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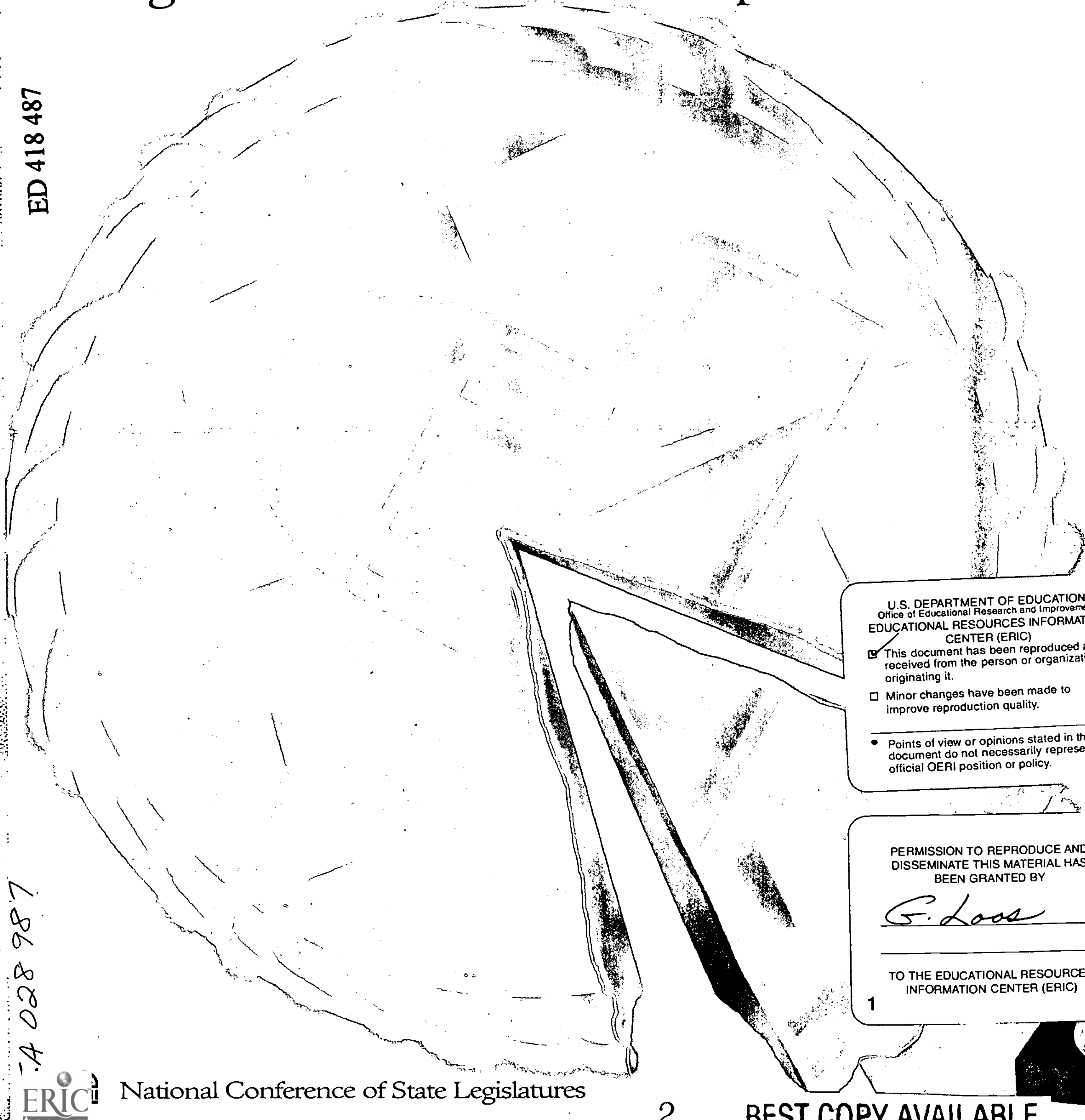
ABSTRACT

The United States is undergoing a transition as state governments reclaim responsibilities that the federal government had assumed earlier in the century. Sorting out which governmental body should take charge of various services is the subject of this report. It focuses on two critical issues in the relationship between state and local governments: which level of government should finance services, and which level of government should deliver those services. Delegating governmental responsibilities presumes that a more fundamental question has been answered--whether government should provide the service at all--has been considered and answered affirmatively. The following five principles constitute a framework for sorting out responsibilities between state and local governments: (1) provide the clearest possible separation of responsibility between state and local governments; (2) assign program responsibility to the lowest possible level of government unless there is an important reason to do otherwise; (3) consider the fiscal effects of state mandates on local governments; (4) assume state responsibility for programs where uniformity or statewide benefits will result; and (5) provide state financial assistance to local governments that have the lowest capacity to raise their own revenue. Case studies are included to illustrate each principle. Principle 1 covers "The Special Case of Education" (p.5). (RJM)

