	IL WI	MO
Community Development					
10. Capital Improvements	26	ME MA VT	NJ PA		IA KS MN NE ND SD
11. Neighborhood Development	14	CT MA	DE MD NJ PA	IN MI OH	MN MO
State-Local Fiscal Relations					
12. State-Local General Revenue Sharing	42	ME MA NH RI	MD NJ NY PA	IL IN MI OH WI	IA KS MN NE ND SD
13. Education Finance	50	CT ME MA NH RI VT	DE MD NJ NY PA	IL IN MI OH WI	IA KS MN MO NE ND SD
14. Assumption of Local Public Welfare	50	CT ME MA NH RI VT	DE MD NJ NY PA	IL IN MI OH WI	IA KS MN MO NE ND SD
15. State Mandate Reimbursements	12	MA RI		IL MI	MO
16. Improving Local Government Access to Credit Markets	42	CT ME MA NH RI VT	DE MD NJ NY PA	IL IN MI OH WI	IA KS MN MO ND
Enhancing Local Self-Help Capabilities					
17. Tax Increment Financing	31	CT ME NH RI	MD	IL IN MI OH WI	IA KS MN MO NE ND SD
18. Local Redevelopment Authorities	49	CT ME MA NH RI VT	DE MD NJ NY PA	IL IN MI OH WI	IA KS MN MO NE ND SD
19. Local Income/Sales Taxes	34		DE MD NJ NY PA	IN MI OH WI	IA KS MO NE ND SD
20. Local Discretionary Authority	50	CT ME MA NH RI VT	DE MD NJ NY PA	IL IN MI OH WI	IA KS MN MO NE ND SD

Source: ACIR staff compilation.

Aid Distressed Communities by Region, 1983

Southeast												Southwest				Rocky Mountains					Far West						Policy Areas and Indicators
																											Assisted Housing
AL	AR	FL	GA	KY	LA	MS	NC	SC	TN	VA	WV	AZ	NM	OK	TX	CO	ID	MT	UT	WY	AK	CA	HI	NV	OR	WA	1.
AL	AR	FL		KY	LA		NC	SC	TN	VA	WV		NM	OK	TX	CO	ID	MT	UT	WY	AK	CA		NV	OR		2.
							NC			VA			NM	OK		CO						CA			OR		3.
										VA															OR		4.
																											Economic Development
																										WA	5.
								SC							TX						AK	CA			OR		6.
														OK			ID					CA				WA	7.
AL	AR	FL		KY	LA		NC	SC	TN	VA	WV				TX							CA	HI			WA	8.
		FL													TX							CA			OR		9.
																											Community Development
	AR		GA	KY							WV		NM	OK	TX	CO	ID	MT	UT	WY	AK		HI			WA	10.
		FL		KY																		CA					11.
																											State-Local Fiscal Relations
AL	AR	FL	GA		LA	MS	NC	SC	TN	VA	WV	AZ	NM	OK			ID		UT	WY	AK	CA	HI	NV	OR	WA	12.
AL	AR	FL	GA	KY	LA	MS	NC	SC	TN	VA	WV	AZ	NM	OK	TX	CO	ID	MT	UT	WY	AK	CA	HI	NV	OR	WA	13.
AL	AR	FL	GA	KY	LA	MS	NC	SC	TN	VA	WV	AZ	NM	OK	TX	CO	ID	MT	UT	WY	AK	CA	HI	NV	OR	WA	14.
		FL							TN							CO		MT				CA	HI			WA	15.
AL		FL	GA	KY	LA	MS	NC		TN	VA	WV	AZ	NM	OK	TX			MT	UT		AK	CA		NV	OR	WA	16.
																											Enhancing Local Self-Help Capabilities
	AR	FL						SC	TN				NM		TX	CO		MT	UT	WY	AK	CA		NV	OR		17.
AL	AR	FL	GA	KY	LA	MS	NC	SC	TN	VA	WV	AZ	NM	OK	TX	CO	ID	MT	UT		AK	CA	HI	NV	OR	WA	18.
AL	AR		GA	KY	LA		NC		TN	VA		AZ	NM	OK	TX	CO			UT	WY	AK	CA		NV		WA	19.
AL	AR	FL	GA	KY	LA	MS	NC	SC	TN	VA	WV	AZ	NM	OK	TX	CO	ID	MT	UT	WY	AK	CA	HI	NV	OR	WA	20.

cial institutions, inappproprate regulation, undue concentration of large amounts of investment capital, and the inability of certain people or firms to gain access to investment capital.

3. Distress is unevenly distributed. Market failure in distressed communities is exacerbated by both structural and cyclical forces. Those communities already experiencing difficulties in the late 1970s faced greater difficulty than other communities in the early 1980s due to the effects of recession. The number of communities experiencing distress increased in 1979-83.

4. The central cities lost population to the suburbs and rural areas. More than 50% of metropolitan area residents lived in suburban communities in the early 1980s, and population was increasing in rural areas as well, with central-city populations declining.

5. The 1981-83 recession exacerbated distress. Throughout the period covered by this study, there was a general increase in the poverty rate, local government revenues failed to keep pace with inflation, service demands rose as assistance was provided to persons out of work and serious public physical infrastructure problems were encountered, states struggled to keep their fiscal houses in order, and federal aid reductions were enacted as national deficits kept rising. These cyclical events abetted longer-term structural changes to heighten the level of distress and to protract its effects.

6. There is no consistent pattern of national policy response to community distress. Since 1965 there has been an inconsistent national policy response to the problems of distressed communities. Among the approaches that have been used are categorical aid, block grants, public-private partnerships, and reliance on volunteerism and free market forces. Recent shifts in national policy toward a free market approach have resulted in substantial reductions in aid to state and local governments. It is unclear which approach is most effective. However, it is clear that the capacity of state and local governments to meet the needs of their citizens needs further improvement.

State Policies and Programs

The summary results of the state monitoring effort for 1983 may be found in Table 7-1. The specific results for each policy area are summarized in the following sections.

Assisted Housing. Safe, sanitary and decent housing has been a national policy objective since the 1930s. And yet, for millions of Americans, particularly minorities, this goal has not been realized. The availability of adequate housing that is affordable is a particularly acute problem in distressed communities and for certain high need groups.

To realize the nation's housing objective, three challenges face public officials.

1. They must identify and use financial resources to pay for or subsidize

housing for individuals and families unable to pay for phyically adequate homes.

2. They must formulate and implement programs to direct financial resources to meet the housing needs of distressed communities.
3. They must target financial resources and programs to geographic areas and population groups experiencing particularly severe housing needs.

This study examined state efforts in four programming areas designed to increase the supply and affordability of adequate housing:

1) single-family home construction and mortgage finance,
2) multifamily housing construction and long-term finance,
3) housing rehabilitation grants and loans, and
4) housing rehabilitation tax incentives.

In assisted housing policy, the Commission found:

1. Particular groups of people, especially minorities, who live in distressed central cities and rural communities have a high level of need for assisted housing. Three kinds of housing problems affect particular population groups and geographical areas. The first is physical inadequacy. For the entire nation, the average home is in better physical condition now than two or three decades ago; plumbing deficiencies and overcrowding have decreased. But physical condition of housing is still a problem for many low-income households, especially minorities in central cities and in rural areas.

   The second problem is related to affordability. Costs of owning a single-family home have tripled in the past two decades while average incomes have only doubled, and those who rent their housing are paying twice the percentage of their income as 30 years ago. While these increases affect everyone, some groups are especially hard hit, and must pay a larger than average share of their income. These groups include households headed by single women, the elderly, Hispanics, and Blacks.

   The third problem is that of limited access to physically adequate and affordable housing. A number of practices continue to restrict the ability of minorities to live in certain areas. These practices include "redlining," or the refusal of lenders to grant mortgages in some neighborhoods with large numbers of minorities; restrictive zoning; and segregated residential patterns.

   These three types of problems most heavily affect four population groups, each of which has its own set of needs. One group is low and moderate-income working families, who cannot afford adequate housing but are not eligible for most current forms of housing assistance, such as public housing rental assistance, or home purchase subsidies. Many of these families are forced to double up in a single house or apartment. The second group consists of disabled or elderly persons with low or moderate incomes, who may need special housing that is free of barriers to their movement, and who may need to be close to social and health related services. The third group consists of Blacks, Hispanics, Native Americans, immigrants, and large single-parent families, all of whom may face obstacles to access as well as problems of affordability. Finally, special problems are faced by families of displaced workers, persons who have been released from institutions without adequate support, disaster victims and the chronically homeless.

2. Major federal aid reductions in 1981-83, and other restrictions, forced some states to cut back on certain housing programs. Most states have empowered independent public finance corporations to carry out their assisted housing policies. These housing finance agencies (HFAs) generally are responsible for raising the necessary funds and for administering programs, without the assistance of other agencies or the treasury. Most state HFAs depend on private-sector profit making and nonprofit developers to construct or rehabilitate assisted housing. Typically, the HFA sells bonds and lends the proceeds to developers to reduce development costs.

   In recent years, state HFAs have depended on two major federal subsidies to support assisted housing: Tax exemptions on mortgage revenue bonds (MRBs) for single-family housing and construction subsidies and guarantees (Section 8) for multifamily housing. In recent years, the former had been suspended while Congress worked out legislation to continue it, and the latter has been terminated.

   Federal tax exemptions on MRBs allow these bonds to obtain lower interest rates than would otherwise be possible. The lower borrowing rate enables HFAs to offer mortgage interest rates one or two percentage points below conventional home mortgages. Concern over the income tax revenues the federal government loses by allowing this exemption led Congress in 1980 to pass a law ending the exemption as of December 31, 1983. In the spring of 1984, Congress passed legislation to extend the tax exemption through 1986. The future of MRBs as a source of funds for state single-family housing aid depends partly on continuing federal tax exemptions and on the bond market stability necessary to make MRBs attractive to investors.

   In 1983, the Department of Housing and Urban Development (HUD) effectively terminated the Section 8 program and its rent subsidies which aided developers and owners of low-rent housing. A national partnership had been created based on the availability of Section 8 funds to increase the supply of low-rent or fair-market-rate housing. State HFAs contracted with private profit making and community-based, nonprofit developers to build new multifamily housing or to rehabilitate existing units. The developer and the housing finance agency would negotiate with HUD to reserve Section 8 funds for whole developments or for a set-aside of units. After the Section 8 new construction program was curtailed, many states cut back or mothballed their assisted multifamily housing programs.

   Another action hurting state programs was the imposition of restrictions on FHA loan guarantees. By increasing investor confidence in assisted housing, the guarantees had effectively reduced the cost of raising money for multifamily housing in the bond market.

3. Despite recent cutbacks, most states still operate housing assistance

programs. Forty-seven states operate 54 programs for single-family home owners targeted to low-income elderly or disabled householders, and 43 states run 56 programs designed to increase and improve the supply of multifamily housing. The most common mechanism for providing homeownership assistance to individual is the mortgage interest rate subsidy. Typically, state housing finance agencies raise funds by issuing tax exempt bonds, arranging for private lenders to originate loans at interest below the regular market rates, and then purchasing these loans, as in a mortgage purchase program.

In multifamily housing assistance, state HFAs raise funds in the bond market and loan out bond proceeds to private for-profit and nonprofit developers. Some HFAs make bond proceeds available to lenders to loan out to assisted housing developers (i.e., loans-to-lenders programs); sometimes loans are made to local governments or local housing authorities to support their multifamily programs. Most states target multifamily funds on the basis of household income limits and set-asides of development units for low-income households. Eighteen states reported cutting back their multifamily efforts and two others terminated their programs altogether when federal funds were cut.

4. Twenty-six states have a total of 54 programs that provide rehabilitation loans targeted to housing for the needy, but only nine states have targeted tax incentive programs.

Rehabilitation loans may serve single-family or multifamily housing and may take the form of direct loans to multifamily housing developers, home improvement loans to single-family, owner-occupied housing, or loans to local governments or community-based organizations operating their own rehabilitation programs. Most single-family programs are targeted on the basis of household income, whereas most multifamily programs are targeted to developments setting aside a minimum number of units for low-income or other needy groups.

Typically a rehabilitation tax incentive program requires a local government to pass an ordinance, designating a lead agency to approve tax incentives, and designating the geographic subsection of the locality in which rehabilitation efforts may receive tax incentives. Property tax incentives include fixed or reduced assessments, exemptions, and abatements.

5. A number of states have initiated new approaches to assisted housing financing, programming, and targeting. Two noteworthy innovations are using permanent public funds, such as pension funds, to finance housing and relying on community-based developers. In California, the public employees' pension fund agreed to commit $100 million to purchase single-family home mortgages. The commitment has resulted in new homes being constructed with the mortgages closed by private lenders and then sold to the pension funds.

In New York, the Neighborhood and Rural Area Preservation Corporation programs are good examples of state reliance on community-based organizations as assisted housing developers. Such a corporation uses its tax exempt status to reduce the cost of assisted housing. The New York City Preservation Corporation, founded eight years ago by the city's major commercial and savings banks, has packaged private mortgage loans and various public subsidies (tax abatements, rent subsidies, CDBG funds, and FHA mortgage insurance) to preserve and rehabilitate multifamily housing.

A third noteworthy area of state innovation is called component cost reduction. Several states have created special funds to help reduce costs of individual components of housing, such as the land. Many of these programs were initiated using general public funds. Florida operates the Revolving Land Acquisition Trust Fund providing below-market interest loans for land acquisition in tandem with other housing programs. Minnesota's Housing Assistance Fund provides deep interest rate and downpayment subsidies to the lowest income single-family participants.

Economic Development. States increasingly are recognizing the importance of economic development programs to their overall economic health. The framework for state responsibility in economic development involves three fundamental objectives:

1) generating and sustaining enough long-term, quality jobs for all who want to work;
2) generating and sustaining economic growth through business development, and ensuring equitable distribution of the benefits of that growth; and
3) promoting and supporting revitalized and stablized local economies to ensure the stability of the state's economy.

This study selected five program indicators to assess the commitment of states to target economic development assistance to distressed communities: (1) industrial and commercial site development; (2) financial aid for industrial and commercial development, including enterprise zones; (3) customized job training; (4) small and minority business development; (5) and industrial revenue bonds.

In economic development policy, the Commission found:

1. Federal aid to state and local governments in economic development programs has been declining since 1980, even as the level of unemployment has increased.

   Unemployment is a particularly critical problem, and certain states and communities are affected more than others. State manpower and development programs are confronted with both structural and cyclical unemployment, which generate several different types of high need groups:

   1) displaced workers who need retraining or enterpreneurial training,
   2) minorities and minority youth who need training and access to jobs on a nondiscriminate basis, and
   3) the underemployed and unemployed who need either training or placement services.

2. Every state has some type of economic development agency, and the pri-

mary activity in this area for most states is using tax and other incentives to recruit out-of-state firms. State programs have only recently begun to shift toward support for small, indigenous firms, which are responsible for most new job development nationally.

According to a 1983 survey conducted by the Council of State Governments, of the 44 states responding, 12 had established their economic development agencies prior to 1960; 11 did so during the 1960s; 13 started agencies in the 1970s; and since 1980, eight states created departments.

One of the major functions of state development agencies has been industrial recruitment, or what sometimes has been called "smokestack chasing." In recent years, the economic wisdom of industrial recruitment has been called into question. There is mounting evidence that only a small fraction of employment gains are due to corporate moves between states, and that the benefits of "beggar thy neighbor" interstate competition are far less than the costs. Furthermore, there is extensive research to show that states can do very little to influence the early stages of business location decisions.

3. Most distressed communities are experiencing capital market failure which, for social or economic reasons, limits the opportunities for smaller firms to start up or expand. Private market lenders are averse to taking great risks and, as a result, businesses in distressed areas are less likely to obtain financing. Furthermore, there are inefficiencies in capital markets, including a lack of competition among financial institutions and discrimination against certain types of firms.

4. States have broad fiscal, regulatory, and expenditure powers to affect economic development programs. However, the level of budgeted financial support is quite low relative to the rest of the budget.

Relevant state powers include the following:

Fiscal Powers

1) all state tax laws -- particularly those related to corporate, personal, income, sales and property taxes;
2) provisions for tax abatements, credits, incentives, and exemptions;
3) authorization of local governments to raise nonproperty tax revenues; and
4) authorization of tax base sharing or relaxation of municipal annexation laws.

Regulatory Powers

1) zoning, land use, and environmental regulations;
2) water and sewer laws;
3) bank charters; and
4) streamlining the permitting process.

Expenditure Powers

1) development programs;
2) state construction and facility siting;
3) creation of public finance institutions; and
4) state procurement.

5. In industrial and commercial site development, only three states had targeted programs prior to 1980, and only 11 states had them in 1983. The greatest concentration of such programs is in the New England and Mideast regions. Site development involves physical improvements to specific sites either for locating new firms or expanding existing ones. Firms seeking to expand on site, particularly in older urban areas, usually need land assembly assistance, plant construction or rehabilitation help, and other services. Firms locating or expanding in high growth areas, as in the Southwest, may tax existing sanitation facilities beyond their present capacity; major new facilities are often required to accommodate them.

6. In financial aid for industrial and commercial development, 22 states have a total of 36 targeted financial aid programs. The number of states with such programs doubled from 1980 to 1983 due to state actions in the New England, Great Lakes, Plains, Southeast, and Far West regions. The greatest concentration of such programs is in the New England, Mideast, and Great Lakes regions.

Half of these 22 states in 1983 provided some kind of loan, loan guarantee or revolving loan fund assistance. New Jersey's Local Development Financing Fund Act is a good example of using loan power. This act establishes a state urban development action grant program, with a revolving loan fund which can be used by municipally sponsored businesses in distressed areas. The public fund can be used to leverage private dollars for development projects "where it would not otherwise occur"; 80% of the state funds are placed in a revolving loan fund. Businesses are eligible for loans, loan guarantees, and state equity participation and grants. These public programs leverage private sector funds by a 3:1 ratio.

Tax incentives are used by over half of the 22 states. Such incentives include income tax credits, employment tax credits and exemptions on property taxes for certain areas, and for equipment.

