

A STAFF REPORT

**Local Revenue
Diversification**

**Rural
Economies**



**Advisory Commission on
Intergovernmental Relations**

SR-13
March 1990

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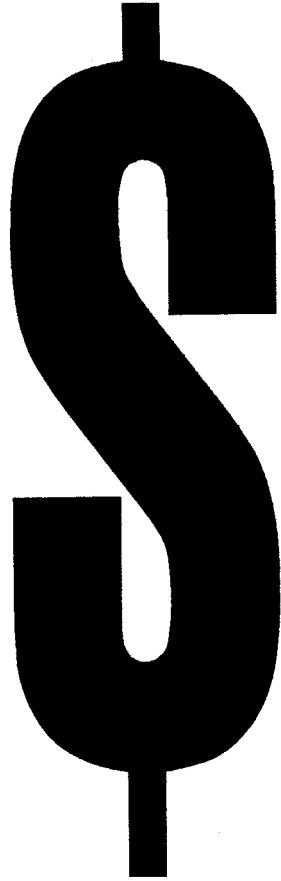
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A STAFF REPORT

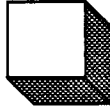
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Introductory Notes

This study is one of a series done by staff and consultants of the Advisory Commission on Intergovernmental Relations on ways in which local governments can lessen their reliance on property taxes by diversifying their revenue bases.

For many years, the local property tax has been the fiscal mainstay of local governments, and it remains their major revenue source. Its dominant role has been due to its many virtues as a revenue raiser: for local governments it is easily enforced because a tax on land and buildings is virtually impossible to evade or avoid; it is capable of generating large amounts of revenue; rates are easily adjusted; and its ad valorem character makes it the only tax presently employed in the United States that taxes unrealized capital gains. While this last characteristic is popular with tax administrators, it makes the levy unpopular with those who must pay the property tax, and it can create a serious burden for the elderly and low-income homeowners and farmers.

Given the acknowledged strengths of the property tax as a revenue raiser, why should local governments wish to resort to other types of taxes? One of the most important reasons is that the inflation of the late 1970s emphasized a major shortcoming of the property tax. Because it taps unrealized capital gains, it is capriciously related to the flow of cash into taxpayers' pockets. As inflation sharply increased land values, property tax bills increased, and taxpayers became increasingly irate and fearful that steadily rising property taxes would force them to sell their homes. The passage of Proposition 13 in California in 1978 marked the most dramatic effort to shield homeowners by capping property taxes.

Another reason for diversifying revenue sources is to gain added protection over the course of the economic cycle. At times when property tax revenues lag, they can usually be supplemented by revenues from the more elastic local income and sales taxes. When local income and sales tax receipts reflect drops in economic activity, the much more stable property tax provides a reliable stream of revenues.

The basic political and economic reasons for diversification of local tax systems lie in the fact that there is no such thing as a perfect tax. Each major tax has unique strengths and weaknesses. The more intensively any tax is used, the more obvious its defects become and the less obvious its virtues. For example, the property tax scores high marks for the reasons cited above: ease of enforcement, fine tuning, and the ability to tax unrealized capital gains. However, when the tax on real property is raised too high, it is widely perceived as a threat to home ownership and a deterrent to certain types of capital intensive business development. In the same way, the local sales tax has the advantage of being convenient, usually paid out in small increments, difficult to avoid, and levied on consumption rather than savings: however, it also is widely perceived as being regressive and as creating an unfavorable business climate. Personal income taxes can be designed to make allowances for individual circumstances of the taxpayer, and they are not regressive, but the automatic response of the tax to inflation has created wide public resentment. A local income or wage tax also may cause taxpayers to move out of the jurisdiction and thus avoid the jurisdictional reach of local government. User charges have the advantage of providing a direct way to link private benefits to public costs incurred; however, too heavy a reliance on user charges can hurt low- and moderate-income families.

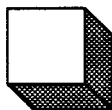
The lesson is clear; an efficient and equitable local revenue system should rely on a well-balanced and diversified set of taxes. In addition to avoiding the problems created by excessive reliance on any single tax, a balanced and diversified revenue system may create a more favorable business climate, lessen taxpayer discontent, and provide for stability of revenue throughout the course of the business cycle.

This final report in the series focuses on the challenges and implications of local revenue diversification for rural local governments rather than on a specific revenue source. The introduction was written by Richard J. Reeder, an economist at the U.S. Department of Agriculture's Economic Research Service. The authors of the three sections of the report are: Larry DeBoer of the Department of Agricultural Economics at Purdue University; Susan A. MacManus, professor of Public Administration and Political Science at the University of South Florida; and Thomas F. Stinson, professor in the Department of Agricultural and Applied Economics, University of Minnesota.

Former ACIR Executive Director John Shannon was responsible for the initiation of this series of Staff Research Reports. Former Senior Analyst Susannah E. Calkins took major responsibility for directing the earlier studies. Carol Cohen coordinated this report.

John Kincaid
Executive Director

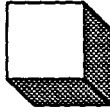
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Introduction

Richard J. Reeder

Revenue diversification is often suggested as a way to improve the stability, equity, and efficiency of state and local revenue systems. The recent form of New Federalism, characterized by the decline of federal aid in the 1980s, led to increased efforts to raise government revenues from state and local sources. Because property taxes have been relatively unpopular in the 1970s and 1980s, much of the new revenue has come from nonproperty sources. As a result, local government revenues have become more diversified and reliance on property taxes has declined.

Other reports in this series have examined specific types of nonproperty revenues—user charges and local sales and income taxes. This report singles out a specific type of government—rural local government—because of the unique challenges it faces in diversifying revenue sources. For a variety of reasons, rural governments (including nonmetropolitan counties, small towns and townships, and rural school districts and special districts) have been under great pressure to come up with new nonproperty revenues. However, rural governments also face formidable barriers to revenue diversification—both statutory and economic. Although they have managed to reduce their reliance on property taxes, highly rural areas (counties with less than 2,500 urban residents) still collect almost 60 percent of their own-source general revenues from property taxes. In contrast, the average metropolitan county has reduced its reliance on property taxes to under 50 percent.¹

A variety of factors might explain this relative lack of revenue diversification in rural areas. For one, rural governments are small, and they lack the staff and leadership required to adopt and administer creative financing approaches used by urban governments. Rural governments also tend to provide fewer services than do urban governments, restricting their opportunities to apply user charges. Rural residents tend to have relatively low incomes, reducing the potential revenues raised by nonproperty taxes (such as income and sales taxes) and user charges. Rural retail sectors tend to be weak or nonexistent, reducing their potential for collecting sales taxes. Some state governments legally restrict local option nonproperty taxes to the larger urban governments.

Despite these obstacles, revenue diversification has been cited as a means for solving the fiscal problems plaguing many rural areas today. Specifically,

revenue diversification has been sought to meet three fiscal needs of rural government in the 1980s: (1) the need for revenues to help offset stagnant or declining property taxes due to recent rural economic difficulties; (2) the need for revenues to offset declining federal aid and increasing federal and state mandates; and (3) the need to restructure rural revenue systems to encourage rural development.

Rural Economic Difficulties

Rural America experienced three distinct economic difficulties during the 1980s. First came the recession of 1981-82. This affected rural America more than urban America, where cities are more service oriented and less manufacturing oriented than in previous years. By 1982, the unemployment rate for nonmetropolitan areas was almost 2 percent higher than that for metropolitan areas. This gap increased for several years, as the economic recovery was relatively slow for nonmetropolitan America. After the recession, there was the farm financial crisis of the mid-1980s, characterized by declines in farmland values, farm income, and population. The last economic crisis to hit rural America in the 1980s was the energy industry slump, which reached its low point in 1986-87.

Rural local governments were affected in several ways. First, the decline in property tax base associated with manufacturing cutbacks and closings, farm bankruptcies, and the energy bust has been significant, forcing local governments to increase property tax rates just to maintain current levels of service. Second, the rural people affected directly by these problems required special assistance, such as job training, welfare, counseling, and housing assistance. Cutbacks in other areas of local government spending, such as education and highways, or further increases in property tax rates may have been required to meet these special public service needs. Third, many of the affected individuals have moved to find better jobs elsewhere, leaving a smaller number of taxpayers to support the "fixed costs" associated with local government. This has resulted in closings of some public facilities, such as rural schools and hospitals, and/or even higher tax rates on remaining residents.

Although taxpayers facing these pressures might be thought of as unlikely supporters of new taxes or user charges, they may have no viable alternatives. For example, if a local school district has reached its statutory limit on property taxes and additional revenues are required to avoid closing schools, revenue diversification may be the only solution. Economic difficulty also might make revenue diversification more appealing to local residents if it involves a more equitable distribution of the tax burden (such as a local income tax) or the export of taxes to nonresidents (such as sales and amusement taxes paid mainly by tourists).

Fiscal Decentralization

The 1980s has been a period of increasing fiscal decentralization, as federal aid has declined and state and local governments have had to fill in the

gap. While most states have increased state aid to local governments, only a few have made a serious attempt to replace all lost federal dollars. Most rural states have had difficulty maintaining current levels of state aid, given the state budget difficulties they have incurred as a result of rural economic difficulties.²

Many local governments view revenue diversification as a way to help replace lost federal aid dollars associated with the termination of General Revenue Sharing and reductions in some other federal aid programs.³ Non-property taxes also can be used to pay for federal and state mandates, which local officials often say is their most important problem.⁴ The fiscal impacts of these mandates, such as the new EPA water standards, often are greatest for small, rural governments that lack the tax base and the management capacity to deal with them effectively.⁵

Rural Economic Development

Economic development is the foremost objective in the minds of many rural policymakers. By helping rural governments meet their short-term fiscal needs during times of acute economic and intergovernmental fiscal difficulty, revenue diversification makes it easier to maintain current levels of government services and infrastructure without incurring excessively high property tax rates. This should help improve the overall rural development outlook because these characteristics are important for retaining or attracting firms into the area.

Revenue diversification may also be looked on as a way of promoting economic diversification. It would do this by reducing reliance on "use value" property taxes, which favor agriculture and natural resource property over other forms of economic activity. This might have a positive effect on rural economic development over the long run because it should encourage development of nonfarm, non-natural resource industries that would partially offset farming, timber, mining, and energy, industries that are currently subject to global fluctuations.

For those areas that are currently experiencing rapid growth, revenue diversification is sought as a way to assure that sufficient revenues exist to finance the growing needs for infrastructure and public services in these places. Rural governments in rapidly growing areas may find that their relatively inelastic property tax bases are insufficient to keep up with growing demands for public services. Revenue diversification approaches, such as the use of impact fees that relieve the fiscal burden of development for existing residents, fills the revenue gap for these booming areas while reducing the friction between new and old residents that otherwise might stave off further economic growth.

Potential Problems with Rural Revenue Diversification

Revenue diversification ought not to be looked on as a total solution to rural government problems. Moreover, there are disadvantages as well as

advantages to rural revenue diversification. For example, revenue diversification is likely to be more productive in rural areas with higher incomes or in rural areas which serve as regional marketing or tourist centers than in rural areas without these characteristics. Thus, for some of the places that need it the most, revenue diversification may not help much. Revenue diversification also may reduce revenue stability for some places with fairly stable property tax revenues and fluctuating incomes and sales, such as manufacturing and retail centers.

Perhaps the most problematic aspect of revenue diversification for federal or state policymakers is that it might increase fiscal disparities among communities. For example, if a state requires that all local governments cut property tax rates and shift to sales taxes, this might actually increase the fiscal disparities between rich and poor communities.⁶ Policymakers should recognize the long-term implications of such shifts and consider making changes in state and federal aid formulas to offset any undesirable aspects of revenue diversification policies.

About This Report

To provide more detailed information about the challenges facing rural governments in their efforts to diversify their revenue systems, three papers were commissioned for this report. The first, by Larry DeBoer, focuses on the fiscal impact of farm economic problems on rural governments in the Midwest. Declining farmland values have put strains on local property taxes in farming areas. But, due to interstate differences in assessment practices, the fiscal effects of the farm recession of the 1980s are not as simple and obvious as some might think. A key issue is the extent to which such problems encourage tax diversification (especially local option sales and income taxes) among farm-dependent rural governments. Another key issue concerns the effect of state restrictions on local tax diversification. Both issues are addressed in this paper.

The second paper, by Susan A. MacManus, examines the different situation facing rural counties and municipalities in Florida. The problem for Florida's high-growth rural areas is much the same as in high-growth areas elsewhere in the country: how to finance public service needs for rapidly growing populations. The new state "growth management" act requires pay-as-you-go financing to accommodate the growth. However, local governments' ability to raise nonproperty taxes is severely restricted by state law. Despite these restrictions, such places have had some success diversifying, resorting to unconventional revenue sources, such as impact fees. Slow-growth rural areas in Florida have been less successful in diversifying their revenue systems, although they suffer from generally higher property tax rates and greater economic difficulty in general. MacManus' paper points out the challenge of dealing with these different situations of high- and low-growth areas.

Whereas the first two papers tend to be regional, empirical, and emphasize the advantages of revenue diversification, the last paper, by Thomas F.

Stinson, provides a more general, theoretical assessment, emphasizing the potential problems associated with rural tax diversification. Stinson notes that revenue diversification can add to interjurisdictional inequity because sales taxes benefit a few communities (such as regional retail trade centers) at the expense of the many communities with weak retail sectors. Tax diversification can also decrease revenue stability for many rural communities. Over the long run, these and other disadvantages could result in undesirable and inefficient reallocation of resources among revenue diversification's winners and losers. Stinson concludes that "balancing equity and efficiency considerations across all communities may require additional state aid for certain types of communities."

Taken together, these papers constitute an important first step toward providing policymakers with the kind of information needed to assess revenue diversification's potential in rural America. It is hoped that this report will stimulate interest in this topic, and that additional research will add to this knowledge base as more data become available.

Endnotes

¹ Richard J. Reeder, *Rural and Urban Government Fiscal Trends, 1977-82* (Washington, DC: U.S. Department of Agriculture, Economic Research Service, May 1988). ERS Staff Report No. AGES880210.

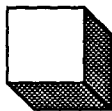
² Michael Lawson, "The Impact of the Farm Recession on Local Governments," *Intergovernmental Perspective* 12 (Summer 1986): 17-23.

³ Philip A. Russo, Jr., Douglas H. Shumavon, H. Kenneth Hibbeln, and Frank McKenna, Jr., *Local Response to Federal Budget Policies: A Study of Nonmetropolitan Communities in Ohio* (Washington, DC: U.S. Department of Agriculture, Economic Research Service, June 1989). ERS Staff Report No. AGES 89 24.

⁴ Richard J. Reeder, "Rural Governments Facing New Fiscal Strains," *Choices* (Fourth Quarter 1987): 26 27. See also Barbara P. Greene, "Counties and the Fiscal Challenges of the 1980s," *Intergovernmental Perspective* 13 (Winter 1987): 14-19.

⁵ See *The Municipal Sector Study: Impacts of Environmental Regulations on Municipalities* (Washington, DC: U.S. Environmental Protection Agency, Office of Policy and Evaluation, September 1988). EPA 230 0988 038.

⁶ See "The Local Sales Tax Base: The Haves and the Have Nots" (Nashville: Tennessee Department of Revenue, April 21, 1989).



Local Government Tax Diversification and Agricultural Recession in the North Central States

Larry DeBoer

Introduction

The agricultural recession of the first half of the 1980s caused fiscal stress for many rural local governments. The severe decline in real estate values was a particular problem. The value of real estate, ultimately, is the base of the property tax, which is still the primary revenue source of local governments. Farm real estate is a large part of this tax base in many rural jurisdictions. The large decline in this tax base, with no recovery expected, could be a source of continuing problems for rural local government finance.

If the property tax is to be permanently less productive, rural local governments may attempt to diversify their tax sources to maintain revenues and services. The agricultural recession may be an incentive to diversify. Further, those local governments that had adopted significant nonproperty taxes by the beginning of the recession may have fared better than nondiversified governments. Diversification may ameliorate the agricultural recession's impact on rural governments.

At first glance, it seems obvious that rapid declines in rural real estate values would reduce property tax revenues. This is not necessarily true, however: the impact of property value declines depends on state-imposed assessment methods, tax rate and levy controls, property tax delinquency, and changes in nonfarm values. Under some conditions, the drop in farmland values may not affect revenues at all. The incentive to diversify, and the need to diversify, will depend in part on the impact of the farm recession on property tax revenues.

The ability of local governments to diversify tax sources also depends on what state governments allow. Some states provide sales or income tax options to rural local governments; others do not. And diversification may or may not be a solution to rural fiscal stress. Nonproperty tax sources also may be vulnerable to farm economic declines.

This section will examine the impact of the farm recession on rural local government revenue in the north central region. The north central states are

chosen for analysis because they were most severely affected by the agricultural recession. The impact of farm real estate declines on the property tax will be examined to determine the extent of the problem and the potential for tax diversification to maintain revenues. The extent of use of nonproperty tax sources by rural local governments is discussed, along with the promise and pitfalls diversification offers as a solution to rural fiscal stress.

Assessment of Farmland

American agriculture experienced a severe recession in the first half of the 1980s. Farm exports declined, high real interest rates increased the cost of farm debt, and farm commodity prices, incomes, and real estate values fell. The 12 north central states were particularly hard hit. Farm incomes in these grain producing states fell radically in three of four years between 1979 and 1983, and did not regain the 1979 peak until 1986 (see Table 1). Land and building market values nationwide peaked in 1981, and fell each year through 1987, by a total of 35 percent. Farm real estate market values fell even further in the north central region. In Illinois, Indiana, Nebraska, and Ohio, values fell more than 40 percent between 1981 and 1986, and in Iowa and Minnesota, farm real estate lost more than half of its value (see Table 2).

Table 1
Farm Income and Real Estate Values, 1970-87

| | Farm Income North Central States (millions) | Percent Change | Farmland and Building Value Index, 48 States (1977 = 100) | Percent Change |
|------|---|-------------------|---|-------------------|
| 1970 | 7,181 | -3.2 | 42 | 5.0 |
| 1971 | 7,693 | 7.1 | 43 | 2.4 |
| 1972 | 9,510 | 23.6 | 47 | 9.3 |
| 1973 | 17,500 | 84.0 | 53 | 12.8 |
| 1974 | 12,842 | -26.6 | 66 | 24.5 |
| 1975 | 13,480 | 5.0 | 75 | 13.6 |
| 1976 | 9,189 | -31.8 | 86 | 14.7 |
| 1977 | 10,886 | 18.5 | 100 | 16.3 |
| 1978 | 13,429 | 23.4 | 109 | 9.0 |
| 1979 | 15,910 | 18.5 | 125 | 14.7 |
| 1980 | 10,432 | -34.4 | 145 | 16.0 |
| 1981 | 15,331 | 47.0 | 158 | 9.0 |
| 1982 | 11,082 | -27.7 | 157 | -0.6 |
| 1983 | 2,917 | -73.7 | 148 | -5.7 |
| 1984 | 12,350 | 323.4 | 146 | -1.4 |
| 1985 | 14,212 | 15.1 | 128 | -12.3 |
| 1986 | 16,602 | 16.8 | 112 | -12.5 |
| 1987 | 17,817 | 7.3 | 103 | -8.0 |

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, *State Personal Income: 1929-82* (Washington, DC: Census, 1984); *Survey of Current Business*, August 1985 and August 1988; U.S. Department of Agriculture, *Agricultural Statistics 1987 and 1985* (Washington, DC: Agriculture, 1987, 1985).

Table 2
Average Value of Farmland and Buildings Per Acre
North Central States, 1981 and 1986
 (dollars)

| State | 1981 | 1986 | Percent Change |
|--------------|-------|-------|----------------|
| Illinois | 2,133 | 1,143 | -46.4 |
| Indiana | 1,972 | 1,058 | -46.3 |
| Iowa | 1,941 | 841 | -56.7 |
| Kansas | 590 | 387 | -34.4 |
| Michigan | 1,232 | 936 | -24.0 |
| Minnesota | 1,231 | 609 | -50.5 |
| Missouri | 941 | 606 | -35.6 |
| Nebraska | 660 | 364 | -44.8 |
| North Dakota | 423 | 317 | -25.1 |
| Ohio | 1,727 | 1,013 | -41.3 |
| South Dakota | 290 | 215 | -25.9 |
| Wisconsin | 1,105 | 711 | -35.7 |

Source: U.S. Department of Agriculture, *Agricultural Statistics 1987 and 1984* (Washington, DC: Agriculture, 1987 and 1984).

These large declines in farm market values might be expected to spur efforts to diversify local tax bases to replace lost property tax revenue. But declining market values do not necessarily imply declining revenue. While the base of the property tax is, ultimately, the market value of real estate, the tax rates are applied to the assessed value of property.

The relationship between farmland assessed value and market value depends on the features of a state's assessment system. Farmland assessed values may diverge from market value if reassessments or changes in equalization rates are infrequent, or if local assessors are not required to be accurate. Infrequent reassessment means that assessed values will reflect "old" market values. If the assessment cycle is long enough, an entire rise and decline of land values could be missed. Local assessors may not have the expertise, experience, or incentive to maintain farmland assessed values at near market value.

In many states, agricultural land is not assessed at its market value, but rather at its "use value." Use value assessment was designed originally to protect farmers on the urban fringe from increases in property assessments due to their land's development potential. By the 1970s, use value assessment became a way to provide property tax relief to all farmers.¹ Assessment ratios reflect the preferential treatment of farmland. Nationwide in 1981, all property was assessed on average at 40 percent of market value; farm acreage was assessed at 24 percent of market value.²

Many states use the income capitalization method of use value assessment, which sets the use value of land as a function of the net income return to land, a discount or interest rate, and the property tax rate:

$$\text{Use Value} = \frac{\text{net return}}{\text{interest rate} + \text{property tax rate}}$$

Use value will be sensitive to variations in farm profitability and interest rates, as well as local tax effort. Lags in the collection of income and interest rate data will affect the response of use value to current conditions. Many states use long-term averages of income and interest rates to lessen year-to-year fluctuations in use value. A few states base use value on the crop or livestock productivity of land, which should lessen the variability of assessed values. As with market value assessment, the frequency of reassessment or use value updating is important.