Critical Issues in State–Local Fiscal Policy

Sorting Out State and Local Responsibilities



National Conference of State Legislatures

CRITICAL ISSUES IN STATE-LOCAL FISCAL POLICY

Sorting Out State and Local Responsibilities

Foundation for State Legislatures
and
National Conference of State Legislatures

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The National Conference of State Legislatures serves the legislators and staffs of the nation's 50 states, its commonwealths, and territories. NCSL is a bipartisan organization with three objectives:

- To improve the quality and effectiveness of state legislatures,
- To foster interstate communication and cooperation,
- To ensure states a strong cohesive voice in the federal system.

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FOREWORD

Ten years ago, the National Conference of State Legislatures convened a Task Force on State-Local Relations to examine critical issues in state-local relations. The task force issued a 1987 report that challenged states to reassess their policies toward local governments, and it developed a set of recommendations and principles designed to guide this process. Task force members were convinced that reduced federal aid for state and local governments, combined with public concern about state and local government accountability and efficiency, would provide the impetus for changes in established state-local relationships.

The changing legislative and economic environment of the late 1990s has brought new urgency to the challenges addressed by the task force 10 years ago. Some of the major challenges facing state and local governments in the late 1990s include the following:

- New federal laws will completely revamp the welfare system and pave the way for deregulation of the telecommunications and electric utility industries. These changes have implications for state and local revenues and expenditures.
- The health care industry is transforming itself through consolidation and managed care, and cost containment efforts will intensify in the next five years. State and local governments will continue to play major roles in health care financing and service delivery, even if the current Medicaid program is restructured.
- Technology is altering the way Americans shop and do business, with implications for how state and local governments deliver services and raise revenues to pay for those services.
- State and local governments face more constitutional and statutory constraints on their ability to tax and spend.

These issues have important consequences for state and local governments, which will assume more responsibility for funding services at a time when their ability to raise revenue is constrained. To manage this period of transition, state and local governments must review their systems for delivering and funding services with the goal of improving efficiency and accountability to the taxpayers.

This Fiscal Foundation Partners project—*Critical Issues in State-Local Fiscal Policy*—builds upon the earlier work of the Task Force on State-Local Relations, recognizing the realities of today's environment.

The project consists of two reports. This first report includes principles to evaluate the sorting out of state and local government responsibilities. The second report discusses the evolution of state-local revenue systems and provides guidelines for evaluating local revenue diversification proposals.

These reports are not intended to provide a prescription for state action or to recommend a specific set of state-local policies. Rather, they provide state legislators with a framework for evaluating their state-local fiscal policies. The unique traditions, values and fiscal characteristics of each state will ultimately determine the design of its state-local system.

PREFACE AND ACKNOWLEDGMENTS

Several members of the National Conference of State Legislatures' (NCSL) Foundation for State Legislatures convened in 1991 to discuss how they could assist in the development of sound state fiscal policy. They concurred that they could pool their resources to examine specific areas of state fiscal policy and then make recommendations on these state fiscal policy issues. This group, known as the Foundation Fiscal Partners, supports the NCSL Fiscal Affairs Program in an ongoing effort to improve the quality of fiscal information available to state policymakers.

A key goal of the partnership is to improve the dialogue among state legislators, business representatives and other organizations interested in state fiscal policy decisions. By increasing awareness among the participants, these groups have developed an effective partnership to address such concerns as fair and stable tax systems and strengthening the budget process.

Critical Issues in State-Local Fiscal Policy is the fourth Foundation Fiscal Partners project. Previous Foundation Fiscal Partners' projects include:

- *Principles of a High Quality State Revenue System* (November 1992)
- *Fundamentals of Sound State Budgeting Practices* (May 1995)
- *State Strategies to Manage Budget Shortfalls* (December 1996)

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Scott Mackey and Judy Zelio are the principal authors of this report. Corina Eckl, Ron Snell and Leann Stelzer provided valuable editing advice, Bruce Holdeman designed the cover, and Lisa Houlihan prepared the report for publication.

SORTING OUT STATE AND LOCAL RESPONSIBILITIES

The nation is experiencing a transition as state governments take back some of the responsibilities that the federal government had assumed between the 1930s and the 1970s. Voter pressure for fiscal discipline at all levels of government is causing state and local governments to assess (and possibly rearrange) their varied responsibilities for funding and delivering services. In sorting out, legislatures have a responsibility to determine the roles of the public and private sectors in service delivery and assign financing responsibility. This report provides five principles as a framework to help guide the sorting out process.

What is Sorting Out?