Nineteen states passed 21 enterprise zone laws in 1981-83. The greatest concentration of states with enterprise zone laws is in the Southeast. Only a handful of these programs, however, were actually implemented during the period of this study.

Community development finance corporations (CDFCs) have been started in four states, largely as the result of a 1975 program innovation in Massachusetts. CDFCs are either nonprofit or for-profit corporations which are initially financed by a general obligation bond, the proceeds of which are used to take equity positions in ventures initiated by community-based development corporations. These ventures are usually high risk ones in distressed neighborhoods. Four states established community development finance corporations (CDFCs) to create a public sector capital market aimed directly at addressing the market failure problem.

A final financial aid approach to assisting businesses in distressed communities is providing of economic adjustment assistance to communities expecting or responding to a plant closing. California has pioneered in this area, using existing state financial and technical assistance resources to help businesses, employees, and communities make this transition.

Enterprise zones are fundamentally a tax incentive approach to aiding distressed communities. All 22 existing enterprise zone laws enacted by 1983 are fairly uniform in their purpose and targeting criteria. They seek to stimulate business and industrial growth and to create jobs in depressed areas through tax incentives and other assistance to business. Targeting always includes areas with high rates of unemployment, welfare, poverty, and physical deterioration. But that is where uniformity ends. In terms of the specific incentives offered and the methods of implementation, each program is different.

7. Only 11 states have targeted customized job training programs. The greatest concentration of such programs is in the Plains region.

Many job development programs focus on either cyclical or structural unemployment. Public sector programs need to recognize both, however, because unemployment is always partially structural, partially cyclical, and partially functional (the latter includes workers shifting from one job or occupation to another).

Job training programs also tend not to be linked to economic development programs and actual jobs, particularly in distressed areas. Even a customized job training program may be ineffective if not coordinated with other job training and placement agencies, the state education system, and the economic development promotion and finance agencies seeking to develop business. States need to recognize the inherent interdependencies among these programs and to link them accordingly if they want to reduce program overlap and increase effectiveness.

8. In the area of Small and Minority Business Development, only eight states have targeted small business programs, and 26 states have some type of minority business development assistance, although the level of financial aid is minimal. The typical minority and small business development package includes technical assistance, public relations, and state contract procurement aid. Several states, including Ohio and Illinois, have minority procurement set-asides mandated by state law.

Independently owned firms of fewer than 100 employees are essential to the economic health and stability of distressed communities. They not only serve the industrial sector as suppliers and subcontractors, but also make up the retail and commercial backbone of a community. Furthermore, small enterprises provide opportunities for entrepreneurs to enter the private market system. New and small businesses are considered to be major sources of innovation; they can play a significant role in generating jobs in distressed areas.

The survey indicated that what little targeting states had done with small business assistance occurred prior to the recent upsurge of interest in small business. Furthermore, the number of such programs is too small to discern any pattern of regional activity.

The survey also showed that state minority business assistance was more widely available than small business programs, although the level of financial activity in most programs is neligible. The primary purpose of nearly every minority business assistance program was to provide management technical assistance. A number of states provided state procurement set-asides, and nine states provided oversight and monitored the procurement process to increase minority participation. Ohio, Michigan, and Illinois were among the states which had definitive guidelines for all state agencies, with 10% to 15% of procurement and contacts set-aside for minority firms.

9. Annually, billions of dollars were being issued in industrial revenue bonds, and yet most of the proceeds were not targeted to distressed communities. Only 11 states targeted any of their IRB aid, and most of them were doing so prior to 1980 and the recent funding reductions.

Industrial revenue bonds are development finance tools authorized by state and local governments to provide financing for acquiring fixed assets in approved industrial projects. Interest earned on the bonds is not subject to federal income tax, although not all states exempt state taxes on income earned from IRBs. They are a particularly valuable tool in a state's economic development kit because this tax exemption provides lower interest rates for borrowing by firms that may locate or expand in a state.

Community Development. The economic stability and vitality of any community requires that it have both a sound public physical infrastructure to meet the needs of industry and the population, and community leadership and institutions capable of developing the community. Both aspects of community development are particularly important in distressed areas where the private market has failed, the capital stock has deteriorated, and the commmunity leadership has left or become inactive. The economic revitalization of a distressed community, therefore, requires a major commitment on the part of state and local governments to community development efforts. This project has assessed targeted state activities in the area of capital improvements and neighborhood development.

In community development, the Commission found:

1. The nation's public physical infrastructure problem is serious, estimated in the hundreds of billions of dollars, although when broken down to its component parts such as highways, bridges, and other capital facilities, the problem appears to be manageable. Given reductions in federal spending, resources to meet these needs must be found increasingly at the state and local levels, if impovements are not to be further delayed.

2. Twenty-six states had a total of 33 targeted state capital improvement programs: 16 in core facility construction, ten addressing energy impacts, and seven for other targeted efforts.

In core construction, 13 states had 16 targeted programs that provided grants or loans for constructing or improving water, sewer and solid waste systems, roads, bridges, or other core facilities. These kinds of targeted programs were found in all but the Great Lakes region. They were funded primarily through general appropriations, with some use of bonds and dedicated taxes.

Energy impact programs are designed to help communities harmed by the boom-bust cycle of energy development, such as towns that expand quickly in areas where oil was sought only to contract again when a worldwide oil "glut" halted exploration. Eight states offered ten programs to aid communities affected this way. They were located in four of the eight regions of the nation, but were most common in the Mountain states. Their funding in nearly every case was from taxes on extracted energy resources or from leasing developed lands.

Seven other capital improvement programs were found in five states, including a program in Massachusetts that created local parks, and one in Vermont that employed unemployed persons in basic types of capital improvement activities throughout the state. Support for these programs came from state general funds or bond revenues.

3. Only four of the 33 targeted capital improvement programs began after 1980 when concern about a physical infrastructure "crisis" began to emerge. The publicity has generated a lot of general state action but not much additional targeted state activity.

4. The nation's neighborhood development problem remained severe, particularly in central cities. Federal aid programs have been sharply cut, in accordance with a greater emphasis on volunteerism and self-help. These cuts have included aid to community groups. For example, the discontinued public service employment funds had been channeled to community groups by many local governments. Neighborhoods suffered as their community-based development organizations became less able to undertake ventures and provide services. Many of these organizations had to disband, while others had to lay off employees. Early evidence indicates a shift toward emphasizing neighborhood development projects essential for survival. Private sector contributions and appropriations by state and local governments were not filling the funding gap resulting from federal aid reductions.

5. Only five states had tax credit programs for corporations that contributed funds to community-based groups, but nine states provided specialized financial or technical assistance. Ohio, for example, empowered distressed cities and villages to extend tax abatement to approved community redevelopment corporations. A Massachusetts program provided community-based business and housing rehabilitation organizations with technical assistance (in organizational development, business counseling, evaluation, and training) if they already were receiving state financial assistance. California provided grants to local nonprofit organizations so that they could provide aid similar to the technical assistance in Massachusetts to other local groups. Minnesota, Wisconsin, and Connecticut were giving grants mainly to community development corporations for

their business ventures. Kentucky provided state funds, mixed with federal, local, and private aid, to local organizations to rehabilitate dilapidated houses, which served as anchors for local development projects. Only three targeted neighborhood development programs started up during the 1980-83 survey.

State-Local Fiscal Relations. State fiscal policies toward local governments do not directly target resources to distressed communities. Instead, these policies and programs are generally designed either to provide local governments with a measure of fiscal relief or to achieve functional efficiency. In either case, however, they indirectly increase a local government's capacity to deal with its own distress. Because distressed communities face serious fiscal problems, including revenue shortfalls and high demand for services, they stand to benefit from reforms in state-local fiscal policies.

This study considered three types of policies designed to help local governments meet their financial responsibilities:

1) Local Government Fiscal Relief: state action allocating funds directly to local governments or shifting financial responsibility for providing certain services to multicounty authorities or to the state level;

2) Redistributive or Equity-Based Policies: state policies directing funds to communities on the basis of "need" criteria; and

3) Fiscal Empowerment of Local Government: state policies enhancing the ability of local governments to generate their own revenues.

The study focused on five programs that served as indicators of a state's commitment to provide fiscal relief to distressed communities: (1) state-local general revenue sharing, (2) education finance, (3) state assumption of local welfare costs, (4) reimbursement of state-mandated programs, and (5) state actions that improve local government access to credit markets.

In state-local fiscal relations policies, the Commission found:

1. Limitations have been placed on local government revenue collections by 45 states, which, when coupled with state mandates for public expenditures and local property tax restrictions in some states, severely affect the capacity of local governments to meet basic service needs. State "lid laws" can restrict local tax rates, levies, expenditures, and debt actions. Such limitations have been justified by state officials as protecting local taxpayers and making local officials more fiscally responsible.

2. In state-local general revenue sharing, only Delaware did not have a program, and 42 states had programs that used an "equalizing" distribution formula. Since 1979, most states had increased the amount of aid they were providing to local governments.

State-local general revenue sharing programs allocated a portion of state revenues to localities to be spent as the localities wished. The state legislature determined the amount and method of allocating such general aid, which typically constituted the second or third largest item of state payments to local governments. Distribution formulas took into consideration local characteristics such as population and property wealth. Revenue sharing can include redistributing state income or sales taxes, payments for exempted businesses or homesteads, or general revenue equalizing programs appropriated from the state general fund.

The key feature of state-local revenue sharing programs was their distribution formulas, which were either equalizing or nonequalizing. Equalizing formulas allocated funds on the basis of indicators of need, such as local tax burden or the concentration of households eligible for public assistance. Formulas that returned revenues to their localities of origin were nonequalizing ones.

States using equalizing formulas distributed funds at least partly on the basis of local population. Fewer than ten of these states distributed funds using formulas designed to favor communities with higher tax or debt burdens, lower property wealth, or lower per capita income.

3. In education finance, most states increased their share and level of expenditures for public education from 1979 through 1983, in part due to the decline in federal aid to public primary and secondary schools. The consolidation into block grants of federal education funds resulted in as much as an 80% drop in funds reaching some central city schools. Twenty-eight states were providing at least half of combined state and local expenditures for primary and secondary schools.

State education aid distribution formulas have been the key aspect of education finance reform. These formulas may allocate resources according to a definition of distributional equity, equalizing expenditures among pupils or guaranteeing pupils or guaranteeing that school expenditures will not depend entirely on local property wealth. Yet education finance reform can also entail allocating educational funds in a compensatory way, recognzing the higher costs of education for disabled students, for students in densely or sparsely populated areas, or for other disadvantaged students. Forty-nine states provided part of their aid to local public schools on the basis of compensation for need.

The percentage share of federal funding in most states has declined since the consolidation of federal categorical grants into a block grant. Federal spending for local public schools declined $238 million between 1981 and 1983.

4. Most states assume all non-federal AFDC and Medicaid costs. By 1982, 39 states assumed the entire cost of the state-local Medicaid bill, and by 1983, 40 states assumed the entire cost of the state-local AFDC bill.

With the exception of general assistance programs sponsored by some state and local governments, most welfare programs were created by the federal government. Two of the largest welfare programs, Aid to Families with Dependent Children (AFDC) and Medicaid, require state and local contributions and state or local administration. State-imposed limits on local revenue raising capabilities restrict the ability of local governments to assume their share of welfare program costs.

5. It is common practice for state governments to mandate local governments to operate certain programs or to follow certain administrative practices, but it has not been common for them to pay the costs of meeting such mandates. In fact, only 12 states had a reimbursement law on the books, and only California and Rhode Island were actually paying reimbursements. Even without reimbursement, however, a regulation requiring disclosure of such costs can have a breaking effect on enactment of new mandates.

   State governments mandate local program initiation or enrichment for a variety of reasons: to promote a social or economic goal, to promote statewide implementation of an activity, and to achieve statewide uniformity. Regardless of the reasons, state mandates are unpopular with local governments, particularly ones in distressed communities.

6. By 1983, 42 states had enacted provisions to improve local government access to credit, compared to 16 states in 1980, and most states had implemented more than one credit enhancing measure.

   Four kinds of state efforts were identified that improve local government credit ratings and access to capital for project funding:

   1. Bond Validation (29 states). A public board, agency or court reviews local bond issues, lending credibility to the bond issue and thus increasing marketability.

   2. Debt Subsidization (8 states). The state makes a direct effort to reduce the cost of local borrowing.

   3. Debt Guarantees (12 states). State or public finance corporations back bond issues or use other mechanisms to direct state aid to local governments in the case of default, e.g., education aid.

   4. State Financial Intermediaries (26 states). State bond banks or finance corporations issue bonds at lower rates and lend bond proceeds to local governments.

Enhancing Local Self-Help Capabilities. As important as federal and state assistance are to local governments, there are times when a community needs and wants to make its own decisions. Diversity among communities often means that what may be desirable or needed in one is not needed in another. State governments cannot meet local needs using a boilerplate formula. Even if that were possible, states do not have the resources to meet all local needs.

Distressed communities in particular need both state targeted development assistance and the capacity to help themselves. The importance of the state role in this policy area became a more visible, if not increased, in 1980-83 in response to the recession, unemployment, and the national government's shift to block grants from programs that traditionally had been targeted.

This study selected four program indicators that represent a state's commitment to enhancing local self-help capabilities:

1) tax increment financing;
2) authority to levy a local sales or income tax;
3) authorization for creating local redevelopment authorities; and
4) local discretionary authority.

Local authority to raise or increase own-source revenues through such means as levying sales and income taxes, using tax increment financing, investing idle cash, and charging user fees increases a community's financial independence and capacity to deal with distress. Local bonding authority allows a distressed community to sell revenue bonds as needed and as the market allows without having to ask the state each time for special authorizing legislation. Enticing industrial relocation to a distressed community, or encouraging a local industry to remain or expand, may be hampered by legislative restrictions and by the timetables of legislative sessions. Authority to form a local redevelopment agency to work with new and existing businesses in urban revitalization efforts not only speeds the process, but allows greater local control. Enabling legislation can be restricted to one or a few of these areas or be as broad as general home rule. Full home rule allows all of the above financial activities, plus the ability to make structural, functional, and personnel decisions best suited to a community's situation.

In enhancing local self-help capabilities, the Commission found:

1. Federal and state aid to local governments decreased overall while the demand for services at the local level increased in 1980-83. This pattern was particularly poignant in distressed communities, which entered the last recession in a more difficult fiscal position than most communities.

In the past three decades, local governments came to rely on intergovernmental grants as essential sources of revenue. Federal funds as a portion of local government revenue increased from 2.5% in 1955 to 62.3% in 1980; state funds as a portion of local revenues increased from 40.6% to 62.5% over the same period.

Economic events of the early 1980s, however, threatened the dependability of those revenue sources for local governments. Federal deficits and state revenue shortfalls caused reductions in most program areas and total elimination in others. At the same time, local governments' largest revenue source, the property tax, faced voter opposition to increases and efforts to reduce rates.

Local governments nationwide were using every means possible to increase local sources of revenue. Where authorized by their states these means included: levying or increasing sales and income taxes, delaying expenditures for capital improvements, freezing personnel levels, investing idle cash, borrowing through bonding, and charging or increasing user fees. Other special taxes local governments could levy were not considered in this report.

At the same time that revenues were stagnating, the demand for services at the local level increased. Counties or cities with responsibilities for traditional welfare or health care programs confronted increasing numbers of indigents because of changes in state and federal programs (AFDC, food stamps, Medicaid) that made more individuals ineligible for those funds. In addition, many local governments that had relied heavily on workers subsidized under the federal Comprehensive Employment and Training Act (CETA) had to cut back some services or bear the costs themselves. Day care, family emergency services, family planning, and rodent control were among the programs dropped with the change to block grants and state administration. Yet, the needs that those programs met did not disappear. Local human services agencies, hospitals and nonprofit organizations had to pick up the increased case load and carry it with their own resources.

2. Thirty-one states gave local governments authority to use tax increment financing (TIF), and a majority of those states direct TIF to distressed areas.

Tax increment financing is a financial tool used by local governments to finance their own redevelopment while increasing their future fiscal capacity through a stronger tax base. When an economically distressed area is designated as eligible for such financing, the governments that levy property taxes in the area freeze their assessments at the level in effect just before development occurs. Then, when actual property values increase as a result of developments or anticipated development, the difference between what governments collect at the frozen assessment level and what they would collect at the new market value goes into a special fund. Money in the fund is used to retire the debt incurred for public costs related to the redevelopment.

Statutory language in a majority of those states using TIF targets the use of this technique to areas defined as "slums" or "blighted." Several states that authorize TIF have gone further to provide technical assistance and seed money to improve their communities' success with this instrument.

While implementation difficulties remain in five states, those states actively using TIF describe it as a useful and sometimes crucial tool for local governments. Implementation difficulties include questions of legality and the tax loss faced by other taxing units within the tax increment district. The constitutionality of TIF was still being considered in two state supreme courts, but in all other cases the courts or the voters have favored continuing TIF. To ease the problem of lost taxes, some states allow one-time payments or payments of percentages of annual increments to certain taxing districts.

No cases of loan default under tax increment financing were found. Most communities used TIF in conjunction with other funds, particularly Community Development Block Grants and Urban Development Action Grants. TIF funds usually were used to leverage revenue bonds, although some states allowed the funds to be used on a pay-as-you-go basis as well.

3. Forty-nine states authorized their local governments to create redevel-

opment authorities. The primary role of most of these agencies has shifted from the urban renewal focus of the 1960s, to a downtown redevelopment and commercial revitalization approach today.

Redevelopment authority, usually encompassed in a state's urban renewal law, empowers an independent or semi-independent governmental body to accept intergovernmental grants and loans, issue bonds, prepare plans, and exercise eminent domain powers. Local redevelopment authorities have undergone several transitions from their original inception under public housing legislation in the 1930s. They received broadened and strengthened powers under the urban renewal amendments of 1954, the community renewal program amendments of 1959, the Model Cities program of the 1960s, and the shift from categorical programs to the Community Development Block Grant during the 1970s. Their status in 1983 was one of renewed activism, predominantly in downtown redevelopment or revitalization, but also in other economic development efforts. The state role, beyond enabling legislation, may include financial support, technical assistance, and entry into certain credit markets.