The impact of use value assessment on the stability of the rural property tax base in the face of large increases and decreases in farmland market values is not obvious. Some analysts have expressed concern that use value assessment will reduce the stability of the property tax base; others argue that stability will be enhanced.³

A comparison of actual assessed value to simulated use value assessments for Lafayette County, Missouri, between 1974 and 1983 shows much greater variation using use value assessment. Annual changes in assessed value averaged plus or minus 5 percent per year, compared to the less than 1 percent per year variation in actual assessed values. On the other hand, a change in 1981 from market value assessment to use value assessment in North Dakota is barely perceptible. Between 1975 and 1980, with market value assessment, the actual market value of farmland rose 59 percent and assessed value rose 13 percent. Between 1981 and 1987, under use value assessment, market value fell 42 percent, and assessed value fell 4 percent.⁴

Rural Assessed Values during the 1980s

Rural assessed values have not fallen substantially in response to the farmland value decline in many north central states, but experiences have varied widely. Table 3 shows the changes in total gross assessed value for the 12 north central states between 1981 and 1986. In each state, total assessed value increased, from a small increase in Kansas to very large increases in Missouri and Wisconsin due to statewide reassessments. Changes in assessed value are also presented for big counties (populations over 100,000) and small counties (populations less than 100,000). In 8 of 11 states, assessed value grew more in the big counties than in the small counties (North Dakota had no "big" counties). Yet, only in Illinois and Kansas did small-county assessments actually fall.

Of course, many of these "small counties" cannot be considered rural. To measure the impact of the farmland value decline on the rural property tax base more closely, the changes in assessed values of "farm-dependent" counties were summed. Farm-dependent counties are defined as those where 20

Table 3
Changes in Gross Assessed Value, North Central States, 1981-86

| | <u>Percent Change In Assessed Value</u> | | | | <u>Number of Farm Counties with: Increased Assessed Value</u> | |
|--------------|---|------------------------------|--------------------------------|-------------------------------|---|--------------------------------|
| | Total State | Big Counties ^a | Small Counties ^a | Farm Counties ^b | Increased Assessed Value | Decreased Assessed Value |
| Illinois | 9.3 | 13.0 | -4.0 | -13.9 ^c | 2 | 27 |
| Indiana | 12.3 | 10.8 | 13.9 | 4.5 | 14 | 0 |
| Iowa | 18.9 | 18.8 | 18.9 | 15.0 | 50 | 4 |
| Kansas | 3.6 | 23.4 | -3.6 | -6.1 | 5 | 35 |
| Michigan | 15.4 | 14.8 | 17.4 | 20.0 | 2 | 0 |
| Minnesota | 17.7 | 31.8 | 0.5 | -16.1 | 3 | 32 |
| Missouri | 69.9 | 73.4 | 66.1 | 48.7 | 36 | 0 |
| Nebraska | 18.4 | 44.1 | 8.0 | 2.4 | 32 | 32 |
| North Dakota | 6.1 | — | 6.1 | 1.9 | 17 | 22 |
| Ohio | 13.8 | 14.1 | 13.1 | -2.8 | 0 | 1 |
| South Dakota | 22.1 | 41.5 | 19.2 | 12.6 | 35 | 7 |
| Wisconsin | 56.6 | 59.8 | 53.1 | 62.4 | 15 | 0 |
| | | | | Total | 211 | 160 |

^a Big counties are defined as having 100,000 or more people in 1981; small counties, less than 100,000.

^b Farm-dependent counties were those with 20 percent or more of income derived from agriculture, averaged over 1975-79.

^c Excludes De Witt County, which increased assessed value 91 percent, an atypical experience.

Source: U.S. Department of Commerce, Bureau of the Census, *1987 Census of Governments*. Preliminary data, 1989.

percent or more of total labor and proprietor income was derived from agriculture during the 1975 to 1979 period.⁵ In 10 of 12 north central states, farm-dependent county assessed values grew less than the state average, and in 4 states farm-dependent county assessed value fell between 1981 and 1986 (note that Michigan has only 2 farm-dependent counties, and Ohio, only one).

A large number of farm-dependent counties (160 of 371) saw assessed value declines during the five years of real estate market value collapse, especially in Illinois, Kansas, Minnesota, Nebraska, and North Dakota. On the other hand, there were no assessed value decreases in the farm-dependent counties in Indiana, Missouri, or Wisconsin, and few in Iowa and South Dakota. Since farm real estate values fell as rapidly in these states as elsewhere (Table 2), the reason for the stability in the property tax base must be in the assessment systems.

Of the states where assessments were most severely affected by the farm real estate plunge, Minnesota and Kansas use market value assessment (see Table 4). Minnesota reassesses property at maximum intervals of four years, while Kansas specifies annual reassessment. Illinois, Nebraska, and North

Table 4
Property Tax Characteristics, North Central States

| | <u>Farmland Assessment</u> | | State Property Tax Controls (R-rate, L-levy) |
|--------------|----------------------------|--------------------------------|---|
| | Type ¹ | Years between Reassessments | |
| Illinois | UV-C | 1 | RL |
| Indiana | UV-P | 10 | L |
| Iowa | UV-C | 2 | R |
| Kansas | MV | 1 | L |
| Michigan | MV | 1 | RL |
| Minnesota | MV | 4 | RL |
| Missouri | UV-C | 1 | R |
| Nebraska | UV-C | 1 | R |
| North Dakota | UV-C | 1 | L |
| Ohio | UV-C | 1 | R |
| South Dakota | MV | 1 | R |
| Wisconsin | MV | 5 | R |

¹ UV-C = use value based on capitalization formula

UV-P = use value based on land productivity

MV = market value

Sources: David E. Ervin, David L. Chicoine, and Paul Nolte, "Use Value Assessment of Farmland: Implications for Fiscal Stability," *North Central Journal of Agricultural Economics* 8 (January 1986): 17-28; Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1988*, Vol. II (Washington, DC: ACIR, 1988), Table 90.

Dakota each use variations of use value assessment. In Illinois, calculated farmland assessments fell by 50 percent, accurately reflecting the decline in market values. The state amended the assessment law in 1984 to restrict annual declines in assessed values to 10 percent, meaning that the full 50 percent decline will not be reflected in actual assessed values until the early 1990s. The Illinois capitalization formula averages five years of data, with a one-year lag, so that 1988 assessments are based on data from 1982 through 1986.⁶ North Dakota adopted an income capitalization approach to use value assessment in 1981. Landowners' incomes are based on six-year running averages, dropping the high and low years. The interest rate is a 12-year average mortgage rate for North Dakota, also excluding the high and low years. Between 1981 and 1987, the "true and full value" of farmland per acre (taxable value is 5 percent of true and full value) fell from \$223 to \$213, much less than the market value drop, but enough to cause assessed value declines in many rural counties.⁷

In some states, particularly Indiana, Missouri, and Wisconsin, assessed values in farm-dependent counties did not decline. Indiana has use value assessment based on soil productivity, with no account taken of incomes or interest rates. The valuation of an average productivity acre is changed only during statewide reassessments, which have occurred at ten-year intervals.

The 1980 reassessment approximately doubled the assessed value of farmland, but there has not been a reassessment since, so farm assessments have not declined.⁸ In Wisconsin, local assessors can assess property at any market value ratio they wish, so long as the ratio is consistent among different classes of property. Since this local ratio can change every year, local assessed values will not necessarily reflect changes in market value, although after 1986 assessed value must be within 10 percent of market value at least one year in four. The Wisconsin Department of Revenue uses the market value of land to calculate equalization rates needed to divide county and school district tax levies among subcounty units with different assessment ratios.⁹

Neither use value nor market value assessment appears to ensure property tax base stability. Two of the five most severely affected states, Kansas and Minnesota, use market value assessment, while the other three, Illinois, Nebraska, and North Dakota, have use value assessment. Three of the least affected states, Indiana, Iowa, and Missouri, use variations of use value assessment, while two, South Dakota and Wisconsin, base assessments on market value. Declines in assessed value appear more likely due to “high quality” assessment: close adherence to a use value formula, as in Illinois, or accurate market value assessment, as in Minnesota. Assessed value stability may often be due to poorer quality assessment, as in the ten-year wait between reassessments in Indiana. As a result, the incentive for local governments to diversify tax sources is likely to be strongest in states with “high quality” assessment practices.

Rural Property Tax Revenue

For most taxes, declines in the tax base cause declines in revenue. A drop in income or sales will reduce income and sales tax revenue. The property tax can be the exception to this rule. Traditionally, property tax rates are set residually. Local governments determine their expenditure requirements, subtract revenue from other sources, and divide the remainder by assessed value to fix the property tax rate. Although state property tax rate and levy limits have reduced local discretion in this process, property tax rates still tend to change every year. A decline in assessed value, such as has occurred in many rural north central counties, may be partially or completely offset by a rise in the tax rate. A drop in revenue may not occur.

Maintenance of the property tax levy—the revenue collected from the tax—is less likely if state property tax controls restrict annual increases in property tax rates. A controlled rate may not be able to rise enough to offset assessed value declines. Drops in farmland values will translate into revenue declines. Alternately, states may control increases in the tax levy itself. In this case, the rate is free to change as needed to raise a controlled amount of revenue. Among the north central states, Iowa, Missouri, Nebraska, and Ohio restrict levies but not rates (see Table 4).

Information on property tax revenues raised by rural local governments during the 1980s is scarce.¹⁰ Annual property tax revenues for counties with populations greater than 100,000 are available, as are the total collections by

local governments in each state (see Table 5). The residual shows revenue changes for counties with populations of less than 100,000. While this is the closest one can come to the receipts of rural counties with currently available data, it should be recognized that many suburban metropolitan counties are included among counties with populations less than 100,000. Many of these "small" counties are not farm-dependent.

Table 5 shows the total change in property tax receipts for all county governments in each north central state between 1981 and 1986, and the percentage changes in big and small counties. Also shown is the percentage increase in prices paid by state and local governments. In 9 of 12 states, property tax revenues rose significantly more than prices, implying an increase in the purchasing power of the property tax levy. In Nebraska, revenue growth matched inflation, and in Missouri and North Dakota, the real value of the property tax levy declined.

Table 5
**Percentage Changes in County Property Tax Revenues
North Central States, 1981-86**

| | All Counties | Big Counties ^a | Small Counties ^a |
|------------------------|--------------|---------------------------|-----------------------------|
| Illinois | 67.3 | 75.7 | 34.1 |
| Indiana | 61.3 | 58.5 ^b | 64.4 |
| Iowa | 36.3 | 36.3 | 36.2 |
| Kansas | 50.6 | 59.4 | 47.2 |
| Michigan | 41.3 | 37.9 | 52.3 |
| Minnesota | 55.9 | 60.8 | 49.2 |
| Missouri | 11.3 | 25.8 | -10.9 |
| Nebraska | 28.0 | 2.4 | 38.8 |
| North Dakota | 11.4 | — | 11.4 |
| Ohio | 42.8 | 44.3 | 37.8 |
| South Dakota | 44.2 | 76.7 | 41.6 |
| Wisconsin | 67.1 | 74.2 | 58.8 |
| Inflation ^c | 26.6 | — | — |

^a Big counties are defined as having 100,000 or more people in 1981; small counties, less than 100,000.

^b Excludes Indianapolis-Marion County unified government.

^c Percentage change in prices paid by state and local governments, National Income and Product Accounts.

Sources: U.S. Department of Commerce, Bureau of the Census, *Governmental Finances, 1980-81 and 1985-86* (Washington, DC: Census, 1981, 1986)

_____, *County Government Finances 1980-81 and 1985-86* (Washington, DC: 1981, 1986)

_____, Bureau of Economic Analysis, *Survey of Current Business*, July 1988 and earlier issues

Small-county revenues increased less than big-county revenues in 8 of 11 states and declined in Missouri. Of the five states where many counties had assessed value declines, Illinois, Kansas, and Minnesota showed lower small-county revenue growth, and in North Dakota, where all counties have populations less than 100,000, property tax revenue grew very little. Nebraska small-county property taxes grew rapidly despite little assessed value growth. Small-county revenues in Indiana, Iowa, and Michigan grew as much or more than large-county revenues, reflecting the growth of small-county assessed values. South Dakota's small-county revenues grew more than 40 percent, a relatively high rate but less than growth in the state's one large county. Wisconsin's small-county revenue also grew rapidly, but less than big-county revenue. Missouri was the only state where rapid assessed value growth was not reflected in small-county revenue growth, and this was probably due to the new availability of a county sales tax in the early 1980s.¹¹

In 11 states, county government property tax revenue in smaller counties increased during the years of rapid farm real value decline. There appears to be a difference between the increases in states with varying property tax controls. The six states with levy or rate and levy controls averaged a 43 percent increase; the six states with rate controls alone averaged 34 percent. There is considerable variation from this pattern, however. Indiana, with levy controls, had the largest property tax increase. Missouri, with rate controls, had the only revenue decline, but Wisconsin, also with rate controls, had the second largest increase.

The details of the control programs, the behavior of the nonfarm economy, the availability of other revenue sources, and the demands by local governments for expenditures are among the factors that probably influenced small county property tax revenue growth. Farm-dependent counties, under greater stress from declining assessed values, may well have seen slower property tax revenue growth or actual decline. But the radical decline in farmland values, and the accompanying recession in agriculture, generally did not cause large declines in small-county property tax revenue. Indeed, in most states small-county revenue growth matched or exceeded inflation in local government prices. The conclusions of a U.S. Senate report that "there is not strong support for assertions that the declines in farmland values alone will create a financial disaster for rural local governments," and of an earlier ACIR study that "although we know that there have been substantial declines in the value of farmland, we cannot assume a significant decline in property tax revenue in the short run," seem to be borne out.¹²

The relative stability of property tax levies seems to reduce the need for tax diversification. Other factors, however, point toward diversification. Though the levies may be maintained, reduced rural incomes may create increases in property tax delinquency. And, while rising tax rates may be offset by falling assessments for farmers, other rural taxpayers may resist property tax hikes. Each of these factors is likely to be an incentive for adopting nonproperty taxes.

Rural Property Tax Delinquency

Property tax revenue can remain stable in the face of land value declines if assessed values do not respond to market value changes and if local governments can offset assessed value changes with tax rate hikes. Each farmer's property tax liability will remain unchanged while farm values and incomes fall. But taxpayers' declining abilities to pay a fixed liability will likely increase tax delinquency.

Tax delinquency was a severe problem for rural local governments during the Great Depression, tripling between 1928 and 1932. Analysts pointed out that the primary problem was the failure of the tax liability to adjust downward as incomes, land values, and ability to pay generally decreased.¹³

There is evidence that property tax delinquency has been a problem for rural governments in the 1980s, increasing substantially in several agriculturally dependent counties.¹⁴ Delinquency rates more than doubled in rural areas in Minnesota and Iowa. One study shows that farm-dependent county delinquency rates in Indiana—where farm tax liabilities do not adjust to farm conditions—tend to increase with decreases in farm incomes and increases in the farm debt-asset ratio.¹⁵ The farm debt-asset ratio increased radically with the decline in farm real estate value.

Delinquency is usually a short-term problem; most delinquent property taxes are paid eventually. This may not be the case in very severe downturns, however. During the Depression, delinquent taxes often were forgiven, recognizing that, probably, they would never be paid. Many states allow local governments to raise their tax levies or borrow short term in anticipation of delinquency, essentially shifting the burden to taxpayers who can or will pay. This is most useful when delinquency rates are stable and predictable.¹⁶ Large, unexpected increases in unpaid taxes can create revenue shortfalls for local governments, creating an incentive to use other tax sources.

Tax Burden Shifts

If farm assessed values fall or grow more slowly than assessed values in other sectors, and the property tax levy is maintained through rate increases, the burden of the property tax will shift toward nonfarm taxpayers. While slow growth or decline in farm assessments may not decrease tax revenues automatically, the resulting large tax hikes to other taxpayer-voters may reduce their willingness to support local government spending.

The increase in property taxes paid by a nonfarm taxpayer to maintain a fixed revenue level can be measured by the formula

$$\text{Percent Change, Nonfarm Taxes} = \left[\left(\frac{100 + \text{Percent Change, Taxpayer AV}}{100 + \text{Percent Change, Farm County AV}} \right) - 1 \right] \times 100$$

where nonfarm AV is the assessed value of the nonfarm taxpayer's property, and total AV is the assessed value of all property in the taxpayer's jurisdiction. Consider a nonfarm taxpayer in Illinois, for example, who lives in an average farm-dependent county, with assessed value declining 13.9 percent over

1981-86, and who owns property with assessed value that increases at the state-wide average for all property, 9.3 percent. To maintain local government revenues at the 1981 level (ignoring inflation and increases in service provision), this taxpayer's liability must rise by 27 percent, an increase due entirely to the shift in tax burden from agriculture to other taxpayers. Table 6 shows the results of this calculation for the north central states. The tax shift has been particularly severe in Minnesota, where the burden on a nonfarm taxpayer needed to rise more than 40 percent, just to keep local revenues constant.

If property tax levies are maintained with increasing tax rates, the tax burden shifts from farm to nonfarm taxpayers. Nonfarm taxpayers may also resist such tax hikes, forcing local governments to accept lower revenue levels. Even if local governments are allowed by state controls to increase their tax levies to offset assessed value declines fully, decreasing willingness of taxpayers to support services may force service cuts anyway. Further, tax shifts toward nonfarm taxpayers can occur when farm assessments grow more slowly than nonfarm assessments, as well as when farm assessed values decline. Rather than face large property tax hikes, local taxpayers may well support diversification to nonproperty taxes.

State Aid to Local Governments

The potential revenue loss by rural local governments and the tax burden increase on rural taxpayers, can be offset by increases in state aid. While aid to

Table 6
**Possible Property Tax Shifts to Nonfarm Taxpayers
North Central States, 1981-86**

| | Percent Change in Total Assessed Value | Percent Change in Farm Assessed Value | Percent Change in Nonfarm Taxpayer Liability ¹ |
|--------------|---|--|--|
| Illinois | 9.3 | -13.9 | 26.9 |
| Indiana | 12.3 | 4.5 | 7.5 |
| Iowa | 18.9 | 15.0 | 3.4 |
| Kansas | 3.6 | -6.1 | 10.3 |
| Michigan | 15.4 | 20.0 | -3.8 |
| Minnesota | 17.7 | -16.1 | 40.3 |
| Missouri | 69.9 | 48.7 | 14.3 |
| Nebraska | 18.4 | 2.4 | 15.6 |
| North Dakota | 6.1 | 1.9 | 4.1 |
| Ohio | 13.8 | -2.8 | 17.1 |
| South Dakota | 22.1 | 12.6 | 8.4 |
| Wisconsin | 56.6 | 62.4 | -3.6 |

¹ To maintain constant property tax revenue, if nonfarm taxpayer's assessed value rises at same rate as total assessed value, and taxpayer resides in an average farm-dependent county (see text for formula).

most local governments will not increase automatically with property tax declines, many states use school aid distribution formulas that depend in part on the property tax base of school districts. For example, a "foundation" aid formula ensures that a fixed level of revenue per pupil will be available when districts impose a given tax rate.

$$\text{Aid} = (\text{Foundation} \times \text{Pupils}) - (\text{Rate} \times \text{Assessed Value})$$

where Aid is state aid to schools, Foundation is the per pupil spending each district is guaranteed, Pupils is the number of pupils in the district, Rate is a standard or minimum tax rate expected of local taxpayers, and Assessed Value is the school district property tax base. The formula is designed so that when a school corporation levies the standard tax rate any shortfall in revenue below the per pupil foundation spending level will be made up by state aid. Clearly, with no change in the foundation amount, enrollment, or the tax rate standards, a decline in assessed value will increase the amount of aid received.

There have been aid increases to rural school districts in Illinois and Michigan. In Illinois, changes in the property tax base were expected to shift more than \$50 million in state aid from Chicago area schools to downstate districts, with 80 percent of the shift going to rural downstate schools. In the Breckinridge school district in Michigan, an 18 percent decline in property tax revenue between 1985 and 1988 was more than offset by a 250 percent increase in school aid. Per pupil revenue increased 26 percent.¹⁷

Agriculturally dependent states may not be able to maintain local aid expenditures in times of agricultural recession. The 1986 ACIR analysis of the recent agricultural recession, which included an examination of six north central states, found that five were experiencing fiscal stress in 1986. Three of these states—North Dakota, Iowa, and Nebraska—were forced to decrease state funding for education after the original budget was adopted.¹⁸ If states with foundation grant formulas reduce total school aid provided, either the foundation level must be cut or the standard tax rate expected of local districts must be increased. Either way, a decline in assessed value will not be offset fully by increases in aid. While foundation aid programs could lessen the incentive or need to diversify taxes, in most states they are available to school districts, if at all, and agriculturally dependent states may not be in a position to increase aid during farm recessions.

Tax Diversification Options for Rural Governments

The property tax continues to be the major source of tax revenue for local governments—74 percent in fiscal 1986. But the trend in local government taxation has been away from the property tax. In 1957, local governments derived 87 percent of their tax revenue from property taxes, 7 percent from sales taxes, and 1 percent from income taxes. By 1986, 16 percent of local government taxes were sales taxes, and 6 percent were income taxes.

Rural local governments appear to be more dependent on the property tax than are urban governments. While city governments received slightly less

than half of their tax revenue from the property tax, county governments received 75 percent from property taxes; townships, 93 percent; and school districts, 97 percent. Urban governments have found greater opportunities for revenue diversification than have rural governments. City governments received 29 percent of their tax revenue from sales taxes and 14 percent from income taxes.¹⁹

Table 7 shows the tax diversification opportunities for rural local governments in the north central states. Eight of 12 north central states allow some of their rural local governments to adopt either a sales or income tax. Counties in Indiana and school districts in Iowa are permitted to use local income taxes. Rural counties in Illinois, Kansas, Missouri, Ohio, and Wisconsin may adopt local sales taxes. Rural-area cities in Illinois, Kansas, Missouri, and South Dakota may adopt local sales taxes. Local income taxes in Michigan are restricted to larger cities, as are local sales taxes in Minnesota, Nebraska, and North Dakota.

Table 8 shows nonproperty tax use as a percentage of total taxes for large and small counties in the north central states. As in Table 5, the dividing point between big and small counties is a population of 100,000, so many small counties would not be considered farm-dependent.

Table 7
**Availability of Sales and Income Taxes to Rural Local Governments,
North Central States**

| State | Rural Local Governments ¹ Can Adopt: | | Comments |
|--------------|---|------------|---|
| | Sales Tax | Income Tax | |
| Illinois | MC | | |
| Indiana | | C | |
| Iowa | | S | |
| Kansas | MC | | |
| Michigan | | | 18 cities have income tax as of 1987 |
| Minnesota | | | 3 large cities have sales tax as of 1987 |
| Missouri | MC | | 2 large cities have income tax as of 1987 |
| Nebraska | | | 22 cities have sales tax in 1987 |
| North Dakota | | | 3 larger cities have sales tax in 1987 |
| Ohio | C | | Most cities and a few school districts have income tax in 1987 |
| South Dakota | M | | 111 cities have sales tax as of 1987 |
| Wisconsin | C | | 10 counties adopted in 1987 |

¹M = municipalities C = counties S = school districts

Source: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1988*, Vol. 1 (Washington, DC: ACIR, 1988), Tables 19, 20, 24, 25.