Sorting out is the process of deciding two critical issues in the relationship between state and local government:

- Which level of government should finance services, and
- Which level of government should deliver those services.

Sorting out governmental responsibilities presumes that a more fundamental question—whether government should provide the service at all—has been considered and answered affirmatively. Because local governments derive their powers from the states, it is then the responsibility of the state legislature to sort out the roles and responsibilities of state and local governments.

A major benefit of sorting out government responsibilities is to make governments accountable to taxpayers for the quality, effectiveness and efficiency of services. Alice Rivlin, in her 1992 book *Reviving the American Dream,* argues that the overlapping responsibilities of federal and state governments make it impossible for citizens to assign responsibility for the success or failure of programs. The same argument applies to state and local governments.

Government or Not?

Any sorting out process must begin with the fundamental question: Should government provide this service? Growing fiscal constraints at all levels of government in the coming years may prompt policymakers to ask this question more frequently and, in some cases, respond that the private or nonprofit sectors are the most appropriate providers. The government's contribution to this process may be simply to provide incentives or reduce regulatory obstacles. Whether government has a role in financing services provided by private or nonprofit providers is another question. Government responses will vary, depending upon such factors as efficiency levels, cost effectiveness, accountability and political considerations.

Partnerships that combine government and nongovernment efforts are common. And, in many instances, these public-private partnerships have been successful.

Cases in Sorting Out: The V'Burg Initiative, a Public-Private Partnership

A unique combination of transitional housing, support services, and education and training in Vicksburg, Miss., was created through a public-private partnership with the purpose of moving low-income women out of welfare and toward self-sufficiency.

The V'Burg Initiative, a nonprofit development organization, was founded in 1989 by the city. Its Self-Sufficiency Committee, which represents 13 human service agencies, coordinates services provided by a network of 28 county agencies. Several federal programs subsidize child care, transportation, meals and social services, supplemented by the United Way and other private sources. The nine-unit housing development, including a child care and adult training facility, cost $1.1 million. It was constructed debt-free with financing that included $500,000 from the state's Community Development Block Grant program. The state made these funds available under a special competition to select innovative projects that proposed linking affordable housing and comprehensive services as a model for helping Mississippi's low-income population gain economic independence. Other financing included $453,233 from the city, $430,000 from the county, donations by the local utility of heating systems worth $62,400, a $30,282 grant from the regional Public Housing Authority, and contributions totaling $18,000 from banks and local businesses. Professionals donated their services—such as appraisal and environmental impact assessment—to many elements of the development.

State or Local Responsibility?

Once the decision is made that government should provide a service, legislatures have an important responsibility to design a financing and delivery system that is rational, efficient and accountable. This first requires a state to determine which level of government should provide a service. If local government is determined to be the appropriate provider, the next decision must be whether the state should assist with financing.

For some state and local programs, such as education, the state constitution provides explicit guidance about the responsibility for funding and delivering services. In most cases, however, state constitutions are silent on the issue. It is then up to policymakers to determine the appropriate mix of service delivery and financing.

The sorting out process requires an explicit recognition of the disparities in the wealth of local governments. A legislative decision to shift program responsibility to local governments could mean that certain services would no longer be provided because some local governments could not afford them, while other more affluent localities become magnets for people in need of these services. To address this concern, some states have adjusted their aid programs or have allowed local option taxes.

The sorting out process often involves weighing the tradeoffs between important, but sometimes contradictory, principles. For example, local governments may better understand the public's needs because they are closer to the citizens they serve. On the other hand, local viewpoints may not take into account the priorities of a broader state constituency. Ultimately, state traditions, values and fiscal systems will lead policymakers to decide which principles will guide their sorting out decisions.

Setting the Stage for Sorting Out

Policymakers first need to decide whether government should have a role in providing a service. If a government role is appropriate, sorting out principles can provide guidance in deciding which level of government is appropriate to finance and deliver the program or service.

Principles for Sorting Out

The following five principles constitute a framework for sorting out responsibilities between state and local governments. They encourage states to review the goals of the state-local government system and to evaluate how proposed changes in the roles and responsibilities of state and local governments can further those goals.

The five sorting out principles are these:

1. Provide the clearest possible separation of responsibility between state and local governments.

2. Assign program responsibility to the lowest possible level of government unless there is an important reason to do otherwise.

3. Consider the fiscal effects of state mandates on local governments, and either assume financing responsibility for costly mandates, allow local discretion in implementing them or repeal them.

4. Assume state responsibility for programs where uniformity or statewide benefits will result.

5. Provide state financial assistance to local governments that have the lowest capacity to raise their own revenue.

PRINCIPLE 1

Provide the clearest possible separation of responsibility between state and local governments.