4. Twenty-nine states authorized localities to levy a general sales tax. Eleven states authorize a local-option general income tax, while two authorize a limited one. However, most local governments with either sales or income tax authority do not use it due to voter resistance.

Local general sales taxes are usually levied on the sale of all goods, with the exception of food and medicine in certain states, and some specified services. Local income taxes vary more than sales taxes among those states that allow them. Some localities levy a commuter tax only on incomes earned within the community; others levy an income tax on all residents, regardless of where the income is earned. Some states allow localities to levy an occupation or license tax; others allow a business payroll tax.

Although many localities with this broadened taxing authority have hesitated to use the option, this situation seemed to be changing; in 1983, local sales taxes were approved by more communities than in past years.

5. An ACIR report issued in 1981 revealed substantial variation among the states in the discretionary authority they give local governments. Most states allow their cities, counties, and towns a measure of discretion in service povision and financial matters.

Local discretionary authority -- commonly referred to as home rule -- is defined as the power of a local government to conduct its own affairs, including the power to determine its own organization, the functions it performs, its taxing and borrowing authority, and the numbers and employment conditions of its personnel. Twenty-seven states authorized some or all of their general-purpose local governments varying amounts of such discretion. However, many legislatures are still using special, or local, legislation rather than granting general powers across the board, and local discretionary authority was reduced by fiscal restraints in every state, either through debt limits, tax limits or a lack of revenue.

The ACIR survey found that in addition to the four indicators listed, enhancing local capabilities required a greater degree of local revenue diversification. States play a key role in local governments' ability to raise nontraditional sources of revenue by authorizing user fees, bonding, and investment of cash balances or pension funds. Several states have set up or authorized cash management trust funds to invest the pooled idle cash balances of smaller communities.

General Observations

Based upon the data on state government activity over the past four years that were developed and analyzed in the annual reports of the Distressed Communities Project, and particularly upon the major findings of the 1983 study as summarized above, the following observations and generalizations can be made.

1. DOMINANCE OF EXTERNAL ECONOMIC AND OTHER FACTORS

Although public tax, regulatory, and expenditure policies have a significant impact on state and local economies, private-sector forces predominate in shaping the nation's economic future.

Government in the United States, at all levels and for all activities, accounts for 30% to 35% of the gross national product. The expenditures of federal, state, and local governments amount to around $1 trillion. Public and private financial policies interact and influence each other, especially in the tax and regulatory areas. Examples include the Economic Recovery Tax Act of 1981, the Tax Equity and Fiscal Reform Act of 1982 and deregulation in transportation and other areas. Federal spending for defense and space activities and intergovernmental outlays for physical infrastructure have direct economic effects on communities and states. Conversely, the behavior of the financial markets and the decisions flowing from corporate boardrooms greatly affect governmental policies.

However, the private sector is twice as large as the public sector, and in the interplay of forces between the two, the private sector is clearly the driving force. Most new jobs in the 1980s will be in the private sector; basic economic trends are influenced by decisions in the business and financial market places, which are in turn affected by public policies, technological change, energy prices, international competition, credit availability, and many other external factors. These private-sector and nongovernmental forces are the primary determinants of the location and level of economic activity throughout the country.

Despite the dominance of the private sector in the nation's economy and the fiscal dominance of the federal government in the public sector, the policies of state and local governments play a significant economic role. Initiatives on the part of these governments often can, at least partially, balance some of the forces operating from outside their borders. Such state and local government policy actions are the focus of this report.

2. VARIANCE OF OPINION ON THE PUBLIC ROLE IN ALTERING ECONOMIC TRENDS

There is a wide range of opinion concerning the extent to which the public sector can or should allocate substantial public resources in attempting to reverse or mitigate basic economic trends affecting particular regions, industries, or communities.

Over the past several decades, public controversy has waxed and waned regarding a variety of national, state, and local public and private programs directed toward improving economic conditions in central cities, depressed rural areas, and other communities undergoing fiscal or economic hardship. Some of these efforts, especially those entailing local public-private partnerships, appear promising. Others have failed to meet their objectives or, as is true for a great many, have had mixed returns. One point has gained general agreement: underlying economic trends are so broad and deep, as well as volatile, that whatever is attempted must take such trends into account. Government efforts can bring about mitigation, gradual adjustment and readjustment, but early and spectacular reversals are most unlikely. Nevertheless, many state and local governments have found it necessary to allocate resources to alleviate human and community distress arising from the varied impacts of these external economic forces.

3. ROLE OF THE FEDERAL GOVERNMENT IN FINANCIALLY ASSISTING DISTRESSED COMMUNITIES, PEOPLE, AND FIRMS

Federal aid to distressed communities has been cut back and in large part shifted away from local governments and toward the states. Remaining federal funds must be directed toward the most distressed states and communities in a way that permits considerable flexibility in their use.

Over the past two decades, the national government carried on several programs directed toward distressed regions, states, and communities. The Appalachian Regional Commission (ARC) was one of the first, begun early in the Kennedy Administration. ARC sought to alleviate economic decay, to stimulate increased business activity and to reduce the incidence of poverty in the multistate area known as Appalachia. The ARC worked primarily with the state governments of the area. In 1965 the Economic Development Administration (EDA) was created, and its public works programs were implemented largely through grants to local governments. The Farmers Home Administration of the Department of Agriculture assisted both individuals and local governments, while the Department of Housing and Urban Development was concerned primarily with urban communities. The HUD-operated Urban Development Action Grant (UDAG) program makes project grants to large and some smaller cities, with the objective of stimulating or leveraging private investment through complementary public infrastructure assistance.

The Community Development Block Grant (CDBG) program originally provided general purpose funds directly to local governments for use in accordance with locally formulated community development plans. However, the CDBG program was changed in 1981 to channel funds directly only to metropolitan cities, allowing state governments to allocate project funds among smaller cities. In addition, funding for both the UDAG and CDBG programs has been reduced. The combination of these budgetary reductions and the shift toward states and away from localities resulted from the grant reforms proposed by the Reagan Administration and adopted by Congress under the Omnibus Budget Reconciliation Act of 1981.

It should be noted that two other related topics regarding the federal role lie beyond the scope of this project: how to divide responsibilities for income maintenance programs, such as AFDC and food stamps, between the national and state levels; and the efficacy of an "industrial policy" that would bring private and public sector planning for economic development into close collaboration to meet national employment and economic growth objectives.

4. ROLE OF THE STATES IN FINANCIALLY ASSISTING DISTRESSED COMMUNITIES, PEOPLE, AND FIRMS

Views diverge about the proper role of the states and the national government. One view holds the states should "unleash local officials" on the federal government to obtain grants directly, while being passive regarding distressed communities. The states' scarce resources, it is argued, should be directed into such areas as employment training and upgrading education.

A different view holds that the state governments, together with local governments, business, labor, civic interests, and community organizations, should exercise policy and program leadership in alleviating distress, and use their own resources to promote community stabilization and revitalization.

The Commission notes that a wide array of state programs exist that help alleviate community, business, and individual distress, with exemplary innovations among them. Yet, these programs are focused upon distressed communities to only a limited extent. State governments' responsibilities in this area currently include: (1) identifying conditions of economic distress within a state; (2) carefully planning and concentrating, within the context of whatever national policies may exist, private and public efforts toward state-local economic growth and long-term stability; and (3) endeavoring to stimulate, empower, assist, and supplement private and nonprofit sources in alleviating poor conditions in the most deeply distressed communities. Programs reviewed in this report are indicative of a continuing and broadening commitment of many state governments to assist their distressed communities.

In examining these policies and programs, several other kinds of state policy actions must be kept in mind because they have a greater cumulative effect on the economic and fiscal conditions of distressed communities than those program areas covered in this study. These other actions include (1) the assumption and direct performance or substantially full financing of such functions as long-term correctional programs and facilities, and state court salaries and facilities; (2) education aid and the degree of "equalization" involved; (3) assistance in transferring the costs of transportation, water, sewer and solid waste treatment from local to areawide bases; (4) direct state performance as well as the financing of certain functions previously carried on by local governments; (5) state tax and environmental policies that attract or repel industrial location; and (6) the nature of the state revenue system, especially its distributive and redistributive effects.

5. EXISTING STATE ROLES IN ASSISTING ECONOMICALLY DISTRESSED COMMUNITIES

Present state government policies and programs have a variety of elements that aid distress including (1) encouraging and facilitating private investment and employment in distressed communities through development finance and assistance programs; (2) empowering local governments, neighborhood self-help groups, and other nonprofit voluntary organizations to engage in public and quasi-public activities promoting community stabilization and improvement; (3) giving direct financial aid to low-income individuals for dwelling rehabilitation; and (4) providing fiscal and technical assistance to local governments.

As shown in the data presented earlier on state government activity in 20 program indicator areas, the states collectively are conducting a wide variety of activities directed toward the problems of distressed communities. Some of these activities are empowering or authorizing in nature, such as permitting local governments to finance various activities through user charges or fees. Others provide state technical assistance to local governments in fiscal management areas, such as risk pooling through self-insurance programs or pooled borrowing through a state instrumentality. Other state programs provide tax incentives for private investment. Still others provide direct financial assistance through subsidized loans or grants to both local governments and low-income individuals for such purposes as housing rehabilitation. Some of these programs are linked to parallel federal activities, as in housing; others, such as state revenue sharing, are not tied to federal programs and involve a substantial outlay of the state government's own resources.

The nature of the state government role in this wide array of program activity may be further defined to include (1) both a constraining and a deregulating role, involving taxes, tax credits, and regulation under the state police power, or the relaxation of such regulation; (2) a planning and coordinating role, whereby activities are centralized or decentralized, and concentrated or diffused; (3) an assistance role, through direct investment such as constructing public facilities or through secondary investments involving guaranty and insurance instruments; and (4) a distributive or redistributive role, manifested in such activities as revenue sharing and grants-in-aid to local governments.

Before drawing any conclusions as to the appropriateness of any of these approaches in a public-private or intergovernmental context, policymakers need to distinguish among their natures and roles relative to the purposes they are trying to accomplish (e.g., empowerment, facilitation, leadership and coordination, technical assistance, and financial assistance).

6. ROLE OF THE STATES IN ASSISTING DISTRESSED COMMUNITIES IN NONFINANCIAL WAYS

State governments can properly provide needed nonfinancial assistance to localities in two ways. First, states can exercise policy leadership in creating a climate conducive to business investment, and in forging strong and effective relationships with the private sector and labor to encourage and facilitate private investment and employment in the state, especially in communities experiencing high unemployment. Second, states can empower local governments, nonprofit organizations, private businesses, and other groups to undertake community betterment activities.

Due to the dominance of external economic forces and the primacy of the private sector in a free-enterprise economy, private investment and private employment have been and will continue to be the bases of economic vitality in all states and virtually all communities, except ones primarily dependent upon one or more large public facilities, such as a state university or a military base. Consequently, it is appropriate and desirable that state governments direct their attention to forming and maintaining strong relationships with the business and industrial sectors of the state. These relationships involve several elements of public policy: (1) an atmosphere of mutual trust and confidence; (2) balancing tax, regulatory, and other state policies; (3) constitutional or statutory authority for public-private cooperative ventures; and (4) effective government organizational frameworks and procedures for businesses and industries to use in conducting their affairs.

7. TARGETING STATE PROGRAMS AND RESOURCES

The basic policy and political problems encountered with targeting are not how to target, but whether or not targeting should be done at all. There are strong arguments that where programs of substantial state financial assistance are involved -- such as subsidized loans, tax credits, and bonds and grants for abating economic or fiscal stress or for mitigating fiscal disparities among local units -- such aid should be concentrated upon the most distressed communities. On the other hand, programs having more general purposes should be available statewide, though they may involve preferences for particular income groups or be adapted to the revenue capacity of local units.

The political problem of targeting was noted in several findings set forth earlier. There is a reluctance to adopt a strategy oriented toward "losers." But distressed community assistance programs can be used to turn "losers" into "winners." If the conditions of economic distress are improved, the state as a whole benefits; if deterioration continues, redistribution in even less desirable forms may occur, through public welfare, corrections, and other social expenditures.

As noted earlier, existing state programs vary widely in purpose and focus. Some, which benefit communities in distress, are focused principally or exclusively upon localities judged by statutory or administrative criteria to be in greater fiscal and economic need than others. Programs of this type include below-market loans, tax credits, or grants to assist or attract new commercial and industrial development, to generate employment in labor surplus areas, or to replace obsolete community infrastructure. Others, such as state revenue sharing and education aid, usually apply to all jurisdictions but are apportioned under formulas having varying degrees of equalization commensurate with the fiscal capacity of the local governments or school districts. Other programs not involving state financial outlays are almost never targeted: technical assistance, empowerment measures providing greater flexibility to local governments in revenue raising and service delivery, and relief of local governments of responsibility for administering or enforcing state mandates.

RECOMMENDATIONS

The Commission makes the following ten recommendations concerning state aid to distressed communities.

Recommendation 1. FORMULATION AND EXECUTION OF STATE ECONOMIC POLICIES

The positive trend toward decentralizing responsibility to the states and lowering the federal profile in economic development and assistance programs, makes it necessary for state governments to: (1) strengthen relationships between state and local governments and the private sector; and (2) provide more explicitly articulated and carefully focused economic policies and plans, accompanied by tighter structuring and coordination of economic development and assistance programs.*

This policy can be implemented by state governments in various ways:

A. Adopting as part of the state's general development plan a legislatively expressed statement of policy and principles concerning the overall economy of the state and the ways in which its development can be furthered, including long-range economic development plans for stabilizing the overall economy and for assisting distressed areas of the state. Such a policy might include such items as capital formation and access to credit, private employment generation and stabilization, community public facility needs, and the necessary organizational arrangements -- including interstate agreements and agencies where appropriate -- to carry out distressed area assistance programs as effectively and economically as possible.

B. Government-business relationships can be strengthened through programs of business deregulation in simplifying the process of obtaining permits and satisfying other regulatory requirements.

C. States can streamline organizational structures and programs concerned with overall economic policy, economic development, and assistance to distressed areas to minimize overlap; to focus assistance more intensively on distressed areas and persons; and to provide expeditious and equitable balancing of employment, environmental and other values in arriving at policy decisions concerning particular projects, thereby providing to the business and financial communities and to local government officials a clearer understanding of the state's economic development policies and attitudes.

D. By initiating and strengthening frameworks and procedures for business-labor-community consultation regarding plant closures and relocations, dealing with the needs of displaced workers, and instituting cooperative measures, states can ease and facilitate the resulting economic and fiscal impacts and readjustments.

* Commissioner Frank dissented.

In the course of its information gathering activities, the Commission found conclusive evidence that: (1) state governors in 1980-83 placed economic development and the relief of economic distress in particular areas of their states near the top of their priority lists, and at the very top after the onset of the 1981 recession; (2) state executives and legislators became increasingly concerned about the proliferation of programs directed toward distressed conditions and communities with separate efforts being mounted against the various manifestations of distress through such means as plant closing assistance, training of displaced workers, assistance in moving from labor surplus areas to places of higher employment opportunity; (3) unsubsidized private employment must become the primary objective of employment assistance programs; and (4) the climate and opportunity for private business investment within individual states must be enhanced.

Involving the state legislative branch in economic policy formulation and approval is essential if investors and the business community are to have confidence in the continuity and stability of state economic policy. Such a policy needs to be expressed in legislation, giving policies and programs a legal basis. Experimental programs and other initiatives can, and should be undertaken with gubernatorial initiative, but they do not acquire lasting power unless they are legislatively enacted.

A national business magazine reported that in 1983 a survey was conducted regarding the extent of paperwork required by state governments and their instrumentalities to incorporate, expand, and relocate business firms, including specialized licenses, permits, impact assessments, and other aspects of business start-ups. Ironically it was found that these requirements were the heaviest in some of the states that were suffering most severely from the economic recession of 1981-83. Careful review and appraisal of the regulations governing business start-up and operation to consolidate and simplify such regulations is in the economic self-interest of both the state government and the regulated enterprises.

Some states already are considering legislation to consolidate separately enacted distressed area assistance programs (numbering 16 in the case of Michigan). Massachusetts has created the Commonwealth Development Cabinet, with a small staff operating out of the governor's office; it is charged with coordinating state economic development and assistance programs and more closely targeting programs and activities toward areas and people in greatest need. When creating such coordinating mechanisms, states should consider including participation by the business regulatory agency and the state environmental protection agency. In this way, the conflicting values sometimes inherent in a particular industrial or commercial undertaking may be thrashed out and resolved at an early stage rather than at a later stage -- often at the expense of prolonged delay and litigation. Early identification of such problems serves the interests of both the business community and the state government. Furthermore, establishing a focal point in the state's executive branch for considering and resolving interagency conflicts and problems provides business leadership and local government officials with a clear-cut point of access, avoiding the necessity of multiple contacts with various people in each of the concerned agencies.

Business-government cooperation is a two-way street. This fact has become painfully evident as the pace and severity of industrial change, especially in basic manufacturing industries, has increased over the past few years. Plant closures on short notice have been especially aggravating to communities and employees left with little or no time to fashion alternatives or to explore readjustment possibilities. State legislation requiring advance notice of closures and employee severance pay was enacted in Maine and Wisconsin, and notification versions were introduced and passed in other states. This response demonstrates the need for close and continued consultation among business, community, and labor leaders in the interest of mutual confidence and cooperation, especially in periods of economic uncertainty.

Recommendation 2.
ENHANCING LOCAL CAPABILITIES

The Commission recommends that states enhance the capabilities of, and lift burdensome restrictions upon, local governments so that those governments may have increased flexibility in coping with local needs and problems as they arise. Such action is a necessary aspect of devolution and decentralization, and the need for it is especially acute in distressed areas.