Table 8
**Percentage of Nonproperty Taxes in Total County Taxes,
 North Central States, 1981-86**

| State | <u>All Counties</u> | | <u>Big Counties^a</u> | | <u>Small Counties^a</u> | |
|--------------|---------------------|------|---------------------------------|------------------|-----------------------------------|------|
| | 1981 | 1986 | 1981 | 1986 | 1981 | 1986 |
| Illinois | 24.4 | 20.9 | 25.6 | 22.1 | 19.3 | 13.8 |
| Indiana | 20.3 | 23.2 | 7.6 ^b | 9.9 ^b | 31.2 | 34.0 |
| Iowa | 2.5 | 2.0 | 3.0 | 2.6 | 2.4 | 1.8 |
| Kansas | 12.6 | 21.9 | 25.3 | 28.0 | 6.4 | 19.0 |
| Michigan | 4.1 | 4.2 | 3.8 | 4.3 | 5.1 | 3.8 |
| Minnesota | 1.5 | 2.0 | 1.1 | 1.8 | 2.1 | 2.3 |
| Missouri | 45.8 | 59.6 | 57.1 | 63.9 | 9.5 | 45.3 |
| Nebraska | 13.7 | 10.9 | 15.2 | 12.7 | 13.0 | 10.3 |
| North Dakota | 3.2 | 3.7 | — | — | — | — |
| Ohio | 26.3 | 30.4 | 26.8 | 30.7 | 24.6 | 29.3 |
| South Dakota | 12.3 | 9.3 | 24.0 | 14.2 | 11.2 | 8.8 |
| Wisconsin | 1.2 | 1.2 | 1.5 | 1.3 | 1.0 | 1.1 |

^a Big counties are defined as having 100,000 or more people in 1981; small counties, less than 100,000.

^b Excludes Indianapolis-Marion County unified government.

Sources: U.S. Department of Commerce, Bureau of the Census, *Governmental Finances, 1980-81 and 1985-86* (Washington, DC: 1981, 1986)

_____, *County Government Finances 1980-81 and 1985-86* (Washington, DC: 1981, 1986).

In five states—Illinois, Indiana, Kansas, Missouri, and Ohio—counties in 1986 derived at least 20 percent of their tax revenue from nonproperty tax sources. In four of these states, big counties use nonproperty taxes more than do small counties. In Kansas and Missouri, however, the use of sales and income taxes by rural counties has grown rapidly: small-county nonproperty tax collections rose 409 percent in Kansas and 604 percent in Missouri between 1981 and 1986. In Indiana, small counties derive a much larger share of their tax revenue from the local income tax than large counties do. This is because the original income tax option largely replaced property tax revenue without providing much new revenue. Agricultural areas eagerly adopted the income tax as an alternative to the unpopular property tax, but urban areas did not adopt it because little new revenue was offered. After 1984, a variation on the income tax option allowed new revenue to be raised, and larger counties began adopting it.²⁰ Small counties in Missouri used the new local sales tax to replace property taxes, as well, because property tax revenue declined between 1981 and 1986 (see Table 5).

The agricultural recession of the early 1980s did not cause (or has not yet caused) a general shift to nonproperty taxation by rural local governments. In

part this is because such taxes are unavailable. In Minnesota, Nebraska, and North Dakota, where large numbers of farm-dependent counties saw assessed value declines (see Table 3), local income or sales taxes were unavailable to rural governments. The use of nonproperty taxes declined or remained small relative to property taxes during the 1981-86 period in these states. In Kansas, however, farm-dependent county assessed values declined and small local governments greatly increased their use of a local sales tax. In Missouri, rural assessed values grew more slowly than nonrural assessments, implying a shift in property taxes toward nonfarm taxpayers (see Table 6). Small local governments vastly increased the use of a local sales tax. In Illinois farm counties, assessed values declined, implying a large tax shift toward nonfarm taxpayers, yet local sales tax revenue fell relative to property taxes in small counties. Again, it is likely that the state made no new diversification options available: By 1981, rural counties were using the local sales tax and could not make further shifts away from property taxes.

Impacts of Rural Tax Diversification

Revenue diversification presents several possibilities for assisting rural local governments to overcome problems created by agricultural value and income declines.²¹

- Nonproperty tax bases may be less dependent on agriculture than is assessed value, lessening the impact of agricultural decline on revenues.
- Nonproperty taxes may be more stable than the property tax, or may vary in different directions at different times, stabilizing total revenue.
- Taxpayers may be more willing to support smaller increases in a variety of taxes, rather than large increases in the property tax, lessening the need for rural government service cuts.

Compared to income, a much larger part of assessed value is likely to be farm-related. Table 9 shows that in every north central state, the percentage of total gross assessed value that was acreage in 1981 was larger than the percentage of total personal income derived from farms, averaged over 1979-82. The income percentage is averaged over four years because farm income is so variable. The farmland percentage in assessed value is usually five to ten times the farm percentage in total income. Farming is "real property intensive," meaning that farm income is produced with a relatively large use of land and buildings per worker. Farming makes a bigger contribution to a county's real property than to its income.

Sales and income taxes may be less influenced by farm-sector growth and decline than is the property tax. In states like Iowa, Nebraska, North Dakota, and South Dakota, farmland value reductions, to the extent that they influence assessed values, will directly affect more than one-third of the property

Table 9
Agriculture in Assessed Value and Income, North Central States

| | Farm Acreage as Percent of Assessed Value 1981 | Farm Income as Percent of Total Income 1979-82 |
|--------------|--|--|
| Illinois | 11.2 | 1.4 |
| Indiana | 10.5 | 1.6 |
| Iowa | 35.8 | 6.4 |
| Kansas | 18.1 | 4.5 |
| Michigan | 10.2 | 0.8 |
| Minnesota | 26.2 | 3.0 |
| Missouri | 8.7 | 1.9 |
| Nebraska | 37.1 | 6.4 |
| North Dakota | 50.1 | 9.0 |
| Ohio | 8.7 | 0.8 |
| South Dakota | 50.3 | 10.5 |
| Wisconsin | 20.5 | 3.4 |

Source: U.S. Department of Commerce, Bureau of the Census, *Taxable Property Values and Assessment Sales Price Ratios, 1982 Census of Governments*, Vol. 2 (Washington, DC: 1984)

tax base. But farm income declines, even in these highly agriculturally dependent states, will directly affect less than 10 percent of personal income, which is closely related to the sales and income tax bases. Revenue diversification toward sales and income taxes and away from the property tax could help shelter rural local governments from farmland value variations.

Agricultural income began to recover from the farm recession in 1984, while farm real estate values continued to decline through 1987 (Table 1). Local governments in farm-dependent regions that taxed sales and incomes would have seen their revenues rise. Those using a property tax with assessed values reflecting market changes would have seen their tax base fall. Diversification would likely have helped in the 1980s.

But the 1980s may not be typical. During the 1970s, land values increased every year, expanding the potential property tax base. Farm income was very unstable, falling in 6 of 14 years between 1970 and 1983, including a drop of nearly 32 percent in 1976, and a collapse of 74 percent in 1983. In farm-dependent areas, such large fluctuations in income will certainly influence the rest of the local economy, resulting in substantial drops in taxable sales and income. Sales and income taxes can present rural local governments with a double problem: the taxes are more responsive to income fluctuations, and farm income fluctuations are greater than nonfarm fluctuations. Sales and income taxes are likely to be less stable than property taxes.

Diversification can make a more subtle contribution to stability, however. If the fluctuations of the various tax sources are timed differently, total

revenue can be more stable than any of the component tax sources.²² If, for example, decreases in property tax receipts are usually accompanied by increases in sales taxes, the variations are offsetting and the revenue sum will be more stable than either tax. Fluctuations in farm income, while of much greater magnitude, are timed somewhat differently than those in the nonfarm economy. Declines in farm income in 1976 and 1983 correspond to nonfarm recovery years, while the rise in farm income in 1975 occurred during a nonfarm recession. Diversification could be stabilizing if one tax was more closely tied to farm income while another reflected nonfarm income.²³

If use value assessment involves data lags and long-term averaging, diversification can stabilize revenue even if farm and nonfarm fluctuations are identically timed. When farm income stops increasing and starts decreasing, data lags and averaging will keep use value assessments increasing, possibly for several years. By the time assessments begin to decline, farm incomes may be rising again.²⁴ If local revenue is derived from the property tax and another tax dependent on farm income, total revenue will be more stable than either tax source.

If farm assessed value falls but the property tax levy does not, nonfarm taxpayers will see higher tax liabilities. Nonfarm taxpayer-voters may resist big tax hikes, forcing local governments to cut services even though the property tax controls legally allow an off-setting tax rate increase. Diversification to nonproperty taxes may lessen this problem.

As tax rates increase, the distortions they impose on the private economy increase. The purchasing decisions of consumers and investment decisions of businesses are altered, so that they are different from what would have been best without the taxes. Consumers receive fewer benefits for their money, businesses invest in less productive endeavors. This loss of welfare and efficiency, beyond the amount of tax dollars collected, is often called "excess burden." Excess burden increases as tax rates rise. It is possible that replacing a single high tax rate with several low tax rates can raise the same revenue with less excess burden. What is more, if voter-taxpayers suffer less excess burden, they may see the costs of local government as lower and support more services. As assessed value falls, the increased use of several other taxes is more likely to maintain support for service levels than is a greatly increased use of the property tax.

Evidence for this is provided by a study of an Indiana local income tax that counties could adopt to replace property taxes. Counties with higher property tax rates were more likely to adopt the income tax, to diversify away from property taxes. This implies that cuts in assessed value that are offset by hikes in the property tax rate would increase the likelihood of income tax adoption. The public appears to prefer diversification to large hikes in a single tax. Other strong determinants of income tax adoption were the owner-occupier proportions. Since high farmland use and high owner-occupier proportions (low renter proportion) are characteristic of rural areas, state governments that offer income tax options to local governments can expect rural governments to adopt the tax. Rural counties with utilities or large mining operations were

much less likely to adopt an income tax, however, because taxpayers perceive much of the property tax burden as exported to nonresident property taxpayers.²⁵

Conclusions and Policy Implications

Tax diversification can offer relief to rural local governments facing fiscal stress. During the severe agricultural recession of the first half of the 1980s, small local governments in two north central states—Kansas and Missouri—greatly increased their use of local sales taxes. This move came in part in response to rural assessed value declines in Kansas and tax shifts to nonfarm taxpayers in Missouri. In other states, however, rural local governments had no diversification options. In the face of declining assessed values, counties in Minnesota, Nebraska, and North Dakota had no local sales or income tax options. While 8 of 12 north central states offer their rural local governments a sales or income tax option, only 6 allow county governments to diversify. Counties are the general purpose governments most likely to be adversely affected by farm real estate value declines. Further, six north central states allow larger cities a tax option that is denied rural governments. Nationwide, urban governments use more diverse tax sources than do rural governments.

Tax diversification can lessen the impact of agricultural recession. A much smaller proportion of income derives from agriculture, compared to the share of farm real estate in assessed value. Adopting local sales and income taxes may make local tax bases less dependent on the unstable farm sector. Farm-dependent areas may not benefit from diversification, however, as declines in farm income may cause declines in the local nonfarm economy.

The property tax is usually found to be the most cyclically stable local tax. Taxable incomes and sales rise and fall with the business cycle, causing corresponding changes in income and sales taxes. But because of lags in property assessments, and the flexibility of the tax rates, property taxes are less responsive to recessions and expansions. During the 1980s, farm incomes recovered more quickly than farm real estate values, to the benefit of rural governments with income-based taxes. But during the 1970s, farm real estate values rose continually, while farm incomes were very unstable. Diversification can improve stability if the cyclical swings of the various taxes are timed differently, meaning the fall in one tax source is offset by the rise in another. Whether such differences in timing exist and are regular enough to benefit rural local governments is an open question.

Taxpayers may be more willing to support local government spending if revenues are maintained with small increases in several taxes rather than a large hike in a single tax. Evidence indicates that taxpayers support the adoption of local income taxes when property tax rates are high. Tax diversification could reduce taxpayer resistance to maintaining spending when farm assessed values decline.

Clearly, the benefits of tax diversification have not been fully exploited by rural local governments in the north central states. In 1986, small counties in only 4 of 12 states used nonproperty taxes to raise as much as 15 percent of

their tax revenues; in 4 states, less than 5 percent of revenue came from nonproperty tax sources. The reason for this lack of diversification is not disinterest, however. When local sales or income taxes are available, rural governments jump at the chance, more so in times of fiscal stress. Instead, it is state restrictions on the use of nonproperty taxes that account for the lack of diversification. Rural local governments can maintain services more readily in agricultural recessions when at least one major nonproperty tax option is available. In times of rural fiscal stress, the relaxation of rate limits on existing sales or income tax options is also likely to help.

Other state rules and restrictions have important effects on the fiscal stress caused by farm recessions. During the radical decline in farmland values during the 1980s, rural assessed value declined in some north central farm-dependent counties, but increased in others. It appears that rural areas in states with accurate assessment—whether market or use value based—were more likely to experience assessed value declines. Stability may be enhanced by the use of long-term averages in the income and interest rate data needed to calculate use value assessments of farmland. States that reassess infrequently tend to keep assessed values stable. Indiana, for example, has not reassessed since the beginning of the farmland value decline. Illinois imposed restrictions on the amount assessments could change from year to year.

One hesitates to recommend many of these procedures, however, because they often conflict with other goals of property assessment. Maintaining farm assessed values while market values decline can result in overassessment of land, meaning farmers pay a larger share of the property tax levy than the value of their property would warrant. If use value assessment calculations lag behind changes in farm income, property tax liabilities will bear less relationship to ability to pay. While short-term fluctuations may be reduced or even eliminated, in the long run, permanent declines in farm real estate values must be reflected in lower assessments.

Local governments may be able to offset declines in assessed value with increases in tax rates. Property tax rates vary every year in most jurisdictions, as expenditure requirements, other revenue sources, and assessed values change. State-imposed property tax controls take the form of restrictions on tax rates in some states, and such restrictions, combined with assessed value drops, may produce property tax revenue declines. States that control levies directly, however, allow property tax rates to rise to offset assessed value declines. Levy controls seem more likely than rate controls to allow rural local governments to maintain services.

Again, problems can arise. If declining farmland values represent a real decrease in taxpayers' ability to pay, the imposition of a fixed tax liability is likely to lead to increases in tax delinquency. Declining land values and drops in farm income are associated with higher delinquency in rural Indiana counties, and several north central rural areas experienced large increases in property tax delinquency during the farm crisis. While most delinquent taxes are paid eventually, delinquency can contribute to short-term fiscal stress. In addition, if levies are maintained as farm assessments decline, nonfarm tax-

payers will face tax hikes. If such increases are resisted, local governments may be unable to maintain levies, and be forced instead to cut services.

Many state school aid formulas take account of assessed value, providing more aid to low assessed value districts. As rural assessed values decrease, potential revenue losses may be offset by increases in state aid. Rural districts in Illinois and Michigan benefited from such state formulas. Perhaps other local governments could be assisted with similar foundation aid formulas, as they are in Massachusetts.²⁶

Given a fixed aid level, however, decreases in farm assessments would mean decreases in aid to nonfarm governments. The rural revenue problem is spread to all the state's governments. While nonfarm governments with stronger economies may be able to accommodate such cuts, they are unlikely to accept less aid without resistance. Total state aid could be increased, to the benefit of rural local governments, but agriculturally dependent states may be in fiscal difficulties themselves, in no position to increase aid. Several north central states were forced to cut school aid during the farm recession.

Endnotes

¹ David E. Ervin, David L. Chicoine and Paul D. Nolte, "Use Value Assessment of Farmland: Implications for Fiscal Stability," *North Central Journal of Agricultural Economics* 8 (January 1986): 17-28.

² U.S. Department of Commerce, Bureau of the Census, *Taxable Property Values and Assessment Sales Rates, 1982 Census of Governments*, Vol. 2 (Washington, DC: Census, 1984), p. 20.

³ Ervin, Chicoine, and Nolte; U.S. Advisory Commission on Intergovernmental Relations (ACIR), *The Agricultural Recession: Its Impacts on the Finances of State and Local Governments* (Washington, DC: ACIR, 1986); Thomas F. Stinson, "The Farm Crisis and the Future of Rural Local Governments," *Publius: The Journal of Federalism* 17 (Fall 1987): 175-188.

⁴ Ervin, Chicoine, and Nolte; Norbert A. Dorow, Jay A. Leitch, and James F. Baltezare, "North Dakota's State and Local Tax System" (Fargo: North Dakota State University Extension Service, October 1988). (EB 53)

⁵ For a list of farm-dependent counties, see David L. Chicoine, "The Financial Crisis in American Agriculture: Implications for State/Local Government Finance and the Elimination of Federal Income Tax Deductibility of State and Local Taxes," Illinois Agricultural Economics Staff Paper No. 86 E 349, March 1986.

⁶ David L. Chicoine, "Ten Percent Limitation Determines 1989 Farmland Assessments," *Farm Economics Facts & Opinions* (Springfield: Illinois Cooperative Extension Service, July 1988).

⁷ Darow, Leitch, and Baltezare.

⁸ Larry DeBoer, "Projecting the Impact of the 1990 Reassessment on Indiana County Assessed Values" (West Lafayette, Indiana: Purdue University, Department of Agricultural Economics, June 1987). (Staff Paper #87 15) Indiana is scheduled to use a four-year assessment cycle after 1996.

⁹ Richard Barrows, "The Farm Economy, Property Taxes and Rural Education" (Madison: University of Wisconsin, January 1987), (Agricultural Economics Staff Paper No. 266); Barrows and Kent Gardner, "Equalized Value, Assessed Value and Your Property Tax Bill" (Madison, Wisconsin: Cooperative Extension Service, 1986). (Publication G3365)

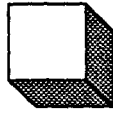
- ¹⁰ See ACIR, "The Agricultural Recession," for a discussion. The 1987 *Census of Governments* will report county property tax revenue totals.
- ¹¹ ACIR, *Significant Features of Fiscal Federalism, 1988*, Volume I (Washington, DC: ACIR, 1988).
- ¹² U.S. Congress, Senate Committee on Governmental Affairs, Subcommittee on Intergovernmental Relations, *Governing the Heartlands: Can Rural Communities Survive the Farm Crisis*, 99th Congress, 2nd Session, S. Prt. 99, 176, July 1986, p. 22; ACIR, *The Agricultural Recession*, p. 17.
- ¹³ Donald Jackson, "Tax Delinquency of Rural Real Estate," *Law and Contemporary Problems* 3 (June 1936): 347-353.
- ¹⁴ U.S. Senate, *Governing the Heartlands*.
- ¹⁵ James Conrad and Larry DeBoer, "Rural Property Tax Delinquency and Recession in Agriculture," *American Journal of Agricultural Economics* 70 (August 1988): 553-59.
- ¹⁶ U.S. Senate, *Governing the Heartlands*.
- ¹⁷ David L. Chicoine and Suzanne Langston, "Structural Changes in Illinois Agriculture and Industry: Impact on Illinois School Finance," Illinois Agricultural Economics Staff Paper No. 85 E 335, December 1985; Lynn R. Harvey, et al., "Agricultural Land Values and Assessments in Selected Counties in Michigan" (East Lansing: Michigan State University, November 1987). (Agricultural Economics Report No. 503)
- ¹⁸ ACIR, *The Agricultural Recession*.
- ¹⁹ All percentages from ACIR, *Significant Features of Fiscal Federalism 1988*, Volume II, pp. 66-67.
- ²⁰ David E. Ervin, David L. Chicoine, and Paul D. Nolte, "Use Value Assessment of Farmland: Implications for Fiscal Stability," *North Central Journal of Agricultural Economics* 8 (January 1986): 17-28.
- ²¹ U.S. Department of Commerce, *1982 Census of Governments, Taxable Property Values and Assessment Sales Rates*, p. 20.
- ²² Fred C. White, "Trade-Off in Growth and Stability in State Taxes," *National Tax Journal* 36 (March 1983): 102-114; Walter S. Misiolek and D. Grady Perdue, "The Portfolio Approach to State and Local Tax Structures," *National Tax Journal* 40 (March 1987): 111-114.
- ²³ The property tax may be tied closely to farm income fluctuations in farm-dependent areas, especially if farm assessed values reflect income changes, as with a use value assessment formula. Sales and income taxes may be less dependent on farm income because farm income is a smaller part of total income than farm assessed value is of total assessed value.
- ²⁴ Ervin, Chicoine, and Nolte.
- ²⁵ Paul R. Blackley and Larry DeBoer, "Tax Base Choice by Local Governments," *Land Economics* 63 (August 1987): 227-236.
- ²⁶ Katherine L. Bradbury et al. "State Aid to Offset Fiscal Disparities across Communities," *National Tax Journal* 37 (June 1984): 151-170.

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Local Government Revenue Diversification: A Comparison of High-Growth and Low-Growth Rural Jurisdictions in Florida

Susan A. MacManus

Across the states, cities and counties have had difficulty responding to the challenges of growth. Traditional arrangements have been shattered. Revenues have been strained.

*Robert B. Bradley, Executive Director
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The most commonly held image of Florida is that of sunshine, beaches, tourists, retirees—and growth. Florida, now the nation's fourth largest state, rarely conjures up visions of rural life or low growth. Yet, for large portions of the state, that vision is the truer one.

Florida, like many other states, is described often as having two faces: one urban, one rural. And, as in other states, the rural face is further divided into high-growth and low-growth sectors. These growth rate differentials clearly have a potentially heavy impact on local governments' revenue diversification efforts.

Growth "affects the delivery of services, the integrity of fiscal bases, the possibilities for social justice, the relations among governments, and the very nature of the problems that must be faced. . . . Growth can complicate governance and administration, diminish public accountability, and erode citizen confidence in the ability of government to handle problems for which it is improperly structured. Growth challenges the architecture of local governance."¹ The effects of growth are felt in rural as well as urban areas.

Rapid growth in rural areas puts a tremendous strain on the revenues of the affected local governments, primarily due to demands for infrastructure expansion. Revenue diversification becomes a high priority, but it may be

limited by a restrictive legal and/or political environment. Frequently, revenue diversification also is a high priority of no-growth or low-growth rural local governments. This is true particularly in states where local taxing authority is restrictive and varies according to a jurisdiction's population size. These governments, which typically rely heavily on the local property tax, face the possibility of reaching the state millage rate limits or encountering extreme hostility from their voters if millage rates are increased. Because they are often characterized by poorer, less educated populations, these jurisdictions also have the most to lose when state-imposed homestead exemption policies remove a large proportion of their property from the tax rolls.

This discussion suggests that, regardless of the growth rate, local governments typically support state legislation enabling them to diversify their revenue sources. Preferably, these new revenue sources will include some that are discretionary rather than earmarked for specific expenditures. Florida offers a good test of whether growth affects the revenue diversification efforts of rural governments within the same state differently. In this study, low-growth rural counties are defined as those where the proportion of the population living in urban areas is below the national average (73.7 percent) and the 1980-1987 population growth rate was at least 50 percent below the state's growth rate (28.6 percent). These counties are: Calhoun, Franklin, Gadsden, Hamilton, Hardee, Holmes, Jackson, Jefferson, Madison, Union, and Washington.