When the responsibilities of state and local governments overlap, citizens have difficulty recognizing and assigning responsibility for the success or failure of programs. A key goal of sorting out should be to provide the clearest possible separation of responsibility between state and local governments.

The primary benefits of separate responsibilities are administrative efficiency, accountability and a reduced potential for cost shifting. Having fewer governments involved in programs should reduce paperwork, minimize duplication and decrease administrative costs. Separation also allows the public to hold a single government accountable for the success or failure of programs. Finally, separation eliminates the cost shifting that can occur when state and local governments share financial responsibility.

Ideally, separation should apply to both the financing and delivery of services. Policymakers should reexamine jointly funded programs to determine if justification still exists for state aid. Legislators may find programs that once needed state support may have met their funding or programmatic goals.

Resistance to change can complicate sorting out decisions. Attempts to modify existing state-local systems of financing and delivering programs that are the results of earlier political decisions and processes will create significant practical problems, particularly in areas like education and social services. Joint arrangements to share data or offer one-stop services may make fiscal sense.

Additionally, strict adherence to the separation principle may be inappropriate for certain programs or services. Application of this principle, for example, would require states to stop providing aid for K-12 education or assume responsibility for education from local school boards. Neither of these alternatives is likely to be acceptable from either a policy or a political perspective.

Cases in Sorting Out: The Special Case of Education

The special case of elementary and secondary (K-12) education illustrates the tradeoffs states face when trying to sort out the roles of state and local governments in financing and delivering services.

Although primary responsibility for delivering educational services rests with local school districts, the average state spends about one-third of its total general fund budget on state aid for K-12 education. This funding plays an important role in equalizing disparities between rich and poor communities, as well as in minimizing the burden of the local school property tax.

States have a well-established role in funding K-12 education. In some states this role is determined by the state constitution, which explicitly assigns responsibility for providing "adequate" or "efficient" education. In others, state supreme courts have assigned this responsibility to state government with little guidance on how to implement the court's ruling to achieve adequacy or efficiency.

K-12 education clearly violates the separation principle, sometimes creating friction between the state and those local school districts that want local control. States have increased the use of mandates to impose educational standards, rules and procedures on local governments. In Michigan, several school districts are suing the state because they claim the state has violated a constitutional prohibition against unfunded mandates. The state claims that state aid provided over the years has been more than adequate to fund these mandates.

State education programs clearly provide an important statewide benefit—an educated work force and citizenry. State aid programs also use the redistributive power of state government to target aid to the poorest school districts.

Most states have decided that the benefits of state education aid programs outweigh the problems they create and have determined that a joint state-local role is appropriate. There are two exceptions, however. In Hawaii, the state fully funds and delivers educational services without local government involvement. In New Hampshire, local school districts have almost complete control over educational funding and delivery decisions. A state foundation program provides just 8 percent of education funding, mostly for special education programs that have been mandated in local districts by federal court orders.

PRINCIPLE 2

Assign program responsibility to the lowest possible level of government unless there is an important reason to do otherwise.

Program responsibilities should be assigned to the lowest possible level of government to foster accountability and best meet local citizens' needs.

This principle fosters greater accountability because local government officials typically are more visible and accessible to citizens than state government officials. At the same time, local governments often have a better understanding of the service needs of local citizens. When the state determines service levels, citizens in different regions may receive more or fewer services than they want or need. Additionally, many types of local services such as public safety, fire protection and street repair are funded by property taxes or user fees collected locally. In many instances, local taxpayers determine their levels of service by accepting or rejecting local tax proposals.

An important caveat in principle 2 is the qualifying phrase "...unless there is an important reason to do otherwise." There are some basic issues that policymakers should consider when deciding if there is an important reason for a state role.

First, economies of scale in certain government functions may allow the state to provide services more efficiently than local governments. For example, the state may provide collection and audit services for local governments levying a local sales tax. Duplication of functions thus can be avoided, saving taxpayer dollars. Advances in technology may create additional savings if local governments can benefit from linkages to state computer systems and technology.

Second, some programs create spillover benefits or costs in a region that encompasses many local jurisdictions. This often occurs in large metropolitan areas. A single local government within the region may not respond at the optimum level if it takes into account only the effects on its residents. In such cases, regional or state financing and delivery of services may be preferable.

Finally, fiscal disparities—mismatches between needs and resources—among local governments might lead policymakers to conclude that a state role is necessary. Poorer jurisdictions often have higher service needs but lack the funding to finance them. Many states have assumed full funding of health and social service programs because of such fiscal disparities. Principle 5 further addresses the role of fiscal disparities between local governments and state policies to alleviate such disparities.