The foregoing policy can take a variety of forms in its effectuation by state governments. These could include:

A. States can authorize local governments to: (1) diversify revenue sources; (2) impose and adjust user charges for particular services to an individual, in contrast to a communitywide benefit; (3) create redevelopment areas and conduct redevelopment activities; (4) utilize tax increment financing for redevelopment activities, possibly with such authorization conditioned upon earmarking a portion of the increment for low-income housing or services targeted to low-income people near or relocated from the redevelopment area, and possibly with such authorization limited to local governments embracing one or more target areas of economic distress.

B. The fiscal capabilities of local government can be strengthened through state conducted programs such as:

   1) facilitating access to credit markets by such means as:

      i) guaranteeing debt service payments on local bonds by earmarking state aid moneys;

      ii) pooling local debt issues into larger issues that are marketed by the state at a lower interest rate;

      iii) creating a municipal bond bank;

      iv) mandatory or voluntary state validation of local issues thereby assuring a higher credit rating;

      v) providing state authorization for local units which have adequate capacity to do so to use newer forms of debt (such as short-term paper and zero coupon/deep discount issues); and

   2) establishing statewide risk management pools covering state and local insurance risks on a self-insured, high deductible basis, possibly including coverage of state and local tort liability;

   3) providing technical assistance on local cash management ac-

tivities including opening access to statewide investment pools administered by the state government, thus allowing a higher interest return on cash balances;

4) developing special provisions for preventing and controlling local government financial emergencies;
5) reimbursing local governments for the additional costs arising from certain state mandates;
6) compensating local governments for state owned property; and
7) in consultation with local governments, states can consolidate small local retirement systems into one or more larger systems to ensure improved actuarial and fiscal stability.

Broadening local government powers while retaining local independence concerning the scope and financing of services avoids unnecessary and undue centralizing of governmental responsibilities best left at the grass roots level. Thirty-three states have authorized local sales or income taxes; over 42 states now provide some degree of assistance to local governments in connection with issuing debt; several states provide pooling services for insurance, and at least ten provide pooling facilities for cash investments; 12 states have enacted constitutional amendments or statutes requiring state reimbursement for increased local costs arising from certain state mandates, especially those concerning pay, fringe benefits, hours of work, local property tax exemptions, and staffing standards. Experience in most of the states shows a substantial reduction in the number and scope of new mandates after such reimbursement requirements are enacted.

Nearly 40 states help cover the cost of providing local services to state property located within local jurisdictions by paying service charges or by allowing part or full taxation of state-owned property. A dozen or so states neither provide compensation nor allow taxation.

The fiscal condition of local government retirement systems worsened during the 70s, especially those with too few members to permit sound actuarial planning. State technical assistance has been helpful in many instances, and in some states consolidating smaller local systems into the state system or into one or more statewide local systems, with governance of such systems drawn from the member local governments, has enhanced actuarial stability. (It should be noted that high interest rates in the early 1980s improved pension fund balances very substantially; but serious problems remain in many plans, especially those of the "defined benefit" type, where extended life expectancies are rendering earlier actuarial assumptions obsolete.)

By lifting burdensome state restrictions upon local governments and by making state technical services and facilities available to local governments upon request, the capacity for local self-government is improved and new opportunities for operating economies are provided. Although considerable progress has been made by state governments along these lines over the four-year period covered by the distressed communities study, many opportunities for further action exist. While some actions to enhance local capabilities apply statewide, rather than to narrowly targeted areas, their fiscal importance to economically distressed communities is commensurately greater because such communities can least afford unnecessary and avoidable governmental costs.

Recommendation 3.
NEIGHBORHOOD ASSISTANCE AND CONSERVATION

The Commission recommends that states encourage and provide technical assistance to neighborhood self-help associations and other community-based organizations, especially those located in distressed areas. Possible implementing measures include:

a) providing state tax credits and other financial and nonfinancial incentives to corporations and other organizations contributing funds, facilities, or equipment to neighborhood nonprofit organizations;

b) involving neighborhood organizations on a volunteer, contractual, or other appropriate basis in state-assisted housing rehabilitation and public facility repair and maintenance programs;

c) broadening state legislation on interlocal contracting and joint enterprise statutes so that nonprofit community-based organizations can contract to deliver city, county, or special district services to the extent deemed appropriate by the overlying local governmental unit; and

d) authorizing local governments to establish neighborhood subunits of government to exercise such powers and conduct such activities as the local units are empowered to conduct and which they are not legally precluded from delegating. The objectives of such authorizing legislation include the opportunity for limited self governance of neighborhoods, provision of local public services in ways responsive to community needs, and the creation of wealth and facilitation of other economic development within the community.

Currently, "community-based organizations," such as community development corporations, neighborhood housing and building rehabilitation corporations, and a wide range of volunteer, neighborhood self-help associations, probably constitute collectively the most potent single resource available for community stabilization and improvement, especially in economically and fiscally distressed urban areas. They provide an organizational base, an opinion forum, and an appealing opportunity for citizens to act in individual and cooperative capacities to meet needs and to cope with problems of both personal and neighborhood concern. They have the capacity for motivating individual effort for the common good and for counteracting apathy and alienation. Successes in revitalizing distressed areas do not come easily; some of the major ones are credited to strong and aggressive community organizations. Yet, as noted in the findings of this study, most state enterprise zone legislation enacted so far fails to involve these organizations.

State governments can be very helpful in the formation and activities of these organizations. Federal aid cutbacks have threatened to curtail the activities of a number of neighborhood development corporations. State assistance of a direct or indirect nature, coupled with corporate and volunteer support, can fill this gap. Enabling legislation can empower them to act in specified quasi-public roles and receive both private and public funds for public purposes. They can be empowered to act in volunteer advisory capacities in such crucial areas as code enforcement, street and sidewalk repair, crime prevention, and in numerous other areas affecting neighborhood quality of life.

Practically all states have enacted interlocal contracting statutes authorizing local governments to contract with one another in delivering services. States can broaden the scope of this legislation to encompass voluntary nonprofit, community-based organizations, thereby providing additional resources to help fill gaps in service maintenance occasioned by local budgetary stringencies.

As a few have already done, states should authorize cities and counties, by their own actions or through petition and election, to establish or modify neighborhood subunits of government to provide advice on matters affecting the neighborhood and to carry out certain public functions on a decentralized, neighborhood basis. In developing such legislation, criteria of effectiveness, efficiency, responsiveness, political accountability, administrative feasibility, and other appropriate factors should be considered.

Recommendation 4.
EMPLOYMENT TRAINING, PRESERVATION, AND OPPORTUNITY

The Commission recommends that states consider enacting legislation to establish and strengthen linkages between and among private employers, education and training providers, employee organizations, and state and local governments to maximize employment opportunity for all employable persons and to provide adequate education, job and entreprenurial training, and re-training facilities, and instruction and placement so there is a literate and otherwise qualified work force for private and public employment.

Measures to help accomplish the foregoing objectives might include:

A. State and local officials can be brought together to reconcile levels, the entry-level, and other job requirements of private employers with the curriculum offerings of public and private secondary, vocational, technical, community college, and higher education institutions. These efforts should: (1) utilize, wherever possible and appropriate, the Private Industry Councils created under the federal Job Training Partnership Act to generate new employment, enhance promotional and other employment opportunities, and develop a better qualified work force; (2) forge an effective relationship between economic development and employment training needs and objectives as a part of the economic planning processes of state governments; and (3) reprogram existing state vocational and other education funds and employment training monies to help provide resources for these purposes.

B. The states can authorize, with appropriate limitations and safeguards, the use of unemployment insurance trust funds for (1) training and retraining unemployment compensation recipients to hasten reemployment; and (2) sustaining work sharing, work week reductions, and similar measures as alternatives to employee lay-offs.

C. Private employee stock-ownership plans can be authorized and state technical assistance and information provided to employers and employee organizations concerning such plans.

D. Welfare dependency can be mitigated and expanded employment opportunity achieved for disadvantaged employable persons through such measures as (1) phased tax credits to private employers providing full-time, regular employment to welfare recipients; (2) mandatory or voluntary referral of employable welfare applicants and recipients to private employment; and (3) continued experimentation by the states with conservation corps, workfare, public service employment, and similar programs directed toward minority youth and other hard-to-employ categories of employable persons.

E. A re-examination should be undertaken of state laws and regulations concerning labor work rules and related provisions affecting employment and employee productivity, with a view to modifying any that impede re-training and subsequent employment of the unemployed, attracting responsible industrial management to locate in the state, or effectuating harmonious and equitable labor management relations.

For several years there have been increasing complaints from institutions of higher education and from private employers that many high school graduates applying for college admission or employment lack basic cognitive skills. These complaints have been coupled with employer and student frustration at the mismatch between vocational education courses and entry level job requirements. These difficulties have assumed more ominous portents with the basic industrial changes now taking place that require retraining and readjustments in many segments of the labor force. The resulting necessity for closer business-labor-education collaboration places new and heavy responsibilities upon state governments, because states set the basic requirements governing curriculum, student and teacher competency, and student graduation. Because of state legal responsibilities and special constitutional or statutory provisions in many states designed to separate the education agency partially or largely from the rest of state government, legislative action usually is necessary to bring the private sector and general local governments into the kind of consultative and participatory relationships with public education that are recommended here.

Nearly every state presently is engaged in reappraising its responsibilities concerning basic skills and vocational training. This reappraisal is especially crucial for businesses and residents in distressed communities, particularly central cities and other areas with high populations of low-income and minority persons. There is a close, direct, but long neglected linkage between the functions of economic development, on the one hand, and education and job training, on the other. Economic renewal activities are not likely to be of optimum benefit to communities unless expanded employment opportunities are provided to community residents rather than importing workers from elsewhere. However, "hometown hiring" cannot be done unless there are qualified applicants. It is essential, as recommended above, that the state-local "educational establishment" which traditionally has operated in an insulated environment, be brought into collaboration with private employers, employee organizations, and public agencies concerned with economic development and readjustment. This collaboration could well embrace such elements as curriculum setting, vocational course content, entrepreneurial training, placement services, apprenticeship and other training programs for school dropouts, entreprenurial training in preparation for starting a small business or embarking on other forms of self-employment, and interschool and interlocal sharing of scarce and highly expensive training facilities and equipment.

State governments also play a crucial role in handling employment training, unemployment insurance, and related programs so as to hasten re-training and re-employment, facilitate creating employee stock ownership plans (employers having such plans already benefit from a federal tax credit), and encourage other alternatives to plant closures or layoffs. As documented earlier in this report, several states are successfully using one or more of these alternatives.

State governments, through legislation dealing with unemployment insurance, occupational licensing, workers' compensation, occupational health and safety, and labor managment relations can have a significant impact upon employment practices, labor costs, employment opportunities and other economic and social aspects of the state's "business climate." Legislation once designed to achieve job security for some may have been rendered counterproductive by the basic industrial changes of the past few years. A fresh look at some of the older legislation (like, unemployment insurance for employees on strike, restrictive occupational licencing, and "featherbedding" practices) may well serve the interests of both employees and employers in striving toward stable employment and a healthy state economy.

State and local governments also need to structure and administer their public assistance programs so that employable applicants and recipients are diverted into regular, full-time employment and begin to break the welfare-dependency cycle. The failure to provide adequate educational preparation and early employment opportunities for youth from low-income families generates heavy subsequent welfare and correctional costs -- both personal and social. One-half or more of many state government budgets goes for education, and an additional considerable portion for welfare and welfare-oriented programs. Increased attention to the cost-benefit relationships between these two areas of public expenditure is warranted in every state.

Recommendation 5.
HOUSING ASSISTANCE

The Commission recommends that state governments concentrate their efforts in the housing field upon: (1) facilitating, through code revision and other deregulatory efforts, the operation of the free market in providing adequate housing and housing opportunities for all citizens; (2) authorizing local government participation in federal housing assistance programs; (3) experimenting, in collaboration with local governments, with alternative methods for delivering housing assistance, such as housing allowances, vouchers and rental certificates; (4) authorizing and assisting in establishing homesteading programs; and (5) authorizing and encouraging formulation of tenant-management associations.*

The Commission believes that whatever state resources may be allocated

*Commissioner Teague dissented.

to housing assistance should facilitate free market processes. For this reason, it is suggested that, in addition to empowering local governments to participate in federal housing programs, state governments: (1) undertake a careful review and revision of those state and local building and housing codes and land use regulations that go beyond basic health and safety standards and tend to increase unnecessarily the costs of housing; (2) experiment with housing vouchers and other ways of providing rental assistance that broaden consumer choice and involve a minimum of governmental administration; and (3) authorize and activate "homesteading" programs, whereby property taxes are waived or deferred for a specified period and loans are made to individuals to rehabilitate residential properties in the city or otherwise publicly owned, with title passed to the borrower upon satisfactory completion of the rehabilitation work.

It is especially important that local governments scrutinize existing building and land use regulations to reduce the "regulatory slice" of house prices, estimated in some areas to be a 20-30% add-on. Distressed areas can least afford code restrictions that add unnecessarily to material and labor costs, and substantial savings in this regard can greatly aid neighborhood stabilization and restoration activities.

In addition to the five actions proposed above, the Commission recommends continuing state financial assistance to housing construction, purchase and rehabilitation as featured in the existing activities of many state housing finance agencies.*

In implementing the general policies set forth above, states might include the following additional measures:

1. States can continue and intensify financial assistance to housing construction, purchase, and rehabilitation, with this assistance focused upon distressed areas and toward low and moderate-income purchasers and renters.

2. Designated proportions of overall loans and loan guarantee authority can be reserved for low-income persons and distressed areas while allowing timely reallocations of unused commitments to other areas and income groups.

3. The allocation of loan and loan guarantee commitments for construction and rehabilitation should be targeted more closely than presently to lower income families, to distressed areas, or to both.

4. Technical assistance should be made available to local governments for emergency shelter programs.

5. Grants can be made for forgivable loans to low-income families for basic repairs to bring dwellings closer to code requirements.

6. Subsidized loans could be authorized for rehabilitating migratory

*Commissioner Teague dissented.

labor housing facilities.

7. Income eligibility levels can be raised for "high cost," low-income groups such as large families and elderly and handicapped individuals.

Practically all states finance housing construction, repair, and rehabilitation in one way or another, usually through a housing finance agency. The principal vehicle for state assistance to low and moderate-income housing over recent years has been the mortgage revenue bond. Issued by the state agency so that interest income on such bonds is exempt from federal income taxation, the bond proceeds can be used for housing assistance at rates one to two percentage points below the market, although the difference varies from state to state. A major issue in conducting state housing finance programs is the extent to which targeting on distressed communities and on low (in contrast to moderate) income families may bring the agency's overall financial program below the break-even point. If brought below that point, debate ensues over the extent to which appropriated funds can or should be used to subsidize home purchases by high-cost groups such as large, single parent families. Yet, as pointed out in this report's findings, minority groups as well as large families often encounter special housing problems, both economic and exclusionary in nature. As reported earlier, seven states now target single-family housing programs more stringently than is required by the federal regulations governing mortgage revenue bonds.

Although state housing finance efforts are influenced greatly by federal tax exemption and rental assistance policies and programs, significant opportunities exist for improving housing needs in distressed areas by: (a) assisting in basic repairs that begin to restore housing to a habitable condition; (b) using neighborhood associations in code enforcement activities; (c) giving technical, or temporary financial assistance to local governments or to their housing agencies for emergency shelter of homeless persons; and (d) extending loans or other assistance to rehabilitate housing for migratory workers.

Too often local governments, for legal or other reasons, face a decision to condemn dilapidated dwellings because the occupants are unable to pay the frequently high cost of bringing the buildings fully up to code requirements. In some states and localities, combining repayable grants or forgivable loans for making dwellings habitable, although not up to code (as in Minnesota), and using neighborhood associations in code enforcement in an unofficial way, has avoided both condemnation and the legal problems of selective enforcement.

Neither the plight of homeless persons nor the condition of housing in migratory labor camps is likely to draw much public concern or support in local or state legislative bodies. Nonetheless, state housing agencies are in a position to give useful assistance to local governments in coping with these seemingly intractable problems.

Rent control is a controversial issue in various localities. It is argued that such controls are sometimes necessary to assure affordable rental housing to people of low and moderate income and to prevent serious abuses by landlords in periods of housing shortages. On the other hand, some studies of the effects of local rent controls identified negative effects of these controls upon housing supply. On repeated occasions in recent years, Congress has seriously considered prohibiting federal housing assistance in localities imposing rent controls.

Two final points should be noted concerning state government housing activities. First, there is a very close connection between housing and economic development, and continuing contact and collaboration is important between economic development and housing agencies at both state and local levels. Second, the assets of state and local pension funds represent a growing source of capital for real estate mortgage loans; approximately one-fifth of such funds' current assets is in mortgages. Investments in mortgages should be authorized where interest rates and other considerations are competitive with alternative investments. A considerable number of states already have taken this action. Investments in tax exempt obligations are not advantageous for public pension funds, but investments in mortgages can provide capital needed at the low-income end of the housing market.

Recommendation 6.
MITIGATION OF LOCAL FISCAL DISPARITIES

The Commission recommends reviewing local fiscal needs and resources and state aid programs from the standpoint of interlocal equity.*

Among the specific measures that states might wish to consider in implementing this general policy are the following:

A. States can establish or revise state revenue sharing programs to take into account wide variances in local fiscal capacity and the special problems of distressed communities.

B. Jurisdictions in densely settled areas can be authorized to share a portion of future increases in their commercial-industrial tax bases: (1) such sharing can reduce the intensity of interlocal competition for valuable industrial and commercial facilities which sometimes is accompanied by actions to exclude the housing required to accommodate the employees of such facilities; and (2) provide a negotiating basis for neighboring jurisdictions to use in balancing utility and other service requirements against the advantages and disadvantages of incorporation or annexation.

For several years, the most fiscally critical and politically difficult feature of state-local financial relations has been interlocal financial disparities. Service needs and fiscal resources do not always match well with local boundaries, and there is debate over the extent to which and how the state government should try to ameliorate these differences.

