

A Response to Fiscal Federalism Readings

Discussing the desires of states, local discretion and political reality

As public demands for government services has grown, so too has the ability of state and local governments to raise revenue to meet those demands. However, the increase in revenues and the responsibility for service allocation has not been divided equally between state and local governments. Several of the readings this week highlighted the recent fiscal interactions of state and local governments—touching on aspects of revenue centralization by the states, constituency demand for spending equalization across different localities and the loss of discretion to local governments these factors bring about. This writing will briefly analyze a sampling of the arguments and comment upon the usefulness of these arguments for future public administrators.

Like the federal government in the early part of last century, the states tapped into enormous revenue-raising power when they began instituting personal and corporate income taxes. Kelly notes that states have become more reliant on this revenue than from funds collected from sales and property tax (pg. 24). Adding greater spending muscle to apply to social concerns makes many constituents and legislators happy, but it apparently conflicts with another phenomenon occurring between states—competition. According to Rivlin, legislators consider raising income and corporate tax rates at their peril, for fear of losing residents and businesses to other states, thus lowering the tax base. If this may seem like a problem, Rivlin claims to have the solutions for them; still advocating a continued reliance on the more progressive income tax.

While this author agrees with Rivlin that greater reliance on the more progressive income tax better serves and individual state's interest, her solution to state competition to lower tax rates seems unworkable. As a long-term solution, she proposes that adjoining states work with the federal government to adopt some common tax rates—for income and sales—and then share the revenue as dictated by formula (pg. 6). There are two main problems with this solution. First, this plan reads like a rehashed version of the federal government's old general revenue sharing plan with an inserted national sales tax. If competition between states for residents and businesses is such problem, it would be better to have the federal government address this and make a cohesive policy at the national level. Second, adopting such a plan would further reduce the ability of many states to raise additional taxes when needed. Rivlin herself states that “political forces arrayed in state capitals are at least as strong as they are in Washington, D.C” (pg. 4). Given the resistance for increasing revenue in individual state capitols, one can imagine how hard it will be to get legislators from numerous states to overcome the anti-tax forces from their respective states. Even if one state has an overwhelming majority ready to raise taxes, that state has the tough sell of convincing the other states to do the same.

Putting aside the notion that instituting or raising state income taxes may breed interstate competition, income taxes substantially increase the amount of available revenue. So much so, in fact, that anti-taxers have gained credibility in asking for state givebacks; especially with regard to the hated property tax (Kincaid and Cole). Famously manifested in California as Prop. 13 (Lyon), Kelly points out that many states have reduced or capped property taxes and refunded the monies to localities from bulky state coffers. Local governments thus lose some ability to independently raise taxes to support demanded services and are vulnerable when states take the money back during times of economic hardship. Compounding this problem, Stonescash notes,

is the fact that local governments have become “more dependent [on state revenue] at a time when questions about inequities among local tax bases and school expenditures have become major issues” (pg. 90).

That local officials allow this to occur without much fuss is striking. Kelly maintains that the lack of local government protesting is due to the fear of that retaining fiscal independence will put too much pressure on local resources to meet expected service requirements (pg. 26). For example, many localities seem to be happy to have state intervention if they provide additional funding to revenue-poor school districts. However, there seems to be a political component as well. Pointing the finger at the state for funding inadequacies diverts attention away from local political leaders up the chain to the more insulated legislators and governor. If delivery of a local program or construction project could be directly traced to the local county board of supervisors, for instance, their future political success would be more closely tied to the success of that program or project. Having the state as a funding source or an imposer of impossible to meet unfunded mandates provides a convenient political out. This may be why Stonescrash mentions that persistent lobbying from localities “to either relax mandates or provide state aid for the required activities”—that is change at the margins—dominates; rather than calls for a wholesale return to fiscal independence. Additionally, today's board of supervisors are tomorrow's state legislators. Presumably, the local politician eyeing higher office will not want to jeopardize 1) the goodwill of current officeholders who she will likely need for endorsements and campaign contacts, and 2) the ability with which she will be able to respond to constituent demands to provide local services through state revenues and regulations.

Overall, local governments face a growing problem—especially in California. They have a reduced ability to increase tax revenue, much of the revenue from the federal and state

governments are earmarked for specific programs and do not always cover those programs in their entirety. As a result, notes Lyon, as the ability of local government to control revenue diminishes, “so has their ability to finance their own general purpose services such as transportation and corrections”(pg. 6). While this week's reading accurately describe the problem, they propose few workable solutions—even though solutions are craved. In fact, Lyon points out that the general public looks to the initiative process to provide answers. Sadly, these answers more often provide greater constraints on good governance (pg. 8).

This author believes that a comprehensive solution to the restraining fiscal relationships between states and local governments will not be realized with the current electoral system in place. The structure of single-seat district elections and its accompanying campaign tactics, along with PACs that have significant impacts on fundraising and get-out-the-vote efforts, will keep a modified version of the status quo in place for the foreseeable future. Only a move to multiple seat elections and its greater emphasis on political parties will provide a structural electoral backdrop for reform to happen. Voters need to see past individual elected officeholders to the groups of people responsible for crafting government policy—namely political parties. Multiple seat elections with proportional representation is a way to achieve that objective (probably a discussion best left to another writing). In the meantime, what do these fiscal constraints upon local government mean for public administrators?

In the short-term, it means doing the best with available resources; working to get awarded federal and state project grants, and negotiating with funding authorities for categorical programs (i.e. housing assistance and child welfare). Administrators will need to continue lobbying local legislators and state capitols for increased resources to meet state requirements. They can also consider advocating to local elected leaders the sale of bonds or adding on to the

sales tax—two of the discretionary revenue raising options left to localities.

Over the long-term, however, these last two options lose potency. Pushing the sales tax too high will drive residents and businesses to locate elsewhere. Administrator could seek to lure “big box” stores and other retail outlets into the area to increase the sales tax base, but an over-emphasis on this approach will likely lead to imbalanced communities. Similarly, if too many bonds are issued, the debt servicing requirement to pay them off only further constrains the amount of discretionary revenue. Any long-term solution will either require a political breakthrough with voters giving politicians the flexibility to raise the necessary taxes to meet the public's service demands, or a painful restriction on government spending as structural state deficits become unsustainable.