Cases in Sorting Out: Jails and Corrections Spending

Jails serve a local public safety function. They usually are county institutions. Their main purpose is to confine people awaiting trial or other legal disposition, adults serving short sentences (generally one year or less) or some combination of both. Local funding and operation of jails is probably appropriate to the extent that these corrections expenses depend on local preferences about strict law enforcement and sentencing.

Six states—Alaska, Connecticut, Delaware, Hawaii, Rhode Island and Vermont—have assumed full responsibility for the jail function. Four of these states are geographically small. Prisons and jails form one integrated system, so they have no local spending. There are significant variations among the other 44 states in terms of how responsibilities for particular functions are assigned. For example, some prisoners who would be held in state prisons in some states may be housed in local jails in others.

Local governments fund about one-third of direct state and local corrections spending, most of which is used to operate local jails. In 1991, the level of real per capita local corrections spending varied widely, ranging from $56.01 in New York to $4.20 in Mississippi. Local corrections spending generally is higher in states with large urban areas. California, New York and Texas have some of the largest jails in the country.

Local governments assumed a much larger share of responsibility for corrections spending between 1980 and 1991, possibly because of increased placement of state prisoners in local jails due to overcrowding in state facilities. State reimbursement to localities for the cost of housing these prisoners often does not cover the full cost. In 1992, Texas had the largest number of state prisoners in local jails, followed by Louisiana, New Jersey and Virginia. Virginia has provided local governments with financial incentives to organize regional jails to achieve economies of scale and improve service levels. As new state prisons become operational, it is likely that some of the pressure on local jails will ease.

Sources: *Jails: Intergovernmental Dimensions of a Local Problem.* Washington, D.C.: U.S. Advisory Commission on Intergovernmental Relations (n.d.).

Analyzing the Growth of State-Local Corrections Spending. Albany: Center for the Study of the States, 1995.

State Aid to Local Governments for Corrections Programs. Denver: National Conference of State Legislatures, 1989.

PRINCIPLE 3

Consider the fiscal effects of state mandates on local governments, and either assume financing responsibility for costly mandates, allow local discretion in implementing them or repeal them.

States sometimes impose requirements—mandates—on local governments to meet state social or economic policy objectives. These can create a hardship for local governments when they are given service responsibilities without adequate means to finance the delivery. Local officials argue that state mandates override local service needs and spending priorities, increase local tax burdens and are an inappropriate use of state power. From the state perspective, because local governments derive their powers from the state, mandating certain services and procedures is a legitimate use of state authority either to ensure uniformity or equity, achieve statewide benefits or encourage good public administration procedures.

Not all mandates are equally onerous in their financial effects on local governments. "Good government" mandates like those requiring public meetings or requiring minimum qualifications for local officeholders, for instance, may not impose significant expense upon local governments and presumably benefit all citizens.

States may want to consider at least three options with respect to mandates.

- Assume state responsibility for financing the mandated programs and services.
- Allow local governments discretion in implementing mandated programs and services.
- Repeal the mandates.

At a minimum, policymakers should closely examine any requirements that could impose significant costs on local governments. These decisions should generally reflect policymakers' decisions under Principle 1—separation of responsibility.

Assessment of the fiscal effects of mandates on local governments is an important step in determining whether the state should assume financing responsibility. The fiscal note process that many states use during the development of legislation can alert state and local governments about the costs of new mandates. Some states—Virginia and South Carolina, for example—catalog existing mandates as an initial step to keep mandates under control. Other states have taken a different approach. At least 15 states have a constitutional or statutory requirement that the state assume some financial responsibility for mandates on local governments.

Cases in Sorting Out: What Are Mandates?

The U.S. Advisory Commission on Intergovernmental Relations (ACIR) has defined mandates as "constitutional, statutory or administrative action that limits or places requirements on local governments." Key categories of mandates include:

- Entitlement mandates that qualify all citizens who meet state-imposed guidelines to be eligible for locally funded services or benefits.
- Service level mandates that require certain minimum service or benefit levels to be provided by local governments.
- Personnel mandates that impose personnel procedures, guidelines, or salary and benefit requirements on local governments.
- Structural mandates that dictate how local government functions must be organized and structured.
- "Good government" mandates that impose public notice, open meeting, open records or other similar requirements.
- Tax base mandates that either provide certain exemptions from local tax bases—usually property tax exemptions—or restrict local revenue raising options.

PRINCIPLE 4

Assume state responsibility for programs where uniformity or statewide benefits will result.

As part of the sorting out process, state policymakers may want to ask whether some level of uniformity is needed when considering program responsibilities. If statewide uniformity is a goal or if there are statewide benefits in providing programs and services, the state may want to assume the responsibility for financing those programs and services.