Over the past two decades, the context within which local governments exercise their responsibilities has changed dramatically. Population growth and settlement patterns have been modified; local economies have experienced wide swings between rapid growth and stagnation or decline; and fiscal burdens

*Commissioners Walker and Teague dissented.

have increased. Additional fiscal strains arise from the new responsibilities that local governments have assumed and from price inflation. State aid systems that were devised during the early years of the century to (a) distribute state funds on some flat per capita basis, (b) entice localities into particular functional areas, or (c) help support certain public services (primarily education and highways) that were endowed with statewide interests, no longer meet the needs of an increasingly urban and technologically interdependent society.

Most of the states now provide some form of general revenue sharing (i.e., unconditional aid) to their local governments, and 40 report some degree of "equalization" in their formulas. (Simply including population as a factor exercises a redistribution effect in most situations.) Factors currently most used in revenue sharing formulas are (1) population, as in California, Illinois, and Minnesota; (2) population and property tax base, in Florida; (3) population and tax "effort" (or "burden"), in Michigan; (4) population, property tax base and income, in New York; and (5) population and "program need," in Ohio. Less than a dozen states, however, use formulas purposely designed to favor localities with high tax or debt burdens, low property tax bases and high proportions of lower income residents.

A review of state revenue sharing formulas is very much in order, given the substantial structural economic changes of the past few years and the proliferation of distress in both urban and rural areas. An especially troublesome technical and political issue is the extent to which "tax effort" should be included in the formulas. (Tax effort reflects the relationship between tax collections and "fiscal capacity," i.e., the relative property wealth and income level of the jurisdiction.) There is considerable debate as to whether a high taxing but moderate fiscal capacity jurisdiction should be rewarded at the expense of a low taxing but high "user-charging" jurisdiction of equal fiscal capacity. Stated another way, if the fiscal capacity or "wealth" of two jurisdictions is equal and one chooses to provide many services at a higher level of intensity, with a consequently higher per capita tax burden, while the other chooses to provide a lower level of service or relies to a greater extent on nongovernmental organizations for the services, should the first jurisdiction receive more in per capita revenue sharing because of its higher "tax effort?" The tax effort debate aside, to the extent that formulas are keyed more to per capita fiscal capacity (i.e., property tax base plus income, divided by population), distressed areas in general are benefited.

A Minnesota statute enacted in 1971 and subsequently amended modestly provides that the municipalities making up the Minneapolis-St. Paul metropolitan area will share 40% of the area's growth in commercial-industrial property assessments after 1971. The tax base rather than taxes is shared. The size of the area base has continued to grow and now amounts to 22% of the total commercial-industrial base. It can be said that nearly a quarter of the commercial-industrial property in the Twin Cities metropolitan area has now been "regionalized." Unless the act were changed, the size of the collective or "regional base" ultimately would increase to nearly 40% of the total assessed value of all such property in the metropolitan area. St. Paul is still a substantial "gainer" from the pooling; Minneapolis, a substantial gainer in the past, is now becoming a "loser," as a result of substantial redevelopment in its own central business district.

Replication of the Twin Cities arrangement would be appropriate only if it were (1) compatible with the particular economic, fiscal and political facts of life in an area, (2) represented a moderately satisfactory trade-off to most of the area jurisdictions concerned, and (3) agreed to by them, either through an interlocal agreement or concurrence in a special legislative act co-sponsored by the constituent delegations. State authorization for effectuating a commercial-industrial base sharing plan would provide an additional avenue for interlocal cooperation. Quite often, protracted negotiations and legal and political conflicts arise among neighboring areas when one unit has utility services that others want, and one or more of the others have tax bases that the "utility-rich" jurisdiction would like to have. Sometimes swapping utility-supply for tax base sharing (as a Virginia city and county recently did) is more satisfactory to all concerned than a prolonged battle over annexation and incorporation.

Recommendation 7.
FINANCIAL AND TECHNICAL ASSISTANCE TO COMMERCIAL AND INDUSTRIAL DEVELOPMENT IN DISTRESSED AREAS

The Commission recommends that state governments adopt individually tailored policies, programs, and institutional arrangements for attracting commercial and industrial development in economically distressed areas; appropriate measures include business deregulation, tax credits, and establishing of enterprise zones.

The need for strong relationships between the state government and the business community has already been stressed, as have state actions that stop short of direct financial assistance. Two additional indirect financial incentives should be considered. One is granting corporate income or other tax credits to firms locating or expanding in distressed areas. Such credits need to be enacted with great care and evaluated carefully to determine the extent to which they are really affecting locational decisions rather than rewarding actions that would have been taken anyway. Furthermore, care must be taken that the credits do not include intrastate employment shifts from one locality to another, where no net increase in employment is affected.

"Enterprise zones" have been established by several states and are being considered by Congress for federal application. Within these "zones of distress" a combination of deregulatory actions (like simplification of permitting requirements and procedures, code modifications, and environmental waivers), tax credits and property tax abatements are authorized by both state and local governments to attract and retain private investment and employment.

It is argued that for states to proceed further and intervene financially through guarantees, loans, grants, and procurement preferences would distort the operation of free market economic and competitive forces and, because few such efforts have been demonstrably successful, would represent a questionable expenditure of public funds. On the other hand, a number of states are providing a variety of such financial incentives. These other programs and activities include: (1) venture capital loans, loan guarantees, equity participation, and other arrangements with industrial and commercial corporations and with community-based organizations (e.g., community development corporations, neighborhood rehabilitation corporations, and neighborhood self-help associations) that are located and operate inside economically distressed communities and with minority-owned, small business enterprises located, opening, or expanding in such areas, sometimes conditioned upon requirements that they provide solid assurance that employment and profit benefits will accrue significantly or primarily to the area and its residents; (2) partially or generally limiting future local industrial development revenue bond issues to local governments in distressed areas; (3) exploring ways in which pension funds of state and local governments might be used effectively, yet prudently, in distressed area investment opportunities; and (4) implementing these and related programs through a single state development finance authority or similar instrumentality.

The major purpose of state financial assistance programs has been to stimulate private enterprise development and to create new jobs in distressed areas. The objects and instruments of assistance cover a broad spectrum. Among the major recipients are community development and neighborhood rehabilitation corporations; new and old businesses starting up or expanding; and local governments in which distressed communities and neighborhoods are located. State funds for the assistance programs are derived from appropriations, general obligation bonds, revenue bonds, returns on capital invested in the projects, and miscellaneous funds available from other state programs, federal UDAG allocations, and private foundation grants.

The principal forms of assistance are loans, loan guarantees, stock purchases or other forms of equity participation, "seed money" grants to community development corporations or other area-based intermediary organizations, and preferential bidding or set-asides in state and local government procurement programs. In terms of state aid flows, the Maryland, Massachusetts, Michigan, and Wisconsin programs are the largest. Before actual project financing and implementation succeeds, the high hopes surrounding initial legislative enactment are usually followed by a lengthy start-up period due to the complexities of the arrangements which require most projects to draw funds from several sources. Some of the early states that initiated aid programs have substantially revised their enabling legislation based on experience gained during initial operations.

Most states have found it desirable to provide financial and technical assistance to community commercial and industrial projects through a state corporation or authority, similar in several respects to state housing finance agencies. However, the proportion of development assistance that requires equity participation is much greater in commercial and industrial development than in housing, and it usually requires a more complex organizational and financial structure. Sometimes the overall state development authority creates one or more for-profit corporations to generate business development, provide technical assistance, and monitor eligible projects.

Recommendation 8.
ASSISTANCE TO MINORITY AND SMALL BUSINESS ENTERPRISES IN DISTRESSED AREAS

The Commission recommends continuing state information sharing, public promotion, technical assistance, and loan activities that benefit minority and small business enterprises in distressed areas.

The Commission believes that existing state programs of information sharing and technical assistance which are aimed at minority-owned and small business enterprises help broaden economic opportunity in a free enterprise economy. More than half the states have such programs and they represent activities of minimal market-place intervention, in contrast to programs of direct grant, loan, or other financial assistance.

Recommendation 9. SUNSETTING AND EVALUATION OF ASSISTANCE PROGRAMS FOR DISTRESSED AREAS

Given the relative absence of meaningful evaluations of state assistance programs for distressed areas, the Commission recommends that states enact stringent sunsetting and program evaluation provisions when adopting any new programs of direct financial assistance or when providing tax credits to encourage economic revitalization in such areas. New programs should carry a repeal date, with evaluations and their results available prior to that date, so the governor and legislature may make informed judgments about continuing, modifying, or lapsing such programs.

As indicated earlier, except for state-assisted programs in housing, this study uncovered few evaluations of state activities aimed at aiding distressed communities. ("Evaluation" in this context does not refer to fiscal audits concerning the propriety of expenditure; it refers to appraising the effectiveness of the expenditure.) Reasons underlying this lack of formal, third-party or other independent evaluations include: (1) reluctance to put at risk a program launched only after several years of intensive up-hill effort; (2) the substantial costs in time and money required for formal evaluations of extensive or complicated programs; and (3) frequent disregard of evaluation findings, throwing into question the wisdom of investing scarce resources in obtaining them. Nevertheless, there is pervasive uncertainty at both the state and national levels as to what kinds of programs or incentives really work or work most effectively. Because of the tightening fiscal constraints facing all levels of government, the Commission considers it imperative that all state financial assistance and tax credit or abatement programs be examined carefully after an appropriate period following enactment, or well in advance of their expiration dates.

In evaluating program effectiveness, state and local governments need to proceed carefully and thoroughly. First, an evaluation capability must be acquired -- either internally, through an evaluation unit attached to the chief executive, state auditor, or an appropriate legislative oversight committee, or externally through management-audit firms, general management consultants, or other appropriate nongovernmental entities.

Second, independent and unbiased judgment must be secured. For example, no evaluations should be conducted by a unit or individual that (1) was involved in developing or proposing the program being evaluated; (2) was at any time a beneficiary of the program under review, or a part of a larger organization that so benefitted; or (3) is an alternate provider of the service or function being evaluated.

Third, and most important, all evaluations should consider: (1) whether or not the program continues to be the most effective means of achieving the statutory objectives; (2) whether the social and economic results achieved are commensurate with the costs incurred; and (3) whether comparable social and economic results could be achieved in the future at less cost through other policy or program approaches within or outside the government. All too frequently, evaluators direct their attention primarily to whether or not significant measurable benefits have been achieved and neglect to compare those benefits with the costs, and what the cost-benefit relations would have been under alternative arrangements. Such a comparison, however, often necessitates trade-offs between efficiency and equity.

Recommendation 10.
VIEWING THE NATIONAL CONTEXT OF STATES AND DISTRESSED COMMUNITIES

During the four years spanned by this project, basic changes occurred in the nation's economy that go far beyond cyclical ups and downs. Distress is not confined to central city ghettos in the Northeast, to rural poverty in Appalachia, to the Upper Great Lakes, and to scattered substate areas of economic decline. Older suburbs and entire industrial regions are changing drastically and readjusting.

International competition, high production costs and low product quality, continued high national budget and trade deficits and interest rates, low savings rates, and a variety of other factors have combined to confront the country and most other industrialized countries of the world with profound economic and fiscal dilemmas of a long-term nature. Over the foreseeable future, fiscal austerity at all levels of government in this country appears to be a given.

A formidable challenge faces the nation: Reacquiring the structural capacity for sustained domestic economic growth, for competitive pricing in the world's markets, for keeping frictional and technological-transitional unemployment at acceptable levels and for affording all segments of society a full opportunity to participate in and benefit from economic well-being. This national context will severely constrain state and local government efforts to cope adequately with the problems of distressed areas. Eligibility criteria for assistance and program evalution criteria will need to be tightened considerably as recommended earlier. The fiscal condition of the national government over the next few years, especially its recurring large annual deficits make problematic any substantial increases in federal aid to state and local governments. State and local government cooperation in striving to assure equity and economy in meeting development needs and providing public services is the best available and most permanent foundation for bringing help to distressed areas.

Continued and concentrated attention to "sorting out" fiscal and functional responsibilities within the federal system is essential. An earnest effort by the Congress, the President, and state and local governments might unearth feasible and equitable ways to improve fiscal balance within the federal system.

The Commission urges, pending a reappraisal of relative responsibilities among federal, state, and local governments, that the national government refrain from further impeding or encumbering state and local governments with new regulatory mandates as they strive to meet increased responsibilities to their citizens in the wake of a reduced federal role. The Commission further suggests that the Congress authorize expanded flexibility for state and local governments to transfer funds among aid categories, within specified maxima, so that problems of the highest urgency which vary from state to state and from locality to locality may be addressed as adequately as possible.

In its 1983 report on Regulatory Federalism: Policy, Process, and Reform, the Commission described the inordinate financial and administrative burdens imposed upon state and local governments by federal regulatory mandates -- statutory, administrative, and judicial. Progress to date by the Congress and executive agencies has been very modest, following a promising beginning in mid-1981. Although the Commission recognizes the fiscal constraints facing Washington, it believes it is incumbent upon the national government to move decisively toward intergovernmental deregulation, while assuring protection of the individual Constitutional rights of all citizens, so that state and local governments are better able to meet new problems, at least part of which are attributable to federal budgetary actions.

Beginning in 1961 and continuing through 1982, this Commission in several reports has repeatedly called for expanded flexibility, through block grants, intercategorical transfer authority, and other means, to maximize the effectiveness of federal aid funds. Conditions vary so widely across the nation that the needs and priorities among specific program categories within a given functional field are bound to differ. To maintain such categorizations in the face of reduced fund availability can only mean that in most communities certain categories are over-endowed in relation to actual local and state need. Authority for interprogram transfers within ranges specified by Congress is a federal grant reform long overdue. Its postponement perpetuates inequities and unnecessarily reduces the effectiveness of each federal aid dollar.

Appendix I

RESEARCH DESIGN AND METHODOLOGY

The research design and methodology for the States and Distressed Communities project evolved over the project's four years. In 1979, the Department of Housing and Urban Development (HUD) asked the Advisory Commission on Intergovernmental Relations (ACIR) and the National Academy of Public Administration (NAPA) to examine what state governments were doing on their own initiative to aid distressed communities.

ACIR and NAPA devised a questionnaire for state directors of departments of community affairs and local officials from 55 jurisdictions identified as "hardship cities" in a study by Richard P. Nathan and Charles F. Adams, Jr. The officials were asked to select what they believed to be the 20 best indicators of a state's commitment to assist distressed communities from a list of 35 programs. The 35 state indicators were selected on the basis of a modified Delphi procedure carried out during a 1979 "thinkers' session" held by ACIR and NAPA. Based on these discussions, 20 program indicators were selected for the state monitoring effort.

In 1980 the objectives of the project were to:

1) develop program area indicators that would accurately reflect the most important areas of state aid to distressed communities,

2) establish criteria to distinguish programs specifically targeted to distressed communities from those available statewide,

3) collect individual program area information from each state.

The NAPA survey met the first objective. To meet the second objective of determining which state programs were targeted to distressed communities, project staff developed the criteria shown in Exhibit I-1.

To meet the third objective, data were collected in 1980 for the housing, economic development, and community development indicators by using a mail-out/mail-back questionnaire, and in 1981 and 1982 by telephone interviews with state officials in the appropriate departments. Data for 11 of 20 indicators were gathered by direct telephone contact. For fiscal assistance and enhancing local self-help capabilities, some program data were collected by interviews, although, the main source of information was secondary data.

Modification in the program eligibility criteria between the 1980 and 1981 reports accounts for some variance in the number of programs counted.

Design of the Final Report

The objectives for 1983, the final year of the project, were broader in scope:

Exhibit I-1

Target Criteria

I. **Housing**
The state program must be directed primarily to persons with low or moderate incomes, or to communities or neighborhoods with a substantial concentration of low-income families or substandard dwellings.

II. **Economic Development**
The state program must be directed primarily to communities with (a) substantial outmigration of population or industry, (b) above-average unemployment or underemployment, or (c) an insufficiently diverse economic base.

III. **Community Development**
The state program must give priority to (a) communities or neighborhoods where public facilities are obsolete, lacking, declining, or underdeveloped, (b) areas which are experiencing rapid industrial and population growth, and (c) areas where capital or community development needs exceed financing and maintenance capabilities.

IV. **Fiscal and Financial Management Assistance**
State programs must seek to alleviate revenue and expenditure burdens of fiscally pressed communities where the tax base is inadequate and the per capita income is below the state average.

V. **Enhancing Local Self-Help Capabilities**
State legislation or authorization must assure that substate general purpose governments are legally equipped to address the fiscal and development problems of distressed communities.

1) provide a national context for understanding the dimensions of distress in our communities,
2) contact directly state officials for 14 of 20 program indicators,
3) increase specificity in program indicator definitions,
4) improve data gathering procedures with an emphasis on revalidation of prior years' data,
5) discuss major national and state policy issues in each policy area,
6) complete four state budget case studies,
7) present the four-year trend data on the indicators wherever possible,
8) draft state legislation covering all five policy areas, and
9) draft recommendations for consideration by members of the Advisory Commission on Intergovernmental Relations.

The project was organized on three tracks: state monitoring, policy research, and draft state legislation.

Several caveats need to be mentioned. First, the project only focused on 20 indicators, meaning that other state efforts to aid distressed communities were not counted. Second, limited resources allowed collection of data only for the 1980-83 time period. Third, limited resources and data did not allow for the evaluation of state programs targeted to distress.

The first point bears some elaboration. By focusing on the 20 indicators selected between 1979 and 1980, the report ignored other kinds of state efforts that could aid distressed communities. For example, the assumption of municipal and county court costs could provide fiscal relief for localities, but was not included among the indicators. In general, the targeted programs included in the report represent only a small portion of a given state's budget. Aid to local public education and welfare, transportation aid, and state-local revenue sharing have far greater budgetary importance than housing, economic development, or community development programs. To a great extent, however, these three program areas are funded off-budget -- that is, through bond issues or through local sources.

State Monitoring

A primary objective of the States and Distressed Communities project was to assemble a central record of state programs targeted to distressed persons, places, and businesses, as well as programs designed to improve the capacity of local governments to address their own problems. This record would serve as a starting point for state governments to explore what other states were doing for distressed communities. A state official contemplating the implementation of new efforts to aid distressed localities could use the States and Distressed Communities as a reference of innovative actions undertaken by other states.