High-growth rural counties are defined as those where the proportion of the population living in urban areas is below the national average and the 1980-1987 population growth rate was at least 50 percent higher than the state's growth rate. These counties are: Charlotte, Citrus, Clay, Flagler, Hernando, Indian River, Marion, Martin, Okeechobee, Osceola, and St. Johns.

Florida's Rural Dimension

The 1980 Census reported that 73.7 percent of the nation's population resided in urban areas. The comparable statistic for Florida was 84.3 percent. However, of Florida's 67 counties, 47 have urban populations below the national average. In fact, nearly half of the counties have urban populations less than half the national average (below 36.8 percent).

Most of Florida's 391 municipalities are small. Only 16 percent (61) had 1987 populations over 25,000. In fact, over 70 percent of the municipalities had 1987 populations under 10,000, and 46 percent (180) are located in the state's 47 "rural" counties. All of the 42 cities located in the 11 low-growth rural counties listed above have populations below 10,000. Among the 11 high-growth rural counties included, 82 percent of their 42 cities have populations smaller than 25,000 and 68 percent have populations below 10,000. All of the rural counties have smaller proportions of their population living in incorporated areas than the state average of 51.2 percent.

These statistics indicate that a significant number of Florida's counties and municipalities are more rural and smaller than U.S. counties and cities as a whole. They also are more agricultural.

Florida's Changing Economic Base

Over the past two decades, the state's economy has evolved from one "based primarily upon agriculture, tourism, and retirement living to an urban economy which includes a sophisticated mix of industrial and commercial activities."² There is no question, however, that agriculture, forestry, citrus, commercial fishing, and mining comprise a major part of the state's economy.

The counties that have demonstrated the greatest shift away from a predominantly agricultural economic base are those bordering on the state's coastline. These are generally the counties that experienced the most rapid growth between 1980 and 1987, largely because of new migrants from the Frostbelt states and the influx of foreign-owned businesses. Not unexpectedly, many of the state's low-growth rural counties still have agriculturally based economies (agricultural broadly defined). But the economic base of Florida has diversified away from agriculture in recent years.

Florida's economy has changed considerably since the recession of 1974-75. (See Table 1.) According to one study by the Florida Department of Commerce: "Numerous government actions were taken to create in Florida an environment for business which supported the growth and expansion of a variety of different types of industrial activity including manufacturing, international trade and finance, small business and entrepreneurship, and motion

Table 1
Florida's Changing Economic Base, 1967-86

| Industry | Percent of —Gross State Product— | | | Percent Change 1967-86 |
|---|-------------------------------------|------|------|------------------------------|
| | 1967 | 1977 | 1986 | |
| Farms | 3.4% | 2.6% | 1.8% | -47.1% |
| Agricultural Services, Forestry, and Fisheries | 0.8 | 1.0 | 0.7 | -12.5 |
| Mining | 0.8 | 0.8 | 0.9 | + 12.5 |
| Construction | 6.3 | 5.5 | 7.3 | + 15.9 |
| Manufacturing | 13.7 | 10.8 | 10.8 | -21.2 |
| Durable Goods | 7.2 | 5.5 | 6.5 | -9.7 |
| Nondurable Goods | 6.5 | 5.3 | 4.3 | -33.8 |
| Transportation and Public Utilities | 9.4 | 10.3 | 9.3 | -1.1 |
| Wholesale Trade | 7.2 | 7.0 | 7.1 | -1.4 |
| Retail Trade | 12.3 | 12.7 | 12.1 | -1.6 |
| Finance, Insurance, and Real Estate | 17.8 | 18.9 | 18.8 | + 5.6 |
| Services | 14.7 | 16.2 | 19.5 | + 32.7 |
| Federal Civilian Government | 2.7 | 2.4 | 2.0 | -25.9 |
| Federal Military | 3.0 | 2.5 | 1.9 | -36.7 |
| State and Local Government | 7.8 | 9.3 | 8.0 | + 2.6 |

Note: Numbers may not add to 100% due to rounding.

Source: Calculated from *Survey of Current Business*, May 1988, Table 2, p. 42.

picture and television production."³ Growth in the high technology industry, especially in the communications equipment and electronic components and accessories segments, has also helped diversify the state's economy. By 1987, the state ranked sixth in the nation in high technology employment.

New industries of the type cited above have located most frequently located on the perimeters of the state's major metropolitan areas, where tax burdens are lower, land and labor are cheaper, and access to major transportation, financial and educational institutions is relatively easy. As a consequence, many of the fastest growing rural counties in the state are located near one of the largest cities. The low-growth, more agriculturally based rural counties are concentrated in the panhandle (North Florida) where there are few major metropolitan areas. (See Map.) Among rural panhandle counties, the social profile of residents has changed little compared to that of high-growth rural counties.

Social Profile Trends and Differences

Florida's tremendous population growth over the past several decades has clearly changed the state's social profile, especially in terms of age. Nearly half (42.8 percent) of the state's net in-migration between 1975 and 1980 was accounted for by individuals aged 55 and over. Fifty-two percent of the state's new residents came from six midwestern and northeastern states (New York, New Jersey, Ohio, Pennsylvania, Illinois, and Michigan, in order). As a consequence, Florida's population is older than the national average. However, the largest age group in the state is the 18-44 category, which has experienced the second fastest growth rate since 1980 (+22 percent), behind the under-5-year-olds (+31.1 percent)—kids of the baby boom generation.

Not unexpectedly, there is a sharp difference in the age profiles of the two groups of rural counties (see Table 2). High-growth rural counties have a higher percentage of residents over age 65 (20 percent) than low-growth ones (13.1 percent). The populations of the low-growth rural counties are more likely to be native Floridians (68 percent), whereas only 30 percent of the residents of the high-growth rural counties were born in Florida.

Age, previous place of residence, and length of residence in Florida all have been found to affect outlooks toward revenues. In general, Florida's older residents are opposed to higher taxes, particularly on property, and new taxes, specifically, a state income tax. Many new residents initially regard taxes as low, but the longer they live in the state, the more likely they are to oppose raising taxes (especially those earmarked for education) and imposing new taxes.⁴ Native Floridians are even more opposed to higher taxes or new taxes. This suggests that while revenue diversification may be most difficult for local governments in low-growth rural areas, it will be difficult for all the state's local governments, especially where diversification is contingent on voter approval.

There also has been a change in Florida's racial and ethnic mix, primarily in the growth of the Hispanic population, although most of this population has located in the heavily urban South Florida region. Florida's black and Hispanic

Map
Classification of Florida's Counties

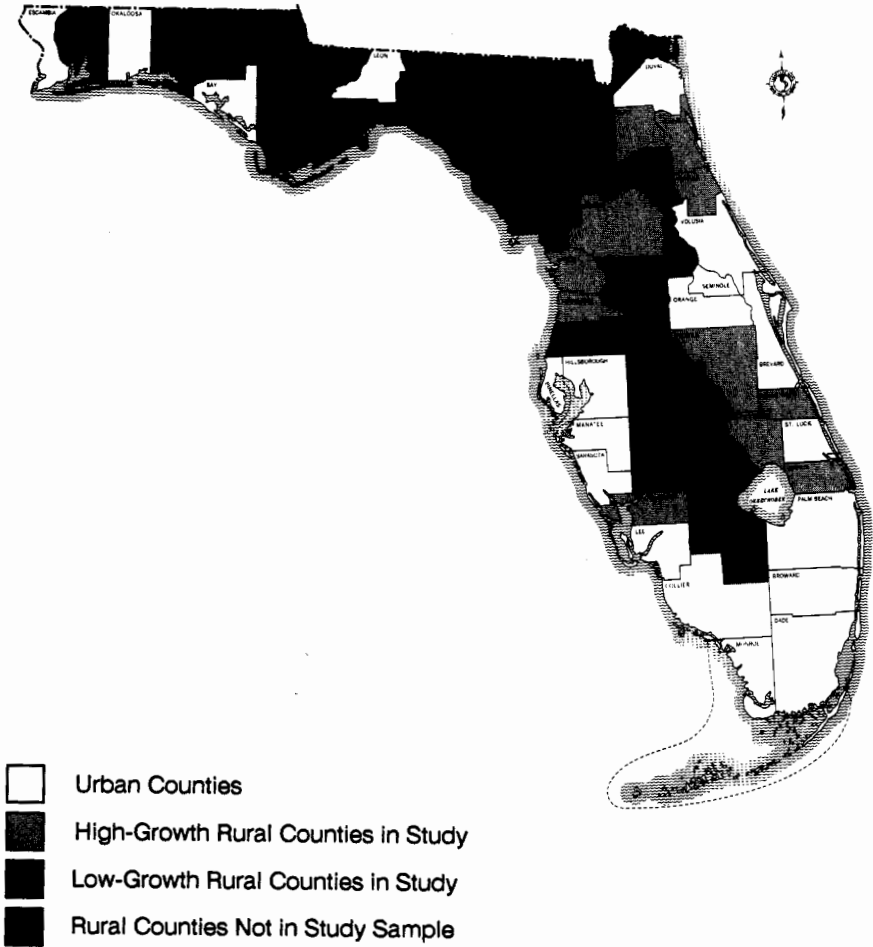


Table 2
**A Comparison of the Demographic, Socioeconomic,
 and Political Profiles of Low-Growth and High-Growth Rural Counties
 in Florida**

| Variable | Rural Counties | | Florida (entire state) |
|--|-------------------|---------------|---------------------------|
| | High Growth | Low Growth | |
| Demographic | | | |
| Population—2000 (estimated) | 21,455 | 126,136 | 15,231,000 |
| Population—1990 (estimated) | 19,891 | 93,673 | 12,597,000 |
| Population—1987 | 19,079 | 81,991 | 12,043,608 |
| Population—1980 | 17,445 | 54,804 | 9,746,961 |
| Population—1970 | 14,866 | 27,351 | 6,791,418 |
| Percent population change—1980-87 | 19.5 | 52.8 | 23.6 |
| Percent population change—1970-80 | 20.1 | 114.4 | 43.5 |
| Square miles—1980 | 579 | 753 | 54,153 |
| Population density—1980 | 32.8 | 110.3 | 180.0 |
| Percent urban—1980 | 21.5 | 43.4 | 84.3 |
| Percent migrated from different state or abroad—1975-80 | 7.4 | 27.4 | 22.2 |
| Socioeconomic | | | |
| Percent employed in farming, mining—1985 | 7.2 | 6.9 | 3.0 |
| Percent manufacturing employment—1985 | 16.2 | 9.6 | 12.6 |
| Percent unemployed—1986 | 7.7 | 6.1 | 8.2 |
| Per capita personal income—1984 | \$7,509 | \$10,891 | \$12,773 |
| Percent college graduate—1980 | 7.6 | 11.8 | 14.9 |
| Percent black—1980 | 26.9 | 8.5 | 13.8 |
| Percent Spanish origin—1980 | 2.5 | 2.2 | 8.8 |
| Percent over 65—1980 | 13.1 | 20.0 | 17.3 |
| Percent born in Florida—1980 | 68.0 | 30.3 | 31.2 |
| Political | | | |
| Percent registered Democrat—1988 | 95.0 | 56.0 | 54.0 |

Sources: U.S. Department of Commerce, Bureau of the Census, *County and City Data Book 1983* (Washington, DC: Census, 1983), Table B. Florida Department of Commerce, *Florida County Profiles* (each county); *Florida: County Comparisons 1987*, Table 17 (Population State—2000 estimated), Table 39 (State Population—1984); *Florida: The Florida Economy* (1987), Table A-4 (Population State—1990 estimated) (Tallahassee: Commerce, 1987).

populations are proportionately larger than the national averages. The labor force participation rates of the two minority groups exceed national averages, more so for blacks than Hispanics.⁵ As shown in Table 2, Hispanics comprise 8.8 percent of the state's 1980 population but only about 2 percent of the populations of the rural counties included in this study. A more significant distinction between the two sets of rural counties is the relative size of their black populations. The proportion of blacks in low-growth rural counties is more than three times that of high-growth rural counties (26.9 percent and 8.5 percent, respectively). Differences also are reflected in the income, employment, and educational levels of the two groups of rural counties. As shown in Table 2, unemployment is higher, and income and educational levels lower, in the rural low-growth counties.

Public opinion surveys have found that Florida's black residents are more than twice as supportive of cutting taxes than are white citizens—26.3 percent and 10.6 percent, respectively, in 1988.⁶ The same surveys have found twice as much support for tax reduction among the low-income population than among more affluent residents. Again, this suggests that revenue diversification may be most difficult for low-growth rural governments and generally more difficult for rural than for urban governments. Political contrasts also may affect revenue diversification efforts differently.

The Changing Political Environment

Once part of the solid Democratic South, Florida is now more of a two-party state. As of November 1988, 54 percent of the state's registered voters were Democrats, 39 percent Republicans, and 7 percent other. The growing strength of the Republican Party is evident in both state and national politics.⁷

A comparison of the political party registration patterns in the two sets of rural counties shows marked differences. The low-growth rural counties have remained one-party Democratic (95 percent), whereas the high-growth rural counties have higher levels of partisan competition (56 percent Democrat). The changing political profile of the high-growth rural counties particularly reflects the migration of new residents from heavily Republican areas of the country. However, these differences in partisan makeup between the two sets of rural jurisdictions may affect revenue diversification less directly than the social factors previously examined.

Public opinion surveys show that Floridians who classify themselves as Conservatives are twice as likely as Liberals to favor tax reduction—21 percent vs. 11 percent.⁸ This suggests that revenue diversification may be most difficult in the high-growth rural areas. However, Democrats in Florida's Panhandle area are more conservative than Democrats in the urban areas, which suggests that there may be a weaker link between attitudes toward revenue diversification and political party identification than between those attitudes and age, income, or race and ethnicity.

The growing strength of the Republican Party throughout the state has had some significant impacts on taxation and revenue issues. For example,

going into the 1989 legislative session, both the governor (Republican) and the Democratic leaders of each house of the state legislature were adamant in saying that “no [new] taxes are in the offing . . . despite new evidence that existing revenue sources won’t meet Florida’s spiraling growth needs.”⁹ In summary, Florida’s fiscally conservative political environment has effectively limited revenue diversification opportunities for many of the state’s general purpose local governments, regardless of their growth rates or rural character.

The Legal Environment for Revenue Diversification

The major sources of locally generated revenue permitted by state law for Florida’s counties and cities are the property tax, local occupational license taxes (counties), and the municipal utility tax (cities). (See Appendix.) Of these, the property tax is the most widely used. It has a 10 mill rate limit for operating purposes. As of December 1988, ten counties were at the cap, and they were all small, rural counties: Calhoun, Dixie, Gadsden, Gilchrist, Lafayette, Madison, Okeechobee, Sumter, Union, and Washington.¹⁰ A comparison of the 1986 millage rates of the rural counties in this study shows that average rates were generally higher in the low-growth counties (8.53) than in the high-growth counties (5.29). For the rural cities in the study, the opposite is true. On average, 1986 millage rates were higher in high-growth cities (3.76) than in low-growth rural cities (1.93). The average statewide figures in 1987 were 7.14 mills for all counties and 4.85 mills for all cities.¹¹

There are two other state-imposed “restrictions” on the local property tax that have severe revenue ramifications, particularly for the low-growth rural governments. These restrictions are a \$25,000 homestead exemption and a differential assessment standard for agricultural property (the “Greenbelt” law). Agricultural property is assessed according to its value in current use (agricultural) rather than its fair market value. Statewide, the estimated taxable value loss of the homestead exemption is \$65,758,000 for each mill levied; for the agricultural land differential assessment policy, \$21,782,600.¹² The homestead exemption by itself is a tax expenditure equivalent to 20 percent of all ad valorem taxes collected.¹³

Political constraints on heavier use of the property tax also are quite significant. Floridians consistently have been more likely to regard local property taxes as too high relative to other tax sources. For example, in 1988, 30.2 percent of taxpayers surveyed rated the local property tax as too high, compared to only 21.8 percent for the state sales tax. Nearly 20 percent of residents regard the local property tax as the least fair of all taxes—federal, state, or local.¹⁴

In spite of significant political opposition, city and county millage rates have begun to rise since a state-mandated rollback in the early eighties, often because the property tax remains one of the few discretionary tax options open to local governments.

Florida has numerous constitutional and statutory constraints on local use of traditional revenue options that are popular among local governments elsewhere. For example, the state and its local governments are constitution-

ally prohibited from levying a personal income or payroll tax. (Only 17 states authorize local use of these revenue sources.¹⁵)

Florida also restricts general purpose governments' use of local option sales taxes. As of 1988, 30 states authorized either municipal or county governments to impose a general sales tax.¹⁶ Florida only recently has permitted local governments to use general sales taxes. In 1987, the state legislature granted county governments the authority to impose a one-cent local option sales tax, subject to approval in a referendum. Not unexpectedly, voter approval has been difficult to obtain.¹⁷

Local use of selective sales taxes is permitted more widely, but the revenues frequently are earmarked by law for functions ranging from county tourist development, indigent care, low-income housing assistance, and criminal justice facilities to the more traditional construction and repair of roads. Many of these earmarked local option sales taxes may be used only by the largest counties: Duval, Hillsborough, and Dade. (See Appendix.) In fact, only four local option taxes may be imposed in all 67 counties, and 80 percent of the taxes require a voter referendum for approval.¹⁸

The restrictiveness of state statutes with regard to local government use of sales taxes has been the target of the Florida League of Cities and the Florida Association of Counties. These groups continue to seek state legislation to allow local governments to impose these taxes without voter approval. The repeal of Florida's services tax has made local officials reluctant to submit local option sales tax referenda to voters.¹⁹ Sixty percent (27 of 37) of the counties initially planning to submit a general local option sales tax question to their voters chose to remove the question from the ballot after the repeal of the services tax. Yet the pressures associated with growth and compliance with the state's growth management act (discussed below) have increased the fiscal pressures on local governments and intensified their search for unrestricted revenues.

While local government use of traditional nonproperty taxes (income and sales) is fairly restricted, Florida is more liberal than many states—it ranks 25th—in the sources and amount of state revenue it shares with local governments.²⁰ Revenue from 17 state sources is shared in some measure with cities and/or counties. Part of the explanation for the extensiveness of shared revenue is that the Florida Constitution (Article VII, Section 1) “preempts to the state all revenue sources not specifically provided by law except for the ad valorem tax.”

Counties receive shares of the state's revenue from taxes on beverage licenses; gasoline, other motor fuels, and roads; cigarettes; insurance licenses; general sales; intangible property; mobile home licenses; oil and gas products; parimutuel betting; and solid materials severance. When the county serves as the primary collection unit (e.g., for beverage, sales, and license taxes) the state's sharing formula generally returns revenues on a point-of-origin basis rather than a redistributive basis. Most of these shared revenues are unrestricted, with the exception of the various gasoline taxes, which tend to be earmarked to transportation-related activities.

Municipalities receive shares of the state's revenues from taxes on: beverage licenses; cigarettes; insurance premiums; intangible property; gasoline, motor fuel, and road usage; general sales; and mobile home licenses. As in the counties, use of these revenues is generally unrestricted (with the exception of gasoline, fuel, and road usage taxes) and is returned on the basis of point of origin.

County school boards share in the state's lottery proceeds and revenues from fuel taxes, parimutuel betting, and mobile home licenses.

Changes in Constitutional and Statutory Authorizations

The general pattern in Florida has been to expand the sources of revenue available to local governments primarily through more liberal sharing of state tax revenues. Both cities and counties have become more reliant on state shared revenue in the 1980s. However, "state shared revenues, while up from their levels at the beginning of the decade, remain fixed at the amounts provided in the early seventies when seen in real terms."²¹ More specifically, Bradley found that counties received slightly more, but municipalities actually received less, in state shared revenue in 1987 than in 1973 once adjustments for inflation were made.

Where new local options have emerged, they have been reserved for certain functions and granted to the state's largest and most heavily urbanized cities and counties. Many of these new revenue sources have become available in this decade. Florida's first revenue sharing program funded from sales tax revenues was authorized in 1982 (Chapter 82-154 of the statutes).²² This program has been revised in nearly every legislative session since 1982, but it remains a major source of local government revenue.²³

In 1987, the legislature passed the sales and use tax on services, which levied a special sales tax on a large number of previously exempted services (e.g., sanitary construction, recreation, legal, and advertising services). A portion of the proceeds of this tax was earmarked for local governments through the revenue sharing program. The tax was repealed in a special session in late 1987, and the legislature increased the sales tax on goods from 5 to 6 percent effective February 1, 1988. The new statute also increased the percentage of state sales tax revenue shared with local governments from 9.846 percent to 9.888 percent, effective July 1, 1988, to make up for the revenue lost from the repeal of the services tax. However, one of the complaints of local officials is that the sales tax is not generating as much revenue as had been forecast for the services tax.

In recent years, Florida also has recognized the special revenue needs of the less populated, less affluent rural counties. Special provisions of the revenue sharing program created in 1982 provide for supplemental and emergency monies to be appropriated to these types of jurisdictions.²⁴

Since 1980, shared state revenues for counties and cities have included monies from the insurance premium tax (cities only), state fuel user's fee, local fuel user's fee, and an additional severance tax on phosphates (counties only). State-shared revenue sources abandoned during this time period were the

auto road tax (eliminated in 1980) and the local additional homestead exemption tax (eliminated in 1982).

For school districts, the state lottery, authorized in Chapter 24.121 of the 1987 Florida Statutes, is the newest revenue source. The statute mandates that "each fiscal year, at least 35 percent of the monies in the Administrative Trust Fund (all money received for lottery sales) shall be deposited in the Educational Enhancement Trust Fund . . . to be used to the benefit of public education." While the lottery greatly exceeded revenue projections in its first year of operation, state and local school administrators have expressed concern that the net gain to local school districts will be minimal. One recent study predicts that there actually may be a negative impact on county school boards in the long term because of the public's perception that all lottery proceeds go to education. "Their ability to raise sorely needed revenues through school board referenda and property tax millage rate increases will be severely hampered by their constituents' erroneous appraisal of their true fiscal condition."²⁵

Some new nontax revenue sources have emerged in recent years, and these sources have been tapped in response to revenue pressures that have intensified due to restrictions on local taxing authority, a decline in levels of federal aid, rapid growth, and passage of the growth management act of 1985.