State-determined uniformity in program benefits may prevent undesirable service level variations, particularly in programs that provide transfer payments to households. Uniformity also may minimize administrative costs and discourage migration by those seeking higher benefits. Voluntary uniformity and cost savings might result from the threat of migration, with local governments reducing benefits to stay in line with neighboring jurisdictions. The potential effects of migration may vary by state size and level of urbanization.

States that do establish uniform benefit levels will need to provide funding for those programs. Imposing uniformity requirements without funding can cause significant financial hardship in some localities. Localities with low fiscal capacity due to few taxable resources often have less flexibility to accommodate additional spending than those with a more valuable revenue base.

State policymakers also will want to consider the values and traditions of the state in determining how broadly to define "statewide benefits." For example, states may choose to establish minimum standards in areas such as air and water quality to ensure that all state citizens benefit equally.

Cases in Sorting Out: Trial Court Funding in California

Policymakers in California are considering uniformity in the context of sorting out state and local responsibilities for trial court funding. The 1997-98 California Governor's Budget proposes to address several problems with the trial court funding system. According to the California Legislative Analyst's Office, the current system of funding fails to promote equal access to justice, does not adequately provide for accountability, and strains county finances and state-county relationships.

Three levels of courts comprise California's judicial system—the state Supreme Court, the courts of appeals and the trial courts. The state funds the first two, while state and county resources together fund the trial courts. The Legislative Analyst's Office points out that the state has a clear interest in equal access to justice. Those accused of comparable crimes expect state laws to be applied uniformly, regardless of the county in which the crime occurs. Under the current trial court system, which depends on county fiscal capacity and budget priorities, disparities in access to the courts and the administration of justice may occur.

In addition, neither the state nor the counties can exercise effective fiscal oversight of court operations. Counties have limited ability to control court costs and review court operations. The state is limited as well. Since individual court system funding levels are determined by individual counties, the state may have difficulty using fiscal incentives or sanctions to promote its goals for court operations.

The governor's proposal would transfer funding responsibility from the counties to the state to ensure uniformity. Policy control and funding responsibility would be consolidated with the same level of government, thus improving accountability.

Source: California Legislative Analyst's Office, Sacramento, 1997.

Cases in Sorting Out: General Assistance Programs

The passage of comprehensive federal welfare reform legislation in 1996 prompted some states to review state and local roles in providing cash assistance to the poor. Federal welfare reform created a new state block grant program—Temporary Assistance to Needy Families (TANF). TANF replaced a federal entitlement program jointly funded by federal and state governments (and local governments in some states). TANF places a five-year limit on federal welfare benefits and removes most legal immigrants from eligibility for federal welfare benefits.

Many state and local governments provide assistance to poor citizens who are not eligible for TANF. These general assistance (GA) programs currently operate in at least one locality in 41 states and the District of Columbia. The programs are administered and funded either by the state or by local governments (usually counties) or a combination of the two. General assistance programs fall into five categories: state control and state funding, state control and state-local funding, state-local control and state-local funding, local control and local funding, and no program (see map).

The repeal of federal welfare entitlement status and the elimination of benefits for legal immigrants has prompted concern by local governments that former TANF recipients may transfer to GA programs, especially where states set most program guidelines but local governments provide much of the funding. This arrangement provides little discretion for local governments to adjust benefit levels or eligibility criteria to meet their budget constraints unless the states modify program requirements. State concerns about local control of benefits and eligibility focus on lack of uniformity.

The majority of the states—38 in all—either have no program or have programs that assign both funding and program control to a single level of government.