Two kinds of state efforts were included in this report -- targeted and nontargeted program indicators. Targeted indicators included four housing assistance programs, five economic development programs, and two community development programs designed to aid distressed persons, places, and businesses. Nontargeted indicators included state efforts to improve the fiscal capacity of local governments (five programs), and policies designed to enhance the capacity of local governments (four programs). Specifically, these indicators were:

Housing

1. Single-Family Home Construction
2. Multifamily Home Construction
3. Housing Rehabilitation Grants or Loans
4. Housing Rehabilitation Tax Incentives

Economic Development

5. Industrial or Commercial Site Development
6. Financial Aid for Industrial or Commercial Development
7. Customized Job Training
8. Small and Minority Business
9. Industrial Revenue Bonds

Community Development

10. Capital Improvements

11. Neighborhood Development

State-Local Fiscal Relations

12. State Revenue Sharing
13. Education Finance
14. State Assumption of Local Public Welfare
15. State Mandate Reimbursements
16. Improving Local Governments' Access to Credit Markets

Enhancing Local Self-Help Capabilities

17. Tax Increment Financing
18. Local Redevelopment Authorities
19. Local Sales or Income Taxes
20. Local Discretionary Authority

Policy Research

The major policy issues affecting distressed communities at all levels of government were reviewed. At the national level, secondary data were collected on major indicators of community and government distress. For each policy area, data were collected and analyzed on the specific issues in that area affecting distressed communities. Specifically, data were collected for the following items:

1) national demographic trends,
2) national economic trends,
3) regional distress (urban/rural, central-city SMSA/ noncentral-city SMSA, Northeast/South/North Central/ West),
4) business trends,
5) state and local fiscal distress,
6) court cases, and
7) national government roles (programs, fiscal and regulatory policy).

Draft State Legislative Materials

Based on ACIR's previous efforts to draft state legislation, the project prepared drafts of 18 bills for states interested in enacting programs and policies designed to aid distressed communities. The content of these drafts was drawn from already enacted state legislation. Of these bills, seven were new bills, six were revised ACIR or Council of State Governments (CSG) bills, and five were reissued ACIR or CSG bills:

I. New Bills

1. Housing Finance and Rehabilitation Agency Act
2. Comprehensive Employment Training, Placement and Relocation Assistance Act
3. Community Reconstruction Financing Act
4. Neighborhood Improvement, Assistance and Organization Act
5. Metropolitan Tax Base Act
6. State Economic Development Policy Act
7. State Development Finance Authority Act

II. Revised Bills

1. State Land Assembly and State Development Act (ACIR 5.103 and CSG)
2. State Mandates (ACIR 4.116)
3. Local Government Borrowing Supervision and Assistance Act (ACIR 4.105)
4. Factory-Built Homes and Structures Act (ACIR 6.302 and 6.303)
5. State Assistance in Local User Charge Formulation and Administration (ACIR 3.205)
6. Tax Increment Financing (CSG)

III. Reissued Bills

1. State Revenue Sharing (ACIR 3.207)
2. Authorization for Consolidation of Local Housing Authorities (CSG)
3. Authorization for a Local Income Tax (ACIR 3.203)
4. Authorization for a Local Sales Tax (ACIR 3.204)
5. Enterprise Zones

Project Advisory Process

The project had a two-tier advisory process. The first level involved the creation of a National Advisory Panel to advise the project on design, legislation, findings, and recommendations during the course of the final year. The panel consisted of seven members: two state legislators, two local elected officials, and one expert each in housing, economic development, and state budget and finance. In order that the project capture a breadth of perspectives, the members were selected with an eye toward geographic and political balance, minorities and women were represented, and one of the panelists was a current member of ACIR (another was a former Commission member). The panel members were:

The Honorable David Nething
Majority Leader, North Dakota State Senate
(current ACIR member)

The Honorable John F. Kelly
Chairman, Senate Committee on Corporations and
Economic Development, Michigan State Senate

The Honorable Thomas Moody
Mayor, Columbus, Ohio
(former ACIR member)

The Honorable Wilson Riles, Jr.
Councilman, Oakland, California

Mr. James Solem
Executive Director
Minnesota Housing Authority

Mr. Harold A. Hovey
Consultant on State Budget and Finance

Ms. Renee Berger
Consultant on Economic Development

The panel met three times for a total of five days over a period of one year.

The second level of the advisory process involved individual and group meetings with representatives from over 25 state and local government public interest groups as well as a number of research institutions. Among the groups invited to participate at several points during the final year of the project were:

1. Council of State Governments
2. National Governors Association
3. National Conference of State Legislatures
4. Academy for State and Local Government
5. National Association of Counties
6. National League of Cities
7. U.S. Conference of Mayors
8. International City Management Association
9. Council for Urban Economic Development
10. Council of State Community Affairs Agencies
11. National Association of Housing and Redevelopment Officials
12. National Association of State Development Agencies
13. Council of State Housing Agencies

In addition, the project sought input from The Brookings Institution, The Urban Institute, The Heritage Foundation, The American Enterprise Institute, the AFL-CIO, and the Council of State Planning Agencies, as well as a number of other organizations involved in specific programs.

The advisory process involved a first round of meetings early in the final year of the project to clarify objectives and obtain input on the issues that the groups wished to have covered. Three months later the groups were polled about their priority concerns for the draft state legislative materials, and then two critics' sessions were held at the end of the project, one on the findings, general observations and recommendations, and the other on the draft report itself.

Project Design

Definition of a Distressed Community

Previous reports have defined "distressed communities" as:

> ... any areas (various types of general units of local government, including rural, urban, and suburban places) which are declining or in need relative to other areas of their state.

For purposes of the final report, however, a more specific and quantitative definition was used:

> Distressed communities are those local government jurisdictions and, in some instances, subareas of jurisdictions, which are in the bottom 25% of all jurisdictions of the same class throughout the state, based on the most appropriate economic measure of distress for the same class of jurisdiction, e.g., income, poverty, and unemployment.

A review of the literature of definitions of distress found no consensus among the experts. A look at federal programs which have targeted aid to distressed communities over the past 20 years also yielded little agreement on criteria measuring "distress." However, four broad categories of measures were used which seemed to reflect what most observers consider to be "distress":

1) socioeconomic measures such as per-capita income, poverty level and rate, welfare dependence, violent crime, and education status;

2) physical measures such as the condition of the roads, bridges, and sewers as well as housing stock;

3) fiscal measures such as the average operating surplus or deficit, the average short-term debt as a percentage of revenues, and dependence on intergovernmental aid; and

4) economic development measures such as population decline, employment or unemployment, business dissolution and start up rates, and levels of plant utilization.

These broad categories of measures were used to generate data in the national context section of the report on the overall dimensions of distress.

Distress was divided into two basic types: (1) community distress, which involves the economic and social conditions of people, places, and businesses, and (2) government distress, which defines the fiscal condition of state and local governments in terms of revenues and expenditures.

Targeting and Distress Criteria for Policy Areas

Reports from previous years identified programs in the five policy areas based on the original distress criteria noted above. To be included in one of the annual reports, a state program in a given policy area had to restrict assistance to a given distressed population, geographic area, or local governments. For example, a housing program had to serve low or moderate-income persons or areas. In the area of fiscal relations, a program had to provide a measure of fiscal relief to communities experiencing revenue or expenditure burdens. These original distress criteria did not have precise definitions. The definitions of terms like "low or moderate income" or "expenditure burden" varied from report to report.

For the 1983 report, a proposal was made to the National Advisory Panel to tighten the distress criteria for each indicator to eliminate ambiguity. Given the project's limited budget and time frame, it was decided to use the existing policy area criteria for each indicator, but to collect data on how the states themselves define distress and target their programs. (The questionnaire is available from ACIR upon request.) For housing, economic development, and community development, to be eligible for inclusion, a program had to be explicitly targeted in the legislation to distressed people, places, or firms.

In the policy areas of state-local fiscal relations and enhancing local self-help capabilities, these targeting requirements were inappropriate. The nine programs in these areas benefited distressed communities less directly, but no less importantly. For example, education finance is the largest category of state-local aid.

1. Housing. Targeting to distress in assisted housing programs can involve either assistance to certain population groups or to geographic areas. With respect to distressed housing population groups, housing programs included in this report can assist low or moderate-income households, or other groups with high levels of need including minorities, large families in the central city, immigrants, the homeless, and the elderly. The Department of Housing and Urban Development's definition of moderate income as 120% of statewide median annual household income can be recognized as the upper income limit, although most state programs have their own established income limits. With respect to distressed places, targeted housing programs can assist areas with relatively high concentrations of groups with high levels of housing needs, or relatively high concentrations of physically inadequate dwellings.

2. Economic Development. Distress in the area of economic development involves people, places, and businesses. Distressed people are the unemployed, minorities, or displaced workers. Distressed places are those with high concentrations of unemployment, blight, or economic disinvestment. Distressed businesses were either those seeking to leave a distressed area, small businesses unable to get conventional financing, or minority-owned/controlled firms.

3. Community Development. The policy area of community development focuses only on distressed places. An area was considered distressed if it met any of the following criteria: a concentration of low-income persons or substandard housing; the deterioration, obsolescence, inadequacy, or absence of public physical infrastructure or public facilities; an insufficiently diverse financial base; or the inability of the local jurisdiction to finance public services or physical improvements.

4. State-Local Fiscal Relations. Programs were included if they provided local jurisdictions with revenue or expenditure relief, i.e., if they provided local governments with funds to pay for public programs or if they entailed state assumption of financial or management responsibilities. State policies were also included if they enhanced the ability of local jurisdictions to finance their own programs.

5. Enhancing Local Self-Help Capabilities. Programs included state statutory efforts to extend power to local jurisdictions to raise their own revenues and implement their own economic development programs. Such powers would allow local governments to improve their fiscal and economic situations.

Criteria for Program Indicators

In addition to meeting the policy area criteria, programs included in this report had to conform to descriptions developed for a specific program indicator. These descriptions served as functional guides for identifying state programs targeted to distress. Like the policy area criteria, program descriptions evolved over the history of the project and are specific to every indicator.

For housing, economic development, and community development, programs were eligible for inclusion if they were:

1) enacted state law by June 30, 1983;
2) targeted to distressed people, places, or firms; and
3) at least 50% funded by the state.

For the fiscal relations and enhancing policy areas, the first criterion had to be met and the law had to enhance local government capacity to deal with distress.

1. Assisted Housing Programs. Single-family housing programs involve state agency efforts to subsidize the construction and mortgage finance of owner-occupied housing. Multifamily housing programs concern state agency efforts to subsidize the construction and long-term finance of rental housing. Rehabilitation grants and loans can include a variety of financial incentives resulting in the substantial repair of single-family or multifamily housing, such as loans to community-based organizations to finance self-help programs, and acquisition or rehabilitation mortgages for owner-occupied housing.

2. Economic Development Programs. Industrial and commercial site development involves state agency efforts to encourage the location of businesses to distressed areas or to enable ones already there to stay. Financial aid for industrial and commercial development involves either direct financial assistance to firms locating in distressed areas or enterprise zones, or technical assistance to communities experiencing economic dislocation due to a plant closing. Customized job training involves programs aimed at training, retraining, or placing unemployed, or displaced workers in existing jobs at existing or new businesses. Small and minority business development programs involve both financial and technical assistance to small businesses unable to obtain conventional financing and located in distressed areas or to minority businesses anywhere in the state. Industrial revenue bond programs involve IRBs targeted to development projects in distressed places.

3. Community Development Programs. The capital improvements component of community development included three kinds of programs: (1) construction of public sanitation facilities, (2) construction of public facilities in energy impact areas, and (3) other public facility improvements. Energy impact areas are those experiencing either rapid development or energy-related resources (boom towns). Other public facility improvement programs include, among others, efforts to improve roads, bridges, or other capital stock.

The neighborhood development component of community development included financial and technical assistance by state agencies to local governments and community-based organizations seeking to improve their community. Such assistance can be extended in the form of commercial strip revitalization or improved capacity for a community-based organization to be able to conduct its own economic development or community service programs.

4. State-Local Fiscal Relations. State-local fiscal relations involves state financial assistance to local governments. The first four program indicators -- (1) state-local general revenue sharing, (2) education finance, (3) assumption of local public welfare, and (4) state mandate reimbursements -- involved either the allocation of state funds to local governments or state assumption of administrative and financial responsibilities. The fourth program indicator--improving local governments' access to credit markets -- involved state efforts to upgrade the credit worthiness of local governments' own bond issues or other efforts to support local capital project finance.

To be included in the survey, state-local revenue sharing programs had to provide nonearmarked funds (funds specified for no categorical purpose). State governments also had to allocate revenue sharing funds at least partly on the basis of an equalizing criterion. Equalizing criteria would act as proxies for distress criteria, reflecting the degree of a community's revenue or expenditure burden.

All efforts by the states to financially support their local primary and secondary public education and local public welfare programs were included. State assumption of public education and welfare costs was assumed to provide a measure of fiscal relief to local jurisdictions. An effort was made to determine the degree of the states' support for local education and welfare, as well as efforts to allocate education finance to communities experiencing higher costs due to relatively high concentrations of disadvantaged pupils. The state mandate reimbursements indicator included state statutes and administrative mechanisms designed to relieve local governments of financial responsibilities for programs or procedures required by state law.

Improving local governments' access to credit markets involves four kinds of state programs and policies: (1) mandatory or optional local bond validation laws, (2) state guarantees of local debt, (3) state subsidization of local bond issues, and (4) state financial intermediaries, such as bond banks.

5. Enhancing Local Self-Help Capabilities. This policy area includes state laws that allow local governments autonomy for the collection of revenue and the administration of their own development efforts. The four program indicators are tax increment financing, local use of sales or income taxes, local redevelopment authorities, and local discretionary authority.

To be included in the report under any of the first three program indicators, a state had to have enacted a law providing for such local powers. In terms of local discretionary authority, a state qualified where local governments had some degree of revenue collection or operational autonomy.

State Monitoring Data Collection

For 14 of the 20 program indicators, data on state programs was collected directly from top agency officials. For other programs, particularly in fiscal relations and enhancing local self-help capabilities, it was necessary to rely upon secondary sources such as reviews of state legislation, census documents, or other ACIR documents.

There were 1,000 pieces of data to be collected for 1983 alone. Given that one project objective was to revalidate the data for the three previous years, the total number of data bits was 4,000. To handle this quantity of data, the project staff devised a data collection, tracking, and recordkeeping system to ensure that data were collected and not lost.

Based on past experience, several collection techniques were used:

1) an initial telephone interview to determine a program's eligibility;

2) a mail-out survey if the program qualified (State Monitoring Guide); and,

3) a duplicate of the state official's guide for staff use during the follow-up, in-depth telephone interview (Interviewer's State Monitoring Guide).

The forms were color-coded by policy area, and questionnaires were tailored to meet the needs of the nontargeted programs. (Samples are shown at the end of this appendix.)

The forms were developed based on data needs for the final report. There was a review by methodological experts which helped sharpen the questions. It was then tested before being fully implemented.

Data collection involved five steps: (1) contact phase, (2) decision phase, (3) monitoring phase, (4) data compilation and analysis, and (5) quality control.

1. Contact Phase. The objective of the contact phase was to identify the person directly responsible for program implementation. Staff started with the agency head noted in a privately published directory of state agency directors. An initial contact list was assembled with the name and telephone number of a state department or agency director for every program indicator for every state.

Telephone calls were placed to these executives to determine if they were in fact responsible for administering a distressed community program. If they were not responsible, the directors were asked for referrals to subordinates or officials in other agencies who might be responsible for the administration of certain programs. Once a state official with administrative responsibility for the program was contacted, the data collection procedure continued with the decision phase.

In many cases, the initial contact sheet listed the same state official with more than one program. In the event of overlap on the initial contact sheet, one member of the ACIR staff placed a call to the state official to determine if he or she were responsible for administering the program in the indicator, or to get referrals. Different ACIR staff members were assigned to collect data in different program indicators, but, to avoid a state administrator getting calls from several ACIR staff members, one staff member placed the initial contact call.

2. Decision Phase. In the initial call, several questions were posed to the state officials to determine whether the program qualified for the report. Once it was determined that the state operated a program fitting the indicator description, the contact was asked whether legislation had been passed empowering an agency to carry out the program. The contact was also asked whether the program was federally funded, and, if so, to what degree. The contact was asked whether the state operated any other programs fitting the indicator description. Finally, the contact was asked whether the program was specifically targeted to distress in the legislation, and, if so, how it was targeted.

3. Monitoring Phase. Each state official responsible for administering an eligible targeted program was sent a copy of the State Monitoring Guide. The official was asked to complete the guide and give the responses over the telephone to the ACIR staff member who arranged the interview. The staff member also had a copy of the guide and could transfer answers and asked for elaboration of items in the guide.

In a few cases, state administrators asked to mail back completed State Monitoring Guides. ACIR staff accommodated these requests but conducted follow-up calls if there was confusion with the results.

Items in the guide were divided into several sections: legislative data, targeting data, implementation data, and evaluation data. Legislative data included the code citation, date enacted, purpose, and recent amendments concerning the statutes which empowered the specific programs. Targeting data included the specific criteria used to direct programming to distressed persons, places, or businesses. Implementation data included 1983 funding levels and sources, funding history, and administrative arrangements. Evaluation data concerned whether the program was evaluated by another state institution or other third party, as well as statistics on program impact. State officials were given the opportunity to explain why a program was successful or not, and to suggest what other states would need to do in order to implement such a program.

4. Data Compilation and Analysis. Once contacting and monitoring were completed, the data obtained were sorted out to reveal certain kinds of trends. Staff determined common administrative arrangements, funding sources, and targeting criteria. Funding and implementation trends were identified for the years 1980 through 1983.

Particular attention was given to indentifying innovative or otherwise atypical programs. The regional distribution of programs was also determined, using Bureau of the Census regions.