The Growth Management Act of 1985: The Fiscal Consequences

In 1985, Florida passed the Local Government Comprehensive Planning and Land Development Regulation Act.²⁶ The general thrust of the law is to require local governments to prepare growth plans for approval by the state Department of Community Affairs in compliance with the state's comprehensive plan.²⁷ The local growth plans must ensure that new developments will not be permitted unless adequate infrastructure (roads, schools, sewer plants, police, parks, etc.) will be available when the development is completed. Known as "concurrency," this pay-as-you-go approach has put an inordinate amount of economic and political pressure on local governments. This is especially true in small, rural, high-growth cities and counties that do not have much experience using debt financing (general obligation or revenue bonds) for major infrastructure expansions.

As a consequence of this law, along with the repeal of the services tax, new fears of submitting local option sales taxes to the voters, and a reluctance to rely exclusively on the property tax, local governments have turned to impact fees to fund infrastructure expansion. Impact fees are defined by the International City Management Association as "monies collected formally through a set schedule, or formula, spelled out in a local ordinance. They are levied only against new development projects as a condition of permit approval, to support infrastructure needed to serve the proposed development. They are calculated to cover the proportionate share of the capital costs for that infrastructure."²⁸ In Florida, impact fees are not authorized specifically by state law, but they have been imposed under the police powers of local government

to protect the public's health, safety, and welfare.²⁹ As of July 1988, 28 counties had impact fee ordinances.³⁰ Most of these were counties with high growth rates between 1980 and 1987.

The imposition of impact fees is not without political controversy. Where imposed, developers generally have opposed them, arguing that they will have a negative effect on economic development in a particular jurisdiction because developers will choose to go instead to cities and counties where there are no such fees or where the fees are lower. Thus far, the revenue realities confronting Florida's local government officials have generally caused them to impose new or higher impact fees in spite of developers' gloomy forecasts of the long-term consequences.

The use of impact fees also has generated some new tensions between the state's cities and counties. In November 1988, the state's Fifth District Court of Appeals ruled that city ordinances barring the county from charging transportation impact fees within city limits were invalid. Several county commissions are investigating the possibility of requiring municipalities to adopt impact fee ordinances consistent with county ordinances.

The emphasis on local economic development efforts brought about by the growth management act has stimulated the use of other financing techniques in addition to impact fees. There has been an increase in the use of industrial revenue bonds (IRBs) and tax increment finance districts to fund infrastructure needs associated with new manufacturing and industrial-based businesses. Of the state's 67 counties, 91 percent authorized IRBs as of 1987. Thirty-nine percent of the counties authorize use of tax increment financing.

Even with these "new" revenue-generating devices, local governments still fear that they will generate insufficient revenue to fund the infrastructure demands in a fast-growing state. They also worry that the state will continue to restrict local tax revenue sources while heaping more functional responsibilities on local governments.

The Mandate Issue

State mandates have become a big issue in Florida and are a pet peeve of city and county officials. The Florida League of Cities and the Florida Association of Counties are conducting a petition drive to place a constitutional amendment on the 1990 general election ballot to limit state mandates. These groups have determined that the legislature has passed more than 225 unfunded mandates since 1980, costing Florida's cities and counties between \$600 million to \$1 billion dollars annually.³¹ Counted among these mandates is the 1985 growth management act. The irony from the perspective of many local officials is that the monies desperately needed to meet the requirements of the infrastructure-intensive growth management act are being siphoned away to cover the costs of other newly mandated local responsibilities, such as a required 50 percent boost in pension benefits for local law enforcement officers and fire fighters.

In summary, the state's legal environment is more permissive for counties than for cities, and for larger jurisdictions than for smaller ones. The restric-

tiveness of the legal environment has had significant impacts on the revenue patterns of the rural jurisdictions.

Changing Revenue Reliance Patterns

Marked differences in the demographic, socioeconomic, and political profiles of the state's low-growth and high-growth rural local governments have produced some interesting variations in their respective revenue patterns over the last decade. And, as noted in the previous section, the legal authority to tap each of the revenue sources available does not apply uniformly to all counties and municipalities.

County Incidence and Reliance Patterns

As the figures in Table 3 show, the largest number of rural counties receive revenue from these sources: property taxes, intergovernmental revenue from the federal and state governments, licenses and permits, user charges for general government services, fines and forfeitures, earnings from interest, and other miscellaneous revenue. In 1986, 13 of the 22 counties in this study had enterprise funds (up from 9 in 1980). These funds are used to account for self-supporting county governmental activities such as electric utilities, water and sewer systems, and airports.³² Enterprise funds are financed predominantly by user charges, and while 90 percent of high-growth rural counties used them, only 27 percent of low-growth counties did so.

The most noticeable contrasts between the tax usage patterns of high- and low-growth rural counties are in the numbers raising revenue from: (1) sales and use taxes—10 of 11 high-growth counties but only 5 of the 11 low-growth counties in 1986; (2) franchise taxes—10 high-growth and 4 low-growth; and (3) professional and occupational license taxes—10 high-growth and 6 low-growth. High-growth rural counties, in general, also rely more frequently on a wider range of user charges. More high-growth rural counties also tap a greater variety of "miscellaneous revenue" sources (rents and royalties; special assessments and impact fees; contributions and donations). In summary, among the rural counties in this study, those characterized by high growth also have more diversity in revenue sources.

In terms of changes in revenue usage from 1980 to 1986 (the latest figures available), the data show that among low-growth counties the biggest percentage increases have been in sales and use taxes (+ 400 percent), utility services taxes (+ 200 percent), and locally shared revenue in lieu of taxes (+ 300 percent). It should be noted that these dramatic increases are attributable in part to low initial, or base, figures.

Generally, there were far fewer new users of different types of revenue among high-growth rural counties, the highest percentage being for sales and use taxes (+ 899 percent).

These figures suggest that changes in the revenue structures of low-growth rural counties have been more dramatic over the past decade, but significantly greater proportions of high-growth rural counties tap a wider variety of permissible revenue sources.

Table 3
Revenue Use Patterns, Florida Rural Counties, 1980 & 1986
 (Governmental Funds)

| Revenue Source | 1980 | | | | 1986 | | | | Change 1980-86 | | | |
|----------------------------------|-------------------------------|-----|---------------------------------------|------|-------------------------------|-----|---------------------------------------|------|-------------------------------|--------|---------------------------------------|--------|
| | Number of Jurisdictions Using | | Percent of Total Revenue ¹ | | Number of Jurisdictions Using | | Percent of Total Revenue ¹ | | Number of Jurisdictions Using | | Percent of Total Revenue ¹ | |
| | Growth: High | Low | Growth: High | Low | Growth: High | Low | Growth: High | Low | Growth: High | Low | Growth: High | Low |
| Taxes | | | | | | | | | | | | |
| Property Taxes | 11 | 11 | 43.1 | 26.2 | 11 | 11 | 42.5 | 32.8 | — | — | -1.4 | +25.2 |
| Selective Sales and Use Taxes | 1 | 1 | 1.0 | — | 10 | 5 | 7.8 | 6.5 | +898.9 | +400.0 | +680.0 | +100.0 |
| Franchise Taxes | 7 | 2 | 1.4 | 3.6 | 10 | 4 | 1.3 | 0.8 | +42.9 | +100.0 | -7.1 | -77.8 |
| Utility Service Taxes | 1 | 1 | — | 17.3 | 2 | 3 | 1.3 | 2.4 | +100.0 | +200.0 | +100.0 | -86.1 |
| Other Taxes | — | — | — | — | — | — | — | — | — | — | — | — |
| Licenses and Permits | | | | | | | | | | | | |
| Professional/Occupational | 11 | 7 | 0.5 | 0.5 | 10 | 6 | 0.3 | 0.2 | -9.1 | -14.3 | -40.0 | -60.0 |
| Building Permits | 11 | 8 | 2.6 | 0.5 | 11 | 11 | 2.3 | 0.5 | — | +37.6 | -11.5 | — |
| Other Licenses and Permits | 6 | 3 | 0.8 | 0.6 | 7 | 7 | 0.2 | 0.1 | +16.7 | +133.0 | -75.0 | -83.3 |
| Intergovernmental Revenue | | | | | | | | | | | | |
| Federal Grants | 11 | 11 | 6.8 | 19.0 | 10 | 10 | 0.9 | 8.1 | -9.1 | -9.1 | -86.8 | -57.4 |
| Federal Shared/Pilot | 11 | 10 | 5.0 | 7.1 | 11 | 11 | 2.6 | 4.1 | — | +11.0 | -48.0 | -42.3 |
| State Grants | 11 | 9 | 1.9 | 3.9 | 11 | 11 | 1.1 | 1.0 | — | +22.2 | -42.1 | -74.4 |
| State Shared/Pilot | 11 | 11 | 20.3 | 29.3 | 11 | 11 | 19.0 | 33.2 | — | — | -6.4 | +13.3 |
| Local Grants | 3 | 3 | 0.6 | 0.4 | 4 | 5 | 0.1 | 0.8 | +33.3 | +25.0 | -83.3 | +100.0 |
| Local Shared/Pilot | — | 1 | — | 0.1 | 4 | 4 | 0.3 | 0.8 | +100.0 | +300.0 | +100.0 | +700.0 |

Charges for Services

| | | | | | | | | | | | | |
|---------------------------------|----|----|-----|-----|----|----|-----|-----|--------|--------|--------|--------|
| General Government | 11 | 9 | 3.1 | 2.4 | 11 | 11 | 6.5 | 4.1 | — | +11.0 | +109.7 | +70.8 |
| Public Safety | 10 | 7 | 1.5 | 2.3 | 10 | 10 | 0.6 | 1.9 | — | +42.3 | -60.0 | -17.4 |
| Physical Environment | | | | | | | | | | | | |
| Electric | — | — | — | — | — | — | — | — | — | — | — | — |
| Gas | — | — | — | — | — | — | — | — | — | — | — | — |
| Water | — | — | — | — | — | — | — | — | — | — | — | — |
| Garbage/Solid Waste | 8 | 4 | 1.2 | 0.4 | 5 | 7 | 1.0 | 0.9 | -37.4 | +74.7 | -16.7 | +125.0 |
| Sewer | — | — | — | — | — | — | — | — | — | — | — | — |
| Water/Sewer Combined | — | — | — | — | — | — | — | — | — | — | — | — |
| Other Physical Environment | 3 | — | 0.1 | — | 4 | 1 | 0.5 | — | +33.3 | +100.0 | +400.0 | — |
| Transportation | 1 | 3 | — | 0.5 | — | 3 | — | 1.6 | -100.0 | — | — | +220.0 |
| Economic Environment | | | | | | | | | | | | |
| Human Services | 7 | 2 | 0.5 | 0.4 | 9 | — | .1 | — | +28.6 | -100.0 | -80.0 | -100.0 |
| Recreation/Culture | 6 | 3 | 0.5 | 0.5 | 7 | 6 | 0.5 | 0.3 | +16.7 | +99.6 | — | -40.0 |
| Other Charges for Services | 3 | 2 | 0.3 | 0.2 | 8 | 1 | 0.3 | 0.4 | +16.6 | -50.0 | — | +100.0 |
| Fines and Forfeitures | 11 | 11 | 3.0 | 4.3 | 11 | 11 | 2.3 | 3.5 | — | — | -23.3 | -18.6 |
| Miscellaneous Revenues | | | | | | | | | | | | |
| Interest Earnings | 11 | 10 | 5.0 | 2.7 | 11 | 11 | 5.4 | 3.2 | — | +10.0 | +8.0 | +18.5 |
| Rents and Royalties | 10 | 6 | 0.2 | 0.4 | 10 | 8 | .1 | 0.7 | — | +33.3 | -50.0 | +75.0 |
| Special Assessments/Impact Fees | 6 | 1 | 3.4 | 1.7 | 9 | 2 | 4.3 | 2.8 | +50.1 | +100.0 | +26.5 | +64.7 |
| Sales and Compensation | | | | | | | | | | | | |
| for Loss-Assets | 9 | 7 | 0.5 | 0.5 | 10 | 10 | .4 | 0.3 | +11.1 | +41.7 | -20.0 | -40.0 |
| Contributions and Donations | 7 | 2 | 0.3 | 0.4 | 11 | 3 | 0.6 | 0.3 | +57.2 | +50.0 | +100.0 | -25.0 |
| Other Miscellaneous Revenue | 11 | 11 | 0.8 | 0.9 | 11 | 11 | 2.0 | 1.8 | — | — | +150.0 | +100.0 |

Note: Percentages in these columns do not add to 100%. They represent the average Percent of Total Revenue only for those jurisdictions utilizing each revenue source. The number of jurisdictions using each revenue source varies, as shown in the column heading labeled Number of Jurisdictions Using.

Source: Calculated from Florida Department of Banking and Finance, *State of Florida Local Government Financial Report: Supplemental Revenue and Expenditure Detail* (Tallahassee: Office of the Comptroller, annual), Table C-2.

The largest pieces of the county revenue pie are different for high- and low-growth counties. As the figures in Table 3 show, among low-growth rural counties, the two largest revenue sources for 1986 were state-shared revenue (33 percent) and property taxes (33 percent). Another 12 percent came from the federal government. The pattern was markedly different for high-growth rural counties. They were characterized by heavier dependence on property taxes (43 percent) and on state-shared revenue (19 percent).

Perhaps the most significant contrast (and change) was the increase in the proportion of revenues from other financing sources used to support the governmental fund (not shown in Table 3). By 1986, interfund transfers-in and debt proceeds supported about a third of high-growth rural counties' governmental funds, and about a fourth of those in low-growth rural counties. A similar pattern characterized county enterprise funds. Interfund transfers are accounting-based shifts of revenue into governmental funds from other funds such as enterprise funds or trust and agency funds.

Municipal Incidence and Reliance Patterns

Two patterns are observable among the rural municipalities in the study. First, municipalities tap a wider range of revenue sources than do counties. Second, there was less change in the revenue usage patterns of municipalities between 1980 and 1986.

The most popular revenue sources among rural municipalities in low-growth counties as of 1986 were: federal and state shared revenues and payments in lieu of taxes (all 42 municipalities get revenue from these sources); interest earnings (39); other miscellaneous sources (37); franchise taxes (36); property taxes (32); and professional and occupational licenses and permits (31). (See Table 4.) The largest shares (percentages) of their total 1986 revenues are generated from: state-shared grants (43 percent); federal grants (28 percent); user charges for garbage and solid waste (13 percent); and utility service taxes (12 percent).

Property taxes contribute only 7 percent of the total revenue of low-growth rural municipalities. The major explanation for this pattern is that, with homestead exemptions and agricultural differential assessments, there is a relatively small proportion of taxable land in these cities. These municipalities are forced to depend more heavily on intergovernmental revenues, especially state-shared revenues and user-based revenues (utility service taxes and user fees for garbage, solid waste, and water).

Between 1980 and 1986, the increase in the number of rural low-growth municipalities using the following sources was: sales and use taxes (over 1,000 percent); franchise taxes (+ 25 percent); and various charges (general government services + 81 percent; public safety + 51 percent; other physical environment + 80 percent; human services + 85 percent). More municipalities relied on miscellaneous revenues, such as rents and royalties (+ 56 percent), special assessments and impact fees (+ 34 percent), and contributions and donations (+ 36 percent). (See Table 4.) Fewer municipalities, however, received revenue from property taxes, building permits, intergovernmental grant sources

(federal, state, local), fines and forfeitures, and various other user fees (e.g., for recreation, transportation, water, and garbage). The relative decline in the number of municipalities relying on user charge financing to support governmental funds is attributable to an increase in the use of earmarking to support their enterprise funds. Similar to the pattern observed among counties, there has been a slight increase in the number of small rural low-growth municipalities using enterprise funds. The number increased from 31 in 1980 to 36 in 1986.

An examination of the changes in revenue reliance patterns between 1980 and 1986 shows that rural low-growth municipalities generally have become more dependent, or reliant, on (1) charges;³³ (2) miscellaneous revenue (interest earnings, special assessments and impact fees, and sales and compensation for loss assets), and (3) licenses and permits. These municipalities have become less dependent on property taxes, sales and use taxes, most types of intergovernmental revenue (except federal grants), fines and forfeitures, and some miscellaneous revenues. Debt proceeds and enterprise and trust fund transfers also declined in importance as revenue sources for these governments' governmental funds. As noted earlier, these sources became more preeminent for support of enterprise funds.

The revenue incidence and reliance patterns of municipalities in the high-growth rural counties in the study are somewhat different. (See Table 4.) Of the 33 cities in this group, many more of them use a greater variety of the revenue sources available to Florida's cities. Much of this, of course, is explained by the pressures of growth and the formula factors associated with many of the local options and tax revenues. For example, municipalities as a group do not have unilateral authority to impose the infrastructure surtax, local option gas tax, tourist development tax, or the one-cent voted gas tax. Municipalities' receipt of revenue from these sources is contingent on county government imposing these taxes. This is more common among high-growth than low-growth rural counties, which explains the greater revenue diversity of these rural high-growth cities. Likewise, the return of state-shared tax revenues on the basis of point of origin makes fast-growing rural municipalities more reliant on these revenue sources than their counterparts in low-growth areas.

In summary, in 1986, municipalities in high-growth rural counties most frequently tapped the following revenue sources for their governmental funds: interest earnings (32); state-shared revenues (29); franchise taxes (29); property taxes (28); federal shared revenues (28); other miscellaneous revenues (28); professional and occupational licenses and permits (28); sales and use taxes (27); building permits (27); and fines and forfeitures (24).

The most productive revenue sources for the high-growth rural municipalities, as measured by their proportional reliance on them for support of their governmental funds, are property taxes (25 percent) and state-shared revenue (24 percent). Debt proceeds (20 percent), interfund transfers (12 percent), and contributions from enterprise operations (10 percent) also were significant supports for governmental funds. The much heavier reliance on the

Table 4
Revenue Use Patterns, Florida Rural Municipalities: 1980 & 1986
 (Governmental Funds)

| Revenue Source | 1980 | | | | 1986 | | | | Change 1980-86 | | | |
|----------------------------------|-------------------------------|-----|---------------------------------------|------|-------------------------------|-----|---------------------------------------|------|-------------------------------|---------|---------------------------------------|--------|
| | Number of Jurisdictions Using | | Percent of Total Revenue ¹ | | Number of Jurisdictions Using | | Percent of Total Revenue ¹ | | Number of Jurisdictions Using | | Percent of Total Revenue ¹ | |
| | High | Low | High | Low | High | Low | High | Low | High | Low | High | Low |
| Taxes | | | | | | | | | | | | |
| Property Taxes | 30 | 33 | 29.2 | 10.2 | 28 | 32 | 25.4 | 7.4 | -6.7 | -12.2 | -13.0 | -27.5 |
| Selective Sales and Use Taxes | — | — | — | — | 27 | 16 | 8.6 | 4.5 | +100.0 | +1365.4 | +100.0 | -64.8 |
| Franchise Taxes | 29 | 26 | 12.8 | 8.9 | 29 | 36 | 11.8 | 9.0 | — | +25.3 | -8.8 | +1.1 |
| Utility Service Taxes | 19 | 24 | 11.3 | 10.9 | 16 | 28 | 11.7 | 11.7 | -15.8 | +5.5 | +3.5 | +7.3 |
| Other Taxes | 2 | 1 | 2.4 | 19.0 | — | — | — | — | -100.0 | -100.0 | -100.0 | -100.0 |
| Licenses and Permits | | | | | | | | | | | | |
| Professional/Occupational | 30 | 26 | 1.9 | 1.0 | 28 | 31 | 1.3 | 1.0 | -6.7 | +7.9 | +31.6 | — |
| Building Permits | 28 | 19 | 3.0 | 0.4 | 27 | 14 | 2.5 | 0.5 | -3.5 | -33.4 | -16.7 | +25.0 |
| Other Licenses and Permits | 14 | 8 | 0.6 | 0.1 | 12 | 10 | 0.3 | 0.2 | -14.2 | +12.8 | -50.0 | +100.0 |
| Intergovernmental Revenue | | | | | | | | | | | | |
| Federal Grants | 17 | 23 | 11.1 | 19.7 | 9 | 16 | 8.8 | 27.5 | -47.0 | -37.0 | -20.7 | +39.6 |
| Federal Shared/Pilot | 30 | 36 | 5.8 | 6.4 | 28 | 42 | 2.2 | 3.8 | -6.7 | +5.6 | -62.1 | -40.6 |
| State Grants | 9 | 15 | 1.9 | 10.0 | 9 | 5 | 3.6 | 1.8 | — | -70.9 | +89.5 | -82.0 |
| State Shared/Pilot | 33 | 3 | 19.2 | 39.9 | 29 | 42 | 23.6 | 43.1 | -12.1 | +5.6 | +22.9 | +8.8 |
| Local Grants | 6 | 10 | 4.2 | 6.8 | 5 | 11 | 1.7 | 2.7 | -16.5 | -0.4 | -59.5 | -60.3 |
| Local Shared/Pilot | 27 | 16 | 2.4 | 1.1 | 21 | 15 | 2.5 | 1.3 | -22.2 | -15.2 | +4.2 | +18.2 |

Charges for Services

| | | | | | | | | | | | | |
|---------------------------------|----|----|-----|------|----|----|-----|------|--------|--------|--------|--------|
| General Government | 17 | 11 | 0.5 | 1.3 | 19 | 22 | 0.7 | 0.9 | +11.8 | +81.3 | +40.0 | -30.8 |
| Public Safety | 12 | 9 | 3.7 | 0.7 | 16 | 15 | 3.1 | 3.2 | +33.2 | +50.6 | -16.2 | +357.1 |
| Physical Environment | | | | | | | | | | | | |
| Electric | — | — | — | — | — | — | — | — | — | — | — | — |
| Gas | — | — | — | — | — | — | — | — | — | — | — | — |
| Water | 2 | 2 | 7.7 | 15.6 | — | 1 | — | 9.4 | -100.0 | -54.7 | -100.0 | -39.7 |
| Garbage/Solid Waste | 11 | 17 | 9.1 | 10.4 | 8 | 15 | 6.6 | 12.6 | -27.3 | -20.1 | -27.5 | +21.2 |
| Sewer | 2 | — | 8.1 | — | — | — | — | — | -100.0 | — | -100.0 | — |
| Water/Sewer Combined | — | 2 | — | 0.2 | — | — | — | — | — | -100.0 | — | -100.0 |
| Other Physical Environment | 10 | 5 | 0.7 | 0.6 | 11 | 10 | 1.9 | 0.9 | +9.9 | +80.3 | +171.4 | +50.0 |
| Transportation | 3 | 2 | 0.6 | 0.0 | 4 | 2 | 0.6 | 0.2 | +33.0 | -9.4 | — | +100.0 |
| Economic Environment | — | 1 | — | 2.1 | — | — | 0.1 | — | — | -100.0 | +100.0 | -100.0 |
| Human Services | — | 1 | — | 0.0 | 1 | 2 | — | 1.0 | +100.0 | +84.6 | — | +100.0 |
| Recreation/Culture | 14 | 14 | 1.2 | 1.8 | 17 | 14 | 0.9 | 0.8 | +21.5 | -9.5 | -25.0 | -55.6 |
| Other Charges for Services | 2 | 6 | 0.1 | 1.2 | 3 | 2 | 0.6 | 0.4 | +49.2 | -69.8 | +500.0 | -66.7 |
| Fines and Forfeitures | 24 | 28 | 2.5 | 2.2 | 24 | 26 | 3.2 | 1.9 | — | -16.0 | +28.0 | -13.6 |
| Miscellaneous Revenues | | | | | | | | | | | | |
| Interest Earnings | 31 | 35 | 5.0 | 2.3 | 32 | 39 | 5.4 | 4.8 | +3.3 | +0.9 | +8.0 | +108.7 |
| Rents and Royalties | 18 | 11 | 0.8 | 2.1 | 20 | 19 | 0.6 | 1.8 | +11.2 | +56.4 | -25.0 | -14.3 |
| Special Assessments/Impact Fees | 5 | 2 | 1.6 | 0.5 | 8 | 3 | 5.2 | 2.1 | +59.2 | +34.0 | +225.0 | +320.0 |
| Sales and Compensation | | | | | | | | | | | | |
| for Loss-Assets | 17 | 18 | 2.2 | 2.0 | 19 | 22 | 0.6 | 3.4 | +11.8 | +10.5 | -72.7 | +70.0 |
| Contributions and Donations | 8 | 4 | 1.0 | 5.0 | 13 | 6 | 7.4 | 3.1 | +62.8 | +36.2 | +640.0 | -38.0 |
| Other Miscellaneous Revenue | 28 | 32 | 2.3 | 1.9 | 28 | 37 | 4.8 | 1.6 | +0.4 | +5.0 | +108.7 | -15.8 |

Note: Percentages in these columns do not add to 100%. They represent the average percent of total revenue only for those jurisdictions utilizing each revenue source. The number of jurisdictions using each revenue source varies, as shown in the column heading labeled Number of Jurisdictions Using.