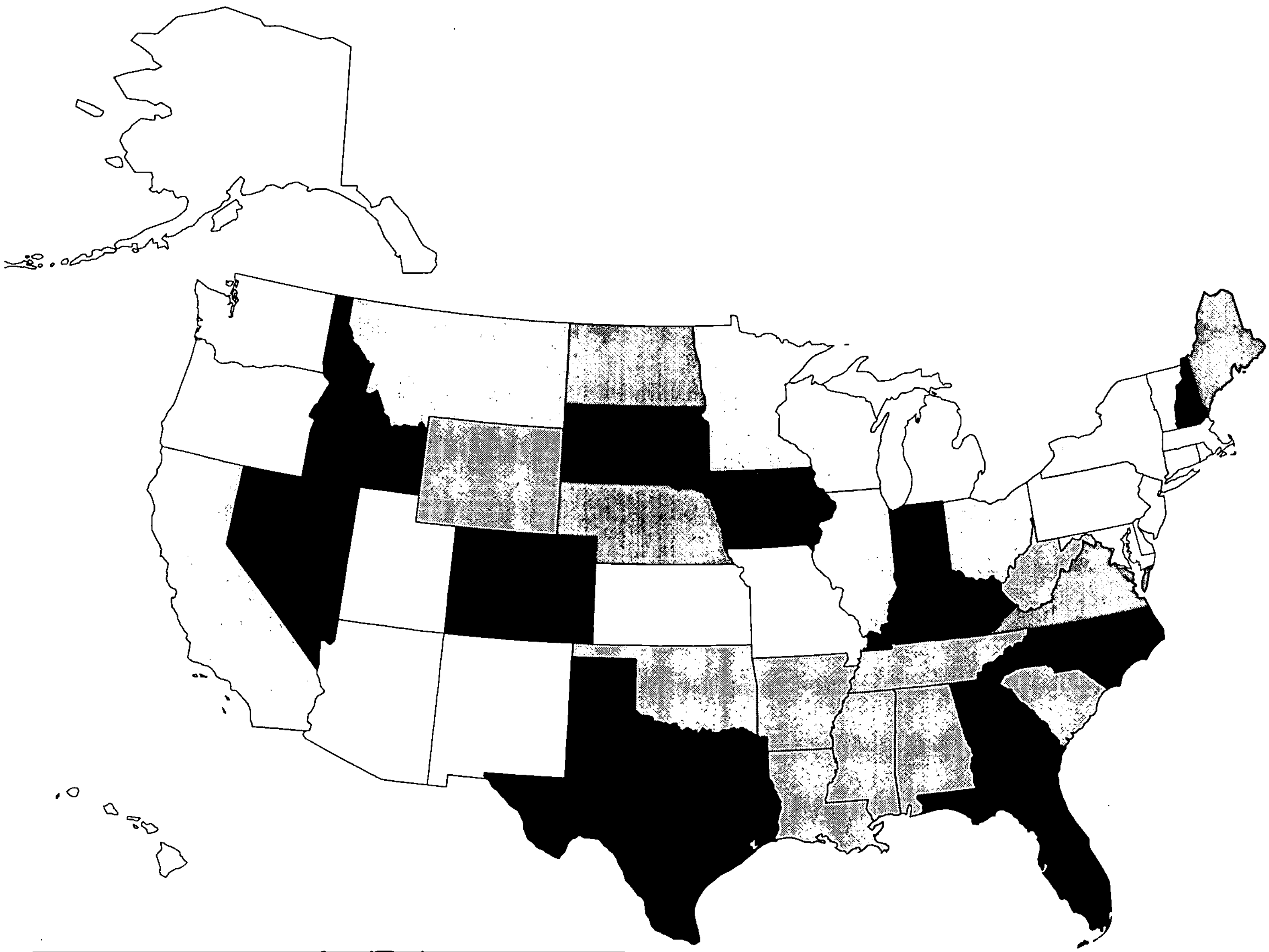
Since 1992, several states have acted to give local governments more control over GA programs. California allowed counties to reduce benefit levels below previously mandated state levels. Three other states—Connecticut, Minnesota and Ohio—eliminated the requirement that local GA programs provide benefits to able-bodied adults without children. Wisconsin replaced its mandated county GA program with a program of optional block grants that allow counties to set benefit levels.

Principles of sorting out would support program funding and control at the same level of government. In those states that decide uniformity is needed, the program should be administered and funded at the state level. Otherwise, the principles support devolving program control and funding to local governments.

Sources: *National General Assistance Survey, 1992.* Washington, D.C.: Center on Budget and Policy Priorities and National Conference of State Legislatures.

Uccello, Cori E. and L. Jerome Gallagher. "General Assistance Programs: The State-Based Part of the Safety Net." Washington, D.C.: The Urban Institute, 1997.

State General Assistance Programs: Control and Funding



State General Assistance

☐	State Control and State Funding	(17)
☐	State Control and State-Local Funding	(9)
▨	State-Local Control and State-Local Funding	(4)
■	Local Control and Local Funding	(12)
▨	No Program	(9)

Note: No information is available for Puerto Rico.

Sources: *National General Assistance Survey, 1992.* Washington, D.C.: Center on Budget and Policy Priorities and National Conference of State Legislatures.

PRINCIPLE 5

Provide state financial assistance to local governments that have the lowest capacity to raise their own revenue.

Poorer localities may have difficulty raising revenues from their own sources. As states consider sorting out, they need to recognize that poorer localities are likely to be disproportionately burdened by new responsibilities. At the same time, these local governments may face a greater demand for poverty related services. State aid programs should serve an equalizing function by attempting to minimize, rather than exacerbate, fiscal disparities between wealthier and poorer localities.

The ability of local governments to raise revenue from their own sources depends upon many factors. The relative wealth of a local jurisdiction—as measured by its tax base—is probably the most important factor. Limits on property taxes and the availability of local option taxes, however, also can affect local government fiscal resources. Some restrictions on local revenues are constitutional, while others are imposed by the legislature.