In the areas of state-local fiscal relations and enhancing local self-help capabilities, staff relied more heavily on secondary data sources. Some data simply required the transcription of data from other publications. Other data required further work. Background data on housing and economic conditions from the Bureau of the Census sources required some calculation of percentages, as did data on the assumption of local public education and welfare costs by state governments. For example, the so-called 95:5 ratio of public education spending disparity among pupils in a state's public schools required calculations from raw data on expenditures by school districts provided by the National Center for Education Statistics.

Data presented in the state budget case studies section were collected directly, and are described in more detail in Appendix II.

5. Data Supplement and Follow-Up. To ensure that all the data were received and were consistent with interview data, staff requested supplementary materials, including copies of the legislation, amendments to legislation, administrative rules and regulations, annual reports, reports of examples, and evaluation reports. ACIR staff consulted state legislation files at the U.S. Department of the Treasury library when legislation was not available from state administrators. Responses to the monitoring effort were checked against these documentary sources.

Staff also conducted reviews of individual program files. These reviews revealed data gaps, which often had to be filled by follow-up interviews with state contacts. An effort was made to pursue state administrators who did not respond to initial requests for program data. Letters to these administrators requesting their mail-back of completed State Monitoring Guides were sent out, and, eventually, a second set of telephone calls was made in order to obtain program data.

The primary data collection procedure relied heavily upon the willingness of state administrators to return telephone calls, respond to questions, complete the State Monitoring Guide, and keep telephone interview appointments. Of the 1,000 pieces of data required for 1983, only 30 pieces remained outstanding by the time the report was drafted. Reducing the original nonreponse rate of about 10% to the eventual 3% required several follow-up steps.

Once the administrator responsible for a program was identified, the ACIR staff member collecting data for the respective indicator would attempt to obtain the administrator's commitment to participate throughout the entire data collection process. If initial attempts to gain cooperation failed, the project director assumed responsibility for collecting program data. If the administrator participated in the initial interview but failed somehow to provide responses to the State Monitoring Guide, then other steps were taken.

A letter from the assistant director of the Implementation Section of ACIR was sent to the state administrator. It requested the administrator to mail back the completed State Monitoring Guide, and included another copy of the guide. If the letter failed to elicit a response, the staff member attempted to contact the administrator by telephone once again. Wherever possible, state administrator requests for interview postponements, information about the project, copies of previous reports, and clarification of guide itmes were met.

Reliability and Validity

Given the large number of data bits, and the number of staff and state officials involved, there are a number of potential sources of error in the data. From the vantage point of the staff, error could occur from:

1) start-up problems,
2) incorrect interpretation of the distress or targeting criteria,
3) phrasing or rephrasing interview questions to assure understanding by the interviewee,
4) incorrect recording of data from the interviewee,
5) lack of interviewee cooperation, or
6) no response.

From the vantage point of the state official being interviewed, potential sources of error included:

1) the wrong official was identified, or the official was new and did not fully understand the problems;
2) the official did not understand the questions, forms, or purpose of the survey;
3) the need to obtain data within a limited time frame;
4) insufficient time to give full explanations; or
5) incomplete forms returned or data incorrectly included.

While these are not all the sources of error, they represent a high percentage. To compensate for them, and to increase the validity of the data collected, a number of steps were taken. First, before launching efforts to collect the data, a pilot monitoring effort was undertaken. This test involved each step of the process for each policy area for five states. Based on the test, the forms were redrafted to make the items more easily understood. The decision process was more closely tailored to the particulars of each policy area. The pilot test confirmed that most state administrators were willing to respond to the monitoring effort. It also confirmed that the contact list provided an adequate first step toward identifying administrators responsible for certain programs.

Second, a training session was conducted with project staff members. Results of the pilot test were presented. Staff members were familiarized with the State Monitoring Guide for the purpose of clarity. The staff participated also in a discussion of possible noncooperation by state administrators.

Third, external reviews of report chapters and indicator data were conducted. The National Advisory Panel was asked to comment on the accuracy of project findings and to identify any missing programs. Critics' sessions were held to review the report.

Finally, the catalogue of state programs was distributed to state and local public interest groups and was sent to each state planning director for final confirmation.

Draft State Legislation

The drafting process involved seven steps: (1) formulation of topic selection criteria, (2) ranking of potential topics, (3) topic selection, (4) research and initial bill-drafting, (5) review of specific bills by public interest groups, (6) detailed review of all draft bills by the National Advisory Panel, and (7) final drafting. In May 1983, members of the National Advisory Panel and the project's critics from public interest groups were asked to rank 78 draft legislation topics according to the prioritizing criteria outlined in Exhibit I-2. Members were asked also to consider the political feasibility of enacting such legislation and the balance among the five policy areas.

By June, after aggregating the rankings and combining some of the topics, ACIR staff began work on 18 bills. Seven would be newly drafted bills, six would be bills revised from previously drafted ACIR and Council of State Government (CSG) bills, and five would be reissued ACIR and CSG bills.

All newly drafted bills were based on enacted state legislation. Such legislation was identified in previous State and Distressed Community annual project files, in the Department of the Treasury library, through periodicals like Housing and Development Reporter, and as a part of the project's state program monitoring effort.

Newly drafted bills were subjected to multiple reviews by persons outside ACIR. Reviewers were asked to examine, in particular, the policy implications of the draft legislation and the controversial issues raised therein. Representatives of various public interest groups reviewed bills whose subject matter was particularly germane to their members' interests. For example, representatives of the Department of Commerce's Minority Business Development Administration and of the Small Business Administration reviewed the development finance agency draft bill; representatives of the AFL-CIO reviewed the employment draft bill; and representatives of the National Association of Housing and Redevelopment Officials reviewed the housing finance draft bill.

The National Advisory Panel conducted a detailed review of the draft legislation over three days during meetings held in July and November. Finally, as a result of the recommendations made by the members of the Advisory Commission on Intergovernmental Relations on December 8, 1983, each draft bill was edited to note these decisions.

Exhibit I-2

SELECTION CRITERIA FOR MODEL STATE LEGISLATION

The following list of criteria will be used to select policy area and program indicator subjects for which model state legislation will be drafted. The criteria were developed in consultation with ACIR staff, state and local public interest groups, and the project's National Advisory Panel. A bill subject that is selected must meet each of the limiting criteria. It does not, however, have to meet each one of the influencing criteria. The influencing criteria were grouped in terms of their importance, rather than weighted. Finally, the entire package of bills will be evaluated using the collective mix criteria. In determining how many bills will be drafted, one overriding criterion is the availability of ACIR staff and resources, which is being taken into consideration when the subjects are ranked on the bill list.

I. Limiting Criteria (eligibility for inclusion)

1. Must lie squarely within a policy area, embracing one or more indicators of major parts thereof.

2. Must deal primarily with issues of program content (in contrast to planning, process, or administration), except where an indicator itself is concerned mainly with organizational or fiscal responsibility, such as school finance reform.

3. Must have been enacted, or have proceeded repeatedly to advanced stages of legislative consideration, in at least one, but in no more than 15 states, except for subject areas in which much experimentation is under way or about to begin, or where policy thrusts of enactments are beginning to diverge sharply. (An exception to the "15 rule" might be considered if all or many enacting states were in a particular geographic region.)

4. Must not be dependent upon the existence or continuance of a federal assistance program.

II. Influencing Criteria (factors affecting inclusion or exclusion of subject)

The following criteria are listed in three priority groupings -- high, moderate, low. They are not listed in any priority within the groupings.

High

1. High significance in terms of (a) forging a new supportive state government role *vis a vis* local governments in heretofore neglected field, or (b) proportional fiscal relief to local communities.

2. Targeted to "really" distressed people (e.g., below poverty line or in bottom income quartile for people-oriented programs); to specifically defined distressed areas, with nondistressed areas excluded from participation; or to a distressed economic sector.

3. On the "cutting edge" of new policy directions, in contrast to having become "conventional wisdom."

Moderate

1. High leverage effect of state direct or indirect outlays or other state action upon private sector or local government activity in the subject field.

2. Required participation of private business, labor, and civic leadership.

3. Existing legislation seasoned enough to have been substantially debugged -- administratively and programmatically -- in at least one state (e.g., pitfalls identified and removed).

4. That the legislation reflect a comprehensive rather than a piecemeal approach.

5. Consensus, or large body agreement from distressed communities or other program observers, as to the degree of help or hindrance of existing programs in the particular indicator or subject field.

Low

1. Has not been disseminated in model or composite bill form (e.g., in the Council of State Government's Suggested State Legislation annual volume, ACIR, or other packages).

III. Collective Mix of Package

1. Balance between state financial assistance and other forms of state aid.

2. Balance among the five major policy areas.

3. Political feasibility balance between "cutting edge" proposals and those more widely considered.

4. Balance among respective targeting to people, place, or economic sector (businesses) and between targeted activities and those that by nature must be of statewide application such as mandate reimbursement or credit market access.

Appendix II

STATE BUDGET CASE STUDIES

Introduction

For the final report of the States and Distressed Communities project, ACIR was asked to assemble case studies on the level of state financial activity for programs targeted to distressed communities. In response, ACIR identified a sample of states and contacted state budget officers in order to assemble budgetary records of state programming targeted to distressed communities in fiscal years 1980 through 1982.

States were selected on the basis of two criteria: (1) the state's enactment of programs in at least ten of the 20 survey program indicators; and (2) a reasonable regional distribution of states. Due to resource constraints, only six states could be selected; they were California, Connecticut, Michigan, Ohio, Pennsylvania, and Alabama. Although Alabama had programs related to only eight of the 20 indicators, it had the best record of any Southeastern state, and was included to round-out the project's geographic distribution.

Each of these states' head budget officer was sent a letter explaining the purpose of the inquiry and including a list of questions concerning expenditures for state programs targeted to distress. A list of targeted programs for each state that was identified as part of ACIR's previous surveys was also included. State budget officers were asked to provide four kinds of data:

1) total expenditures for fiscal years 1980, 1981, and 1982:

    a) general expenditures, defined by the Bureau of the Census as "all expenditures of a government other than utility expenditures, liquor store expenditures, and insurance-trust expenditures;" and

    b) own-source expenditures, defined as general expenditures less intergovernmental revenues received and expended in a given fiscal year.

2) expenditures for specific targeted programs for fiscal years 1980, 1981, and 1982;
3) source of program funding and the proportion of program funding from state sources; and
4) explanations of increases or decreases in the level of funding.

Not all the data requested were submitted, and two states, Alabama and Pennsylvania, did not respond at all. None of the four states that did respond (California, Connecticut, Michigan, and Ohio) explained why expenditures for particular programs were increased or decreased. In only two of the four case studies did state officials distinguish between general expenditures and own-source expenditures. For several programs no state-level budgetary data were available, particularly for tax increment financing.

Because the programs presented here represent the efforts of ACIR staff in prior years (1980-82) to identify targeted programs and came from varying sources of data reflecting different interpretations of what is a targeted program, the list of programs presented in this appendix may differ from the 1983 catalogue of state programs.

With these limitations in mind, the following findings can be reported about the four budget case studies in addition to data collected from the Bureau of the Census:

1. The national aggregate of state revenue and expenditures increased during the 1980-82 period.

2. Federal government contributions to state revenue decreased between 1981 and 1982, although there were increases in local government contributions.

3. State government indebtedness increased during the 1980-82 period, although the total amount of debt backed by the full faith and credit of the state declined between 1981 and 1982.

4. State expenditures for potentially targeted programs like housing and capital improvements are miniscule in comparison with expenditures for education and welfare.

5. Of the four states included in the case studies, three states spent an equivalent of less than 1% of general expenditures on programs targeted to distressed communities.

6. Two states reduced funding for targeted housing assistance programs during the 1980-82 period, while one state increased funding.

7. Comparing 1980 to 1982 budgetary data, all four states increased funding for targeted economic development programs.

8. In general, the states increased funding for targeted community development programs.

9. With the exception of Michigan, no budgetary data were available for tax increment financing programs; few states collected data on this program, which is typically implemented by local authorities.

10. The reliance on certain funding sources for certain program areas varied from state to state:

    a. In housing, California shifted its reliance from bond issues to general appropriations, whereas Connecticut and Michigan relied heavily upon bond issues over the full three-year period.

    b. In economic development, Connecticut and Ohio relied more heavily upon bond issues, California and Michigan leaned more heavily upon general funds.

c. In economic and community development, California relied most heavily upon local funding sources.

More detailed data on spending for distressed community programs follows in the next three sections. The description begins with national aggregate and state-by-state data on state government finances in 1980-82. This is followed by the responses of state financial officers. Then, the final section discusses the sources of funding for programs targeted to distress.

National Aggregates of State Finances

In its annual report, State Government Finances, the Bureau of the Census provides data on state revenues and expenditures, both in the national aggregate and by state. Table II-1 provides a summary of state revenue, expendi-

Table II-1

SUMMARY OF STATE GOVERNMENT FINANCES, 1980-82
(in millions of dollars)

Revenue	Percent Annual Change 82-81	1982	Percent Annual Change 81-80	1981	1980
Total	+6.5%	$330,949	+12.2%	$310,828	$276,962
General Revenue	+6.6	275,162	+10.5	258,159	233,592
Intergovernmental Revenue	-2.3	69,166	+10.0	70,786	64,326
Federal Revenue	-2.7	66,026	+9.7	67,868	61,892
Local Revenue	+7.7	3,139	+19.9	2,918	2,434
Expenditure					
Total	+6.6	310,292	+13.1	291,527	257,812
Education	+6.0	102,984	+8.7	96,921	87,939
Public Welfare	+7.4	55,257	+16.4	51,463	44,219
Highways	-1.2	25,131	+1.6	25,439	25,044
Police	+6.7	2,730	+13.0	2,558	2,263
Sewerage	+17.1	921	+16.2	821	744
Housing	+13.0	778	+14.4	688	601
Indebtedness					
Debt at End of FY	+9.4	147,470	+10.6	134,847	121,958
Long-Term Debt	+8.4	143,702	+10.6	132,521	119,821
Long-Term Guaranteed Debt	-2.0	49,364	+6.5	51,507	52,582
Short-Term Debt	+62.0	3,768	+8.8	2,325	2,137

Source: U.S. Bureau of the Census, State Government Finances in 1982, Washington, DC: U.S. Government Printing Office, 1983, Table 1.

Table II-2

STATE EXPENDITURES, 1980-82
(in millions of dollars)

State	General Expenditures			Sewerage			Housing and Urban Development		
	1982	1981	1980	82	81	80	82	81	80
Alabama	4181	3927	3579	<1	<1	<1	<1	<1	<1
Alaska	3034	2424	1931	33	20	8	60	35	27
Arizona	2966	2841	2447	<1	<1	<1	<1	<1	<1
Arkansas	2159	2169	1993	1	1	1	1	<1	<1
California	35492	34525	29427	94	78	88	31	48	28
Colorado	3216	2981	2581	3	3	4	2	1	6
Connecticut	3498	3740	2957	12	15	7	35	42	36
Delaware	1005	933	820	3	1	1	9	4	3
Florida	8757	7807	7005	<1	<1	<1	<1	<1	<1
Georgia	5523	4979	4574	<1	<1	<1	9	8	2
Hawaii	1826	1700	1539	2	3	4	41	39	21
Idaho	1021	1001	917	6	4	3	12	9	6
Illinois	11203	11776	11045	44	39	59	16	7	7
Indiana	5148	4970	4448	16	19	19	5	4	9
Iowa	3449	3210	3107	3	3	3	1	1	<1
Kansas	2403	377	2104	<1	<1	<1	<1	<1	<1
Kentucky	4225	4295	4213	<1	<1	<1	43	23	15
Louisiana	5773	5216	4463	<1	<1	<1	<1	<1	<1
Maine	1307	1216	1143	6	8	6	<1	<1	<1
Maryland	5416	5056	4740	35	39	19	5	5	4
Massachusetts	7771	7258	6715	20	19	21	134	120	123
Michigan	11506	10993	10513	7	14	29	11	10	8
Minnesota	6385	5512	5066	17	16	10	12	22	21
Mississippi	2725	2696	2460	<1	<1	<1	<1	<1	<1
Missouri	3966	4006	3617	19	17	13	17	11	1
Montana	944	929	864	<1	<1	<1	<1	<1	<1
Nebraska	1576	1495	1341	4	3	3	1	<1	4
Nevada	1110	927	817	<1	<1	<1	2	2	2

ture, and indebtedness for the years 1980-82. This table provides an aggregate view of the level of state finances as well as state spending in several categories related to aid to distressed communities.

In Table II-1, the revenue section is divided into five parts. Total revenue is the sum of all state receipts. General revenue refers to state revenues less those collected for special funds and earnings on special accounts. Intergovernmental revenue is the sum of federal government and local government transfers to the state level. With the exception of total and federal intergovernmental revenues between 1981 and 1982, all state revenue categories increased between 1980 and 1982. Federal intergovernmental revenues fell nearly $2 billion between 1981 and 1982, reflecting reduced federal grants-in-aid to the states. The overall loss of federal revenue was compensated for by increases in revenues from local government sources.

Table II-2 (cont.)

State	General Expenditures			Sewerage			Housing and Urban Development		
	1982	1981	1980	82	81	80	82	81	80
New Hampshire	822	782	735	18	16	20	4	8	4
New Jersey	9215	8455	7288	44	36	27	26	22	14
New Mexico	2272	1936	1663	2	3	3	1	1	1
New York	25533	23261	21345	128	78	95	154	123	121
North Carolina	6180	6004	5340	38	35	26	14	6	7
North Dakota	1119	943	854	<1	<1	<1	<1	<1	<1
Ohio	10416	9890	8808	211	170	204	19	3	24
Oklahoma	3697	3321	2868	<1	<1	<1	<1	7	4
Oregon	3445	3194	2987	3	21	10	10	7	4
Pennsylvania	12353	11262	10316	23	19	20	41	53	46
Rhode Island	1402	1300	1184	8	7	6	4	3	3
South Carolina	3216	3168	2799	<1	<1	<1	3	3	2
South Dakota	794	801	712	<1	<1	<1	3	1	2
Tennessee	3813	3785	3543	<1	<1	<1	14	13	8
Texas	13189	12023	10815	<1	<1	<1	1	1	<1
Utah	1756	1696	1597	<1	<1	<1	2	3	2
Vermont	720	637	608	2	2	3	9	9	5
Virginia	5682	5566	4919	12	11	10	10	12	11
Washington	5893	5834	4856	30	24	16	6	7	4
West Virginia	2351	2342	2263	3	3	5	5	5	13
Wisconsin	6202	6093	5574	71	92	31	<1	<1	1
Wyoming	1001	865	720	<1	<1	<1	4	6	3

Source: U.S. Department of Commerce, Bureau of the Census, State Government Finance in 1980, in 1981, and in 1982 (draft), Washington, DC: U.S. Government Printing Office, 1981, 1982, 1983, respectively.