Source: Calculated from Florida Department of Banking and Finance, *State of Florida Local Government Financial Report: Supplemental Revenue and Expenditure Detail* (Tallahassee: Office of the Comptroller, annual), Table C-2.

property tax by these governments in contrast to that of low-growth municipalities is attributable primarily to an expanding, more valuable tax base, not to higher millage rates.

In terms of changing reliance patterns between 1980 and 1986, municipalities in the high-growth rural counties intensified their relative dependence on sales and use taxes, charges for some services, and most miscellaneous revenue sources. However, the proportions contributed by these sources remained relatively small in relation to property taxes and state-shared revenues. It is apparent that diversification is easier with regard to various types of locally generated nontax revenues (license and permits; charges for services; fines and forfeitures; special assessments; rents, royalties, and sale of properties; contributions and donations) and revenue bond-financed debt than for tax revenues.

The changes in revenue incidence and reliance patterns of high-growth rural municipalities are evidence of the general pattern of revenue diversification that has been observed among both groups of rural municipalities. Another commonality has been the increase in the use of enterprise funds and the propensity to fund them through service charges and debt.

As among rural counties, there have been some similarities and some contrasts in revenue diversification patterns among low- and high-growth municipalities. The contrasts are frequently a product of the different demographic, socioeconomic, and political profiles associated with variations in growth rates.

Summary of Major Findings

This comparison of the revenue diversification patterns of low- and high-growth rural counties and municipalities in Florida over the past decade has shown that for both groups:

- 1) Their ability to adopt a number of traditional local option taxes, especially without voter approval (e.g., local general and selective sales taxes and local income taxes), is severely restricted by state law.
- 2) They are heavily dependent on state-shared revenue sources. While these sources have expanded in number and/or size, the inflation-adjusted amount of revenue returned has declined for cities and increased only marginally for counties.
- 3) They have had to endure the fiscal pressures associated with reductions in federal funding levels and increases in the number of state mandates, including the labor- and capital-intensive requirements of the state growth management act.
- 4) They have generally "diversified" with regard to nontax revenue sources (licenses and permits; charges and user fees; miscellaneous revenues, including impact fees and special assessments). With the exception of the new local option sales tax for counties (contingent on voter approval) and the lottery for local school

boards, no new tax sources have been permitted for local governments in quite some time.

- 5) They have become more frequent users of enterprise funds and debt financing to handle infrastructure expansion.

Growth differentials have produced sharply different demographic, socioeconomic, and political profiles among the low- and high-growth rural governments in this study. These contrasting profiles have resulted in significantly different revenue incidence and reliance patterns, especially where statutes and state-shared revenue formulas have incorporated some growth-related eligibility criteria. The major differences observed between low- and high-growth rural counties and municipalities are:

- 1) Low-growth counties are less frequent users of sales and use taxes, franchise taxes, professional and occupational license taxes, and user fees than are high-growth counties. Low-growth counties are heavily dependent on property taxes and shared state revenue.
- 2) High-growth counties generate revenue from significantly more and different revenue sources than do low-growth counties. High-growth counties are more dependent on user charges.
- 3) The expanding tax bases of high-growth rural counties allow them to impose lower millage rates but to raise significantly more money from the property tax. Low-growth rural counties are often close to millage rate limits, but they have less valuable tax bases and a greater proportion of their property removed from the taxable roll due to homestead exemptions and agricultural assessments. As a consequence, the pressure to diversify has been greater among low-growth counties, but the ability to generate significant amounts of revenue from nontax sources such as charges, user fees, and impact fees has been limited by their lack of growth.
- 4) Rural municipalities tap a wider range of revenue sources, particularly service charges, than do rural counties, due primarily to differences in their functional responsibilities.
- 5) Low-growth rural municipalities intensified their use of non-property taxes and some types of user fees. High-growth rural municipalities increased their dependence on nontax revenue sources (charges and miscellaneous revenues, including growth-stimulated special assessments and impact fees).

These findings should be of interest to officials in other states where local government taxing authority is fairly restricted and where there are markedly different intrastate growth patterns. There is a consensus among Florida's local government officials that their limited taxing authority, in combination with increasingly expensive state-imposed mandates and declining federal aid levels, has placed both low and high-growth rural governments in a fiscal bind.

Major Challenges in the 1990s: Florida's Rural Local Governments

The central challenge to Florida's rural local governments in the next decade will be how to raise sufficient revenue to meet the requirements of the growth management act. New local taxing options are a high priority of the membership of the Florida League of Cities and the Florida Association of Counties. At a recent legislative hearing, the executive director of the Florida Association of Counties stated that "without new sources of revenue, this act will self-destruct within a few years. . . . Without that extra revenue, there is just no way we can meet the requirements of the act within a few short years."³⁴ Recognizing the difficulty of overcoming a constitutional prohibition against income taxes, local government officials are pushing first for greater flexibility in local sales tax options, both general and selective. Specifically, they are lobbying the legislature and the governor for the elimination of the voter approval requirement currently attached to local (county) adoption of sales taxes.

The clash between public sector officials and private sector developers no doubt will intensify if the only new local revenue sources continue to be nontax revenues, such as user charges, special assessments, and impact fees. One of the more interesting recent developments is a movement among a group of powerful Florida business leaders and organizations to promote a state income tax. They argue that an income tax is more progressive and a more stable source of revenue than the services tax or the sales tax. They also argue that an income tax is the only potential relief for the growing strain on the property tax. There is evidence that their public relations campaign is having an impact on the general population. Between 1988 and 1989, the percentage of Floridians favoring the establishment of a state income tax increased from 13.8 percent to 19.3 percent.³⁵ This still is not a significant proportion of the electorate.

The property tax will become an increasing problem for low-growth rural governments if millage rate caps and state-imposed exemption policies remain fixed while mandates increase. As discussed above, many of these governments are near the cap. They fear that if they continue to have flat growth rates in the assessed value of their tax base they will not have an adequate revenue base to support even minimal governmental operations. Among high-growth rural jurisdictions, rapidly rising land values have the potential to create a taxpayers revolt.

Florida's politics are such that it is unrealistic to include a state or local income tax in any revenue diversification forecast for the new few years or the next decade. As a consequence, state economic and tax experts are currently examining the economic feasibility of a variety of growth-related revenue alternatives (impact taxes, pro-rated ad valorem assessments, interim service fees). They also are investigating the revenue benefits of a land value capital gains tax, a property value added tax, a rezoning tax, and the recapturing of agricultural assessments. Broad-based taxes, such as a real estate transfer tax, a sales tax on real estate transactions, and a gap tax also are being examined.³⁶

To date, there has been little focus on the consequences for Florida's small and rural local governments of using these new revenue sources. This

study suggests that these sources would have different impacts on low- and high-growth rural jurisdictions. Revenue diversification options are a high priority among most of Florida's local government officials. However, diversification for the sake of diversification may create some unusual inequities. Careful consideration needs to be given to whether these new policies might contribute further to widening the differences in the demographic, socioeconomic, and political profiles of Florida's local governments.

Implications of Florida's Lessons for Other States

The mobility of the nation's population has produced intrastate variations in growth patterns not just in Florida but in other states as well. There is ample evidence that such demographic trends will continue well into the next decade. This contrast of revenue diversification trends among rural local governments in one of the fastest growing states has shown that both high growth and low growth produce intense pressure for revenue diversification among small, rural, general purpose local governments.

The pressures associated with growth are exacerbated by: (1) restrictive local revenue raising options; (2) hefty state-imposed ad valorem exemption and differential assessment policies; and (3) an aging, increasingly conservative population reluctant to support either higher existing taxes or new tax sources. The significance of the social and political trends for future revenue diversification efforts should not be downplayed. In fact, Florida is viewed increasingly as a "leading indicator" of what to expect in the nation as the population ages.

Notes

- ¹ Robert B. Bradley, "Intergovernmental Design, Legislative Mandates, Revenue Flexibility and Local Relations," Paper Presented at the Governor's Conference on Local Government in the 1990s, Clearwater, Florida, January 18-20, 1989, p. 24.
- ² Florida Department of Commerce, *The Florida Economy: An Analysis of the Economy and Its Industrial Structure* (Tallahassee: Department of Commerce, Division of Economic Development, Bureau of Economic Analysis, 1987), p. 7.
- ³ *Ibid.*, p. 28.
- ⁴ David F. Sly, William J. Serow, and Shannon Calhoun, "Migration and the Political Process in Florida," *Florida Public Opinion* 4 (Winter 1989): 8-12.
- ⁵ Florida Department of Commerce, *The Florida Economy*, p. 99.
- ⁶ Suzanne L. Parker, *The Florida Annual Policy Survey 1989: Policy Preferences and Priorities of the Florida Public* (Tallahassee: Florida State University, Policy Sciences Program, 1989).
- ⁷ In 1979, 80 percent of Florida's delegates to the U.S. House of Representatives were Democrats. By 1986, this figure had dropped to 63 percent. In 1988, Republicans picked up one U.S. Senate seat and two House seats. The state gave Republican President George Bush his largest margin of victory. Turnover among Florida's congressional delegation is high (21 percent in the 1988 election, compared to the national average of 8 percent). This statistic is indicative of the state's changing population profile. Long-time incumbents, especially Democrats, who leave safe seats to run for higher offices now frequently lose those elections. They are the victims of fleeting name recognition and the state's changing partisan profile. A "Republicanization" of state pol-

itics also is occurring. Florida's current governor is only the second Republican governor in more than a century. The six-member Cabinet elected statewide (Secretary of State, Attorney General, Insurance Commissioner, Agriculture Commissioner, Education Commissioner, and Comptroller) now includes two Republicans; only four years ago, there were none. In 1989, Republicans made up 40 percent of the state legislature—47 in the 120-member House and 17 in the 40-member Senate. (In 1978, only 26 percent of the state legislators were Republicans.) Republicans in 1989 were only 14 seats away from a House majority and 4 away from a Senate majority. There are enough Republican members in the House to sustain a veto by the Republican governor. Republican Party leaders believe that in 1990 they can gain control of the Senate and possibly the House. This would give the Republicans an advantage in the reapportionment negotiations in 1992. See also Bruce Dudley, "State GOP Itching for a Fight as Reapportionment Looms," *Tampa Tribune*, December 19, 1988.

⁸ Florida State University, Survey Research Center, "Florida Public Opinion: The 1988 Florida Annual Policy Survey," *Florida Public Opinion* 3 (Summer 1988): 6-19.

⁹ Don Pride, "Tallahassee's 1989 Slogan: No New Taxes," *Tampa Tribune*, December 11, 1988.

¹⁰ Bradley.

¹¹ *Ibid.*

¹² Florida Department of Revenue, *Florida Tax Sources: Fiscal Impact of Potential Changes: 1988-1989* (Tallahassee: Department of Revenue, Office of Tax Research, and Joint Legislative Management Committee, Economic and Demographic Research, 1988), p. 47.

¹³ Bradley, p. 18.

¹⁴ Florida State University, "Florida Public Opinion," p. 15.

¹⁵ Local income and payroll taxes are used by about 3,550 local governments in Alabama, California, Delaware, Indiana, Iowa, Kentucky, Maryland, Michigan, Missouri, New Jersey, New York, Ohio, Oregon, and Pennsylvania. These taxes are authorized but not used in Georgia and Arkansas. Kansas taxes only the interest earned on income. See also U.S. Advisory Commission on Intergovernmental Relations, *Local Revenue Diversification: Local Income Taxes* (Washington, DC: ACIR, 1988).

¹⁶ U.S. Advisory Commission on Intergovernmental Relations, *Local Revenue Diversification: Local Sales Taxes* (Washington, DC: ACIR, 1989).

¹⁷ Before the debate on repealing the services tax got under way, 37 percent of the state's counties (25 of 67) planned to put such an alternative before the voters. Ultimately, only ten proceeded, and their success rate was 70 percent. The success rate has worsened. Since 1987, of the 19 counties submitting the issue to a vote, it has passed in 10.

¹⁸ Bradley, p. 21.

¹⁹ MacManus, Susan A., with Charles J. Spindler, "The Real Impact of the Services Tax Repeal in Florida: A Fiscal Squeeze on Local Governments," *USF Public Affairs Reporter* 2 (Summer 1988): 3-6.

²⁰ Bradley.

²¹ *Ibid.*, p. 11.

²² Florida's first revenue sharing program actually began in 1972 (Revenue Sharing Act of 1972, Chapter 72-360, Laws of Florida). This act designated separate revenue sharing trust funds for cities and counties and utilized two separate formulas to distribute funds. The municipal revenue sharing formula was originally funded by proceeds from three tax sources: (1) 11 cents of the cigarette tax; (2) the 8th cent of the motor fuel tax; and (3) the cities' share of the auto road tax (repealed in 1980). The county

revenue sharing formula was funded by: (1) 1 cent of the cigarette tax; (2) 55 percent of the total net intangibles tax; and (3) the counties' share of the auto road taxes (repealed in 1980).

- ²³ Revisions were minor until the 1987 legislative session. The only major revisions to the municipal revenue sharing program have dealt with eligibility requirements and the addition and deletion of a revenue source (the auto road tax was repealed in 1980 and, in 1984, 25 percent of the state alternative fuel decal users fee was added to the municipal revenue sharing funding sources). In 1987, the legislature expanded the amount of funds that counties may use for bonding purposes by creating a second guaranteed entitlement equal to the revenues received by eligible counties in FY 1981-82. This entitlement is earmarked for acquisition of insurance contracts or contracts from a local government liability pool.
- ²⁴ Florida Department of Revenue, *Florida Tax Sources*.
- ²⁵ MacManus, Susan A., with Charles J. Spindler, "Florida's Lottery: How Long Education's Sacred Cow?" *Florida Policy Review* (December 1988): 4.
- ²⁶ Joseph F. Zimmerman and Thomas D. Wilson, "New Florida Land Development Act Affects County and Municipal Regulation," *National Civic Review* 75 (March-April 1986): 106-107.
- ²⁷ The law required counties to submit their plans between July 1 and December 1, 1987; coastal municipalities, between January 1 and December 1, 1988; and other municipalities, between January 1 and December 1, 1989. Extensions have been granted to counties and coastal cities.
- ²⁸ Maureen G. Valente and Clayton Carlisle, "Developer Financing: Impact Fees and Negotiated Exactions," *ICMA MIS Report* 20 (April 1988): 1-15.
- ²⁹ Florida Department of Revenue, *Florida Tax Sources*, p. 84.
- ³⁰ Bay, Brevard, Broward, Charlotte, Citrus, Collier, Dixie, Franklin, Hernando, Hillsborough, Indian River, Lake, Lee, Manatee, Martin, Monroe, Nassau, Orange, Osceola, Palm Beach, Pasco, Pinellas, Polk, St. Johns, St. Lucie, Sarasota, Seminole, and Volusia.
- ³¹ Stevan Allen, "Local Leaders Join Forces to Fight State Mandates," *St. Petersburg Times*, November 7, 1988.
- ³² Enterprise funds as defined in the state's Uniform Accounting System are those used "to account for operations (a) that are financed and operated in a manner similar to private business enterprises—where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes."
- ³³ The fact that low-growth counties rely less on user charges than do low-growth municipalities is due to differences in their functional responsibilities. Many of the services delivered by cities, such as parks and recreation, water, sewers, and utilities, are amenable to user fees. In contrast, counties deliver a larger proportion of nonpriceable, or "public good," services, such as courts, corrections, roads, health, welfare, and libraries. See also Bradley.
- ³⁴ Michael McClelland, "Speaker Urged to Back Growth Law with Taxes," *Tampa Tribune*, January 13, 1989.
- ³⁵ Parker, p. 31.
- ³⁶ Florida Department of Revenue, *Florida Tax Sources*.

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Appendix
Major Local Government Tax Sources: Florida, 1987

AD VALOREM (property)

| | |
|--|--|
| <i>Administration Unit:</i> | Local Governments and Florida Department of Revenue |
| <i>Legal Authority:</i> | Statutes (Chapters 192, 193, 196, 197, 200), Constitution (Article VII, Section 9) |
| <i>Base:</i> | Fair market value of locally assessed real estate, tangible personal property, and state assessed railroad property ¹ |
| <i>Rate:</i> | Varies by local government; subject to constitutional and statutory limitations; counties, cities, ² and school districts ³ limited to 10 mills for operating purposes |
| <i>Voter Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | Unrestricted |
| <i>Percent of Eligible Jurisdictions Imposing:</i> | 87% of cities (317 of 365); 100% of counties (67). |
| <i>Additional Provisions:</i> | |
| <i>(1) Rate:</i> | Additional mills may be authorized for debt service without a time restriction, and for other purposes for a period of not longer than 2 years. |
| <i>Voter Approval Requirements:</i> | Voter approval required |
| <i>Restrictions on Use:</i> | Debt service; unrestricted |
| <i>Percent of Eligible Jurisdictions Imposing:</i> | 100% |
| <i>(2) Rate:</i> | Counties providing municipal services may levy up to additional 10 mills above 10 mill county limit within areas receiving municipal-type services |
| <i>Voter Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | Municipal services delivered by county |

LOCAL OCCUPATIONAL LICENSE

| | |
|-----------------------------|---------------------|
| <i>Administration Unit:</i> | Counties |
| <i>Legal Authority:</i> | Statute Chapter 205 |

Appendix (cont.)

Major Local Government Tax Sources: Florida, 1987

LOCAL OCCUPATIONAL LICENSE (cont.)

| | |
|--|--|
| <i>Base:</i> | <i>County:</i> the privilege of engaging in or managing any business, profession, or occupation, including professional associations and their members. As of 1986, authorized to exempt certain businesses located within an enterprise zone from 50% of the tax. <i>Municipality:</i> every person engaging in or managing any business, profession, or occupation not violative of commerce clause of U.S. Constitution. ⁴ |
| <i>Rate:</i> | As of 1980, both counties and cities were authorized rate increases of 100% (prior tax \$100 or less); 50% (prior tax \$101-\$300); 25% (prior tax above \$300). ⁵ |
| <i>Voter Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | General fund—unrestricted ⁶ |
| <i>Percent of Eligible Jurisdictions Imposing:</i> | 100% (all cities and counties) |

MUNICIPAL UTILITY TAX

| | |
|--|--|
| <i>Administration Unit:</i> | Municipalities Tax is collected by seller of taxable item and remitted to the municipality levying the tax ⁷ |
| <i>Legal Authority:</i> | Statute (166.231) |
| <i>Base:</i> | Purchases of electricity, metered or bottled gas (natural LP Gas or manufactured), water service, telephone service ⁸ and telegraph service. Can be levied only on purchases within municipality. ⁹ Exemptions include cable TV service, fuel oil, ¹⁰ fuel adjustment charges subsequent to October 1, 1973, government purchases, and church purchases |
| <i>Rate:</i> | Up to 10% ⁹ |
| <i>Voter Approval Requirements:</i> | None (by ordinance) |
| <i>Restrictions on Use:</i> | Nonrestricted |
| <i>Percent of Eligible Jurisdictions Imposing:</i> | 70% of cities (255 of 365); 9% of counties (2 of 11 home rule charter counties). |

LOCAL OPTION TAXES

TOURIST DEVELOPMENT TAX

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Sections 125.0104, 212.03) |
| <i>Rate/Base:</i> | 1-2% of all rental charges subject to transient rental tax ¹¹ |
| <i>Approval Requirements:</i> | Referendum |
| <i>Restrictions on Use:</i> | To finance a County Tourist Development Trust Fund |
| <i>Jurisdictions Imposing:</i> | 28 Counties (42%) |

INDIGENT CARE SURTAX

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Sections 212.054 and 212.055 (2)) |
| <i>Rate/Base:</i> | 1/4% surtax on all taxable sales transactions |
| <i>Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | To be used by county to provide health care to indigent patients |
| <i>Jurisdictions Imposing:</i> | Hillsborough County only (by definition) |

CHARTER COUNTY TRANSIT SYSTEM SURTAX

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Sections 212.054 and 212.055 (1)); Chapter 212) |
| <i>Rate/Base:</i> | Up to 1% sales surtax on first \$5,000 of transactions taxable under Chapter 212 |
| <i>Approval Requirements:</i> | Referendum |
| <i>Restrictions on Use:</i> | The development, construction, maintenance, and operation of a fixed guideway rapid transit system and supportive services. Only counties with charter adopted prior to June 1, 1976, or counties with city-county consolidation are eligible. ¹² |
| <i>Jurisdictions Imposing:</i> | Duval County; defeated in Dade County—1978 |

COUNTY-VOTED GAS TAX

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Section 336.021; Chapter 206) |
| <i>Rate/Base:</i> | Imposed on all motor fuel and special fuel taxable under Chapter 206 ¹³ |
| <i>Approval Requirements:</i> | Referendum |
| <i>Restrictions on Use:</i> | To fund a county voted gas tax trust fund |
| <i>Jurisdictions Imposing:</i> | 14 Counties (21%) |

Major Local Government Tax Sources: Florida, 1987

CRIMINAL JUSTICE FACILITIES SALES TAX

| | |
|--------------------------------|---|
| <i>Legal Source:</i> | Statute (Section 212.058; Chapter 212) |
| <i>Rate/Base:</i> | 1% sales tax on first \$1,000 of transactions subject to state sales tax in Part I of Chapter 212 |
| <i>Approval Requirements:</i> | Referendum |
| <i>Restrictions on Use:</i> | The construction, repair, or improvement of criminal justice facilities in county |
| <i>Jurisdictions Imposing:</i> | 11 Counties (16%)—1985 |

CONVENTION DEVELOPMENT TAX

| | |
|--------------------------------|-----------------------------|
| <i>Legal Source:</i> | Statute (Section 212.0305) |
| <i>Rate/Base:</i> | 2-3% |
| <i>Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | County promotion of tourism |
| <i>Jurisdictions Imposing:</i> | 3 Counties (4%) |

COUNTY LOCAL OPTION GAS TAX

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Section 336.025) |
| <i>Rate/Base:</i> | 1-2 cents; 3-6 cents on all motor fuel and special fuel taxable under Chapter 206. ¹³ |
| <i>Approval Requirements:</i> | Majority vote of county or extraordinary vote of commission |
| <i>Restrictions on Use:</i> | Funding of county "local option gas tax trust fund" |
| <i>Jurisdictions Imposing:</i> | 63 Counties (94%) |

METROPOLITAN TRANSPORTATION AUTHORITY-VOTED GAS TAX

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Section 336.026) |
| <i>Rate/Base:</i> | 1-4 cents on all motor fuel and special fuel taxable under Chapter 206 |
| <i>Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | Unearmarked |
| <i>Jurisdictions Imposing:</i> | 0 Metropolitan Transit Authorities ¹⁴ |

DISCRETIONARY SURTAX ON DOCUMENTS

| | |
|--------------------------------|--|
| <i>Legal Source:</i> | Statute (Chapters 83-220; 84-207) |
| <i>Rate/Base:</i> | Up to 45 cents for each \$100 or fractional part thereof on deeds and documents relating to realty (except for single family residences) |
| <i>Approval Requirements:</i> | None |
| <i>Restrictions on Use:</i> | Funding of county's Housing Assistance Loan Trust Fund to assist low and moderate income families in the purchase or rehabilitation of a home or apartment |
| <i>Jurisdictions Imposing:</i> | 1 County (Dade) |

LOCAL GOVERNMENT INFRASTRUCTURE SURTAX

| | |
|--------------------------------|---|
| <i>Legal Source:</i> | Statute (Section 212.055(2)) |
| <i>Rate/Base:</i> | 0.5%-1% for period up to 15 years on all transactions subject to taxation under Statute 216; \$5,000 cap on tax |
| <i>Approval Requirements:</i> | Referendum |
| <i>Restrictions on Use:</i> | Used to finance, plan, construct, or improve capital infrastructure within the county. |
| <i>Jurisdictions Imposing:</i> | 10 counties (15%) |

Notes:

¹ Excluding intangible personal property, which is separately assessed and taxed by the state. Less certain exclusions, differentials, exemptions, and credits. Exclusions include: transportation vehicles (subject to license tax); personal property brought into state for transshipment; and real property used for private purposes but leased from a governmental entity. Differentials are reductions in assessments that result from a valuation other than fair market value, such as value in current use (e.g., agricultural) or value at a specified percentage of fair market value (e.g., inventory and livestock).