States are well suited to minimize fiscal disparities between wealthy and poor local jurisdictions. The state tax base is spread over a large geographical area that includes both wealthy and poor regions. Many states also rely upon the income tax for a significant share of their revenues. Income taxes tend to be less burdensome on poorer residents. This combination allows states to use both expenditure and tax policy to alleviate fiscal disparities.

Cases in Sorting Out: Minnesota's Fiscal Disparities Program

Fiscal disparities—imbalances between public service needs and financial resources in certain communities—are addressed in Minnesota through a property tax base sharing program that involves seven metropolitan counties. The shared tax base is redistributed to all municipalities on the basis of a formula that uses as its factors population and market value of taxable real property. It is designed to redress the problem of uneven distribution of property tax base that results from concentrations of commercial-industrial development in some areas. "Fiscal capacity is defined as equalized market value per capita. Equalized market value is market value adjusted for differential assessment levels between jurisdictions," explain Karen Baker and Stephen Hinze, Minnesota House legislative analysts. "Other things being equal, businesses are more likely to expand in communities with high fiscal capacity (because of low tax rates), further exacerbating differences in fiscal well-being." A disadvantages of the program is its administrative complexity. Advantages are that tax base sharing can spread the fiscal benefits of business development and encourage orderly growth. Older areas in need of redevelopment also can receive additional resources.

Source: Research Department, Minnesota House of Representatives, St. Paul, Minn.

CONCLUSION

The nation is moving into what economist John Shannon has called "middle of the road federalism," in which neither the federal government nor state governments clearly dominate the fiscal landscape. States are responding to technological, political and fiscal changes by reevaluating services and making new decisions about which level of government should have which responsibilities. State legislatures must design service delivery systems that encourage rational and efficient actions by state and local governments. They must consider the effect of state decisions on the ability of local governments to respond to community needs. They must determine the appropriate source of funding for programs. Five principles to guide the sorting out of these responsibilities are discussed in this report. The principles assume that policymakers have decided that government is the appropriate financing and delivery system for the services under consideration.

The sorting out process involves tradeoffs; the relative importance of these tradeoffs will depend upon existing state fiscal systems, traditions and values. A state's responsibility for uniformity, for example, may have to be weighed against local autonomy. On one hand, local governments may better understand the public's needs because they are closer to the citizens they serve. On the other hand, local viewpoints may not take into account the priorities of a broader state constituency. Accountability may be easiest to determine when only one level of government—preferably the lowest level—has funding and service responsibilities. However, not all local governments have the same service needs and financing capacity. These are some of the considerations that state lawmakers must weigh as they reshape our complex state-local fiscal system.

Critical Issues in State–Local Fiscal Policy

Sorting Out State and Local Responsibilities

The nation is experiencing a transition as state governments take back some of the responsibilities that the federal government had assumed between the 1930s and the 1970s. Federal "devolution" and taxpayer pressure for fiscal discipline at all levels of government are causing state and local governments to assess (and possibly rearrange) their varied responsibilities for funding and delivering services.

A major benefit of this "sorting out" process is to make governments more accountable for the quality, effectiveness and efficiency of the services they provide. State legislatures have the responsibility to determine the roles and relationships of the state, local governments, and the private and nonprofit sectors in financing and delivering services to citizens. The report suggests five principles to help legislatures in this difficult task, recognizing that the unique traditions, values and fiscal characteristics of each state ultimately will determine the design of its state-local system.

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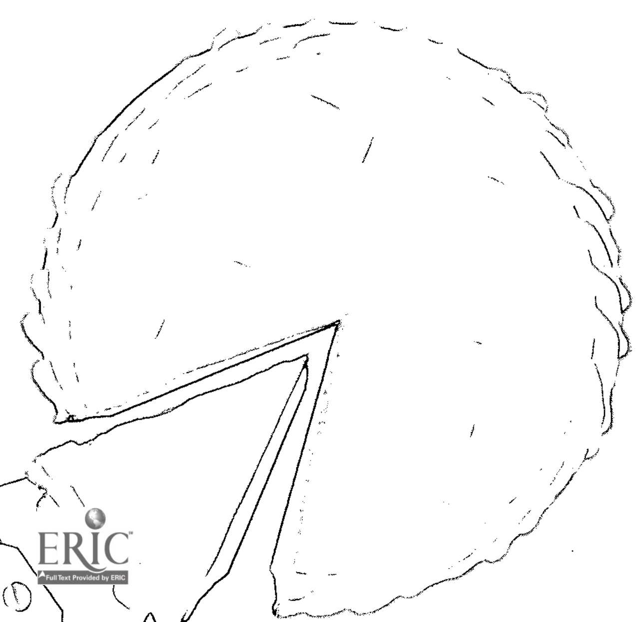

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