The pattern of state expenditures also reflected increases. Between 1980 and 1982, all categories of aggregate state expenditure showed increases, with the exception of highway expenditures between 1981 and 1982.

The expenditure section of Table II-1 also demonstrates the relative budgetary importance of the various expenditure categories. The largest category, by far, is for education. By comparison, state expenditures for sewerage and housing are miniscule.

The third section of Table II-1 concerns state government indebtedness, i.e., the outstanding debt at the end of the given year. All categories of indebtedness increased between 1980 and 1982, except for long-term guaranteed debt between 1981 and 1982. The increase in long-term debt accompanied by the decrease in guaranteed debt demonstrates a reduced willingness of state governments to back their debt issues with the full faith and credit of the state. The increase in nonguaranteed debt suggests an increase in industrial and mortgage revenue bonds, which are rarely guaranteed by the state. Short-term debt is shown at about 2% of total indebtedness, suggesting a reliance by state government on long-term debt issues.

Table II-2 provides individual state data on general expenditures, sewerage, and housing. General expenditures refer to state expenditures less utilities, liquor stores, and insurance trusts.

State spending for two potentially targeted program categories, sewerage and housing, increased in fewer states between 1980 and 1982 than did total general expenditures. With respect to sewerage, expenditures declined in eight states during that same period. With respect to housing and urban development, expenditures dropped in seven states between 1980 and 1981, and in nine states between 1981 and 1982. No state reported consecutive annual housing spending drops. In most states, spending for sewerage and housing represents less than one percent of general expenditures.

Funding for Programs Targeted to Distress

The data in Tables II-3 through II-7 cover state programs, in the four case study states, that were targeted to distress in three policy areas: assisted housing, economic development, and community development, plus one additional program, tax increment financing. The programs listed are those identified in The States and Distressed Communities: Annual Report 1982. The following discussion focuses on any increases or reductions in these targeted expenses, the revenue sources underpinning such state spending, and the budgetary importance of these programs.

A. California. Budgetary data on distressed community programs for the state of California are presented in Table II-3. Both general expenditures and own-source expenditures increased in California during the 1980-82 period. State spending for distressed community programs did not follow the rise in general expenditures. Spending for targeted economic development programs increased during the period, but spending for targeted housing assistance was lower in 1982 than in 1980. Insufficient data were available for targeted community development programs to identify spending trends.

In the area of targeted housing assistance, the predominant source of funding shifted from state-level bonding ($80.4 million in 1980 and $6.3 million in 1982) to general appropriations ($6.4 million in 1980 and $50.3 in 1982). Total spending for targeted housing programs declined during the period, from $86.9 million to $47.6 million to $56.6 million. The apparent reason is the phasing out of the Home Ownership Home Improvement Program for Neighborhood Preservation. This single-family housing acquisition and rehabilitation program has since been repealed. The Rental Construction Program is responsible for the modest increase in housing expenditures and is administered by the Department of Housing and Community Development. With decreases in federal government support for assisted housing, the states have had to become more self-reliant on their sources to support multifamily housing.

Major increases in spending have been reported in the area of targeted

Table II-3

CALIFORNIA STATE BUDGET CASE STUDY, 1980-82

Program Area	Item	Expenditures (in millions of dollars) 1982	1981	1980	Source General Funds	State Bonds	Local Sources
Total Spending	General Expenditures	35,655	34,614	29,455			
	Own-Source Expenditures	24,791	24,367	21,295			
Housing	HFA Single Family	6.0	4.9	3.6		x	
	Homeownership	2.2	0	0	x		
	Rural and Urban Predevelopment	4.8	3.2	3.9	x		
	Rural Land Purchase	0.1	0.9	0	x		
	Rental Construction	40.7	0	0	x		
	Farmworker Grant	2.5	2.5	2.5	x		
	Home Improvement & Preservation	0	25.7	74.7		x	
	Deferred Payment Loan	0.3	10.3	2.1		x	
	Rehabilitation Tax Incentives	<0.1	0.1	0.1			x
	Total	56.6	47.6	86.9			
	Percent Annual Change	(+18.9)	(-45.2)				
Economic Development	Worksite Education & Training	4.7	4.6	0.9	x		
	Small Business Loan Guarantee	3.1	3.5	1.3	x		
	Small Business Loan	2.4	1.3	0.9	x		
	IDFA (local revenue bonds)	1324.7	0	0			x
	Total	1334.9	9.4	3.1			
	Percent Annual Change		(+203.2)				
Community Development	Marks-Foran Rehabilitation	1.1	0	0			x
	Community Redevelopment Act	356.1	NA	NA			x
	Total	357.2	NA	NA			
	Percent Annual Change	NA	NA				

Source: ACIR survey.

economic development. Whereas state level expenditures did not increase dramatically over the three-year period, economic development expenditures were buoyed by a state law permitting local authorities to issue their own industrial development bonds. Excluding local bonding, economic development expenditures constitute less than 0.1% of California's own-source expenditures. Also in the area of targeted community development programs, California relies heavily upon local incentives. In particular, California's Community Redevelopment Act allows local governments to extend tax incentives for a wide range of activities.

B. Connecticut. The state of Connecticut did not provide a breakdown between general and own-source expenditures. The general expenditure figures that were provided show an increase in total state spending over the 1980-82 period. Over the same period, Connecticut first decreased then increased its spending on targeted housing, increased then decreased its spending for targeted economic development, and increased its community development spending. No state data were available on tax increment financing, since the power to implement such a program belongs to local governments.

With the exception of housing rehabilitation tax incentives provided by local governments, all of Connecticut's housing programs were financed through the issuance of bonds. The single largest assisted housing program in Connecticut was a single-family mortgage subsidy program administered by the Housing Finance Agency. That agency also administered the multifamily housing program, the second largest program. Reflecting a drop in bonding for the single family program in 1981, Connecticut's spending on targeted housing programs declined from $192.9 million in 1980 to $125.9 million in 1981. Total spending for targeted housing programs increased to $234.9 million by 1982.

Most of the state's targeted economic development programs were financed by general appropriations, although the two largest programs were bond financed: industrial development grants and the self-sustaining industrial revenue bond fund. Connecticut increased its targeted economic development spending between 1980 and 1981, from $99.3 to $173.0 million, but then, due to a drop in the self-sustaining IRB program, declined to $130.7 million in 1982.

Connecticut has the oldest enterprise zone law in the country, but as of 1982, no expenditure had been made. Although a much smaller spending category than housing or economic development, community development spending increased significantly over the three-year period. The source of funding reported for both of these community development programs was bond financing.

Connecticut's spending for distressed community programs represents a sizable portion of state general expenditures (although several of the programs are financed off-budget by independent public finance corporations which issue bonds).* Connecticut's ratio of general expenditures to distressed

*General expenditures represent on-budget funding or funds appropriated by the state legislature. Off-budget funding refers to financial items which the state legislature does not consider as part of its budget, such as monies raised by the issuance of bonds by state agencies or quasi-public finance corporations.

Table II-4

CONNECTICUT STATE BUDGET CASE STUDY, 1980-82

Program Area	Item	Expenditures (in million of dollars) 1982	1981	1980	Source General Funds	State Bonds	Local Source
Total Spending	General Expenditures	2969	2739	2401			
Housing	HFA Single Family	166.7	62.2	123.1		x	
	Downpayment Loan	3.1	1.8	1.7		x	
	HFA Multifamily	52.5	42.8	55.8		x	
	Elderly Rental	6.9	13.1	6.7		x	
	Congregate Housing	0.8	<0.1	<0.1		x	
	Moderate Rehabilitation	2.5	4.0	5.0		x	
	Housing Development Corporations	0.3	0.4	0.2		x	
	Site Development	1.4	1.4	0.4		x	
	Neighborhood Rehab. Grants	0.7	0.2	0		x	
	Rehabilitation Tax Incentives	NA	NA	NA			x
	Total	234.9	125.9	192.9			
	Percent Annual Change	(+86.6)	(-34.7)				
Economic Development	Industrial Development Grants	4.1	8.4	6.2			
	Urban Jobs	0.5	0.5	0.8			
	Enterprise Zones	0	0	0			
	Customized Job Training	0.7	0.6	0.8			
	Small Business Centers	<0.1	<0.1	<0.1			
	Self-Sustaining IRB	125.4	163.5	90.6			
	Total	130.7	173.0	99.3			
	Percent Annual Change	(-24.5)	(+74.2)				
Community Development	Urban Action Grant	2.7	0.6	0.2		x	
	Neighborhood Housing Services	0	0	0.1		x	
	Total	2.7	0.6	0.3			
	Percent Annual Change	(+350.0)	(+100.0)				
Other	Tax Increment Financing	NA	NA	NA			x

Source: ACIR survey.

program expenditures is less than 10:1. Connecticut's spending record diverges from most of those reported in Table II-2, where potentially targeted programs constitute only a tiny part of state expenditures and economic development programs are not even listed in Census reports.

C. Michigan. Michigan's state finances have experienced severe stress in the past three years. Own-source expenditures declined between 1980 and 1981, and 1982 expenditures remained below the 1980 figure. General expenditures, however, increased over the period due in part to the impact of the recession. During 1980-82, Michigan decreased its spending for targeted housing programs, and increased its targeted economic development and tax increment financing expenditures. The state's targeted community development program expenditures were too low to be effectively included in the profile.

In the area of targeted housing assistance programs, Michigan's State Housing Development Authority relied heavily upon bond financing for program resources. Targeted housing expenditures declined by nearly 40% over the three-year period. Between 1980 and 1981, targeted housing expenditures decreased from $292.4 million to $175.2 million, and slid to $95 million by 1982.

Michigan's targeted economic development programs experienced modest increases during the three-year period. Largely financed by state general funds, economic development spending increased from $17.7 million in 1980, to $22.9 million in 1981, and to $25.0 million in 1982. The MEDIC program (Michigan Economic Development Investment Corporation) was phased out over the three-year period and has now been terminated. The increase in the state's targeted economic spending can be linked to increased expenditures for the Community Redevelopment District/Plant Business Development Program.

Michigan was the only state of the four that reported tax increment financing figures, and recorded a significant increase in spending for this purpose. However, such spending still represented less than 1% of state general expenditures.

D. Ohio. General expenditures in Ohio were estimated by the Bureau of the Census as $3.58 billion in 1980, $3.93 billion in 1981, and $4.18 billion in 1982 (see Table II-2). Own-source expenditure data were not available.

In the housing area (Table II-6), the Ohio Housing Finance Agency had not yet become operational by 1982. The Community Reinvestment Act provided powers to local housing authorities for the extension of tax incentives for development activities.

Ohio's targeted economic development spending (Table II-6) increased significantly over the three-year period, from $63.1 million in 1980, to $107.4 million in 1981, and $184.4 million in 1982. The largest economic development item noted is the industrial revenue bond program, expenditures for which increased each year between 1980 and 1982. All other targeted economic development programs were financed through the state's general fund. The Ohio Economic Development Finance Authority's programs account for the overall spending increase in the economic development area.

Disaggregated data were not available for the two targeted community de-

Table II-5

MICHIGAN STATE BUDGET CASE STUDY, 1980-82

Program		Expenditures (in millions of dollars)			Source		
Area	Item	1982	1981	1980	General Funds	State Bonds	Local Sources
Total Spending	General Expenditures	10,288.0	10,087.8	9,918.7			
	Own-Source Expenditures	7,198.8	7,003.4	7,213.9			
Housing	HFA Single Family	25.0	0	80.0		x	
	HFA Section 8	40.0	153.9	208.2		x	
	Home Neighborhood Improvement*	30.0	21.3	4.7	x	x	
	Total	95.0	175.2	292.4			
	Percent Annual Change	(-45.8)	(-40.0)				
Economic Development	Urban Land Assembly	1.9	0	0	x		
	Community Redevelopment and Plant Business Development	24.1	21.5	16.1	x		
	Small Business Development	0.3	0.3	0.3	x		
	IRB (job authority)	0.5	0.3	0.6		x	
	MEDIC	0.1	0.8	0.7	x		
	Total	25.0	22.9	17.7			
	Percent Annual Change	(+9.2)	(+29.4)				
Community Development	Neighborhood Assistance	<0.1	0	0	x		
	Total	<0.1	0	0			
	Percent Annual Change						
Other	TIF: Downtown Development	2.1	0.1	0			x
	TIF: Authority Act	<0.1	0	0			x
	Total	2.1	0.1	0			
	Percent Annual Change	(+2000.0)					

*This program has two different funding sources depending upon who receives the funds.

Table II-6

OHIO STATE BUDGET CASE STUDY, 1980-82

		Expenditures (in millions of dollars)			Source		
Program Area	Item	1982	1981	1980	General Funds	State Bonds	Local Sources
Total Spending	General Expenditures*	4,181	3,927	3,579			
	Own-Source Expenditures	NA	NA	NA			
Housing	HFA Program	0	0	0		x	
	Community Reinvestment Act	NA	NA	NA			x
	Total	NA	NA	NA			
	Percent Annual Change						
Economic Development	IRBs	92.3	83.2	59.7		x	
	DFC Direct Loans	6.6	11.8	2.6	x		
	DFC Loan Guarantee	0	9.3	0	x		
	DFC Minority Business	0.4	0.3	0	x		
	EDFA Direct Loans	53.8	2.1	0	x		
	EDFA Loan Guarantee	28.3	0	0	x		
	DOC Training	2.0	0	0	x		
	Technology Transfer	0.5	0.2	0.3	x		
	Urban University Job Training	0.5	0.5	0.5	x		
	Total	184.4	107.4	63.1			
	Percent Annual Change	(+71.7)	(+70.2)				
Community Development	Safe Water Program	($209 1980-82)				x	
	Water Development (local gov't.)	($605.5 1975-82)				x	
	Total	NA	NA	NA			
	Percent Annual Change	NA	NA				
Other	Tax Increment Financing	NA	NA	NA			x
	Urban Resources Corporation	NA	NA	NA			x
	Total						
	Percent Annual Change	NA	NA	NA			

*Bureau of the Census.

Table II-7

STATE-LEVEL EXPENDITURES BY TARGETED PROGRAM AREA AND SOURCE, 1980-82

(in millions of dollars)

Program Area	State	1982	1981	1980
		GENERAL FUNDS		
Housing	California	50.3	6.6	6.4
	Connecticut	0	0	0
	Michigan	0	1.3	4.2
	Ohio	0	0	0
Economic Development	California	10.2	9.4	3.1
	Connecticut	1.2	1.1	1.6
	Michigan	17.1	22.6	26.4
	Ohio	92.1	24.2	3.4
Community Development	California	0	0	0
	Connecticut	0	0	0
	Michigan	<0.1	0	0
	Ohio	NA	NA	NA
		STATE-LEVEL BOND ISSUES		
Housing	California	6.3	40.9	80.4
	Connecticut	234.9	125.9	192.9
	Michigan	95.0	173.9	288.2
	Ohio	0	0	0
Economic Development	California	0	0	0
	Connecticut	129.5	171.9	97.1
	Michigan	0.5	0.3	0.6
	Ohio	92.3	83.2	59.7
Community Development	California	0	0	0
	Connecticut	2.7	0.6	0.3
	Michigan	0	0	0
	Ohio	NA	NA	NA
		LOCAL SOURCES		
Housing	California	<0.1	0.1	0.1
	Connecticut	NA	NA	NA
	Michigan	0	0	0
	Ohio	NA	NA	NA
Economic Development	California	1,324.7	0	0
	Connecticut	0	0	0
	Michigan	0	0	0
	Ohio	0	0	0
Community Development	California	357.2	NA	NA
	Connecticut	0	0	0
	Michigan	0	0	0
	Ohio	0	0	0
Tax Increment Financing	California	NA	NA	NA
	Connecticut	NA	NA	NA
	Michigan	2.1	0.1	0
	Ohio	NA	NA	NA

Source: ACIR survey.

velopment programs included in Table II-6. Data were available for the three-year period for the Safe Water Program, but only aggregate data for the years 1975-82 were available for the Water Development Program. Both programs provided funds for the construction of water treatment facilities. Two tax increment financing programs were identified although no data were not available.

Summary

The spending records for the four case studies are mixed. Some states increased distressed community spending, whereas others reduced it. Connecticut spent a sizable portion of its total state expenditures on programs targeted to distress, while the other states dedicated only a small portion of total expenditures to aid distressed communities.

Reliance upon general funds, bond issues, or local sources varies between states as well. Table II-7 summarizes the amount of targeted program funding from these sources. The table covers the programs included in the four case studies and provides a breakdown of targeted program funding by source, state, and program area. California provides the only example, among these cases, of a state that shifted its reliance from one source of funds to another over the 1980-82 period. In targeted housing programs, California shifted its reliance from bond issues to general appropriations. In the economic and community development areas, California increased its reliance upon local sources.

In the area of housing, with the exception of California, the states with targeted housing programs depended upon bond issues for program finance. In the area of economic development, the California, Michigan, and Ohio legislatures, respectively, have appropriated more general funds than state agencies have raised in bond issues. Connecticut relied more heavily upon bond issues than general appropriations for economic development funding. So few community development programs were reported that it is not practical to identify spending source trends.

With the exception of Michigan, there were no budgetary data available on tax increment financing. This made identification of any trends in this area impossible.

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