Exemptions are deductions from assessed value that are typically specified as a dollar amount (e.g., the homestead exemption of \$25,000). Certain exemptions are equal to the total assessed value

of the property (e.g., charitable property) or a fraction of the total assessment based on the percentage of exempt use (which must exceed 50%). In Florida, the only credit allowed is an early payment discount of not more than 4%.

Exclusions: transportation vehicles; property held for transshipment; government property used for private purposes.

Differentials: agricultural land (Section 193.461(6)(a)); private park and recreational land (Section 193.501); environmentally endangered land (Section 193.501); lands of critical state concern (Section 193.507(5)); annual agricultural crops, non-bearing fruit trees and nursery stock (Section 193.451(3)); pollution control devices (Section 193.621(1)); building renovations for the physically handicapped (Section 193.623).

Appendix (cont.)

Major Local Government Tax Sources: Florida, 1987

Exemptions: \$25,000 homestead exemption (Section 196.031(2)(d)); \$500 widows' and widowers' exemption; inventory (Section 195.185); \$500 disability or blindness exemption; total exemption for total and permanent disability; veterans (Section 196.081(1)); nonveterans (Section 196.101(2)); household goods (Section 196.181); institutional exempt property; charitable; literary; religious; scientific; educational; government exempt property (federal, state, local); nonprofit private sewer and water companies (Section 196.2001(1)); renewable energy source exemption (Section 196.175(1)); local option economic development—county (Section 196.1995); local option economic development—municipal (Section 196.1995).

² For fiscal years 1982-83 through 1984-85, county and municipal millage rates, including dependent districts, were subject to certain statutory limitations restricting the rate of growth in revenues (Section 200.085).

³ School districts are subject to certain statutory caps less than 10 mills to be eligible to participate in the K-12 funding program (FEPP).

⁴ Exempted are: (1) nonprofit activities of religious, charitable, and educational institutions; (2) sales of farm products or products manufactured from farm products, except intoxicating liquors when grown or produced and sold by the same person; (3) certain activities of disabled persons, widows with minor children, and persons 65 years of age and older; (4) certain fund raising activities of fraternal, youth, civic, or service organizations; and (5) set-up operations of licensed mobile home dealers or manufacturers. Certain disabled veterans and their unmarried surviving spouses are exempt from the first \$50 of any license tax.

⁵ *Counties:* Before 1972, counties had no authority to levy the tax. The state imposed the tax and shared the revenues with counties. In October 1972, the state tax was repealed (Chapter 72-306) and counties were authorized to impose an occupational tax at state rates in effect on October 1, 1971. In 1980, Chapter 80-274 took effect authorizing current rate increases.

Cities: Prior to 1972, cities would levy and set rates on only those taxes authorized by state statute on an individual city basis. In 1972, the legislature amended Chapter 205 to authorize all municipalities to levy occupational license taxes but limited them to rates in effect in the municipalities at that time. In 1980, the legislature authorized rate increases identical to those granted the counties.

⁶ In 1986, Dade, Broward, Collier, and Monroe counties were authorized to increase their license taxes 50% to implement and oversee a comprehensive economic development strategy (Section 205.033(6)(b)).

⁷ Sellers of telecommunications services may retain 1% of the taxes collected as compensation for recordkeeping and collecting and remitting the tax.

⁸ In 1985, telecommunication services, rather than telephone services, were made taxable by municipalities.

⁹ Municipalities are allowed to levy a surcharge of up to 50% on some services they provide to persons outside of their corporate limits.

¹⁰ Many municipalities exempt and tax different services at different rates.

¹¹ An additional 1% may be levied by extraordinary vote of the gov-

erning board or by referendum of any county which has levied either the 1% or 2% tax for a minimum of 3 years and which does not levy a convention development tax.

¹²Prior to 1985, only Dade County was eligible. A 1985 modification expanded the provision to any county with a charter adopted before June 1, 1976. In 1987, eligibility was extended to include counties consolidated with one or more municipalities.

Sources: Economic and Demographic Research, Joint Legislative Management Committee, and Florida Department of Revenue, Office of Tax Research, *Florida Tax Sources: Fiscal Impact of Potential Changes 1988-89* (Tallahassee: March 1988), pp. 53-59. Gale Sittig, "Memorandum: Local Government Taxing Capacity," Tallahassee: Executive Office of the Governor, April 28, 1988.

¹³Retailers remit the tax on all fuels sold within the county levying such tax.

¹⁴Only Metropolitan Transit Authorities with a regional ground transportation plan adopted and ratified by the voters pursuant to Statute 168.805 are eligible. The tax can be levied only in counties within the MTA's jurisdiction that levy the county local option gas tax at 4 cents or more (in 1989 there were 57 such counties).



Local Revenue Diversification: Implications for Nonmetropolitan Communities

Thomas F. Stinson

Local governments are again being urged to consider adopting local sales or income taxes. Continually growing local financial needs, increasingly tight state budgets, and the dim prospects for expanded federal aid have made revenue diversification a popular and politically attractive alternative to higher local property taxes.

Originally justified as a way for central cities to meet their revenue needs without increasing property taxes, local sales and income taxes attained a general legitimacy after their endorsement by the Advisory Commission on Intergovernmental Relations in 1974.¹ At present, there has been only limited use of these taxes, and the revenue collected from them has not increased substantially as a percentage of local own-source revenue during the past decade.²

Still, many see advantages to using local income and sales taxes. The property tax remains unpopular, and it is argued that a system heavily dependent on the local property tax may be less responsive to economic growth, and perhaps less equitable than one which also draws on a local sales or income tax.³

Shifting the sources of local government revenues, however, is not without risks. While some localities—those providing employment or shopping for a wide geographic area, for example—would be clear winners, many others would lose. Most analyses of local sales and income taxes use the central city and the suburbs as their points of reference. Implicit in such studies has been the assumption that the finances of communities outside metropolitan areas will be unaffected because those economies are relatively independent and self-contained.

This report questions that assumption. Nonmetropolitan economies have become increasingly interdependent, and it can no longer be assumed that their residents shop and work in the community in which they reside. As a result, local sales and income taxes have the potential to transfer income from rural residents to the support of both central city and suburban local governments. In addition, substantial inter-community income transfers among non-

metropolitan communities are likely. The result, after all transfers are taken into account, is likely to be additional financial stress in smaller, rural communities where the fiscal capacity to support adequate service levels is limited.

The report begins with an overview of the status of the economies in rural America. An examination of the general rationale for local revenue diversification follows. Evaluations of the potential gains and risks associated with both local sales taxes and local income taxes are also offered. Throughout, the emphasis is on effects on smaller, nonmetropolitan communities, not on the overall advisability of local sales or income taxes. A discussion of the potential impacts of local revenue diversification on migration of rural residents, local economic development, and the structure of rural local government concludes the report.

Nonmetropolitan America as It Enters the 1990s

The public image of rural America no longer matches the reality. The popular media equate rural with agriculture, and portray the 2,400 non-SMSA counties as, for the most part, a series of homogeneous, idealized farm communities. Such a picture, if it ever were true, is no longer accurate.

Rural local governments also differ from the popular stereotypes. The nonmetropolitan local public sector is smaller, and it does benefit more from voluntarism than does its urban counterpart. This does not mean that financial stress is any less severe in communities outside the urban centers. The revenue needed to finance public service is a substantial drain on the limited resources of smaller communities, and the fiscal effort required to fund local government services continues to be as high for most nonmetropolitan governments as for those in urban areas.

Understanding the nonmetropolitan economy and the structure of rural local government is an important prerequisite to any evaluation of the impact of local revenue diversification on rural communities.

The Rural Economy

Nonmetropolitan population growth has not kept pace with urban growth since the late 1970s.⁴ The celebrated rural revival of the 1970s has faded, and rural population growth now lags behind the national growth rate.⁵ Nonmetropolitan unemployment rates now exceed the national level, and rural incomes remain substantially below the national average. These urban-rural disparities are not purely a regional phenomenon; within each state, metropolitan residents have higher average incomes than do those living outside the metropolitan areas.

The aggregate statistics hide a wide range of regional and local differences. The U.S. Department of Agriculture's Economic Research Service has identified seven distinct types of nonmetropolitan counties. Today, most nonmetropolitan counties do not have a dominant agricultural sector, and many receive a greater proportion of their income from manufacturing than from farming.⁶ USDA classifies as farm dependent counties receiving 20 percent or more of their labor and proprietors' income from farming. Less than 30

Table 1
**Nonmetropolitan Counties Categorized
 by Dominant Economic Characteristic**

| County Group | Number | Percent of Nonmetropolitan Counties |
|-------------------------|--------|--|
| Farming Dependent | 702 | 29 |
| Manufacturing Dependent | 678 | 28 |
| Mining Dependent | 200 | 8 |
| Specialized Government | 315 | 13 |
| Persistent Poverty | 242 | 10 |
| Federal Lands | 247 | 10 |
| Retirement Destination | 515 | 21 |
| Ungrouped | 370 | 15 |

* Total adds to more than 100 percent because some counties meet the requirements for inclusion in more than one group.

Source: L.D. Bender, et al., *The Diverse Social and Economic Structure of Nonmetropolitan America* (Washington, DC: U.S. Department of Agriculture, Economic Research Service, September 1985).

percent of the nonmetropolitan counties met that criterion. (Table 1) Nearly as many counties received more than 30 percent of their labor and proprietor's income from manufacturing and were classified as manufacturing dependent.

Transfer payments, principally from social security benefits and pensions, have become a major source of personal income in the nonmetropolitan economy. During the peak of the agricultural recession in the early 1980s, transfer payments were the largest source of personal income in many counties. From 1980 through 1984, transfer payments averaged 17.4 percent of taxable personal income in nonmetropolitan counties, more than 4 percentage points more than the 13.4 percent average for metropolitan counties.⁷ In the mideast region, transfer payments averaged almost 20 percent of taxable personal income in nonmetropolitan counties between 1980 and 1984.

Data on sources of personal income for nine predominantly agricultural counties in southwestern Minnesota suggest how important transfer payments have become in some regional economies. In 1983, transfer payments (which do not include federal farm program payments) totaled over \$220 million, more than \$40 million more than was provided by either the agricultural or the manufacturing sector.⁸

Some nonmetropolitan communities, particularly the larger trade centers (communities with a population of 5,000 or more outside the influence of a metropolitan area), will continue to grow, but many others are now evolving into bedroom communities with minimal commercial sectors. Price, selection,

and convenience determine where rural residents shop, just as they do for urban residents, and the advantages of regional shopping malls are winning out over the convenience offered by the small town, main street merchant.

Suburban shopping malls located on the outskirts of metropolitan areas often offer even better selection and price than is available in the larger trade centers, and increasing numbers of nonmetropolitan residents do part of their shopping in the suburbs. The attractiveness of shopping in the regional trade centers and the suburban malls, combined with the aging and retirement of many of main street's existing merchants is likely to continue to cut back commercial activity in smaller rural communities, reinforcing the current trend toward smaller business districts in most nonmetropolitan cities.

Larger nonmetropolitan trade centers have benefited from the changes in consumer buying patterns and the restructuring of the areas' economies. Their retail sectors have held their own, and even gained by attracting shoppers from surrounding localities.⁹ These communities also have captured a disproportionate share of the job growth that has occurred outside the metropolitan area. Many of those new jobs, however, have been filled by individuals who live in smaller surrounding communities and commute to the trade center for work and shopping.

The dollar volume of goods and services sold in smaller trade centers, the local convenience centers, and the hamlets has fallen, and is likely to fall further. A recent study of Minnesota retail trade patterns notes that retail sales volume has declined in smaller communities throughout the state, while increasing in suburban counties with regional shopping malls.¹⁰ Similar results were found in Iowa.¹¹ The self-contained, self-sufficient economies commonly believed to exist in small towns are rapidly disappearing, if they ever existed.

What is occurring is a redefinition of the role that lower order central places play in a regional economy. Improved transportation and communication have expanded the market area that individual firms can serve and reduced the set of goods and services that must be offered in each community.

This downsizing of main street does not mean that the communities, their residents, or their residents' needs for local government services will disappear. Just as urban neighborhoods did not disappear when neighborhood retail activity shifted to the suburban shopping malls, rural communities will not disappear as more of their main street activity shifts to regional malls.¹²

Some will migrate from the smaller communities, but many others will continue to reside there. Focusing on expected migration and the closing of local businesses can be misleading, yielding the mistaken impression that the problem of ensuring adequate levels of public services for individuals living in smaller communities can be ignored, for it will soon go away. In reality, however, dealing with the public sector needs of those people who remain in place in smaller, nonmetropolitan communities will continue to be a challenge for state and local policymakers, even if rural outmigration continues.

Rural Local Governments

Rural local governments are no more homogeneous than are rural economies, and differences in the local institutional structure make it difficult to

generalize about the revenue needs of a particular type of local government or about the impact of any institutional change on the structure of local government. In some states, counties are the dominant general purpose local government. Elsewhere, cities and school districts are the chief providers of services. In New England and across the northern tier of states, townships may replace the city or the county as the most important general purpose government.

Local dependence on the property tax also varies greatly among and within states. And, even in regions primarily dependent on agriculture, the proportion of the local tax base made up by farmland varies widely.¹³ The farm crisis of the 1980s reduced the market value of agricultural land substantially, but combinations of underassessment and special assessment rules cushioned many rural local governments from the full impact of those declines in land value.

Federal aid to nonmetropolitan communities has not filled the gap caused by the slow growth in property tax collections. Cutbacks in federal assistance also have increased the burden on non metropolitan taxpayers. A U.S. Senate study found that the loss of general revenue sharing in 1986 may have had a greater impact on the financial outlook for many local governments than did the massive declines in farmland values that occurred during the early and mid-1980s.¹⁴

As noted above, it is unrealistic to expect many rural communities to die or disappear. Some individuals will migrate from the smaller rural cities to urban areas and regional trade centers, but others will continue to live in their current location. Low-priced housing, the inability of potential migrants to capture their current housing equity, and existing social ties are strong incentives encouraging individuals to remain in their community, even those who have found employment in nearby towns. Others, particularly those nearing retirement age, recognize that their prospects for employment elsewhere are limited and are also likely to choose to remain in place.

As the economic role played by the community changes from shopping center to neighborhood, the local tax base also will change. Commercial property values will decline and that portion of the local property tax passed on through higher prices for consumer goods will need to be replaced through higher levies on the remaining property. At the same time, lost size economies for local government services may increase the per capita cost of providing those services to the community.

Such an outcome promises to make it difficult to provide minimally adequate government services in the smaller, more independent rural communities. Even by 1982, local governments in the most isolated and smallest rural counties devoted a larger fraction of their personal income to local government than did those living elsewhere.¹⁵ Today, following the 1982 recession and the massive decline in farm sector income of the early and mid-1980s, residents of those communities are likely to be devoting an even larger fraction of personal income to the local public sector.

Public policy prescriptions should not incorporate the assumption that the financial problems of rural local governments are somehow self-correcting

because the local population is no longer growing. Most rural governments are likely to continue to be important providers of public services. Indeed, population decline may heighten the financial problems of small communities. Consolidation, interlocal cooperative agreements, contracting, and shared service agreements are all ways for rural residents to retain access to minimally adequate levels of public services, but local resources may still be insufficient even after all management improvements have been utilized.

Maintaining and improving the quality of public services in non-metropolitan communities is a key priority for the 1990s. If rural services are allowed to deteriorate, those growing up today in rural communities may lack the human capital needed to compete successfully within the global economy. Local property tax rates in many areas are well above those in the more desirable urban locations, however, and the higher taxes needed to ensure that services are adequate outside the metropolitan areas could drive away more families and businesses, adding further to local problems.

The Rationale for Revenue Diversification

It has become popular to argue that local governments should decrease their dependence on the property tax and increase their use of other local taxes. Sometimes the reasons given are simply criticisms of the property tax or complaints that local property taxes are too high. Others justify shifting to local sales or income taxes on the basis that it will be easier to raise needed additional local revenue.

Economic efficiency and equity arguments also can be made to support adoption of local nonproperty taxes. If, for example, all benefits from locally provided goods and services are not captured by those in the community who pay for them, alternative funding mechanisms are necessary. Another argument for revenue diversification is that it can reduce the excess burden or welfare cost of taxation and is a means of providing for revenue stability.

Each of these justifications is developed and discussed in more detail below. The arguments, while fairly technical, have important implications for public policy because each describes a condition under which imposition of a local sales or income tax will increase the overall standard of living, not simply transfer income from one group of taxpayers to another. Each section begins with a brief discussion of the underlying economic concepts, followed by a description of how it applies to rural local government finance.

Externalities

Perfectly competitive, free market economies can be shown, given certain assumptions, to allocate resources automatically to the production of goods and services in a *pareto optimal* way, that is, so that no one can be made better off without making someone else worse off.¹⁶

One crucial assumption for this result to hold is that consumption of any particular good or service must benefit only those who purchase that good or service. Individuals who do not pay for a particular item must not benefit from its use. Economists agree that if those who do not pay benefit from someone

else's purchase of a product—that is, if those who benefit are “external” to the market transaction—too little of that particular good will be produced.

This “market failure” can be eliminated if the government intervenes and supplements the supply of that product. But, if the public sector does not act, an economically efficient mix of goods and services cannot be obtained. Correcting and adjusting for external benefits are key justifications for the existence of a public sector.

Similarly, the market also fails if some benefits from a particular publicly funded activity accrue to individuals who are not required to pay taxes to the government providing that service. One theory of public sector decisionmaking holds that rational local officials will allocate funds to a particular service only up to the point where the additional benefit to the median voter is equal to the additional tax cost to that same voter.

If that decision rule is followed, local governments will not provide adequate support for activities that also benefit individuals living outside their boundaries. Parks and recreation areas supported by one community but used by everyone in a metropolitan area are examples of public activities with such external benefits.

It can also be argued that when individuals not subject to local taxes require services from a locality, insufficient levels of those services will be available. Commuters, for example, often are said to increase the need for police and fire protection in the community in which they are employed, while making no direct contribution to defray their costs, leading in turn to less than optimal levels of central city expenditures on police and fire protection.

Federal or state grants can be used to offset some of the distortions between those receiving benefits and those paying for the services. By collecting taxes from those living outside as well as within a local government's boundaries, then redirecting some of that revenue to support services where significant externalities are present, an appropriate level of local government output can be encouraged.

Alternatively, if the individual to whom the external benefits accrue shops or works in the community but resides elsewhere, local income and sales taxes can be used to extract payment. These taxes, because they collect revenue from nonresidents as well as residents, can play a crucial role in helping the public sector fund economically optimal levels of government services.

User charges may be an alternative for some services, recreation, for example. But police and fire protection, and those services whose benefits are less direct, will require use of the taxing power if the necessary funds are to be raised. Local nonproperty taxes are an alternative to increased state and federal aid for encouraging local officials to increase the level of public spending on items that have external benefits.

The Excess Burden of Taxes

Local nonproperty taxes may also help to reduce the economic distortions caused by taxation. Taxes induce shifts in production and consumption, leading to a reduction in national output over what could have been produced at the

same cost in a taxless environment. This loss of potential output, or “excess burden,” of the tax system is magnified when one particular tax is relied on heavily.

All federal, state, and local taxes have associated excess burdens, or “deadweight losses,” and those losses increase with the square of the tax rate.¹⁷ When one tax is the principal source of revenues, the deadweight loss associated with the tax system can be reduced (while still collecting the same amount of revenue) by lowering the rate at which that particular tax is levied and increasing other tax rates.

Policymakers should not ignore the excess burden of their tax system, even though that cost is not immediately apparent to voters. Deadweight loss is a measure of the potential growth in real income forgone by the economy, and some studies indicate that loss to be substantial.¹⁸ A sensible tax policy cannot be based solely on economic efficiency considerations, but ignoring the deadweight or efficiency loss from taxation is equally inappropriate.

The excess burden of any particular tax system can be limited by choosing the mix of taxes that minimizes interference with consumers’ and producers’ choices. The optimal mix of taxes is not one in which all activities are taxed at an equal rate, however, or where state and local rates are set so as to collect equal amounts of revenue from each major tax.¹⁹ Neither of those rules guarantees an economically efficient outcome. Instead, it can be shown that the most efficient tax system, the one that minimizes the deadweight loss, is the one in which tax rates are set so that the percentage reduction in the quantity demanded of each commodity is the same.²⁰

When applying the excess burden-economic efficiency criterion to the design of state-local tax systems, it is important to remember that deadweight loss measures the impact of all taxes—not just those levied by state and local governments. Federal tax structure and rates are major contributors to the excess burden of any particular tax system; state and local taxes often play only a subordinate role. Recent changes in the federal income tax—lowering the maximum individual rate and eliminating the deductibility of state and local sales taxes, for example—are likely to have had a greater impact on the excess burden of the tax system than would the nationwide replacement of a portion of the property tax with a 1/2 percent local sales tax.

But, despite the limited impact of changes in state and local tax systems on national economic efficiency, reduced reliance on the property tax does appear likely to produce efficiency gains. National estimates of marginal excess burdens of taxation (based on the tax structure existing before the property tax revolt in the late 1970s and federal income tax reform in 1986) indicate that the excess burden of an additional dollar of property tax liability was substantially higher than that of an additional dollar of personal income tax or sales tax revenue.²¹

Revenue Stability

Further reliance on nonproperty taxes also may help to stabilize state and local revenues. If local tax collections are more volatile than the economy,

local tax rates and expenditures may fluctuate rapidly from year to year, increasing uncertainty and making planning for the future difficult for both private agents and public decisionmakers.

The property tax base has always been the most stable of all tax bases, but diversified tax systems that rely on more than one tax can be less volatile than those dependent on a single tax, even if that tax has a history of stability. Recent declines in farmland values, for example, have shown that the property tax base can decline as well as increase. The property tax base also may grow more slowly than the economy, or income, or retail sales. And, in practice, the growth in the property tax base depends on the value assigned to parcels by the local assessor, incorporating the well-known inefficiencies and lags of the assessment process. As a result, revenue diversification may increase the responsiveness of the local tax base to local economic growth.

Revenue diversification also introduces a new source of instability—forecasting errors. Property tax collections can be estimated quite accurately because they depend on the known value of property in place and a known tax rate. Sales and income tax collections, which depend on economic conditions after the forecast is made, are subject to much larger forecast errors. The disadvantages associated with the fiscal uncertainty caused by local use of sales or income taxes may, in some instances, outweigh the benefits of a more rapidly growing tax base.

Local revenue diversification can be obtained in ways other than increased use of local sales and income taxes. An equal degree of diversification occurs when a state-levied sales or income tax is rebated on a prorata basis to the localities where the revenues were collected, as when localities actually levy the taxes themselves. Indeed, if a locality's share of state sales or income tax receipts is determined on some basis other than local collections of that tax, payments based on state collected sales or income tax receipts may offer more financial stability to local government than would a local sales or income tax levy.

Equity and Redistribution Issues

Local sales and income taxes also can be used to redistribute the costs of supporting the public sector from local residents to others who reside outside the community but shop or work there. When outsiders impose significant costs on a community, some method of collecting reimbursement for those costs is legitimate and necessary if an economically efficient allocation of goods and services is to occur.

Those same local sales and income taxes also can be used to export local taxes to individuals who live outside the community, in effect forcing outsiders to subsidize local public sector activity. Revenues far in excess of the benefits outsiders receive may be collected through sales and income taxes on nonresidents, reducing the cost of local government services for those residing in the community and producing an income transfer from those living outside to those living within the locality.

Economic theory gives no guidance as to the appropriate or optimal distribution of income. Such matters are for resolution in the political arena. It is important, however, to know the size of any income redistribution that could be attributed to use of local sales or income taxes. Research estimating the external costs commuters and shoppers impose on host communities and the external benefits received by individuals living outside a locality's borders is an important first step toward an informed debate on the merits of local revenue diversification.

Other Justifications

Other, less well supported arguments have been offered for the expanded use of local nonproperty taxes. It has been noted that, often, the advocates of revenue diversification simply revert to listing inadequacies of and dissatisfactions with the local property tax system.²²

Other advocates assert that because the property tax is not particularly well liked its prominence as a local revenue source should be reduced.²³ A slight twist on this argument is that public distaste for the property tax makes it more difficult to raise additional local revenue than would be true if local sales or income taxes were an alternative.²⁴ Implicit in many arguments for local revenue diversification is the assumption that local government revenues are inadequate and that a local sales or income tax is the most palatable way for local officials to raise additional funds.

Arguments for a change in local tax structure because the property tax is too noticeable or not well liked are difficult to evaluate. If property tax bills are particularly noticeable or particularly objectionable in form—making individuals more conscious of public sector service costs—increased use of local sales and income taxes could lead to a more economically efficient result. But, if the goal of instituting local nonproperty taxes is to mask the cost of local government, or have part of its costs assumed to be part of the cost of state government, such taxes can remove local political accountability and lead to overconsumption of local government services and, possibly, less than optimal levels of state-funded services.

Local Sales Taxes and the Rural Economy

Increased use of local sales taxes is one way of providing additional revenues for local government without increasing property tax rates.²⁵ Even now, in relatively prosperous times, many nonmetropolitan communities expect continuing difficulty in financing local public services. Elimination of general revenue sharing, further reductions in federal aid, and tight state budgets have increased the local financial strain.²⁶ If a recession were to occur, local government's financial situation would surely deteriorate.

Local sales taxes can solve the financial problems of some communities. Unfortunately, though, statewide use of a local sales tax may create additional problems by transferring income away from other, equally needy communities. Sales tax coverage varies greatly across states, but, often, food and other items likely to be purchased close to home are exempt, while consumer

durable goods and other higher priced items typically subject to tax are more likely to be purchased outside the local economy. When local sales tax receipts are retained by the community in which the sale takes place, many rural residents are likely to be paying taxes to support government services in communities other than their own. That the communities likely to benefit most from this transfer of income are the regional trade centers with higher growth rates and fewer immediately apparent financial needs will only add to the discomfort of those taxpayers.

One safeguard often suggested—use of countywide levies, presumably with all receipts going to the counties—will alleviate only some of the problems. The economic geography of rural America has evolved to a point at which each county can no longer support a major trade center. Regional shopping malls, serving three or more counties, have become increasingly important in the retail sector. Counties that do not have a regional mall should expect to be net revenue losers if a local sales tax were adopted.

The increasing tendency for nonmetropolitan residents to make periodic trips to suburban shopping malls complicates the issue. A stronger geographical hierarchy of shopping patterns, with convenience items and staples bought locally, supplemented by weekly shopping trips to the regional trade center and quarterly shopping trips to the suburban shopping malls, appears to be emerging. Given that shopping pattern, the volume of taxable local sales is likely to be heavily skewed in favor of communities with a major retail sector. Those communities also are likely to have a strong and growing property tax base due to their active retail and service sectors. In this situation, some of the suburban tax load will be exported to rural residents.

Local Income Taxes and the Rural Economy

Local payroll or income taxes can be levied on those living or working in a particular political or taxing jurisdiction.²⁷ The tax can be collected through a piggyback levy attached to the state levy, or as a locally administered payroll tax. Both the form of the tax and whether receipts go to the local government providing services to the taxpayer's home or place of employment are important considerations in evaluating the desirability of local income taxes for nonmetropolitan communities.

Income and payroll taxes levied by a community on its residents are simply substitutes for higher property taxes. As such, they have certain distributional results, lessening the tax on landowners, particularly those with lower incomes and substantial amounts of high valued property, and increasing the proportion of taxes paid by renters and individuals with higher proportions of income to taxable property value.

Local income taxes levied at the point of employment and returned to the community where levied rather than to the community in which the taxpayer resides also add the possibility of redistributing income from stable or declining communities to those where employment is increasing. Such a tax structure appears to offer additional financial incentives to individuals to leave their community and move to the regional growth centers, and will discourage

some from remaining in place and commuting to work. Encouraging migration may be an appropriate national or state policy goal, but such a policy should be explicit, not a result (intended or unintended) of provisions in the state-local tax system.

Local payroll and income taxes appear to have several disadvantages in nonmetropolitan areas that are not as prominent in urban settings. First, the rural economy has a larger proportion of proprietors, farmers, and retired individuals. Because wages and salaries are a smaller percentage of nonmetropolitan incomes, payroll taxes, or taxes only on wages and salaries, will raise substantially less revenue per capita than in the urban areas. In addition, the perceived inequities created by omitting a large number of potential taxpayers—farmers, sole proprietors, other self-employed, and the retired—is likely to weaken support for the tax. A tax utilizing the full federal or state tax base seems essential for public acceptance.

A second concern is the stability of the nonmetropolitan income tax base. Rural economies—often dependent on a single resource-based industry or a single manufacturing sector—tend to be more vulnerable to national business cycles than are metropolitan economies.²⁸ Farm income, in particular, is much more volatile than agricultural land values. For many rural economies, introduction of an income tax will make local revenues more rather than less volatile. As noted earlier, the volatility of the income tax base also makes it more difficult to forecast local income tax revenues.

Many are willing to give up some stability and predictability for the potential growth possible from an income tax, but there is no guarantee that the income tax base will grow faster than the property tax base. As many local economies reduce their reliance on the resource-based industries, retirements, lost jobs, and the downsizing of the local retail and service sectors may produce larger declines in the income tax base than in the local property tax base.

Local income taxes levied at the point of residence and using the federal or state definition of income can help reduce rural dependence on the local property tax. They are not, however, likely to be a panacea for the financial problems facing rural local governments. The benefits from revenue diversification and the redistribution of tax burdens offered by a local income tax may easily be overshadowed by the additional volatility and uncertainty imposed on local revenues.

Rural Communities, Economic Efficiency, and Nonproperty Taxes

Widespread use of local sales and income taxes would be a fundamental change in the institutional structure of much of rural America. Even if use of those taxes is restricted to metropolitan counties, nonmetropolitan residents will be affected. Such an institutional change may not limit economic growth or increase fiscal stress on nonmetropolitan residents, but the full impact of those changes is impossible to predict. That impact will be determined by the size of the revenue shift, the way the additional revenues are distributed

among local governments, changes in the state's local aid programs, and the intensity of household preferences.

This section raises some fundamental questions about the long-term effects of widespread use of local sales and income taxes. Three items of concern to nonmetropolitan America—population migration, economic development, and the structure of rural government—are examined. Several specific assumptions underlie the analysis. The most important of those assumptions is that few rural communities are expected to disappear during the next two decades. Many are expected to lose population, and many additional main street shops will close, but people are expected to remain in rural communities and to require services from their local governments.

The second key assumption is that access to minimally adequate levels of public services (such as elementary and secondary education) is a right of all households, not an item subject to individual consumer choice. The logical implications of this assumption are that all households are guaranteed access to minimally adequate levels of public services, and that if a particular locality cannot afford to provide services at that level, higher levels of government must provide the additional funding necessary.

Rural Migration

Widespread use of local income and sales taxes will add further to the incentives to migrate from small towns. Even if local property taxes are reduced by an amount equal to that collected through a local sales or income tax, disposable (after tax) income of rural residents is likely to decline relative to those living in the regional growth centers and the metropolitan areas if local sales or income taxes are enacted. By forcing households in small towns to help fund the costs of public services in communities in which they work and shop, in addition to paying the full amount for services in their own community, local nonproperty taxes add to the price one pays to live in a small town.

In a market economy, migration is one way in which human resources are reallocated into more productive activities at alternative locations. Migration stimulated by changes in local tax structure, however, will not necessarily increase national output. Indeed, local revenue diversification in rural areas may be counterproductive.

To offset the additional incentives to migrate, expanded aid programs for smaller local governments may be needed. Without such aid, the loss of population coupled with an accompanying loss of size economies could force already financially stressed local governments to raise taxes and cut back on the quality of services, encouraging further migration. Those additional financial pressures could result in substandard public service levels in smaller communities, leading in turn to an environment in which a culture of long-term, intergenerational poverty could develop.²⁹

Rural Economic Development

There is renewed debate over how rural development efforts should proceed. Industrial recruitment and subsidized development strategies are

losing popularity as localities recognize that interlocal competition for new firms may have gone too far and become too costly. A trend toward grass roots regionalism appears to be emerging as smaller communities are modifying their expectations and goals, incorporating a county or areawide view of economic development. Some now contend that interlocal cooperation is a more likely route to the long-term growth desired by nonmetropolitan communities and that small towns need to view themselves as interdependent, spatially separated neighborhoods, not as separate independent economic entities.³⁰

Increased use of local sales and income taxes will delay that needed reorientation of development goals by adding to the incentives for use of the independent, locally subsidized development and recruitment strategy. The existence of a local sales tax, for example, adds substantially to the local revenue impact attributable to a new retail firm. Attracting a Walmart or a K Mart, which in turn attracts shoppers from surrounding communities, becomes an even greater coup when expected sales tax receipts can be added to the new property taxes that will be generated. Local sales and income taxes are likely to increase competition for new commercial and manufacturing development (producing larger and larger publicly paid subsidies to firms choosing a particular location) rather than limiting such competition.

Interlocal competition for new firms will reduce the cost of operation for relocating and startup firms—possibly even subsidize their operation—but the full cost to society could be substantial. By encouraging additional use of tax abatements and local tax-based financial subsidies, further competition for new firms will make it more difficult for all rural communities to obtain revenues sufficient to fund adequate local services.³¹

Increased interlocal competition may also delay the essential restructuring required for the local economy to meet the future needs of non-metropolitan residents. Rural economies must continue to evolve if they are to remain viable, adjusting to consumers' changing tastes and to improved transportation and communications networks. This evolution means that fewer outlets for goods and services will be available in each community, and all employment and all goods and services cannot be expected to be within walking distance as was once the norm in small towns.

In the long run, there will be fewer merchants in each community, but better compensation for those who remain. In addition, as the boundaries between the local economy and the trade area's economy blur, additional goods and services may become available in communities other than the regional trade centers.

As local residents begin to recognize that their own economic future depends in part on the region's economic growth, cooperative, coordinated development activities, capturing available economies of size and utilizing the financial resources and comparative advantage of the entire trade area become possible. Rural development activities also will be able to draw on a larger base of community leaders. The resulting programs including regional or areawide specialized training and retraining and capital market enhance-

ments, are likely to be more successful than the fragmented, underfunded efforts initiated in the past. Wider use of local sales and income taxes, by increasing the benefits capturable by communities that attract new businesses successfully, will impede those cooperative efforts as well as delay local recognition of the essential linkages to the region's economy.

Impacts on Governmental Structure

Expanded use of local sales or income taxes may also change the structure of local government. When one type of government is given access to a tax base that grows more rapidly than the property tax, that government's revenues will grow more rapidly over time, providing the financial flexibility to initiate new programs. Eventually, changes in responsibilities for providing services could result. Countywide sales or income taxes, if all revenues are kept by the counties, could allow counties the opportunity to provide additional services and eventually diminish the role of city government. Sales or income taxes collected and kept by the cities, on the other hand, would limit the role of the county and expand the role of the cities.

Local sales and income taxes also could change relationships between state and local government. Increased local political accountability for local government spending is often cited by state policymakers as one justification for allowing local governments to levy sales or income taxes. State officials may feel that local option sales or income taxes will reduce or eliminate the need for additional state aid.

If the price for permission to levy local sales or income taxes is less state aid, all local governments could suffer. Even if hold-harmless provisions are incorporated into the law, some communities will not fare as well over time as they would under the existing property tax and aid system. Smaller, non-metropolitan communities are likely to be among those not gaining from the expanded use of local sales and income taxes.

Conclusion

Ultimately, decisions about the advisability of local sales and income taxes must be made on the basis of what is best for an entire state, not simply what is best for those who live outside the metropolitan areas. Trade-offs between state aid and expanded local taxing authority are possible, and the structure of government finances can be changed without serious damage to the financial structure of any community. Still, concerns remain about the long-term impacts of local revenue diversification on nonmetropolitan communities.

If the revenue diversification decision were to hinge solely on economic criteria, the externality issue is the key. Neither the excess burden issue nor the revenue stability argument, alone, appears to be sufficiently strong to warrant large-scale changes in the local tax structure. But, if local government output is not at the level where its marginal social cost is equal to the marginal social benefit, exportable sales and income taxes may be justified on economic efficiency grounds. When local sales or income taxes can be used to encourage a more efficient allocation of goods and services then such taxes are clearly

warranted. If, on the other hand, such taxes lead to a less efficient distribution of goods and services, local revenue diversification should be discouraged on economic grounds.

Many equity arguments can be made for and against use of local sales and income taxes. All changes in the tax system redistribute income among individuals and among regions, and there will be winners and losers after any change.

The acceptability of a local sales or income tax will depend on where one lives. Individuals living in central cities, suburbs, regional trade centers, and smaller rural communities will see different net impacts. Decisions on equity and income redistribution are necessarily part of the political process, depending on local values and income distributions, and the final results will vary from state to state.

Balancing equity and efficiency considerations may require additional state aid for certain types of communities if the disadvantages or adverse effects of local nonproperty tax revenues are to be overcome. Voters and decisionmakers need to be sure to look beyond the short-term revenue impacts to the long-term implications for both rural economic growth and local government's ability to fund minimally adequate levels of public services.

Endnotes

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- ⁸ Thomas F. Stinson, "Can Rural Communities Survive the Farm Crisis?" in *Coping with Change: Rural America in Transition* (Washington, DC: U.S. Senate, Committee on Governmental Affairs, Subcommittee on Intergovernmental Relations, 99th Congress, 2d Session, S. Prt. 99-214, 1987), p. 55.

- ⁹ David Senf and Thomas Anding, "Overview of Minnesota Retail Sales Trends," *CURA Reporter* (Minneapolis: University of Minnesota, Center for Urban and Regional Affairs, December 1988), pp. 1-18.
- ¹⁰ "Retail Market Centralization Increases in Minnesota," *Population Notes* (St. Paul: Minnesota State Planning Agency, January 1989).
- ¹¹ Roger Ginder, Ken Stone, and Dan Otto, "Impact of the Farm Financial Crisis on Agribusiness Firms and Rural Communities," *American Journal of Agricultural Economics*, December 1985.
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- ¹³ U.S. Senate, Committee on Governmental Relations, Subcommittee on Intergovernmental Relations, *Governing the Heartlands: Can Rural Governments Survive the Farm Crisis?* 99th Congress, 2d. Session, S. Prt. 99-176, July 1986, pp. 17-19.
- ¹⁴ *Ibid.*, p.58.
- ¹⁵ Richard J. Reeder, *Rural and Urban Government Fiscal Trends, 1977-1982* (Washington, DC: U.S. Department of Agriculture, Economic Research Service, May 1988), p. 20 (Staff Report AGES880210)
- ¹⁶ A more complete discussion of the concept of *pareto* optimality and the conditions under which market economies fail can be found in any welfare economics text. See, for example, Robin Broadway and Neil Bruce, *Welfare Economics* (New York: Basil Blackwell, 1984), chapters 3 and 4.
- ¹⁷ For a further discussion of the excess burden of taxation, see any finance text book, for example, Harvey Rosen, *Public Finance*, 2d Edition (Homewood, Illinois: Irwin, 1988), pp. 291-314.
- ¹⁸ See, for example, Charles Ballard, John Shoven, and John Whalley, "General Equilibrium Computations of the Marginal Welfare Costs of Taxes in the United States," *American Economic Review* (March 1985): 128-138.
- ¹⁹ It has been suggested recently that in an ideal state-local tax system sales, income, and property taxes should each produce between 20 and 30 percent of the revenues. That distribution of revenues would not minimize the excess burden of taxation. It may, however, minimize the risk of a state being singled out as having a bad business climate. Robert J. Kleine and John Shannon, "Characteristics of a Balanced and Moderate State-Local Revenue System," in Steven D. Gold, ed., *Reforming State Tax Systems* (Denver: National Conference of State Legislatures, 1986), p.33.
- ²⁰ Frank P. Ramsey, "A Contribution to the Theory of Taxation," *Economic Journal* (1927): 47-61. In more technical terms, it is necessary that the ratio of the tax rates applicable to particular commodities and activities be inversely proportional to the price elasticity of demand for the separate products. Efficient taxation requires relatively high tax rates on items for which demand is relatively insensitive to price and lower tax rates on those items whose consumption varies substantially with price.
- ²¹ Ballard, Shoven, and Whalley.
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- ²⁴ John Shannon, "Faces of Fiscal Federalism," *Intergovernmental Perspective* 14 (Winter 1988): 15.
- ²⁵ A more complete discussion of the local sales tax can be found in U.S. Advisory Com-

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²⁶ US Senate, *Governing the Heartlands*.

²⁷ More detailed information about local income taxes is contained in U.S. Advisory Commission on Intergovernmental Relations, *Local Revenue Diversification: Local Income Taxes* (Washington, DC: ACIR, 1988).

²⁸ McGranahan, p. 2-3.

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³⁰ Deavers.

³¹ Use of local tax-based financing programs can be costly to a state's treasury as well. Recent Minnesota evidence, for example, indicates that local use of tax increment financing to attract new business increases state aid payments by \$53.5 million per year. J. Michael, T. Strom, and S. Heinze, "House Research Department Estimates of State Intergovernmental Costs of Tax Increment Financing" (St. Paul: Minnesota House of Representatives, Research Department, January 1989).

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| Estimates of Revenue Potential from State Taxation of Out-of-State Mail Order Sales, SR-5, 9/87, 10 pp. | \$3.00 |
| Fiscal Discipline in the Federal System: National Reform and the Experience of the States, A-107, 8/87, 58 pp. | \$10.00 |
| Federalism and the Constitution: A Symposium on <i>Garcia</i> , M-152, 7/87, 88 pp. | \$10.00 |

What is ACIR?

The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three federal executive officials directly, and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Representatives by the Speaker of the House of Representatives.

Each Commission member serves a two-year term and may be reappointed.

As a continuing body, the Commission addresses specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with important functional and policy relationships among the various governments, the Commission extensively studies critical governmental finance issues. One of the long-range efforts of the Commission has been to seek ways to improve federal, state, and local governmental practices and policies to achieve equitable allocation of resources and increased efficiency and equity.

In selecting items for the research program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR, and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policy recommendations.

